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Monetary Policy and the Management of the Public Debt

HEARINGS

BEFORE THE

SUBCOMMITTEE ON

GENERAL CREDIT CONTROL AND DEBT MANAGEMENT

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

CONGRESS OF THE UNITED STATES

EIGHTY-SECOND CONGRESS

SECOND SESSION

PURSUANT TO

Section 5 (A) of Public Law 304

(79th Congress)

MARCH 10, 11, 12, 13, 14, 17, 18, 19, 20, 21, 24, 25, 26, 27, 28, AND 31, 1952

Printed for the use of the Joint Committee on the Economic Report

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

MONDAY, MARCH 10, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to notice, at 10:05 a. m., in room 318 Senate Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman, Senators Douglas, Flanders; Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director; Henry C. Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

The Joint Committee on the Economic Report was created by the Employment Act of 1946. Its primary purpose, and the one which has given it its name, is to study the Economic Report of the President, and report to the Congress on its implications and its significance in terms of desirable congressional action.

The committee also has authority directly or through subcommittees to make such inquiries into economic matters and to prepare such reports as it believes will be helpful to the Congress and to the public, generally. It is not a legislative committee and has no authority to bring in bills in either House.

The Subcommittee on General Credit Control and Debt Management was appointed by Senator Joseph C. O'Mahoney, of Wyoming, chairman of the full committee, last spring, for the purpose of conducting a general inquiry into monetary policy and debt management. The members of the committee, in addition to the chairman, are Senators Paul H. Douglas, of Illinois, and Ralph E. Flanders, of Vermont, and Representatives Richard Bolling, of Missouri, and Jesse P. Wolcott, of Michigan.

As most of you are aware, a similar subcommittee was appointed by Senator O'Mahoney in the spring of 1949 under the chairmanship of Senator Douglas. The membership of that committee was identical with the membership of the present subcommittee except that Representative Buchanan, who has since passed away, has been replaced by Representative Bolling.

The subcommittee, under the chairmanship of Senator Douglas, divided its attention about equally between fiscal policy, meaning

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primarily bugetary policy, and monetary policy. The present subcommittee, on the other hand, will devote its attention entirely to monetary and debt management policy.

The more than 2 years which have elapsed since the hearings and the report of the earlier subcommittee have been packed with significant events. At that time the country was just emerging from a business recession, and Korea was merely an unfamiliar name on a map.

Since that time, the international situation has greatly worsened, and Federal expenditures have been greatly increased by the necessity for strengthening our defenses.

In the meantime, the country has passed through a serious period of inflation, spurred by the buying wave which followed the outbreak of hostilities in Korea. For about a year now we have had a precarious lull in inflationary price rises. National production is at a high level, and the same is true, with a few notable exceptions, of the level of employment.

Despite the high level of defense expenditures the people as a whole are enjoying as high a standard of living as they have had at any time in the history of our country, but we cannot be complacent.

On the one hand, there are serious indications of continuing inflationary dangers while, on the other, some people see signs of a coming recession. Clearly, it is time to give the situation another look, both with respect to the proper steps which should be taken in the field of monetary and debt management policy under present and possible future conditions and with respect to the extent to which our agencies are properly set up to handle the task which the Congress has delegated to them.

It is in this spirit and with an open mind as to the right answers to all of the questions before us that the subcommittee has approached its task.

As the first step in its investigation the subcommittee addressed a series of questions to the top Government officials concerned with these tasks, and to a large number of persons in the private economy. The answers to these questions have been published in a document entitled "Monetary Policy and the Management of the Public Debt; Their Role in Achieving Price Stability and High-Level Employment," which was released to the press a week ago last Friday.

I should like again to express my thanks and those of the other members of the subcommittee to the large number of persons whose labors have made this document possible.

It has placed before us in a much clearer manner than ever before a statement of the areas of agreement and disagreement among the Treasury Department, the Federal Reserve System, and the Council of Economic Advisers, with carefully reasoned statements supporting their respective views.

In arriving at these statements, the agencies have, in my opinion, tended to move somewhat closer together. This is all to the good.

The subcommittee has always emphasized in its dealings with each of the agencies that it sought as a first choice to obtain an agreed statement of their views, but to the extent that this was not compatible with the sincerely held convictions of the responsible agency heads, it desired to obtain reasoned statements of the nature and extent of their disagreements.

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The subcommittee has never sought and does not now seek to reopen old wounds.

A week ago I furnished to the press a tentative schedule covering 3 weeks of hearings. This schedule, which I shall insert in the record at the close of these remarks, was arranged with a view to permitting the presentation of all important points of view on the principal issues before the subcommittee.

I recognize, however, that setting up any schedule of this kind involves many questions of judgment and, as I said, in my press release a week ago I have invited the other members of the subcommittee to suggest any additional witnesses whom they may desire, and have said that I would be glad to make arrangements for their appearance, extending the duration of the hearings, if necessary, for this purpose.

In addition, I should like to invite any other person who desires to be heard to make application to the subcommittee, and we will arrange, if possible, a personal presentation of views or for the submission of briefs.

The hearings which we are starting today ought to be exceptionally fruitful because the preliminary spade work which has already been accomplished. Each of the official witnesses and many of the private ones have prepared or participated in the preparation of the answers included in our compendium. Their carefully thought out points of view have already been presented at length and they have had an opportunity to read and study the points of view of others. This will make it possible for each witness not only to greatly shorten his statement but it will permit him to direct it to the important points on which he finds himself in disagreement with other witnesses who have contributed to the symposium.

It will also be of great assistance to the members of the subcommittee in directing their questions to significant points of difference in the various views which have been set before them.

The first chapter of the symposium, which we released last week, is devoted to the replies of the Secretary of the Treasury, Mr. Snyder. These replies state the position of the Treasury Department on the principal issues of interest to the subcommittee in a clear and incisive manner, and provide a most appropriate background for the testimony of our first witness, Mr. John W. Snyder, Secretary of the Treasury.

(The schedule previously referred to is as follows:)

CONGRESS OF THE UNITED STATES

JOINT COMMITTEE ON THE ECONOMIC REPORT

CHAIRMAN WRIGHT PATMAN OF THE SUBCOMMITTEE ON GENERAL CREDIT CONTROL AND DEBT MANAGEMENT ANNOUNCES TENTATIVE SCHEDULE OF HEARINGS

Representative Wright Patman, of Texas, chairman of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, today announced a tentative schedule of witnesses for the hearings of the subcommittee which will begin on Monday, March 10, and are expected to run for about 3 weeks.

Chairman Patman said that he had asked the other members of the subcommittee—Senators Paul H. Douglas, of Illinois, and Ralph E. Flanders, of Vermont, and Representatives Richard Bolling, of Missouri, and Jesse P. Wolcott, of Michigan—to suggest any additional witnesses whom they might desire and

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that he would be glad to make arrangements for their appearance, extending the duration of the hearings if necessary for this purpose.

The schedule announced by Chairman Patman, together with suggested topics of discussion for each of the round tables to be held in connection with the hearings, follow:

First week

Monday, March 10: John W. Snyder, Secretary of the Treasury.
Tuesday: March 11: William McC. Martin, Jr., Chairman, Board of Governors, Federal Reserve System.
Wednesday, March 12:
- Leon Keyserling, Chairman, Council of Economic Advisers.
- Roy Blough, Member, Council of Economic Advisers.

Friday, March 14:
- A. L. M. Wiggins, chairman, board of directors, Atlantic Coast Line Railroad Co. (formerly Under Secretary of the Treasury).
- Preston Delano: Comptroller of the Currency.
- Maple T. Harl, Chairman, Board of Directors, Federal Deposit Insurance Corporation.

Second week

Monday, March 17:
- Marion B. Folsom and J. Cameron Thomson, Committee for Economic Development.
- W. L. Hemingway, American Bankers Association.
- John F. Fennelly, Investment Bankers Association.

Tuesday, March 18:
- Seymour Harris, Harvard University.
- Aubrey G. Lanston, Aubrey G. Lanston & Co., United States Government security dealers.

Wednesday, March 19:
- Malcolm Bryan, President, Federal Reserve Bank, Atlanta.
- Oliver S. Powell, Member, Board of Governors, Federal Reserve System.
- Carrol M. Shanks, Life Insurance Association of America and American Life Convention.

Thursday, March 20:
- Beardsley Ruml, New York City.
- Allan Sproul, President, Federal Reserve Bank, New York.
- E. E. Brown, chairman, board of directors, First National Bank of Chicago.

Friday, March 21: Paul Appleby, Syracuse University.

Third week

Monday, March 24: Panel discussion, The Role of the Banking System in a Dynamic Economy:
- Robert Fleming, Riggs National Bank, Washington, D. C.
- Wesley Lindow, Irving Trust Co., New York.
- Roy Reierson, Bankers Trust Co., New York.
- Jesse W. Tapp, Bank of America, San Francisco.

Tuesday, March 25: Panel discussion, What Should Our Monetary and Debt-Management Policy Be?:
- Milton Friedman, University of Chicago.
- Raymond Mikesell, University of Virginia.
- Paul Samuelson, Massachusetts Institute of Technology.
- C. R. Whittlesey, University of Pennsylvania.

Wednesday, March 26: Panel discussion, How should our monetary and debt-management policy be determined?:
- G. L. Bach, Carnegie Institute of Technology, Pittsburgh.
- E. A. Goldenweiser, Institute for Advanced Study, Princeton.
- James K. Pollock, University of Michigan.
- Jacob Viner, Princeton University.

Thursday, March 27: Panel discussion, The role of business, labor, and agriculture in the determination of monetary and debt-management policy: (Representatives of American Farm Bureau Federation, American Federation of Labor, Congress of Industrial Organizations, National Association of Manufacturers, The National Farmers Union, The National Grange, United States Chamber of Commerce).

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Friday, March 28: H. Christian Sonne: National Planning Association.

Panel discussion on the role of the banking system in a dynamic economy (Monday, March 24)

Participants.—Robert Fleming, Riggs National Bank, Washington, D. C.; Wesley Lindow, Irving Trust Co., New York; Roy Reierson, Bankers Trust Co., New York; Jesse W. Tapp, Bank of America, San Francisco.

Suggested topics for discussion.—

1. What should be the role of the private financial community in the formulation of monetary policy? To what extent does this role reflect its status as a special interest group and to what extent does it reflect its status as the repository of specialized skills and information valuable to the general interest?
2. What is the responsibility of banking institutions for the economic development of their communities? Should banks, as a long-term proposition, be more venturesome in undertaking lending risks? Has a lack of venturesomeness on the part of banks contributed to the growth of Government-lending agencies? How does this apply to the special problems and inflationary hazards of the present defense period?
3. How successful has the voluntary credit-restraint program been? What should be its role over a longer-term period? Has the treatment accorded State and local governments been more rigorous than that accorded private business firms?
4. To what extent do time deposits represent a stable form of savings? Demand depoits? Is it desirable to encourage the holding of savings in these forms? Under what conditions?

Panel discussion on What should our monetary and debt management policy be? (Tuesday, March 25)

Participants.—Milton Friedman, University of Chicago; Raymond Mikesell, University of Virginia; Paul Samuelson, Massachusetts Institute of Technology; C. R. Whittlesey, University of Pennsylvania.

Suggested topics for discussion.—

1. How much reliance should be placed on (*a*) direct controls, (*b*) selective credit controls, (*c*) general monetary (i. e., "tight money") policies in combating inflation? Under present circumstances? Under other circumstances?
2. Is a tight-money policy compatible with maximum production and employment?
3. How desirable is a stable Government bond market? Now? Under conditions closer to total war? In a peacetime inflation?
4. What kinds of securities should the Treasury issue? Now? Under other circumstances?
5. What is the proper relationship between monetary and fiscal policy?

Panel discussion on how should our monetary and debt-management policy be determined? (*Wednesday, March 26*)

Participants.—G. L. Bach, Carnegie Institute of Technology, Pittsburgh; E. A. Goldenweiser, Institute for Advanced Study, Princeton; James K. Pollock, University of Michigan; Jacob Viner, Princeton University.

Suggested topics for discussion.—

1. What should be the role of the private financial community in the formulation of monetary policy? What are the implications in this respect of the private ownership of the stock of the Federal Reserve banks?
2. Is the division of authority over monetary policy between the Board of Governors and the Open Market Committee desirable? If not, how should it be resolved?
3. Should the monetary authority be vested in one man or a board? What is its proper relationship to the Treasury, the President, Congress?
4. What should be the role of the monetary authority in the determination of debt-management policy?

Panel discussion on the role of business, labor, and agriculture in the determination of monetary and debt-management policy (*Thursday, March 27*)

Participants.—Representatives of American Farm Bureau Federation, American Federation of Labor, Congress of Industrial Organizations, National Association of Manufacturers, The National Farmers Union, The National Grange, United States Chamber of Commerce.

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Suggested topics for discussion.—

1. What are the special interests of business, labor, and agriculture in monetary policy? How should each be represented in its formulation (except as they are represented in ordinary course in the formulation of Government policy generally)?
2. Should individual members of the Board of Governors or individual directors of the Federal Reserve banks represent special interest groups? If so, should the interested groups participate in their selection?
3. What monetary and debt management policy is most in the interests of business? Of labor? Of agriculture? Now? Under other conditions?

(This schedule is reproduced exactly as given to the press for release on March 3, 1952. There were minor changes in the course of the hearings as indicated by the day-to-day record.)

Representative PATMAN. Before hearing from Mr. Snyder, I would like to ask if other members of the subcommittee would like to make statements. Senator Douglas, would you like to make a statement?

Senator DOUGLAS. I think, perhaps, Senator Flanders should have the right to lead off.

Representative PATMAN. Senator Flanders?

Senator FLANDERS. Mr. Chairman, these very important hearings should attract the interest and demand the earnest consideration of all officials and institutions, public and private, which are concerned with inflation, in general, and the amount and value of our money and credit supply, in particular.

As a minority member of this committee, I would like to bring my tribute to the careful and able staff work which has preceded the hearings. Comprehensive and incisive questionnaires were prepared in order to throw light on all significant aspects of general credit controls and debt management.

This groundwork has resulted in the 1,300-page volumes of the compendium Monetary Policy and the Management of the Public Debt.

The staff has also been largely responsible for making arrangements for these hearings in which various opinions may be further developed and examined by the committee.

Following up this excellent staff work, it is proper to call public attention to the time, effort, and thought that have been given by those who have replied to the questionnaires sent out. It is clear that Government agencies, business groups, and individual economists have prepared their answers with great care.

The high quality of these answers on monetary and banking theory, as well as on practical-policy proposals, has been gratifying.

The compendium of these views provides a valuable reference to those of us concerned with immediate policy questions, and it also will, no doubt, long serve as an important source of material for all those who study these general problems.

We may also hope that those who have labored to provide the committee with information have also reaped some benefit themselves from the process of thinking through the issues involved, and of formulating their answers.

We are now entering upon the more direct work of the subcommittee in hearings, examination, and attempting to reconcile the views of witnesses.

With the careful work that has been done and the high quality of the responses received, I am sure that we can continue this undertaking in an objective and unbiased manner. Our aim is to have a thorough

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exploration of all the important aspects of the problems that are before us, and I am confident that this can be accomplished.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. No comment, Mr. Chairman.

Representative PATMAN. Senator Douglas?

Senator DOUGLAS. I want to join Senator Flanders in congratulating the chairman and the staff for the very excellent job which they have done in preparing these two volumes of background material on monetary policy and debt management.

Whatever differences of opinion may develop during the course of the hearings, I think Congressman Patman and Dr. Murphy are to be thanked for the fairness and comprehensiveness of their inquiry.

I think that these two volumes are the best discussion that we have of the issues involved. It has been very helpful to have the frank statement by the Treasury and by the Federal Reserve and by the representatives of various shadings of opinion; and I would say that if nothing more happened, that the subcommittee has already justified its existence.

I want to join Senator Flanders in the hope that this will be an inquiry for truth and for public policy. In the course of that inquiry, it is inevitable that differences of opinion will develop, but I hope that we may be objective, and that we will credit each other with the best of motives.

Representative PATMAN. Thank you, Senator Douglas.

Mr. Wolcott?

Representative WOLCOTT. I have no statement.

Representative PATMAN. Mr. Snyder, we would like to hear from you at this time. We appreciate your coming, and we shall look forward to hearing your testimony.

STATEMENT OF HON. JOHN W. SNYDER, SECRETARY OF THE TREASURY, ACCOMPANIED BY MEMBERS OF THE TREASURY STAFF

Secretary SNYDER. Thank you, Mr. Chairman. I have a prepared statement, Mr. Chairman, which, with your permission and that of the subcommittee, I would like to read into the record.

Mr. Chairman and gentlemen, the hearings which are beginning this morning represent the culmination of a number of months of intensive study and preparation of replies to the questions raised by your subcommittee. Anyone who has worked on this complex project cannot help but be impressed with the scope and searching nature of the questions which were asked. In our already heavy work schedules it was not easy to find the time to set down the pros and cons of the many issues presented for generalized discussion in the questionnaire. In view of the importance of the study, however, we felt that time must be found; and I am very glad that we were able to give full and considered replies to all of the questions submitted to us.

I believe that everyone who reads the written replies received by the subcommittee will feel, as I do, that the body of material which you have assembled will be of great value in the field of debt management and monetary policy for many years to come. Not one point of view, but many points of view—I am almost tempted to say, all

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points of view—seem to have been elicited by the subcommittee in the written answers to the various questionnaires which were sent out. A policy record, in the most fundamental sense, is not only a record of decisions made and actions taken—it is a record of appraisals, of conclusions, and of judgments. Those who replied to the subcommittee's questionnaires, it seems to me, have attempted to be fully responsive in this fundamental sense.

I want to say here, Mr. Chairman, that I do hope that these 1,300 pages will be read with a great deal of care, and carefully digested by all people who are charged with any part of the preparation of the studies and the formulation of decisions in connection with debt management and monetary policies.

I want to add my words to those of your colleagues who have addressed their remarks previously to the complimentary appreciation of what has gone ahead in laying the groundwork for these hearings. I think that we could well say that this has been the most carefully and most studiously prepared hearing on this subject that we have experienced. I am extremely hopeful that out of this fine foundation will grow discussions and studies that will be extremely helpful in the great problems we have in the future.

In our own case, we found in replying to the questionnaire that it was often difficult to reconstruct past events in the context of the times when they took place. In our swiftly moving economy circumstances are always changing, and our views as to appropriate actions and policies must change with them. There would be little purpose in trying to reconstruct the background of important actions in the past unless the details gave us added ability to plan our future course wisely. This is true, I believe, with respect to the subjects which will be covered in the present hearings. In answering the questionnaire submitted earlier by the subcommittee, therefore, I have gone into considerable detail as to the reasons why the Treasury took certain actions at certain times; what we hoped to accomplish by them and what—viewed retrospectively—we did accomplish.

It will be of particular value, I feel, for the public to become better acquainted with the nature of the responsibilities with which the various agencies have been charged by the Congress—and the relation of practical policies to the fulfillment of these responsibilities. This represents, in my view, a most important part of the study which the subcommittee is undertaking. I should like to take a few minutes, therefore, to comment briefly on the nine general economic objectives which the Treasury Department seeks to further through the use of the powers which have been given to it by the Congress. These objectives, which are described more fully in the answer to question 2, are as follows:

1. To maintain confidence in the credit of the United States Government.

This is the basic objective of all Treasury policies; and, at the present time, it is the cornerstone of the financial soundness of this country, and a vital factor in the defense effort of the entire free world. In the broadest sense, safeguarding the credit of the Government depends upon our ability as a Nation to keep our free-enterprise economy healthy and growing, and to use our governmental instruments wisely in promoting this end.

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2. To promote revenue and expenditure programs which operate within the framework of a Federal budget policy appropriate to economic conditions.

Through action of Congress and by executive decisions, the budget is subject to constant change; and it is of the utmost importance that revenue and expenditure programs be kept appropriate to changing economic circumstances. The Treasury and the Bureau of the Budget work closely with the President and with the Congress to further this end.

3. To give continuing attention to greater efficiency and lower costs of governmental operations.

I consider this objective a continuing obligation, not only of the Treasury Department but of every department and agency of the Government. Both within the department and in association with other branches of the Government, the Treasury carries on continuing programs aimed at providing maximum service on the part of the Government at the lowest possible cost to the taxpayers.

4. To direct our debt management programs toward (*a*) countering any pronounced inflationary or deflationary pressures (*b*) providing securities to meet the current needs of various investor groups, and (*c*) maintaining a sound market for United States Government securities.

Success in achieving these specific objectives of debt management is essential to the maintenance of confidence in the credit of the United States Government. Many of the questions sent to us by the subcommittee related to problems and actions in the area of debt management. The Treasury has attempted to give the fullest possible replies to these questions; and I am hopeful that the hearings will provide a forum in which these fundamental matters of national financial policy can be thoroughly explored.

5. To use debt policy cooperatively with monetary-credit policy to contribute toward healthy economic growth and reasonable stability in the value of the dollar.

The importance of this objective, I feel, is self-evident. It is a primary goal of both Treasury and Federal Reserve policy, and an important part of public economic policy in general, as expressed in the Employment Act of 1946.

In addition to these five economic objectives of Treasury policy, there are other objectives which we keep constantly in mind. These are:

6. To conduct the day-to-day financial operations of the Treasury so as to avoid disruptive effects in the money market and to complement other economic programs.

7. To hold down the interest cost of the public debt to the extent that this is consistent with the foregoing objectives.

8. To assist in shaping and coordinating the foreign financial policy of the United States.

9. To manage the gold and silver reserves of the country in a manner consistent with our other domestic and foreign policy objectives.

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Each one of these specific objectives is important in itself; and, generally, a number of them must be considered together in framing a practical program which will further our basic goals of maintaining the confidence of the public in the debt obligations of the Government and promoting the economic well-being of the Nation.

The present hearings, I feel, will provide an excellent opportunity for furthering public understanding of the responsibilities and policy objectives which I have just summarized. They are discussed at greater length—and in relation to many different situations—in the answers to the questionnaire.

It is my further hope that the subcommittee will give careful consideration to the possibilities which I have brought forward in the answer to question 10, relating to the creation of a top-level advisory group to the President on broad questions of monetary and fiscal policy. In that question, it was suggested that a small consultative and discussion group be created within the Government. This group might consist of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Budget, the Chairman of the Council of Economic Advisers to the President, and the Chairman of the Securities and Exchange Commission. From time to time, the heads of other agencies (both permanent and special agencies) might be added to the group, as various problems arise. This group would serve two major purposes. First, by regular and periodic meeting and discussion among the heads of the agencies having to do with fiscal and monetary policies, differences of opinion would become less likely to develop. A group of this nature would do much to achieve accord before discord arises. Second, the means would be provided for informal discussions with the President on broad questions of monetary and fiscal policy. The advisory group could report to the President—preferably on an informal and confidential basis—as often as desired.

It is my present intention to recommend to the President that he consider the creation of a national council along the lines which I have just described, with advisory authority in the area of monetary and fiscal policy. Prior to doing so, however, I should like to obtain the views of the subcommittee as to the advisability—the pros and cons—of such a step. I am looking forward with great interest, therefore, to the discussion of this matter in the hearings, and to your own deliberations with regard to it.

The question of a national council which would act as an advisory group with respect to monetary and fiscal policy brings up another matter which I hope the subcommittee will find time to consider from all angles. In question 9 of the questionnaire sent to me, a discussion of the relationship between the President and the Federal Reserve System was called for. In answering this question, I indicated my opinion that it was desirable for the Federal Reserve System to retain its independent status. I expressed further, however, my strong feeling that it is natural, proper, and desirable for the President to seek to settle disputes by having all of the interested parties sit around a table to discuss their differences, in the interests of coordination. This, it seems to me, represents the essence of independence—that the President and the Board should have both the right and the duty to discuss the problems with each other, on the basis of a free interchange of views.

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The Joint Committee on the Economic Report is in a very good position to help obtain the kind of cooperation and cohesiveness of policy which we need to emphasize constantly in all branches of Government. This is because the committee has the responsibility for looking at the economic problems involved from every point of view. You are not concerned solely with revenues, for example, or with expenditures, or with appropriations; rather it is your unique function among the committees of Congress to appraise the whole complex of measures and programs having a significant influence on the economic well-being of the country.

Because of our appreciation of this fact, we have given special attention to the questions requesting general views. Right now, however, we are faced with a practical financing problem which must be worked out in the immediate future; and I should like to discuss with you briefly how a problem of this sort, in practice, ties in with the more general considerations which govern Treasury policy.

On the basis of the estimates in the President's budget, as much as $10 billion of the defense program may have to be financed by additional borrowing from the public before the end of the present calendar year. The budget is, of course, subject to revision as the year progresses, and particularly as we see how the expenditure program shapes up. Whatever the final figures turn out to be, however, the amounts which we shall have to borrow will be substantial.

Earlier in this statement, I noted that the general goals of our debt management programs are (*a*) countering any pronounced inflationary or deflationary pressures, (*b*) providing securities to meet the current needs of various investor groups, and (*c*) maintaining a sound market for United States Government securities. These objectives are the guides which we use in arriving at policies which are appropriate to current economic conditions.

The difficulties of this procedure in practice, however, and the many balanced judgments which are involved, could not be better illustrated than by our present situation. As I have stated, we may have to borrow as much as $10 billion in new money from the public before the end of this calendar year; and it is generally agreed that these funds should be obtained to the greatest extent possible outside of the commercial banking system. From this point forward, however, we must proceed on the basis of a careful analysis of the many conflicting factors in the immediate outlook. There is no single, simple approach which will solve the entire problem for us.

To begin with, we must be constantly watchful with respect to the development of inflationary or deflationary tendencies. There appears to be a lull, at present, in inflationary pressures; but it would be imprudent to give less than full weight to the inflationary implications of our large defense program and of the deficit financing operations which will have to be undertaken in connection with it. For some time to come, defense production will draw heavily on our physical resources; and the existence of a significant deficit will add to the supply of funds available for spending or saving.

In the second place, we must take account of the fact that our present borrowing program will have to be geared to a set of circumstances which are unlike those experienced in connection with any previous large-scale borrowing operations. In contrast to the World War II

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situation, for example, a large sector of industry and trade is engaged in substantially normal operations; including operations—such as capital expenditure programs—which draw on investment funds. When we found it necessary to borrow large sums of money early in World War II, moreover, the Government's debt was much smaller than it is now, both in absolute terms and in relation to the size of the economy. Today, our Government debt accounts for almost half of all the debt obligations in the country, public and private; including—in addition to Federal securities—bonds of State and local governments, obligations of private corporations, mortgages, bank loans, consumer installment paper, et cetera. Public debt obligations represent an important part of the assets of our financial institutions, of numerous business corporations, and of millions of individuals and families throughout the Nation.

Against this background, the practical meaning of the broad objectives of debt management which I outlined earlier becomes clear. It is evident that we must use great care to maintain an atmosphere which will be favorable not only to the purchase of new Government securities, but to the retention of current holdings—and particularly, of course, the holdings of nonbank investors. To maintain investor confidence, inflationary or deflationary tendencies must be countered, and sound conditions must be maintained in the market for United States Government securities. To sell the greatest possible amount of securities outside of the commercial banking system, issues must be provided which will meet investor needs. Each one of the general requirements of a sound debt management program, therefore, is seen to have direct application to our present problem.

In order to formulate a program suited to the current situation, the Treasury—as it has done in connection with each important financing operation in the past—has been making extensive analyses of the money and investment markets; it has been discussing the problems on a continuing basis with representatives of the Federal Reserve System; and it has been conducting a series of informal conferences and discussions—in which the Federal Reserve participates—with representatives of leading investor and financial groups and others during recent weeks.

While I have found general agreement, as I noted earlier, on the need for securing the necessary amounts from nonbank investors, there is a wide divergence of views on how we ought to go about securing the funds; and there are differences of opinion, also, as to measures which should be taken outside the area of debt management to maintain stability in the price structure and in the economy generally.

These differences of opinion are to be expected. The problems involved are extremely complex; they are all inter-related; and they all touch on major aspects of public economic policy affecting wide areas of the economy.

When we review all of these facts in the Treasury, and evaluate them in terms of the problem at hand, the situation seems to us to add up to these conclusions:

It is essential for the well-being of the country that the Treasury and the Federal Reserve continue to work in the closest cooperation. Both agencies are in wholehearted agreement on this matter. There is no substitute for working together on the important problems which we

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shall have to solve jointly if the fundamental strength and productive power of the American Economy are to be maintained. I feel that an advisory council of the sort which I have discussed with the committee today would be of help in broadening the scope of cooperation. The spirit of cooperative effort, however, is the essence of the matter.

The prospect of substantial deficit financing in the period immediately ahead underscores the importance of the broad economic objectives of the Treasury, and particularly of debt management policy. The Treasury has succeeded during the postwar period in reducing the proportion of the public debt held by the commercial banking system from 42 percent at the peak of World War II financing to 33 percent at the present time. Is has succeeded in maintaining savings bond ownership not only at the wartime peak, but at a figure which is now close to $58 billion—$9 billion higher than the amount held at the close of World War II financing. Our deficit financing program must conserve these gains—and it must add to them.

For these reasons, the Treasury places great emphasis on the need for prudence with respect to policies which affect the Federal debt. As the subcommittee's questionnaires brought out so clearly, a governmental agency does not operate in the field of abstract theory; full account must be given at all times to the practical implications of the policies and programs undertaken. The opportunity which the present hearings will provide for a discussion of measures appropriate to our present situation will, I am convinced, make a most important contribution to public understanding of the problems now confronting us.

Representative PATMAN. Thank you, Mr. Secretary.

Senator Douglas, would you like to ask any questions?

Senator DOUGLAS. Thank you, Mr. Chairman.

Secretary Snyder, may I ask you what you think the policy of the Federal Reserve System should be in the event of a large refunding of Government securities or the issuance of a new set of Government securities? Do you think that the Federal Reserve Board should be committed to buy a sufficient quantity of those securities so that the price may be maintained at the interest rates charged, and so that a general feeling of confidence may be given so that the issue may be subscribed?

Secretary SNYDER. Senator, I think that is a matter that will have to be worked out between the Treasury and the Federal Reserve Board as the situations arise. I have found that the Board and the Open Market Committee have been very cooperative in our recent issues and our refundings, and I think that we have worked out a fine cooperative atmosphere, and I think that is a matter that we will have to continue to work out.

Senator DOUGLAS. Mr. Secretary, I want to point out that my question to you was perfectly courteous. It was a question of what you thought the policy should be, and your answer, in effect constitutes refusal to answer the question.

I want to know whether you think that it is a function of the Federal Reserve Board to purchase a sufficient quantity of Government securities in the event of a refunding of or a new issuance of securities so that the issue may go off successfully and be sold to the public at the interest rate charged; and what you, in effect said was, "We will work that out. I am not going to reply to the question."

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Now, with all kindness I do not think that is treating a congressional committee, which is trying to be fair with you, as a party——

Secretary SNYDER. Senator, I have no question as to your courtesy, and I did not raise any such question intentionally.

Senator DOUGLAS. May I ask you what you think the policy of the Federal Reserve Board should be under those conditions?

Secretary SNYDER. I think that the policy of the Reserve Board should be one of cooperation with the Treasury.

Senator DOUGLAS. And should the cooperation consist in purchasing a sufficient number of securities in the open market so that you can sell the securities at the interest rates which you decide upon?

Secretary SNYDER. I tried to answer that very positively, sir.

Senator DOUGLAS. I could not understand the answer at all, and I would like to have the answer of the Secretary read back.

Representative PATMAN. The reporter will read the Secretary's answer.

(The Secretary's answer was read.)

Senator DOUGLAS. Would you like to add anything?

Secretary SNYDER. I would like to state, Senator, as each situation arises that will have to be a matter that will be worked out in the light of conditions at the time.

Senator DOUGLAS. You do not wish to make a statement of general policy for the benefit of this congressional committee?

Secretary SNYDER. Not as to the Federal Reserve policies.

Senator DOUGLAS. What do you think, then——

Secretary SNYDER. Other than that, as I have stated, I think it is one of close cooperation.

Senator DOUGLAS. Then you would not carry on any conversations with the Federal Reserve Board should a question such as I have described arise?

Secretary SNYDER. That is not my answer, Senator. If you will reread it, you will see that I said it is a matter in which we will have to cooperate most closely, and it will involve carrying on conversations, of course.

Senator DOUGLAS. What do you think you will say to the Federal Reserve Board when you have these conversations?

Secretary SNYDER. That depends on the circumstances under which we are holding the conferences and the problems that face us.

Senator DOUGLAS. This is what congressional committees frequently face from administrative officials when we are trying to work out policy. We are kept from the real point of view of the administrative officials, and it becomes almost impossible for us to arrive at any conclusion. I am very disappointed, Mr. Secretary, in your reply.

Do you think that the Federal Reserve Board should purchase Government securities or should not purchase Government securities in the circumstances I have outlined?

Secretary SNYDER. The Federal Reserve's policy has been to conduct their Open Market Committee operations in support of the Treasury's financing operations and, therefore——

Senator DOUGLAS. You mean to buy a sufficient quantity?

Secretary SNYDER. I think they should continue their policy of supporting the proper financing of Government operations.

Senator DOUGLAS. Does that mean they should, if necessary, buy an unlimited quantity of Government securities?

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Secretary SNYDER. It will have to be bottomed on conditions at the time those decisions are made.

Senator DOUGLAS. Is not the best protection for security issues the general prosperity of the country, a balanced budget, protection against the danger of future inflation, and a satisfactory interest rate? If those conditions are met, to what degree is it necessary for aritficial support to be given by the Federal Reserve System?

Secretary SNYDER. As the Senator knows, I have advocated balanced budgets ever since my opening statement when I became Secretary of the Treasury, and I still feel that we should maintain balanced budgets to the greatest possible extent.

Senator DOUGLAS. If those conditions are met why is it necessary for the Federal Reserve Board to purchase any securities? Why couldn't the bond issue be met by the general investment market?

Secretary SNYDER. Well, in general, I think that you have stated a very proper reason for believing that there would be no occasion, but we would have to look at conditions that have occurred in the past, and also have to measure what might develop in the future as to just what would be the circumstances at any given time under any given condition of the market or of the amount of financing that the Government has to maintain, whether it be refunding or whether it be new issues. As to the using of the interest rate alone, that is a matter that has caused a great deal of debate and discussion, and one which we have tried to meet in our answers to the subcommittee's queries. We have to measure very carefully the decisions that will be made as to interest rates.

Senator DOUGLAS. Well, certainly, in times past the Treasury has asked the Federal Reserve Board to stand ready to purchase Government bonds if there were not enough private subscriptions; is that true?

Secretary SNYDER. The Federal Reserve has offered to do that, and been requested——

Senator DOUGLAS. Has not the Treasury requested that it do that?

Secretary SNYDER. I was just finishing my answer.

Senator DOUGLAS. I beg your pardon.

Secretary SNYDER. I said they have offered to do that, and the Treasury has requested them to do that; that is correct.

Senator DOUGLAS. The Treasury has asked them to do that?

Secretary SNYDER. Asked them to support the financing.

Senator DOUGLAS. What would you say to the contention that you are asking the Federal Reserve Board to do that which if practiced by a private underwriter with regard to private issuances, would render him liable to prosecution under the securities and exchange statute by the Securities and Exchange Commission for pegging the market?

Secretary SNYDER. I am sure the Federal Reserve Board got their legal opinion on that before they undertook it.

Senator DOUGLAS. The Securities and Exchange Commission, in order to strike at one of the evils of private underwriting, provides that the issuing house should not without due notice create an artifical market by guaranteeing to support the price of securities by purchases.

Now, has not the policy in the past sometimes been in effect to urge the Government to do that which is a penal offense for private underwriters to do?

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Secretary SNYDER. I am quite certain that when the Federal Reserve adopted such a procedure that they carefully weighed the public welfare.

Senator DOUGLAS. There is no penalty against the Federal Reserve Board's supporting the market without publicly proclaiming that it is doing so. It is not statutorily a criminal offense. But what I am trying to get at is this: Just as we are trying to create natural conditions in the stock market where issues can sell on their merits without artificial support should we not with respect to the Government securities market, depend on the general condition of the country, the soundness of the Federal budget, the protection against the danger of future inflation, and a realistic interest rate rather than upon artificial support through the purchase of bonds by the Federal Reserve to maintain bond prices?

Secretary SNYDER. I think that we have had to measure this each time. Of course, as you know, Senator, there was only 1 year in which there was any net Federal Reserve support of the Government bond market in the postwar period up until the time of Korea; that is beside the point as to your question, but it is interesting to note that net purchases have not been generally the case all the way through the postwar period.

Senator DOUGLAS. It was true 1 year.

Secretary SNYDER. In 1 year; that is correct, sir.

(The following was submitted for the record:)

This matter is discussed in detail in the answer to question 17 of the questionnaire submitted to the Secretary of the Treasury by the subcommittee. The following table provides statistical information relating to the discussion:

Net purchases or net sales of Government bonds by the Federal Reserve, Jan. 1, 1946, to June 30, 1950, inclusive

	Billion
Jan. 1 to Dec. 31, 1946, net sales	$0.2
Jan. 1 to Nov. 12, 1947, net sales	([1])
Nov. 13 to Dec. 15, 1948, net purchases	10.4
Dec. 16 to Dec. 31, 1949, net sales	3.9
Jan. 1 to June 30, 1950, net sales	1.6

[1] Less than $50 million.

Senator DOUGLAS. It was true after Korea?

Secretary SNYDER. That is correct. I think we have to measure carefully the broad public interest, and I am sure that is what the Federal Reserve Board and the Open Market Committee take into consideration in carrying out their obligations.

Senator DOUGLAS. There is a fundamental issue involved here, namely, whether you will provide so-called natural markets for Government securities or the degree to which you will provide artificial markets for Government securities.

Perhaps, I am using question-begging words in referring to the purchase of the Federal Reserve as an artificial device, but the question is the degree to which the Government will maintain its own bond market or to the degree to which it will allow the bond market to be settled by natural forces in the private field.

Secretary SNYDER. Well, it boils down to the meeting of a practical situation, I think, Senator, as long as——

Senator DOUGLAS. When you face a practical situation without any general philosophy you are apt to come to great difficulties; and what

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we are trying to do here, if this inquiry has any merit—and if it does not have merit we should close it out immediately, Mr. Chairman——

Secretary SNYDER. Well, the question is——

Senator DOUGLAS (continuing). Is to see if we can try to work out general principles for meeting these concrete situations which lie ahead.

Secretary SNYDER. The question then arises as to whether or not we should have an open-market operation.

Senator DOUGLAS. No, that is not the question. It is the degree——

Secretary SNYDER. I think so.

Senator DOUGLAS (continuing). To which the Federal Reserve System should be committed to enable a Treasury issue to be successful or the degree to which a Treasury issue should be allowed to take its own chances in the public bond market or the private bond market.

Secretary SNYDER. I think we have to consider the public interest involved. With the large financings that we have to conduct in these days, with the debt the size it is, there must be some assurance mutually agreed on between the Federal Reserve and the Treasury that these operations will be carried out with assurance as to the stability of the Federal Government bond market.

Senator DOUGLAS. In other words, the Federal Reserve System should be willing and agree to purchase a sufficient number of securities so that the issue can be sold?

Secretary SNYDER. I think that is a matter that will have to be carefully weighed.

Senator DOUGLAS. Who is to determine the interest rate?

Secretary SNYDER. Well, that matter is always discussed very carefully, sir.

Senator DOUGLAS. Who is to make the final decision on it?

Secretary SNYDER. There is only one place that it can finally be made by law, and that is in the Treasury Department.

Senator DOUGLAS. When the Treasury makes the decision, therefore, is the Federal Reserve Board supposed to purchase a sufficient number of bonds so that the issue can be a success at the interest rates determined by the Treasury?

Secretary SNYDER. I think we can work out cooperation.

Senator DOUGLAS. Cooperation is a beautiful word, but it is like an overcoat, it covers quite a range of reality.

Secretary SNYDER. It has to do that, sir. In these days we have to face realities as well as theories.

Senator DOUGLAS. Mr. Secretary, when the Federal Reserve Open Market Committee buys Federal securities, what happens? How does it pay for these Government securities?

Secretary SNYDER. Well, of course, it pays for it out of the funds that it creates.

Senator DOUGLAS. You mean it pays for them by check?

Secretary SNYDER. I beg pardon?

Senator DOUGLAS. You mean it pays for them by check?

Secretary SNYDER. Or by giving credits, which is the same thing.

Senator DOUGLAS. When it pays for them by check, these checks go into the hands of the banks?

Secretary SNYDER. It goes to the credit of the bank; yes, sir.

Senator DOUGLAS. And the banks do what with the checks?

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Secretary SNYDER. You are just talking about the mechanics of it, are you?

Senator DOUGLAS. That is right.

Secretary SNYDER. When the Federal Reserve buys securities from the banks, why, it is——

Senator DOUGLAS. Let us take the situation when Federal Reserve buys from the banks or private security dealers.

Secretary SNYDER. When it buys from a bank, of course, it will issue a check or give it direct credit on the books of one of the Federal Reserve banks. In either event that increases the deposit of the seller of the securities.

Senator DOUGLAS. And of the member bank, is that not true?

Secretary SNYDER. Well then, of course, they increase the deposits.

Senator DOUGLAS. Yes; the deposits. When these checks are presented by the banks either directly or the banks' acquiring these checks from the private security dealers, they are deposited by the banks, are they not, in their accounts with the Federal Reserve?

Secretary SNYDER. Yes; the deposits with the Federal Reserve banks are member-bank reserves.

Senator DOUGLAS. I understand. They, therefore, increase the deposits which the member banks have with the Federal Reserve; is that not true?

Secretary SNYDER. Yes.

Senator DOUGLAS. That is right. And it, therefore, increases the reserves which the member banks have; is that not true?

Secretary SNYDER. That is correct.

Senator DOUGLAS. The reserve requirements presently in effect are 14, 20, and 24 percent, respectively, for the country, reserve city, and central reserve city banks. On the average, I believe the reserve requirement is 16 percent, and that is for each dollar of short-time deposits there must be roughly a 16-percent reserve.

That leads me to this question: When the reserves of the member banks increase, what happens to the lending capacity of the member banks?

Secretary SNYDER. In general, it is increased, of course.

Senator DOUGLAS. And approximately in what ratio?

Secretary SNYDER. I do not know just what that ratio is——

Senator DOUGLAS. It is approximately 6 to 1, at least theoretically.

Secretary SNYDER. Generally, it is considered somewhere around 5 to 1. What it is precisely I do not know.

Senator DOUGLAS. Well, the Federal Reserve says 6 to 1. The reserve ratio of 14 percent for the banks in the smaller cities, 20 percent is the next group of cities, and 24 in the largest cities——

Secretary SNYDER. 5 to 1 or 6 to 1.

Senator DOUGLAS. The Federal Reserve says 6 to 1. So that the increase of the reserves of the member banks in the Federal Reserve System increases their lending capacity in a sixfold ratio to that of their increase in reserves is that not true?

Secretary SNYDER. Something in that area.

Senator DOUGLAS. Yes.

Now, then, banks; do the banks like to keep earning capacity idle?

Secretary SNYDER. Well, they would be accused of poor banking if they did.

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Senator DOUGLAS. That is right. Therefore, they will want to lend, assuming the risks are sound, up to the limit of their lending capacity, is that not true?

Secretary SNYDER. They, generally speaking, do that; that is their policy.

Senator DOUGLAS. That is, except when you have a period of depression.

Secretary SNYDER. That is the policy of good banking management; yes.

Senator DOUGLAS. Except when you have a period of depression?

Secretary SNYDER. Yes.

Senator DOUGLAS. Therefore, the increase of reserves will probably be accompanied by a parallel increase in bank loans, in a ratio up to 5 or 6 times that of the increasing reserves, is that not true?

Secretary SNYDER. It sometimes works out that way.

Senator DOUGLAS. If we have a period of comparatively full employment, such as we have now with unemployment at roughly 3 percent, and unemployment chiefly in localized areas such as Detroit, New York, and certain other regions, will this increase in loans cause substantially more goods to be produced? Will it put idle labor to work with idle resources producing commodities which otherwise would not be produced?

Secretary SNYDER. Would an increase in bank credit accomplish that?

Senator DOUGLAS. Yes.

Secretary SNYDER. Well, it might aid in it; yes.

Senator DOUGLAS. I mean if you have comparatively full employment, in which virtually everyone has a job. Do you think you would effect any substantial reduction in unemployment below the 3.3 percent which we are supposed to have now?

Secretary SNYDER. Well, then we get into the realities of the question. Now when we are talking about——

Senator DOUGLAS. Yes.

Secretary SNYDER. The answer to your statement theoretically would be that any expansion of credit under conditions of full employment and full utilization of manufacturing capacity would only tend to oversupply the market.

Senator DOUGLAS. Over-supply what market?

Secretary SNYDER. The credit market.

Senator DOUGLAS. That is a vague phrase. My question was whether you thought there would be any significant increase in physical production because of a further expansion of bank loans when you have substantially full employment.

Secretary SNYDER. Yes; that is what I was addressing myself to.

Senator DOUGLAS. Do you think there would be any significant increase in physical production?

Secretary SNYDER. I think that it all depends on whether you want credit to flow to increase production, and that is why I said we get into the realities of whether or not it is a question of supplying credit.

Senator DOUGLAS. With unemployment down to 3.3 percent, do you think you can drive it down much further than that by an expansion in bank loans?

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Secretary SNYDER. The question that we are really faced with, though, right now, Senator—I am willing to answer all your theoretical questions.

Senator DOUGLAS. These are not theoretical questions, Mr. Secretary.

Secretary SNYDER. Well, it turns out that way from a practical standpoint.

Senator DOUGLAS. These are extremely broad and important questions.

Secretary SNYDER. It turns out to be a theory against practice, because if in this defense program bank credit had been completely shut off, then the question would come up as to who would supply the credit to these expanding operations for the defense program.

Senator DOUGLAS. Mr. Secretary, I am not proposing to shut off bank credit. I am merely saying if the Federal Reserve is asked to buy large quantities of Government securities in the open market, does it not create added bank reserves in the Federal Reserve System, and the answer to that has been "Yes"; isn't that correct?

Secretary SNYDER. That is correct.

Senator DOUGLAS. The next question was, with added bank reserves in the Federal Reserve System, does not this lead, too, to increased bank loans, and the answer to that was "Yes."

The third question was do these increased bank loans in a period of comparatively full employment lead to an increase in production or do they lead to an increase in prices? That is what I am coming to.

Secretary SNYDER. Well, they could well lead to an increase in prices.

Senator DOUGLAS. That is the point. Now, will they not lead to an increase in prices when the only unemployment which exists is seasonal and transitional, plus a few isolated pockets which cannot be removed by the expansion of bank credit?

Secretary SNYDER. Well, the question, of course, that is raised then is how to prevent that expansion of bank credit. We get into the problem of what could or could not prevent the expansion of bank credit.

Senator DOUGLAS. Mr. Secretary, is it not true that the expansion of bank loans in a period of comparatively full employment will furnish the economy—public and private—with more monetary purchasing power, which will then be used for the purchase of commodities and for labor?

Secretary SNYDER. That is certainly true, and we have encouraged every possible way of holding back the expansion of inflationary bank credit.

Senator DOUGLAS. Just a minute. I think you are pursuing contradictory aims, that is the point. The expansion of bank credit will furnish to private persons and to some degree the Government, added monetary purchasing power which they will use to bid for goods and services but virtually all the labor is employed so that in effect, you will have more purchasing power to buy the existing stock of goods and services. Will not that inevitably force prices up?

Secretary SNYDER. That is correct.

Senator DOUGLAS. Well, that is inflation, is it not?

Secretary SNYDER. That is a definition of it.

Senator DOUGLAS. That is right.

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Here is the point: In order to maintain the price of the bonds, you ask the Federal Reserve System to purchase large quantities of Government securities; but the purchase of these large quantities leads to inflation, by adding to the reserves, and hence the lending capacity of banks.

Now, then, you stated that one of your purposes was to prevent inflation. How much weight do you give to the prevention of inflation as compared to the maintenance of a bond market at a low interest rate? When these two principles come in conflict, which is to have precedence?

Secretary SNYDER. Well, the question, of course, then comes into sharp focus as to whether interest rates are going to hold back the seeking of bank credit by users of bank credit.

Senator DOUGLAS. Just a minute. Economists have frequently tried to emphasize the control of credit on the demand side by the interest rate. I want to assure you that that is not my point. I am not saying that an increase in the interest rate will appreciably decrease the private demand for capital.

What I am asking is: Should it not be a function of Government to prevent the supply of bank credit from expanding more rapidly than the quantity of physical production, because if the quantity of bank credit does expand more rapidly than the quantity of physical production the inevitable result, as you have admitted, is an increase in prices.

Secretary SNYDER. Well, the problem then arises as to directing available bank credit into the noninflationary areas.

Senator DOUGLAS. What are those?

Secretary SNYDER. And that——

Senator DOUGLAS. What are those?

Secretary SNYDER. Well, that would be for the normal supply of neded capital for the operation of necessary business; and for, of necessity, in these conditions, the supply of credit to carry on the defense program.

Senator DOUGLAS. Have you ever thought of the fact that possibly the total supply of bank credit should not be increased or at any rate should not be increased more rapidly than the volume of production? How can you expect to pour additional credit into the economy and yet prevent that credit from spilling over in the form of an increase in prices in a period of full employment?

Secretary SNYDER. Well, in order to prevent it, we had to put controls in, because unless you control the production in nondefense areas—then you are going to have created a situation demanding additional credit. But if you could control production and let the wages and the raw materials flow into the production of materials needed for defense requirements—if you could thus balance the demand and requirement for the use of labor and raw materials between the defense and the nondefense programs, we could hold total credit down to a certain level.

Senator DOUGLAS. Mr. Secretary, if you force the Federal Reserve System to purchase additional large quantities of Government bonds, thus expanding bank reserves, thus expanding credit, the task of trying to prevent prices from increasing, after all this is done, it will be just as futile as when I fill this glass of water and keep pouring it in, and

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then try to mop up the overflow with a pocket handkerchief. Why not get at the source and try to prevent the undue expansion of the total quantities of bank credit itself?

Secretary SNYDER. We would like to accomplish that, Senator, as much as you would, of course.

Senator DOUGLAS. If you force the Federal Market Committee to purchase unlimited quantities of Government bonds, far from stabilizing the price level, you are inflating the price level.

Secretary SNYDER. How would you prevent the undue expansion of bank credit? How would you meet the credit needs of the defense program when Congress has not put in the necessary control measures?

Senator DOUGLAS. Oh, I voted for those control measures.

Secretary SNYDER. Just a minute, we are talking generally.

Senator DOUGLAS. I voted for those control measures, and I think they have a limited degree of aid, but to depend solely upon direct controls to restrain prices when you are inflating the money supply is to my mind foolish—forgive me for saying so—and if anybody has more glasses of water, I will demonstrate again.

Secretary SNYDER. We will accept the——

Senator DOUGLAS. Just pouring in credit, pouring in more credit and then to say put in direct controls——

Secretary SNYDER. Senator, we will accept the demonstration; you are spoiling one of your reports there.

Senator DOUGLAS. It is just utterly foolish. Why not stop pouring?

Secretary SNYDER. Well, I wish you would, because you are spoiling one of those fine reports there. [Laughter.]

Senator DOUGLAS. I wish you would stop pouring credit or trying to force the Federal Reserve System to pour credit into the banking system; where the damage is far greater by pouring the credit than in pouring the water.

Secretary SNYDER. There is no question about that, Senator; and it is a problem that we have to face very seriously; you know that. I am no more an inflationist than you are.

Senator DOUGLAS. You say you want to keep interest rates down, but you also want to prevent inflation. Which is better, a stable interest rate but expanding bank loans and rising prices or a stable price level even though it may mean a rising interest rate?

Secretary SNYDER. Well, Senator, as I have said many times, I have no doctrinaire views on holding interest rates generally over a long period of time at any one point. We have demonstrated that during the postwar period when the Treasury cooperated with the Federal Reserve in permitting interest rates to rise in the short-term securities market, because we felt that was the proper thing to do.

For a further discussion of this point, reference can be made to the answer to question 17 beginning on page 50 and the answer to question 28 beginning on page 103 of part I of the subcommittee's document containing the replies to questionnaires submitted by the subcommittee.

Senator DOUGLAS. But here is my point: I think we have established it pretty clearly that if the Federal Reserve is forced to buy unlimited quantities of Government securities or large quantities of Government securities, the inevitable effect in a period of comparatively full

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employment such as we have now, with only 3.3 percent unemployed, is to inflate the money supply, and drive up prices. This in turn, increases the cost of Government services, eats into the income of those with fixed incomes and creates all the havoc of inflation. Is that not a rather poor policy?

Secretary SNYDER. Well, let us take a look at the whole picture. Since the end of World War II financing, actually the bank-owned public debt has declined by over thirty billions of dollars. The point is we have not been——

Senator DOUGLAS. 1945 and 1946—that period was a very fortunate year, because the high war tax rates were in effect, and military expenditures had tapered off, and if we were to get into a discussion of budgetary policy, we would get into further issues, but I understood our chairman to say we were not going to discuss budgetary policy, so I am not going to pursue that subject any further.

Secretary SNYDER. I am not trying to get into budgetary policy; I am just trying to point out, though, that it is not a matter of continually forcing the Federal Reserve to buy over the long run.

Senator DOUGLAS. I helped conduct hearings parallel to these 2½ years ago, and the testimony was perfectly clear, supported by sufficient documents that were introduced, to indicate that the Treasury has generally insisted in the past that the Federal Reserve System purchase Government bonds in order to support the market, and did so until the famous accord of April, agreed upon in March, but dated, I believe, early in April 1951.

Now, some of us are a little fearful that this accord may be discontinued or if cooperation is obtained that it may be by the Federal Reserve agreeing to the policies of the Treasury.

Now, I believe, we have a right to be fearful about that, Mr. Secretary.

Secretary SNYDER. And the Treasury has a right to be hopeful——

Senator DOUGLAS. You mean hopeful that there will be inflation?

Secretary SNYDER. That we will have accord. We do not have quite as much suspicion about an accord as you do.

Senator DOUGLAS. And that the Federal Reserve will purchase unlimited supplies of Government bonds?

Secretary SNYDER. No, that we will have cooperation and the Federal Reserve and the Treasury in the fashion——

Senator DOUGLAS. Does that accord, in your mind, carry with it the idea that there will be large purchases by the Federal Reserve?

Secretary SNYDER. It carries with it the idea that the Federal Reserve and the Treasury are going to sit down and work things out together to the best interests of the public.

Senator DOUGLAS. Well, I do not know what to say that would reply to an answer like that. I suppose I ought to send bouquets to you both in the hope that you have a happy meeting.

Secretary SNYDER. I hope you will share with me the hope that you will do that. [Laughter.]

Senator DOUGLAS. Are you worried about inflation?

Secretary SNYDER. Yes, sir; I have been continually.

Senator DOUGLAS. Yet the purchase of large quantities of bonds by the Federal Reserve System leads to inflation, does it not?

Secretary SNYDER. It contributes in a degree.

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Senator DOUGLAS. Therefore, I should think you would be very fearful and be afraid that the Federal Reserve System might buy large quantities of these bonds.

Secretary SNYDER. We have the practical problem of managing the debt, Senator.

Senator DOUGLAS. Which takes precedence, the management of the debt or the maintenance of a stable price level?

Secretary SNYDER. I think that they are interrelated.

Senator DOUGLAS. But when they conflict which do you think is the more important?

Secretary SNYDER. You have to measure the conditions of the moment when you are making the decision—that is not a decision you make for all time.

Senator DOUGLAS. That is, you might at certain times conclude that the management of the debt was more important than the maintenance of stable prices assuming the two are in conflict?

Secretary SNYDER. At times I think that you will find that it might be.

Senator DOUGLAS. In a nonwar period?

Secretary SNYDER. I did not say that. That is why I pointed out in times such as we are faced with now——

Senator DOUGLAS. During a nonwar period, do you think the management of the debt is more important than the maintenance of a stable price level?

Secretary SNYDER. I think that was the type of problem faced by the Employment Act of 1946.

Senator DOUGLAS. The Employment Act does not solve that problem.

Secretary SNYDER. I know it does not solve it. It points up to us the real problem of meeting both inflationary and deflationary pressures, and put the problem right up to Congress and to the Treasury and to all of the Government.

Senator DOUGLAS. And the way the Treasury solved it is to look the issue squarely in the face and say, "We won't solve it"?

Secretary SNYDER. I will not project how we are going to handle all these issues in the future. I certainly could not, Senator, not in open session, unfortunately.

Senator DOUGLAS. Then, since I am foreclosed from discussing the future, is it possible for me to discuss the past?

Secretary SNYDER. That is right.

Senator DOUGLAS. Did not the purchase of securities, Government securities, by the Federal Reserve System after Korea, give rise to an increase in (*a*) in the reserves of member banks in the Federal Reserve System, (*b*) increased loans by the member banks to private industry and individuals and (*c*) an increase in the price level?

Secretary SNYDER. I think we cover that in answer 17 of the questionnaire. I will be glad to prepare another——

Senator DOUGLAS. Would you reply to it in hearings?

Secretary SNYDER. I would be glad to read that into the hearing, yes.

Senator DOUGLAS. Answer 17 is quite an answer. It extends over some pages.

Secretary SNYDER. Yes, sir.

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Senator DOUGLAS. I would like to ask you very briefly, did not the purchase of Government securities by the Federal Reserve System after Korea result in an increase in bank reserves in the Federal Reserve System?

Secretary SNYDER. I will be glad to read this into the record.

Senator DOUGLAS. Mr. Chairman, I suggest that this is not an appropriate answer on the part of the Secretary.

Secretary SNYDER. I want to suggest to the Senator that I have the responsibility to manage the debt, and I am going to be very careful how I answer each question.

I want the best good to come out of these meetings. I am the person responsible for final decisions in the management of the debt, except in those cases in which the issuance of securities is subject to the approval of the President. I must be extremely careful of everything I say——

Senator DOUGLAS. I am asking you about the past.

Secretary SNYDER. Yes, sir; I want to give you exactly what happened in the past. I don't want to rely on memory.

Senator DOUGLAS. May I say for the record, the answer to question 17 began on page 50, and it concludes on page 74. Is it the intention of the Secretary to read 24 pages into the record, each page of which consists of approximately a thousand words?

Secretary SNYDER. Well, I will add this sentence, substitute this for that. Of course, 17 is part of the record anyway and is available to the committee, but I would like to say here that at the start of the Korean invasion on June 25, 1950, the Federal Reserve System was selling bonds, continuing that policy which had been adopted in November 1949, making bonds readily available as prices were marked down. From November 1949, to June 21, 1950, the Federal Reserve holdings of bonds declined approximately $1,900,000,000.

Senator DOUGLAS. Holdings of the Federal Reserve declined?

Secretary SNYDER. Yes, sir.

Senator DOUGLAS. From June 1950?

Secretary SNYDER. From November 1949, to June 21, 1950.

Senator DOUGLAS. Oh, well I am speaking of the period immediately after Korea, namely, from July 1, 1950, on.

Secretary SNYDER. Oh, ——

Senator DOUGLAS. Is it not true that after Korea the holdings of the Federal Reserve System of Government bonds increased from 18.2 billions on June 28, 1950, to 22.2 billions on March 7, 1951, or an increase of 4 billions? These figures are found in the report of the Federal Reserve Bulletin for May 1951, page 515, and in the same document, page 527, the figures on all bank loans are given.

These loans increased from 52 billions on June 30, 1950, to 62 billions on February 28, 1951, and 63 billions on March 28, or an increase in that time of 11 billions. That is, during the 8-month period when there was an increase of $4 billion in securities held by the Federal Reserve System, there was an increase of $11 billion or roughly 21 percent in bank loans. During the same period we also had an increase of 16.6 percent in wholesale prices.

Now was not the increase in bank loans one of the reasons which permitted the increase in wholesale prices to take place?

Secretary SNYDER. It could have been one of the many reasons.

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Senator DOUGLAS. Well, was it not an important reason; in fact, the important reason?

Secretary SNYDER. Well, I would not say it was the important reason.

Senator DOUGLAS. What other important reason could there be? Here you have bank credit increasing by 21 percent, wholesale prices increasing between 16 and 17 percent. The inference seems to me obvious. When you increase the quantity of money in relationship to goods, the price level rises.

Secretary SNYDER. There was a general rushing in to buy by the consumer.

Senator DOUGLAS. Yes; but they could not have made these speculative purchases had they not been able to get the bank loans, and the bank loans would not have been obtained unless bank reserves had been expanded through the purchase of additional securities by the Reserve System. It was the purchase by the Reserve System of the securities which made bank credit available for speculative purchasing.

Secretary SNYDER. There was a tremendous amount of stored-up savings in the business world that had no effect——

Senator DOUGLAS. These are not by any means all stored-up savings. These are loans, which made up the added monetary purchasing power.

Secretary SNYDER. Loans were only a part of the picture. That is why I say that was not the whole matter.

Senator DOUGLAS. Is it not interesting that you have an increase in the quantity of bank credit at about the same ratio as the increase in the price level? Incidentally you will find that the increase in physical production and in velocity roughly balanced each other at about 8 or 9 percent apiece. You can therefore throw those out. It is the increase in the quantity of money and credit that primarily caused the increase in prices.

Secretary SNYDER. It was, of course, recognized that efforts must be made to curtail credit expansion.

Senator DOUGLAS. But during this entire time the Federal Reserve System, under encouragement from the Treasury, was purchasing enormous quantities of Government securities.

Secretary SNYDER. Well, the total holdings of the Federal Reserve in Government securities today are not much different from what they were—they are really lower than at the end of the war finance period.

Senator DOUGLAS. I am not speaking about the war. I am taking this critical post-Korea period, and I am pointing out that in that period the Reserve purchased roughly $4 billion net of Government securities, building up member bank reserves. These increased member bank reserves in turn permitted member banks to increase loans, which they did in the total of $10 billion, that is up to March 1, 1951. This would be an increase in the quantity of credit of 19 percent with prices increasing by about 17 percent during the same period. And when you increase the quantity of money in relationship to goods, you increase the price level.

Secretary SNYDER. Well, of course, Senator, it is interesting to note that since the accord——

Senator DOUGLAS. Well, since the accord, quite right.

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Secretary SNYDER. But loans have gone up just the same since the accord—credit has not been cut off—and prices have leveled off. That is the point I was making.

The statistics which support this statement are as follows:

Federal Reserve holdings of Government securities went up $1.6 billion between February 28 and December 26, 1951, and commercial bank loans went up $4.8 billion. But wholesale prices went down during this period—over 3 percent as measured by the Department of Labor's all-commodity wholesale prices index (900 commodities) and 15 percent for the 28 commodities included in the Department of Labor's basic commodity index. Wholesale prices were, in fact, beginning to show a tendency to level off at the time the accord was reached.

The following tables give the figures in detail:

TABLE 1. *Federal Reserve holdings of Government securities and commercial bank loans*

[In billions of dollars]

	Feb. 28, 1951	Dec. 26, 1951	Increase
Federal Reserve holdings	21.9	23.5	1.6
Loans of all commercial banks	53.5	58.3	4.8

TABLE 2.—*Department of Labor index of all commodity wholesale prices*

[1926=100]

Week ended—		*Month*	
1951—Jan. 2	176.8	1951—January	180.1
Jan. 9	178.1	February	183.6
Jan. 16	178.7	March	184.0
Jan. 23	180.0	April	183.6
Jan. 30	180.9	May	182.9
Feb. 6	182.3	June	181.7
Feb. 13	183.4	July	179.4
Feb. 20	183.3	August	178.0
Feb. 27	183.0	September	177.6
Mar. 6	183.5	October	178.1
Mar. 13	183.4	November	178.3
Mar. 20	183.9	December	177.8
Mar. 27	183.9		

NOTE.—The weekly index covers a much smaller number of commodities (115) than the monthly index (900); it is used primarily to indicate the trend of price changes in the interim periods between the publication of the monthly figures.

TABLE 3.—*Department of Labor index for 28 basic commodities*

[August 1939=100]

Week ended—		*End of month*	
1951—Jan. 2	370.4	1951—Jan. 31	388.6
Jan. 9	381.7	Feb. 28	386.9
Jan. 16	385.5	Mar. 30	378.9
Jan. 23	389.5	Apr. 30	372.0
Jan. 30	388.7	May 31	359.7
Feb. 6	388.9	June 29	342.9
Feb. 13	389.7	July 31	326.9
Feb. 20	389.2	Aug. 31	323.2
Feb. 27	387.9	Sept. 28	328.9
Mar. 6	385.7	Oct. 31	326.9
Mar. 13	379.6	Nov. 30	327.6
Mar. 20	378.4	Dec. 28	327.3
Mar. 27	378.4		

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Senator DOUGLAS. Well, now just a minute. They had some idle reserves, that is the answer to that. They had unused reserves upon which they could expand.

Secretary SNYDER. But the fact that the Fed. was not buying Government bonds did not stop——

Senator DOUGLAS. But the past purchases, particularly in the winter, gave the banks reserves which they did not immediately use but which they could utilize in the subsequent period.

Secretary SNYDER. Well, we would have to analyze to see what those reserve holdings were.

(The material subsequently submitted is as follows:)

The table that follows shows excess reserves of member banks weekly for the year following the outbreak of hostilities in Korea. The figures fluctuated from week to week, but there was no significant upward trend as a result of the expansion of the Federal Reserve portfolio during the period.

Member bank excess reserves

[In millions of dollars]

1950	Excess Reserves	1951	Excess Reserves
June 28	526	Jan. 3	1,191
July 5	791	Jan. 10	1,111
July 12	904	Jan. 17	969
July 19	630	Jan. 24	650
July 26	830	Jan. 31	937
Aug. 2	842	Feb. 7	826
Aug. 9	831	Feb. 14	741
Aug. 16	685	Feb. 21	577
Aug. 23	756	Feb. 28	700
Aug. 30	518	Mar. 7	716
Sept. 6	864	Mar. 14	1,042
Sept. 13	931	Mar. 21	577
Sept. 20	353	Mar. 28	488
Sept. 27	862	Apr. 4	646
Oct. 4	778	Apr. 11	987
Oct. 11	960	Apr. 18	1,116
Oct. 18	1,250	Apr. 25	694
Oct. 25	687	May 2	456
Nov. 1	727	May 9	563
Nov. 8	719	May 16	766
Nov. 15	1,010	May 23	291
Nov. 22	538	May 30	306
Nov. 29	679	June 6	863
Dec. 6	949	June 13	1,070
Dec. 13	1,100	June 20	840
Dec. 20	866	June 27	538
Dec. 27	759		

Senator DOUGLAS. We could easily work that out by getting the figures on excess reserves by periods. I think that would show that the banks laid up for themselves reserves which they did not immediately use but which were available not only for the expansion in credit between July 1950 and April 1951, but after April as well.

The only conclusion I can draw is that the Federal Reserve under Treasury stimulus was a big contributor to inflation during this period.

Secretary SNYDER. Well, there are many other factors besides that. This is discussed in question 17 of the questionnaire—page 69 of volume I.

Senator DOUGLAS. It was the chief contributor.

Secretary SNYDER. I doubt it.

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Senator DOUGLAS. In other words, according to you, the primary factor, the primary cause of inflation, is not the ratio between the total quantity between money and credit on the one hand, and total quantity of goods on the other, but some other element or elements?

Secretary SNYDER. I said I doubted that the Federal Reserve purchase of Government bonds was the important contributor to inflation, and I do say it.

Senator DOUGLAS. Mr. Secretary, the purchase of these Government bonds increased member bank reserves by $4 billion. That would theoretically enable them to loan out from $20 billion to $24 billion more of credit, and you said that was their tendency, being unwilling to leave idle lending capacity.

They actually increased their loans by $10 billion during the same period, increasing from 52 to 62 billions, an increase of 19 percent. They have expanded total loans $6 billion more since then, or have expanded the total quantity of credit by $16 billion, an increase of about 30 percent since Korea.

Now how can you avoid the conclusion that it was the purchase of Government bonds during this period which was a primary factor that led to inflation, or that it was the main cause?

Secretary SNYDER. I don't consider it the main cause.

Senator DOUGLAS. What would be the main cause then if this is not?

Secretary SNYDER. I think the general attitude, the scare buying.

Senator DOUGLAS. But the scare buying was financed by credit.

Secretary SNYDER. But not entirely by credit created this way, not by a long shot.

Senator DOUGLAS. But partially by this.

Secretary SNYDER. Well, partially, I am willing to admit partially, but it was not the important cause.

This matter was discussed in the answer to question 17 of the questionnaire submitted to the Secretary of the Treasury by the subcommittee, as follows:

"The primary cause of the inflationary situation, throughout the entire postwar period, was an unprecedented demand for goods by business and consumers generally. Before Korea, individuals bought goods to fulfill the stored-up demands which had resulted from the shortages of World War II; and industry replaced and expanded plant and equipment in order to meet civilian peacetime needs. After Korea, individuals and businesses, remembering the shortages of World War II, bought goods in anticipation of shortages in the defense period; and requirements for materials and goods were also stepped up sharply in order to meet the expanded military needs of the period. Some of these purchases were financed by an expansion of bank credit—but not all of them, by any means. Bank credit, for example, accounted for only about one-tenth of the 1950 financial needs of business corporations."

Senator DOUGLAS. In other words, it was not an important cause of inflation.

Secretary SNYDER. I said not the important. Please don't let's get my words mixed up, Senator. I have a hard enough time with them as it is.

Senator DOUGLAS. I have some trouble, too.

Secretary SNYDER. It was a partial cause, but when you had to measure what the other side of the picture would have been. Now how would you have prevented the banks from going to the Federal to sell their bonds? Would you have risked letting the price of the bonds go to the bottom?

Senator DOUGLAS. Then you say in order to maintain the price of the bonds the Federal Reserve should have purchased?

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Secretary SNYDER. No, I am just asking you how would you have prevented it.

Senator DOUGLAS. I am asking you, Mr. Secretary.

Secretary SNYDER. You seem to be bringing up the point. I said I don't think it caused it, but we have to have the other side of it. Could you have prevented—by any measure that you took—the creation of a considerable amount of credit, and might not other steps that might have been taken by the Federal Reserve and the Treasury been somewhat more disruptive than what was done?

Senator DOUGLAS. Well, when the Federal Reserve ceased purchasing unlimited quantity of bonds, I believe you and others said that this policy would occasion a great fall in the price of the bonds.

Secretary SNYDER. No, sir, I don't think you will find I ever made such a statement.

Senator DOUGLAS. You were fearful of it, were you not?

Secretary SNYDER. I don't think you will find I ever made that statement, because prudence would tell me, as Secretary of the Treasury, who was responsible for debt management, not to make such statements.

Senator DOUGLAS. What is all the shooting about then?

Secretary SNYDER. Well, I don't know.

Senator DOUGLAS. Well, I don't know either at this point.

Secretary SNYDER. You are holding the guns, I am not.

Senator DOUGLAS. If you didn't think there was any danger of the price of bonds falling disastrously, then why should the Federal Reserve System be compelled to purchase them?

Secretary SNYDER. I would be very interested in trying to find wherever I made such a statement, because prudence would tell me not to go out scaring people about the United States bond market.

Senator DOUGLAS. Well, if you did not make such a statement, certain other highly placed men in the Government did make it.

Secretary SNYDER. Of course, I don't control the voice of the Government.

Senator DOUGLAS. Well, then you think that it is not necessary for the Federal Reserve Board to purchase the bonds in order to maintain the price——

Secretary SNYDER. I don't think I ever made that statement, either.

Senator DOUGLAS. Then what have you said, or has this been an exercise in trying to conceal your meaning from congressional committees?

Secretary SNYDER. No, it certainly has not been, but there has been such free conversation about what I have or haven't said, I think——

Senator DOUGLAS. Do you think it necessary for the Federal Reserve Board during this 8-month period following Korea to have purchased large quantities of Government bonds in order to maintain their price?

Secretary SNYDER. The Federal Reserve open market committee had to meet their responsibilities in assisting the Treasury to maintain the Government's financial operations.

Senator DOUGLAS. Answer yes or no. Do you think they should have purchased these bonds during the period?

Secretary SNYDER. I think the operation was necessary.

Senator DOUGLAS. You believe that it was necessary?

Secretary SNYDER. Yes, sir.

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Senator DOUGLAS. Even though it occasioned this inflation?

Secretary SNYDER. I did not say it occasioned the inflation. I again want to be sure that I did not admit that, sir. It may have had a partial effect on it, yes, sir, but then we had to measure the partial effect on the other circumstances.

Senator DOUGLAS. The effect it had on inflation according to you was not as bad as the beneficial effect of maintaining the price of Government bonds.

Secretary SNYDER. Of not only the Government bonds, but the whole stability of the financial system.

Senator DOUGLAS. Has the United States come to such a pass that its securities need artificial support? Again I ask, are not the productivity of the country, the degree of financial soundness of the country, and some adjustment of interest rates sufficient to provide a market for Government bonds without "pegging" the market through Federal Reserve purchases?

Secretary SNYDER. I just want to recall what happened after World War I. We have got to consider that.

Senator DOUGLAS. I believe we have heard of that.

Secretary SNYDER. I think we have heard it, too. I certainly have.

Senator DOUGLAS. Mr. Secretary, are the bonds that you issue now the same as were issued during the first world war?

Secretary SNYDER. No, they have all been liquidated.

Senator DOUGLAS. Now, Mr. Secretary——

Secretary SNYDER. You asked a question. I am going to have to reply.

Senator DOUGLAS. You reply as the State Department commonly replies. Now, Mr. Secretary, what about the differences in the types of savings bonds which are issued now—Series E, F, and G as compared to then? Are those redeemable?

Secretary SNYDER. Yes, they are redeemable.

Senator DOUGLAS. Can be cashed in at any time?

Secretary SNYDER. Yes, sir, at any time after they have been held a stated minimum period.

Senator DOUGLAS. At any time?

Secretary SNYDER. That is correct.

Senator DOUGLAS. And at what price?

Secretary SNYDER. There may be some notice period.

Senator DOUGLAS. At what price?

Secretary SNYDER. At a stated price.

Senator DOUGLAS. At par, isn't that true?

Secretary SNYDER. At a stated price on the back of the bond.

Senator DOUGLAS. At par.

Secretary SNYDER. Well, that is not exactly correct.

Senator DOUGLAS. Is it not 99 44/100 percent correct?

Secretary SNYDER. I would have to look on the back of the bond and see how old it was and so on.

Senator DOUGLAS. As a general rule are they redeemable at par or are they not redeemable at par?

Secretary SNYDER. At maturity they are redeemable at par.

Senator DOUGLAS. Were the bonds in World War I redeemable at par?

Secretary SNYDER. At maturity they were.

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Senator DOUGLAS. Were they redeemable by the Government at par?

Secretary SNYDER. At maturity, yes.

Senator DOUGLAS. What about the terms of maturity? What about the difference in time?

Secretary SNYDER. We had not developed the savings-bond plan in World War I.

Senator DOUGLAS. Precisely so. In other words, the length of maturity was a long, long time.

Secretary SNYDER. But we are not talking about savings bonds. We are talking about the whole Government security market.

Senator DOUGLAS. Well, that is an important element.

Secretary SNYDER. Yes; very important.

Senator DOUGLAS. One argument which was commonly used as a justification for supporting the bond market was that you do not want bonds to fall to 82. There is no prospect that E, F, and G bonds would fall to 82, since they have short-time maturities which would come due quickly and would be redeemable at par at those times.

Secretary SNYDER. I was not referring to the savings bonds.

Senator DOUGLAS. What were you referring to?

Secretary SNYDER. To the whole Government financing picture when we were talking about where bond prices might go.

Senator DOUGLAS. What were the other elements in this picture?

Secretary SNYDER. The savings bonds don't enter into this Federal Reserve matter that we are talking about because the Federal doesn't buy savings bonds. It is the other securities of the Government.

Senator DOUGLAS. Suppose the Federal Reserve had not bought the securities; what would have happened?

Secretary SNYDER. That is what I brought up.

Senator DOUGLAS. What would have happened?

Secretary SNYDER. I don't know.

Senator DOUGLAS. When the Federal Reserve stopped buying unlimited amounts of securities in April, did anything catastropic happen?

Secretary SNYDER. Of course, a long march of time had taken place between the beginning of Korea and when the——

Senator DOUGLAS. Did anything catastropic happen when the Reserve stopped buying Government bonds?

Secretary SNYDER. No; it has worked out very well.

Senator DOUGLAS. You hope it will continue, do you not?

Secretary SNYDER. I hope it continues to work well.

Senator DOUGLAS. You hope that the Federal Reserve System will not be committed to purchase bonds in unlimited quantities in order to support the Government bond market?

Secretary SNYDER. I hope that conditions will permit that; yes, sir.

Senator DOUGLAS. That is a consummation devoutly to be desired. Now, I am more interested in the future than in the past, but on pages 72 and 73 of your reply you make very serious charges against the Federal Reserve System. You imply that on three occasions the Federal Reserve System broke faith with you. That is the implication which I drew from your statement.

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First, on page 72, if you will consult your reply, in speaking of the summer of 1950, I read:

The terms of the issue were approved by the President; and the Chairman of the Board of Governors assured the Treasury of the full cooperation of the System in the refunding operation.

On the first trading day after the announcement of the new issue was made, the Federal Reserve permitted the market to go off sharply, notwithstanding the fact that the issue had been proposed by the Federal Reserve and the Chairman of the Board of Governors had assured the Treasury of the System's full cooperation.

That is equivalent, I think, to a charge of——

Secretary SNYDER. I will just ask the staff to read into the record, if I may, the report. I am not trying to change any figures.

Representative PATMAN. We will identify the person who is doing the reading, Mr. Secretary.

Secretary SNYDER. Assistant Secretary Overby.

Mr. OVERBY. Mr. Chairman, may we introduce into the record this statement: Hourly quotations on United States Government securities and World Bank bonds—we are not talking about World Bank bonds here—for November 24, 1950.

Senator DOUGLAS. Just a minute; are we speaking of the same thing?

Mr. OVERBY. That was the first trading day after the announcement. Do you wish me to read this, Mr. Chairman?

Senator DOUGLAS. Yes; I would appreciate it.

Representative PATMAN. Go right ahead.

Mr. OVERBY. There are quite a few issues, sir.

Secretary SNYDER. Show it to the Senator so he can see the nature of it.

Representative PATMAN. Suppose you let Senator Douglas see it.

(The document above referred to is as follows:)

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Hourly quotations on U. S. Government securities and World Bank bonds,[1] *Nov. 24, 1950*

	Previous close	10	10:30	11	12	1	2:15	3:15 (close)
Treasury bonds:								
1½% 1950 [2]	0.25%	100.04	100.03	100.02	100.02	100.02	100.02	100.02
2¾% 1951–54	100.29							100.28 (−1)
2% September 1951–53 [2]	100.12		100.12 +(+1/64)	100.12 +(+1/64)	(+1/64)	(+1/64)	[3] 100.12	100.12
3% 1951–55	101.16							101.16
2¼% 1951–53	101.06	101.07 (+1)	(+1)	(+1)	(+1)	(+1)	[3] 101.06	101.06
2% 1951–55 [2]	100.15							100.15
2½% 1952–54 [2]	101.05				101.04 (−1)	(−1)	(−1)	101.04 (−1)
2% June 1952–54 [2]	100.20	100.19 +(−1/64)	100.19 (−1)	(−1)	100.18 +(−3/64)	100.18 (−2)	100.18 +(−3/64)	100.18 +(−3/64)
2¼% 1952–55 [2]	100.31	100.30 (−1)	(−1)	(−1)	100.29 (−2)	(−2)	(−2)	100.29 (−2)
2% December 1952–54 [2]	100.25		100.24 (−1)	(−1)	100.23 +(−3/64)	(−3/64)	100.24 (−1)	100.24 (−1)
2% 1953–55	102.05		102.04 (−1)	(−1)	102.03 (−2)	(−2)	(−2)	102.03 (−2)
2¼% 1954–56	103.25	103.24 (−1)	(−1)	(−1	(−1)	(−1)	(−1)	103.23 (−2)
2⅞% 1955–60	107.02	107.01 (−1)	107.00 (−2)	(−2)	(−2)	(−2)	(−2)	106.28 (−6)
2½% 1956–58 [2]	103.25	103.22 (−3)	103.20 (−5)	103.19 (−6)	(−6)	(−6)	103.21 (−4)	103.21 (−4)
2¼% 1956–59 [2]	102.26	102.22 (−4)	102.20 (−6)	102.19 (−7)	(−7)	(−7)	102.21 (−5)	102.22 (−4)
2¾% 1956–59	108.17	108.16 (−1)	(−1)	(−1)	108.14 (−3)	108.12 (−5)	(−5)	108.12 (−5)
2¾% 1958–63	110.15	110.14 (−1)	(−1)	(−1)	110.12 (−3)	110.10 (−5)	(−5)	110.10 (−5)
2¼% June 1959–62 [2] R	100.23	100.21 (−2)	(−2)	100.18 (−5)	(−5)	100.17 (−6)	100.18 (−5)	100.18 (−5)
2¼% December 1959–62 [2] R	100.22	100.20 (−2)	(−2)	100.18 (−4)	100.17 (−5)	100.16 (−6)	100.17 (−5)	100.17 (−5)
2¾% 1960–65	113.01	113.00 (−1)	(−1)	(−1)	112.30 (−3)	112.27 (−6)	(−6)	112.27 (−6)
2½% 1962–67 [2] R	102.27	102.26 (−1)	(−1)	102.23 (−4)	(−4)	102.21 (−6)	102.23 (−4)	102.24 (−3)
2½% 9163–68 [2] R	102.04	102.03 (−1)	(−1)	102.00 (−4)	(−4)	101.31 (−5)	102.00 (−4)	102.01 (−3)
2½% June 1964–69 [2] R	101.20	101.19 (−1)	101.18 (−2)	101.16 (−4)	(−4)	101.15 (−5)	101.16 (−4)	101.17 (−3)
2½% December 1964–69 [2] R	101.14	101.13 (−1)	(−1)	101.11 (−3)	101.10 (−4)	(−4)	101.11 (−3)	101.11 (−3)
2½% 1965–70 [2] R	101.10	101.09 (−1)	101.08 (−2)	101.06 (−4)	(−4)	101.05 (−5)	101.06 (−4)	101.07 (−3)
2½% 1966–71 [2] R	101.09	101.08 (−1)	101.07 (−2)	101.05 (−4)	(−4)	101.04 (−5)	(−5)	101.05 (−4)
2½% June 1967–72 [2] R	100.26			100.25 (−1)	100.24 (−2)	(−2)	(−2)	100.24 (−2)
2½% September 1967–72 [2]	104.05	104.00 (−5)	103.29 (−8)	103.26 (−11)	103.22 (−15)	(−15)	103.25 (−12)	103.25 (−12)
2½% December 1967–72 [2] R	100.26			100.25 (−1)	100.24 (−2)	(−2)		100.24 (−2)
Certificates of indebtedness:								
1⅛% 1/1/51 [2]	1.10%	100.03	100.02	100.02	100.01	100.01	100.01	100.01
Treasury notes:								
1¼% series B 7/1/51 [2]	1.45%							
1¼% series C 7/1/51 [2]	1.45%							
1¼% series D 7/1/51 [2]	1.45%							
1¼% series E 8/1/51 [2]	1.46%							
1¼% series A 10/1/51 [2]	1.48%							
1¼% series F 10/15/51 [2]	1.49%							
1¼% 11/1/51 [2]	1.49%							
1⅜% 3/15/54 [2]	99.07	99.06 (−1)	99.04 (−3)	99.03 (−4)	(−4)	(−4)	99.04 (−2)	99.05 (−2)
1½% 3/15/55 [2]	99.15	99.14 (−1)	99.10 (−5)	(−5)	(−5)	99.11 (−4)	99.12 (−3)	99.12 (−3)
Treasury bills:	*Bid* *Ask*							
11/30/50 [2]	1.37%–1.18%							
12/7/50 [2]	1.37%–1.18%							
12/18/50 [2]	1.37%–1.20%							

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12/21/50 [2]	1.37%-1.22%						
12/28/50 [2]	1.37%-1.24%						
1/4/51 [2]	1.38%-1.26%						
1/11/51 [2]	1.38%-1.28%						
1/18/51 [2]	1.38%-1.30%						
1/25/51 [2]	1.38%-1.30%						
2/1/51 [2]	1.39%-1.31%						
2/8/51 [2]	1.39%-1.32%						
2/15/51 [2]	1.39%-1.32%						
2/23/51 [2]	1.39%-1.35%						
World Bank bond: 3% 7/15/72 [2]	102.14						
Federal land bank bonds:							
2¼% 2/1/53-55 [2]	100.16						
1¾% 10/1/55-57 [2]	98.14						

[1] Quotations with percent signs represent yields. All other quotations are prices, and the figures shown after the decimal points represent thirty-seconds of a point. Plus and minus figures represent net changes from close on previous day.
[2] Taxable bonds.
[3] Unchanged.
R—Restricted bonds.

Source: Office of the Fiscal Assistant Secretary.

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Senator DOUGLAS. You are trying to establish the fact that the market fell sharply, I take it.

Mr. OVERBY. The market declined on that day, sir.

Senator DOUGLAS. Which would you take as the best security—2½'s?

Mr. OVERBY. It was a 5-year offering, if I remember the circumstances.

Senator DOUGLAS. Would the 2½'s be all right?

Mr. OVERBY. Yes, sir; the 2½'s of 1956–58 give an indication of what happened in the market generally. They were 103.25 at the close of the preceding trading day.

Senator DOUGLAS. Suppose I take the 2½'s, 103.22 at 10 o'clock; at 10:30, 103.20; 11 o'clock, 103.19; 103.21 at the end of the day. That was a fall of four thirty-seconds, one-eighth of a point during the day. Would you say that was catastrophic?

Secretary SNYDER. I don't think I said it was catastrophic.

Senator DOUGLAS. In other words, that the Federal Reserve should not have permitted the market to fall by one-eighth of a point?

Mr. OVERBY. On a short-term issue, that is of some consequence.

Senator DOUGLAS. What you are saying in effect, therefore, since the Federal Reserve System acted improperly in allowing a fall of one-eighth, they should not have allowed a fall at all. I think four-thirty-seconds is rather small.

Now did you have an agreement with the Chairman of the Federal Reserve Board that the Federal would purchase an unlimited quantity of bonds at the interest rates that you were issuing sufficient to maintain the price at the initial figure, 103.25?

Mr. TICKTON. 103.25.

Senator DOUGLAS. Did the Chairman of the Federal Reserve Board pledge himself to purchase such a quantity as to maintain prices at the interest rates charged?

Secretary SNYDER. I stand on the statement in 17 that we were assured of cooperation.

Senator DOUGLAS. Well, "cooperation" is a very vague word. That is one of the troubles here. You use the term "cooperation," but you may mean dictation.

Secretary SNYDER. I don't consider it dictation. There has never been any evidence of the Treasury since——

Senator DOUGLAS. Did you understand the Chairman of the Federal Reserve Board to pledge that he would see that the Open Market Committee bought such a number of bonds as would maintain fixed prices at the interest rates at which you were issuing these?

Secretary SNYDER. Senator, you agreed with me that it would be a very fine thing if we could continue the accord, and that is what I am going to try to do. I will stand on this answer, and I am not going to expand.

Senator DOUGLAS. You wrote the statement.

Secretary SNYDER. And I am going to stand on it.

Senator DOUGLAS. What you say is that the Federal Reserve broke faith.

Secretary SNYDER. I won't expand on that question, sir. I think it is answered.

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Senator DOUGLAS. Now on page 73 you refer to a conference between the Chairman, Board of Governors, the President and yourself in January 1951. You say:

At this meeting the three of us—the President, the Chairman, and I—agreed that market stability was desirable, and the Chairman again assured the President that he need not be concerned about the 2½-percent long-term rates on Government securities.

Did the Chairman of the Federal Reserve Board on that occasion make a pledge that the Federal Reserve Board would buy an unlimited quantity of Government securities so that the interest rate need not rise above 2½ percent and so that the price of Government securities would be maintained?

Secretary SNYDER. I will stand on the statement made in the answer to the question there.

Senator DOUGLAS. What is that, that the Chairman made such a pledge?

Secretary SNYDER. The words are there, sir. I will stand on what is there.

Senator DOUGLAS. "Need not be concerned." What do those words mean?

Secretary SNYDER. Well, what they mean is just what I have said right here, that "the Chairman again assured the President that he need not be concerned about the 2½-percent long-term rate on Government securities."

Senator DOUGLAS. Did you understand that to mean that he agreed that the Federal Reserve System would purchase an unlimited quantity of bonds so as to maintain the price?

Secretary SNYDER. I understood it to be just what it said here, and I stand on that statement.

Senator DOUGLAS. Talleyrand said that words were used to conceal thought. I have always thought that words should be used to express thought, and it is the lack of this quality which I find unsatisfactory in your testimony throughout.

Secretary SNYDER. I have the responsibility of trying to continue to manage the debt, and I am going to try to do that, sir. We are getting along fine with the Federal Reserve Board, and I want that to continue.

Senator DOUGLAS. Are you getting along fine with an organization which already you have accused twice of practicing bad faith?

Secretary SNYDER. You are putting the interpretation in there.

Senator DOUGLAS. Let me go ahead and read this:

It was against this background that I made a speech on January 18, 1951, before the New York Board of Trade, announcing this policy. The market strengthened following this speech. Then some officials of the Federal Reserve System began to differ publicly with the policy. This created further uncertainties in the Government security market. At about this time, also—on January 29—the Open Market Committee further reduced its buying price for Victory loan 2½'s—which was the most significant of the long-term Treasury issues—

and so forth.

Representative BOLLING. Would you yield there?

Senator DOUGLAS. Yes, sir.

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Representative BOLLING. Mr. Secretary, when was the accord reached?

Secretary SNYDER. March 4, 1951.

Representative BOLLING. I gather that the accord received a great deal of publicity as the basis of its being an elimination of friction. It would be my impression that your desire would now be to maintain the good relations that had been obtained by the accord?

Secretary SNYDER. It certainly is my desire and my intent.

Representative BOLLING. And the purpose of the answer to these questions was to relate the history as you saw it?

Secretary SNYDER. That is correct.

Representative BOLLING. Thank you.

Secretary SNYDER. The history as the facts were according to our records.

Senator DOUGLAS. I would like to point out that I am merely asking questions on statements that the Secretary has made to the committee which, by implication, charge bad faith on the part of the Federal Resevre System.

Secretary SNYDER. I stated the facts. You are putting in the implication.

Senator DOUGLAS. Bad faith, at any rate, previous to the accord.

Secretary SNYDER. I stated the facts. You are putting in the implication, sir.

Senator DOUGLAS. I want to know whether there was a definite pledge by the Chairman of the Federal Reserve Board in both of these cases to buy unlimited quantities of Government bonds in order to maintain prices at the interest rates which you decided upon. That is the issue.

If there was such a pledge, and if it was not later honored, then the Chairman may have been acting in bad faith, but there was not such accord, then I don't think these statements should be made.

Of course there is also always a question as to the degree to which the Chairman can commit the Board itself. You raised this issue, Mr. Secretary, and we are simply trying to find out the facts.

Secretary SNYDER. I simply related the facts as requested by the questionnaire, and there they are. I am not going to expand on them, with the permission of the chairman.

Senator DOUGLAS. I ask for a ruling by the Chair.

Representative PATMAN. What is your question that you stated is not answered properly, Senator Douglas?

Senator DOUGLAS. I asked whether the Secretary asserted that the Chairman of the Federal Reserve Board had promised to purchase an unlimited quantity of bonds in the open market in order to maintain prices at the interest rates fixed by the Treasury on those securities.

Representative PATMAN. Obviously the session will last into the afternoon. I would like for you to pass that over for the present and continue your interrogation.

Senator DOUGLAS. The third question involves the point that is in the third paragraph on page 73:

> About this time a series of conferences was held between the Treasury, the Chairman of the Board of Governors, the chairmen of the two banking committees in Congress, and the chairman of the Joint Committee on the Economic Report. It was generally agreed between the parties involved that there should be no change in the existing situation in the Government security market, and no congressional hearings held on differences between the Treasury and the Fed-

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eral Reserve, for a short period while I was in the hospital recuperating from an eye operation.

Shortly after these meetings, however a change in the Federal Reserve attitude began to be apparent; and the Chairman of the Board informed the Treasury that, as of February 19, the Federal Reserve was no longer willing to maintain the existing situation in the Government security market.

Now that is an implication that the Federal Reserve went back upon the promise, went back upon a general agreement that there would be no change in the governmental bond market.

Secretary SNYDER. I have answered it in 17.

Senator DOUGLAS. Did the Chairman of the Federal Reserve Board in the conferences which were held agree that the Reserve Board would purchase an unlimited quantity of Government bonds in order to maintain prices at the interest rates charged by the Treasury?

Secretary SNYDER. I stand on the answer that is——

Senator DOUGLAS. That is a refusal to answer.

Secretary SNYDER. I have answered it in the question.

Senator DOUGLAS. No; you haven't.

Secretary SNYDER. I am going to stand on the answer that is in the question.

Senator DOUGLAS. I interpret that as a refusal to answer, as I interpret the reply to the other questions.

Now, Mr. Secretary, may I ask you about this advisory council which you suggest. You would have that advisory credit council composed of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, Director of the Budget, the Chairman of the Council of Economic Advisers, and the Chairman of the Securities and Exchange Commission.

Aside from the Chairman of the Federal Reserve Board, how many of these would be Presidential appointees?

Secretary SNYDER. All of them.

Senator DOUGLAS. All of them would be Presidential appointees. Of course, the Chairman of the Federal Reserve might himself be a Presidential appointee.

Secretary SNYDER. I included him. I said all of them were.

Senator DOUGLAS. But the majority of the members of the Board of the Federal Reserve System probably would tend not to be Presidential appointees, or might not be?

Secretary SNYDER. Well, all the members of the Board are Presidential appointees. It may not be the incumbent.

Senator DOUGLAS. Not the incumbent President?

Secretary SNYDER. Maybe not by the incumbent President.

Senator DOUGLAS. That is the point.

Secretary SNYDER. That is right.

Senator DOUGLAS. Now suppose this advisory council decided that the Federal Reserve Board should purchase an unlimited quantity of Government securities in order to maintain prices at the interest rates charged, and the Chairman of the Federal Reserve Board did not agree with this. To what degree would the opinion of the advisory council be controlling? I believe you used the term "authoritative advice."

Secretary SNYDER. Of course there is no one outside of the Federal Reserve Board that can force them to take any action. The Federal Reserve Board was set up by Congress and they make their final determination.

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Now it seems to me it would be extremely valuable for everybody to sit around the table and talk about the problems that each one represents, the responsibility that each one represents, so that there would be a full understanding of the problems that are faced by each, and that the decisions then would be made in the face of the responsibilities of each.

Senator DOUGLAS. It might be an opportunity to twist the arm of the Federal Reserve System, too, might it not?

Secretary SNYDER. Certainly the Treasury gets its arm twisted enough, and I would be glad to pass it around a little.

Senator DOUGLAS. I do not want to have it understood that I am necessarily opposing such a monetary council. But it has great danger in the form now suggested.

Secretary SNYDER. I think honestly, Senator, it would be a very good thing.

Senator DOUGLAS. But I do want to point out some of the issues involved, and I am curious by what is meant by your phrase, "This would have advisory authority."

Secretary SNYDER. That is right.

Senator DOUGLAS. I can understand its offering advice, but I do not quite understand the meaning of the phrase "advisory authority." What do you mean by advisory authority?

Secretary SNYDER. Well, that term is used, "advisory authority" because that is the scope in which it would be used. Just offer advice about the various segments of the economy.

Senator DOUGLAS. Well, then, why not strike the word "authority" from your statement and simply say "offer advice"?

Secretary SNYDER. That is all right.

Senator DOUGLAS. That is, you do not wish to have this body have any iron-clad authority.

Secretary SNYDER. It was not intended that it should have. Its only function would be advisory; each agency would still have authority over its own operation.

Senator DOUGLAS. Suppose there is a clear conflict with the rest of the Presidential appointees wanting the Federal Reserve System to buy an unlimited quantity of bonds at fixed prices and given interest rates; and suppose that the Chairman of the Federal Reserve Board demurred; should he be a good fellow and cooperate and go along even though in his judgment that will mean inflation, or should he be lacking in cooperation in order to preserve the solvency of the country? Cooperation is a mystic phrase.

Secretary SNYDER. Well, I am sure that the Federal Reserve Board would react the same as all the other agencies.

Senator DOUGLAS. You mean that the Board would cooperate and agree to do what the rest wanted them to do?

Secretary SNYDER. I did not say that, sir. I said they would have to operate within the scope of their own responsibility, but the decisions that they might make certainly might give some weight to the problems that are discussed around the table. Certainly that would fit within the scope of the limits of their decisions.

You could make a decision one way or another many times, but if you have certain facts, it may lead you to a sounder decision than if you made it without all of those facts.

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Senator DOUGLAS. Is this an attempt to create at this juncture a climate of opinion which will make it psychologically impossible for the Chairman of the Reserve System to purchase unlimited quantities——

Secretary SNYDER. You are putting that thought in my mind. I did not have it in there at the time I made this suggestion. I doubt if I would use it if it did occur to me.

Representative PATMAN. Senator Douglas, I have been determined to restrain myself and not interrupt at all, but I would like to suggest that you consider that this is comparable to the advisory group set up by the private commercial banks, is it not, Secretary Snyder?

Secretary SNYDER. Well, there are advisory groups all over the place in addition to the Federal Advisory Council. The Commerce Department has an advisory group, the State Department has an advisory group, the Treasury has half a dozen advisory groups—or more. There is the National Advisory Council on International Monetary and Financial Problems.

There are many groups of this nature, and they are extremely helpful in sitting down and talking over the various problems. It gives an opportunity in an informal fashion to discuss things rather than have them brought up bilaterally or otherwise.

Senator DOUGLAS. That finishes my questions, Mr. Chairman. I want to thank you for the courtesy of permitting me to ask them, and to compliment you upon the fairness with which you have conducted the hearing.

Representative PATMAN. The question you have brought up, if it is all right with you, the Chair will wait until this afternoon to make a ruling upon.

Senator DOUGLAS. Certainly.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Secretary, I would like to have you keep in mind that I was not a member of the former committee considering similar subjects. Are there any substantial differences between Government bonds and other bonds?

Secretary SNYDER. In what fashion? Of course, one of them has the full credit of the Government behind it and other bonds are limited to the resources of the organization, the instrument issuing them.

Representative BOLLING. There is at least that one difference.

Secretary SNYDER. Well, that is a very big difference, of course.

Representative BOLLING. What, in your judgment, would be the effect on the economy if there should be a substantial falling off of Government bonds?

Secretary SNYDER. That is a question I would like to answer in executive session, because I am the one and only person that is responsible for the final decisions on debt management, except that the President must approve all offerings of issues having maturities over 1 year. To discuss things of that sort in an open session—I cannot measure what the effect might be.

Representative BOLLING. Mr. Chairman, there may be a number of questions I will want to ask if not in executive session, then for the committee to address a letter on further expansion of certain points.

Secretary SNYDER. I think, Mr. Chairman, you must bear in mind that I do have that responsibility.

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Representative PATMAN. I assume the Secretary will be glad to answer any questions written and sent to him by correspondence.

Secretary SNYDER. I do not want to withhold any information from the committee, but I do have to restrain myself in answering questions that in my judgment might have some effect on the general operation of debt management, because it must be remembered I cannot possibly detach myself as an individual from being Secretary of the Treasury.

I cannot give personal opinions that would not be translated into the thinking of the Secretary of the Treasury, as much as I might try to do so.

Representative BOLLING. Mr. Chairman, I am very anxious to avoid putting the Secretary in that position, and the other method will be perfectly satisfactory to me. I would like to pursue this problem that Senator Douglas raised. It may fall in the same category as my first question, of the future.

I am entering into this hearing with a completely open mind, and I am interested in the future, not particularly in the past. I would like to make some assumptions so that this will be theoretical.

Let us assume that the Congress enacts legislation which will provide for a substantial deficit. I assume also there is only one way in which the Treasury can raise the money to take care of that deficit. It will have to borrow it from some source.

Secretary SNYDER. That is correct.

Representative BOLLING. Granted the deficit, and the necessity of raising the money, what are the alternatives confronting the Treasury as to the question that Senator Douglas has raised?

Do you have any alternatives aside from those mentioned in the replies to your questionnaire in which you can borrow money without having inflationary impact? Is there any alternative except those of support through Federal Reserve activity to the bond market dropping off?

Secretary SNYDER. Do you mean outside of congressional action?

Representative BOLLING. Yes, sir.

Secretary SNYDER. Well, I think we have to carefully judge each one of the instances on the basis of the facts when it comes to a refunding operation, or when it comes to an offering of new money financing. I think we have got to measure it against the whole economy at the time that that operation is undertaken, because it changes from month to month. The last 6 months have seen a considerable change in the general situation in the economy.

Representative BOLLING. What I am trying to get at is what are some of those factors you have to take into consideration aside from those that have already been discussed.

Secretary SNYDER. We have to take into consideration the supply of funds at the time—whether the normal investment groups have surplus cash on hand that is seeking investments.

We have to consider the approach to attracting as much nonbank investment as we can. We have got to measure all of those. We have got to consider trying to attract savings.

We have got to give all of those considerations very careful study in order to try to meet the situation of keeping as much of this financing out of the bank area as we can.

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Representative BOLLING. Then suppose you in your consideration in this theoretical case discover that in your judgment a very substantial amount of the borrowing is going to have to be borrowing through the banks, commercial banks and otherwise, what alternatives then do you face? What alternatives do you have?

You have the two that I see, obviously, of letting the bond market take its course in a free market, and you have the other one of support through Federal Reserve activities. Are there any other alternatives?

Secretary SNYDER. None.

Representative BOLLING. In other words, just the free market on the one hand, and a free market influenced by the Federal Reserve activities on the other hand. Those are the only two.

Secretary SNYDER. You mean assisted by the Federal Reserve, you mean in their orderly market operations?

Representative BOLLING. Yes. That is all I wanted on that particular subject.

Mr. Secretary, you say in your answer to question 34 on page 118, about a third of the way down the page:

Holdings of series E savings bonds amounted to 34¾ billion on December 31, 1951.

and I think somewhere else it is indicated that that is about the highest level of series E holdings.

I have before me a breadown of the cash sales and redemptions in those bonds through that period and through 1951. There are obviously, I think, each month more redemptions than there are sales. I assume that the fact that this is the highest point, December 31, 1951, is based on the very substantial amount of interest that accrued through that year.

Secretary SNYDER. Well, actually the amount of cash investment in savings bonds is as high today as it was at the end of the war period after all of the stimulation of the war selling of savings bonds. The actual total of cash invested in the bonds today, in the E bonds, is over $1 billion more than it was at the end of the war. That is without the interest consideration, so the actual totals have been maintained and increased by over $1 billion since the end of the war.

Analysis of series E savings bonds outstanding to show amount of cash investment and accrued discount

[In millions of dollars]

Year	Month	Cash investment	Accrued discount	Amount outstanding
1945	August	29,455	449	29,905
1946	December	29,298	964	30,263
1947	do	29,570	1,427	30,997
1948	do	30,219	1,970	32,188
1949	do	31,152	2,614	33,766
1950	do	31,153	3,340	34,493
1951	do	30,656	4,072	34,727
1952	February	30,653	4,173	34,826

NOTE.—May not add to total amount outstanding due to rounding.

Representative BOLLING. Mr. Secretary, I am curious as to your opinion—and this again may fall into the other area—I am getting the

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impression from the origin of A bonds in 1935 and their modification to E bonds of a later date, that the desire was to make E bonds sufficiently attractive to small uninformed investors so that it would be easy for people to have confidence and buy them. That that was done because it was assumed that this class of borrowing was actually deflationary rather than inflationary.

Secretary SNYDER. In 1941 when we were entering upon defense financing prior to World War II, the E bond was designed to help drain off the surplus earning power of the public as we began to draw more of the materials and labor out of production for peacetime domestic consumption and put it into defense and war production. It had a dual purpose during the war of helping to finance the war deficit, and also as a very material assistance in controlling inflationary trends.

Representative BOLLING. This is one method of financing a deficit that is actually somewhat deflationary.

Secretary SNYDER. That is what?

Representative BOLLING. Somewhat deflationary.

Secretary SNYDER. An anti-inflationary method, certainly.

Representative BOLLING. Mr. Secretary, I am curious for your opinion, if you care to give it—if not in open session, then otherwise—as to the relative position of an E bond today as compared with an E bond at the date of its inception in relation to interest, and so on. I gather that it was intended to have a favorable position. I wonder whether it now does have a favorable position.

Secretary SNYDER. You mean competitive position?

Representative BOLLING. Yes.

Secretary SNYDER. Well, I think that there were many things that entered into the original design of the E bond. We have always got to consider carefully the competitive position of the E bond; we can't get it too competitive because we have got to have the support of all investment groups in supporting the distribution and the sale of it.

That is correct, but we have certainly got to consider carefully at all time the attractiveness of the bond to the purchaser in every fashion—in its liquidity and its ease of purchase, its ease of liquidation and the general confidence of the people in the instrument itself.

Representative BOLLING. I haven't added up these monthly figures that I have, but they indicate a very substantial redemption over purchase for the year 1951.

Secretary SNYDER. Well, by January and February of this year that trend had changed quite a bit in the E bonds.

Representative BOLLING. I don't have the figures for E alone for January and February.

Secretary SNYDER. In the F's and G's it did not hold true, but in the E bonds, sales were up in January and February combined by 6 percent over the same 2 months of 1951, and redemptions were down by 9 percent over the same 2 months, so there was a change in the trend there.

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The following table shows sales and redemptions of series E bonds in January and February of 1951 and January and February of 1952:

Series E bonds

[In millions of dollars]

	1951	1952	Change	
			Amount	Percent
Sales:				
January	343	364	+21	+6.1
February	272	288	+16	+5.9
Total	615	652	+37	+6.0
Redemptions including accrued interest:				
January	448	406	−42	−9.4
February	362	334	−28	−7.7
Total	810	740	−70	−8.6

Representative BOLLING. Do you feel that the change in the trend is significant enough to indicate that as they are now is perfectly satisfactory or that the rather surprising net redemption in 1951 may require action further than has been taken already?

Secretary SNYDER. That gets into the area that I would be glad to discuss in executive session, as to what we might or might not do with the savings bond. It is not a matter that we can discuss at this time because that might indicate an action that would have some effect on our markets.

Representative BOLLING. I would want to follow that up in another fashion.

Representative PATMAN. Mr. Wolcott?

Representative WOLCOTT. Should we continue this afternoon?

Representative PATMAN. Would 2:30 be satisfactory, Mr. Secretary?

Secretary SNYDER. Any time you say, Mr. Chairman.

Representative PATMAN. The committee will recess until 2:30.

(Whereupon, at 12:15 p. m., the subcommittee recessed to reconvene at 2:30 p. m. of the same day.)

AFTERNOON SESSION

Representative PATMAN. The committee will come to order.

Mr. Wolcott, of Michigan, would you like to ask any questions?

STATEMENT OF HON. JOHN W. SNYDER—Resumed

Representative WOLCOTT. Very simple ones.

Mr. Secretary, I think we all recognize deficit financing as a fundamental cause of inflation. Why is it?

Secretary SNYDER. I beg your pardon?

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Representative WOLCOTT. Why does deficit financing cause inflation?

Secretary SNYDER. Well, the fact is that it puts additional spending into the economy that is not compensated by drawing off a similar sum in revenues and, therefore, we have an unbalanced budget, and there is more poured into the economy than is withdrawn from it.

Representative WOLCOTT. Is it not also due to the fact that the debt may be monetized?

Secretary SNYDER. I beg your pardon?

Representative WOLCOTT. Is it also due to the fact that the debt may be monetized?

Secretary SNYDER. There is also danger of monetization of the debt in deficit financing when you have to resort to bank financing of the new money needs.

Representative WOLCOTT. In the thirties the Congress and the administration collaborated in an effort to bring about inflation, and I think we were reasonably successful in creating inflation. We found it advisable to continue inflation throughout the war as an easy means of financing the war.

Now, you will recall that in the thirties, somewhere, we changed the theory of the Federal Reserve Act in respect to the flexibility of currency when we tied the volume of currency to debt. It used to be that the Federal Reserve would create currency as it was needed by business, and the needs of business were reflected largely by the commercial paper which was in the banks. Is not that substantially correct?

Secretary SNYDER. I think that is correct; yes, sir.

Representative WOLCOTT. Then, as a means of pumping some more money in our economic life line, we told the banks that they could put up evidences of Government debt as well as commercial paper, thereby divorcing the size or the amount of the currency from business needs.

What I am leading up to is that we have accepted as a matter of policy that we must keep our debt and the value of our money wedded.

In your discussions with the Federal Reserve or with anyone else, has any thought been given to the possibility of removing the influence which deficit financing has on the value of our money by sterilizing any part of our gold holdings or our bank-held Government debt beyond which the debt in gold cannot be monetized?

Secretary SNYDER. I would like to prepare a reply to that one, Mr. Congressman, please.

Representative WOLCOTT. Just by way of foundation for the reply, it is not as simple as this, but we have about 28 billion of currency now outstanding.

Secretary SNYDER. That is correct.

Representative WOLCOTT. Theoretically if we wanted to put a ceiling on the amount of currency which could be issued at, we will say, 30 billion, with 25 percent of gold and 75 percent of debt—you do not have to answer it now, but this is just a background for your statement—could we provide that not more than a quarter of that or 7.5 billion in gold, and more than three quarters of it, or 22½ billion of debt—that would put a ceiling of 30 billion theoretically on the amount which could be issued? It seems to me that this committee should be giving some thought to removing the influence which deficit financing, and the debt, have upon the value of our currency.

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Then, there are other things which we did in the thirties to cause inflation. We reduced the gold reserve behind Federal Reserve notes from 40 to 25 percent; we reduced the reserve of deposit liability from 35 percent to 25 percent; yet when the House in the Eightieth Congress restored those reserves to their respective 35 and 40 percent, somebody influenced the Senate against taking any action on it.

Has the administration's opinion changed any in that respect since then, do you know?

Secretary SNYDER. May I study that question and prepare a reply?

Representative WOLCOTT. I should like to be told that I was not stating the truth, but there are those in the Congress who have been so unkind as to say it was the studied policy of the administration—to create inflation, and that it is now the studied policy of the administration to maintain inflation. Otherwise it would recommend an about-face in the things which we once did to create inflation, among which are the two that I have mentioned, and three or four other things which we did in the thirties and have continued since then to create and maintain cheap money. Would it not be well for this committee to give some consideration to a reversal of those processes by which we depreciated the value of the dollar?

Secretary SNYDER. I will include that in my comments on the first two questions, Mr. Congressman.

(The material referred to is as follows:)

The questions Representative Wolcott asked related primarily to Federal Reserve functions. Chairman Martin of the Board of Governors was asked substantially the same questions when he appeared as a witness before the subcommittee and agreed to prepare an answer to submit to the subcommittee. Such an answer has been prepared and I concur in it. I should like, therefore, to have it inserted at this point in answer to the questions which Representative Wolcott asked me.

"The Federal Reserve Act as amended in 1945 requires that each Federal Reserve bank hold reserves in gold certificates equal to 25 percent against its Federal Reserve notes in circulation and against its deposits. In the case of Federal Reserve notes, the law also requires that each Reserve bank shall pledge with the Federal Reserve agent of its district collateral equal to 100 percent of the amount of such notes in circulation. Such collateral may consist of gold certificates, paper originating in commerce, agriculture, and industry—that is, so-called eligible paper—or direct obligations of the United States Government.

"Prior to 1945, the required reserve percentages were 40 percent of gold certificate reserves against Federal Reserve notes and 35 percent of gold certificates or lawful money against deposits. The main reason for the lowering was that the gold reserve ratio had fallen significantly during World War II as a result particularly of the very large expansion of Federal Reserve notes in circulation because of wartime demands for currency. This increased volume of money has remained in circulation since the war.

"The use of Government securities as collateral for Federal Reserve notes was authorized on a temporary basis by the Glass-Steagall Act of 1932 and was periodically renewed, and the authority was made permanent in 1945. This provision was necessitated by the large-scale withdrawal of currency from bank deposits in the early years of the depression, by the then reduced volume of eligible private paper in Reserve bank portfolios, and by the desirability of Federal Reserve purchases of Government securities in order to prevent the development of tight money conditions during the depression.

"It would appear undesirable at this time to change either the legal reserve requirement regarding gold certificates or the legal collateral requirement regarding United States Government security holdings of the Federal Reserve banks. The legal provision permitting the Reserve banks to use Government securities as collateral for notes is necessary under present conditions, since the volume of commercial, agricultural, and industrial paper now held by these banks would be inadequate for the purpose. Also, the provisions of law regarding the

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reserve requirements of the Reserve banks are important in enabling flexibility in monetary management to meet changing conditions.

"These legal provisions are not inflationary per se. Federal Reserve credit is not created just because the basis for such creation is available. It is the duty of the Federal Reserve System to see that Reserve bank credit is adjusted to the needs of the economy. Changes in the volume of such credit outstanding are now determined mainly by actions of the Federal Reserve System in accommodating the credit needs of consumers, commerce, agriculture, industry, and State and local governments, as well as the Federal Government. Such actions are taken only after a careful review of the economic and financial situation in the country at the time and after a full consideration of their inflationary and deflationary implications.

"An automatic check on the expansion of Federal Reserve bank credit, such as would be imposed by an increase in the ratio of gold certificates required against Federal Reserve notes and deposits would not be desirable. It was in part to prevent arbitrary and mechanical limitations on the volume of bank credit and money, resulting from too rigid a relationship between the credit and money supply and gold, that the Federal Reserve System was initially established."

Representative WOLCOTT. You, perhaps, will recognize that this is a fetish with me.

Secretary SNYDER. I beg your pardon?

Representative WOLCOTT. You will, perhaps, recognize that this is one of my fetishes.

Secretary SNYDER. I did not hear what you said.

Representative WOLCOTT. I say, you will realize that this is one of my fetishes.

Secretary SNYDER. Yes; but they are appropriate questions, as all are from the committee, and we would like to give a careful, studied reply to them.

Representative WOLCOTT. You mentioned in your statement that pressures were not quite as great as they had been—this is on page 5—and you say that there appears to be a lull at the present in inflationary pressures, and you go on to say, of course, that it is merely a lull, indicating that we are on some sort of a plateau, a little below where we were a few months ago.

What effect has "the accord," which you and the Federal Reserve reached, and the action which was taken by the Federal Reserve in not supporting the Government-bond market and increasing the rediscount rates to 1¾ from 1½, and the issue by the Treasury of your 2¾, which could not be monetized, what would you say—what influence have those things had upon easing the situation?

Secretary SNYDER. Well, the raising of the rediscount rate had taken place prior to the accord. That took place in August.

Representative WOLCOTT. I guess that is right.

Secretary SNYDER. Yes.

Well, there has been, of course, a leveling off of inflationary pressures in recent months. The cost index on a number of items has gone down, the pressure of large inventories has had some effect and has been in some evidence as a depressant; the soft-goods area has had a depressing experience. I would say that we have been experiencing a lull in inflationary pressures, and I think that we all give due weight to the accord for being one of the many factors that brought about this situation.

Of course, the production capacity of the Nation had a great deal to do with it, too, in being able to rise to the demands and supply much of the requirements, even under the increased volume of income.

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I think that we can sum it up by saying that the monetary steps that were taken were a part of the broad influence that brought about the situation we are experiencing now. I do feel that we must carefully keep in mind that as a result of defense spending inflation may become a trend again.

Representative WOLCOTT. Would you care to comment upon what effect the reduction in the value of the dollar of 46.15 percent in the last 10 years has had upon the savings bond market?

Secretary SNYDER. Well, on the E bond market over the whole postwar period, I do not think that the consideration of any change in the purchasing value of the dollar had any particular effect. Up to Korea savings bond purchases were well maintained. There was some increase in redemptions along with increased withdrawals from other types of savings in the heavy goods buying experience that we had following Korea. It has tapered off in recent months, however.

Representative WOLCOTT. When you say it has tapered off, you mean the——

Secretary SNYDER. The redemptions.

Representative WOLCOTT. The redemptions?

Secretary SNYDER. And sales.

Representative WOLCOTT. Since Korea?

Secretary SNYDER. The relationship between sales and redemptions has improved in recent months.

Representative WOLCOTT. What I am leading up to, since Korea the value of the dollar has dropped from 59 cents or 60 cents, somewhere along there, to its present 52.85. That has been the situation since Korea. It has dropped down 6 points since Korea. Has that any effect upon your savings bond market?

Secretary SNYDER. May I have you repeat the question? I just could not hear it.

Representative WOLCOTT. What effect has the drop of 6 percent in the value of our currency since Korea had upon your savings bond market?

Secretary SNYDER. Well, the indication I gave this morning was that for January and February, the most recent months for which we have a record the sales had gone up percentagewise over the same months for last year, and the redemptions had decreased over the same period. So it appears a corrective trend is being experienced.

Representative Wolcott. There is not any question, is there, but what inflation has affected the market for Government bonds, especially in the field of savings bonds?

Now, what incentive, excepting through stabilization of our economy, can we use to create a better atmosphere in which bonds can be marketed, except to increase the interest rates slightly?

Secretary SNYDER. Mr. Chairman, may I ask the subcommittee, you and the subcommittee, this privilege—that anything that has to do with future actions in reference to securities of the United States Government—I be permitted to answer in writing for executive consideration?

Representative WOLCOTT. That is perfectly agreeable to me.

Secretary SNYDER. Yes.

Representative PATMAN. That will be all right.

Secretary SNYDER. Thank you, sir.

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Representative WOLCOTT. We talk about these things so freely that I guess we do not respect your position in that field.

Secretary SNYDER. Unfortunately, as I said this morning, I just cannot detach myself from being Secretary of the Treasury, and as much as I would like to talk freely on my own sometimes, why——

Representative PATMAN. That will be eminently satisfactory, Mr. Secretary. I have some questions along that same line, but I will withhold them as you suggest.

Secretary SNYDER. Thank you.

Representative WOLCOTT. Would you recommend, as the President has, that we give the Federal Reserve additional power to increase reserves, reserve requirements?

Secretary SNYDER. I believe that in answers 35 and 36 I addressed myself to that problem. I will be glad to call attention to that answer. It has already been submitted.

Representative WOLCOTT. The problem seems to be that the Federal Reserve Board at the present time has been unable to agree upon the amount of authority which they are going to ask us for. I wondered, when the President in the economic message asked for additional reserve authority, whether he and the Federal Reserve Board had come to some understanding in respect to the authority which they would ask for, how much they would ask for.

Secretary SNYDER. I am not in a position to answer that.

Representative WOLCOTT. Last year when we brought it up it was suggested that probably they would not have too much trouble in getting a little more authority to have some more reserves, and my memory is that we could not get the Board to agree on how much they should ask for, and so no action was taken.

Have there been any discussions in respect to the restoration of these gold reserves that I mentioned behind the deposit liabilities issued by the Federal Reserve?

Secretary SNYDER. That looks like an easy question to answer, but I would like to do it in writing. I say I would like to answer that one in writing. Unfortunately, Mr. Congressman, too many times when I have said that we have had, or have not had, discussions the remarks have been interpreted as meaning we have some plans. That is the reason why I am making that request.

Representative WOLCOTT. Well, we are all against inflation; are we not?

Secretary SNYDER. We can agree on that.

Representative WOLCOTT. Now, speaking for myself, and I will not ask you for an answer to affirm my position, it seems to me that if we are against inflation, having created inflation legislatively in the 1930's, the Congress could stop the inflation if it did an about-face and restored the powers and authority and the standards and guides that were in existence in legislation in the 1930's before we changed them.

Secretary SNYDER. Well, I think we would have to measure it very carefully against conditions at that time and conditions today, and the problems facing us at both times before we could make a complete acceptance of the theory of reversal.

Representative WOLCOTT. Do you think that we have got to accept inflation as a matter of permanent governmental policy?

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Secretary SNYDER. I certainly hope not. We had up until last June an over-all balanced budget situation for 5 years, as you know—in fact, receipts exceeded expenditures by nearly $8 billion in that period. I would be very hopeful that we can return to a balanced-budget situation as quickly as possible.

Representative WOLCOTT. Thank you, Mr. Secretary. I think that is all I have, Mr. Chairman.

Representative PATMAN. Mr. Secretary, I would like to ask you a few questions. I have two written out here that I think I will read to you first.

About a year ago prices suddenly stopped advancing. Since then they have declined slightly, at least at wholesale. Some of the price-control people and some of the monetary people have taken pretty complete credit for this. Others think that it was principally a natural reaction from the post-Korean buying spree. What do you think about it?

Secretary SNYDER. First, and most important in my mind, was a leveling off in consumer and business demand after the early rush to buy goods and stock large inventories after the outbreak of hostilities in Korea. Largely, this was the result of a rapid increase in the output of consumer and other civilian goods before defense demands had created a shortage of materials—thereby easing the fear that there would be shortages such as prevailed in World War II. Coupled with this has been an array of measures designed to alleviate particular areas of inflationary pressures. We have had priorities and allocations of scarce and strategic materials; Government production loan guaranties and loans to increase production for national defense needs; selective restrictions on credit in areas such as consumer credit and real-estate credit; the voluntary credit-restraint program; and price and wage controls—all of which have made an important contribution to the over-all problem of inflation control.

Representative PATMAN. You have said that you favored some flexibility in interest rates as an instrument for influencing inflationary and deflationary forces. Do you believe at the present level of interest rates on marketable securities that it is suited to present conditions? Will you distinguish in your answer between short-term and long-term rates?

Secretary SNYDER. The present situation is one in which we are experiencing a lull—inflationary and deflationary forces seem to be about in balance. In this situation, stability in interest rates seems appropriate—in both the short- and long-term area.

Representative PATMAN. I asked you the next question in writing and you have submitted the answer. It was, Could you present a table for the record showing the change in interest rates since the end of 1949 and tell us briefly what it shows.

Secretary SNYDER. We would like to put the answer into the record, the answer that I have supplied.

Representative PATMAN. You gave me a letter on that, and without objection we will insert that in the record at this point. It is quite interesting.

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(The document referred to follows:)

Effect of Changes in Interest Rates on the Cost of Servicing the Public Debt

GENERAL STATEMENT OF THE PROBLEM

Interest costs are affected by four elements: (1) Changes in the total amount of the debt; (2) the nature of the debt in which changes occur; (3) changes in composition of the debt resulting from refunding operations; and (4) changes in interest rates.

There are five different classes of debt which must be considered in dealing with interest costs: (1) Short-term marketable debt which currently is responsive to changes in interest rates (e. g., Treasury bills and certificates of indebtedness); (2) longer-term marketable debt which reflects changes in interest rates as the debt matures and is refunded; (3) nonmarketable debt which has been affected by changes in rates, such as Treasury savings notes; (4) nonmarketable debt, the rates on which have not yet been affected by changes in interest rates on other debt, such as United States Savings bonds; (5) special issues for trust accounts which are affected by the over-all average rate of interest, viz., the Old-Age and Survivors Insurance Trust Fund and the Unemployment Trust Fund; and (6) special issues which are not affected by changes in the average interest rate, such as the National Service Life Insurance Fund.

Increases or decreases in interest rates affect interest costs to the Treasury on different types of debt in different ways, and at different times. For instance, the interest costs on short-term marketable debt is more quickly affected by changes in interest rates than the interest cost on long-term marketable securities, the nonmarketable debt, and the special obligations which are issued to trust funds and Government investment accounts. Changes in interest rates in Treasury bills are reflected more currently since they are rolled over every 91 days, but even here there is some overlapping of the effects of interest rate changes as between fiscal years.

The amount of change in interest costs as a result of increased or decreased interest rates cannot be determined merely by comparing total interest payments in one fiscal year with that of another. One of the reasons for this is that the full effect of a change in the interest rate on actual expenditures is not reflected in expenditures until the fiscal year following the one in which the change in the rate has occurred. This is generally true in the case of securities which have a year or more to run. As an illustration, the interest on a 1-year certificate of indebtedness issued in August of one fiscal year would not be payable until August of the following year. The same sort of situation occurs with respect to securities, the interest on which is payable semiannually. For instance, a note or bond dated in the first half of a fiscal year would carry only one 6-month interest coupon payable in that fiscal year, and a bond or note issued in the second half of a fiscal year would not have any interest coupons payable during that fiscal year.

CHANGES IN INTEREST RATES

During the period from December 31, 1949, to February 29, 1952, the interest rates on 90-day Treasury bills fluctuated between 1,076 percent and 1,883 percent. The latest issue in December of 1949 was sold to yield 1.087 percent on an annual basis, as compared with a rate of 1.563 percent for the latest issue in February of 1952, an increase of 0.476 percent. If this increase in rate should be applied to the total amount of 91-day Treasury bills outstanding on February 29, 1952, the increase in the annual interest cost on this segment of the debt would be $74 million.[1]

The interest rate on an 11½-month certificate of indebtedness dated March 1, 1952, was 1⅞ percent, as compared with a 1-year rate of 1⅛ percent in December of 1949, an increase of ¾ percent. On the total amount of certificates of indebtedness outstanding on February 29, 1952 ($29 billion), this would result in an increase in the annual interest cost of $218 million.

On April 1, 1951, as part of the Treasury-Federal Reserve accord, the Treasury issued $13,574 million of 2¾ percent of nonmarketable bonds in exchange for an equal amount of 2½ percent marketable bonds of 1967–72. An increase of ¼ per-

[1] Does not include the tax anticipation bills.

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cent in the interest rate on this amount of bonds would amount to $34 million on an annual basis. However, these bonds are exchangeable for 1½ percent 5-year marketable notes. Therefore, the effect of these exchange operations on interest costs will vary from year to year and will be governed to a large extent by subsequent exchanges of the 2¾ percent nonmarketable bonds for the 1½ percent marketable notes. The figures as of February 29, 1952, in connection with this exchange operation are as follows:

NOTE.—On February 29, 1952, the Federal Reserve System owned $22,528,000,000 of Government securities, the annual interest on which amounts to $439,000,000. Since Federal Reserve banks return to the Treasury 90 percent of their net earnings, a considerable portion of their interest earnings comes back to the Treasury. The net earnings paid to the Treasury for the calendar year 1951 amounted to $255,000,000.

	Amount outstanding	Annual interest
2¾ percent bonds	$12,034,000,000	$331,000,000
1½ percent notes	1,540,000,000	23,000,000
Total	13,574,000,000	354,000,000
2½ percent bonds exchanged (annual interest)		339,000,000
Increase in annual interest cost		15,000,000

On March 1, 1952, the Treasury issued $922 million of 7-year taxable bonds carrying an interest coupon of 2⅜ percent. In December of 1949, the market yield on a 7-year taxable bond was approximately 1½ percent. An increase of seven-eighths of 1 percent on $922 million of securities would involve an increased annual interest cost of $8 million.

Except for the above-mentioned bond the Treasury has not issued any marketable securities with maturities of over 5 years since December of 1949. The market yields, however, on the long-term restricted Treasury bonds of December 15, 1967–72 increased from 2.24 percent on December 31, 1949, to 2.72 percent on February 29, 1952, indicating that long-term financing in this area would have to be done at an increase of about one-half of 1 percent per annum. While the rate increases in the long-term area have not yet been reflected in Treasury interest payments, unless interest rates decline in the meantime the effects will be felt when maturing issues are refunded and in any long-term financing which may be conducted in the present emergency.

Increases in interest rates appear to have affected the sale and redemption of Treasury savings notes, which are used to a large extent by corporations and others for the purpose of accumulating tax reserves. If these securities are to be kept attractive for investors, the interest return must be kept in line generally with short-term market rates. Consequently, the interest rate on savings notes must be responsive to changes in market yields, although there may be a time lag before all outstanding savings notes reflect such changes in yields.

The 3-year rate on Treasury savings notes was increased on May 15, 1951, from 1.40 percent per annum to 1.88 percent. This increased rate on savings notes has not yet been fully reflected in interest payments. Of $8,044 million of these notes outstanding on February 29, 1952, $2,039 million represents the older, lower rate notes. The average interest rate on the notes outstanding is currently 1.758 percent compared with 1.360 percent on December 31, 1949, an increase of .398 percent. This represents an increase of $32 million in the annual interest charge on savings notes, based upon the present amount outstanding.

There are two other large areas of the public debt where material changes in interest rates have not taken place. These are (*a*) the United States savings bonds, and (*b*) the special issues to trust funds (e. g. Old-Age Survivors Trust Fund and State Unemployment Trust Fund).

Sales of United States Savings bonds have held up remarkably well, particularly among the smaller savers. The amount of outstanding Series E bonds (including interest accruals) on February 29, 1952, was $34,903 million, as compared with $33,754 million on December 31, 1949. There are now approximately 7 million persons buying savings bonds regularly on payroll savings plans as compared with 4½ million a couple of years ago. The number of $25, $50, and $100 denominations sold was $34,900,000 in the first 7 months of the fiscal year 1950 and about the same number in the comparable period of the fiscal year 1951.

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Sales of these denominations increased to $40,500,000 in the first 7 months of the fiscal year 1952.

Present law limits the interest rate on such bonds to 3 percent per annum, compounded semiannually. Series E bonds now yield 2.9 percent, compounded semiannually, if held to 10-year maturity, so there is little leeway for an increase in the rate of interest which can be paid on these bonds under existing law. Series F and G bonds yield 2.53 percent and 2½ percent, respectively, if held to 12-year maturity.

There is another large segment of public debt on which the impact of higher interest rates has been only partially reflected in Treasury interest payments. They are the special obligations issued to trust funds. There are over $36 billion of such special obligations outstanding. The interest rates on obligations issued to two of these trust funds (i. e., Old-Age Survivors Trust Fund and Unemployment Trust Fund, amounting to over $20½ billion) are, by law, based upon the average interest rate on the total outstanding public debt, except when the average rate is not a multiple of ⅛ of 1 percent, the interest rate on the special securities is fixed at the next lower multiple of ⅛ percent. At the present time $20,775,000,000 of special obligations are held for account of the Old-Age and Unemployment Trust Funds, on which the average interest rate is 2.135 percent as compared with $16,399,000,000 of special issues held for such funds in December of 1949, at an average rate of 2⅛ percent. However, it should be pointed out that although the rate on special obligations currently being issued to these trust funds is 2¼ percent, over $19 billion of the special securities now held by the funds were issued when the average rate on the public debt was somewhat lower, and bear a rate of 2⅛ percent. At the end of this fiscal year all of the special securities held will have to be reissued on the basis of the average rate on the public debt at that time, which probably will result in a 2¼ rate on all of the Old-Age and Unemployment Trust Fund obligations. An increase of ⅛ of 1 percent on the special securities held for these funds would increase the annual interest charge by $26 million. Thus, in considering the additional cost of servicing the public debt as a result of increases in interest rates, care must be exercised in appraising the long-run effects not only on the marketable debt as it is refunded, but also on other categories.

AVERAGE INTEREST RATES

The amount of outstanding public debt, by classes and issues, and the rates of interest paid on the different issues, are published in the Daily Statement of the United States Treasury, as of the last day of each month. Copies of such statements as of December 31, 1949, and February 29, 1952, are attached. The average rates as of December 31, 1949, and February 29, 1952, are set forth on the following page:

Type of securities	Average interest rates	
	Dec. 31, 1949	Feb. 29, 1952
	Percent	*Percent*
Marketable:		
Treasury bills	1.090	1.683
Certificates of indebtedness	1.219	1.875
Notes	1.375	1.561
Bonds	2.316	2.322
Nonmarketable	2.581	2.638
Average for public issues	2.145	2.261
Special issues	2.617	2.608
General average	2.208	2.310

While the foregoing figures are of interest as an indication of the changes in average rates borne by interest-bearing securities outstanding now as compared with December 31, 1949, they do not reveal the ultimate effect of the changes on total costs to the Treasury.

LONG-TERM PROJECTION OF INTEREST COSTS

As has previously been mentioned, it will take some time before the higher rates are infiltrated throughout the different segments of the public debt. Not

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only will the increases in rates be felt as maturing issues are refunded but they will also be reflected in increases in the costs of financing the budget deficits created by the defense mobilization program. In the general statement I made before the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report, on December 2, 1949, I said that—

"Even a relatively small increase in the average interest rate on the debt would add a substantial amount to the total annual interest cost. It is estimated hat the interest on the debt will amount to $5.7 billion in the calendar year 1949. About $1¼ billion would be added to this amount if the average interest rate were one-half of 1 percent higher."

No one can accurately predict the movement of interest rates in future years. There is a possibility that rates will further increase and at the same time it must be recognized that economic conditions in the future could produce lower interest rates. Likewise, it cannot be determined now what changes will take place in the future in the composition of the public debt.

At the present time the total amount of interest-bearing debt outstanding, for the purpose of computing an average interest rate, is about $258 billion. The average interest rate has increased from 2.208 percent on December 31, 1949, to 2.310 percent as of February 29, 1952. If this increase of 0.102 percent should be applied to the total amount of interest-bearing debt outstanding at the present time, mentioned above, the increase in the computed annual interest change would be about $262,815,000. If the over-all average rate should eventually be increased by one-fourth of 1 percent, the increase in the annual interest charge would amount to about $645,000,000, and if the over-all rate should be increased by one-half of 1 percent, the increase in the annual interest charge would be about $1,290,000,000. On the other hand if in the future the average interest rate should decline by one-tenth of 1 percent (based upon a $258 billion interest-bearing debt), the reduction in the annual interest charge would be about $258 million; a reduction of one-fourth of 1 percent in the average rate would result in the annual interest charge being reduced $645,000,000; and a reduction of one-half of 1 percent would result in decreasing the annual interest charge by $1,290,000,000.

Representative PATMAN. You stated in reply to the questions that have heretofore been submitted to you, Mr. Secretary, that you favor an independent Federal Reserve Board. I wish you would enlarge on that by stating independent of whom and independent of what?

Secretary SNYDER. Well, I considered my statement to be that I preferred to see the Federal Reserve Board remain an independent agency due to my high regard for the purposes for which it was created, and for the important influence that it can have, and does have, on our whole fiscal operation and monetary operation.

The Federal Reserve Board has a most important function to fulfil, and I would like to have it preserved in the framework in which it was created. However, in these times, with our radidly developing economy, which has grown to the size that it has, and when our national debt has grown to the size that it has, Federal Reserve actions must be appraised in the light of these different circumstances.

The Federal Reserve has undertaken, at the direction of the President, on several occasions to take over certain functions, such as regulation X in the real-estate field, and two or three other functions that have pretty well tied it into Executive direction. These actions were certainly with congressional sanction, and so it becomes apparent that the Congress realizes that this absolute independence must be temperate at times—in light of existing conditions—to meet the tremendous problem of trying to maintain the well-being of our over-all economy.

But you asked independent of whom and of what? In a general way, I do not think that the Federal Reserve should take any direction or dictation from anyone. But I think many times, of necessity, to carry out the functions as given to them, and the responsibilities as

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given to them—by Congress—that the Federal Reserve certainly must measure carefully the conditions and the times and the problems facing the Nation at the time they make decisions.

Now, if that is an influence that somewhat tempers their absolute independence of action, then I think it must be tempered to that extent. But so far as not having any dictation or direction, that is the type of independence that I said I would like to see preserved.

Representative PATMAN. In the beginning of your answer you stated that you would like to see it kept within the framework in which it was created. I understood you to say that, Mr. Secretary.

Secretary SNYDER. That was right.

Representative PATMAN. That being true, as the act was created, the Secretary of the Treasury was Chairman of the Board and the Comptroller of the Currency was on the Board and then, of course, and for many years afterwards the public debt was not very large, and it was not too important that these two officials be on the Board, probably, to carry out an independent administrative job. But do you believe that this law should be changed now and restored to the framework of its original creation by restoring the Secretary of the Treasury as Chairman of the Board, and placing on the Board the Comptroller of the Currency?

Secretary SNYDER. Well, I meant when I said "created," I meant created and developed, of course.

Now, as to whether or not the Comptroller or the Secretary of the Treasury should be on that Board or not is a matter for careful deliberation. At times it would appear that there would be a very good advantage in having one or the other—I do not know whether it is necessary to have them both or not, or whether it is necessary to have either or not. In the discussion of how we should answer the questionnaire, we discussed that matter freely.

I have not suggested, however, in answer to your questionnaire, that such legislation be considered—that the Secretary be put back on the Board. As a matter of fact, I specifically said, as I study it today, that I do not see the necessity for any legislation at this time to give the Treasury more authority over the Federal Reserve Board—I think that we are going to work this out within each agency's own responsibility.

Representative PATMAN. Being more specific, you are opposed to the executive having any direct power to direct the Federal Reserve Board to do anything, and you are also opposed to the commercial banks, on the other side, having any direct power to direct the Federal Reserve Board to do anything.

Your views, I assume, are that the original act contemplated that the public interest should be looked after first, and that neither the President nor the commercial banks would absolutely control the Board.

Secretary SNYDER. Yes, sir. I feel that way, and that was the thought that prompted the recommendation that would bring about a better chance for consultation and discussion, so that the whole situation at any one particular time could be freely discussed on an advisory capacity basis, advising as to facts and other relevant considerations, rather than having any legislative action.

Representative PATMAN. That is the reason you suggested the coordinating agency that you suggested, I believe, on page——

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Secretary SNYDER. Well, I did not call it coordinating

Representative PATMAN. I called it that.

Secretary SNYDER. Yes.

Representative PATMAN. I mean something along that line to get the people around the table to coordinate their views and get consideration.

Secretary SNYDER. I call it advisory.

Representative PATMAN. An advisory committee.

Secretary SNYDER. Yes.

Representative PATMAN. Does it not compare in many ways with the advisory group that is set up by the commercial banks?

Secretary SNYDER. Well, it does because they have no coordinating authority, as I understand it.

Representative PATMAN. What I mean is that——

Secretary SNYDER. But they have an advisory capacity.

Representative PATMAN (continuing). They have an advisory committee, as they should have, to get their views over to this, what you might call a, supreme court of finance.

On the other hand, the Government, as you suggest, should have some way—the people who are interested and the heads of these different departments and, particularly, the Secretary of the Treasury should have some way—of getting his voice heard and getting his views considered, although he would not have the power to direct that they be carried out.

Secretary SNYDER. Well, we have found that such advisory groups have been extremely beneficial to the Treasury in its operations and in its responsibilities.

We have found that such discussions, in many of which we sit side by side with Federal Reserve representatives, are very beneficial and helpful.

Representative PATMAN. I agree with you that the Executive should not have the power to direct the Federal Reserve Board or the Federal Reserve banks to make loans or anything like that; that is way beyond anything that I would even dream of. I do not think that that power should even be thought of, to give any Executive that power. But what I am wondering about is whether or not the public interest is paramont at all times in view of the present set-up, and I expect to try to get some light on that as we go along in these hearings.

I know at first when the Comptroller of the Currency, selected by the President, and the Secretary of the Treasury, in the Cabinet selected by the President, when they were on that Board there was no question but what the public interest was represented through those two members of the Board, at least; I am not saying that the others did not represent the public interest, too. In other words, they were appointed by somebody who was elected by the people and accountable to the people. Whatever was done by that Board then the people could charge to the administration in power and vote for or against it by reason of what the Board did, just like in foreign affairs with the State Department, but if you get the Federal Reserve Board so independent that there is no way to charge the administration in power with what is done by that Board, whether it is very beneficial or very devastating, there is no way for the people to charge the Administration in power; do you not think that that should be given consideration, Mr. Secretary?

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Secretary SNYDER. I would be very happy if this subcommittee during the course of its hearings would test out that thought among all the various groups. Personally, there are certain angles that I can see that would be advantageous, because the Secretary of the Treasury's tenure of office as a member would certainly be limited—I mean his tenure of membership on the Board would be limited—to his actual tenure in office as Secretary of the Treasury, and would not be prolonged beyond his active duties in connection with the operation of the Treasury, in which capacity he has the responsibility for debt management; and, therefore, it could be advantageous.

There are some areas which might indicate that it would not have advantage, but personally I have not any strong feelings one way or the other, and I would be very pleased to see what would be developed in these hearings on that subject as to others' views as to whether or not such a course would be helpful.

I can see, as I have said, many areas in which it could be of advantage. There are others where the general feeling might be it would be just as well not to have the Secretary tied in too closely to the necessary decisions and operations of the Federal Reserve Board.

Representative PATMAN. Of course, I refer to consideration of policy matters only. I am not even harboring any thought that the Executive or the Secretary of the Treasury should ever be allowed to direct the Board to make loans or anything like that or any Federal Reserve bank——

Secretary SNYDER. Well, that was the area in which I had my reservation for him to be a full-fledged member of the Board with full Board responsibilities. You have touched on the very area in which I had questions.

Representative PATMAN. I recall, from reading about the Federal Reserve Act, that Senator Glass was insisting all the time that it should not be run by the banks, and President Wilson was the same way; and I recall reading something in Senator Glass' book about it, about a conference, I guess. I assume that you read about that conference at the White House—in which President Wilson suggested it would be just the same as letting the railroads select the Interstate Commerce Commission to set the rates as to let the bankers run the Federal Reserve Board and have control over their policies. You recall that, I assume?

Secretary SNYDER. Yes, I recall that.

Representative PATMAN. In other words, everything in the writing of that law was in the direction of preventing the banks from having control over the Federal Reserve System. Do you agree to that? You do, do you not?

Secretary SNYDER. I think that is very appropriate.

Representative PATMAN. Yes. At the same time there was not anything in there to indicate that it was desired by those pushing the legislation that they wanted the President to have the power to direct the Board to do certain things.

Secretary SNYDER. I am quite sure that that is the legislative history.

Representative PATMAN. That is right.

I just wondered if we have not gotten away from that too far. Now, at first the terms of the members of the Board were much shorter than they are now, and at first I believe the longest term went up to 10

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years, did it not, 10 years, and then later on it was extended to 12 years, and then later on it was extended to 14 years?

Secretary SNYDER. That is the present, 14.

Representative PATMAN. Now, when the President appoints a member of the Board for 14 years, of course, he has no further control of that member. He is not supposed to have, and I am not advocating that he should have or that I want him to have. I want the members to be free and independent to use their own best judgment according to the facts as presented at the particular time. But a Board composed of members for 14 years, and no one on there that is under obligation to anyone who was elected by the people, as the Executive is elected by the people, I just wonder if that has gotten too far away and becoming too independent? What do you think about that?

Secretary SNYDER. Well, there could be rather broad implications there; it could get too far away.

My recollection is, however, that the Secretary, when he was an ex officio member, was a full member of the Board with all responsibilities and not just a policy-making member. I think that is true.

Representative PATMAN. I did not get that last.

Secretary SYYDER. When I did not quite agree with putting the Secretary of the Treasury back into the position that he was originally as a member of the Board, it is because I think he was a full ex officio member with full responsibilities.

Representative PATMAN. There is no question about that; he was Chairman under the law.

Secretary SNYDER. Yes.

Representative PATMAN. He was Chairman of the Board.

Secretary SNYDER. Yes. The original Federal Reserve Act provided that—

> A Federal Reserve Board is hereby created which shall consist of seven members, including the Secretary of the Treasury and the Comptroller of the Currency, who shall be members ex officio, and five members appointed by the President of the United States, by and with the advice and consent of the Senate. * * * Of the five persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. * * * The Secretary of the Treasury shall be ex officio Chairman of the Federal Reserve Board.

Representative PATMAN. And he, of course, did have full responsibilities.

Secretary SNYDER. I feel that so far as policy-making in the areas in which fiscal and monetary operations are concerned, it might well be considered by your group as to whether or not it would be beneficial to give him that position. I would be glad to hear comment on that.

Representative PATMAN. Anyway, we will give it consideration.

Without objection, I will insert in the record at this point the statement in Senator Glass' book that I referred to a while ago.

(The statement referred to is as follows:)

The Honorable Carter Glass, of Virginia, had a lot to do with the passage of the Federal Reserve Act. In his book, An Adventure in Constructive Finance, published in 1927, describing a discussion of this very question by President Woodrow Wilson with an important group of bankers at the White House, it is stated on page 116:

"When they had ended their arguments, Mr. Wilson * * * said quietly: 'Will one of you gentlemen tell me in what civilized country of the earth there are important government boards of control on which private interests are

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represented?' There was painful silence for the longest single moment I ever spent; and before it was broken Mr. Wilson further inquired: 'Which of you gentlemen thinks the railroads should select members of the Interstate Commerce Commission?' There could be no convincing reply to either question, so the discussion turned to other points of the currency bill; and, notwithstanding a desperate effort was made in the Senate to give the banks minority representation on the Reserve Board, the proposition did not prevail."

Representative PATMAN. I wanted to ask you about the Research Department in the Treasury Department as compared to the Research Department in the Federal Reserve.

Now, over the years I have been impressed—whether it is true or not I do not know, and I am not in a position to say—that the research staffs in the different divisions or offices of the Treasury—I would not say they had gone down in ability; they have not, I am sure, and I am also sure that you have able, just as able, people there as you ever had in the world—but the number of people helping them and the amount of money available for that purpose seems to me to have been less and less. Is that correct or not?

Secretary SNYDER. It is true, and it has been over our very strong protests, because we have asked that we be given funds to bring in new people constantly and keep our organization in full operation for the tremendous responsibilities that we have; but for some reason or other Congress has seen fit to curtail those funds.

Representative PATMAN. But Congress has not curtailed the Federal Reserve. Of course, Congress has not——

Secretary SNYDER. Of course, Congress has no appropriation function over the Federal Reserve.

Representative PATMAN. That is, it has not assumed it so far.

Secretary SNYDER. I beg pardon?

Representative PATMAN. It has not assumed that power so far.

Secretary SNYDER. Well, I will pass that one, but I am talking about the Treasury, and I am hopeful that out of this will grow some support to help us with appropriations, to help us build up our technical staff. I think we have an excellent one, but we need to have funds to build it up to a size that will meet all the problems of the time; and I am very hopeful that this subcommittee will, in their wisdom, after they have studied this, see fit to help us out in that regard.

Representative PATMAN. Well, I am personally right now committing myself to you on that problem. I am strongly in favor of that because I think that your divisions have been weakened somewhat by the lack of sufficient money to keep the necessary personnel.

On the other hand, there is the Federal Reserve System which is not a competing agency—I am not claiming it is a competing agency—but it has unlimited funds at its disposal; that is, they own about $20 billion in bonds. Are those all Government bonds?

Secretary SNYDER. Total holdings of Government securities are nearly $23 billion.

Representative PATMAN. $23 billion in Government securities.

Now, the interest on those Government bonds, of course, creates a considerable sum, and under present policies and practices they use that money as they see fit, and under existing law they are not even required to put any part of their earnings in the form of surplus back into the Treasury, but I understand what has been done customarily in the recent past——

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Secretary SNYDER. We have had a working arrangement that after they deducted——

Representative PATMAN. I beg your pardon?

Secretary SNYDER. We have had an arrangement with them for the past several years where a certain percentage is returned.

Representative PATMAN. You mean about 90 percent? That used to be the law.

Secretary SNYDER. About 90 percent after certain adjustments.

Representative PATMAN. That is right. But now these deductions, that means that they can spend any amount of money for research or anything else, and that is, of course, permissible under existing law and rules as distinguished from the Treasury that must come to Congress for their appropriation.

Do you know of any other independent agency of Congress like that that does not come to Congress for their appropriations annually?

Secretary SNYDER. The only one that occurs to me quickly would be the FDIC, I am not specifically——

Representative PATMAN. I think the Comptroller of the Currency in some respect, too.

Secretary SNYDER. Yes, in some respect.

Representative PATMAN. But outside of that there are 25 to 50 in a comparable situation that must come back to Congress for appropriations, and I think I will put the list in the record at this point.

(The list referred to is as follows:)

THE LIBRARY OF CONGRESS,
LEGISLATIVE REFERENCE SERVICE,
AMERICAN LAW SECTION,
Washington 25, D. C., March 6, 1952.

To: Joint Committee on the Economic Report, Subcommittee on General Credit Control and Debt Management.
(Attention: Mr. Henry C. Murphy.)

Subject: Federal Agencies Having Independent Sources of Income.

In response to your letter of February 20, 1952, we submit herewith a representive list of Federal agencies which have independent sources of income, classified to show whether (*a*) such income is available for expenditure by the agency without congressional authorization or appropriation, (*b*) it may be spent by the agency only with the annual authorization of Congress, or (*c*) it must be turned in to the Treasury and the expenditures of the agency paid by moneys appropriated by Congress.

The following agencies collect certain moneys which they are permitted to use in accordance with law without special congressional authorization or appropriation:

Comptroller of the Currency:
- Assessments for bank examinations (12 U. S. C. 481, 482).
- Assessments against insolvent banks for expenses of liquidation (12 U. S. C. 196).
- Reimbursement by Federal Reserve banks for expenses of note issue and redemption (12 U. S. C. 420).

Federal Deposit Insurance Corporation:
- Premiums for deposit insurance (12 U. S. C. 1817).
- Interest on investments (12 U. S. C. 1823).

Federal Reserve Board: Assessments against Federal Reserve banks for expenses of Boards (12 U. S. C. 243).

Home Loan Bank Board: Assessments for examination of financial institutions (24 C. F. R. 123.20, 12 U. S. C. 1439a).

Department of Agriculture: Charges for inspection and certification of certain farm products and license fees (7 U. S. C. 55, 499c, 585).

Federal Security Agency:
- Federal Credit Union fees (12 U. S. C. 1756).
- Fees for examination of sea food (21 U. S. C. 372a).

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General Services Administration: Fees for testing commodities (41 U. S. C. 219).

The following agencies are, to a large extent, supported from revenues of the enterprises operated or supervised by them, or from the property they administer, but they must obtain special authorization to use moneys in their hands for designated purposes, or in some cases, for any purposes:

Federal Crop Insurance Corporation (7 U. S. C. 1508, 1516, Public Law 135, 82d
China Trade Act Corporation fees (15 U. S. C. 157).
Office of Alien Property (Public Law 188, 82d Cong.).
Commodity Credit Corporation (15 U. S. C. 712a, Public Law 135, 82d Cong.).
Export-Import Bank of Washington (15 U. S. C. 712a, Public Law 111, 82d Cong.).
Federal Crop Insurance Corporation (7 U. S. C. 1508, 1516, Public Law 135, 82d Cong.).
Federal Farm Mortgage Corporation (15 U. S. C. 712a, Public Law 135, 82d Cong.).
Federal Intermediate Credit Banks (Public Law 135, 82d Cong.).
Federal National Mortgage Association (Public Law 137, 82d Cong.).
Federal Prison Industries, Inc. (Public Law 188, 82d Cong.).
Federal Savings and Loan Insurance Corporation (15 U. S. C. 712a, Public Law 137, 82d Cong.).
Home Owners Loan Corporation (15 U. S. C. 712a, Public Law 137, 82d Cong.).
Inland Waterways Corporation (Public Law 137, 82d Cong.).
Panama Canal Company (Public Law 203, 82d Cong.).
Production Credit Corporations (Public Law 135, 82d Cong.).
Public Housing Administration (Public Law 137, 82d Cong.).
Federal Crop Insurance Corporation (7 U. S. C. 1508, 1516, Public Law 135, 82d Cong.).
Virgin Islands Corporation (Public Law 136, 82d Cong.).
Tennessee Valley Authority (16 U. S. C. 831h–2).

The following agencies collect certain moneys which are covered into the Treasury and which can be withdrawn only upon appropriation by Congress:
Attorney General:
- Aliens and immigrants.
- Various receipts (8 U. S. C. 115, 133, 155 (c)).

Department of Agriculture:
- Farm Credit Administration—assessments for examination and supervision deposited in special fund in Treasury which is authorized to be appropriated for those purposes (12 U. S. C. 832).
- Forest Service receipts (16 U. S. C. 580e).
- Inspection fees, etc. (7 U. S. C. 78, 149, 161a, 395, 415d, 499n, 511e).
- Rural Electrification Administration—proceeds of loans, in certain circumstances (7 U. S. C. 903f).

Department of Commerce:
- China Trade Act Corporation fees (15 U. S. C. 157).
- Service and publications, fees and charges (5 U. S. C. 276).
- National Bureau of Standards, fees for tests, etc. (15 U. S. C. 276).
- Patent Office fees (35 U. S. C. 79).

Department of Interior:
- Electricity—sales from various power projects (16 U. S. C. 825s, 825s–1, 832j, 833i).
- Geological Survey—sale of publications (43 U. S. C. 41).
- Grazing fees (43 U. S. C. 315i).

Federal Power Commission: Water power license fees and charges (16 U. S. C. 810).
Federal Security Administrator: Food inspection fees (21 U. S. C. 24a, 46a).
Post Office Department: Postal revenues (31 U. S. C. 495; 39 U. S. C. 786, *cf.* 39 U. S. C. 794a).
Securities and Exchange Commission: Fees for registration of securities, national securities exchanges and qualification of trust indentures (15 U. S. C. 77f, 77ggg, 78ee).

A complete list of agencies which receive independent income could be made only after a detailed examination of the entire United States Code, which cannot be accomplished in the limited time available. Accordingly, the above list does

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not purport to be comprehensive, either with respect to the agencies which receive moneys from outside sources or with respect to sources of revenue of the agencies listed.

MARY LOUISE RAMSEY,
American Law Section.

Representative PATMAN. It occurs to me maybe we should give consideration to the question as to whether or not an agency like the Federal Reserve can be an agency of Congress and not come to Congress for its money. All other agencies do. I mean all other agencies do except two or three which you mentioned, which are the exceptions, and I think maybe our subcommittee should give some consideration to that.

Who audits the Treasury, Mr. Snyder, the General Accounting Office?

Secretary SNYDER. GAO, the Comptroller General.

Representative PATMAN. The Comptroller General? Who audits the Federal Reserve System?

Secretary SNYDER. I do not know.

Representative PATMAN. I will get that from them.

The Comptroller General was provided for under the Norris Act.

Secretary SNYDER. Mr. Lindsay Warren.

Representative PATMAN. It was 15 years appointment, where a person could not succeed himself; and he is free and independent, footlose and fancy-free.

Secretary SNYDER. He is accountable only to Congress.

Representative PATMAN. That is right.

Representative WOLCOTT. Mr. Patman, will you yield a moment?

Representative PATMAN. Yes.

Representative WOLCOTT. Is the Comptroller of the Currency a part of the Treasury?

Secretary SNYDER. The Comptroller of the Currency is under the general framework of the Treasury operation, yes.

Representative WOLCOTT. In the framework, but he is independent of Treasury domination?

Secretary SNYDER. He is a Presidential appointment and, as you recall, I appeared before Congress in 1950 in connection with Reorganization Plan No. 1—and in support of Reorganization Plan No. 26—recommending that the Comptroller be permitted to retain all of the functions vested in him by statute.

(The Comptroller of the Currency, who is an official of the Treasury Department and is in charge of the supervision of national banks, and the Comptroller General, who is responsible only to Congress and its Government assistants, are different persons.)

Representative PATMAN. I would like now to ask a question about the Federal Reserve bank's supporting the Government bonds.

Do you consider that there is a free market in the sale and purchase of Government securities, Mr. Secretary?

Secretary SNYDER. I think it must be recognized that there is a special situation existing in the Government security market. The Federal Reserve System uses open-market operations in Government securities for credit-control purposes. As long as open-market operations involve billions of dollars of transactions a year, we cannot

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consider that the market for Government securities is an entirely free one.

Representative PATMAN. In the ordinary sense of the word, like a commodity that is sold at the wholesale centers, you know, of bringing the best price where there is a demand at a certain price for a certain commodity, that is a free market as I consider it, where it is offered freely and bought freely, and the market is fixed by the demand of purchasers principally. Do you have that kind of a free market in the——

Secretary SNYDER. No; I do not consider so. Also the Open Market Committee has realized that with a tremendous debt and with the financing that has to be done, you could not allow a small segment of that financing to upset the whole market and, therefore, the Open Market Committee has taken care of that kind of a situation. It is a little different from where you have a stock offering or a private bond offering. Whether that was a success or failure would be important, of course, to those interested, but it may not be of vital importance to the economy as a whole.

And as I said a few minutes ago, I think that when it comes to complete freedom, if you are speaking of it in terms of absolute freedom—no restraint one way or the other—that there is a limitation to that freedom by the very law permitting the Federal Reserve to conduct open market operations in Government securities.

Representative PATMAN. And to that extent it would not be perfectly free, of course. I say, to that extent.

Secretary SNYDER. Yes.

Representative PATMAN. The bond market, I noticed, after it had commenced to slide, went down to about 96, and it has not fallen below that. Maybe I am mistaken, but I just noticed it occasionally. Has it fallen below, have the prices fallen below, 96, for long-term bonds?

Secretary SNYDER. On one occasion, one issue went to $95^{22}/_{32}$.

Representative PATMAN. Well, there must be some support there or it would slide on certain occasions much lower, would it not, Mr. Secretary?

Secretary SNYDER. Well, I think that the Open Market Committee has been interested in maintaining an——

Representative PATMAN. An orderly market around 96?

Secretary SNYDER. I do not know what range of fluctuations is, but there has been an orderly market with only very minor Federal Reserve operations since last April.

Representative PATMAN. Suppose they wanted to maintain a market at 100 percent, and assuming that, as Senator Douglas explained, that it would be highly inflationary, that is, the banks could sell the bonds to the Federal Reserve Bank and have reserves of a million dollars and would then have reserves with which to extend credit amounting to some $6 million; that is all conceded. But is there not some way, some alternative action that can be taken? Can't you have the Reserve requirements changed by the Congress in a way to offset that and still maintain the bonds at 100 cents on the dollar?

Secretary SNYDER. Well, that I would not like to answer.

Representative PATMAN. What would you offer as a suggestion to consider in the way of a law for Congress to pass respecting reserves that would be helpful in preventing that kind of inflation?

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Secretary SNYDER. Well, since that is invading another agency's responsibility, I would not like to come out with an answer.

Representative PATMAN. That is all right. I will not insist on it at this time at all.

I wanted to ask you about some E bonds, but I will defer to your suggestion and put it in writing.

Secretary SNYDER. We will be glad to try to answer whatever questions are put to us.

Representative PATMAN. Will you tell us briefly what weight you believe should be given to increases in the interest costs on the public debt in determining our monetary policy?

Secretary SNYDER. I think we have to always measure very carefully what the corresponding advantages would be measured against the other problems that must be faced. I certainly do not have any fixed opinion; I just do not have any desire to fix a rate and let that be the one rate for all time. I think that we have to look at it under the conditions and circumstances of periods in which we are operating.

Representative PATMAN. Under existing law, Federal Reserve banks buy bonds only in the open market, do they not? Except, I believe, back during the war there was a law enacted which permitted the Treasury to sell directly to the Federal Reserve banks obligations, short-term obligations, up to a certain amount.

Secretary SNYDER. Five billion dollars.

Representative PATMAN. Five billion dollars?

Secretary SNYDER. That is correct.

Representative PATMAN. That authority expires this year?

Secretary SNYDER. We are asking for an extension.

Representative PATMAN. You are asking for the extension?

Secretary SNYDER. That has only been used in temporary short-term periods of a few days at a time, and never for any extended periods. It has permitted us to take care of a slight operational deficiency in balances.

Representative PATMAN. And only for short-term obligations?

Secretary SNYDER. Only for a very limited time.

Representative PATMAN. Senator Flanders has returned, and I will ask him if he has any questions.

Senator FLANDERS. Mr. Chairman, I come into this thing fresh because I was absent all day. I did, however, read the Secretary's formal document on the train, and was much interested in his constructive suggestion for sort of a conference group on monetary and debt management policy.

One question has been in my mind for some time past, and that has been—let me first say, Secretary, that I am one of those who places very much more trust in monetary and fiscal policies for controlling inflation than I do in direct controls of prices and rationing or particularly of price without rationing.

Now, however, I have wondered some as to whether there were limitations on monetary control that would apply, for instance, at a time immediately after the outbreak of the war in Korea, at which time there was universal business and popular sentiment that the thing to do was to buy because the expectation was that prices were going up.

Now, I have wondered whether in a broad spread movement of that sort, based on extraordinary happenings, whether monetary controls

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alone would not have to be so drastic in order to control such a situation that they would be almost destructive.

It is not like the day-to-day, month-to-month control of small movements by appropriate means, but you meet an emergency, and the question that comes to me is whether that emergency could be controlled by purely monetary means without creating a monetary crisis.

Now, you are not responsible for monetary policies specifically in the sense that we feel that the Federal Reserve System is, so I should ask that question primarily of the Federal Reserve Board folks. But let us have a preliminary try-out with you, if you don't mind speaking on it.

Secretary SNYDER. Well, of course, I would prefer for the Federal Reserve to address themselves to that subject. But I do have grave reservations in my own mind, as do you, Senator, that in a situation where there is a sudden upheaval of buying or rushing in to do financing of various sorts due to an act such as the outbreak of aggression in Korea—which left us for a considerable time, and even yet, doubtful as to where it is going and what its full impact might be—I think that to try to control a situation of that sort entirely by monetary regulations and procedures could well lead to disastrous results. This is because of the fact that in a spirited buying spree of that sort, controlled largely by the belief that there will be a scarcity of articles, price really is no restraining influence at all—purchasers would pay almost any price to get control of large quantities of articles or commodities. To try to control such a situation by monetary measures alone could well upset the operations that have to be going on in the economy regardless of that impulse of scare-buying, and I do feel that we have to take a very careful view of ever attempting to use strictly monetary measures to control such an occasion—such a condition.

Senator FLANDERS. As I said, Mr. Chairman, I am asking that question as one who is convinced of the usefulness of the monetary control, and have placed prime dependence upon it, but I think still we should be concerned with the dangers or difficulties involved in it.

Thank you, Mr. Secretary.

Secretary SNYDER. Yes.

Representative PATMAN. I want to ask you a question or two about the voluntary credit restraint program. Are you on that Board? I do not believe you are on the committee.

Secretary SNYDER. No, sir.

Representative PATMAN. I think that is around the Federal Reserve Board. Governor Powell, I think, is in charge of that.

Secretary SNYDER. That is correct.

Representative PATMAN. I assume we will have Mr. Martin here tomorrow and he can tell us about that.

You come in contact with that program?

Secretary SNYDER. Yes. I have been very enthusiastic about it, a very enthusiastic supporter of the program, and I think that in the two instances where we have had a voluntary credit restraint program—back in 1948 and again recently—I think that it has had a degree, an important degree, of influence on the restraint of bank credit.

Representative PATMAN. Would you like to ask any further questions, Senator Douglas?

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Senator DOUGLAS. No.

Representative PATMAN. Mr. Wolcott?

Representative WOLCOTT. That last answer you made, Mr. Secretary, inspires some discussion ,and I do not know whether we want to go into it right now, but do you think that the regulation W or regulation X has been a deterrent to increases in the volume and velocity of credit, or has it acted merely to cut down the demand for goods in the lines in which they operate?

Secretary SNYDER. I would have to give you a studied reply on that one. I would be glad to try to prepare something.

Representative WOLCOTT. I think I can go along with the idea that it cut down on the demand for goods.

Secretary SNYDER. The reply I made was to the voluntary credit-control program.

Representative WOLCOTT. The voluntary credit?

Secretary SNYDER. Yes, sir.

Representative WOLCOTT. I beg your pardon?

Secretary SNYDER. That was the reply I made to it.

Representative WOLCOTT. I did not catch the fact that you were talking about voluntary control.

Secretary SNYDER. Yes. They asked about Mr. Powell's operation in the Federal Reserve on the voluntary credit control program, and that was what I was addressing my reply to.

Representative WOLCOTT. All right.

Representative PATMAN. Senator Flanders, do you have any more questions?

Senator FLANDERS. No, thank you.

Representative PATMAN. Dr. Murphy, do you have any questions?

Mr. MURPHY. I would just like to ask several questions, Mr. Secretary. They may sound a trifle pedantic, but I think they may serve to clear up one of the matters that was discussed this morning.

First, the total amount of debt that has to be placed is determined, is it not, principally by the receipts and expenditures of the Government? It is a matter over which you have very little control.

Secretary SNYDER. It is entirely controlled by that.

Mr. MURPHY. And all debt, of course, must be held by someone. You desire under present circumstances that as little of the debt should be held by banks as possible.

Secretary SNYDER. We have supported such an idea, both in practice and in theory; we have attempted to try to get the debt into nonbank hands to the greatest extent possible.

Mr. MURPHY. And since the whole debt must be financed, this is primarily a matter of maximizing holdings by nonbank investors.

Now, this leads to the question of the means or techniques by which nonbank holdings of Government securities can be maximized. Is it always possible to sell additional amounts of Government securities simply by letting the market, as we will say, seek its own level, or do you feel that under some circumstances maintaining a reasonably stable market will permit you to sell more securities to nonbank investors and have them more firmly placed than you could by simply having Federal Reserve withdraw from the market and letting the market seek its own level?

Secretary SNYDER. Well, as I stated a while ago, Doctor, with the large debt operations that we have to work with—the financing of

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refundings and of new money operations—it is vitally important that each issue be successful.

Mr. MURPHY. And can the success of these issues in itself be a means in the long immediate run for placing more rather than less securities with nonbank investors?

Secretary SNYDER. I think it could.

Mr. MURPHY. By building up their confidence in the securities?

Secretary SNYDER. I think it would. It would give people confidence, whereas a very small issue could affect the whole debt if it were badly received.

Mr. MURPHY. The only point I wanted to try to bring out, Mr. Secretary, was that the Federal support of a particular Treasury operation, by preserving confidence in the market, might be a way—and if properly handled would be a way—of maximizing nonbank holdings rather than the reverse.

Secretary SNYDER. I think so.

Mr. MURPHY. That is all.

Representative PATMAN. I will ask Dr. Grover W. Ensley, the staff director of the full committee, if he would like to ask any questions.

Mr. ENSLEY. Just one, Mr. Secretary. I have been very much impressed with the answers to the subcommittee's questionnaire by the Treasury, as well as the representatives of the Federal Reserve System. I know that you personally spent many hours on this assignment. There must have been a tremendous amount of staff work going into this job. I think it would be interesting for the record to show the process, the method, that you used, as well as the Federal Reserve Board, in the preparation of these answers in such a short time and so elaborately. Undoubtedly you called in outside consultants, and we would like to know who they were, how did they work, and how did you evolve this excellent monograph in response to the subcommittee's questions so quickly. Would you prepare a memorandum on this for our printed record?

Secretary SNYDER. We will be pleased to do that because, as I stated in my opening remarks, we took this study very seriously, and we applied a great deal of time to the answers. For your information, I personally spent many, many hours with the study group over the period of preparation of answers, and we have conscientiously applied every possible source of information that we could gather. We have brought in a great number of outside consultants; we brought in groups to talk with us on it, and I think it would be very constructive to show the procedure that we followed in trying to arrive at the replies to the questions that were submitted to us. We will be glad to do that.

Senator DOUGLAS. Mr. Patman, in view of the questions of Dr. Murphy, I would like to be privileged, if I might, to ask some questions.

Representative PATMAN. Certainly, Senator.

Senator DOUGLAS. As we all know, last April the Reserve Board adopted the so-called policy of flexible support of the Government-bond market, rather than absolute or rigid support. Has that policy of flexible support resulted in making it difficult for the Treasury to refund its issues, nonbank holdings——

Secretary SNYDER. In the period——

Senator DOUGLAS (continuing). Since April of 1951?

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Secretary SNYDER. We have been able to in the climate in which we have worked——

Senator DOUGLAS. That was done with only flexible support and with a net decrease in the total volume of Government securities held by the Reserve.

Secretary SNYDER. Well, the Reserve holdings are a little higher than a year ago.

The pertinent figures on Federal Reserve holdings of Government securities referred to are the following:

	Million
Feb. 28, 1951	$21,881
Mar. 6, 1952	22,514

Senator DOUGLAS. But the last figure——

Secretary SNYDER. It does not make any difference.

Senator DOUGLAS. The last figures I saw were $300 million lower than——

Secretary SNYDER. In June of 1951, yes.

Senator DOUGLAS. Well, if refunding operations since the accord were carried out successfully without any large degree of support from the Federal Reserve, what reason do you have for thinking they could not be carried out successfully prior to the accord without any appreciable degree of support?

Secretary SNYDER. If we could do all of our operations by back sighting, Senator, I think maybe we would be all right. If you are faced with a proposition at a certain time, there are certain unknowns—it falls on you to make a decision, and if we were always able to look backward to make a decision——

Senator DOUGLAS. Does this mean that on the basis of hindsight you believe that the Treasury and Reserve policy from Korea until March was wrong?

Secretary SNYDER. No.

Senator DOUGLAS. And from date of the accord on it was correct?

Secretary SNYDER. I made no such statements, Senator. Let us stick to what I said.

Senator DOUGLAS. Let us go back to the point. If this worked successfully in a period of large refunding, that is, if the Federal Reserve, buying comparatively small quantities of Government bonds did not interfere with the large refunding operation of the Treasury, why could not the same policy have worked before April when your refundings, I think, were not nearly as great as they were later? Why was it necessary to load the member banks up with $4 billion worth of Reserve dollars?

Secretary SNYDER. I hope that we can avoid any situation like that in the future.

Representative PATMAN. Any other questions?

Senator DOUGLAS. The question was not directed to the future but directed to the past. I was trying to keep off the future lest I interfere with the confidential nature of the operations which we may have to carry on, but I thought if the future was barred to us it was at least permissable to analyze the past.

Secretary SNYDER. Well, we are speculating and not analyzing when we say wouldn't certain things happen if certain things did happen. We might say today is a nice, pretty day, so, therefore, wasn't 2 weeks ago a pretty day. I just can't go on that theory. We

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have to go back to the conditions which we faced at the time, Senator, when we made certain decisions.

Senator DOUGLAS. I remember that the refunding problems of the Treasury were not as great in '50 as they were in '51, isn't that true?

Secretary SNYDER. They were serious.

Senator DOUGLAS. But not as great. You had this terrific volume of refundings in '51 which I believe you did not have in '50, isn't that correct?

Secretary SNYDER. We had a heavy volume in both years.

Senator DOUGLAS. And yet in a more severe situation in '51 than we had in '50 the operation was carried on very successfully without the Federal Reserve buying an appreciable quantity of Government bonds. In fact from June on they actually made net sales of Government bonds, diminishing the volume of securities held by the System.

The question naturally comes if the problem was debtwise less severe in 1950, why was it necessary for the Reserve to purchase $4 billion worth of bonds and create billions of reserves upon which a $16 billion credit expansion was ultimately based, with an increase of 16 percent in the wholesale price level and an increase now of 10 percent in the cost of living and an increase in cost to the Federal Government of some $10 billion a year?

Secretary SNYDER. We are very pleased with our present relationship with the Treasury, Senator.

Senator DOUGLAS. With the Federal Reserve?

Secretary SNYDER. I mean with the Federal Reserve. We are also pleased with our relationship with the Treasury and with this subcommittee.

Senator DOUGLAS. Since the future and the past are both closed to us, we can find out nothing about either. I would like to know of what the present consists.

Representative PATMAN. Mr. Secretary, we appreciate your attendance and we will feel free to call on you in the future. And of course in our requests we will make it subject to your convenience as much as possible. We appreciate your coming here today and giving us the benefit of your views and the answers to the questions that have been asked you.

Thank you very kindly, Mr. Snyder.

(The information previously requested by Mr. Ensley follows:)

PREPARATION OF ANSWERS TO QUESTIONNAIRE

Submitted by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report

Early in August 1951, the subcommittee submitted a list of questions covering a wide range of matters relating to the management of the public debt and monetary, credit, and fiscal policy, both in this country and abroad. In the course of extensive discussions during August and September this list was revised somewhat and some new questions were added which the Treasury staff thought would help to give a well-rounded presentation of its point of view on the underlying problems. These suggested additions were welcomed by the staff of the subcommittee. I felt that the fullest possible answers should be given to each of the questions, with the objective of providing the subcommittee with adequate basic materials upon which to undertake the comprehensive study which had been assigned to it.

With this in mind, I made it clear to Treasury officials that I was prepared to spend as much time as was necessary in the months ahead to shape the answers

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into final form. Furthermore, I instructed the General Counsel to act as official contact with this congressional subcommittee in the same manner as he is the contact with other committees of Congress. I instructed the Director of the Technical Staff, the Fiscal Assistant Secretary, and the General Counsel to detach from other duties, insofar as possible, such members of their staffs as were necessary to prepare material for the answers to the questionnaire, and to assemble a group of consulting experts, both economic and legal, who could both help us prepare answers to the questions and provide varying points of view with respect to how the questions might be answered.

The following consultants were contacted and were brought to the Treasury from time to time between mid-August and late December:

Mr. Wesley Lindow, vice president and economist, Irving Trust Co., New York, N. Y.

Dr. G. Lee Bach, director of industrial administration, Carnegie Institute of Technology, Pittsburgh, Pa.

Dr. Douglas Anderson Hayes, professor of business administration, Universtiy of Michigan, Ann Arbor, Mich.

Mr. Miroslav Kriz, foreign research division, Federal Reserve Bank of New York, New York, N. Y.

Dr. Paul W. McCracken, professor of business administration, University of Michigan, Ann Arbor, Mich.

Dr. Marcus Nadler, Graduate School of Business Administration, New York University, New York, N. Y.

Mr. Joseph J. O'Connell, Jr., Chapman, Bryson, Walsh & O'Connell, Washington, D. C.

Dr. Roland I. Robinson, professor of banking, the School of Commerce, Northwestern University, Evanston, Ill.

Judge Samuel I. Rosenman, New York, N. Y.

Dr. Lawrence H. Seltzer, professor of economics, Wayne University, Detroit, Mich.

Dr. Henry C. Wallich, Department of Economics, Yale University, New Haven, Conn.

These men have had a wide range of experience in matters relating to debt management, monetary, credit, and fiscal policy. One was a former General Counsel of the Treasury, two were former Assistant Directors of the Treasury's Technical Staff, two were former members of the Research Staff of the Board of Governors of the Federal Reserve System, one was a former member and another a current member of the research staff of the Federal Reserve Bank of New York, one was a former member of the research staff of the Federal Reserve Bank of Minneapolis, and one was former counsel to the President of the United States. In the aggregate, they represented great technical ability and various points of view. They provided us with a great deal of help—both in Washington and at their home locations—and contributed many useful ideas and suggestions, many of which were worked into the final answers.

A number of the questions dealt directly with general material on the subject of public debt management and monetary, credit and fiscal policy, and drafts of the answers to these questions were prepared initially by the consulting experts. In many cases, two or more answers were prepared in order to obtain a variety of ideas. Answers to some of the other questions, particularly those relating exclusively to Treasury operations and techniques, were prepared by officials dealing with these matters most closely.

I met frequently in my office and in the Treasury conference room with the Treasury people and the consultants preparing the answers. Meetings generally ran from 1 to 2 hours, and there were about 25 of them during the course of the project. Each question was taken up on several occasions; drafts of answers were discussed thoroughly; competing points of views were analyzed; and agreed-upon presentations were then developed, sometimes by Treasury staff members and sometimes by our consultants.

After each answer had reached a semifinal stage, it was circulated to all members of the Treasury staff concerned for comment and was mailed to each consultant at his home location, where he went over it and submitted suggestions or alternative wordings for particular paragraphs or sentences. It was also sent to a number of outside people who had a great deal of experience in the debt management and fiscal-monetary field. Among these were the following, two of whom were former Under Secretaries of the Treasury:

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Mr. Daniel W. Bell, president, American Security & Trust Co., Washington, D. C.
Dr. Harold Stonier, executive manager, American Bankers Association, New York, N. Y.
Mr. A. L. M. Wiggins, chairman of boards of the Atlantic Coast Line Railroads and the Louisville & Nashville Railroad, Hartsville, S. C.

The suggestion made by all people reviewing the draft answers were gone over by members of the Treasury's technical staff, who acted as the final coordinating group to revise the answers and incorporate the necessary adjustments.

This procedure continued during the last part of August, September, October, and November. Late in November, I attended a NATO conference in Rome; and the staff airmailed to me a set of revised answers to all questions which had been prepared up to that time. On my return trip I spent many hours aboard ship going over each answer carefully, making suggestions and changes where I felt it necessary.

At this point, copies of our answers were sent to the Council of Economic Advisers and to the Board of Governors of the Federal Reserve System for their comment. Suggestions from these agencies were taken up by the staff in January and worked into the answers wherever possible.

During January and in early February, I spent many hours with Treasury staff people, going over the answers in final form. The materials were carefully checked both in final draft and in galley proof and page proof; and, where necessary, records were brought together and special files established to completely document the answers to some of the questions.

Representative PATMAN. The committee will stand adjourned until 10 o'clock tomorrow at the same place.

(Whereupon, at 3:50 p. m., the committee adjourned, to reconvene at 10 a. m., Thursday, March 11, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

TUESDAY, MARCH 11, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL,
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

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

Present: Representative Patman; Senators Douglas and Flanders; Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

Senator Flanders, did you have a statement to make?

Senator FLANDERS. No; I just wish to suggest that this present occasion reminds me of a passage in the Scriptures of the parable of the man out of whom seven devils were cast, leaving his interior swept and garnished, whereupon seven other devils saw the opportunity and moved in.

We had one group yesterday and have another group today and I thought, perhaps, that that passage in the Scriptures might be appropriate. [Laughter.]

Representative PATMAN. You are calling them all devils?

Senator FLANDERS. Well, they are guilty until they are proved innocent. [Laughter.]

Representative PATMAN. We have with us this morning Mr. Martin, Chairman of the Board of Governors of the Federal Reserve System. You have a prepared statement, I believe, Mr. Martin?

STATEMENT OF WILLIAM McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MARTIN. I have, Mr. Chairman.

Representative PATMAN. Would you like to present your prepared statement before yielding to questions?

Mr. MARTIN. If it is agreeable to you, Mr. Chairman, I would.

Representative PATMAN. It would be satisfactory to us.

Mr. MARTIN. Mr. Chairman and members of the committee, in coming before you today I should like to express what I know has

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been in the minds of all of us in the Federal Reserve System in preparing the answers to your questionnaire. We have welcomed this opportunity to put down on paper our concepts of what our function is in the governmental structure and in the economy. You give us a heavy load of homework and we have all profited by it. I know that for me it has been more than a refresher course—it has been a liberal education in what I prefer to call reserve banking, rather than central banking operations. The task of preparing answers to the comprehensive and searching questions has been formidable and I will not pretend that I approached it without some reluctance. Now that the task is done and the results are published I realize how worth while has been the time and effort expended not only by those of us in the System but by the many others to whom you addressed questionnaires. Irrespective of the conclusions you may reach as a committee, you have assembled a body of information that I think will prove to be invaluable for a long time to all who are interested in the special problems of general credit control and debt management.

Beyond that, however, we have all genuinely welcomed this inquiry. The Federal Reserve System is a servant of the Congress and, through you, of the people of the United States. You created it, you can abolish or change it. Our task is to carry out your will and it is our duty to lay before you all the facts at our command for which you ask and to give you our best judgment on these important matters.

We are glad of the opportunity to make any contribution we can to the improvement of this reserve banking mechanism. Like all human institutions, it is not perfect or infallible. In the nearly four decades of its existence, the System has undoubtedly made mistakes. It has also learned from experience. One of the fundamental purposes of the Federal Reserve Act is to protect the value of the dollar. Yet that value today in terms of purchasing power is less than half of what it was when the System was founded. In this span of years the country has engaged in two World Wars and is now in the throes of what might be called an undeclared war. With the vast economic changes brought about by military and security needs, monetary policy by itself cannot maintain economic stability and preserve unchanged the purchasing power of the dollar. Even aside from these disturbances, it is probably fair to say that monetary policy has not always been as timely or as effective as it could have been.

Your first concern, I take it, is to look at the record of the past principally for the light it can throw on the road ahead. We are trying to look forward, as you are. In his first inaugural address as President, Woodrow Wilson included a statement, part of which is inscribed in the lobby of the Federal Reserve Building:

> We shall deal with our economic system—

he said—

> as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon; and step by step we shall make it what it should be, in the spirit of those who question their own wisdom and seek counsel and knowledge, not shallow self-satisfaction or the excitment of excursions whither they cannot tell.

I am sure it is the purpose of this inquiry, as it is of all of us, to appraise judicially this reserve banking mechanism and to do whatever appears wise so that it may render the best possible public service.

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The Federal Reserve System and the Federal Reserve banks sometimes are referred to as bankers' banks, but that describes only a part of their functions. The various services which the Reserve banks perform for the banking community, such as supplying currency, transferring funds, and collecting checks, have proved to be an essential element in keeping the mechanics of modern-day commercial banking in step with the financial needs of a growing and changing private enterprise economy. The overriding purpose of this Reserve System is to serve the interests of the general public in business, industry, labor, agriculture, and all walks of life. As I understand the intent of this inquiry and of these hearings, it is to explore how that interest of the public can best be served in the area of general credit control and debt management on which the activities of the Federal Reserve System have so important a bearing. The approach to this broad subject by the members of this committee and of the Banking and Currency Committees and those of use to whom you entrust the duty of carrying out your wishes must be in the spirit to which President Wilson referred. We must always question our own wisdom and seek counsel and knowledge.

Considering that money is one of the most controversial of all subjects, it is rather remarkable that the replies elicited by your questionaire reveal so little fundamental divergence. Honest judgments may differ as to whether the Reserve System, for example, has done its job well or poorly. There are bound to be differences of opinion concerning the structure and internal operations of the System but essentially I find very little difference in all the replies on fundamentals. There is a general recognition of the need for a mechanism of this kind to perform substantially the functions and to render the services that this System now furnishes. If the Congress were to do away with the present system some other way would have to be found to perform its function and to play its role in the economy.

Basically, the job of the Federal Reserve System is that of monetary management—to increase the money supply and make it more easily available when there is evidence of weakness in the economy and to reduce the volume of money and make it less easily available when indications show that there is excessive expansion. In other words, it is the business of monetary management to contribute to the broad objectives of steady economic progress which is the ultimate goal of all national policy.

The instruments by which these broad purposes of monetary management are achieved are dealt with in detail in the answers to your questionnaire. How and when and why these instruments have been used is likewise set forth at some length. You will have to judge how wisely or unwisely they have been used in the revealing light of hindsight. You have to judge whether these instruments can be improved, or others provided. We have called attention to some of the various problems for which, perhaps, better answers can be found but we are not, as you may have noted, recommending any broad or sweeping changes. The test that, I have no doubt, you will apply is whether the public interest is well served. I think that, generally speaking, it has been well served by the System.

The System is a unique concept, an ingenious merging of public and private interests in a characteristically democratic institution. The

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doctrine of the separation of powers, as Mr. Justice Brandeis once pointed out, was adopted "not to promote efficiency but to preclude the exercise of arbitrary power." The purpose was "not to avoid friction, but by means of the inevitable friction incident to the distribution of the Government powers among three departments, to save the people from autocracy." Doubtless this reserve banking mechanism could be more efficiently devised or differently organized in the governmental structure but it would be at the cost, I think, of something far more important. In any case, such an institution will in the last analysis render good or bad public service depending upon the abilities of the human beings engaged in its operation rather than upon its organizational form and structure. And by the same token, the resolution of difficult problems and of conflicts of opinion must come out of the minds of men and not from the forms in which they chance to be organized.

I have sought to indicate in a general way the attitude with which we have approached this important inquiry into the public's business as discharged by the Federal Reserve System. We have looked at this System, not as if we had a clean sheet of paper to write upon, but in the light of the concepts on which it was based and its performance over the years. We have tried to be honest with you and honest with ourselves. Certainly we have nothing to withhold or conceal. The record is an open book.

We have sought to make clear that monetary policy cannot, by itself, achieve stable economic progress but that it is an indispensable means to that end. It must go hand in hand with fiscal policy and debt management.

We have tried also to spell out as plainly as we can the meaning of the accord which we reached with the Treasury last March, in which you are naturally interested. Its achievement illustrates the point which I mentioned before that the solution of difficult problems and the reconciliation of differing viewpoints depends upon the ability of men to come to a meeting of minds in the best interest of the public rather than upon the forms of institutional organization. That accord was not a transitory or empty gesture. It is a reality under which debt management and monetary policy are moving together toward the same objectives with mutual understanding and meeting of minds.

May I add that I concur fully in your chairman's confident prediction that the fundamental issues with which the committee is concerned "will be found vastly too complex to permit of facile generalization."

I think it may prove useful to the members of the committee for me to present a summary which I have prepared of our replies to your questionnaire.

This summary presents, first, the major points of reserve banking philosophy developed in the answers, second, some of the more important positions taken on the issues raised, and, third, several general points as to changes in banking structure and as to foreign monetary organization and experience. Each reply submitted undertakes to deal with the question asked on its own merits and to provide a direct, objective, and comprehensive answer.

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RESERVE BANKING PHILOSOPHY

The following views are expressed with respect to the role of credit and monetary policy and the organization within the Government for such policy.

1. Flexible credit and monetary policy, together with flexible debt management policy and an adequate fiscal program, is essential to economic stability.
2. The established relationship of the Federal Reserve Board of Governors to other branches of the Government is consistent with and adequate for the function which the Reserve System performs.
3. The status of the Board as an independent establishment of the Government is sound on the basis of accepted principles of democratic governmental organization, regardless of any theoretical question as to the branch of the Government in which it falls.
4. Changes in money market conditions and in interest rates reflect the interplay of basic forces of supply and demand for short- and long-term credit. Supply is made up of new individual and corporate savings, accumulated cash balances offered for investment, repayments on past loans, and credit expansion by the commercial banking system. Demands from business enterprises, farmers, consumers, State, local, and foreign governments, and the Federal Government form the major components of credit demand.
5. Credit and monetary policy operates primarily through its effects on the availability and supply of credit; it cuts out of the market or brings into it fringe credit demands.
6. In this process, credit and monetary policy affects, but does not determine, interest rates in the market. Interest rates are prices which perfom vital economic functions and they should be responsive to basic supply and demand conditions. In a rich, high savings economy with well integrated financial markets, significant changes in the availability of credit, and hence in the volume of spending, need be accompanied by only small changes in the cost of money.
7. On balance, the System, through its support of Government security prices, accentuated postwar inflationary pressures.
8. In early postwar years, the System favored and defended a support program as a part of transitional adjustment and sought other means of restraining inflationary credit expansion. This policy took account of the need for time to develop a debt-management program that would lodge a greater proportion of the public debt permanently in the hands of nonbank investors. As time passed and the System's support policy led to increasing monetization of the public debt, the Federal Reserve became more and more concerned about the contribution of its operations to inflationary pressures.
9. More flexible credit and monetary policies, applied through the discount and open market mechanism within the framework of an orderly Government securities market, have demonstrated their effectiveness since they were undertaken in March of 1951.
10. In addition to measures affecting credit generally, flexible credit and monetary policy includes the use, in occasion, of selective credit regulations—relating to stock market, consumer, and real estate credit—as well as voluntary measures.

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11. Credit and monetary policy cannot be fully effective without public understanding and support. The System strives to keep the public fully informed on all credit and monetary developments.

MAJOR POSITIONS

Of the specific positions brought out in the answers to different questions, the following are the more important:

1. The Federal Reserve Board is subject to the Employment Act of 1946. Fairly interpreted, the congressional directive stated in this act implies a goal of monetary stability and needs no modification.
2. Existing Congressional directives to the Federal Reserve System afford a broad workable guide for policies and operations.
3. The status of the Board as an independent establishment of the Government, subject to the direction and scrutiny of the Congress, should be preserved. Budgetary discretion is essential to maintain the basic character of the Reserve System.
4. No legislation is required with respect to the organizational relationship between the Treasury and the Federal Reserve or the Executive and the Federal Reserve.
5. Advantages of the existing regional status and organization of the 12 Federal Reserve banks far outweigh disadvantages.
6. Considering the functions in Government of the Federal Reserve Board, a board type of organization may be preferable to a single governor type. The weight of advantage may lie, however, with a smaller size board—say, five men.
7. No substantial gain in efficiency of Federal Reserve decision-making would be likely from centralizing the authority for all credit instruments in one body, the Board or the Federal Open Market Committee.
8. Member bank borrowing at the Federal Reserve should be the principal means of obtaining additional bank reserves. Discount rate changes and open market operations should be the main instruments through which credit and monetary policies are adapted to changing conditions in the economy. This means increased use of the discount mechanism, increased importance of discount rates in comparision with credit policy experience of the past decade, and reliance on open market operations to reinforce discount policy.
9. The present organization for the execution of open-market operations is designed to protect the public interest. The Federal Open Market Committee is constantly studying this organization with a view to making adaptations which will improve it.
10. Open-market operations should be conducted impersonally without resort to moral suasion.
11. Only in exceptional circumstances should use be made of authority to change reserve requirements, which is a blunt and inflexible instrument.
12. The existing structure of reserve requirements could be modernized in some respects for purposes of more efficient and equitable administration. Also, standard legal reserve requirements could be applied to all banks without raising the question of the dual banking system, the preservation of which the Board favors. This is not an urgent problem at the present time, however.

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13. Extension of selective credit regulation to areas other than stock market, consumer, and real-estate credit is not feasible. Further experience with regulation in both the consumer and the real-estate credit areas is needed to determine their role on a long-run basis.

14. With effectiveness of discount policy and open-market operations reestablished, disadvantages of supplementary reserve proposals outweigh advantages.

15. Direct control or rationing of bank credit by the Federal Reserve or any Government agency should not be resorted to except in an extreme emergency.

Several general points in the replies are of interest. These include:

1. Generally speaking, the banking system has kept pace with both the growing and changing credit needs of the different segments of the economy. Today business, agriculture, and consumers are more adequately supplied with banking services of various kinds than they were 25 years ago.

2. Commercial banks are meeting short- and intermediate-term credit needs of smal businesses reasonably satisfactorily. Provision of special long-term credit assistance in this area, such as would be authorized by bills introduced in recent years, namely, Government guarantee of loans made by private financing institutions or the establishment of special investment companies, would be untimely in an inflationary period.

3. Foreign experience with central banking and monetary policy does not yield lessons that are directly applicable to the United States. The following foreign developments are nevertheless suggestive:

(*a*) It has been widely recognized, at least in the countries of the free world, that the central bank should have a large measure of independence within the governmental structure.

(*b*) In a number of foreign countries, postwar credit policy was first operated mainly through selective regulations, but subsequently such regulations have been supplemented or replaced by measures of general credit policy, such as reserve requirements and discount-rate changes.

That finishes my prepared statement, Mr. Chairman.

Representative PATMAN. Senator Flanders, would you like to ask some questions?

Senator FLANDERS. Yes. Mr. Martin, on page 2 of your remarks you state:

> One of the fundamental purposes of the Federal Reserve Act is to protect the value of the dollar.

Now, is that specifically stated in the original legislation setting up the Federal Reserve System?

Mr. MARTIN. No, sir. It is not explicitly stated in the legislation, but it is inherent in the entire legislative history of the act and in the surrounding circumstances.

Senator FLANDERS. Has it ever been in legislation, early or late, specifically stated as a fundamental purpose?

Mr. MARTIN. I do not think it has ever been stated explicitly in legislation.

Senator FLANDERS. What you are saying then, is that it is implicit, and that if it is not taken into account the Federal Reserve Act cannot

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be satisfactorily administered in the explicit purposes for which it was set up?

Mr. MARTIN. That is correct.

Senator FLANDERS. On the same page 2, down toward the end of the central paragraph, I see what you have stated more than once in the course of your two documents here, that—

Monetary policy by itself cannot maintain economic stability and preserve unchanged the purchasing power of the dollar.

I asked Secretary Snyder yesterday whether in such extreme cases as a general conviction on the part of both the business interests and the consumers of the country that prices were going to rise which, therefore, generated a broad-spread purchasing program, whether monetary policy alone could have kept it in control. I spoke, of course, as a specific example, of the buying wave which succeeded the opening of the troubles in Korea.

Do you think monetary policy alone could have kept that under control?

Mr. MARTIN. No, sir; I do not think monetary policy alone could have, but I do think that monetary policy was an indispensable part of any program of control. I think that we tend sometimes to exaggerate the role of monetary policy and at other times to underestimate the role of monetary policy.

I think it can substantially lessen a buying wave such as occurred in the post-Korean period by gradually reducing the available supply of money.

Now, that takes some time. There are psychological factors that enter into it, and if the push is very heavy, it takes a little time before you bring the push to a halt.

Senator FLANDERS. Looking back on that period in retrospect you certainly would have, I take it, applied monetary measures quite definitely and quite strongly. Do I get from what you have said that you would not have expected them to be immediately and totally effective?

Mr. MARTIN. I do not think any one policy could have been immediately or totally effective. I think that when you get into a period of semihysteria, such as followed after Korea, that about all you can do is use all the weapons in your arsenal to check the inflationary pressures; that is why we had selective credit controls, along with the monetary controls, and why we engaged in all the other activities of Government, including the voluntary credit restraint program.

Senator FLANDERS. Yet you feel that those other things were applied early enough or were they applied a little bit later than they should have been?

Mr. MARTIN. Well, in retrospect——

Senator FLANDERS. Ideally?

Mr. MARTIN. Ideally, I think, they were applied later than they should have been, but that is hindsight, and——

Senator FLANDERS. Yes.

Mr. MARTIN (continuing). I would say definitely in retrospect I think that we could have all of us in every endeavor acted a little bit more wisely if we had been prompter in seeing the dangers that lay ahead.

However, we also had to recognize that we had a changing situation which could, for example, have developed into a Dunkirk in Korea, to

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take the extreme case, and that we did not want to do anything that would hamper unduly the mobilization effort which was just coming into being. It was an extremely difficult period to pass judgment on.

Senator FLANDERS. Are you implying from that that if we had been drastic with monetary policy we might have done more damage than good to the situation—that is, if we had shut off the supply of new money and new credit so drastically that the wave of buying was checked? Would we have done damage to the productive activity of the country?

Mr. MARTIN. I think it is possible that we might have, and that was one of the considerations for not acting too drastically at the time.

Senator FLANDERS. Going back just a moment to the point that a fundamental purpose is protecting the value of the dollar, has that ever been expressed in any legislative directives that have been given to the Federal Reserve Board?

Mr. MARTIN. I really do not know. It is implicit in the Employment Act of 1946, but there again it is not a direct statement.

Senator FLANDERS. That Employment Act, as I remember it, does not mention the Federal Reserve System directly.

Mr. MARTIN. No, sir.

Senator FLANDERS. But as a branch of the Government it implies that that must be taken into account?

Mr. MARTIN. And I am accepting the Employment Act of 1946 as national policy and being applicable to the Federal Reserve System.

Senator FLANDERS. Yes.

Again on page 6 of your statement in the second full paragraph you say:

> We have sought to make clear that monetary policy cannot, by itself, achieve stable economic progress but that it is an indispensable means to that end.

You say that monetary policy cannot by itself do the job of maintaining the purchasing power of the dollar, so that your position seems to be clear on that in this document.

Mr. MARTIN. That is correct, sir.

Senator FLANDERS. In your summary of your replies on page 3 you speak of a need for more flexible credit and monetary policies applied through the discount and open market mechanism within the framework of an orderly Government securities market; and at a later point you speak of the increased importance of discount rates in comparison with credit policy experience of the past decade, and reliance on open market operations. Do I understand from that that the Reserve System is giving renewed emphasis to the discount function and that it has had some measure of success in reviving that part of the Reserve bank operations, or is that a hope, a purpose, or is it something that is actually under way?

Mr. MARTIN. No, that is something that we think is actually under way under the accord that we have with the Treasury. We have been operating extremely satisfactorily, and relations have been steadily improving between the staff of the Treasury and the staff of the Federal Reserve Board. Under the accord we endeavored to free the market without letting it become a disorderly market, and to permit the short-term rate that had been previously more or less pegged to adjust around the discount rate, which had been previously increased to 1¾ percent. That was a part of the understanding. At one point

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near the end of this current year we had discounts get up to nearly a billion dollar level for the first time in a long time.

Now, that was a temporary situation. Right now we are worried because some borrowing by the banks through the discount operation, we fear, is for excess profits tax purposes and we do not want that to happen. But we are seeing the gradual restoration of more normal market conditions instead of a market that for a long time was pretty stagnant and entirely dependent on the peg.

Senator FLANDERS. What type of collateral is involved in this expanded rediscount market operation?

Mr. MARTIN. Almost entirely Government securities.

Senator FLANDERS. There has been no particular increase in the discount of commercial paper?

Mr. MARTIN. There has been very little discounting of commercial paper or other types of loans with the Federal Reserve banks; most borrowings from the Federal Reserve banks have been on Government securities as collateral. We used to have quite a few bankers' acceptances. I would like to see the bankers' acceptances market redeveloped, but it has been practically dormant for some time. I hope it will come back into being.

Senator FLANDERS. Just one other group of elementary questions for the sake of having them in the record. It seems really silly to ask them, but I am going to ask them just the same. When the Treasury sells bonds to the bank, that increases or decreases the available money supply?

Mr. MARTIN. That increases the available money supply.

Senator FLANDERS. All right.

When the Treasury retires bonds held by the banks that decreases the money supply?

Mr. MARTIN. Decreases.

Senator FLANDERS. When the Federal Reserve System buys Government bonds from the banks, what does that do to the money supply?

Mr. MARTIN. That increases the reserves of the member banks which, in turn, increases the money supply if they lend the money.

Senator FLANDERS. So when the Government buys, that is, retires its bonds it decreases the money supply. When the Federal Reserve bank buys bonds from the commercial banks it increases the basis for credit, and so tends to increase the money supply.

Mr. MARTIN. It is a creative process.

Senator FLANDERS. Yes. And the reverse, of course, is true, when the banks sell, when the Reserve System sells bonds. I just put that into the record because it seemed to be a little bit mysterious that the Government selling should do the opposite thing from the Federal Reserve banks' selling in its effect on the money supply, so I just wanted that stated in the record.

Mr. MARTIN. Yes.

Senator FLANDERS. That is all, Mr. Chairman.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Martin, yesterday in the colloquy between Senator Douglas and Secretary Snyder, after describing the activities of the Federal Reserve in the post-Korean period, and then putting into the record what happened in the expansion of credit,

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Senator Douglas said, in speaking of the inflationary impact of the increase of the money supply:

> Well, was it not an important reason and the important reason, the increase, the support efforts of the Federal Reserve on the inflationary situation?

I would like to discuss that in the light of your own statement and in the light of some figures taken from the chart in part I, which includes your reply, the chart which begins on page 216, and details in brief form the actions of the Federal Reserve System since its inception, and in relation to some figures that have to do with the consumer's price index over two periods of years. I believe my figures are correct, but they could easily be corrected if they are not.

In this chart you indicate that in a period 1942 to 1945 the Federal Reserve increased its holding of Government securities by $22 billion, bills $12.8 billion, certificates $8.4 billion, and notes $1.3 billion. You say that bond holdings decreased $500 million.

I am not in a position to use exactly comparable figures, and, therefore, the comparison may not be completely fair, but I note that the monthly average of consumer's prices for 1943—I do not have the 1942 figure—was 123.7, and for 1945 128.6, an increase of 4.9 in a period roughly the same period when the Federal Reserve increased its holdings of Government securities by 22 points.

Then, in the period from January 1946 to August 1950, again from your chart it appears that the Federal Reserve reduced its holdings by a net of 5.9 billion. In that same period from 1945 to June, I have, of 1950, the consumer's price index went from 128.6 to 170.2, which is a rise of about 42.

I am sure my point is clear, it appears on the surface that during a period when large increases of Federal holdings existed that the consumer price index moved much more slowly than it did in a period where the exact reverse process was taking place in the holdings by the Federal Reserve; they were reducing them, and yet the inflation, as indicated by consumer prices—that may not be the fairest way—was going at a greater rapidity.

Mr. Martin. Well, you have just illustrated the difficulty of attributing to any one factor the shifts in prices.

Now, since the Treasury-Federal accord there has been an increase in the volume of bank credit of a substantial amount. There would have been, in my judgment, a whole lot larger increase in that bank credit if it had not been for the Treasury-Federal accord, and we did not add reserves to the market during that period. Nevertheless, you have got to take care of the needs of essential financing.

Now, the period you are talking about is a difficult one because it was a period of war and postwar readjustment. During the war, we created a lot of money and we sold a lot of Government securities to the public. Prices were held down by rationing, allocations, price controls, and voluntary savings by the people to help win the war. At the end of the war, the economy was extremely liquid. Because of the large volume of monetary resources created to finance the war, we had a condition of suppressed inflation. Then, when we removed wartime controls, inflationary forces took effect. After the immediate postwar transition inflation, we had still more inflation, and further

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credit and monetary expansion contributed to the additional price advances.

There is no way of blinking at that record. While it might be good tactics for me to say that there was no war or postwar inflation at all and that the Government including the Treasury and the Federal handled everything perfectly—I am not saying that.

If you will notice in my statement, we at the Federal assume some of the responsibility. I think the Treasury and the Federal have a mutual responsibility for dealing with the inflation problem. And I want to say that no man has labored harder than has Secretary Snyder to meet the postwar inflation problem through fiscal action involving higher taxes.

Another aspect of the problem, and it has many aspects, is that of debt management policy. We had to deal with the debt structure as it was at the end of the war; we didn't have a clean sheet of paper, to go back to my earlier illustration. There were many suggestions for revising the schedules and maturities of Government securities and for shifting the debt held by the banks to nonbank investors. It was a very complex financing situation. No one has labored harder to improve that situation than Secretary Snyder. And I want to add that when I first went into the Treasury I had a whole lot of ideas about how I would change the thing overnight; I revised my ideas when I saw the difficulties that were there.

At one point, the Federal Reserve Board advocated, and I personally rather subscribed to, the idea of a supplementary reserve requirement for banks to be held in short-term Government securities. Because we had a balanced budget, even a budget surplus, and were trying to find some way of redistributing the undigested debt in the economy while restraining monetization of the debt at the same time, the supplementary reserve appeared quite a reasonable way to approach it.

Now, recently I have veered away from the idea of such a supplementary reserve requirement. I have done this because, as we approach a deficit I do not want it to appear that the Federal and the Treasury are using a supplementary reserve device as a method of compelling the banks to finance the deficit. I believe that we ought to finance this deficit in a noninflationary way by attracting the savings of nonbank investors into Government securities. The Treasury and the Federal are now working persistently on the steps necessary to accomplish this.

Representative BOLLING. In line with that statement and the statement in your formal presentation, and your replies to Senator Flanders, I gather that it would be safe to say that you do not agree with an excerpt from a statement which appears in the hearings of the January 1951 Economic Report held by the joint committee from the statement by a group of economists entitled "The Failure of the Present Monetary Policy." The statement I have in mind, having reference to the immediate post-Korean period, is: "Indeed, prices would probably be today a little above their level in May if the Federal Reserve System had kept its holdings of Government securities unchanged instead of adding to them by 3.5 billion dollars."

Mr. MARTIN. That is a judgment; I personally would not completely concur in that judgment.

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Representative BOLLING. So that, in effect, in your mind, monetary policies are a very important aspect of the whole problem, not the important factor.

Mr. MARTIN. That is right.

Representative BOLLING. In the question of timing, I know it must be extremely difficult to make a generalization in reply to this kind of a question, but how long ordinarily would it be necessary for an action in the monetary field to have an effect? I am speaking specifically to point 9 on page 3, where you say:

> More flexible credit and monetary policy applied to the discount and open market mechanism within the framework of an orderly Government securities market have demonstrated their effectiveness since they were undertaken in March of 1951.

I would like you to answer the general question in the light of that.

Mr. MARTIN. I do not think you can give a categorical answer to that, but I would say, on the basis of the record, that whatever you attribute the forces to, it did not take very long at that time before there was some evidence.

I am not one who claims for the Treasury-Federal accord all of the credit for restraining inflation since April 1951. But I do think that it was certainly one of the important factors because it made people stop, look, and listen all across the country as they saw the market forces once again come into play.

Now, as regards time measurement, if you are a real enthusiast for monetary policy, you might say that the mortgage market dropped out of bed within X weeks. However, I do not think that you can measure effects so precisely in the kind of dynamic economy that we have today.

Representative BOLLING. What are the other factors involved in your opinion, in this effect, not in detail, but in general?

Mr. MARTIN. Well, let us take the Treasury-Federal accord as an example. There is a limit to a buying binge in the sense that you reach a point where people have pretty well become overinventoried and overstocked. There is a diminution of enthusiasm for storing up for shortages.

Then, there are subsidiary programs such as the impact of higher taxes, the increasing effectiveness of our selective credit controls, materials allocations, and our voluntary credit restraint program which came into effect about that time and attempted to postpone the financing of certain deferrable activities.

I claim for the Treasury-Federal Reserve accord only that it was the spark which ignited a lot of powder that had been accumulating around that period and, therefore, was one of the elements along with fiscal action, selective controls, and other measures, as well as the constant awareness and alertness of public psychology to the programs we were facing. It was one of the elements that contributed to resolving the difficulty that we were then in in the business expansion field without undermining the drive to make progress on necessary defense work.

Representative BOLLING. Mr. Martin, you probably are aware that I was not a member of the subcommittee which Senator Douglas chaired on monetary credit and fiscal policies. All other members of

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this committee were, and this may not be an appropriate question. If you do not wish to answer it, it is all right with me.

On page 2 of this report there is stated:

> It is the will of Congress that the primary power and responsibility for regulating the supply, availability, and cost of credit, in general, shall be vested in the duly constituted authority of the Federal Reserve System, and the Treasury actions relative to money, credit and transactions in the Federal debt shall be made consistent with the policies of the Federal Reserve.

Just as the words say, it appears to indicate that the policy of the Executive could be, in effect, if that were carried into execution, made subordinate to that of the Federal Reserve, and I would like to have your thinking on that particular recommendation.

Mr. MARTIN. Well, the difficulty I find in the recommendation is that I have never been able to resolve in my own mind the line between debt management and monetary and credit control policies. I do not think you should subordinate the Treasury to the Federal Reserve or the Federal to the Terasury.

I think that they have both got to be equals in approaching this problem from their respective responsibilities, one in debt management and the other in credit and monetary control; you have got to have a merging of the thinking with respect to both to achieve a worth-while result.

The nature of the problems that we are discussing here is not such that judgments on them can be precise. Their solution requires some experimentation, some probing, some accommodation of views. No one can be sufficiently arrogant intellectually to think that he can give an exact answer to any of them.

It reminds me a little bit of when I was working in the foreign field, and I had a fellow for 5 years that would come to me and say: "Well, now, we have the problem of the British-held sterling balances, and we are going to have a meeting on Friday afternoon and settle that."

We have been meeting on this problem now for 5 years, and it is still a problem that is going to continue to be with us for a long time. I think you can only make progress over time on a complex and difficult problem. I think we are making progress on our credit and monetary and debt management problems at the present time.

The Treasury and the Federal are working very hard today to accommodate the legitimate interests of both for the benefit of the people. Constructive public policy in the financial field is something that can come only from long, torturous, persistent, humble study.

Representative BOLLING. One other thing, Mr. Martin: The Secretary of the Treasury yesterday in his statement suggested an advisory council. I would like to have your comment on that.

Mr. MARTIN. No; I did not comment on that, but I have read the Secretary's statement. Knowing Secretary Snyder, I appreciate the spirit in which the suggestion is offered. It is one of desiring to get beforehand as much information, intelligence, and judgment as possible on very difficult problems. But I have to confess to some uneasiness as I subject the proposal to analysis. It is difficult enough, as it is, with the New York Federal Reserve Bank as the operator or agent for the Open Market Committee, and an open market committee of 12 men, and the Treasury with its staff, to sit down and resolve some of these problems.

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Now, we are always glad to have advice from anyone and everyone, but at some point the power of decision must be encountered and be effective. I take it that his proposal is for a nonstatutory body on a semi-informal basis, although it is not worded quite that way. I would call your attention to the fact that the Federal Reserve has a judicial function to perform. We have been called the supreme court of finance and I do not want to overstress that. But it is the judicial judgment of the Federal Reserve with respect to its particular province which warrants our independence, and which has been in the thinking of all foreign governments in modern economics and of our own Government from the beginning of the System's existence. To maintain this position of judicial judgment is the problem in political science of the relationship of the central bank to the Treasury.

I express my reservations about the advisory council quite respectfully because I know the spirit in which Secretary Snyder has presented this proposal. He has an honest desire to solve the problem. I would not want to see this council confined to just debt management and monetary and credit control. It ought to be quite considerably broader than that, and we ought to be very careful that the advisory function does not merge with the power of decision. Otherwise we will not be more effective in our operations but less effective, because it is difficult enough today to arrive at some of these decisions.

Representative BOLLING. Putting it another way, do you feel that in the present state of affairs in the present state of statutes, that it is possible that the problems which you and the Treasury confront, in effect together, to be solved without changes in statute, changes in relationship, changes in organization?

Mr. MARTIN. I do, sir.

Representative BOLLING. That is all.

Representative PATMAN. Senator Douglas?

Senator DOUGLAS. Mr. Martin, my first question, in a sense, will cover ground that Senator Flanders referred to. I merely want to bring it up in order that we may have a factual basis on which we may proceed.

When the Open Market Committee buys Government bonds, how are these bonds paid for?

Mr. MARTIN. They are paid for by a check, by deposit.

Senator DOUGLAS. You mean that the banks, the Federal Reserve banks, create credit——

Mr. MARTIN. That is right, sir.

Senator DOUGLAS (continuing). With which they buy Government bonds from private parties.

Mr. MARTIN. That is right, sir.

Senator DOUGLAS. What happens to these checks which the Federal draws from a created credit account? What happens to those checks?

Mr. MARTIN. They go into the reserve account.

Senator DOUGLAS. Yes; that is the second step. What is the first step? They are given to the holders of securities; is that true?

Mr. MARTIN. That is right.

Senator DOUGLAS. Then they are presented through member banks to the Federal Reserve System; is that not true?

Mr. MARTIN. That is right.

Senator DOUGLAS. When they are deposited in the Federal Reserve System, how are they set up as a credit?

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Mr. MARTIN. To the reserve account of the bank, of the depositing bank.

Senator DOUGLAS. Does this increase the lending capacity of the banks?

Mr. MARTIN. Under our present fractional reserve system by about a 6-to-1 ratio.

Senator DOUGLAS. The average reserve is——

Mr. MARTIN. Assuming they lend all the money, I think they can, on that basis.

Senator DOUGLAS. So that if the Federal Reserve buys a million dollars worth of bonds that will increase the maximum lending capacity of the members banks by $6,000,000?

Mr. MARTIN. Assuming that the demands for the credit are there.

Senator DOUGLAS. I know. But is the lending capacity available.

Mr. MARTIN. Yes.

Senator DOUGLAS. Now, do banks like to keep idle assets?

Mr. MARTIN. They do not.

Senator DOUGLAS. Therefore, if they have this lending capacity, does not this added lending capacity make them more ready to make loans than they otherwise would be?

Mr. MARTIN. In a period of active credit demand, no doubt about it.

Senator DOUGLAS. So that the purchase of Government bonds by the Federal Reserve System tends to lead to increased loans by member banks to private business; is that not true?

Mr. MARTIN. Correct.

Senator DOUGLAS. If there is not a commensurate increase in physical production, what then happens to the price level?

Mr. MARTIN. The price level tends to rise, sir.

Senator DOUGLAS. Therefore, the purchase of these bonds by the Federal Reserve System tends to have an inflationary effect?

Mr. MARTIN. There is no doubt of it.

Senator DOUGLAS. Yes.

Now, then, if you look back on the period after Korea, was the purchase of $4 billion, approximately, of securities by the Federal Reserve System disassociated from the increase in bank loans of approximately $10 billion in that same period?

Mr. MARTIN. It was not disassociated.

Senator DOUGLAS. But was it not a cause?

Mr. MARTIN. Not the only cause, sir.

Senator DOUGLAS. Well, was it not a partial cause?

Mr. MARTIN. It was a partial cause; yes, sir.

Senator DOUGLAS. That is, when the member banks had more reserves in the Federal Reserve System, that permitted them to make more loans, and they did make more loans.

Mr. MARTIN. That is right.

Senator DOUGLAS. And the ratio immediately was nearly three-to-one. Furthermore, did it not create excess reserves so that they had a margin upon which they could expand loans from April 1951 on?

Mr. MARTIN. No doubt about it.

Senator DOUGLAS. So that part of the increase in loans since April 1951 was due to the purchase of securities by the Reserve System prior to April 1951?

Mr. MARTIN. Part of it was, but part of that credit, we think, was needed to help readjust to a defense economy and to sustain the econ-

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omy. Since that time there has been no appreciable rise in the price level.

Senator DOUGLAS. But there was an increase in prices, of course, between June 30, 1950, and March 1951.

Mr. MARTIN. That is correct, sir.

Senator DOUGLAS. The increase in wholesale prices was approximately 17 percent. The increase in bank loans was approximately 19 percent. Do you think there was some connection between the increase of 19 percent in bank loans and the increase of 17 percent in wholesale prices?

Mr. MARTIN. I think there was some connection, but I would not say that was the only——

Senator DOUGLAS. The coincidence is very close; is it not?

Mr. MARTIN. You have to beware of statistical coincidences when you are interpreting a general economic development.

Senator DOUGLAS. I just wanted to point out that we started upon a basis of logic, and this logic led you to the conclusion that an increase in Federal Reserve purchases of bonds would lead to an increase in bank loans, and that this in turn would lead to an increase in prices.

Now, we turn from logic to history, and history seems to bear out logic, so that it is not merely a coincidence; it seems to be the working of a law in fact.

Mr. MARTIN. Well, there is nothing in my statement, Senator, that would contradict the general thesis that general monetary expansion has some influence on price developments; the contrary is, in fact, stated.

Senator DOUGLAS. But here is a case of a lack of monetary control being practiced by the Reserve.

Mr. MARTIN. Also the converse is true.

Senator DOUGLAS. A complete lack of monetary control, the complete flooding of the market with bank loans, with the result that prices go up. If you bring in the question of the velocity of the circulation of money, which I thought probably would be your next defense, I would like to counter and say that the increase in velocity and the increase of physical production approximately balanced each other, so if we use an equation of four terms and not merely two, we will find that the relationship still applies.

Mr. MARTIN. No; I was not going to counter with velocity because I find velocity very difficult to handle.

Senator DOUGLAS. Well, the increase of velocity and the increase of physical production were roughly 8 percent, and may offset each other, roughly. Allowing those to balance each other you have an increase of 19 percent in bank credit and an increase of 17 percent in wholesale prices and you have said that an increase in bank credit, other things being equal, results in an increase in wholesale prices, so why did not the increase in bank credit during this period cause the increase in prices?

Mr. MARTIN. Well, I think that is perhaps too facile a generalization.

Senator DOUGLAS. Well, I submit that it is an historical truth.

Now, before I ask the next question, I want to say that you are a very fine public servant and an extremely tactful man, Mr. Martin. I marvel at the way you tread on eggshells. I say this very sincerely.

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Now, do you think that the policy of the Federal Reserve in making these purchases during this time was completely voluntarily, was it a completely voluntary decision?

Mr. MARTIN. Senator, I am not going to make any comment on anything except from the time I went to the Reserve Board. I was a subordinate in the Treasury prior to that time.

Senator DOUGLAS. You were on the other side of the fence then.

Mr. MARTIN. I can say to you—well, I would not make any assertions one way or the other except that I have complete confidence in Secretary of the Treasury Snyder. I have never worked with a more open-minded, intelligent man who wants to do the right thing at all times. He has made mistakes, I have made plenty of mistakes. I would just like to——

Senator DOUGLAS. Mistakes can be very educational providing we recognize them so that they do not occur again, and that is my sole purpose in bringing out this history, both for clarification of the past and also possibly as a prophylactic against future aberrations.

Mr. MARTIN. Let me say unequivocally, since it has been put in this framework, that since I have been in the Federal Reserve there has been—I will not say a hundred percent agreement on everything that has been done—that would be going too far, but I would say there has been complete harmony of decision, and no dictation by the Treasury to the Federal Reserve.

Senator DOUGLAS. Now, then, you say you would only comment personally on what has happened since you left the Treasury and became Chairman of the Federal Reserve Board. Would you submit for the record the documents of protest drawn up (*a*) by the Open Market Committee, (*b*) by the Federal Reserve Board itself, which were submitted to the President and to the Secretary of the Treasury in the winter of 1950–51?

Mr. MARTIN. Well, I think that raises the question of public policy, whether the minutes of the Federal——

Senator DOUGLAS. These are not minutes. These are letters of protest or letters of statements of position of the Federal Reserve Board and the Open Market Committee.

Mr. MARTIN. I do not think that the records will add anything to the——

Senator DOUGLAS. May the committee be the judge of that?

Mr. MARTIN. I will be very glad to have the committee be the judge of that if they would take a look at it——

Senator DOUGLAS. Well, I am going to ask that the witness be requested to submit for the record and for the inspection of the press the documents which the Federal Reserve Board and its Open Market Committee prepared in the winter of 1950–51, so that the full record of those transactions may now be made available to the public.

Mr. MARTIN. Mr. Chairman, I would question a little bit the propriety of that as a matter of public policy. I would be perfectly willing to have you, Mr. Chairman, or your committee or anyone you designate, take a look at any records we have, and make a determination on what you want to do, but I think there is a very serious problem of public policy involved.

Representative PATMAN. You think it is a matter that should be passed on or considered in executive session if at all?

Mr. MARTIN. I would so state.

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Senator DOUGLAS. Mr. Chairman, I do not wish to argue this point at length. I want to point out that at pages 72 and 73 of the report, the Secretary of the Treasury accused the Chairman of the Federal Reserve Board, by implication, of bad faith on no less than three separate occasions during this period.

I would also like to point out that this was the period in which the Federal Reserve Board was purchasing large quantities of Government bonds with what seems to me to have been the clear effect of feeding inflation. Finally the Board decided it could not stand the policy any longer; it made protests and these protests ultimately led to the triumph of the Federal Reserve point of view. This is all a vital public matter. I do not know why it should be hidden from the public gaze.

I have always felt as you have stated, that popular support is needed for these measures, and in order to have popular support, popular understanding is necessary, as well; and I have never felt that the Federal Reserve System was a private institution which could keep its documents from public analysis.

Representative BOLLING. Mr. Chairman, if the Chair intends to rule on that at this time, I would like to be heard. If you intend to postpone it I would not.

Representative PATMAN. I would like to hear you, Mr. Bolling.

Representative BOLLING. I think involved in this is a very fundamental matter of public policy. I am not particularly aware of what the documents might contain, but it seems to me very clear that, particularly in the last few years, there has been a tendency on the part of Congress to infringe on the lower-level processes of decision-making in the executive branch, and I personally think it is a constitutional question, as well as a question of the advisability from a public policy point of view. I would feel very strongly that this should be approached deliberately, certainly with an initial examination on the part of the committee prior to making the full jump from privacy to publicity.

Senator DOUGLAS. May I reply to my good friend and colleague, Congressman Bolling, that I had always understood that the Federal Reserve prided itself on being the agency of the Congress rather than the agency of the executive, and that this has been affirmed again and again by the Federal Reserve System. Congress is not asking in this case to have executive papers turned over to it. I am making the request that our agent—and I hope this does not sound too tough—our creature—file with us vital papers affecting fundamental matters of public policy.

Representative BOLLING. The Senator would agree, however—excuse me.

Senator DOUGLAS. Yes.

Representative BOLLING. The Senator would agree, however, if this particular approach is taken that inevitably it will probably be at least apparent that the Treasury will be compelled to present its side of the question or the public will not be served on the basis of information.

Senator DOUGLAS. Well, I will make no such request upon the Treasury that they produce the papers; but I do think it is proper for the Federal Reserve to produce the papers. With regard to the

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three questions which I had asked Secretary Snyder yesterday, and which he did not wish to answer, I told the chairman privately, and I said publicly, I am perfectly willing to abide by his ruling without appealing from that ruling. But very grave charges were made by the Secretary of the Treasury against the previous Federal Reserve Board, and it seems to me that since the Federal Reserve System is the creature of the Congress, that it is quite proper for Congress to ask for the papers, and I renew my request.

Representative PATMAN. I wonder if it would be satisfactory—you are willing for the papers to be examined by members of this committee?

Senator DOUGLAS. No, I would like to have them made a part of the record so that——

Representative PATMAN. May I finish?

Senator DOUGLAS. I beg your pardon.

Representative PATMAN. I wonder if it would be possible for Senator Douglas and Mr. Bolling to examine the documents first, and after they have examined the documents and if they insist upon it, why, then we will decide the question.

Mr. MARTIN. Might I suggest, Mr. Chairman, that we might prepare a summary of the pertinent comments on this that your committee might take a look at and determine what they are. The problem of charges which the Senator raises is not going to be answered by anything in our records.

Representative PATMAN. Well, he will see that for himself when he sees the documents.

Senator DOUGLAS. May I say that I do not think that Congressman Bolling and I should examine the documents. If they are examined they should be examined by the committee as a whole, certainly not by two members of the same political party.

Representative PATMAN. Well, yes, you have an objection there.

Representative WOLCOTT. I will be glad to serve.

Senator DOUGLAS. I must again respectfully suggest that the Federal Reserve is the creature of Congress; that we are merely asking that our agent furnish us with information upon this matter. A knowledge of the past is vital for the decisions of the future.

Representative WOLCOTT. Senator, would you yield?

Representative PATMAN. Yes, Mr. Wolcott.

Representative WOLCOTT. I think all of us who have had a year of law recognize the distinction between a servant and an agent, and I notice that the Chairman of the Federal Reserve System recognizes that the Federal Reserve System is the servant of the Congres, and we are supposed to have a little more domination over a servant than we would have over an agent.

Mr. MARTIN. That is correct.

Representative PATMAN. Had you finished, Senator Wolcott?

Representative WOLCOTT. I thank you for the promotion.

Representative PATMAN. Senator Flanders wanted to be heard, and I wanted to make sure that you were through.

Representative WOLCOTT. I just wanted to say seriously that the Federal Reserve was set up as the agent of the Congress, which was given the constitutional obligation, and they operate as a statutory agent of the legislative body, which was given the constitutional obligation to coin money and regulate the value of it.

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Now, I think that this committee, and I think the Congress, in line with Senator Douglas' suggestion, has a right to determine any matter which involves its agent with respect to monetary policy, and I was going to suggest later in the day, perhaps, this is as good an opportunity as any—that perhaps for background we should have Mr. Eccles here. I notice that he is not on the list. Apparently he has not been invited to testify, and it probably was an oversight, but may I request now that Mr. Eccles be invited to appear?

Representative PATMAN. Certainly, and he will be invited.

Senator Douglas?

Senator DOUGLAS. May I suggest that Thomas B. McCabe, the former Chairman of the Federal Reserve Board, be invited also?

Representative PATMAN. He will be invited.

Had you finished, Mr. Wolcott?

Representative WOLCOTT. Yes.

Representative PATMAN. Senator Flanders?

Senator FLANDERS. On this question, I would agree that we are well within our responsibilities in asking for these documents. I think we would not be discharging our responsibilities if we asked to, if we required that they be made public without looking at them. We should look at them first and then we decide whether or not it is within the public interest to make them public.

Representative PATMAN. The committee is only a small committee and I think all five members can very well serve in examining the documents, and I wonder if you are willing to make them available to the whole committee in executive session, Mr. Martin.

Mr. MARTIN. I will make them available in executive session. I meant what I said about the open record.

Representative PATMAN. I wish you would elaborate on that statement, please.

Mr. MARTIN. I said I meant what I said in my statement about our records being open. Now I question very much the wisdom as a matter of public policy of making the minutes of the Federal Reserve System public, so that hereafter we would have to write all minutes in terms of a public document. I think that is poor public policy.

Representative PATMAN. Well, of course the committee can pass on the question of whether or not they should be made public, but I think under the law you are required to make a lot of information public, are you not, even the votes?

Mr. MARTIN. Our policy decisions in the open market committee are published annually and made available to you, Mr. Chairman.

Representative PATMAN. There are rather full and complete records there, are there not?

Mr. MARTIN. That is right.

Representative PATMAN. Even to how any particular member voted.

Mr. MARTIN. That is correct, on policy questions.

Representative PATMAN. Mr. Wolcott, would you like to ask some questions? Oh, excuse me, Senator, had you completed your questioning?

Senator DOUGLAS. I had not quite finished.

Suppose the Federal Reserve System were to become a branch of the Treasury, what effect on its credit policy would be likely in a period of full employment?

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Mr. MARTIN. You can't determine that, Senator, because it depends on the Secretary of the Treasury. The Secretary of the Treasury is just as interested as the Federal. I can certainly speak for the present Secretary in that he is just as interested in restraining inflation.

Senator DOUGLAS. Are not all the pressures in the direction of inflation, that is, the movement of costs and the movement of wages?

Mr. MARTIN. Pressures on inflation are very great always.

Senator DOUGLAS. And aren't there certain advantages in a period of full employment in having the banking mechanism of the country somewhat insulated from inflationary pressures? I am not asking for complete insulation, but somewhat insulated.

Mr. MARTIN. I think it is very desirable to have it.

Senator DOUGLAS. And a good deal of weather stripping, so to speak, might be very helpful in restraining inflation; isn't that true?

Mr. MARTIN. I think that is the concept of the founders of the Federal Reserve System, and on examining it carefully again in preparing for this committee, I think they showed real wisdom in setting it up the way they did.

Senator DOUGLAS. Would you favor having the Secretary of the Treasury a member of the Board of the Federal Reserve System?

Mr. MARTIN. That is a difficult question, Senator. I have flirted with the idea that we would have in the open market committee the active consultation with the Secretary of the Treasury which I think is essential to a satisfactory solution of common problems.

Now at the present time we have it. We have daily and almost persistent consultation, but there is no actual provision whereby the Secretary of the Treasury or the Board come together except by sufferance. Now a lot of the people in the System and a lot of the proponents of independence get terribly upset at the thought of having the Secretary of the Treasury on the Board as he was at the start, with the Comptroller of the Currency.

My feeling about it revolves around the question of the vote, the question as to whether the Secretary of the Treasury would be chairman of the open-market committee if he were a member of the committee and his office would be such that in the normal way you would expect him to be chairman; is he to be chairman with 1 vote against 12 votes, which in a sense puts the Secretary of the Treasury in a rather bad relationship to the committee? Nevertheless, we certainly wanted a voice and consultation in all of these problems.

Now, as the chairman of the open-market committee at the present time when we have a 3- or 4-hour session of the committee, I go back to the Secretary of the Treasury and try to tell him, when we have arrived at a point of decision, what the thinking of the committee is. I would really be very happy if I did not have to tell him what transpired but could actually have had him present during the time the discussion was going on.

Now, I realize the dangers of that. Senator Glass said that, with a strong man in the office of the Secretary of the Treasury, he would exert influence and therefore would distort the judicial process of an independent Federal Reserve System.

I don't get too excited about that argument. You will appreciate, I know, that I am discussing this with you very honestly and openly. I am not recommending that there be a change at the present time

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because there are a lot of very sincere people opposed to it, and I have talked to them from coast to coast. I have explored this idea with a great many people. Particularly under the present atmosphere you get the reaction that this is just a device to put the Secretary of the Treasury in control of the Federal Reserve Board.

Now, I think that public servants at some point have to stand up and be counted. If I am not strong enough to hold my own with the Secretary of the Treasury, then I am not entitled to the job I occupy. And if the legal position is such that the open-market committee has control, there is a very real question whether it would not be wise to have the Secretary of the Treasury a part of the deliberations.

I know pretty well the background of this suggestion, and I recognize the dangers of it also. I want to emphasize again that I am not recommending at the present time that it be adopted. But I think your committee could render a very worth-while service by sincerely studying that problem from all angles. We now have the New York bank, the Treasury, and the Board of Governors in a situation where constant, daily, persistent study of these questions is required, and yet it is all done on an informal basis.

Senator DOUGLAS. What would you say to the proposal advanced by some that the term of service of members of the Federal Reserve Board be reduced from 14 to 6 years?

Mr. MARTIN. Well, I would prefer that.

Senator DOUGLAS. You would prefer it?

Mr. MARTIN. I would prefer it; yes, sir.

Senator DOUGLAS. That would make the Board of course the much more under the control of the president.

Mr. MARTIN. I question that. I would like to see the term as we say in our answers here, reduced to 6 years with ability to take another term.

Senator DOUGLAS. With a seven-man board that would mean one man would be retiring each year so that the President in the course of 4 years would appoint the majority of the Board.

And furthermore, the prospect that a man would be coming up for reappointment shortly might make him more amenable than if he knew that he had a 14-year tenure. For instance, the 14-year tenure has applied to the New York Court of Appeals and has resulted in the court being almost completely independent. It is one of the finest courts in the country.

Now if they felt that they were coming up for renomination every 6 years, might that not make the members of the Board much more amenable to what the President wanted? Would it not tend to make the Board an executive agency rather than a congressional agency?

Mr. MARTIN. Well, I question that. I think that the type of man that we should have appointed to the Federal Reserve Board would be satisfied with a 6-year term, and I don't think he would change his approach.

Senator DOUGLAS. You believe the members of the Board would always be strong, vigorous characters who can stand out against executive pressure and therefore you need not provide them with any protection?

Mr. MARTIN. Well, I think the 6 years would be some protection, Senator. You make it 14 and you have a tendency sometimes for—very few people serve 14 years.

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Senator DOUGLAS. But the knowledge that they can serve 14 years gives the members a good deal of independence.

One final question. You speak of the equal status which you believe both the Federal Reserve and the Treasury should possess. What happens when you come to a question such as this: Should the market on Government bonds be supported at par? The Treasury insists that the market should be supported at par. You feel that it should not. Under those conditions what happens to equality of status? What happens to the blessed word "cooperation" about which we have heard so much?

Mr. MARTIN. There is nothing in the law which compels us to support bonds at the present time.

Senator DOUGLAS. That is true, but suppose the Treasury pushes you to do so and you do not wish to do so. Then what should happen?

Mr. MARTIN. You have got to have a meeting of the minds.

Senator DOUGLAS. That is highly desirable, but frequently in life that is not possible. Suppose what continues is a conflict of the minds, which is what prevailed as you well know for year after year after year prior to your coming to the Board.

Mr. MARTIN. Well, it would be——

Senator DOUGLAS. And the issue was settled almost every time until early 1951 by the Board yielding. Now when there is a conflict between the two, which should be prevalent?

Mr. MARTIN. I think that you have got to adjust a conflict between the two. For the Federal to take the law into its own hands and just automatically let a Treasury financing fail would, I think, be a mistake. It would be an irresponsible action.

Now let me explore that a little bit. The Open Market Committee developed, sort of grew like Topsy. The first committee was set up informally in 1923. The Banking Act of 1935 gave us our present set-up with participation by the presidents of the Reserve banks with the Board in an open-market committee. In 1937 with a lot of pressure on the market, the Federal, for the first time, supported Government security prices in the market on an orderly market basis.

Our relationship with the Treasury through the war period—and I am not going to say whether I think the war was financed the right way or the wrong way, but through the war period—resulted in the establishment of the peg. That kind of market operation continued until last March. Now today in pricing a new Treasury issue, the Federal is in the position of underwriter. During the period of the offering the Federal tries to see to it that the Treasury's issue is successful, because one of the primary purposes——

Senator DOUGLAS. And therefore it should support the market in order to make it successful?

Mr. MARTIN. It stabilizes the market just the way any underwriter does.

Senator DOUGLAS. I asked Secretary Snyder the question yesterday. This practice by private issuing houses would subject them to criminal penalty.

Representative PATMAN. He did not use the word "support." He used the word "stabilize."

Mr. MARTIN. So far as I know, I haven't checked on SEC regulations recently, but I believe they permit a stabilizing operation during

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a period of an offering. When the offering is over, the Federal is under no compulsion whatever to support the market. Its only responsibility to the public is that of maintaining an orderly market.

Senator DOUGLAS. The question of letting a Federal bond issue fail completely is not in the sphere of controversy. The issue is between a policy of rigid support which the Treasury forced the Federal Reserve to adopt up until March of 1951, versus a policy of flexible support which you have followed since then. Suppose the Treasury insists on rigid support, you still hold out for flexible support. Whose judgment should prevail?

Mr. MARTIN. All I can say at the moment is we would sit around the table and hammer it out.

Senator DOUGLAS. Well, suppose you still have a conflict of wills and time presses and you have to make a decision. You are up against the gun of time.

Mr. MARTIN. As I said earlier, Senator, I sincerely think that this is a problem that is not decided just in that way. I think that there has to be some give and take in it, and I don't think that an entirely one-way decision would resolve the problem.

Senator DOUGLAS. Well, I may point out that in the midst of this terrific struggle of last year when it was not certain whether the will of the Treasury or the will of the Federal Reserve prevailed, in company with Senators Flanders, Fulbright, Gillette, Tobey, and Thye, I introduced a resolution, Senate Joint Resolution 45, making effective the recommendation which our previous subcommittee on monetary policy had made, namely:

> That notwithstanding any other provisions, the primary power and responsibility for regulating the supply, availability, and cost of credit in general shall remain vested in the duly constituted authority of the Federal Reserve System and the policies and actions of the Secretary of the Treasury relative to money, credit, and transactions affecting the Federal debt shall be made consistent with the policies of such Federal Reserve authorities.

That was introduced on March 6, 1951. Now I do not wish to give too much credit to this resolution, but I have heard that it was very helpful to the Federal Reserve, enabling it to assert its independence and to reach an accord with the Treasury.

Mr. MARTIN. Well, I can't say anything on that, Senator, other than that the accord that was worked out was hammered out over a period of weeks of hard work.

Senator DOUGLAS. It sometimes helps, however, to have a little legislative protection, and I notice the Federal Reserve flies to Congress when it wants protection and then tries to push Congress off and disavow any relationship when it wants to follow its own course. That is human, I suppose, and you are most certainly human.

Mr. MARTIN. Well, as Mr. Wolcott says, we are the servant of Congress.

Senator DOUGLAS. Now two more questions and then I will be finished. Would you object to an audit of your books by the General Accounting Auditing Office?

Mr. MARTIN. Yes; I would.

Senator DOUGLAS. Why do you object to that? Every other governmental agency is audited by the General Accounting Auditing Office. You are the only agency so far as I know which audits itself.

Mr. MARTIN. Well, I think that budgetary control is an essential

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part of the independent judgment required for the operation that we are engaged in. I think that to preserve the public-private character of the Reserve System it is better for us to retain the auditing procedure in our own hands.

Senator DOUGLAS. Is it safe to have any group audit its own accounts?

Mr. MARTIN. Well, I think that you have got a point there, and I can say to you that we have had our auditing procedures reviewed by outside accountants.

Senator DOUGLAS. When was this?

Mr. MARTIN. Price, Waterhouse reviewed our auditing procedures a couple of years ago, and Arthur Anderson & Co. is going to audit us within the next few months.

Senator DOUGLAS. After this question was raised by Representative Patman.

Mr. MARTIN. After this question was raised by Congressman Patman. And I want to say, as we say in the answer to our question, that our auditing procedures and our budgetary procedures are laid out in the answers to these questions. We had been audited periodically by the auditors of the individual reserve banks coming in on rotation.

Senator DOUGLAS. And who names the presidents of the reserve banks?

Mr. MARTIN. They are named by the Board of Directors, subject to the approval of the Board of Governors.

Senator DOUGLAS. So that the auditors of the Federal Reserve banks whose presidents are selected by you have been coming in and auditing your books.

Mr. MARTIN. Well, I don't think that is the best procedure. I don't think, however, that there is the slightest indication that the audits were improper or unsatisfactory.

Senator DOUGLAS. I want to make the record clear that I am not charging that.

Mr. MARTIN. All right.

Senator DOUGLAS. But I do want to suggest this seems to be an extraordinary procedure. We have in Lindsay Warren, the Comptroller General, one of the great public servants of all time, incorruptible, experienced, fair-minded, able. Now what objection is there to having him audit your books?

Mr. MARTIN. Well, I think it would be better if we were audited by private auditors just on the independence thesis that you so ably espoused.

Senator DOUGLAS. You can't be a public institution at one time and then a private institution some other time. When you want public protection you are a public institution. When you want special privilege you are private institution.

Now you must be consistent on this matter. You cannot blow hot and cold in alternate sentences and in answer to divergent questions in the questionnaire.

Mr. MARTIN. Well, we are a hybrid institution.

Senator DOUGLAS. And therefore when it pleases you you are a private organization, and when it pleases you, you are a public organization.

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Mr. MARTIN. I think that is an oversimplification.

Senator DOUGLAS. That is all.

Representative PATMAN. Mr. Wolcott, it is nearly 12. I wonder if it would suit you to commence your questioning in the afternoon session.

Representative WOLCOTT. Perfectly all right.

Representative PATMAN. Will it be satisfactory for you to come back in the afternoon, Mr. Martin?

Mr. MARTIN. Whatever time you say, Mr. Chairman.

Representative PATMAN. Would 2:30 be all right?

Mr. MARTIN. 2:30 would be fine.

Representative PATMAN. The committee will stand recessed until 2:30 this afternoon.

(Whereupon, at 11:45 a. m., a recess was taken, to reconvene at 2:30 p. m. of the same day.)

(The confidential correspondence referred to during this session appears on pp. 942–966.)

AFTERNOON SESSION

Representative PATMAN. The committee will come to order.

Mr. Wolcott, you may proceed.

STATEMENT OF WILLIAM McC. MARTIN, JR.—Resumed

Representative WOLCOTT. Mr. Martin, in the Treasury's answer to the question, and yours also, I think, you cover this question of the accord agreement. The history leading up to it indicates that there was some disagreement between the Treasury and the Federal Reserve previous to that with respect to policy, and the accord you entered into was supposed to be a solution of those problems. Was that on a permanent or a temporary basis? I mean by that, the three or four major things which you agreed upon, were they to be in perpetuity or were they just temporary?

Mr. MARTIN. The answer to that, Mr. Wolcott, is that the original understanding on some of the items was to last through the end of the calendar year. Since the end of the calendar year we have continued to work just the same as if our agreement was in perpetuity. In order to answer you specifically I have to say that some of the points in the original accord expired on the 31st of this year, but they have since been renewed by implicit and explicit action.

Representative WOLCOTT. Well, in respect to discount rates—this is in answer to question No. 18 by the Secretary of the Treasury, and I quote from that answer:

> It is expected that during the remainder of the year—

which, I assume, would be 1951; is that right, 1951?

Mr. MARTIN. That is right.

Representative WOLCOTT (continuing):

> The Federal Reserve discount rate, in the absence of compelling circumstances not then foreseen, would remain at 1¾ percent and that the Federal Reserve would operate to assure a satisfactory volume of exchanges in the refunding of maturing Treasury issues.

Have you any agreement with the Treasury that that discount rate would be continued?

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Mr. MARTIN. No agreement with respect to that, sir. However, to allay any suspicion that may creep into speculators' minds, there is no intention at the moment of the Federal Reserve to change the rediscount rate.

Representative WOLCOTT. I guess that answers my next question as to whether you have given any consideration to the manipulation of the discount rate to prevent inflation.

Mr. MARTIN. I am sorry, I did not get that.

Representative WOLCOTT. I say, I guess that answers my next question, which would be whether you have given any consideration to the manipulation of the discount rate to prevent inflation.

Mr. MARTIN. Well, we are giving that consideration constantly because we now have the market, the play of the market, against which to gage things, and we are watching the lending trend very carefully, and working very closely with the Treasury to determine what the most appropriate steps are from here on out.

Representative WOLCOTT. I think we are in agreement that inflationary pressures are not quite as great as they were a few months ago?

Mr. MARTIN. That is right?

Representative WOLCOTT. Do you attribute that at all to the use of your indirect controls?

Mr. MARTIN. You mean to selective——

Representative WOLCOTT. No, not selective controls. Maybe we had better clear this up.

Mr. MARTIN. I see.

Representative WOLCOTT. The use of the orthodox controls which the Federal Reserve has traditionally had to stabilize our economy we refer to here in Congress as the indirect controls, that is, reserve requirements, rediscount rates, open market operation, and things of that character.

Mr. MARTIN. Yes, sir. I attribute a part of the slowing up of inflation to the unpegging of the market that occurred at the time of the accord. I do not attribute all of the lull to that, but a part of it.

Representative WOLCOTT. Could you attribute some of it, perhaps, to the fact that you had previously increased the rediscount rates from a low of 1 percent in three steps up to 1¾ percent?

Mr. MARTIN. Yes, sir; I would say that played a part. I would say that the increase in reserve requirements at the start of last year played a part.

Representative WOLCOTT. What influence did the issues of 2¾, 29-year bonds, which could not be monetized have? Did that have an influence on the market, on inflation?

Mr. MARTIN. Yes. I think that was a very successful operation that removed a large overhang in the long-term market.

Representative WOLCOTT. Do you think——

Mr. MARTIN. Pardon me, but I was just going to say that we succeeded in placing about 8 billion of those with investors, and an additional 5 billion were in the Federal Reserve portfolio, so you removed the direct overhang to the long-term market to the tune of about $13 billion.

Representative WOLCOTT. Do you think that the economy had a right to suppose that because you had done those things that the Government was going to firm up its monetary policy and that, perhaps,

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helped somewhat? In other words, that we were, perhaps, about at the peak of the inflation, as inflation was caused by cheap money policies, that the Government, perhaps, from then on might be expected to firm up our economy and use these indirect controls to stabilize the economy?

Mr. MARTIN. Yes, I do. I think that the mere effect of the Treasury and the Federal Reserve getting together on a program for a minimum monetization of the debt and for financing the Government's requirements, was one of the most salutary things that came out of the accord.

Representative WOLCOTT. If the application of a little of that would help, why would not a little larger dose do the major job? I do not mean necessarily by increasing discount rates alone; I mean the utilization of all of the indirect controls you have over the volume of credit—why can we not stabilize our economy through the use of indirect controls?

Mr. MARTIN. Because the country has a mobilization program, we have to make certain that a large amount of credit flows into defense output and also make certain that the financing of the whole program goes forward satisfactorily.

We are living in a time of considerable unrest and differing points of view among people, and I think——

Representative WOLCOTT. Would you think that inflation causes unrest?

Mr. MARTIN. Inflation is one of the factors in unrest, but at the moment there is no necessity for any further measures to restrain inflation. Inflation, I think, is asleep at the moment.

Representative WOLCOTT. In view of the fact that we are about to give consideration to a continuance of DPA, you might want to qualify that a little bit in the revision of your remarks. [Laughter.]

Mr. MARTIN. That does not mean that the pressures could not break out again at any time.

Representative WOLCOTT. Getting a little, perhaps, ridiculous, to bring out the point, what would happen if you raised the rediscount rate to 7 percent, with the usury rates in most of the States east of the Mississippi 7 or 8 percent?

Mr. MARTIN. It might have a considerable psychological impact, and there just would not be any sizeable amount of borrowing through discounts.

Representative WOLCOTT. What would happen if there were any borrowing?

Mr. MARTIN. There would not be many loans; there would be a reluctance on the part of banks to get reserves through the discount-rate process.

Representative WOLCOTT. The banks would not be loaning anything; the banks would not be loaning anything, would they?

Mr. MARTIN. Well, the banks, if they had reserves, would be lending.

Representative WOLCOTT. Yes.

Mr. MARTIN. Unless they needed additional reserves.

Representative WOLCOTT. But if you control the rate of interest through the manipulation of rediscount rates, you control the money market pretty much, do you not?

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Mr. MARTIN. No; we influence but do not control the market. We are the marginal buyer and seller in the market, but the market is determined by the interplay of the forces of supply and demand.

Representative WOLCOTT. Then, what effect has an increase in the rediscount rate on inflation?

Mr. MARTIN. It has the effect of making it more expensive to borrow when there is a need for the borrowing.

Representative WOLCOTT. So that, at least, is an indication of a firmer policy on the part of the Federal Reserve and, perhaps, the administration?

Mr. MARTIN. That is right; and in our judgment it is not necessary to have a firmer policy at the present time.

Representative WOLCOTT. Now, the President, in his economic message, asked for, in your behalf as I understand it, authority to increase reserves, and in reading your statement there is an implication, if you do not say so outright, that you do not want any further authority or you do not think it is necessary or advisable, something like that.

Mr. MARTIN. At the present time, we do not, Mr. Wolcott. I cannot see what an increase in reserve requirements would do at the present time except to put additional pressure on the Government securities market.

Representative WOLCOTT. How would you go about stabilizing under these conditions of credit inflation were you not compelled to give consideration to debt management?

Mr. MARTIN. Well, you would be compelled to give consideration to debt management.

Representative WOLCOTT. Just say that we have no debt, that is, the debt is not an influence, something that does not have to be considered, similar, perhaps, to the credit inflation of 1929. How would you go about preventing credit inflation?

Mr. MARTIN. When there is no debt at all?

Representative WOLCOTT. We will just assume that. You do not have to take into consideration debt management.

Mr. MARTIN. You would go about it in exactly the same way.

Representative WOLCOTT. What way?

Mr. MARTIN. You would increase the discount rate, reenforce it with restrictive open market operations, and see what the market forces would do to the supply and demand for money.

Representative WOLCOTT. It might raise the reserve requirements, might it not?

Mr. MARTIN. You might raise reserve requirements at that point, assuming statutory authority, and without any Government debt there would be no pressure on the Government securities market.

Representative WOLCOTT. You surely would not continue supporting the Government bond market under those circumstances?

Mr. MARTIN. That is right.

Representative WOLCOTT. Would you, perhaps, recommend to the Congress that they restore the gold reserve behind the Federal Reserve notes from 25 percent to the earlier 40 percent, and behind the deposit liability from 25 to 35 percent?

Mr. MARTIN. I would not see any necessity for that at the present——

Representative WOLCOTT. I am just assuming a condition which——

Mr. MARTIN. Oh, under those conditions?

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Representative WOLCOTT. Yes. What I am trying to find out when I get all through is what influence debt management has upon the powers which would ordinarily be exercised by the Federal Reserve to stabilize our economy. So you would use all of these methods, these indirect methods, would you not?

Mr. MARTIN. That is correct.

Representative WOLCOTT. And you probably would recommend to the Congress that they restore to the 40 and 35 percent, respectively, the reserve behind—the gold reserve behind—deposit liability and Federal Reserve notes.

Mr. MARTIN. Under your hypothesis I might request an increase in reserve requirements, but that would depend on a number of circumstances.

Representative WOLCOTT. Yes. You are not going to ask for a restoration of gold reserves of 40 percent?

Mr. MARTIN. No, sir.

Representative WOLCOTT. You are not going to ask for any increase in reserve requirements, Federal Reserve?

Mr. MARTIN. Not at this time, sir.

Representative WOLCOTT. Does that mean that because of the influence which debt management has on the value of the money that so long as we have a high national debt we must accept inflation as a matter of Government policy?

Mr. MARTIN. No, sir; because we have—we have succeeded in restraining inflation at the moment; we have a large debt. It means that it is essential——

Representative WOLCOTT. We have got inflation.

Mr. MARTIN. What is that?

Representative WOLCOTT. We have got inflation.

Mr. MARTIN. Well, we have had——

Representative WOLCOTT. The value of the dollar has been going down constantly, it has been going down 6 or 7 percent since Korea, and setting an all-time low now of 52.85. It was 59, was it not, at the time of Korea?

Mr. MARTIN. I don't have the figures on that—that is substantially correct. The purchasing power of the consumer's dollar has declined about 10 percent since Korea.

Representative WOLCOTT. What can be done, what can we do, to prevent any further drop? Must we accept as a matter of policy continuing inflation?

Mr. MARTIN. I see no reason to.

Representative WOLCOTT. What can we do about it?

Mr. MARTIN. Well, we have got to do everything we can to get our budget in balance.

Representative WOLCOTT. What is that? That is what we are here for.

Mr. MARTIN. We want to get our budget in balance as nearly as we can, and if we are running a deficit we want to finance that deficit out of the genuine savings of the people until such time as we can balance the budget at a later date.

Representative WOLCOTT. Well, the balancing of the budget is not alone a solution, is it? We balanced the budget last year, and when

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the dollar was depreciating 6 percent there must have been some other things that we have got to do besides balance the budget.

Mr. MARTIN. Would you repeat that, Mr. Wolcott?

Representative WOLCOTT. I said the balancing of the budget would not alone correct inflation, because we balanced the budget last year.

Mr. MARTIN. We have to pursue an active restrictive monetary policy; that is also indespensible.

Representative WOLCOTT. An active restrictive monetary policy?

Mr. MARTIN. A restrictive monetary policy; yes sir.

Representative WOLCOTT. What are you doing to restrict it now?

Mr. MARTIN. At the present time? Well, we have reduced our holdings of Government securities. Recently, by and large, monetary policy has been pretty neutral; the money stream has kept just about steady.

Representative WOLCOTT. It has not been restricted to the point where it has had any influence on inflation.

Mr. MARTIN. Well, I beg to differ with you there. It seems to me that our studies show that——

Representative WOLCOTT. How can you differ with me when the dollar has been depreciating in value constantly almost proportionately as we indulge in deficit financing?

Mr. MARTIN. May I ask Mr. Young to answer this question?

Representative WOLCOTT. Certainly.

Mr. YOUNG. The big increase in prices following Korea was in the 8 months immediately thereafter. Subsequent to that sensitive prices and wholesale prices receded somewhat and leveled off, and the rate of increase in consumer's prices also leveled off gradually. In February there was a decline in consumer prices and since December there has been a further decline in wholesale prices.

Representative WOLCOTT. Mr. Wilson tells us that we have got to continue price controls and we have got to continue these other controls because of the impact which defense spending is going to have upon the value of our currency sometime in the future. He has been telling that to us since the middle of last year when, I think, he said that we were going to meet the impact in the summer sometime, and then we were going to meet it in October, and then we were going to meet it in January, and then we were going to meet it sometime this spring, sometime this summer, and I think his last statement is that we are probably going to meet it sometime in October, 1952; so the only reason why we have got to continue these direct controls is because of the possibility that some time in the future deficit financing, due to our defense effort, is going to make prices higher.

Mr. MARTIN. That is substantially correct, Mr. Wolcott.

Representative WOLCOTT. Then, can we assume that the use of the indirect controls that you have has caused this leveling-off process?

Mr. MARTIN. One of the important factors in causing the leveling-off process; yes, sir.

Representative WOLCOTT. Were it not for debt management—getting back to that hypothesis, were it not for debt management, would you recommend that we continue or not continue the practice of inflating the debt against the Federal Reserve notes, or would you think we might safely go back to the law in the thirties when we had to put up commercial paper in addition to those?

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Mr. MARTIN. In postwar years, there has been quite a increase in bank holdings of commercial paper, but I should not think that it would be ——

Representative WOLCOTT. We did not have then, and——

Mr. MARTIN. But we had a large volume of excess reserves in the banks during most of the thirties.

Representative WOLCOTT. As I understand the original purpose of the Federal Reserve System it was to provide a flexible currency to meet the demands of business, from time to time. You could put it out or you could contract it, and there was an affiliation between the amount of commercial paper which you had and the volume of money which you issued, and that was the original intention, was it not?

Mr. MARTIN. Yes. That was the way they thought it would work.

Representative WOLCOTT. The volume of the needs of business for cash would be determined by the amount of commercial paper; that was the guide, was it not?

Mr. MARTIN. Yes, I would say that that is what they thought. The original Federal Reserve Act was to correct an inelastic currency, and to mobilize bank reserves.

Representative WOLCOTT. Now, to lick a depression in the thirties we abandoned that idea, did we not? We substituted debt for commercial paper?

Mr. MARTIN. That is correct. To lick depression and create excess the Federal Reserve bought securities in the open market and also lowered discount rates.

Representative WOLCOTT. And we so wedded our debt to the value of our currency in the abandonment of the idea that the Federal Reserve which was set up to meet the business demand with respect to money, that the value of our currency is dependent largely or is influenced largely by the debt.

Mr. MARTIN. That happened during the war. One of our principal problems today is the value of public debt; that is right.

Representative WOLCOTT. Have we got to continue to have our currency depreciate proportionately as our debt goes up, or is there not some way that we can correct that situation and remove that influence? Otherwise, it seems to me, we are sunk. We will have deficits this year ranging anywhere from 10 to 14 billion; we will have them next year from 14 to 20 billion, perhaps. We are entering another deficit financing era which we are told might be carried on for 10 years.

If the value of the dollar has shrunk 6 percent in the last 18 months, it might shrink 12 percent in the next 3 years, and we will then have a 40-cent dollar.

Now, it seems to me that this committee, and you and the Treasury, with all the help we can get, ought to find a solution to it. It is not too simple, but does it not occur to you that we might have some studies looking to the discovery of a method of sterilization of some part of the debt, bank-held debt, and some part of gold, above which gold and the bank-held Government debt could not be monetized, and thereby remove the pressure, the influence, which deficit financing has on the value of the money?

Mr. MARTIN. The important thing is to eliminate the deficit. I think we should have such studies, and I will be glad to have a paper prepared for you on how we can go about it.

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Representative WOLCOTT. I wish you would, because for a couple of years I have had this hare-brained idea in my head that somehow, sometime or other, we were going to find a solution to that problem, and when we found a solution to that problem we probably could stabilize our curency and stabilize our economy. Frankly, I cannot take very seriously the use of direct controls until that basic reason for inflation is solved. It has been said here, and I think we all agree, that when you put on direct price controls or direct consumer credit controls you almost automatically put into operation the machinery for the creation of just enough more credit to offset all the deflationary influences that accompany the application of direct price controls and consumer credit controls.

If I may use an example of what I mean—this is my own opinion and I do not ask you to agree with me on it, but I wish you would have it in mind in preparing this paper—to me the selective application of consumer credit controls has no more influence upon inflation than to rest your hand lightly upon a child's toy balloon with the expectation that you were going to prevent its inflation. You have got to cut the air off at the source. Now, the source, to me, is the Federal Reserve System.

Mr. MARTIN. Well, I will give you a paper on that. I agree that selective controls, like consumer credit controls, are supplementary to restrictive discounts and open-market operations and not a substitute for them.

(Supplementary statement by Mr. Martin follows:)

RESERVE BANK RESERVE REQUIREMENTS AND FEDERAL RESERVE CREDIT

The Federal Reserve Act as amended in 1945 requires that each Federal Reserve bank hold reserves in gold certificates equal to 25 percent against its Federal Reserve notes in circulation and against its deposits. In the case of Federal Reserve notes, the law also requires that each Reserve bank shall pledge with the Federal Reserve agent of its district collateral equal to 100 percent of the amount of such notes in circulation. Such collateral may consist of gold certificates; paper originating in commerce, agriculture, and industry—that is, so-called eligible paper—or direct obligations of the United States Government.

Prior to 1945 the required reserve percentages were 40 percent of gold certificate reserves against Federal Reserve notes and 35 percent of gold certificates or lawful money against deposits. The main reason for the lowering was that the gold reserve ratio had fallen significantly during World War II as a result particularly of the very large expansion of Federal Reserve notes in circulation because of wartime demands for currency. This increased volume of money has remained in circulation since the war.

The use of Government securities as collateral for Federal Reserve notes was authorized on a temporary basis by the Glass-Steagall Act of 1932 and was periodically renewed, and the authority was made permanent in 1945. This provision was necessitated by the large-scale withdrawal of currency from bank deposits in the early years of the depression, by the then reduced volume of eligible private paper in Reserve bank portfolios, and by the desirability of Federal Reserve purchases of Government securities in order to prevent the development of tight money conditions during the depression.

It would appear undesirable at this time to change either the legal reserve requirement regarding gold certificates or the legal collateral requirement regarding United States Government security holdings of the Federal Reserve banks. The legal provision permitting the Reserve banks to use Government securities as collateral for notes is necessary under present conditions, since the volume of commercial, agricultural, and industrial paper now held by these banks would be inadequate for the purpose. Also, the provisions of law regarding the reserve requirements of the Reserve banks are important in enabling flexibility in monetary management to meet changing conditions.

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These legal provisions are not inflationary per se. Federal Reserve credit is not created just because the basis for such creation is available. It is the duty of the Federal Reserve System to see that Reserve bank credit is adjusted to the needs of the economy. Changes in the volume of such credit outstanding are now determined mainly by actions of the Federal Reserve System in accommodating the credit needs of consumers, commerce, agriculture, industry, and State and local governments, as well as the Federal Government. Such actions are taken only after a careful review of the economic and financial situation in the country at the time and after a full consideration of their inflationary and deflationary implications.

An automatic check on the expansion of Federal Reserve bank credit, such as would be imposed by an increase in the ratio of gold certificates required against Federal Reserve notes and deposits, would not be desirable. It was in part to prevent arbitrary and mechanical limitations on the volume of bank credit and money, resulting from too rigid a relationship between the credit and money supply and gold, that the Federal Reserve System was initially established.

Representative WOLCOTT. I think that would be in keeping with the original purpose of the Federal Reserve Act; and you commented on the original purpose when, on page 212 of volume I in your answers, you quote the then chairman of the Committee on Banking and Currency, whom I assume to be Senator Glass, as follows:

> Senate bill 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.

That, I think, very briefly sets out the reasons why the Congress set up a Federal Reserve System.

Then, you recognize that in your annual report for 1923, in which you say the problem "in good administration under the Federal Reserve System is not only that of limiting the field of uses of Federal Reserve credit to productive purposes but also of limiting the volume of credit within the field of its appropriate uses to such amount as may be economically justified; that is, justified by commensurate increase in the Nation's aggregate productivity"—that is what you say on page 212.

Representative PATMAN. Mr. Wolcott, will you yield for what I believe to be a correction?

Representative WOLCOTT. Yes.

Representative PATMAN. It says here the report to the Senate in 1913. I believe that Senator Robert Owen was chairman of the Senate Banking and Currency Committee at that time.

Representative WOLCOTT. I was not sure; I think, perhaps you are right.

Representative PATMAN. And Senator Glass was then the chairman of the House Committee on Banking and Currency.

Representative WOLCOTT. That is right. This would be Senator Robert Owen.

Representative PATMAN. That is right.

Representative WOLCOTT. I did not want to take any credit from Senator Owen with respect to the co-sponsorship of the Federal Reserve Act.

Then, again in the 1945 bank report which you quoted, you said:

> 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

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policy permit, to an economic environment favorable to the highest possible degree of sustained production and employment. Traditionally this over-all policy has been followed by easing credit conditions when deflationary factors prevailed and, conversely, by restrictive measures when inflationary forces threatened.

Now, it seems to me that if you had the independent status that we intended you should have when Congress set up the act, if you were allowed to exercise it, if you were allowed to do the job that we set you up to do, not to manage the debt, that is, but to stabilize our economy—recognized as recently as 1945 as your purpose and objective—the Federal Reserve, with the powers it now has, could have prevented this inflation. It can likewise prevent further inflation, and I think that we in this committee have got to determine what deficiencies there are in the act, but we have not run onto any so far.

You say you do not need any statutory authority to raise reserve requirements. They have been as high as 7 percent, have they not, under existing law?

Mr. MARTIN. The reserve requirements?

Representative WOLCOTT. I mean the rediscount rate, pardon me. Were they not as high as and up to 7 percent in 1929 when the Board belatedly approved the applications of the banks for an increase in rediscount rates?

Mr. MARTIN. It was up that high during part of 1920 and 1921; the rate reached 6 percent in the fall of 1929.

Representative WOLCOTT. It was up to 6 percent?

Mr. MARTIN. That is right.

Representative WOLCOTT. Now, the Board can initiate those increases, can they not?

Mr. MARTIN. That is right, but the initiative ordinarily is taken by a Federal Reserve bank.

Representative WOLCOTT. So this situation is similar but somewhat different from that which confronted us in the credit inflation of 1929. At that time the Board had to wait for action to be taken initially by the Federal Reserve banks, did they not? Now, the Board itself can initiate changes in rediscount rates. Once they were as high as 7 percent; since then we have inflated the currency, pumped more blood into the economic stream, as much as we can get into the veins of the body meanwhile putting rediscount rates down to an all-time low of 1 percent.

Now, it seems to me that if we could find the golden mean between those two extremes with, perhaps, the utilization of a few of your other powers that we could stabilize and still carry the debt. I remember on the administration level shortly after World War II we were told that it should be our objective to stabilize at about an 80-cent dollar, and if we did we could carry the debt and do all the other things we had to do. At the same time we encouraged production to get productivity and stability. I still think that we can do that if we recognize that the real cause of inflation is that we have wedded our debt to our money so closely that increases in the debt, which are going to be inevitable for the next 8 or 10 years, are going to be reflected in proportionate decreases in the value of our currency. If we find that answer, then I think the Federal Reserve Board can come in here and recommend what it has to have in the way of legislation. If you have to have more authority to raise reserves, and you come in and make a case out for it, I do not think they are going to quibble too much

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about that. You do not now need any statutory authority to raise the rediscount rates. You do not now need any more statutory authority in respect to open-market operations, or do you?

Mr. MARTIN. No, sir.

Representative WOLCOTT. I am sure that the Congress—the House, at least, next year—would be willing to restore the gold reserve requirements to where they were before we reduced them to lick the depression; it was done in the Eightieth Congress. The Eightieth Congress—there is nothing political in this at all—I am just taking pride in the fact that in the Eightieth Congress we had 2 years of balanced budgets, and took the initiative in stabilizing our economy. I think if the Senate had to do it over again they would have considered the bills which were passed by the House in keeping with our policy, and not have been so susceptible to administration pressures that inflation be continued for political expediency beyond the time when it was necessary to help finance the war.

That is our problem. How are we going to find out what the Federal Reserve Board is going to do from now to prevent further depreciation in the value of the dollar short of divorcing debt from money?

Mr. MARTIN. The Board is going to devote its best efforts to prevent the depreciation of the dollar.

Representative WOLCOTT. That is a good answer. That is the best that I know of that you can give under the circumstances; but it is not the answer that I think you would give if you were at liberty to manipulate or to utilize these indirect controls, as I think you would, were it not for the influence which the administration, concerned with debt management, brings to you in respect to policy. That is why I started out to ask you about this accord.

There is nothing permanent about it; you can change it, you are not bound by it. You can state to the Treasury, "Here now, from now on we are going out and stabilize this economy."

Mr. MARTIN. Well, we have got to have fiscal policy, debt management, and monetary policy working closely together to achieve that stabilization you are seeking.

Representative WOLCOTT. You have it under this present situation, yes; but you would not have it, that is, it would not have the same degree of influence if you divorced your debt from your money.

Do you know what the discount rate from the Bank of England is?

Mr. MARTIN. It is, I think——

Representative WOLCOTT. I know what it was yesterday. What is it now?

Mr. MARTIN. Two and a half to four—4 percent. It was raised today to 4 percent.

Representative WOLCOTT. Raised today, was it?

Mr. MARTIN. Yes, sir.

Representative WOLCOTT. To 4 percent?

Mr. MARTIN. Yes.

Representative WOLCOTT. That compares with our 1¾.

I think I have taken all the time that I should, Mr. Chairman.

Representative PATMAN. Mr. Martin, in your testimony are you expressing your own views or the views of the Federal Reserve Board?

Mr. MARTIN. In the testimony I have handed you, Mr. Chairman, I am expressing views that are concurred in by the Board of Governors?

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Representative PATMAN. By the Board of Governors?

Mr. MARTIN. That is correct.

Representative PATMAN. Mention was made this morning about commercial banks selling Government bonds to the Federal Reserve Banks through the Open Market Committee, I assume, and thereby accumulating reserves that can be expanded six times which is, of course, inflationary, highly inflationary.

Do you know of any remedy that could be enacted by the Congress that would permit you to support the Government bond market and the bonds at a hundred percent and, at the same time, prevent commercial banks from having that privilege of adding to their reserves?

Mr. MARTIN. Well, I presume the banks could be compelled to hold Government securities.

Representative PATMAN. That is what I am talking about.

Mr. MARTIN. I see.

Representative PATMAN. In other words, freeze them in the banks for that purpose.

Mr. MARTIN. That could be done; I think it would be most unwise.

Representative PATMAN. Of course, it is a drastic remedy, but any control is a drastic remedy, whether it is a direct or indirect control or anything else, it is a drastic remedy to be resorted to only in case of emergency, but it could be done that way could it not, Mr. Martin?

Mr. MARTIN. It could be done; yes, sir. We could also order banks to stop lending.

Representative PATMAN. You could do most anything in that direction to stop the inflationary trend that Senator Douglas has talked about?

Mr. MARTIN. That is right.

Representative PATMAN. Or the effects caused from it.

I want to ask you about the voluntary restraints, the voluntary credit restraint program. I believe the official name of it is the voluntary credit restraint program. The Federal Reserve Board is represented on that committee.

Mr. MARTIN. That is right, sir.

Representative PATMAN. I believe Mr. Powell, a member of your organization, is on the Board, and is head of the committee?

Mr. MARTIN. That is correct, sir.

Representative PATMAN. I notice that the other members of that committee are representatives of commercial banks and insurance companies and investment bankers; they are the people who are involved in this. Does it occur to you that the Government should be better represented on that Board? I do not mean to say that Governor Powell would not represent the Government interest and the people's interest, but it seems to be pretty dominantly composed of people who are selfishly interested.

Mr. MARTIN. Well, those are the people who would be selfishly interested in undertaking the lending or the underwriting. They are sacrificing profits by foregoing their financing opportunities.

Representative PATMAN. It is up to them. You think that is a good policy to pursue?

Mr. MARTIN. I think that the voluntary credit restraint program has succeeded in organizing the managerial resources of the banking and business community to look for the longer-range profit instead of the shorter-range profit.

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Representative PATMAN. You would not recommend that other people connected with the Government be on that Board?

Mr. MARTIN. No, sir; I do not think it would work as a voluntary program in that way. I would be very much interested to have Governor Powell answer that question also when he testifies before your committee.

Representative PATMAN. Taking your reasoning, would that not apply to regulation W? Why not give the people a voluntary restraint credit program?

Mr. MARTIN. We have endeavored to consult regularly with the trade on regulation W.

Representative PATMAN. I know, but you are not just consulting here; you are giving them—you make it voluntary. They are doing it themselves. Why do you not let the people affected by regulation W do the same thing?

Mr. MARTIN. Well, think of how many people there are affected by regulation W.

Representative PATMAN. The number is not the important thing; it is the principle involved.

Mr. MARTIN. How would you devise the administrative procedure other than consulting with the trade groups?

Representative PATMAN. Well, they have trade groups, all of them, I know.

Mr. MARTIN. We try to consult with all of them on regulation W. While I am not particularly keen on regulations W and X, I consider them necessary at a time like this, because we have got to use all the weapons in our arsenal to restrain inflation. The reason I am not more sympathetic with them is that they impinge on so many individuals and so many businesses, and intervene in so much of the life of the people.

Representative PATMAN. The ones affected by Regulation W have another selfish interest, too. It would have the tendency to restrain the abuse of credit; that is, they want to get their money back when they sell their goods. They do not want to give such terms so that payments will be unlikely, and they want to demand a substantial amount in cash. They wish a substantial amount in cash or its equivalent.

Mr. MARTIN. That is right. So our interest in regulation W is in the over-all money supply and not in the trade practice aspect of it.

Representative PATMAN. It is just an interest in the over-all money supply? Well, is not your interest in the voluntary restraint committee, too, in the over-all money supply?

Mr. MARTIN. In the over-all supply of credit, plus a desire to see some of the demand for financing postponed until a later time when that demand may be needed considerably more. For instance, take a museum, or something like that. Some people may seek to finance such items under present high employment conditions. They could be financed much better a few years from now when we have less employment and less need for conserving our resources than we have at the moment.

Representative PATMAN. How much has the credit increased under regulation W in the past calendar year?

Mr. MARTIN. Have you got that figure now?

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Mr. YOUNG. About $50 million, I believe.

Mr. MARTIN. About $50 million.

Representative PATMAN. How much has it increased in credit through the banks and insurance companies and investment bankers, all of them, that are involved in the restraint committee program?

Mr. MARTIN. Do you mean, how much has been deferred as a result of that——

Representative PATMAN. No, not as a result, but how much has happened anyway? Now, this $50 million, that increase happened notwithstanding the controls and what has happened with the other—give me a comparable figure. Have the banks increased many billions of dollars in the past year?

Mr. MARTIN. A large part of that is for defense work. That is true, but a large part of it is for defense.

Representative PATMAN. Well, part of this $50 million would be for defense work, too. You know, they have to have automobiles to travel back and forth.

Mr. MARTIN. About $4.1 billion, Mr. Chairman.

Representative PATMAN. You mean the commercial banks?

Mr. MARTIN. Commercial banks; that is right, sir.

Mr. YOUNG. Business loans of commercial banks.

Representative PATMAN. Business loans? What other loans? Would there not be any increase——

Mr. YOUNG. Real estate loans $1 billion.

Representative PATMAN. $1 billion?

Mr. YOUNG. All other about $800 million.

Representative PATMAN. About $7 billion?

Mr. YOUNG. For total loans of commercial banks; that is correct.

Representative PATMAN. Now, you are giving some people a lot of power here who are not connected with the Government; they are not directly responsible to the people or to anybody elected by the people and you are giving them the right to say who will get credit and who will not get credit. Do you not think somebody who is more directly connected with the Government should be on that Board in view of those circumstances and the facts?

Mr. MARTIN. We have a Federal Reserve representative at each meeting, Mr. Chairman.

Representative PATMAN. Well, of course, that is a little bit—I do not know at these meetings—if there is a conflict of interest between the banks and the Government, which side would the Federal Reserve Board representative take?

Mr. MARTIN. The Federal Reserve representative would naturally take what he conceives to be the interest of the defense program and the Government.

Representative PATMAN. In a case of conflict of interest where it was just a question of deciding which side he would take, the one that he would take would be on the side of national defense, if there is a defense issue.

Mr. MARTIN. That is right; and it is very difficult to determine whether some of these are defense or not.

Representative PATMAN. That is right; unless you know the facts in any particular case.

Mr. MARTIN. That is correct.

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Representative PATMAN. And I thoroughly agree with you. Now, on regulation X, why could you not administer it the same way through a volntary committee, just like the voluntary restraint committee here, rather than have the compulsory process that you have?

Mr. MARTIN. Mr. Young tells me there has been a supplementary voluntary program in connection with real estate credit.

Representative PATMAN. Supplementary program? It is not set up by law, is it?

Mr. YOUNG. It is under the voluntary credit restraint program.

Representative PATMAN. I see. It is under the Defense Production Act?

Mr. YOUNG. To deal with certain areas not covered by regulation X.

Representative PATMAN. You could set it up for regulation W that way, could you not?

Mr. YOUNG. The lenders subject to regulation W have considered themselves and been considered by the voluntary credit restraint program, as outside of that program since they were otherwise covered. There were discussions with the sales finance industry, I believe, at one time as to whether or not they cared to come into the volunteer credit restraint program, and they thought that they would prefer to remain out, although they circulated among lenders copies of the voluntary credit restraint program statements of principles.

Representative PATMAN. That does not sound like what I have been hearing. Do you mean to say that they were given an opportunity of joining in on a voluntary basis?

Mr. YOUNG. Not as a substitute for regulation W.

Representative PATMAN. Oh, you are going to have regulation W, too? Well, I do not blame them; I would not want a double-barreled thing.

Mr. YOUNG. To give them a chance to——

Representative PATMAN. But they were not offered the same opportunity that the bankers were offered?

Mr. YOUNG. They were not offered the same opportunity, but the consumer installment credit field has special features.

Representative PATMAN. Well, would you be willing to offer them that opportunity?

Mr. MARTIN. I would have to study it considerably more, Mr. Chairman.

Representative PATMAN. How many people do you have trying to enforce regulation W, I mean in the way of policing it?

Mr. MARTIN. I would say not over 150 for the whole country.

Representative PATMAN. I get complaints that they are going to people's homes and calling people out, interrogating them, about buying something on the installment plan.

Mr. MARTIN. Well, we have had——

Representaitve PATMAN. Do you have people doing that?

Mr. MARTIN. We have had lots of complaints of that. We have tried to minimize that type of enforcement. I think they are exaggerated, but it is not a happy lot to be the policeman at anything these days.

Representative PATMAN. I know, but it is rather ironical that you should chase somebody down to their own home and call them out to ask them about a wheelbarrow that they bought on the installment plan. You let the bankers have a credit of millions of dollars a year without restraint.

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Mr. MARTIN. The banks as well as all other lenders are subject to regulation W and regulation X. I know of only one case where someone has complained because he was questioned at his home. Naturally, we have been doing our best to enforce the regulations. I do not like any better than you do having Federal Reserve people going to people's homes.

Representative PATMAN. Do you not think we could well afford to do without regulation W for the next year on a trial run basis?

Mr. MARTIN. Unless we get more flexibility than we now have with it, I question how much serviceability there is in it.

Representative PATMAN. You mean a shorter term in which to pay than 18 months on automobiles and trucks?

Mr. MARTIN. No. I mean the flexibility for us to tighten it if we felt that conditions warranted it. At the moment we would not make any material change in the regulation if we had full authority.

Representative PATMAN. But you would like to have the power so that in the event you needed it, you would have it there?

Mr. MARTIN. That is correct.

Representative PATMAN. On fighting inflation, I guess the best way on earth is to induce people to invest in E bonds or to keep their savings intact and not spend them; is that right?

Mr. MARTIN. That would be very desirable.

Representative PATMAN. That is the best way.

Well, what is the amount of the demand deposits in commercial banks now, do you know, approximately?

Mr. MARTIN. About a hundred billion.

Representative PATMAN. If there is some way of inducing the people not to give checks on their deposits and to keep them intact, it would be a very constructive move to fight inflation, would it not?

Mr. MARTIN. It would.

Representative PATMAN. What do you think about restoring the privilege we have taken away from the commercial banks of paying interest on demand deposits. You know, that was a rather arbitrary action on the part of Congress but it was done a few years ago.

Suppose Congress were to restore that privilege of letting banks pay interest on demand deposits, and they were to commence paying interest, would that not have a tendency to retard inflation?

Mr. MARTIN. If they retained the deposits, yes.

Representative PATMAN. Well, do you think it would be an inducement? Do you not think it would be an inducement if they got paid for it?

Mr. MARTIN. It would be some inducement; yes, sir.

Representative PATMAN. According to the amount they were paid.

Mr. MARTIN. It would be progressively more of an inducement the more they were paid.

Representative PATMAN. Well, this E bond campaign is a good thing, and they pay a pretty small rate, and that keeps a lot of the savings from going into the channels of trade and distribution, does it not?

Mr. MARTIN. It does.

Representative PATMAN. This would work in the same way, except that it would be on their actual deposits.

Would you recommend any change in that law, Mr. Martin?

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Mr. MARTIN. Not without considerably more study than I have been able to give it up to this moment, Mr. Chairman.
Representative PATMAN. You would want to study this some more?
Mr. MARTIN. I would want to study it some more.
Representative PATMAN. But you admit it would be a fine weapon to fight inflation?
Mr. MARTIN. It would be a weapon to fight inflation.
Representative PATMAN. Well, its usefulness would depend on the amount that the banks would pay, would it not?
Mr. MARTIN. That is correct, but it would also introduce a major new factor in the money market.
Representative PATMAN. And the ability of the banks to pay a sufficient amount, to make it sufficiently attractive, to induce people to keep their deposits there and not spend them.
Mr. MARTIN. They can shift their demand deposits now into time deposits or over into savings banks.
Representative PATMAN. They get nearly as much there as they do on the E bonds.
Mr. MARTIN. That is correct.
Representative PATMAN. But that requires a change.
Was that law to make it unlawful for banks to pay interest on demand deposits, was that considered as permanent legislation at the time it passed? I do not recall just the debate in question.
Mr. MARTIN. I am afraid I do not know, Mr. Chairman.
Mr. YOUNG. I am not familiar with that, Mr. Chairman.
Representative PATMAN. My recollection is rather indistinct, but I thought——
Mr. YOUNG. It was an amendment to the act.
Representative PATMAN. But I believe it was more of a temporary device.
Mr. YOUNG. I believe not, sir.
Representative PATMAN. I think it was passed in 1935.
Mr. YOUNG. It was in the Banking Act of 1935 for insured banks and in the Banking Act of 1933 for member banks.
Representative PATMAN. And the best of my recollection is that there was not a great deal of discussion about it on either floor, and was it not put in in conference?
Mr. YOUNG. I think the feeling about it, Mr. Chairman, was that the practice of paying interest on demand deposits had been a factor in the twenties operating to result in the deterioration of the quality of our banking.
Representative PATMAN. I recall that, sir.
Mr. YOUNG. It got rather competitive in that period.
Representative PATMAN. That was a persuasive argument.
Mr. YOUNG. And it was a factor in the crisis of 1930 to 1933.
Representative PATMAN. Would that argument be equally persuasive now in view of the fact that deposits are insured up to $10,000?
Mr. YOUNG. It is not so persuasive now, but it would have to be given careful consideration.
Representative PATMAN. Anyway, you are not recommending it and you are not deciding against it? You are going to consider it?
Mr. MARTIN. Yes.

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Representative PATMAN. The Federal Reserve bank earnings now are practically all from Government bonds, Government securities, are they not, Mr. Martin?

Mr. MARTIN. That is correct, sir.

Representative PATMAN. It was contemplated in the original act that a certain amount would be paid to the Treasury over and above expenses; I believe they call it a franchise tax, do they not?

Mr. MARTIN. That is right, sir.

Representative PATMAN. And 90 percent—and then the law was amended two or three time; first it said after a surplus of a certain amount had been accumulated, then it was amended again to increase the amount of the surplus, but finally the banks commenced to pay into the Treasury 90 percent. When was the law changed to repeal that provision?

Mr. MARTIN. The law was never actually changed, Mr. Chairman. Both committees in the House and Senate were informed of the practice that was going to be used. I would personally be glad to see the law formally changed or see a franchise tax restored.

Representative PATMAN. You say the law was not changed? I think you are mistaken there, Mr. Martin.

Mr. MARTIN. Am I?

Representative PATMAN. I think the law was changed. In other words, the 90 percent provision was repealed.

Mr. YOUNG. That was repealed. The 90 percent that is now in operation——

Representative PATMAN. The what?

Mr. YOUNG. The 90 percent payment that is now in operation is by an agreement between the Treasury and the——

Representative PATMAN. I did not ask you about that, Mr. Young. I am going to get to that.

Mr. YOUNG. You are correct; it was repealed by the Banking Act of 1933.

Representative PATMAN. The original law was that after the payment of the expenses and after the accumulation of a certain amount in the reserve fund of each bank, the remainder—90 percent of the remainder—would go over to the Treasury as a franchise tax. Now, in some way that law got repealed. I do not know how. I have not looked into the history of it. I just know it was repealed, but the question I am asking you is, When was that repealed?

Mr. MARTIN. We will get you the data and put it in the record, Mr. Chairman. That is some more homework I will have to do.

Representative PATMAN. And any discussion that you find in either House about it, I would like to have my attention called to that, too, if you please.

Mr. MARTIN. Right, sir.

(The supplementary statement by Chairman Martin follows:)

PAYMENTS TO TREASURY BY FEDERAL RESERVE BANKS

FRANCHISE TAX ON FEDERAL RESERVE BANKS

In section 7 of the original Federal Reserve Act, it was provided that all earnings, after necessary expense and dividends, should be paid to the United States as a franchise tax, except that one-half of such net earnings should be paid into the Federal Reserve bank surplus until it amounted to 40 percent of its paid-in capital stock. In 1919, this provision was amended to provide that the net

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earnings after expenses and dividends should be paid into the surplus fund until it amounted to 100 percent of the bank's subscribed capital stock, and that thereafter only 10 percent should be paid into the surplus fund. In other words, the law required that, after accumulation of the prescribed surplus, 90 percent of net earnings of the Reserve banks be paid to the United States as a franchise tax; and this situation continued until 1933.

The Banking Act of 1933 eliminated the requirement for the payment of a franchise tax but, at the same time, required the Federal Reserve banks to subscribe $139,000,000 for Federal Deposit Insurance Corporation capital stock, an amount equal to one-half of their surplus on January 1, 1933. The bill which became the Banking Act of 1933, as reported in both Houses of Congress and as passed by the Senate, contained the provision eliminating payment of the franchise tax by the Federal Reserve banks. However, when the bill was under consideration by the House, this provision for the elimination of the tax was stricken from the bill. The conference committee, however, followed the Senate version in this respect and restored the provision.

The reports of the Banking and Currency Committees on the Banking Act of 1933 do not show reasons why the franchise tax was being eliminated. However, when the bill was presented to the House the chairman of the House committee stated, with respect to the subscription of $150,000,000 by the Treasury for stock in the Federal Deposit Insurance Corporation, that—

"This fund covers the larger part of sums that have been paid into the Treasury by the 12 Federal Reserve banks in lieu of a franchise tax. Approximately $150,000,000 is to be subscribed by the Federal Reserve banks, the plan requiring that each Federal Reserve bank subscribe for the capital stock of the Deposit Insurance Corporation in an amount equal to one-half of its surplus" (Congressional Record, vol. 77, pt. 4, p. 3836).

During debates in 1932 on an earlier draft of a similar bill, Senator Glass had stated his reasons for a proposal to eliminate the franchise tax. When the 1933 bill came before the House of Representatives, Representatives Patman and Keller expressed their opposition to the proposal. Excerpts from the statements by Senator Glass and Representatives Patman and Keller are attached.

SUBSCRIPTION TO CAPITAL STOCK OF THE FEDERAL DEPOSIT INSURANCE CORPORATION

The Banking Act of 1933 creating the Federal Deposit Insurance Corporation required that each Federal Reserve bank subscribe to non-dividend-paying stock of the Corporation in an amount equal to one-half of the Reserve bank's surplus on January 1, 1933.

When the proposal for cancellation of the Federal Deposit Insurance Corporation stock was under consideration, the Board recommended, and the legislation provided, that the amount received by the Corporation from the Federal Reserve banks for such stock be paid to the Treasury rather than returned to the Reserve banks. This was done in October 1947.

PAYMENT OF INTEREST ON FEDERAL RESERVE NOTES

In April 1947 the Board of Governors announced that it had decided to invoke the authority granted to it under section 16 of the Federal Reserve Act to levy an interest charge on Federal Reserve notes issued by the Federal Reserve banks. The purpose of this interest charge was to pay to the Treasury approximately 90 percent of the net earnings of the Federal Reserve banks for that year. Such payments have been continued for succeeding years. The statement pointed out that at the end of 1946 the surplus of each Federal Reserve bank was equal to its subscribed capital and that under this policy the Board would be able to accomplish the same results as were accomplished by the payment of a franchise tax.

Prior to the adoption of the policy the proposal was discussed by Chairman Eccles with Representatives of Congress and with the Secretary of the Treasury. In particular, the matter was the subject for discussion between Representative Patman and Chairman Eccles at the hearings March 4, 1947, before the Committee on Banking and Currency on H. R. 2233 (p. 29).

DISTRIBUTION OF FEDERAL RESERVE BANK NET PROFITS, WITH SPECIAL REFERENCE TO PAYMENTS TO THE TREASURY

From earnings of the Federal Reserve banks since organization through 1951 the Treasury has received $1,175,000,000 as franchise tax, contribution for the

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purchase of stock in the Federal Deposit Insurance Corporation, and interest on Federal Reserve notes.

Net profits of the Federal Reserve banks since organization has been disposed of as follows:

Total payments to Treasury		$1,175,000,000
Franchise tax		149,000,000
FDIC stock		139,000,000
Interest on Federal Reserve notes:		
1947	$75,000,000	
1948	167,000,000	
1949	193,000,000	
1950	197,000,000	
1951	255,000,000	
		887,000,000
Dividends to member banks		306,000,000
Paid U. S. Treasury from earnings on funds received from the Treasury for the purpose of making working capital loans to industry (sec. 13b loans)		2,000,000
Net transfers to—		
Reserves for contingencies		106,000,000
Surplus (sec. 7)		538,000,000
Net profits since organization		2,127,000,000

ATTACHMENTS

Excerpts from statement by Representative Patman (Congressional Record, vol. 77, pt. 4, p. 3842)

During debates in 1933 on the bill, Representative Patman, in commenting upon this proposed amendment, stated:

"The money [for the Federal Deposit Insurance Corporation] is coming from three sources; namely, $150,000,000 from the Treasury of the United States, $150,000,000 from the surplus fund of the Federal Reserve banks, which, as a matter of right, should be in the Treasury of the United States today. That money does not belong to the Federal Reserve banks. It belongs to the United States Treasury. It never has belonged to those banks. It never was intended that those banks should get that money. Therefore, of the $450,000,000 appropriated, $300,000,000 of it represents the people's money, coming from the Treasury of the United States. The other one-third will come from the depositors, one-half of 1 percent being assessed against the deposits of the banks.

"*Surplus fund of Federal Reserve banks.*—Now, let me tell you about this surplus fund of the Federal Reserve banks. When those banks were organized, they were not intended as profit-making institutions. It was stated they were going to use the credit of this Nation, and for the purpose of compensating the people for the use of that credit, when they paid their operating expenses and 6-percent dividends on the amount of capital invested by the member banks the remainder would go into the Treasury as a franchise tax. As conclusive evidence, if a member bank should fail or should withdraw from this System, that member bank would only get its capital stock back. It does not get back a part of that surplus, because that surplus does not belong to the member bank. It belongs to the Treasury of the United States.

"*Evidence of intent.*—The law provides that in the event a Federal Reserve bank becomes insolvent and it is necessary to liquidate that bank after the expenses of the bank are paid, the surplus goes into the Treasury of the United States. If the theory of the gentleman from Alabama, Mr. Steagall, is correct, that surplus should go back to the member banks that subscribed to the capital stock in that particular Federal Reserve bank. It is written into the law from beginning to end, that as to those banks using the credit of our Nation in the manner they are, the excess profits they make shall be paid into the Treasury of the United States. Now you come along in section 3 of this bill and attempt to change the entire policy of our Government in that regard. You attempt to divert from the Treasury of the United States back to the Federal Reserve banks that surplus, when there was written into the law language that said it should go into the Treasury of the United States. Now you come here and claim you are going

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to use that money as an insurance premium to insure bank deposits for private banks, and that it is necessary to do it in the interest of the general welfare. Yes; I say it is all right to do it in the interest of the general welfare, but do not restrict it to just 6,000 banks. Give all banks an opportunity to come in. and when this bill is subject to amendment under the 5-minute rule, I expect to offer two amendments in particular.

"One is to strike out section 3 which changes the policy of this Government in regard to the excess earnings of the Federal Reserve banks. * * *"

Excerpts from statement by Senator Glass (Congressional Record, vol. 75, pt. 9, pp. 9885–9886)

During debates in 1932 on an earlier draft of the bill, Senator Glass, in commenting upon this proposed amendment, stated:

"Section 4 of the bill relates to the distribution of earnings. Although the Federal Government has never expended a dollar in the maintenance of the Federal Reserve System and does not own one dollar of proprietary interest, it has collected in excess of $150,000,000 from the earnings of the Federal Reserve banks upon the pretense that it was a franchise tax for privileges granted. Senators will find upon examination that the 12 Federal Reserve banks do, without charge, a fiscal business for the United States Government that 20 times over compensates the Government for any privilege the Federal Reserve banks may have * * *

"* * * The Federal Reserve banks do a fiscal business for the United States Government that has never been paid for. The Government has not floated a loan since the beginning of the World War that it has not done it through the agencies and instrumentalities of the Federal Reserve Banking System.

"We propose now a different distribution of the earnings of the System. We propose to pay the member banks 6 percent cumulative dividends on their stock, as always has been done. Then we propose to transfer future earnings of the banks to surplus account. We propose to recapture from the Federal Treasury $125,000,000 of the $150,000,000 and odd that has been paid into the Treasury, and pass it to the credit of a revolving fund for prompt liquidation of failed banks. * * *

* * * * * * *

"* * * In other words, we propose to take $125,000,000 from the Federal Treasury, which we conceive to be a recapture of a part of a larger amount paid into the Treasury to which it was not entitled. Then we propose to take one-quarter [subsequently changed to one-half] of the existing surplus of the Federal Reserve banks themselves and apply it to this fund; but hereafter the future earnings of the Federal Reserve banks will go to the surplus fund of the Federal Reserve banks and none to the Government."

Excerpts from statement by Representative Keller (Congressional Record, vol. 77, pt. 4, pp. 3913, 3914)

During debates in 1933 on the bill, Representative Keller, in commenting upon this proposed amendment, stated:

"This bill is in most regards a splendid bill. It represents a vast amount of labor on the part of the committee. But for all their thought and care somehow a section has found its way into this bill that would nullify most of its benefits. I refer to section 3, which seeks to turn over to this privately owned bankers' banking system for all time to come every penny of the franchise tax which has existed from the start.

* * * * * * *

"A previous Congress, as representatives of our people, saw fit to give a small group of our citizens the power to issue money. For that privilege it exacted a small tax. That small group has paid itself a generous profit on that privilege in the past, and it now comes to the representatives of a sovereign power and asks that it be given all the profit.

* * * * * * *

"Now, what does this section 3 mean? It means this and nothing less, that if section 3 becomes the law we forever give up all claims to any return to the Government whatever. If section 3 had been in the original law, we would not have received the $149,000,000 which we have received, but the Federal Reserve System would have added that amount to the present $279,000,000 surplus, or $428,000,000 would belong to this purely private banking system.

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"Therefore, if we keep section 3 in this bill, it means the people will never receive another penny from this private banking system for the tremendously valuable franchise which it holds. Any man who votes to retain it in the bill votes to take from the people all the hundreds of millions of money which will come to them if this section is left out of this bill."

Representative PATMAN. Anyway, notwithstanding the repeal of that 90-percent provision, you have agreed voluntarily to pay—the Federal Reserve banks, each bank—into the Treasury that 90 percent just as though the law were effective at this time, and you are doing that now?

Mr. MARTIN. That is right.

Representative PATMAN. The point I am getting to now is with respect to a Federal Reserve bank. Who determines the expenses of that bank; who determines what they can legally spend that money for and what it cannot be spent for, and the purposes for which it can be used? Who determines that at each bank?

Mr. MARTIN. Each Reserve bank has a board of directors.

Representative PATMAN. And they determine it?

Mr. MARTIN. They determine it. We have some budgetary procedures which are listed in the answers to the questionnaire, but I think they are rather a distinguished group of directors who have had a good deal of business experience, and who pass on it.

Representative PATMAN. Yes; I am sure they all are fine people. But, now, who supervises that; after they pass on it, who looks over it?

Mr. MARTIN. The Board of Governors, sir.

Representative PATMAN. The Board of Governors looks over it?

Mr. MARTIN. That is correct, sir.

Representative PATMAN. And what policy do they have concerning the expenditure of these funds? Do you lay down any rules that you can spend it for this purpose but you cannot spend for that purpose, and do you have any do's and don'ts in it?

Mr. MARTIN. We have a very careful budget review on a business——

Representative PATMAN. Do you have a copy of that that I could see?

Mr. MARTIN. In the answer to the questions we have listed——

Representative PATMAN. I have seen that. You need not furnish anything that is already furnished or has already been furnished, in answer to the questions.

Mr. MARTIN. Well, we tried to cover our procedures thoroughly.

Representative PATMAN. I was given information here a while back that the Federal Reserve banks have gotten into the policy and habit of even calling conferences, inviting people from a distance and paying their way and their hotel bills and paying for the meetings. Have you run into anything like that?

Mr. MARTIN. All the expenses of the Reserve banks are accounted for by major functions in the statement of expenses already submitted. They are all accounted for.

Representative PATMAN. You mean where something like that would be itemized; it would be identified?

Mr. MARTIN. It is my understanding it would be included under the appropriate functional classification.

Representative PATMAN. My attention has been called to the statements being gotten out by these banks, one in particular—and it hap-

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pened to be the Dallas, Tex., bank; I will name it so that others will not be involved—that is on the fringe of or border of propaganda, pure propaganda, to influence legislation or the action of the Congress. Do you know anything about that?

Mr. MARTIN. No, sir; I do not know the particular reference.

Representative PATMAN. Well, who would pass on the legality of such an expenditure as that? Suppose they do get out a booklet there or something of that order, and they distribute it at their own expense, who would pass on whether or not that was a legal expenditure?

Mr. MARTIN. The board of directors of the bank.

Representative PATMAN. Of that bank?

Mr. MARTIN. Operating under budget approvals from the Board of Governors here in Washington.

Representative PATMAN. Who audits that bank?

Mr. MARTIN. As stated in the reply to the questionnaire, each Federal Reserve bank is audited by a resident auditor, an officer of the bank, appointed by the board of directors, who is responsible directly to the directors. In addition, each Federal Reserve bank is examined at least once a year by the Federal Reserve Board through its staff of examiners.

Representative PATMAN. And the Federal Reserve Board—who does the Federal Reserve Board get?

Mr. MARTIN. Who audits the Federal Reserve Board?

Representative PATMAN. Yes.

Mr. MARTIN. Well, we are about to have a noted private firm audit our accounts.

Representative PATMAN. Who selected this private firm?

Mr. MARTIN. It was selected by the Board of Governors.

Representative PATMAN. Well, since you are a servant of the Congress, why did you not ask the Congress to suggest someone to audit the Federal Reserve Board and the Federal Reserve Bank?

Mr. MARTIN. Because, Mr. Chairman, budgetary control of our operations, of our budget, is fundamental in our concept of the independent status of the System. If you want to nationalize the System, why, the surest way to do it is through control of the budget.

If we are not handling our budgetary expenses properly, why, the Banking and Currency Committee, your committee, any other committee, can see listed our expenses and what they are for and why we expended the money, and we are subject to your comments on it. But just let me mention one thing, the voluntary restraint program as one example. How in the world could we have embarked upon that program unless we had known in advance that we were going to encounter a period of excitement and expansion of credit? We had to have budgetary discretion to organize and set up that program, which was provided for under the Defense Production Act as a means of working toward the preservation of the purchasing power of the dollar.

Representative PATMAN. You mean by that that you must have a large amount of money at your disposal, and you do not know how much it will take.

Mr. MARTIN. We make a very careful estimate. We follow a budget procedure all the way through, but the discretion as to whether we should exceed the budget or not, we think, is a fundamental prerogative of an effective Reserve banking system.

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Representative PATMAN. I notice you said that you are under the direction and scrutiny of Congress.

Mr. MARTIN. That is correct.

Representative PATMAN. Now, of course, normally an agency of Congress is required to submit to an examination by the General Accounting Office, and I noticed this morning in your answers to Senator Douglas' questions you oppose that. You do not believe that is a good thing to do, to have your 12 banks and the Board audited by the General Accounting Office.

Mr. MARTIN. Because I think that would be a step toward nationalization of the System.

Representative PATMAN. Nationalization of the System? Well, is it not pretty well nationalized now, Mr. Martin? On every issue of money that belongs to the Government, the Bureau of Printing and Engraving prints the money.

Mr. MARTIN. I do not believe it is today, Mr. Chairman. I think that it maintains a balance between the public and the private status. I think that is the concept on which it was founded and the way it should be maintained.

Representative PATMAN. You do not mean to say that the small amount of stock that the banks hold, 6 percent of their capital, 3 percent paid up, I believe it is—6 percent capital and 3 percent paid—that is not enough to where you would say that the banks own the Federal Reserve System, do you?

Mr. MARTIN. No, sir; I would not say that. I think that the Federal Reserve banks are quasi-public institutions, and I think that this stock ownership is a means of providing for member-bank participation. It is a part of the democratic process to provide for participation by the member banks in determining who some of the directors of the Reserve banks will be.

While I do not think it is a vital thing, it seems to me that the advantages of retaining that ownership for the purpose of obtaining this participation on a democratic basis in the individual Federal Reserve banks more than outweighs any disadvantages.

Representative PATMAN. It is more of a token subscription, is it not?

Mr. MARTIN. It is more of a token; yes, sir.

Representative PATMAN. It does not really amount to anything so far as——

Mr. MARTIN. It does not amount to a great deal in terms of stockholders' control, but it does give them a participation and interest in the System that I think they would not have without it.

Representative PATMAN. What is the business done by the banks in a year? Does it run into two or three hundred billion or a trillion dollars a year?

Mr. MARTIN. The collection of checks, I would not have any way——

Representative PATMAN. Let us see, it was not two trillion dollars last year, was it?

Mr. YOUNG. It could have been.

Representative PATMAN. Two trillion dollars?

Mr. YOUNG. Largely, in collections of checks.

Representative PATMAN. That is in clearing checks?

Mr. YOUNG. In clearing checks.

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Representative PATMAN. In transactions—two trillion dollars; that is two thousand billion dollars. I cannot comprehend that much money, but certainly——

Mr. MARTIN. There is a lot of service rendered.

Representative PATMAN. Yes; a lot of service rendered; I know there is.

Concerning the scrutiny of Congress, normally the Congress appropriates money for its agencies. How would you feel about turning in all of your funds to the Treasury, like dozens of other agencies do now, and getting a direct appropriation from Congress each year?

Mr. MARTIN. Well, I would think that our status as an independent agency had been severely challenged by such a process.

Representative PATMAN. Why would it? That would just be under the scrutiny of Congress, and you say you are under the scrutiny of Congress.

Mr. MARTIN. We are under the scrutiny of Congress, but we retain budgetary discretion. Now, the Congress can take it away from us.

Representative PATMAN. But you are not under it in an effective way. Now, under parliamentary rules and procedures it is easy to say that you are under the scrutiny of Congress, but you are not inconvenienced by it if they have no power to control the purse strings of your agency. It is a rather cumbersome procedure to pass specific laws controlling an agency, so you are not under much restraint or inconvenience at all. Of course, I do not mean inconvenience just to inconvenience you, but I mean to quickly pass upon policies, and even major policies.

Mr. MARTIN. The Board's funds are not appropriated funds. They come through assessments on the Reserve banks, and that is part of the mechanics of the Reserve System.

Representative PATMAN. From which banks, the Federal Reserve?

Mr. MARTIN. The Federal Reserve banks.

Representative PATMAN. Well, the Federal Reserve banks use Government money, do they not?

Mr. MARTIN. Not for their expenses.

Representative PATMAN. I mean that is what they deal in with Government money. They deal in credit of the Nation, do they not?

Mr. MARTIN. They deal——

Representative PATMAN. That is their stock in trade. Without that they would not have anything, would they?

Mr. MARTIN. No. They are the service mechanism for the banking machinery of the country, and as such the concept was that the System would have an independent status to perform that service. And I think that budgetary discretion is vital to it.

Representative PATMAN. And you would be opposed to any change in the law whereby you would deposit your funds in the Treasury like other departments, like other agencies do, and have to come to Congress for your funds?

Mr. MARTIN. I do, sir.

Representative PATMAN. You would be opposed to that?

Mr. MARTIN. I would be opposed to it.

Representative PATMAN. Mr. Bolling, did you want to ask some questions?

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Representative BOLLING. Yes, Mr. Chairman; I have some more.

Mr. Martin, the President's Economic Report transmitted in January recommended that Congress provide power for the Board of Governors of the Federal Reserve System to impose additional bank reserve requirements.

Are you familiar with the nature of the proposed weapons that are suggested by that proposal of the President?

Mr. MARTIN. Well, I do not know what weapons were proposed, Mr. Bolling, because——

Representative BOLLING. They were not proposed specifically, and I am trying to find out whether you know what specifically was in the President's mind when he made the suggestion.

Mr. MARTIN. No, sir; I do not.

Representative BOLLING. I gather from your statement that you do not feel that at this time such additional——

Mr. MARTIN. That is correct.

Representative BOLLING. You think that there should be consideration given by this committee to making them available, not with the idea that they would be used now, but that they might be necessary in the future?

Mr. MARTIN. Well, I think we would always like to have stand-by authority, and I think it would be very desirable for your committee to review the whole reserve situation. But at the moment I do not think we need it, and I would hesitate to request authority when we do not need it.

Representative BOLLING. Do I gather from that that you do not foresee the possibility of needing it?

Mr. MARTIN. At the moment I do not foresee the possibility of it.

Representative BOLLING. On the 26th of February 1951, the President, in a memorandum requested of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve, the Director of the Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraints on private credit expansion and, at the same time, to make it possible to maintain stability in the market for Government securities.

He also said:

> While this study is under way, I hope that no attempt will be made to change the interest rate pattern, so that stability in the Government security market will be maintained.

When this memorandum from the President was released on the 26th of February, Mr. Wilson expressed the hope that a report could be made by the four agency heads to the President within 10 days or 2 weeks. If my memory serves me correctly, the accord between the Federal Reserve and the Treasury was in March?

Mr. MARTIN. March 4.

Representative BOLLING. In this report that Mr. Wilson had expressed the hope would be made to the President within 10 days or 2 weeks, was filed on May 11.

In reaching their accord in early March of 1951, did the Treasury and the Board consult with the Director of Defense Mobilization and the Chairman of the Council of Economic Advisers prior to the announcement of that accord?

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Mr. MARTIN. I do not think we formally consulted with them with respect to the terms of the accord. Mr. Wilson was informed of the progress that was being made, and Mr. Keyserling was informed that the accord was being made and the general essence of the accord was discussed with them. I do not know that we can truthfully say that they actively participated in the formulation of the accord, but they were consulted about it.

Representative BOLLING. Mr. Chairman, I would like unanimous consent to print in the record at this point the memorandum from the President to the four agencies, together with the report of the four agencies, submitted to the President on May 11.

Representative PATMAN. Without objection it will be done.

(The documents referred to follow:)

The President met this morning (February 26, 1951) with the following:

Mr. Thomas McCabe, Chairman, Board of Governors, Federal Reserve System
Mr. Charles Wilson, Director, Office of Defense Mobilization
Mr. Edward Foley, Under Secretary of the Treasury
Mr. Charles Murphy, special counsel to the President
The Council of Economic Advisers, Mr. Leon H. Keyserling, Chairman; Mr. John D. Clark and Mr. Roy Blough
Mr. William McChesney Martin, Assistant Secretary of the Treasury
Mr. Allan Sproul, Vice Chairman, Federal Reserve Open Market Committee
Mr. Harry A. McDonald, Chairman, Securities and Exchange Commission.

The President read the attached memorandum to the group and there was a general discussion of the subject covered by the memorandum. The President did not ask any of those present for any commitments on the subjects under discussion, but expressed the hope that they would go ahead speedily with the study requested.

Mr. Wilson expressed the hope that a report could be made to the President within 10 days or 2 weeks.

Memorandum for: The Secretary of the Treasury,
The Chairman of the Board of Governors of the Federal Reserve System,
The Director of Defense Mobilization,
The Chairman of Council of Economic Advisers.

I have been much concerned with the problem of reconciling two objectives: First, the need to maintain stability in the Government security market and full confidence in the public credit of the United States, and second, the need to restrain private credit expansion at this time. How to reconcile these two objectives is an important facet of the complex problem of controlling inflation during a defense emergency which requires the full use of our economic resources.

It would be relatively simple to restrain private credit if that were our only objective, or to maintain stability in the Government security market if that were our only objective. But in the current situation, both objectives must be achieved within the framework of a complete and consistent economic program.

We must maintain a stable market for the very large financing operations of the Government. At the same time, we must maintain flexible methods of dealing with private credit in order to fight inflation. We must impose restraints upon nonessential private lending and investment. At the same time, we must maintain the lending and credit facilities which are necessary to expand the industrial base for a constant build-up of our total economic strength. Instead of fighting inflation by the traditional method of directing controls toward reducing the over-all level of employment and productive activity, a defense emergency imposes the harder task of fighting inflation while striving to expand both employment and production above what would be regarded as maximum levels in normal peacetime.

What we do about private credit expansion and about the Government securities market is, of course, only a part of the problem that confronts us. A successful program for achieving production growth and economic stability in these critical times must be based upon much broader considerations.

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We must make a unified, consistent, and comprehensive attack upon our economic problems all along the line. Our program must include, in proper proportion, production expansion policy, manpower policy, tax policy, credit policy, debt management and monetary policy, and a wide range of direct and indirect controls over materials, prices, and wages. All of these policies are necessary; each of them must be used in harmony with the rest; none must be used in ways that nullify others.

We have been striving in this emergency to develop such a unified program in the public interest. Much progress has already been made, both on the production front and on the antiinflation front. Many peacetime activities of Government, including the activities of lending and financing agencies, have been pruned down. Cut-backs of civilian supplies and allocations of essential materials have been successfully undertaken. Important expansion programs for basic materials and productive capacity needed in the defense effort have been gotten underway. Price and wage controls have been initiated. Restraints on consumer and real estate credit have been applied. Large tax increases have been enacted, and additional tax proposals are now pending. In all these fields further action is being planned and will be taken as needed.

One outstanding problem which has thus far not been solved to our complete satisfaction is that of reconciling the policies concerning public-debt management and private credit control. Considering the difficulty of this problem, we should not be discourged because an ideal solution has not yet been fund. The essence of this problem is to reconcile two important objectives, neither of which can be sacrificed.

On the one hand, we must maintain stability in the Government security market and confidence in the public credit of the United States. This is important at all times. It is imperative now. We shall have to refinance the billions of dollars of Government securities which will come due later this year. We shall have to borrow billions of dollars to finance the defense effort during the second half of this calendar year, even assuming the early enactment of large additional taxes, because of the seasonal nature of tax receipts which concentrate collections in the first half of the year, and because of the inevitable lag between the imposition of new taxes and their collection by the Treasury. Such huge financial operations can be carried out successfully only if there is full confidence in the public credit of the United States based upon a stable securities market.

On the other hand, we must curb the expansion of private loans, not only by the banking system but also by financial institutions of all types, which would add to inflationary pressures. This type of inflationary pressure must be stopped, to the greatest extent consistent with the defense effort and the achievement of its production goals.

The maintenance of stability in the Government securities market necessarily limits substantially the extent to which changes in the interest rate can be used in an attempt to curb private credit expansion. Because of this fact, much of the discussion of this problem has centered around the question of which is to be sacrificed—stability in the Government securities market or control of private credit expansion. I am firmly convinced that this is an erroneous statement of the problem. We need not sacrifice either.

Changing the interest rate is only one of several methods to be considered for curbing credit expansion. Through careful consideration of a much wider range of methods, I believe we can achieve a sound reconciliation in the national interest between maintaining stability and confidence in public credit operations and restraining expansion of inflationary private credit.

We have effective agencies for considering this problem and arriving at a proper solution.

Over the years, a number of important steps have been taken toward developing effective machinery for consistent and comprehensive national economic policies. One of the earliest steps in this century was the establishment of the Federal Reserve System before World War I. At that time, under far simpler conditions than those now confronting us, the Federal Reserve System was regarded as the main and central organ for economic stabilization. After World War II, in a much more complex economic situation and a much more complex framework of governmental activities affecting the economy, the Council of Economic Advisers was established by the Congress under the Employment Act of 1946 to advise the President and help prepare reports to the Congress concerning how all major economic policies might be combined to promote our economic strength and health. Still more recently, in the current defense emergency, the Office of Defense Mobilization has been established to coordinate

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and direct operations in the mobilization effort. In addition, some of the established departments, such as the Treasury Department, have always performed economic functions which go beyond specialized problems and affect the whole economy.

Consequently, I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities. While this study is underway, I hope that no attempt will be made to change the interest rate pattern, so that stability in the Government security market will be maintained.

Among other things, I ask that you consider specifically the desirability of measures: (1) to limit private lending through voluntary actions by private groups, through Government-sponsored voluntary actions such as was done in a narrow field by the Capital Issues Committee of World War I, and through direct Government controls; and (2) to provide the Federal Reserve System with powers to impose additional reserve requirements on banks.

Under the first heading, I am sure that you are aware of the efforts that are already underway by the American Bankers Association, the Investment Bankers Association, and the life insurance association. I want you to consider the desirability of this or other kinds of private voluntary action in bringing about restraint on the part of lenders and borrowers.

I should like you to consider also the establishment of a committee similar to the Capital Issues Committee of World War I, but operating in a broader area. The objectives of such a Committee would be to prevail upon borrowers to reduce their spending and to curtail their borrowing, and to prevail upon lenders to limit their lending. The activities of this committee could be correlated with those of the defense agencies under Mr. Wilson with the objective of curtailing unnecessary uses of essential materials.

Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act.

Under the second heading, you will recall the recommendation I made to the Congress a number of times in recent years to provide additional authority for the Federal Reserve System to establish bank reserve requirements. I should like you to consider the desirability of making that or another recommendation with the same general purpose at the present time.

You are all aware of the importance of this problem, and the need for an early resolution. I should like your study to proceed as rapidly as possible in order that I may receive your recommendations at a very early date. I am asking the Director of Defense Mobilization to arrange for calling this group together at mutually convenient times.

At the same time that we are working to solve this problem of maintaining the stability of the Government securities market and restraining private credit expansion, we shall, of course, continue vigorously to review Government lending and loan guarantee operations. Since the middle of last year, we have taken a series of steps to curtail such operations and limit them to amounts needed in this defense period. I am directing the agencies concerned to report to me by March 15 on the nature and extent of their current lending and loan guarantee activities, so that these operations may again be reviewed as part of our over-all anti-inflationary program.

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF DEFENSE MOBILIZATION,
Washington, May 17, 1951.

The PRESIDENT,
The White House, Washington, D. C.

DEAR MR. PRESIDENT: Referring to your memorandum of February 26, 1951, addressed to the Secretary of the Treasury, Chairman of the Board of Governors of the Federal Reserve System, the Director of the Office of Defense Mobilization,

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and the Chairman of the Council of Economic Advisers, asking us to study ways and means to provide necessary restraint on private credit expansion and at the same time make it possible to maintain stability in the market for Government securities, I am enclosing herewith a signed report of this committee.

I have been acting as chairman of the committee, and the report speaks for itself.

Sincerely yours,

CHARLES E. WILSON.

REPORT OF THE FOUR-MEMBER COMMITTEE APPOINTED FEBRUARY 26, 1951

INTRODUCTION

The President's memorandum of February 26, 1951, to the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers stated: "I am requesting the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers to study ways and means to provide the necessary restraint on private credit expansion and at the same time to make it possible to maintain stability in the market for Government securities."

The present problem of restraining the expansion of credit must be attacked under conditions differing vastly from those of any other inflationary period in the Nation's history. To a large degree the problem is fashioned by the continuing influence of the tremendous accumulation of public debt during World War II, and by the imminent task not only of refunding the large portion of that debt which matures in the near future but also of undertaking new financing. Conditions in the market for Government securities become, therefore, a compelling consideration. Within this framework, nonetheless, restraints must be exerted on over-all credit expansion, particularly for nondefense purposes, in order to keep combined Government and private demands within the bounds of available supplies of goods and services and yet not interfere with the maximum possible expansion of output in vital lines.

We submit to you in the present report (I) a brief review of current problems of credit control, as they have emerged in the postwar period and as we face them in connection with the national defense effort; (II) a review of the accomplishments in these fields since your memorandum of February 26; (III) a summary of credit controls available under permanent, expiring, and proposed legislation; and (IV) our conclusions and recommendations with respect to further needed actions.

I. CURRENT PROBLEMS OF CREDIT CONTROL

During World War II, because of the large Government deficits, banks and other financial institutions and many other investors bought large quantities of Government securities. In the postwar period, Federal Reserve use of traditional instruments to restrain credit was conditioned by the objective of maintaining a market for these securities without a substantial and general increase in interest rates. This latter objective limited the effective use of open market operations for purposes of counteracting inflation. The possible restrictive effect of increases in reserve requirements was also limited by the large holdings of Government securities by banks and other institutions.

General credit control again became a matter of national concern when new inflationary pressures developed after the initiation of the expanded defense program. Various measures were adopted by the Federal Reserve and other Government agencies in this period to restrain credit expansion. Nevertheless, the needs of public debt management, the large available supply of liquid assets, and the increased accent upon full employment and production, continued to limit the Federal Reserve System's pursuit of a more effective policy of credit limitation.

The period since the outbreak in Korea has been characterized by anticipation on the part of consumers and business concerns of the effects of the expanded national security program. This anticipatory buying was financed in a variety of ways. Credit expansion was one of the available means which financed the enhanced demand, and the support policy was one of the factors which facilitated credit expansion. Commercial banks and other financial institutions were in a favorable position to extend credit, since they could always sell Government

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securities and the Federal Reserve System stood ready to make purchases whenever other investors were not ready to buy at prevailing prices. While any feasible Federal Reserve policy could not have prevented individuals and business concerns from financing their purchases, a stronger policy of credit restraint could have made it more difficult and would have reduced the total amount. Part of the credit extended, of course, was necessary, and as a result the American economy today is better stocked and better tooled for tackling a large defense production program than it was at the time of the Korean outbreak.

The fact that some credit extension serves a highly useful purpose in the defense effort, while other is less useful or even harmful under present circumstances, makes it desirable to use credit controls as selectively as possible. While selective credit controls, such as consumer credit, real-estate credit, and credit for securities markets, have a continued usefulness in the mobilization period, general credit curtailment, or a general rise in interest rates, does not have so selective an impact in relation to defense priorities. General credit control is, however, essential to reinforce the effectiveness of the voluntary and other efforts of restraint. The objective of a discriminating credit policy is further aided by Government agencies through loan guarantees, tax amortization, and direct financial aid to defense-related activities. Supplemented by such programs, general credit controls are an effective instrument in the program of mobilization and stabilization. They must, of course, be reconciled with the Government's requirements for refunding and new financing.

Credit policy will be modified in character and intensity as the mobilization effort passes through various stages. We are now shifting from the preparatory to the production phase of the defense effort. In the preparatory stage, private credit expanded while Government budgets showed a surplus. Expenditures for the defense programs have now commenced to increase substantially and as long as these expenditures are not financed on a pay-as-we-go basis the Treasury will be faced with the need for deficit financing in addition to large refunding operations. There is at the same time no certainty that private demand for investment and credit will subside. At the peak of defense production direct controls of materials may curtail private credit demands. But physical controls are still in the developmental stage and their full effect cannot be foreseen. We are facing therefore a period in which we have to deal with both the problem of Federal financing and the need for controlling private credit expansion.

The large existing inventories and the fluctuations in the public's appraisal of the seriousness of the international situation may create a temporary relaxation in the demand for credit. Such a relaxation, however, may be of short duration only, and the slightest darkening of international relations may set in motion another wave of buying.

Even if requirements of national security should remain high for a considerable time, we hope that an increase in total output may, after a few years, permit a relaxation or modification of physical controls. We would then enter another stage, still fully within the period of mobilization, during which some expansion in the production of consumer goods and in private investment might lead to a renewed growth in demand for private credit. In that event, our chief reliance must be on fiscal, monetary, and credit policy.

II. ACCOMPLISHMENTS

There has been a substantial record of accomplishment since the President appointed this Committee on February 26, 1951.

On March 4, the Treasury and the Federal Reserve System announced that they had reached "full accord with respect to debt management and policies to be pursued which would affect the successful financing of the Government's requirements and, at the same time, would minimize monetization of the public debt".

On March 4, the Treasury announced the offering of a new investment series of 2¾ percent long-term nonmarketable bonds in exchange for the outstanding 2½ percent marketable bonds of June 15 and December 15, 1967–72. Subsequently, during the time allowed investors for the exchange, more than $13.5 billion of the outstanding amount of $19.7 billion of 2½ percent marketables were offered in exchange for the new nonmarketables. Of the total exchange, $5.6 billion were owned by the Federal Reserve Banks and Government investment accounts, and of these approximately 20 percent was acquired in the few weeks prior to the Treasury's announcement and during the period in which exchange was permitted.

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Since March 5, prices of outstanding Government securities have been permitted to decline, a number of the issues falling below par. An important result of this action has been the effect in the markets for mortgages and new capital issues.

It is still too early to appraise conclusively the effectiveness of this measure. It may be noted that, beginning in April, the rate of expansion in bank loans began to slacken. But this change may also reflect seasonal factors in the demand for credit, the softening of consumer demand that became apparent in that month, and voluntary credit restraints then undertaken, as well as the decline of security prices. It appears that new commitments by insurance companies and savings banks to purchase mortgages have been reduced. Some plans for new securities to be issued have been withdrawn or postponed and others have had to be revised, although the total volume of new issues has continued very large. The new tone in the market may have an important effect upon many new offerings that were, or might otherwise have been, contemplated.

4. On March 9, a program for voluntary credit restraint was instituted by the Board of Governors of the Federal Reserve System, pursuant to section 708 of the Defense Production Act of 1950, after consultation with the Office of the Attorney General and with the Federal Trade Commission. This program is now in full operation and includes major financial institutions throughout the Nation. The program has set up a national committee as well as regional committees covering all sections of the country.

The national committee has issued three bulletins, the first dealing with means of restraining inventory financing, the second with the principles to be followed in financing capital expansion programs and the third with State and local government financing. These bulletins, together with the statement of principles of the program, have been distributed to all financing institutions participating in the program to provide a common guide for combating inflationary loan expansion in their respective fields. Other bulletins, as may be appropriate and helpful, will be issued from time to time. Meanwhile financing institutions are requesting the regional committees for opinions as to the desirability under present conditions of loans in debatable classes. These opinions are being relayed to all committees to insure uniform policy Nation-wide.

While there has not yet been time to build up a body of statistical information to enable the committee to analyze thoroughly the effects of the program, there are indications that the initiation of the program has had a salutary effect on the trend of credit.

Endorsements of the program and pledges of wholehearted cooperation have been received from many representative industry groups. Under these circumstances, those connected with the program are most encouraged, and it is the committee's view that the authorization for this unique cooperative effort as one means of restraining the further expansion of private credit should be continued.

On March 12, the Director of Defense Mobilization appointed five task forces from among the personnel of the Treasury, Board of Governors of the Federal Reserve System, the Council of Economic Advisers, and the Office of Defense Mobilization to implement the joint studies of these agencies undertaken in response to the President's memorandum.

On March 23, the Director of Defense Mobilization wrote the Secretary of Commerce, referring to the President's memorandum of February 26, 1951, and suggested that the Business Advisory Council of the Department of Commerce undertake a program to complement the voluntary credit restraint program. The implication of the letter was that efforts of lending institutions to limit credit expansion would be more effective if borrowers exercised restraint in their requests for financing. As a result, the business advisory council has undertaken a continuing Nation-wide program to bring to the attention of lenders and borrowers the fact that the success of the voluntary credit restraint program rests equally on both of them.

On May 7, the Director of Defense Mobilization wrote the Governors of all States, the mayors of all major cities and financial officers of principal counties and other political subdivisions. He requested that all State and municipal projects, which necessitated borrowing and which were postponable, be postponed. In particular, he asked that every proposed borrowing by a State or municipality of $1 million or over, before being consummated, receive the approval of one of the regional committees appointed under the voluntary credit restraint program.

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III—CREDIT CONTROLS AVAILABLE UNDER PERMANENT LEGISLATION, EXPIRING LEGISLATION AND PROPOSED LEGISLATION

The following summary indicates the more important actions for credit restraint that can be taken under existing legislation, that can be employed if expiring legislation (notably the Defense Production Act of 1950) is extended, and that could be initiated if new legislation were passed in conformance with the recommendation made by the committee. Such a classification clarifies the problem and indicates the responsibilities of the several branches and agencies of the Government in implementing a program designed to achieve credit restraint and stability in the market for Government securities.

1. Permanent legislation

(*a*) The Federal Reserve System has power to change rediscount rates.

(*b*) The Open Market Committee of the Federal Reserve System has the authority to conduct open-market operations in Government securities and such transactions can be undertaken with a view to stabilizing the market for such securities and tightening or relaxing credit conditions.

(*c*) Existing legislation would permit the Board of Governors of the Federal Reserve System to raise reserve requirements of central reserve city banks very slightly above existing levels.

(*d*) Under existing legislation the Board of Governors can amend regulations T and U so as to raise margin requirements for listed securities to 100 percent, and restrict withdrawals and substitutions of securities in margin accounts.

(*e*) Section 5 of the Trading with the Enemy Act of 1917, as amended, and section 4 of the Emergency Banking Act of 1933 authorize the President, by Executive order, to regulate and limit the issuance of credit. While these powers should not be exercised except in an extraordinary emergency, the statutory authority appears to be sufficient.

2. Expiring legislation

(*a*) Section 708 of the Defense Production Act of 1950 provides the legislative basis for the present voluntary credit restraint program.

(*b*) Regulation X of the Board of Governors of the Federal Reserve System, which governs the extension of real estate construction credit, stems from authority granted the President under section 602 of the Defense Production Act of 1950; he in turn is permitted to utilize the services of the Federal Reserve System in this connection. Present authority would permit the Board of Governors to restrict the use of real estate construction credit substantially more than has already been done. Should the proposed change in the act be enacted (H. R. 3871 and S. 1397, 82d Cong. 1st sess., sec. 106) it would be possible to restrain the use of real estate credit in the purchase of existing structures.

(*c*) Section 601 of the Defense Production Act of 1950 authorizes the Board of Governors of the Federal Reserve System to exercise consumer credit controls in accordance with Executive Order 8843 (August 9, 1941). Regulation W of the Board of Governors restricts the use of consumer credit; the use of such credit could be tightened substantially beyond the degree currently permitted.

3. Proposed legislation

(*a*) As noted above, section 106 of H. R. 3871 and S. 1397 would permit restrictions on the use of real estate credit in connection with the purchase of existing structures.

(*b*) Section 611 of H. R. 3871 and S. 1397 would permit the President, whenever he determines that speculative trading on boards of trade causes or threatens to cause unwarranted changes in the price of any commodity, to prescribe rules governing the margin to be required with respect to speculative purchases or sales for future delivery. The provisions of section 21 of the Securities and Exchange Act of 1934 are made applicable in administering and enforcing this provision.

(*c*) Reserve requirements of commercial banks have been raised virtually to the limits of existing authority.

It is recommended that, as an emergency measure, legislation be sought to empower the Reserve authorities for a limited period to impose additional reserve requirements, either increasing the authorized percentages or in some other appropriate way that will have a minimum adverse effect on the Government security market. The refunding and new issue operations of the Treasury in the last half of this calendar year alone amount to in the neighborhood of $50

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billion. Under these circumstances, it is imperative that any additional requirements for bank reserves imposed by the Federal Reserve should be such that they do not have a disruptive effect on the market for Government securities. In view of the emergency such requirements should apply to all insured banks. The feasibility of permitting nonmember insured banks to hold the additional reserves in balances with their correspondents should be explored.

The task force on supplementary reserve requirements has considered various plans for reenforcing existing bank reserve requirements and has reported that two plans offer the greatest promise, namely; (1) The loan-expansion reserve plan and (2) the primary (securities feature) reserve plan, which provides for additional required reserves and gives a bank, under conditions to be prescribed by regulation, the option of holding the additional reserves in the form of cash or Government securities.

The provisions of these plans may be summarized as follows:

Loan-expansion reserves.—Every insured bank receiving demand deposits, other than a mutual savings bank, would be required to maintain additional reserves equal to a percentage, to be prescribed by the Board of Governors of the Federal Reserve System, of that part of its loans and investments in excess of a certain prescribed base.

In computing loans and investments, all assets of the bank would be included except (1) cash, (2) balances due from banks, (3) direct obligations of the United States, and (4) such special types of assets as the Board might prescribe from time to time.

Primary reserves and Government securities.—Either in substitution for or in addition to the requirement discussed above, an insured bank receiving demand deposits, other than a mutual savings bank, might be required to maintain additional reserves equal to a limited percentage of its demand deposits, in addition to the deposit balances now required.

Such percentages could be different with respect to banks in central reserve cities, reserve cities, or elsewhere.

In lieu of such a deposit balance, a bank under certain conditions, could count Government securities either at an amount equal to the dollar amount of the deposit balance which the securities replace or at some lesser figure. For example, the Board might prescribe that, for reserve purposes, $1.50, or $2 or $2.50 in securities might be equivalent to $1 of cash.

Within a few days the Board of Governors will ask the Congress to consider definitive legislation providing for supplementary requirements.

IV. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The measures thus far adopted make up the beginning of an effective program of credit restraint. There is, however, no assurance that these measures will prove sufficient to deal with the inflationary situation that may be anticipated as the national security program expands. Additional measures are needed to contribute to the anti-inflationary program and at the same time maintain stability in the market for Government securities.

In general, the additional measures which should be taken are: The extension and reinforcement of the voluntary credit restraint program, whose work this committee wholeheartedly endorses; the enactment of legislation to permit continuation and some broadening of selective credit controls; an emergency increase in the authority of the Board of Governors to require, in case of need, supplementary reserves for all insured banks. With a view to the possibility that all other anti-inflationary measures fail, or that needed powers may not be obtained in time, plans should be readied for the imposition of mandatory limits on total credits extended by banks and other financial institutions (excepting essential loans) if, in an extraordinary emergency, such controls should become necessary.

Recommendations

1. That section 708 of the Defense Production Act of 1950, which provides the legislative basis for the voluntary credit restraint program, be extended.

2. That close liaison be maintained between the Office of Defense Mobilization and the Voluntary Credit Restraint Committee. The Voluntary Credit Restraint Committee cannot exercise the most informed judgment regarding lending policy unless it is guided by up-to-date criteria of the shifting requirements of the defense program.

3. That the cooperation of such bodies as the Council of State Governors and the United States Conference of Mayors be enlisted by the Voluntary Credit

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Retraint Committee to help postpone issues of State and municipal securities to finance deferable expenditures.

4. That the appropriate Government agency consider whether financing institutions, not now included in the voluntary credit restraint program, be included in it.

5. That Government loan and loan guarantee agencies should follow policies consistent with those of comparable private lending institutions as set forth in the statement of principles of the national voluntary credit restraint program. If the policies of the two groups of lenders are not coordinated the voluntary program might be undermined. This subject is more fully treated in the forthcoming report of the Director of the Budget, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers on the policies of Government lending agencies that was requested by the President to complement the work of the present committee.

6. That section 601 of the Defense Production Act of 1950, which provides authority for regulation W of the Board of Governors restricting the use of consumer credit, be extended.

7. That section 602 of the Defense Production Act of 1950, which furnishes the legislative basis for regulation X of the Board of Governors regulating the extension of real-estate construction credit, be extended and that the proposed change in the act (sec. 106, H. R. 3871 and S. 1397, 82d Cong., 1st sess.), which would make it possible to restrain the use of real-estate credit in the purchase of existing structures, be enacted.

8. That section 611 of H. R. 3871 and S. 1397 be enacted, which would permit the President, whenever he determines that speculative trading on boards of trade causes or threatens to cause unwarranted changes in the price of any commodity, to prescribe rules governing the margin to be required with respect to speculative purchases or sales for future delivery.

9. The committee recommended that the Congress be urged to act promptly and favorably on the proposals for emergency additional bank-reserve requirements, when these are advanced by the Board of Governors of the Federal Reserve System.

10. That mandatory control of credit be imposed only if the problem to be solved is most serious, and only after a demonstration that more moderate measures are too slow in their impact, or too uncertain in operation, or are otherwise inadequate. While we do not propose the imposition of such mandatory controls at this time, detailed plans for their imposition, in the unfortunate event they become necessary, should be prepared.

11. We have pointed out in this report that credit controls must play an important role in a program of economic stabilization that is in accord with the necessities of the defense program and the Government's financial requirements. We wish to point out with equal emphasis that neither selective nor general credit controls can, in themselves, assure such economic stabilization. Economic stabilization requires, first and most importantly, a pay-as-we-go tax program. Any failure in this respect aggravates immeasurably the problems of economic stabilization. Even with adequate fiscal and credit policies there still remain inflationary pressures during the expansion of the security program. During that period, therefore, direct controls, such as allocations and price and wage controls, are essential. Only in a rounded program in which each control measure contributes its share can we accomplish the purposes of mobilization and stabilization.

C. E. Wilson,
The Director of Defense Mobilization, Chairman.

John W. Snyder,
The Secretary of the Treasury.

Wm. McC. Martin, Jr.,
The Chairman of the Board of Governors of the Federal Reserve System.

Leon H. Keyserling,
The Chairman of the Council of Economic Advisers.

Representative Bolling. The report, which came out on the 17th of May, and was transmitted by a letter from Mr. Wilson and was signed by Mr. Wilson, Mr. Snyder, yourself, and Mr. Keyserling, included this statement:

Within a few days the Board of Governors will ask the Congress to consider definitive legislation providing for supplementary requirements.

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That deals with reserves. It is pretty obvious that your view has changed substantially since that time.

Mr. Martin. Mr. Bolling, the best made plans of mice and men "gang aft agley."

Representative Bolling. Would you, in view of that "gang aft agley" discuss what are the major differences in your mind between the economic conditions now and those of last May?

Mr. Martin. I think that right now there are a number of soft spots in the economy. Starting last April or May, textiles, shoes, and several other industrial lines, including output of consumer durables, were beginning to slow down, and over the summer a number of other lines began to slow down. So far activity in these areas has not revived significantly.

Department-store sales are currently running lower than they were a year ago. It is too early to tell what the spring situation is going to be, but so far there has been no sign of any marked upturn in department-store sales. When I say that it does not mean that we are not watching very carefully for the possibility of an upsurge. But there has been quite a shift in the economic climate and in general economic activity, apart from the defense activity, since last April or May.

You must also remember that during that period we had W and X amended by Congress in July, and to put it bluntly, it is quite possible that, if we had asked for special authority to impose additional reserve requirements at that time, we might not have gotten it.

Representative Bolling. Then, that comes back to the thing that concerns me. There is inevitably a lag even in an issue such as this, in which there seems to be relatively little controversy. It would seem to me that if inflation is only asleep, and therefore not dead, and perfectly capable of awakening again, that considering the recognizable legislative lag between the request for the new tool and its granting, and remembering back to the very brief period which brought on a very substantial inflation in the post-Korean period, I am a little concerned at the idea that there is going to be no concrete proposal from anybody on this other tool, the supplementary reserve requirements. I do not know how to assess exactly the legislative lag that exists, but it certainly is a matter of several months, and it is conceivable that considerable damage could be done in a very short period.

Mr. Martin. My best judgment on that is that we do not need the authority at this time. We still have two points in our existing reserve requirement authority with respect to central reserve cities. I would not see any point in increasing those requirements because I think that would just put pressure on the market for public debt. I agree with Mr. Wolcott that it would be nice if we did not have the present large public debt, but we have it, and we have got to handle it. I think that, with a Government securities market that is now relatively free of any interference by the Federal Reserve, and which is on the whole becoming stronger, and has more vitality than it has had for some time, there is every reason to believe that the weapons we have are adequate to deal with prospective situations. I would like, of course, to get flexibility restored in regulations W and X, granted that they are not too impressive credit control weapons—and Mr. Chairman, I certainly would agree with you that regulations W and X are not loaded with dynamite as far as credit control is con-

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cerned. But I do feel that in a period like this we need to have such weapons in our arsenal. However, I would question very much whether we ought to get involved at this time in the use of a loan expansion reserve plan, which would be an administrative headache, or in the use of some other type of supplementary reserve plan.

On the other hand, this might be a good time to review whether reserve requirements ought to be made uniform for all banks. There are a number of studies that would be desirable on this question. So far as the immediate problem is concerned, however, there is serious question as to whether any additional reserve requirement authority is the course to pursue.

Representative BOLLING. Mr. Martin, if inflationary pressure started pushing prices up could you conceive of a situation where it might be desirable for the Federal Reserve, in addition to not supporting the Government bond market, actually selling part of its $22 billion in holdings of Government bonds in order to restrict reserves?

Mr. MARTIN. I think that is a situation—you can conceive of a lot of situations, but I would not want to comment on a hypothesis of that sort. I thing that the Federal Reserve certainly intends to be only the marginal supplier or the marginal buyer in the market, and we want to maintain an orderly market for Government securities. I do not want to engage in a hypothetical discussion.

Representative BOLLING. I see. That is all right with me.

Mr. Martin, we had some discussion yesterday with Secretary Snyder on the question of E bonds and their competitive position, and so on. I wonder if you would care to make any comments on the situation with regard to saving bonds?

Mr. MARTIN. No, Mr. Bolling, I would not. It seems to me that any comments on interest rates on savings bonds or specific issues ought to be in executive session, and I certainly would not want to be in the position of commenting on the Treasury's present problem, which they are struggling day and night to resolve.

Representative BOLLING. I sympathize with your position on that.

Mr. Chairman, I would like for us to pursue that through questions and letters so that we can have it as part of our own consideration.

Representative PATMAN. You mean——

Representative BOLLING. For the committee to send certain questions to Mr. Martin.

Representative PATMAN. Certainly.

Representative BOLLING. Is that satisfactory?

Mr. MARTIN. Yes; that is perfectly satisfactory.

Representative PATMAN. The fact that I asked you certain questions does not mean that I am advocating the things that I mentioned.

Mr. MARTIN. I understand.

Representative PATMAN. Mr. Martin, I am learning a lot.

Mr. MARTIN. I can assure you I am, too, Mr. Chairman.

Representative PATMAN. I do not know much myself, but these four gentlemen on the committee with me know a lot, and I am learning a lot from them, and the staff members here.

I am not just pulling something out of the hat when I mention about the appropriations through Congress. I desire to invite your attention to the fact that there are a number of agencies now supported from revenues of the enterprises operated or supervised by them or

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from property they administer, but they must obtain special authorization to use moneys in their hands for designated purposes or in some cases for any purpose whatsoever.

I refer to the Federal Housing Administration, the Home Loan Bank Board, the Office of Alien Property, the Commodity Credit Corporation, the Export-Import Bank of Washington, the Federal Crop Insurance Corp., the Federal Farm Mortgage Corp., the Federal Intermediate Credit Banks, the Federal National Mortgage Association, the Federal Prison Industries, Inc., the Federal Savings & Loan Insurance Corp., the Home Owners Loan Corporation, the Inland Waterways Corp., the Panama Canal Co., the production credit corporations, Public Housing Administration, the Reconstruction Finance Corp., the Virgin Islands Corp., the Tennessee Valley Authority.

The following agencies collect certain moneys which are covered into the Treasury. That is what I asked you about a while ago—which are covered into the Treasury, and which can be withdrawn only on appropriations by Congress.

The Attorney General, fees of aliens and immigrants, various receipts of the Department of Agriculture, including the Farm Credit Administration, the Forest Service receipts, inspection fees, Rural Electrification Administration; the Department of Commerce, including the China Trade Act Corp. fees, service and publications, fees and charges, National Bureau of Standards, fees for tests, and so forth, the Patent Office fees; the Department of Interior, electricity, sales from various power projects, the Geological Survey, sale of publications, grazing fees; the Federal Power Commission, water power license fees and charges; the Federal Security Administrator, including food inspection fees; the Post Office Department, postal revenues; and the Securities and Exchange Commission fees for registration of securities, national securities exchanges and qualification of trust indentures.

I read these off, Mr. Martin, to let you know that it was not something new that I was proposing, but something that has been in effect a long time concerning other agencies, some of them not as important, I do not claim, as your own agency, but some, of course, rather important themselves, like the Post Office Department, for instance.

Mr. MARTIN. I understand that thoroughly.

I would just like to make the comment that I have the greatest respect for all those agencies that you listed. One of them I had the privilege to head for a 3-year period, but I feel definitely, and I would like to have this in the record, that the Federal Reserve is in different category, and that its independence is something entirely different from any of those agencies; that it has a unique status and a unique place in our economy, and that as such, budgetary control is a vital element in preserving that position. That is essentially my thinking, and I just wanted you to have it.

Representative PATMAN. Of course, if it were necessary to sell all your bonds and you did not have any income, why, you would naturally expect an appropiration from Congress, would you not?

Mr. MARTIN. No, we would have to find some other source of income. You might be interested to know that the Open Market Committee really got its start by the need for several of the Reserve banks for earnings; the need for earnings is why they wanted to make some investments.

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Representative PATMAN. Well, that is what reminded me of it, and not the reverse of it.

Dr. Murphy, would you like to ask any questions?

Mr. MURPHY. I have three questions, Mr. Chairman.

First, there has been a great deal of discussion during the past 2 days of the amount of United States securities which Federal has purchased for the purpose of supporting the Government bond market, and I think it should be placed in the record what has been the net change in the Government security portfolio of the Federal Reserve banks from the end of the war to the present time.

It is my understanding that during that period the portfolio has decreased rather than increased in total amount; is that correct?

Mr. MARTIN. I think that is correct. We will put the exact figure in the record.

Mr. MURPHY. Would you insert it in the record, Mr. Chairman?

Mr. MARTIN. Certainly, we would be delighted to.

(The information referred to follows:)

At the end of 1945, following the Victory Loan drive, the Federal Reserve held $24.3 billion of Government securities and at the end of February 1952 holdings were $22.5 billion. The net decline over the entire period of $1.8 billion reflected a reduction in the period January 1946 through June 1950 of $6 billion and an expansion of $4.2 billion from July 1950 through February 1952. The decline in the period prior to the Korean outbreak reflected in part the Treasury's program of using both large excess cash balances and current cash surpluses for retirement of publicly held debt. This program, which totaled about $31 billion, was focused largely on securities held by banks, including the Reserve banks.

Changes in the Federal Reserve portfolio of Government securities need to be related to the other factors affecting bank reserves in order to be adequately evaluated. Over the full period January 1946 through February 1952, commercial banks were supplied with over $5 billion of new reserves from factors outside the direct control of the Federal Reserve, such as a net gold inflow and a reduction in Treasury cash holdings and Treasury deposits at the Reserve banks. Since the Federal Reserve reduced its holdings on balance by only $1.8 billion over this period, it did not fully offset the effect of these changes and total member bank reserves expanded nearly $4 billion. This increase in reserve balances made possible an expansion in total bank deposits of about $13 billion, including a decrease in Treasury deposits at commercial banks of $22 billion and an increase in privately held deposits of $35 billion.

Mr. MURPHY. Second, the subcommittee of 2 years ago, under the chairmanship of Senator Douglas, included in its report the following statement:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against rather than promote the purposes of the Employment Act, and we recommend that no step in this direction be taken. * * *

What would be your reaction to this subcommittee including a statement to the same effect in its report?

Mr. MARTIN. I concur in that statement.

Mr. MURPHY. Finally, Mr. Martin, in the questions which we submitted to you we did not include any questions on public-debt instruments, because we did not want to burden you unnecessarily; but, would you care to comment on the pros and cons of the advisability of issuing a bond, the repayment of which would be guaranteed in terms of purchasing power?

Mr. MARTIN. I would comment that there are administrative difficulties in the issuance of such a bond, but I am sure you know them

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better than I do, Dr. Murphy, and I question very much whether it could be worked out on a satisfactory basis.

Mr. MURPHY. That is all, Mr. Chairman.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. Mr. Chairman, Mr. Bolling a short time ago inserted in the record a memorandum from the President last February designating this special committee—I believe the so-called Wilson committee——

Mr. MARTIN. Correct.

Mr. ENSLEY. He also inserted the May 17th report of that committee. In the light of the experience of that committee do you have any suggestions or recommendations with respect to the possibility of future committees of that type set up specially to look into a special problem?

Mr. MARTIN. Oh, I think they can be very helpful when set up to look into a special problem.

Mr. ENSLEY. That is all I have, sir.

Representative WOLCOTT. Mr. Patman, may I ask a question?

Representative PATMAN. Mr. Wolcott.

Representative WOLCOTT. In view of Mr. Murphy's question about the gold, I was a member of that committee, and I had some doubts as to the advisability of putting that into that report without some explanatory language, because so many people were of the opinion that the restoration of the gold standard, some sort of gold standard, might be advisable, and I think, in consequence of my criticism of it at that time, the words "at this time" were put in. It originally read:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion would militate against—

And it was my suggestion that that language "at this time" be put in, reserving the right to suggest later on that we have some studies as to the desirability of restoring the gold standard. That was 2 years and a half ago.

I wonder if the same situation prevails now that prevailed at that time?

Mr. MARTIN. Well, my judgment would be that it does. I think that as long as we have Russia a hostile power, and the world in the general upset condition that it is, that we are operating on the right basis today.

Representative WOLCOTT. Going on further, we say in that report:

> We also recommend a thorough congressional review of existing legislation relating to the power to change the price of gold with a view to repealing any legislation that might be so construed as to permit a change in the price of gold by other than congressional action.

Now, that apparently had in mind the Gold Reserve Act which gave the President——

Mr. MARTIN. Of 1934—the 1934 act.

Representative WOLCOTT. Yes; which gave the President the authority to further devalue gold. I understand that that authority has expired, has it not?

Mr. MARTIN. That is correct.

Representative WOLCOTT. Is there any other power or authority that you know of that that language might apply to now?

Mr. MARTIN. I do not think so, but I would have to check it to be absolutely certain.

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Representative WOLCOTT. I think, Mr. Murphy, that perhaps we might have that answer before we recognize that there might be some authority somewhere outside of Congress to further devalue gold.

(The material referred to above is as follows:)

AUTHORITY TO CHANGE THE PRICE OF GOLD

The President was authorized to change the weight of the gold dollar by section 43 of the so-called Thomas amendment of May 12, 1933, as amended by section 12 of the Gold Reserve Act of 1934. That authority of the President, however, was in effect only for a temporary period and terminated on June 30, 1943.

Under sections 8 and 9 of the Gold Reserve Act of 1934, the Secretary of the Treasury has authority to purchase and sell gold at home or abroad "at such rates and upon such terms and conditions as he may deem most advantageous to the public interest." In addition, the Secretary is authorized by section 10 of the Gold Reserve Act, with the approval of the President, "to deal in gold" for the account of the stabilization fund established by that section. These powers of the Secretary, however, are effectively limited by provisions of the Bretton Woods Agreements Act of 1945 and the Articles of Agreement of the International Monetary Fund.

The Articles of Agreement of the Fund, which the United States has accepted under the Bretton Woods Agreements Act, provide that no member of the fund shall buy gold at more, or sell gold at less, than par value, plus or minus a margin or charge which the fund is authorized to prescribe and which has been set at one-fourth of 1 percent. Thus the United States, as a member country, may not purchase gold at a price greater, or sell gold at a price less, than par value in relation to the dollar, plus or minus the prescribed margin. Moreover, the par value of the dollar cannot be changed without the consent of Congress, since section 5 of the Bretton Woods Agreements Act provides that "neither the President nor any person or agency shall on behalf of the United States * * * propose or agree to any change in the par value of the United States dollar" unless such action is authorized by Congress.

Under section 14 (a) of the Federal Reserve Act, the Federal Reserve banks are authorized to deal in gold at home or abroad. However, the authority of the Reserve banks to purchase and sell gold under this section must also be read in connection with the provisions of the Articles of Agreement of the International Monetary Fund and the Bretton Woods Agreements Act mentioned above, as well as the provisions of the Gold Reserve Act of 1934.

A further discussion of the authority of the Secretary of the Treasury to deal in gold is contained in the answer given by the Secretary of the Treasury in reply to question D-12 of the questionnaire submitted to him by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report.

Representative WOLCOTT. Has any discussion been had on the desirability of this country's initiating an international monetary conference which would be particiapted in by the four countries looking to the possible restoration of the gold standard?

Mr. MARTIN. I do not know of any, sir. I think the International Monetary Fund——

Representative WOLCOTT. I should have said outside the International Monetary Fund, because I think that—my own thinking and my own thought is—that the study should be made outside of the fund, because the restoration of the gold standard would, of course, contemplate the dissolution of the International Fund. [Laughter.]

(Mr. Murphy is a member of the staff of the International Monetary Fund.)

You do not know of any conference?

Mr. MARTIN. No, I do not know of any, sir.

Representative WOLCOTT. All right. Thank you.

Representative PATMAN. Any other questions?

Mr. Martin, we appreciate the very fine and comprehensive statement that you have given us this morning, and we especially appreci-

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ate your forthright answers to our questions. We will probably ask you to meet with us in executive session sometime at your convenience and go over the documents that were discussed at the morning session, and any further questions we desire to ask you in writing, I assume that you will be willing to answer?

Mr. MARTIN. I would be very glad to answer them.

Representative PATMAN. Is there anything else?

Mr. MARTIN. Might I say one thing?

Representative PATMAN. Yes, sir.

Mr. MARTIN. Mr. Chairman, I would like to say that we have had the finest cooperation from Dr. Murphy with our staff, and that it has been a real pleasure for the Board to work on these problems.

Representative PATMAN. We are glad to hear that, Mr. Martin. Thank you very much.

Mr. MURPHY. Thank you very much.

(Supplementary statement filed by Mr. Martin is as follows:)

The Secretary of the Treasury was asked to prepare and insert at the end of his remarks a statement for the record indicating the process whereby the answers to the questionnaire were compiled, with particular reference to the use of outside consultants. It was stated that a similar record would be obtained from the Federal Reserve. In view of this the following statement is submitted:

PROCEDURE AND OUTSIDE CONSULTANTS USED IN PREPARING REPLIES TO THE QUESTIONNAIRES OF THE SUBCOMMITTEE ADDRESSED TO THE CHAIRMAN OF THE BOARD OF GOVERNORS AND THE CHAIRMAN OF THE FEDERAL OPEN MARKET COMMITTEE OF THE FEDERAL RESERVE SYSTEM

The answers to these questions were prepared by the Board's regular staff. This was considered the most appropriate procedure in order that the material submitted might be based on experience and background developed within the system. Outside specialists served on a consultative basis to criticize the drafts of replies prepared by the staff and to discuss general subjects and specific answers selected by the Chairman, other Board members, or the staff. This procedure for using regular staff in preparing replies to 61 questions covering the scope and detail of those submitted by the subcommittee presented a task of great magnitude, even though adjustments were made in the regular workload of the staff members involved. As a consequence the time required for completing the answers was much longer than originally scheduled, staff members devoted a great deal of overtime over a period of 3 to 4 months to preparing replies, and a considerable amount of regular work was given less attention or postponed.

Responsibility for organization of the work on answers, the critical review of them, and their revision was given to the Director of the Division of Research and Statistics. His internal advisory group was the senior staff; those who were most active on this assignment were the Assistant to the Chairman, the Assistant to the Board, the Economic Adviser to the Board, the Secretary of the Board, the General Counsel, and the Directors of the Divisions of International Finance, Examinations, Bank Operations, and Selective Credit Regulation. The senior staff group was relied on to select members of the staff to prepare draft replies to individual questions, to consult with staff members on problems raised by answers, to prepare replies to key questions, and to review answers generally.

Work on answers to individual questions—their preparation and revision—involved a substantial proportion of the time of more than 30 other staff members throughout the organization who were selected on the basis of their specialty and the subject material covered by the question. In this manner the Board drew on its complete resources of professional, technical, clerical, and stenographic staff not only in the Division of Research and Statistics but also in the Office of the Secretary, the Legal Division, and the Divisions of Bank Operations, International Finance, Examinations, and Selective Credit Controls. While this spreading of the work increased the problems of organizing the flow of work and of reviewing and integrating the replies, the procedure was necessary in order to prepare the answers along with other duties.

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Replies were developed through a process of draft, review, and redraft. The first draft of all answers was largely completed by the end of October, the second draft by late November, and the third draft by December 21. The first draft was prepared with a minimum of group consultation and the complete draft was circulated to all authors for comment . The second and third drafts were reviewed largely by the senior staff. For most questions the revision of the third draft was submitted to the subcommittee to be set in type and was proofed and checked through the page proof stage.

Preparation of the replies to some questions required modification of the above procedures, especially A–3, E–27, and the open market questions. Question E–27 was prepared in cooperation with the Federal Reserve banks and the banks supplied a part of the material presented in the reply and reviewed the draft reply. The staff of the New York bank collaborated in preparing the reply to the open market questions and reviewed the policy record presented in the reply to A–3.

The chairman and the other members of the Board were continually reviewing the replies as they were prepared, devoted many meetings to the replies, and made many suggestions. The Chairman was in constant contact with his senior staff discussing points raised by the answers and making decisions on content.

A group of 10 outside experts was appointed for consultation on the replies. These experts included some who had had extensive experience within the System and others without such experience but with recognized standing in the fields of money and credit and of Government structure and finance. These consultants commented by mail on both the first and the second drafts. Their main contributions, however, were made at a 3-day round-the-table discussion with the staff focused on subjects and questions selected by the staff and the Board. These meetings were held November 30 and December 1 and 2. The consultants were Robert deP. Calkins, E. A. Goldenweiser, Chester Morrill, Carl E. Parry, Herbert V. Prochnow, R. J. Saulnier, Theodore W. Schultz, Walter W. Stewart, Jacob Viner, and L. Wilmerding, Jr. The Board's expenditures for their services totaled $6,655.

Representative Patman. We will stand in recess until tomorrow morning at 10 o'clock, when we will meet in the committee room of the House Banking and Currency Committee.

(Whereupon, at 4:20 p. m., the subcommittee recessed to reconvene at 10 a. m., Wednesday, March 12, 1952 in room 1301, New House Office Buiding.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

WEDNESDAY, MARCH 12, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:05 a. m., in room 1301, New House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman, Senator Douglas, Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

It was suggested at the meeting yesterday afternoon that Mr. McCabe and Mr. Eccles be invited to appear before this committee. Each one of these gentlemen has been invited, but each one has reserved a decision in the matter.

However, if they want to appear and testify, time will be arranged for their appearance. The time suggested to them was satisfactory, so the invitations have been extended.

This morning we have with us Mr. Keyserling and Mr. Blough, members of the Council of Economic Advisers representing the Council of Econmic Advisers, before our committee.

Mr. Keyserling, are you ready to proceed?

Mr. KEYSERLING. Yes, Mr. Chairman.

Representative PATMAN. Will you suggest as to how you would like to proceed? Would you like to first make a statement or what would be your pleasure?

STATEMENT OF LEON H. KEYSERLING, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. KEYSERLING. Mr. Chairman, I have a prepared statement, in accord with the customary procedure, which is available for the committee and for others interested in it. I would much prefer rather than reading the statement in full to try to summarize the statement, but since summarizing the statement is a little more difficult than reading it, I would like to have a chance to summarize it and then have the questions come after the summary, because the mingling of my effort

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to summarize it with questions at the same time might not gain the advantage of time that would be gained by summarizing it rather than reading it.

Representative PATMAN. That will be satisfactory and we will respect your wishes, so you may proceed, Mr. Keyserling.

Mr. KEYSERLING. Mr. Chairman and members of the committee, I welcome this opportunity to discuss before you the role of monetary policy and the management of the public debt in achieving price stability and high-level employment. By high-level employment, we must mean the fairly consistent expansion of employment opportunity, because our labor force grows greatly from year to year. And since our technology is dynamic, our productive power tends to increase more rapidly than employment. With manpower and technology both advancing, our economy must expand in order to be stable. It cannot be stable by standing still. In addition to a stable and growing economy, we must make sure that our resources are being devoted to necessary purposes, and these change with the times. For example, if we now had a stable and growing economy without any defense program, we would be living in a fool's paradise.

Monetary policy and debt management are not ends in themselves. They are specific instruments which can be used wisely only in the context of the functioning of the economy as a whole, the objectives to which we now adhere as a nation, and the relative urgency and priority of problems arising in our economy under the threatening current of world conditions. Consequently, I believe that I can be most helpful to the committee, not by commencing with a technical discussion of monetary and debt management problems, but rather by outlining first what seem to me the most salient features in the current and foreseeable economic situation under a national policy of building our defenses, and then in this perspective evaluating the practical range and nature of relevant monetary and debt management policies.

For example, the size and pace of the defense program, its effect upon the disposition and utilization of our economic resources, and the specific character of the problems it imposes upon the whole economy, are vitally important starting points for a consideration of specific economic measures, including monetary and debt management policies.

These considerations seem to me doubly valid because much of the traditional theory about monetary policy, sometimes recited out of context, found its original roots in the minds of philosophers rather than practicing economists. These men sought to describe a static and perfectly consistent economic system, which probably never existed in the world of reality, and which in any event has little relevance to the dynamic American economy of today and to the entirely novel and rapidly moving problems with which we must now deal. One of the reasons why monetary officials in recent years have not pursued some of these theories relentlessly to their logical results has been, not that others prevented them from doing so, but rather that they themselves have shrunk from the appalling practical consequences of such action.

This may explain why the differences in viewpoint concerning monetary policy and debt management, expressed by those charged with practical problems and public responsibility, have not been so great as

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the differences expressed by some commentators in search of sensation and by some theorists not challenged by the duty to act.

So far as I have been able to observe, the differences between what a responsible Treasury official and a responsible Federal Reserve official would actually do under current conditions, if either had complete authority to do as he pleased, are small differences contrasted with their magnification by those who are not sobered by imminent and vital responsibilities to perform.

The evidence already brought before this committee that the Secretary of the Treasury and the Chairman of the Federal Reserve Board, and their associates, have sought to reach working agreements, is not hard to explain. This development has not resulted from compulsion either by the Congress or by the President. It has resulted from the compulsion of economic reality, based upon looking frankly at conditions both at home and abroad. Economic conditions at home do not leave a very wide range of election in monetary and debt management policy. While there may still be some shadings of emphasis, the underlying situation and the limitations which it imposes upon novel experimentation or wide deviation from a fairly well-established course make it only natural that men in positions of active responsibility should be anxious and able to reconcile their views. And conditions abroad make it apparent to all men of good will that the American people and their public officials must do their best to pull together in a common cause.

I can find nothing suspicious or surreptitious in the fact that the Secretary of the Treasury and the Chairman of the Federal Reserve Board are trying, and it is to be hoped successfully trying, to harmonize their views. All that this proves to me is that Mr. Snyder and Mr. Martin, and their associates, are sensible, hard-headed, experienced, and patriotic men.

I shall endeavor, if it please the committee, to commence with a general description of the economic problems now confronting this Nation in the course of a defense effort novel both in character and purpose. I believe that only in this perspective can the more specialized problems of monetary policy and debt management be intelligently depicted or intelligently solved. Some of the fuss and fury stirred up in these specialized areas has resulted from looking at a few trees without surveying the forest.

I do so because it is my view that a great mistake has been made in looking at monetary and fiscal policy within a narrow framework rather than trying to fit it into our economy today, its dynamic problems and its world responsibilities, and I think if we start from that point of vantage we not only get a better perspective but come nearer to realizing the limitation upon monetary and management policy and what it can and cannot do.

Proposition No. 1 is that our transcendently important economic problem today is how much of our productive power and economic resources should be allocated to national defense.

Obviously, the size and pace of the defense program most importantly affects the degree of inflationary pressures, the fiscal situation of the Government, and the entire range of economic policies worthy of serious attention.

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By national defense, I mean the whole range of programs which reflect our undertakings to enlarge the mutual security of the free world.

Consistent with a position that I have always taken, I voice no opinion as to how large or how fast these undertakings should be from the viewpoint of national security. I may have views on this as a citizen, but in my role as chairman of the Council of Economic Advisers I have nothing to offer which can compete with the superior judgment of those in our defense and international agencies, subject to the ultimate judgment of the President and the Congress.

But I feel compelled to raise my voice as an economist in the public service when I witness the growth of a strong, if not predominant, sentiment that our security program as a whole must be drastically reduced in order to maintain a strong economy. The clear facts since the original Korean aggression, and the weight of judgment now as to the economic outlook, simply do not support the proposition that we must slash the security program to protect our economy.

The primary test of whether a security program of given size and pace, in a long period of partial mobilization, is weakening or impairing our general economic strength, cannot be determined by looking only at the dollar value of the security program, nor by looking only at the deficit in the Federal budget, even though these be important considerations. The primary test of the impact of the security program upon our general economic strength involves these three paramount questions, and these three alone in my judgment:

1. Is the security program, through its drain upon our resources, leaving or threatening to leave our business system with inadequate resources or incentives to safeguard and advance that productive power which is the ultimate source of our economic strength?

2. Is the security program imposing such strain or deprivation upon consumers as to weaken the strength or morale of our people—155 million strong?

3. Is the security program, by its very nature, incompatible with the protection of the Nation against further inflation, assuming that we do not want to resort, during a long period of partial mobilization, to a scope or intensity of controls which in the long run might impair our productive power or corrode our basic freedoms?

My views are so well known on the subject that, from the economic point of view, the security program is not imposing that kind of strain on our economy, that I will summarize very briefly on these three points.

First, it cannot be argued that the prospective or present size of the security program is unduly impairing our productive strength, when at a uniform price level we had in 1951 by far the highest level of investment in plant and equipment, which is at the heart of our productive strength, and in business investment generally, that we have ever had in our history, and where as a matter of fact the main question validly raised then was not whether business had the funds, the incentives, the manpower to invest adequately in productive equipment, but rather whether in view of the inflationary dangers the level of over-all business investment was too high and ought to be further curbed.

Second, from the viewpoint of consumer supplies, the year 1951 was only slightly lower than 1950, in fact by some measurements it

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was higher, and in any event it was higher than in any other year in our history, and here again the main operating force at the present time upon the level of consumer supplies is not restrictions imposing deprivations on the people, but their unwillingness in many areas even to buy at the level of available supplies.

In the third place, we come to the question of whether the program is of a size which makes the stabilization of prices impractical without excessive controls. The record on that indicates that over the past year we have had a very unusual record of price stability for a high level economy.

Wholesale prices have trended somewhat downward; retail prices moved up slightly for a large part of the year, but their trend has been downward in the most recent period.

As we look forward to the remainder of the year 1952 and beyond, it is a curious paradox that some of those who a year or so ago were extremely doubtful about the capacity of our productive resources to support the demands of the security program are now exhibiting trepidation lest even with the security program we run into a recession due to the inability of the economy to maintain demand for that part of our productive resources which are not employed in the security program. I do not believe that this trepidation is justified, for reasons which it would not be germane to develop at length here. Nonetheless, the trepidation at least underscores the point that there is a growing recognition that the security program can be borne by the economy without excessive strain.

I would be the last person imaginable to take the unsound position that the security program should be maintained at now contemplated levels, or raised above these levels, in order to maintain high-level production and employment. That is manifestly not an appropriate function for a security program. I am firmly convinced that our economy now has or must find the ways to maintain stability and growth, if and when the world situation permits a vast reduction in the security program. The only point I am making here is that, while we should by all means reduce the security program when the best informed appraisal of the world situation dictates that course, we do not need and should not dare to do so before that time on general economic grounds.

The question of the necessary size of the security program should not be confused with the question of efficiency and the weeding out of waste in its execution. Every sensible person will agree that it would be a net gain, if ways could be found to get the same amount of security for less money. I hope that such ways can be found, and I commend every effort toward that end. But I believe that only confusion and danger to this country can result from failing to distinguish between trying to get necessary security as economically as feasible, and trying to cut security below necessary levels on the ground that we do not have the economic strength to do the job without embarrassment or impairment of our economy.

Since we have the resources of manpower, materials, and business and institutional skills to carry forward the security program, we cannot say that we do not have the means to finance it. It would be somewhat better, in my judgment, to pay for a security program at the now contemplated level entirely out of taxation rather than partly by borrowing. But, even if it is financed partly by borrowing, the Con-

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gress will need to weigh whether the amount of borrowing involved could threaten the Nation to the extent that it would be threatened by a deficiency in national security.

I have dwelt upon this point at some length, because I believe that it is the greatest economic issue which we face as a Nation, and one alongside of which other economic issues pale into relative insignificance. It seems to me that those who do not give top priority to this question cannot find the right answer on other questions of economic policy. We have reasonable grounds for believing that, if we are strong enough to resist and deter the Communist menace, the American economy will continue its timeless progress toward new productive achievements and even greater strength. But if, through mistaken economic analysis concerning the capacity of our economy, we should fall down on this top job, then no other policies could save us from dangers beyond description.

Proposition No. 2 is that, with a large security burden, economic policy must concentrate above all upon the expansion of production.

And here I would summarize briefly, what I think is my known view that, while we must to a degree use controls to help allocate our resources so that we can do the security program more effectively, they are no substitute for and are not of equivalent value in the American economy to the expansion of production.

We can outproduce the Russians; we cannot hope to outcontrol them, and I think that particularly for a long period of partial mobilization we must be very careful not to resort to controls to a degree which, while they might accomplish the purpose of allocating resources or restricting inflation, would at the same time dim the edge of the most important of all our great nonsecret weapons, the capacity to produce; and that capacity to produce, as I shall indicate, could be seriously and indiscriminately impaired by the use of controls along lines which, while they might have been relevant to the simple problem of using all-out weapons to fight the traditional kinds of inflation or deflation, are not so relevant to the particular problems of this kind of new and difficult mobilization effort.

The facts speak for themselves. Not only in World War II when we had a slack use of our resources at the beginning of the war, but even since 1950 when we had a situation of many a tight use of our resources at the beginning of the mobilization effort, we have nonetheless expanded over-all production about apace with the defense program, and for that reason, which is the most fundamental of all economic reasons getting beyond any type of specialized analysis, for that basic reason alone we have thus far carried the security program with an advancement of our investment and productive tools and equipment which is the real source of our strength, and without serious impairment of our civilian economy or our civilian morale.

Proposition No. 3 is that the expansion of production must be responsive to the priorities of national needs. We cannot do everything at once. And in my ardent advocacy of production I do not claim that we do not have to sacrifice some things, or that we can, rich as we are, do everything at the same time. This means that balance must be maintained in the utilization of our resources.

Balance in the utilization of our resources means very simply that in this kind of mobilization effort some things must be expanded at the same time that other things are contracted.

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We must expand the production of steel facilities, contract the production of automobiles. We must expand the production of weapons, contract the production of houses, and so on all up and down the line; and, in seeking to arrive at a wise composite of resource use in that dual process of expansion and contraction, we must rely largely upon selective devices directed to those particular ends and cannot rely to the degree that in a classical fight against an all-out inflation or a classical fight against an all-out depression we could adopt on a broad scale measures of a contracting character or measures of an expanding character.

We have to ask ourselves, in adopting measures of a general character to contract or to expand the economy, would they contract first the things that we want to contract, or would they contract first the very things that we must of necessity expand rapidly if we want to build up the productive strength and the wise composition of our total strength, which, at least according to my analysis, is at the heart of this whole problem.

Proposition No. 4 follows naturally from the third, the task of curbing inflation in a defense economy must be reconciled with the need at one and the same time for expansion in some areas and for contraction in others.

We are not fighting basically a war against inflation. We are not fighting basically a war against a depression. We are fighting primarily a new kind of limited international engagement, and the tasks and problems of that kind of situation are different either from the tasks of 1932 which called for an all-out use of antideflationary weapons, or the tasks of some of the kinds of all-out inflations which have occurred in some countries at some periods of time.

Proposition No. 5 is that the nature of our current and foreseeable economic tasks is too complicated for extreme or major reliance on any one type of economic measure. This applies to monetary policy as well as to other policies.

As indicated above, the complicated and unique character of the current defense program requires a combination of efforts, some designed to expand parts of the economy rapidly, and others designed to contract other parts of the economy with similar rapidity (insofar as the increase in over-all production does not in itself take care of the necessary expansion of the security program).

Theoretically, one might argue that one type of economic policy might be predominantly relied upon in the current situation to prompt all of the necessary and varied adjustments in resource use. For example, it might be argued theoretically that, since tax reductions are stimulating and tax increases repressive, a complex tax scheme could be worked out on paper which would provide sufficient inducements for expansion wherever needed and sufficient restraints for contraction wherever needed. But the effort to formulate and apply such a complicated and refined tax system would deprive the tax system of one of its main virtues—namely, that it is rather generalized—and would make taxation more complicated and cumbersome, more detailed and personalized, than the most extreme kind of price and wage control. Similarly, one could work out theoretically on paper a price-control policy, or a credit-control policy, or a policy governing the allocation of materials, so comprehensive and so discriminating as to accom-

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plish by that one device alone all of the objectives for the economy which must now be sought. But the utilization of any one device to this extent would break down of its own weight, and would result in a system of controls far more harsh, rigid, and excessive than the moderate utilization of a variety of weapons in mild proportion.

These comments are applicable to general monetary policy. I am heartily in accord with the moderate utilization of monetary policy to exercise some general restraining influence in an inflationary period. But intrinsic limitations upon its utility lead to major reliance upon a variety of other measures.

Representative PATMAN. Mr. Keyserling, since you have elaborated on all these points rather fully, don't you think that you could go through them and just bring out the points and then yield for questions? Probably a lot of it could be brought out through the questioning.

Mr. KEYSERLING. Yes; I can certainly do that.

The first point I make is that monetary policy is hardly adjusted under present circumstances to the expansionary phases of the task, and that is vitally important in building up our strength.

Second, insofar as it is adjusted to the contracting phases, it is commonly recognized by various authorities with whom I agree and whom I cite here, that for general monetary policy to be pushed far enough to produce a general contraction of the economy and thus to have a pronounced effect upon prices or upon investment, it would have to be pushed far enough to result in a general contraction of employment and production.

And I set forth in my prepared statement various statements from various sources to that effect, and that in that way by producing a general contraction of production and employment, we would far outweigh the benefits which might be derived, particularly because, as I have said, the contraction would not be selective and for reasons which I could give would be more likely to occur first in those areas which we are seeking affirmately to expand, and last in those speculative and relatively nonessential areas which other more selective measures can more quickly contract.

The next point I make is that there is general agreement among the authorities that monetary policy directed toward variations in the money supply and changes in interest rates and through the composite of those factors to effect the level of investment would by common agreement among the authorities have to be under current circumstances rather narrow, and that there may be real questions whether if so narrow they would produce such limited adjustments in interest rates and in other sectors of lending as to make it very questionable as to whether much would be accomplished, except a general upward push in interest rates, and as to whether that is desirable from the viewpoint of long-range trends, I suppose the committee's judgment is as good as mine.

Now I have summarized several pages. Proposition No. 6 is that the current and foreseeable economic situation calls for an admixture of economic tools, without excessive reliance upon anyone. Now let me read there a statement from Dr. Goldenweiser in Harper's magazine for April 1951:

First, we must bend every effort to increase production by greater exertion, greater efficiency, longer hours, fewer leisure people, less of the gracious things

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of life * * *. Second, we must economize—make sure that no money is spent unnecessarily * * *. Third, as large a share of the necessary expenditures as possible must be met by taxation * * *. Fourth, the Government must borrow what has to be borrowed (insofar as possible) in such a way as to tap income that would otherwise be spent by the person receiving it * * *. Fifth, the Government should borrow from the banks only the unavoidable minimum * * *. Sixth, over-all restraint should be exercised over loans by banks to businesses and individuals * * *. Finally * * * price and wage controls—to hold the line until the other measures become effective—are highly desirable.

The foregoing seems to me to set forth admirably, and in proper order, the rounded elements in a program for stability and growth. Further, I would like to stress the extent to which most of those who have been challenged by the responsibilities of practical action, and particularly by the responsibilities of public office, find themselves in essential agreement in this matter—although there will always be some shadings of emphasis.

Then proposition No. 7, which is my final one, Mr. Chairman, and which I would like to read.

Proposition No. 7 is that basic economic policies which affect the whole Nation should seek harmony, and that under our system the most powerful force toward this harmony is men of good will working cooperatively together. With this force present, neither new machinery nor new legislative definitions of authority seems essential.

Above all, there is widespread agreement that those agencies of public authority which vitally affect the national economy should try to reconcile their actions, because pulling in opposite directions is manifestly hurtful regardless of which side is "on the side of the angels."

There will always, of course, be differences of opinion on policy issues. But neither sober and reflective businessmen nor anybody else would want various important agencies of public power, each vitally affecting the economy, to pursue conflicting policies of a fundamental character for an enduring length of time. Nothing could be more inefficient, more uneconomical, more demoralizing to our business system, or more conducive to the undermining of the people's confidence in public authority, and I think the people must have confidence not in only one public authority but in all public authorities.

Senator Douglas. Is this irrespective of their performance?

Mr. Keyserling. No, sir; not irrespective of their performance. That is not the point I am making, but no one agency has a monopoly on correct performance at all times.

It is true that different agencies of public power have different accents of responsibility, and different prime objectives and functions. But no one of them can believe that its perspective or its point of emphasis is transcendently important, to the exclusion of all others. The very fact that in our democracy there are at the national level so many agencies of public power, makes it essential that a process of reconcilitation and harmonization move constantly forward. It has always been this way; and it will always be this way.

The possibility of some fundamental collision of policy between two agencies of public power which fundamentally affect the national economy is by no means limited to the case of the Treasury and the Federal Reserve Board. Other agencies of public power are now undertaking functions quite as vital to the economy as a whole, and

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quite as important to the lives and fortunes of the individual. For example, it would be hard to imagine a more far-reaching authority than that of allocating scarce materials throughout the economy, which carries with it the very power of life or death over substantial segments of our business system. The relationship between monetary policy and fiscal policy is indeed important; but no one can prove that it is of a very different category of importance from the relationship between price policy and wage policy, or tax policy and spending and lending policy, or defense policy and policies affecting industrial and civilian supplies.

The Congress has consistently and increasingly recognized that all of these policies are vital, that no one of them is supreme, and that constantly improved machinery should be sought both in the legislative and the executive branch for evaluating these policies as a whole and their relationship to one another. The Joint Committee on the Economic Report and the Council of Economic Advisers are both statutory examples of this recognition. The advent of the defense program has intensified the search, both by the people and their Government, for basic mutuality of purpose and basic consistency of effort among the various instruments of public power affecting the whole economy and its very security.

Whenever there might be a fundamental collision of policy between any two or more agencies of public power which fundamentally affect the national economy, manifestly the solution does not lie in arid debate as to how independent one or the other is or should be, or in proposals to subordinate one to the other by legislative fiat. If by independence one means that men of integrity should look for the right answers and express their views vigorously without suppression or recrimination, that, of course, is desirable. Nor would I undertake to enter upon discussion of the question turning upon the fact that the Congress has established the Federal Reserve Board in a different relationship to the Government from that applying to the executive departments. This is a matter of congressional policy. But in no event can any realistic concept of independence mean that there is no relationship or interdependence among the policies and problems dealt with by the various important agencies of public power importantly affecting the national economy. Consequently, they must all try to work together on problems which affect them all.

In the final analysis, in the event of collision, all agencies of public power must recognize the ultimate and decisive authority of the Congress; and all must recognize that the Presidential office under our traditions and experience has always had the legitimate function of lending its influence toward harmonizing the executory or administrative aspects of national economic policy. But the genius of our system resides not so much in reliance upon command as in reliance upon voluntary accommodation through hard work, fair purposes, and mutual respect. Surely the Council of Economic Advisers, which finds its life in a statute the essence of which is cooperation, cannot bring itself to believe that cooperation is not the best method in dealings between any important organs of public power.

From the peculiar vantage point of the Council of Economic Advisers, it has seemed to me that the Treasury and the Federal Reserve Board, as well as other agencies, have worked harder and with a finer spirit than the general public realizes to join hands in the national

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interest in these trying times. For example, those not involved in the process hardly realize how thoroughly the reports to the Congress under the Employment Act of 1946 are made the subject of full discussion, interchange of views, and a wise spirit of give and take among all of the agencies concerned with national economic policy. I have always found the Treasury and the Federal Reserve Board independent in the sense of being sturdy and vigorous in the assertion of their views; but I have never found any of them independent in the sense of being remote or unapproachable, provincial or narrow-minded, or overzealous in the control of its own domain. The result of this process of cooperation has not been perfect. But it has produced over the years, I believe, a more intelligent and harmonious approach to the problems of our national economy than would have been possible under any other approach.

Based upon my observation of the relationships now in effect, I do not see the need for additional formal machinery, or for new legislative efforts to redefine relationships or relative responsibilities. I believe instead that we must continue to work together, seeking to improve our tools of economic analysis, to achieve even greater objectivity, and to enlarge the popular understanding of what we are trying to do. These things depend upon men, and not upon laws. I think the men with whom I have worked measure up to the task, and that is what is most important.

At the same time, if it should be deemed desirable to follow the suggestion recently made by the Secretary of the Treasury, to the effect that the Treasury, the Federal Reserve Board, the Council of Economic Advisers, and certain other agencies recognize more explicitly through some new cooperative unit their mutual interests, and if the Federal Reserve Board should feel likewise, such a proposal would certainly meet with the hearty support of the Council of Economic Advisers.

In summary, I think we are in an economic situation different from any we have faced before, that it calls for a composite of measures to use our resources wisely, bringing on rapid expansion in some areas and contraction in others.

That consequentlly most of the classical approaches designed to deal theoretically with the over-all contraction of the economy to avoid inflation or its over-all expansion to avoid depression are not highly relevant to the current situation.

That consequently what we must rely more upon is selective devices to achieve differing results and different trends in different areas of the economy.

That consequently we should refrain from using excessively abrupt and generalized weapons which would accomplish some useful purposes which in the main would be outweighed by the use of the blunt weapon on a broad scale.

That broadly speaking the trends over the past long period of time toward lower interest rates and a more abundant credit generally speaking are associated with, though by no means entirely responsible for, the great growth in our productive capacity, and broadly speaking the more generous sharing of its benefits both on the business side and on the consumer side.

Consequently I think that the range of policy called for in these times is first an intense and active stimulation of our productive genius

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which I do not think has gone anywhere far enough, and which both on the economic side and on the moral side can stimulate and hold together the American people as nothing else can.

Second, the moderate use of controls so as not to interfere with that productive genius, and the use of those controls in a composite pattern which has proved moderately successful over the past year, moderately successful during World War II, although I think tax policy was then too lax, and with that, Mr. Chairman, I would be very glad to answer any questions that the committee may have in mind.

(The prepared statement submitted by Mr. Keyserling in its entirety is as follows:)

TESTIMONY OF LEON H. KEYSERLING, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, BEFORE SUBCOMMITTEE ON GENERAL CREDIT CONTROL AND DEBT MANAGEMENT OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT, WEDNESDAY, MARCH 12, 1952

Mr. Chairman and members of the committee: I welcome this opportunity to discuss before you the role of monetary policy and the management of the public debt in achieving price stability and high-level employment. By high-level employment, we must mean the fairly consistent expansion of employment opportunity, because our labor force grows greatly from year to year. And since our technology is dynamic, our productive power tends to increase more rapidly than employment. With manpower and technology both advancing, our economy must expand in order to be stable. It cannot be stable by standing still. In addition to a stable and growing economy, we must make sure that our resources are being devoted to necessary purposes, and these change with the times. For example, if we now had a stable and growing economy without any defense program, we would be living in a fool's paradise.

Monetary policy and debt management are not ends in themselves. They are specific instruments which can be used wisely only in the context of the functioning of the economy as a whole, the objectives to which we now adhere as a Nation, and the relative urgency and priority of problems arising in our economy under the threatening current of world conditions. Consequently, I believe that I can be most helpful to the committee, not by commencing with a technical discussion of monetary and debt-management problems, but rather by outlining first what seem to me the most salient features in the current and foreseeable economic situation under a national policy of building our defenses, and then in this perspective evaluating the practical range and nature of relevant monetary and debt-management policies.

For example, the size and pace of the defense program, its effect upon the disposition and utilization of our economic resources, and the specific character of the problems it imposes upon the whole economy, are vitally important starting points for a consideration of specific economic measures, including monetary and debt-management policies.

These considerations seem to me doubly valid because much of the traditional theory about monetary policy, sometimes recited out of context, found its original roots in the minds of philosophers rather than practicing economists. These men sought to describe a static and perfectly consistent economic system, which probably never existed in the world of reality, and which in any event has little relevance to the dynamic American economy of today and to the entirely novel and rapidly moving problems with which we must now deal. One of the reasons why monetary officials in recent years have not pursued some of these theories relentlessly to their logical results has been, not that others prevented them from doing so, but rather that they themselves have shrunk from the appalling practical consequences of such action.

This may explain why the differences in viewpoint concerning monetary policy and debt management, expressed by those charged with practical problems and public responsibility, have not been so great as the differences expressed by some commentators in search of sensation and by some theorists not challenged by the duty to act.

So far as I have been able to observe, the differences between what a responsible Treasury official and a responsible Federal Reserve official would actually do under current conditions, if either had complete authority to do as he pleased, are small differences contrasted with their magnification by those who are not sobered by imminent and vital responsibilities to perform.

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The evidence already brought before this committee that the Secretary of the Treasury and the Chairman of the Federal Reserve Board and their associates have sought to reach working agreements is not hard to explain. This development has not resulted from compulsion, either by the Congress or by the President. It has resulted from the compulsion of economic reality, based upon looking frankly at conditions both at home and abroad. Economic conditions at home do not leave a very wide range of election in monetary and debt management policy. While there may still be some shadings of emphasis, the underlying situation and the limitations which it imposes upon novel experimentation or wide deviation from a fairly well-established course make it only natural that men in positions of active responsibility should be anxious and able to reconcile their views. And conditions abroad make it apparent to all men of good will that the American people and their public officials must do their best to pull together in a common cause.

I can find nothing suspicious or surreptitious in the fact that the Secretary of the Treasury and the Chairman of the Federal Reserve Board are trying—and it is to be hoped successfully trying—to harmonize their views. All that this proves to me is that Mr. Snyder and Mr. Martin and their associates are sensible, hard-headed, experienced, and patriotic men.

I shall endeavor, if it please the committee, to commence with a general description of the economic problems now confronting this Nation in the course of a defense effort novel both in character and purpose. I believe that only in this perspective can the more specialized problems of monetary policy and debt management be intelligently depicted or intelligently solved. Some of the fuss and fury stirred up in these specialized areas has resulted from looking at a few trees without surveying the forest.

Proposition No. 1 is that our transcendently important economic problem today is how much of our productive power and economic resources should be allocated to national defense.

Obviously, the size and pace of the defense program most importantly affect the degree of inflationary pressures, the fiscal situation of the Government, and the entire range of economic policies worthy of serious attention.

By national defense I mean the whole range of programs which reflect our undertakings to enlarge the mutual security of the free world.

Consistent with a position that I have always taken, I voice no opinion as to how large or how fast these undertakings should be from the viewpoint of national security. I may have views on this as a citizen, but in my role as Chairman of the Council of Economic Advisers I have nothing to offer which can compete with the superior judgment of those in our defense and international agencies, subject to the ultimate judgment of the President and the Congress.

But I feel compelled to raise my voice as an economist in the public service when I witness the growth of a strong, if not predominant, sentiment that our security program as a whole must be drastically reduced in order to maintain a strong economy. The clear facts since the original Korean aggression, and the weight of judgment now as to the economic outlook, simply do not support the proposition that we must slash the security program to protect our economy.

The primary test of whether a security program of given size and pace in a long period of partial mobilization is weakening or impairing our general economic strength cannot be determined by looking only at the dollar value of the security program nor by looking only at the deficit in the Federal budget, even though these be important considerations. The primary test of the impact of the security program upon our general economic strength involves these three paramount questions:

(1) Is the security program, through its drain upon our resources, leaving or threatening to leave our business system with inadequate resources or incentives to safeguard and advance that productive power which is the ultimate source of our economic strength?

(2) Is the security program imposing such strain or deprivation upon consumers as to weaken the strength or morale of our people—155 million strong?

(3) Is the security program, by its very nature, incompatible with the protection of the Nation against further inflation, assuming that we do not want to resort during a long period of partial mobilization to a scope or intensity of controls which in the long run might impair our productive power or corrode our basic freedoms?

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By none of these three paramount tests can respectable evidence be adduced that the now contemplated security program is excessive from the viewpoint of the economist, if it is not excessive from the viewpoint of its primary purpose to make us as secure as we can reasonably hope to be in a threatening and uncertain world.

It can hardly be argued that the security program is in process of impairing our basic productive strength. In 1951 gross private domestic investment was at an annual rate of approximately $59 billion, contrasted with about $52½ billion in 1950 and about $47½ billion in the previous peak year 1948. All comparisons are in terms of 1951 prices. Investment in producers' durable equipment, which is at the heart of our productive strength, was above $27½ billion in 1951, contrasted with about $24½ billion in 1950, and about $23 billion in the previous peak year 1948. The growth of our productive strength has been even more impressive when measured by facilities and supplies in certain key areas, such as steel, aluminum, and electric power. In fact, the pertinent issue with respect to private capital formation in 1951 was not whether business had available the materials, the manpower, the funds, and the incentives to build adequately our productive strength, but rather whether capital formation was proceeding at a higher level than desirable.

Nor can it be argued that the security program is in process of reducing consumer supplies below satisfactory levels. With the possible exception of 1950, the year 1951 witnessed the highest level of consumer supplies on record. A few things, such as housing and automobiles, were produced at a somewhat lower level than in 1950, but at a much higher level than in any year before World War II.

Similarly, it cannot be said that the size or pace of the security program is inconsistent with the maintenance of economic stability. The past year has almost established a new record for general price stability. Wholesale prices have tended slightly downward since March 1951. Retail prices during the past year have moved very moderately upward, but have begun to turn downward in recent weeks. This stability has not been achieved under an anti-inflationary program which most informed persons would call excessively severe. On the contrary, it has been achieved under policies of taxes, credit controls, and direct controls which have been somewhat milder and looser than most experts thought necessary—and the major explanation of this has been our enormous productive power and the general amplitude of supplies.

As we look forward to the remainder of the year 1952 and beyond, it is a curious paradox that some of those who a year or so ago were extremely doubtful about the capacity of our productive resources to support the demands of the security program are now exhibiting trepidation lest even with the security program we run into a recession due to the inability of the economy to maintain demand for that part of our productive resources which are not employed in the security program. I do not believe that this trepidation is justified, for reasons which it would not be germane to develop at length here. Nonetheless, the trepidation at least underscores the point that there is a growing recognition that the securiy program can be borne by the economy without excessive strain.

I would be the last person imaginable to take the unsound position that the security program should be maintained at now contemplated levels, or raised above these levels, in order to maintain high-level production and employment. That is manifestly not an appropriate function for a security program. I am firmly convinced that our economy now has or must find the ways to maintain stability and growth, if and when the world situation permits a vast reduction in the security program. The only point I am making here is that while we should by all means reduce the security program when the best informed appraisal of the world situation dictates that course, we do not need and should not dare to do so before that time on general economic grounds.

The question of the necessary size of the security program should not be confused with the question of efficiency and the weeding out of waste in its execution. Every sensible person will agree that it would be a net gain, if ways could be found to get the same amount of security for less money. I hope that such ways can be found, and I commend every effort toward that end. But I believe that only confusion and danger to this country can result from failing to distinguish between trying to get necessary security as economically as feasible, and trying to cut security below necessary levels on the ground that we do not have the economic strength to do the job.

Since we have the resources of manpower, materials, and business and institutional skills to carry forward the security program, we cannot say that we do

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not have the means to finance it. It would be somewhat better, in my judgment, to pay for a security program at the now contemplated level entirely out of taxation rather than partly by borrowing. But even if it is financed partly by borrowing, the Congress will need to weigh whether the amount of borrowing involved could threaten the Nation to the extent that it would be threatened by a deficiency in national security.

I have dwelt upon this point at some length, because I believe that it is the greatest economic issue which we face as a nation, and one alongside of which other economic issues pale into relative insignificance. It seems to me that those who do not give top priority to this question, cannot find the right answer on other questions of economic policy. We have reasonable grounds for believing that, if we are strong enough to resist and deter the Communist menace, the American economy will continue its timeless progress toward new productive achievements and even greater strength. But if, through mistaken economic analysis concerning the capacity of our economy, we should fall down on this top job, then no other policies could save us from dangers beyond description.

Proposition No. 2 is that, with a large security burden, economic policy must concentrate above all upon the expansion of production.

When any nation assumes a large defense burden, there are only two major ways of carrying it. One way is to expand total output, so that defense needs can be served without subtracting too much from other economic needs. The second way is to use economic controls to divert productive resources away from other purposes and toward defense purposes. Even in a nation as strong and productive as the United States, both of these methods must be used for the time being. But it is clearly in our interest, particularly in a long period of partial mobilization, to accomplish as much of the defense program as possible through the expansion of production, rather than through drawing down upon other elements in our national economic strength. This is the basic philosophy of the current mobilization program.

The soundness of this philosophy is conclusively demonstrated by all experience. During World War II at its peak, we allocated to defense purposes annually almost as much resources as the total product of our economy during the year before the war started. But we so expanded total output that we were able to do this without a damaging curtailment of civilian supplies, and while carrying forward many industrial expansion programs to provide the sinews for the war effort. Further, when the war was over, we found that the expansion of our productive facilities could be translated into peacetime goods and services without serious or prolonged economic dislocation. Since the Korean outbreak, although our then existing productive resources were more fully utilized in mid-1950 than in 1939, we nonetheless have relied predominantly upon our genius for still further productive expansion to carry the additional burden. Since mid-1950, our expansion of total output has roughly kept pace with the expanding defense program, and consequently the defense program has not resulted in impairment of our industrial or civilian strength. We have used controls to facilitate an orderly transition, and to deal with specific shortages. But fortunately, we have not fallen into the error of substituting the philosophy of all-out controls for the philosophy of all-out production. It is by doing the job in the American way that we have kept our economy so strong, and in fact made it stronger.

Our greatest reserve strength still lies in our capacity further to increase production. The ceiling of our productive ability has no more been reached in 1952 than in 1950 or in 1948. Without appreciably lengthening the workweek, and without applying the forced pressures of a full-war economy, we have ample resources to increase total production by at least 5 percent per annum over the next few years. If additional pressure should require us to do so, we could for at least a few years almost double the annual rate of productive increase. It is this which, more than all else in material things, gives us our true measure of superiority over the Russian system.

Insofar as we need to fight inflation through the imposition of controls and restraints, indirect or direct, we must do so in ways that do not seriously militate against the achievement of our productive potential. This has a most important bearing upon the nature of controls that we can afford to use, and upon the extent to which we can afford to use them. Those who would employ without reservation the classical measures of "fighting inflation," seem not to have taken into account the imperative necessity for fighting inflation in ways that do not repress the general rate of productive advance which is the surest way to keep our economy strong throughout an enduring defense period.

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Proposition No. 3 is that the expansion of production must be responsive to the priorities of national needs. We cannot do everything at once. This means that balance must be maintained in the utilization of our resources.

Great though our productive resources are, we cannot afford to do everything at once. While some lines of production must be rapidly expanded, others must be contracted. For example, in order to build more airplanes, we must for a time build less automobiles. In order to build more plants to produce steel, we must for a time build less houses than we otherwise would. Further, expansion and contraction in various areas must achieve sufficient consistency to avoid excessive economic dislocation and to fulfill the defense program itself. For example, if the expansion of machine tool facilities were not sufficiently coordinated with the defense program, bottlenecks would multiply in the execution of the defense program. If defense expansion and civilian contraction were not harmonized, either the manpower and the materials for the defense program would be lacking, or excessive and premature disutilization of manpower and materials would occur.

The most important decisions of a defense period, both private and public, involve this concurrent expansion in some areas and contraction in other areas. Hence the economic policies to be used must be far more refined and selective than if the simple purpose were to produce a general expansion or contraction of the economy as a whole. We are not fighting primarily an inflation or a depression; we are fighting primarily a limited international struggle. It follows that the classical economic theories directed toward producing general stimulation or general contraction throughout the whole economy, i. e., the traditional "anti-inflationary" or "antideflationary" policies, are not suitable for universal or broadside application to the current problems of the defense economy.

Proposition No. 4 is that the task of curbing inflation in a defense economy must be reconciled with the need at one and the same time for expansion in some areas and for contraction in others.

The essence of controlling inflation is to prevent available funds, coupled with the desire to spend them, from exceeding by great amounts the available goods and services for which these funds would be used. When the simple purpose is to expand general buying power to facilitate recovery from a depression, or to contract total buying power in order to cut down the demand for goods and services of all kinds, it is relatively easy to apply the classical set of "anti-inflationary" or "antideflationary" weapons. But in the current situation, it is necessary to couple some types of expansion with some types of contraction, and consequently to expand some types of investment and other buying while contracting others. Therefore, efforts to influence spending must be conformed to the pattern of resource use which the defense program demands.

It follows that measures to contract spending power and employment and production in some areas, no less than measures to produce expansion in other areas, must be sufficiently selective and discriminating to expedite the defense program, to build up the industrial mobilization base, to expand some other areas of production, and at the same time to exercise necessary restraints in still other areas. All this must be borne clearly in mind as one reviews available economic tools, not in terms of how they were talked about by some classical economists who never attempted to use them and who never imagined the current situation, but rather in terms of how these tools may now be applied by practical people in the face of tasks confronting the Nation quite different in character from any in the past.

Proposition No. 5 is that the nature of our current and foreseeable economic tasks is too complicated for extreme or major reliance on any one type of economic measure. This applies to monetary policy as well as to other policies.

As indicated above, the complicated and unique character of the current defense program requires a combination of efforts, some designed to expand parts of the economy rapidly, and others designed to contract other parts of the economy with similar rapidity (insofar as the increase in over-all production does not in itself take care of the necessary expansion of the security program).

Theoretically, one might argue that any one type of economic policy might be predominantly relied upon in the current situation to prompt all of the necessary and varied adjustments in resource use. For example, it might be argued theoretically that, since tax reductions are stimulating and tax increases repressive, a complex tax scheme could be worked out which provides sufficient inducements for expansion wherever needed and sufficient restraints for contraction wherever needed. But the effort to formulate and apply such a complicated and refined

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tax system would deprive the tax system of one of its main virtues—namely, that it is rather generalized—and would make taxation more complicated and cumbersome, more detailed and personalized, than the most extreme kind of price and wage control. Similarly, one could work out theoretically a price-control policy, or a credit-control policy, or a policy governing the allocation of materials, so comprehensive and so discriminating as to accomplish by that one device alone all of the objectives for the economy which must now be sought. But the utilization of any one device to this extent would break down of its own weight, and would result in a system of controls far more harsh, rigid, and excessive than the moderate utilization of a variety of weapons in mild proportion.

These comments are applicable to general monetary policy. I am heartily in accord with the moderate utilization of monetary policy to exercise some general restraining influence in an inflationary period. But intrinsic limitations upon its utility lead to major reliance upon a variety of other measures. Clearly, monetary policy is hardly the device for stimulating the rapid expansion in some areas of the economy which is now desirable. General monetary policy is a suitable device, within appropriate limits, for imposing some necessary restraints upon the economy. But if most of the restraint is to be highly selective, as I think it must be under current conditions for reasons which I have already given, general monetary policy cannot do very much of the job. And if monetary policy were to be exercised for the purpose of putting brakes upon the rate of activity of the economy as a whole, it could hardly be pushed far enough to do this under current conditions without reducing substantially the over-all level of production and employment—which would cut directly across the vital objective of utilizing our resources fully and expanding our over-all productive strength.

In this connection the inability to place great reliance upon general monetary policy has been fully recognized by those who are regarded as outstanding exponents of its appropriate use geared to the time in which it is used.

Thus in a statement before the Joint Committee on the Economic Report on May 12, 1948, Mr. Allan Sproul, president of the Federal Reserve Bank of New York, had this to say:

"A general monetary control, if used drastically enough, works through a restriction of production. The steps in the process are restriction of money supply, rise of interest rates, contraction of employment and production, contraction of income. I know of no monetary device which would enable us to avoid these consequences. * * * In order to get the effect our critics suggest, would mean that our action would have to be drastic enough to lower the money income of a large segment of the consuming public. To accomplish this by over-all monetary or credit action would mean a serious decline in production and employment. Such action could only be justified if we were faced with a runaway inflation due solely or primarily to monetary causes. That is not our present situation and that cannot be the right policy now."

It is hard, indeed, to find in the current situation any reason for departing from the principles which Mr. Sproul set forth so cogently in May 1948. The immediate inflationary trends now are certainly not as pronounced as they were in May 1948, and the need not to reduce substantially the total of production and employment is certainly greater now than it was at that time.

Still more important is this consideration: Even if it were to be conceded that the over-all reduction in production and employment were not too high a price to pay for the drastic use of general monetary policy, it does not appear that this reduction would concentrate in those areas where the economy can best afford such a reduction under current conditions. On the contrary, analysis indicates that such a policy would be first reflected in the reduction of production and employment in those very areas where the further expansion of facilities and output is most critically needed, and would appear last, if at all, in those highly speculative and nonessential areas where more selective and pointed measures can be effective quickly.

Recently, before the forty-fifth annual meeting of the Life Insurance Association of America on December 12, 1951, Mr. Sproul had this to say:

"All that should be claimed for general credit controls, in my opinion, is that combined with other measures working in the same direction, such as fiscal policy, debt management, and, in extraordinary circumstances, direct controls, they can contribute to anti-inflationary and anti-deflationary forces. * * * It seems to me that the same circumstances which are responsible for the problems of coordinating debt management and credit policy contribute to the effectiveness of mild general credit policies, and that we can have an expanding economy without throwing too much of the gasoline of easy credit on the fires of active business."

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It is my belief that the limitations now placed upon the utilization of general monetary policy, by the imperative need for expanding over-all production, and by the need for being highly selective in imposing restraints upon particular segments of the economy, are perhaps more important than other reasons advanced for the very moderate utilization of general monetary policy. These other reasons include the size of the national debt, its carrying costs, and its profound influence upon the country's financial structure.

For example, Dr. E. A. Goldenweiser, a first-rate theoretical economist with great practical experience within the Federal Reserve System, in the American Economic Review in June 1947, recognized the undesirability of substantial increases in the long-term interest rate, saying:

"Not only would such a rise increase the cost of borrowing to the Government at the time of refunding, but it would make inroads on the capital values of securities acquired by institutions and individuals in support of the war effort. The Government is determined not to repeat the experience after the First World War when Government securities went down to the 80's. One reason, among others, for this determination is the size of the debt and its dominant position in the country's financial structure."

I feel that, if the security program is to be carried forward and not dangerously reduced, the economic and fiscal outlook make these comments of Dr. Goldenweiser in 1947 at least as pertinent today. The Federal surplus of 1947 has been replaced by a deficit, which will increase for a time. The problems of Treasury financing will be larger, not smaller, than in 1947.

It should also be taken into consideration that extreme changes in the interest rates on long-term Government obligations are out of the question under current conditions, and that very small variations might not achieve the stated purpose of narrowing the gap between these interest rates and interest rates on other types of obligations.

In testifying before the Joint Committee on the Economic Report on November 22, 1949, Mr. Marriner Eccles had this to say:

"In a falling bond market, with general credit demand strong, rates on other securities and loans would tend to rise at least proportionately as much. Under these conditions, can it be expected that insurance companies or savings and loan associations or other institutional investors would act materially differently with the yield on Governments at 3 percent than they do now at 2½ percent?

"Loans or investment, other than Government securities, would have as much, if not more, relative attractiveness to lenders and investors. Few, if any, borrowers would be priced out of the market for funds by rate increases of the size contemplated. * * *

"Any moderate rise in long-term interest rates would not, in itself, reduce significantly the demand for money. Investing institutions, which are now switching from long-term Government bonds to private credit forms, would still be motivated to do so by a continuing margin of return between the two kinds of investment."

The Congress has had occasion to observe in recent months that the effort to increase the interest rate on long-term Government obligations has been accompanied by efforts to move up other interest rates. An outstanding recent example has been in the field of housing, where ironically the argument was advanced, not that interest rates should be raised to repress credit expansion, but rather that interest rates should be raised to enlarge the volume of housing loans. While my mind is not wedded inflexibly to any particular level of interest rates in general, and while some flexibility in the general interest structure may be desirable, care should certainly be taken not to jeopardize the maintenance of a generally low interest rate structure by departures from it which—while small at first—might gain dangerous momentum. When one considers the painful process by which the interest rate structure as a whole has been brought far below the levels obtaining prior to the great depression, plus the indisputable evidence that this trend has been a major contributory factor in the great and sustained productive expansion of the economy and the more equitable sharing of its benefits among a wider range of business firms and consumers, the case against risking a reversal of that trend is strong indeed.

None of the foregoing should be interpreted as an expression of disagreement at this time with the accord reached between the Treasury and the Federal Reserve Board last March, involving some experimentation with flexibility in interest rate policy. To be sure, I am still prone to reserve judgment, depending upon the further unfolding of events, as to whether this mild modification in policy has

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been demonstrably beneficial. It has had some desirable and some undesirable results, and the net balance is far from clear. But the main point I now desire to make is that the accord of March 1951, as I understand it, is consistent with a view held by the Treasury and the Federal Reserve Board, in which the other distinguished authorities whom I have cited seem to join. This view in essence is that variations in monetary policy and interest rate policy must be kept within very narrow limits indeed under current conditions. And consequently, monetary policy can be no more than one mild tool among many in the quest for economic stability and growth within a high-defense environment.

I do not dissent from what has been done. However, I do maintain that the relative economic stability during the past year has been due not to one device, but instead to a wide variety of factors—productive growth, higher taxes, general abundance of consumer supplies, high voluntary savings, selective as well as general credit restraints, price and wage stabilization, and the movement of the defense build-up at a somewhat slower pace than had been estimated a year ago. By the same token, I cannot accept the viewpoint that the main key to future economic stability consists in pushing monetary manipulation as far as it seemingly would be pushed by those who regard it as a panacea and not simply as one useful device among many. It is a device which cannot be relied upon heavily, without bringing in its train undesirable consequences of a certain character far outweighing any speculative and thus far unproved benefits which might follow.

Proposition No. 6 is that the current and foreseeable economic situation calls for an admixture of economic tools, without excessive reliance upon any one.

It has become common practice for some overexuberant proponents of a particular economic policy to ascribe to it alone the entire or major credit for some desirable result which has been achieved. This they do by setting in juxtaposition the utilization of this policy and the desirable result. Those who are strong for price controls can point to the coincidence of price controls and a stable price level at times; those who are against price controls can point to periods where prices remained stable without price controls, and other periods when prices moved upward even with price controls. Those who claim that the money supply is the all-controlling factor can point to periods when an increase in the money supply was accompanied by an expansion of credit and by price inflation; but those who believe to the contrary can point to periods when prices rose rapidly while the money supply was contracting. Most of these demonstrations are rather spurious, because coincidence is not the same as cause and effect, and because at any given time there are many forces at work in the economy and no single one can be designated as being all-prevailing or decisive in its influence.

The most responsible weight of opinion seems to me to be that economic stability and growth depend upon a variety of measures used in moderation, without excessive zeal in the application of any one. A well-balanced perspective on this point appears in an article by Dr. E. A. Goldenweiser, in Harper's magazine for April 1951. Dr. Goldenweiser had this to say:

"First, we must bend every effort to increase production by greater exertion, greater efficiency, longer hours, fewer leisure people, less of the gracious things of life * * *. Second, we must economize—make sure that no money is spent unnecessarily. * * * Third, as large a share of the necessary expenditures as possible must be met by taxation. * * * Fourth, the Government must borrow what has to be borrowed (insofar as possible) in such a way as to tap income that would otherwise be spent by the person receiving it. * * * Fifth, the Government should borrow from the banks only the unavoidable minimum. * * * Sixth, over-all restraint should be exercised over loans by banks to businesses and individuals. * * * Finally * * * price and wage controls—to hold the line until the other measures become effective—are highly desirable."

The foregoing seems to me to set forth admirably, and in proper order, the rounded elements in a program for stability and growth. Further, I would like to stress the extent to which most of those who have been challenged by the responsibilities of practical action, and particularly by the responsibilities of public office, find themselves in essential agreement in this matter—although there will always be some shadings of emphasis.

The economist who has to maintain only a theoretical position, or to write his name imperishably (in his belief) into the literature of his profession, may mistake the shadings for the essence and magnify the differences of view. But

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in all my dealings with responsible public officials, in the Treasury, the Federal Reserve Board, and elsewhere, I have continuously been impressed by the amount of agreement on fundamentals.

The Council of Economic Advisers undertakes long and searching consultation with the whole range of those concerned with economic policy, both private and public, at least twice a year in the development of our semiannual published reports. To be sure, some differences of viewpoint arise. But in the overwhelming majority of cases, these prove susceptible to accommodation, on the part of men who after all are looking at the same facts and who share the objective of a stable and growing American economy.

Proposition No. 7 is that basic economic policies which affect the whole Nation should seek harmony, and that under our system the most powerful force toward this harmony is men of good will working cooperatively together. With this force present, neither new machinery nor new legislative definitions of authority seems essential.

Above all, there is widespread agreement that those agencies of public authority which vitally affect the national economy should try to reconcile their actions, because pulling in opposite directions is manifestly hurtful regardless of which side is "on the side of the angels."

There will always, of course, be differences of opinion on policy issues. But neither sober and reflective businessmen nor anybody else would want various important agencies of public power, each vitally affecting the economy, to pursue conflicting policies of a fundamental character for an enduring length of time. Nothing could be more inefficient, more uneconomical, more demoralizing to our business system, or more conducive to the undermining of the people's confidence in public authority. It is true that different agencies of public power have different accents of responsibility and different prime objectives and functions. But no one of them can believe that its perspective or its point of emphasis is transcendently important to the exclusion of all others. The very fact that in our democracy there are at the national level so many agencies of public power makes it essential that a process of reconciliation and harmonization move constantly forward. It has always been this way; and it will always be this way.

The possibility of some fundamental collision of policy between two agencies of public power which fundamentally affect the national economy is by no means limited to the case of the Treasury and the Federal Reserve Board. Other agencies of public power are now undertaking functions quite as vital to the economy as a whole, and quite as important to the lives and fortunes of the individual. For example, it would be hard to imagine a more far-reaching authority than that of allocating scarce materials throughout the economy, which carries with it the very power of life or death over substantial segments of our business system. The relationship between monetary policy and fiscal policy is indeed important, but no one can prove that it is of a very different category of importance from the relationship between price policy and wage policy or tax policy and spending and lending policy or defense policy and policies affecting industrial and civilian supplies.

The Congress has consistently and increasingly recognized that all of these policies are vital, that no one of them is supreme, and that constantly improved machinery should be sought, both in the legislative and the executive branch, for evaluating these policies as a whole and their relationship to one another. The Joint Committee on the Economic Report and the Council of Economic Advisers are both statutory examples of this recognition. The advent of the defense program has intensified the search, both by the people and their Government, for basic mutuality of purpose and basic consistency of effort among the various instruments of public power affecting the whole economy and its very security.

Whenever there might be a fundamental collision of policy between any two or more agencies of public power which fundamentally affect the national economy, manifestly the solution does not lie in arid debate as to how "independent" one or the other is or should be or in proposals to subordinate one to the other by legislative fiat. If by "independence" one means that men of integrity should look for the right answers and express their views vigorously without suppression or recrimination, that, of course, is desirable. Nor would I undertake to enter upon discussion of the question turning upon the fact that the Congress has established the Federal Reserve Board in a different relationship to the Government from that applying to the executive departments. This is a matter of congressional policy. But in no event can any realistic concept of "independence" mean that there is no relationship or interdependence among the policies and problems dealt with by the various important agencies of public power impor-

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tantly affecting the national economy. Consequently, they must all try to work together on problems which affect them all.

In the final analysis, in the event of collision, all agencies of public power must recognize the ultimate and decisive authority of the Congress; and all must recognize that the Presidential office has always had the legitimate function of lending its influence toward harmonizing the executory or administrative aspects of national economic policy. But the genius of our system resides not so much in reliance upon command as in reliance upon voluntary accommodation through hard work, fair purposes, and mutual respect. Surely the Council of Economic Advisers, which finds its life in a statute the essence of which is cooperation, cannot bring itself to believe that cooperation is not the best method in dealings between any important organs of public power.

From the peculiar vantage point of the Council of Economic Advisers, it has seemed to me that the Treasury and the Federal Reserve Board, as well as other agencies, have worked harder and with a finer spirit than the general public realizes to join hands in the national interest in these trying times. For example, those not involved in the process hardly realize how thoroughly the reports to the Congress under the Employment Act of 1946 are made the subject of full discussion, interchange of views, and a wise spirit of give and take among all of the agencies concerned with national economic policy. I have always found the Treasury and the Federal Reserve Board "independent" in the sense of being sturdy and vigorous in the assertion of their views; but I have never found any of them "independent" in the sense of being remote or unapproachable, provincial or narrow-minded, or overzealous in the control of its own domain. The result of this process of cooperation has not been perfect. But it has produced over the years, I believe, a more intelligent and harmonious approach to the problems of our national economy than would have been possible under any other approach.

Based upon my observation of the relationships now in effect, I do not see the need for additional formal machinery, or for new legislative efforts to redefine relationships or relative responsibilities. I believe instead that we must continue to work together, seeking to improve our tools of economic analysis, to achieve even greater objectivity, and to enlarge the popular understanding of what we are trying to do. These things depend upon men, and not upon laws. I think the men with whom I have worked measure up to the task, and that is what is most important.

At the same time, if it should be deemed desirable to follow the suggestion recently made by the Secretary of the Treasury, to the effect that the Treasury, the Federal Reserve Board, the Council of Economic Advisers, and certain other agencies recognize more explicitly through some new cooperative unit their mutual interests, and if the Federal Reserve Board should feel likewise, such a proposal would certainly meet with the hearty support of the Council of Economic Advisers.

Representative PATMAN. Senator Douglas, would you like to ask some questions?

Senator DOUGLAS. First, let me thank you, Mr. Keyserling, for your statement. May I ask if it is a function of the Council of Economic Advisers to offer current advice on economic developments to the President?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. Do you understand it to be a function of the Council of Economic Advisers also to offer current advice to the Congress?

Mr. KEYSERLING. Yes, sir. I would like, if there is any question about that, to state briefly why I think so.

Senator DOUGLAS. No; that is not necessary at all.

Now did you watch the situation currently from the 1st of July 1950, until the 1st of March 1951?

Mr. KEYSERLING. I have tried to.

Senator DOUGLAS. You kept in touch with current figures?

Mr. KEYSERLING. Yes, sir.

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Senator DOUGLAS. Month by month, week by week, and in some cases day by day. And therefore you were continuously apprised of what was happening. Were you aware that the Federal Reserve Board through its open market committee was purchasing large quantities of Government securities during this period?

Mr. KEYSERLING. I would be inclined to think that one would be aware of that, and I was aware of it.

Senator DOUGLAS. Were you?

Mr. KEYSERLING. Yes.

Senator DOUGLAS. You were aware of it?

Mr. KEYSERLING. Yes.

Senator DOUGLAS. Were you aware of the fact that during these 8 months the Federal Reserve, depending on the precise termination date, purchased from $3½ to $4 billion of Government securities?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. Were you aware of the fact that bank reserves in the Federal Reserve System were rising during this period?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. Rising by not quite as much as the purchases of bonds, but by substantially as much. Did you think there was a connection between the purchase of Government bonds by the Federal Reserve System and the rise in bank reserves?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. An immediate and direct connection?

Mr. KEYSERLING. That is a question of degree, but I would be willing to answer it by saying there is a substantial and important connection.

Senator DOUGLAS. And a direct connection?

Mr. KEYSERLING. And direct connection.

Senator DOUGLAS. The Federal Reserve Board testified yesterday that the purchase of Government bonds is paid for by checks which, moving through the banking system, are deposited in the Federal Reserve System and automatically become reserves of the member banks.

Mr. KEYSERLING. I agree with that.

Senator DOUGLAS. Did you notice that bank loans were increasing?

Mr. KEYSERLING. Yes; bank loans were increasing.

Senator DOUGLAS. Bank loans increased during the period of 8 months by ten billions of dollars, or an increase of approximately 18 percent. Did you notice that?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. Did you think there was a connection between the increase in bank loans and the increase in bank reserves?

Mr. KEYSERLING. By no means the probable direct and substantial connection that there was with respect to the earlier parts of what you recited, Senator.

Senator DOUGLAS. Is it not true that an increase in bank reserves makes possible an increase in bank loans due to the fractional reserve system?

Mr. KEYSERLING. I think I would approach it from the other end and look at the volume of investment that took place.

Senator DOUGLAS. I am not speaking of investment banking. I am not speaking of savings. I am speaking of bank loans, that is, of created credit. Of course, the fundamental distinction in banking is

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between the investment of savings through the investment machinery and the creation of bank credit in the commercial banking system.

Mr. KEYSERLING. Senator, let me begin by saying as a coloration to my whole discussion, that at points where we differ, either of us may be right, and let's proceed from there.

Now let me answer your last question, if I may. I have used the word "investment" in a somewhat different sense from what you have used it. I have used the word "investment" to express the use of funds to command materials, money, and human effort in the production of facilities, plant equipment, and housing, and other things of that kind, and I think that the point at which money exercises an inflationary impact upon the economy is when it begins to command goods and services.

In other words, you and I can exchange loans ad infinitum, and more and more loans, so long as we do not do anything with them.

Senator DOUGLAS. What do you understand the difference between commercial banking and investment banking to be?

Mr. KEYSERLING. May I answer the other question and then come back to that? I want to carry through with the idea.

Senator DOUGLAS. There seems to me to be a connection between the increase in bank reserves in the Federal Reserve System and the increase in bank loans. I am referring to the Federal Reserve Bulletin for May 1951, on page 527. In the second column it is marked "Loans." whereas the third, fourth, and fifth columns are "Investments," so I am not speaking about loans and investments. I am speaking of loans.

Mr. KEYSERLING. Senator, I am not at all sure there will be any disagreement if I can carry through on the one idea I am trying to express here.

Senator DOUGLAS. Did you see any connection between the increase in bank reserves in the Federal Reserve System and the increase in short-term bank loans?

Mr. KEYSERLING. I was trying to discuss, Senator, how much connection I saw. A question like that cannot be answered "yes" or "no." There is some connection between any two coincident events of a large character in the economy. What I am trying to say is that in looking at the question of investment——

Senator DOUGLAS. I am not speaking of investment. I am speaking of loans, commercial loans.

Mr. KEYSERLING. But the loans have no effect upon the economy until they are translated into some kind of overt economic action.

Senator DOUGLAS. Let me ask you this: Is it not true that in the case of commercial loans what happens is that the loan is made first and it is made in the form of a credit which is set up to the account of the borrowers so that the loan creates the deposit, whereas in investment banking the savings are made out of the current incomes of individuals and corporations and are then deposited in financial institutions, which then act as middlemen to distribute these sums to the places where the investments are made?

In the case of the investments, therefore, the saving creates the deposit, the deposit creates the loan or investment, whereas in the case of commercial banking the credit is created by the bank when the amount of the loan is deposited to the account of the borrower and the borrower draws upon.

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In the case of commercial banking, therefore, the creation of this new credit constitutes an addition to the total money supply, whereas in the case of the investment banking what we have is a diversion of existing income for the purposes of investment and saving rather than for consumption.

Now, isn't that distinction a valid distinction?

Mr. KEYSERLING. Yes, sir, it is a valid distinction, but I think the distinction I am making is also a valid distinction, and let me carry it through to indicate its significance to this general point.

The general point I am making is that you can start at either end of this road and the end I start at is this: That ultimately the impact on an economy occurs when manpower, materials, and economic activity are generated to command resources. In other words, if you and I lend loans——

Senator DOUGLAS. We did not have much unemployment in 1950. So that there was not much possibility of putting idle people to work on idle resources.

Mr. KEYSERLING. I did not say that. Let me carry this forward.

You and I, Senator, to simplify this thing, possibly oversimplify it, can lend money back and forth to each other, or a bank and individual or two kinds of banks can lend money back and forth to each other, and the volume of loans increases by that. It is only at the point where the loan is used for a dynamic economic function that it exercises a strain on the economy.

Now, the point I am making is that, looking at the volume of investment, using investment in the broad sense of how our business system was commanding resources of manpower and materials and plant and equipment, which is what exerts the inflationary strain, during the period that you refer to—and here I come to the part of it that is directly relevent to your question—I do not see as clearly as you do that the variation in bank reserves or the variations in the factors that you mentioned were the controlling or even the major factors in the actual level of capital formation which took place.

I think that, under the conditions obtaining between the middle of 1950 and early 1951, the amplitude of business resources was such of all kinds, depreciation reserves, accrued profits, capacity to borrow that they would have maintained under any set of circumstances except changes so drastic in the economy that they would have knocked it for a loop, and I think the level of business outlays between 1950 and 1951 was conditioned primarily by availability of manpower, by the prospect of big markets, particularly in view of a new and growing defense program, by the general capital position of these businesses resulting from many accrued years of prosperity with unusually high profits even after taxes.

In other words, the part at which I must respectfully depart from you, Senator, is the extent to which you ascribe functionings in the economy to a particular limited set of events. Now, I am perfectly willing to admit that that played some part, but I happen to think that that particular development played a relatively very small part in the level of business investment——

Senator DOUGLAS. Wait a minute; I am speaking of loans—let that be understood—commercial loans.

Do you think that the increase in the reserves played a very small part in the increase in loans, the increase in reserves being around $3½

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billion, the increase in loans during the same period was around $10 billion.

Do you say that the increase in reserves played a very small part in the increase in loans?

Mr. KEYSERLING. I think that is true within any variant that any responsible public official would have wanted to apply if he had had absolute power to contract that volume of loans. Now, I am perfectly willing to admit——

Senator DOUGLAS. Did not the increase in reserves make possible an increase in loans?

Mr. KEYSERLING. It made possible an increase in loans, but——

Senator DOUGLAS. And is it not true that on the whole each added dollar of reserves makes possible increased loans of $6?

Mr. KEYSERLING. I think you could get different computations as to whether it is $6 or $5, but broadly speaking there is a connection.

Senator DOUGLAS. Required reserves of the class C banks were 14 percent, of the class B banks 20 percent, of the class A banks 24 percent.

They were up virtually to their maximum. Class A could have gone up to 26, but it was 24. The general average is approximately 16 percent, a little over 16, so that you have a potential multiplier—and I want to put that word "potential" in—a potential multiplier of 6; isn't that true?

Mr. KEYSERLING. Yes, but I think——

Senator DOUGLAS. If that is true, an increase of $3 billion in reserve would have made possible an increase of about $18 billion in loans. Now, a $10 billion increase did occur. Is it your contention there was little connection between the increase in reserves and the increase in loans?

Mr. KEYSERLING. It is my contention that if the Federal Reserve Board had been following at that time the policy which—I think this is the easiest way I can describe it: If the Federal Reserve Board had been following at that time the policy which they are following now as described by them before this committee and reflecting the "accord," if that policy had then been in effect rather than the policy which was then in effect, it is my contention that the ultimate level of business investment, of capital formation, of economic activity in that sector of the economy, would during that period have been, under all the conditions playing upon it, approximately the same. Now, that is all I am trying to say, and I think that is important.

Senator DOUGLAS. I appreciate your reply, which I think is somewhat elliptical to the question which I asked. My question is: Was there any connection or appreciable connection between the increase in reserves of banks in the Federal Reserve System and the expansion of commercial loans which they made to private business?

Mr. KEYSERLING. Why, Senator, on the line of questioning which asks if there is any connection, I am perfectly willing to agree that there is a connection.

Senator DOUGLAS. Do you think there is an appreciable connection?

Mr. KEYSERLING. You move from "any" to "appreciable" to "great" to "prevalent."

Senator DOUGLAS. One step at a time.

Mr. KEYSERLING. Yes, but that one step at a time involves some leaps.

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Senator DOUGLAS. Do you think there is any appreciable connection between the increase in reserves and the increase in loans by banks?

Mr. KEYSERLING. Yes, there is some connection.

Senator DOUGLAS. An appreciable connection?

Mr. KEYSERLING. Well, Senator, I think I have made myself clear on that. You are more adept than I am in synonyms, but no two synonyms mean the exact same thing.

Senator DOUGLAS. You are more adept than I am. I feel I am moving in a semantic wilderness.

Mr. KEYSERLING. No, sir; I think that the basic issue in the period under discussion is whether, in view of the complexion of the national job that we had to do at that time, the level of capital formation was too high or too low or misdirected. That is the ultimate result of these various beginnings of economic policies.

Now, what I am saying is this: First, that I don't believe that the composition would have been very different during that period if there had pertained during that period the policy which you think represents an improvement over the policy then pertaining.

Senator DOUGLAS. For the moment I haven't come out with conclusions at all. I am merely trying to establish a chain of causation, and then when we reach conclusions that is something else.

At the moment I am simply asking you a very simple question: Do you think there was an appreciable connection between the increase of $3½ billion in bank reserves in the Federal Reserve, and the increase of $10 billion in the loans made by banks to private borrowers?

Mr. KEYSERLING. Well, Senator, I am willing to go along with you on accepting the word "appreciable." I do think that while your questioning precedes your conclusions, your questioning is moving inexorably toward your conclusions.

Senator DOUGLAS. If truth leads us there, let us not shy away.

Now, I agree with you in this statement that there is an appreciable connection because I would like to point out that according to the Federal Reserve bulletin for May, page 515, which I would like to have checked, final column, the excess reserves of member banks as of June 28, 1950, was said to be $526 million.

That is, on the basis of the reserves which the member banks had at the end of June, there was only $526 million above that required for their existing outstanding quantity of loans.

Therefore, if used up, every dollar of this excess reserve—and you never can use up all your reserves—they would only have been able to have expanded loans by about $3 billions. As a matter of fact, you can't use up every dollar. You have to have some margins.

Probably they could not have expanded their loans more than a billion to a billion and a half. But the Federal Reserve Board purchased large quantities of Government bonds, hence built up the reserves of the member banks, and hence increased the lending capacity of banks.

And, as a matter of fact, if you trace this relationship the banks approximately kept their loans in pace with the reserves which they built up, because by February 28, 1951, excess reserves amounted to only $700 million, so that they had obviously loaned up to the capacity of the reserves which had been created for them, and it seems to me that the conclusion is perfectly clear that the increase in loans could

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not have occurred to any appreciable degree had there not been this purchase of Government securities by the Federal Reserve. Is there anything wrong with that line of reasoning?

Mr. KEYSERLING. I am here to be questioned and not to ask questions. I realize that.

Senator DOUGLAS. Is it not true, then—if you don't wish to comment—that the increased loans were made possible virtually entirely by the increase in bank reserve which in turn, as you have testified, was made possible by the purchase of securities by the Federal Reserve System?

Mr. KEYSERLING. There is a connection between the two, but I would then want to raise the question of how much less the policy of increasing bank reserves would have had to be in order to result actually in an appreciably lower level of loans.

Now, you yourself say, Senator, that the level of loans did not push up to the maximum at all times of the possibility. All I am saying is that under the conditions then pertaining in the economy, I cannot see how the variant in policy which you suggest, insofar as I get it, would have resulted actually in a lower level of capital formation during that particular period.

Senator DOUGLAS. Wait a minute. Did the increased bank reserves account for the major portion, or at least make possible the major portion of the bank loans?

Mr. KEYSERLING. Yes; that is the way our system works.

Senator DOUGLAS. Good. It has taken a long time to develop that fact.

Now, then, when you increase the quantity of bank loans, other things being equal, what happens to the price level?

And here we are dealing not with investment, not with the diversion of an already existing national monetary income into one direction rather than another, but with the creation of monetary purchasing power by the banking system itself, namely, through the making of a loan and the crediting of that loan as a deposit. Because it is true, though the commercial bankers sometimes deny this fact, that the commercial banks are manufacturing agencies. They manufacture bank credit, which they sell.

Representative PATMAN. Senator Douglas, I think that is generally admitted now. A few years ago it was not admitted, but I think Mr. Eccles impressed that point so strongly that it is now generally accepted.

Senator DOUGLAS. Now, what is the effect of an increase in the quantity of bank credit, other things being equal, upon the price level?

Mr. KEYSERLING. Senator, the whole point I am making turns upon your phrase "other things being equal."

Senator DOUGLAS. One step at a time.

Mr. KEYSERLING. But other things were not equal then and other things are not equal now.

Senator DOUGLAS. Let us take one thing at a time. You just take the questions that I ask. Other things being equal, what is the effect of an increase in the quantity of money upon prices?

Mr. KEYSERLING. But, Senator——

Senator DOUGLAS. Yes or no.

Mr. KEYSERLING. I am engaging in an economic discussion, not an inquisition. I can't answer that yes or no.

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Senator DOUGLAS. All right; if there is anything inquisitorial, I will strike this.

Mr. KEYSERLING. I can't answer a question like that yes or no.

Senator DOUGLAS. Is this an unfair question? You are the Chairman of the Council of Economic Advisers, the most important economic position in the country. I am asking you a very basic economic question which every student in the introductory course in economics is supposed to know, and which every Congressman ought to know.

What is the effect, other things being equal, of an increase in quantity of bank credit upon prices?

Mr. KEYSERLING. Senator, I said at the beginning of my statement, and I again say—and I think this is relevant to your question—that the examination of this problem in terms of an assumption, even for purposes of discussion, that other things are equal is the probing of this problem in just that kind of tight little logical symmetrical nondynamic world of theoretical economists which does not cover the problems that we have to deal with.

Senator DOUGLAS. But we are both subject to the laws of logic, and one of the laws of logic is the method of one step at a time.

Now I am asking you a very simple question. I hope you won't decline to answer it. Other things being equal, what is the effect of an increase in the quantity of active bank credit upon prices?

Mr. KEYSERLING. Other things being equal, the effect is to increase prices.

Senator DOUGLAS. Well, now, why didn't you come to that before? It is perfectly simple.

Suppose you have $20 here representing the quantity of money, and this package of cigarettes representing the quantity of goods—then you add another $20 to the existing $20, the price which was $20 before is now $40, isn't that true, each being offered for the other? Isn't that true?

Mr. KEYSERLING. That is, of course, true, Senator.

Senator DOUGLAS. Well, then, that is a very simple relationship, but it is highly important to get it established.

Now, then, other things being equal, what would be the effect of an increase in the quantity of bank credit during the period in question?

Mr. KEYSERLING. Senator, I should like to point out with reference to the rules of logic, that it is also the rule of logic that anybody can set up a logical system which is not necessarily correct.

Anybody can take a hypothesis and proceed step by step by deductions from it to certain conclusions, and that is what you are doing now. I disagree with your conclusions.

Senator DOUGLAS. I am taking an historical analogy, moving forward both by event and by logic—if there is anything wrong with my facts or my logic, I want to have it pointed out.

Here we have this increase of $10 billion in bank loans. How much was the increase in wholesale prices during this period?

Mr. KEYSERLING. Senator, there was a substantial increase in wholesale——

Senator DOUGLAS. Do you accept the index of the Bureau of Labor Statistics?

Mr. KEYSERLING. Yes, of course.

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Senator DOUGLAS. I believe that shows an increase of between 16 and 17 percent during the period in question. The increase in bank loans of $10 billion amounted to an increase of 18 percent in the volume of bank loans.

Do you think the percentage increase in the quantity of bank loans had any relationship to the percentage increase in prices?

Mr. KEYSERLING. Well, now, we are back again to any relationship.

Senator DOUGLAS. Do you think it had any relationship?

Mr. KEYSERLING. It had some relationship.

Let me say this: that I can take a chart showing trends in prices in bank loans, in the money supply, and all the factors to which you refer, a chart running from 1946 to 1951, and if one is simply trying to prove a thesis, you can take different points in time on that chart where you can prove by your line of logic directly contrary thesis because you have a complicated economy in which you have a different juxtaposition of events, and if you want to, you can say because prices rose so much in this period and something else happened, there is that cause and effect, but there are other periods of time in the past 5 years where you had a rising price level with a decreasing money supply.

Senator DOUGLAS. Mr. Keyserling, you have said that there was a logical connection between the increase in quantity of bank loans and increase in the price level. Now, I point out that historically also these two were associated.

I thought you were going to say that there were other factors operating during this period which negatived the increase in bank loans so that bank loans were not a cause.

Mr. KEYSERLING. No; I was going to say——

Senator DOUGLAS. I want to play fair with you. I want to suggest to you, do you want to name any of these other factors?

Mr. KEYSERLING. I was going to say there are other factors operating to which I would ascribe the main casual effect upon the rising prices during that period.

Senator DOUGLAS. The main causes were not the increase in bank loans.

Mr. KEYSERLING. Well, now, there again you have moved a step because I don't think that the increase in bank loans was exactly correlated with these differentiations in reserve policies.

Senator DOUGLAS. Now, wait a minute. You have just said that the increase in bank loans was caused by the increase in reserves.

Mr. KEYSERLING. Well, I first say there was a relationship, and then an appreciable relationship, but I never said was caused by—

Senator DOUGLAS. Then you said a very direct relationship.

Mr. KEYSERLING. You see, you start with a relationship, then you move to an appreciable relationship, then to a direct relationship, then to cause.

Senator DOUGLAS. I thought you were under way finally. If you wish to retrace your steps——

Representative BOLLING. Could I interrupt?

Mr. KEYSERLING. I think there is a great difference.

Representative BOLLING. Mr. Keyserling, are there any other ways by which banks can create reserves?

I gather that during 1950–51 the banks createed reserves by selling their bonds to the Federal Reserve. Suppose it had been profitable

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for them to make loans, couldn't they have acquired revenue by selling bonds on the open market?

Mr. KEYSERLING. Go ahead, Senator, don't let me interrupt you.

Representative BOLLING. The question was addressed to you. Is there only one way in which commercial banks can create reserves when they are confronting a very favorable market for loans?

Mr. KEYSERLING. I don't think so.

Representative BOLLING. What are some of the others?

Mr. KEYSERLING. I think the one you mentioned is one way.

Representative BOLLING. They can do that regardless of whether the bonds were at par or otherwise?

Mr. KEYSERLING. Well, there are differing degrees of opinion as to with what facility they could do it under these varying circumstances, but I think they could do it.

Representative BOLLING. That is all, Senator. Thank you.

Senator DOUGLAS. Do I understand you to say that you think there is no appreciable connection between the proportionate increase in the quantity of bank loans——

Mr. KEYSERLING. I agreed with you, Senator, that there was an appreciable connection if you do not find the difference between some connection and appreciable connection too appreciable.

Senator DOUGLAS. Are you saying there was no causal connection between the increase in bank loans and the increase in prices?

Mr. KEYSERLING. Well, if there is some connection there is some causal connection.

Senator DOUGLAS. Are you saying there was a causal connection between the increase in bank loans and the increase in prices?

Mr. KEYSERLING. Some causal connection.

Senator DOUGLAS. And then the increase in bank loans was a cause for the increase in prices?

Mr. KEYSERLING. One of the causes.

Senator DOUGLAS. An appreciable cause?

Mr. KEYSERLING. Senator, despite what you say, I am not interested in dialectics. I am interested in trying to convey to you what I am saying here as best I can and trying to answer your questions, because, as I said before——

Senator DOUGLAS. Please credit me with the same desire.

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. I am trying to find out—you are the supreme economic adviser to the Government—whether you think there was an appreciable connection during this crucial period between the increase in bank loans and the increase in prices which quantitatively happened to be identical and for which you say there is a logical connection as well.

Mr. KEYSERLING. Well, first as to the point that they were quantitatively identical, I would say that that is a nonconclusive coincidence because there were many other periods within recent economic history where they were not only quantitatively identical but were moving in opposite directions.

Senator DOUGLAS. May I point out in this case the actual quantitative relationship is in harmony with the logical relationship and not contrary to it.

Mr. KEYSERLING. If you want to assume, Senator, that you start with a theory that A causes B, and then at times——

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Senator DOUGLAS. You agree to that theory.

Mr. KEYSERLING. May I conclude this?

Senator DOUGLAS. Surely.

Mr. KEYSERLING. If you want to start with the theory that A causes B, and then say that at points where an empirical observation that A causes B it is in harmony, but at point of empirical observation where A does not cause B, where A happens and B does not happen, they are not in harmony, of course you are correct.

But the point I am making is that if we look at the period over the past 5 or 6 years, there are so many periods where this harmony did not exist that one cannot subscribe, at least as I look at it, to the conclusion that this is the main conditioning factor within the range of our economy on price trends under current conditions or on the level of capital formation.

Now, what I am really trying to develop, Senator—and I think that at least part of this you will agree with—that what we want to look at ultimately is what is happening in the economy.

Senator DOUGLAS. I notice that in that economy during this period there was a 17 percent increase in wholesale prices, an increase of 8 percent in the cost of living, which has since gone up to 10, an increase in the cost of identical services to the Government of around $8 to $10 billion, and an impairment of the standard of life of those living on fixed incomes, so that that is a great thing that was happening. I will change the word "great." That was a very powerful force operating to the detriment of great groups in the community.

Mr. KEYSERLING. Senator, I think—let me try to illustrate the point I am bringing before the committee, in this way—that if today, with the variation in monetary policy which has taken place, if today, A, you had no price control, and, B, the economy were hit by an event comparable to what happened when the Chinese invaded North Korea, with a $23 billion annual rate of personal savings, with the position which business is now in, with the material situations as it now exists, I believe—and, of course, this is a belief because that is not happening now, but it illustrates my point—that if now the economy were hit by a situation comparable to that Chinese situation, that you could very, very easily and probably would have a sharp upward spurt in prices, in inventory accumulation, in hoarding, in consumer buying, and that you would have it under the existing policy as well as under the one which then pertained.

Now, that is the basic point I am making, and I do not desire to dissent from your proposition that all these things have a relationship.

I am simply saying that these other economic factors are quite as important in the situation as the one to which you attach particular attention, and that consequently in looking at all of them together, we can't look at this one device and say this is the way to do it, and we can't accept this as the answer and say we have to push this as far as we can without considering alternative ways or other necessary ways of stabilizing prices, and without weighing some of the collateral consequences of trying to do it in this particular way.

Senator DOUGLAS. Are you finished?

Mr. KEYSERLING. Yes, sir.

Senator DOUGLAS. Let me say that in order to show that I do not totally disregard other factors, as to matters of record, that the index

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of physical production, although it is not completely satisfactory, increased, as I remember, in this period by about 8 to 10 percent.

Let me also indicate that the velocity of circulation of credit increased by about 8 to 10 percent during this period. Of course, the money supply is affected by the velocity of credit as well as by the total amount of credit, and if the quantity times the velocity, the product of the two, increases in proportion to the increase in physical production, the price level is static. But if it increases in a greater proportion than the increase in production, the price level tends to rise.

What we had during this period was the fact that the increase in velocity roughly counterbalanced the increase in productivity, and, therefore, the same amount of money turning over more rapidly was offset by the increased quantities of goods at the same price level, but we increased the total active amount of commercial loans by 18 percent, and prices rose by 17 percent, precisely as we would expect under the well-known quantity theory of money formula.

I am not saying that this was the sole cause; nobody says that was the sole cause in the tempestuous stream of events over this era.

I am quite well aware that the scare buying that took place after Korea was a situation where everybody said they were not going to do any excessive buying, or any hoarding, but rushed out to get the goods before some other hoarder got there. I do not deny that there was a drawing down of savings accounts, and that this would naturally drive up the prices of automobiles and durable consumer goods. We did have a drawing down of savings and a distortion of prices.

What I want to point out is that the Federal Reserve System added to this difficulty by permitting, and indeed stimulating, the creation of $10 billion of additional credit, so that far from introducing a stabilizing factor into this situation they introduced a further unstabilizing factor in increasing the total money supply.

Now, I have been in favor of selective controls. I favored the stronger selective controls on consumer credit that Congress adopted, and fought and bled and died for that on the floor of the Senate, as Congressman Patman and Congressman Bolling did on the floor of the House.

Representative PATMAN. There were certain types I was opposed to, regulation W, particularly.

Senator DOUGLAS. I favored the restriction on loans for housing, in the way of selective controls. I am not saying that we should regret selective controls, but I am saying that it is reckless to rely on selective controls exclusively when you have the central banking mechanism of the country inflating the mony supply. That is my statement.

Now, let me ask you a question. As you watched matters during this period did you call to the attention of the President, the Secretary of the Treasury, or any group of administrative officials that you believed that there was a connection between the purchase of Government bonds by the Federal Reserve System and the rise in the price level?

Mr. KEYSERLING. I do not recall having called that particular fact to——

Senator DOUGLAS. That is, you do not recall it?

Mr. KEYSERLING. I do not recall it.

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Senator DOUGLAS. Did you offer any advice as to whether the policy of the Federal Reserve System in purchasing these bonds should be continued or discontinued?

Mr. KEYSERLING. There were various discussions of that, Senator. I believe that those discussions took more crystallized form a little later on.

Senator DOUGLAS. Well, I am speaking of the 8-month period from July 1950 to the 1st of March 1951.

Mr. KEYSERLING. I was not affirmatively responsible at any time for the advice——

Senator DOUGLAS. Did you offer any advice?

Mr. KEYSERLING. That is what I am intending to say. I was not at any time affirmatively responsible for advice which led to this change in policy. Does that answer your question?

Senator DOUGLAS. No; it does not.

Did you call attention to the President or any executive officer that prices were rising, that the credit supply was increasing, that reserves were rising, that Federal purchases of bonds were increasing, and there was a connection between these events?

Mr. KEYSERLING. All of those things we called to his attention and tried to be worked out.

Senator DOUGLAS. You pointed out that there was a connection?

Mr. KEYSERLING. But not in the point of emphasis that you make because, frankly, my interpretation does not square with yours as to the relative weight to be attached to the various factors.

Senator DOUGLAS. Well, you admit there was a connection?

Mr. KEYSERLING. All—they are all interconnected, but I did not advise that this factor was as important as you, quite properly, I mean—these are matters of judgment—seem to think it was, because I did not think, and still do not think, that that was as important as you think. I did not place as much stress on it as you place on it.

Senator DOUGLAS. Did you advise a discontinuance of policy of the Federal in purchasing unlimited quantities of bonds during this time?

Mr. KEYSERLING. I think I answered that question by saying that I was not affirmatively responsible for advising the change in policy reflected in the March accord.

Senator DOUGLAS. That answers the second question on the so-called accord which I had not come to.

Did you advise the continuance or the discontinuance of the policy during the period July 1, 1950, to March 1, 1951?

Mr. KEYSERLING. I can only answer that by saying that, as I think back now to what my views were then, that if it had been left to me I would not have advised discontinuance of the policy, and I hope that answers your question adequately.

Senator DOUGLAS. In other words, that you were in favor of the continuance of the previous policy?

Mr. KEYSERLING. I think that would be too strong a statement, Senator.

Senator DOUGLAS. Or were you neutral on the subject?

Mr. KEYSERLING. I would say that I am neutral on the subject in the sense that I believe that that particular variation does not have the economic significance which you attach to it and, consequently, since it produces——

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Senator DOUGLAS. That is, you did not regard it as important?

Mr. KEYSERLING. I do not regard it as of central significance within the range of the type of action that either the Federal Reserve Board or the Treasury would be willing to take if either had an absolutely free hand. In other words, I do not believe that, within the range of what the Federal Reserve Board would do, that this particular policy, in view of all of the factors playing on the economy, is of central or general significance.

Senator DOUGLAS. Did you make any reports to the President or to any other high administrative official on this matter during this period?

Mr. KEYSERLING. Senator, I believe that I can stand on the proposition that——

Senator DOUGLAS. Did you or did you not make any reports to the President?

Mr. KEYSERLING. The only reason I cannot answer that is because, since we talked with the President orally on an indefinite number of occasions, and so forth, it is hard to separate them out, but I think I have answered your question fully when I say that if it had been left to me I would not during this period have recommended this change in policy.

Now, I want to make it equally clear that that does not mean that I now say that the change was undesirable; that it may not have produced good results. I think it has produced some good results. I think it has produced some bad results, and I would not be prepared yet to make a judgment on its net effect.

Senator DOUGLAS. In other words, everything that exists at a given time is all right?

Mr. KEYSERLING. Oh, no.

Senator DOUGLAS. It was all right for the Federal Reserve Board to purchase the bonds and all right for the Federal Reserve Board to discontinue buying them?

Mr. KEYSERLING. I did not say that at all. Senator, you asked me, in effect, what my view was at that time, and I think I answered that fully when I said if it had been left to me I would not have made a recommendation for that change, which is another way of saying that I do not believe that the need——

Senator DOUGLAS. You did not think this policy did any real damage?

Mr. KEYSERLING. What is that?

Senator DOUGLAS. You did not think this policy of purchasing unlimited quantities of Government bonds during this period did any real damage?

Mr. KEYSERLING. I do not think on balance that it is clear that it did damage, and I do not think you have let me explain why I do not think it is clear that it has not done damage.

Senator DOUGLAS. I would be delighted to have you do that.

Mr. KEYSERLING. There are two reasons why I do not think it clear that it has done damage, and here, Senator, is where I have a somewhat different approach from you to the analysis of these problems.

Before I reach a final conclusion as to whether an economic policy has done damage, I want to look at what I call the end results in the economy. In my judgment, the end results in the economy are the level and distribution of the production of its resources. In other

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words, here we are producing, we are making certain goods and services and business skills and judgments available for defense, certain ones available for consumption, certain ones available for investment—and I am using "investment" in the broad general sense of the business build-up.

Now, the first thing I would want to look at in that period to which you refer is to look at what was happening to those three components and ask these questions: In view of the fact that we have limited resources at full employment, were consumers getting too many goods? Was business getting too much capital formation? Was the defense program moving too fast or too slow?

Now, let me take the business side of it first because that is the one on which you are mostly concentrating. My view is that it is not clear that all types of capital formation at that time were too high. I think there were many types of capital formation going forward, which, from the viewpoint of our productive strength, from the viewpoint of the additional burden of the defense program, had to be carried forward. I am glad they were carried forward as fast as they were. I wish some of them had been carried forward faster.

Consequently, I would not, with ease, recommend or indulge in a general restrictive policy until I knew or felt or thought that that restrictive policy would begin to operate upon the kinds of activities which were nonessential before commencing to operate upon those which seemed to me to be at the very heart of the mobilization effort.

Senator DOUGLAS. Mr. Keyserling, would it be impolite if I interjected something in here?

Mr. KEYSERLING. No, sir.

Senator DOUGLAS. I want to make it clear that I am not saying that the Federal Reserve System should have sold Federal bonds. I am not saying it should have diminished reserves. The question is merely whether they should have expanded them. I am not advocating a policy of restriction, but I am asking whether they should have expanded the money supply more rapidly than the index of production.

Mr. KEYSERLING. I think the difference, Senator, between saying they should not have expanded them and saying they should have restricted them still gets to the point that I assume you feel if they had not expanded them there would have been a lower level of capital formation, because if they would have been the same level of capital formation, my point is that so far as the functioning economy is concerned your strains and pressures would have been the same.

Senator DOUGLAS. Where did this capital formation come from, Mr. Keyserling?

Mr. KEYSERLING. It came from the effort of labor, from the directing skill of business, and from the availability of financial and physical resources to do jobs which, in terms of the mobilization program, businessmen thought it would be profitable or patriotic or both to do.

Senator DOUGLAS. May I ask you this: How did the increase in bank loans make possible all these desirable results?

Mr. KEYSERLING. It does not alone make them possible.

Senator DOUGLAS. Well, that is the issue, whether it was necessary to increase bank loans as much as they did expand in order to put more labor to use, to get greater skill for management, and so forth.

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How did this increase in loans do that when there was virtually full employment at the time?

Mr. KEYSERLING. Senator, the question I have raised is different and, I think, very important. The point I have made is that—may I resort for just a second to this tool of logic?

Senator DOUGLAS. Surely.

Mr. KEYSERLING. Proposition A: It must be assumed from the point of view of your line of discourse that if the expansion of the kind of credit that you are talking about had been less, not by a restrictive policy but by not letting it expand, it must be assumed that there would have been a lower level of the end result which commands our resources, namely, construction, building, employment, and so forth and so on.

Senator DOUGLAS. These things do not come out of the air, Mr. Keyserling. How was it that this increase in loans made possible the increase in production, the increase in savings, the increase in investment, and so on?

Mr. KEYSERLING. I am not, through my own fault—I have not made myself clear, Senator. I am saying that if the varying policy which you suggest, if the varying policy which you suggest had not appreciably changed the level of capital formation, of investment and of employment in specific lines of economic activity, if it had not substantially changed those levels, its ultimate effect upon the economy and upon the price level would have been nugatory because it is the spending of funds for business activities, whether by business or consumers, that puts the pressure on prices.

To state it another way, if there had been other factors at play in the economy which would have resulted in an equal level of capital formation, of investment and in business activity, with or without this variant you suggest, then I cannot ascribe much importance to the variant. Now, that happens to be what I think. It may be wrong, but I do not think that the variant that you suggest would have much changed the level at the end of what would have happened in the economy during that period to employment, to investment, to capital formation.

The I raise a second questions which seems to be——

Senator DOUGLAS. Let us take this first one, and I want to make it clear. Is it your contention that it was necessary in order to get this expansion in production that bank loans should be increased by $10 billion?

Mr. KEYSERLING. No; my contention is that if the expansion of bank loans was not necessary to that purpose, and if that expansion in production would have taken place anyway, it is that expansion which exerts the impact upon the economy; that is the point I am making.

Senator DOUGLAS. These double negatives are very hard to follow. Is it your statement then that it was the increase in production which required the increased bank loans?

Mr. KEYSERLING. No. It is my statement that what increased the strain upon the economy is what the functioning business system did. In other words, if you have a shortage of steel, and you undertake a steel expansion program which puts an increasing demand upon steel to build steel plants, that is what exerts the pressure.

Now, if you say that that would have taken place equally without the expansion of the bank loans, then I say that the expansion of the

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bank loans is not what made it take place, which is the very point I have been trying to develop; and that since it did take place, that is what put the pressure on the economy, and this is equally true of other areas of business activities.

Senator DOUGLAS. I take it what you are saying is that it was the demand for production in specific lines which created the demand for added bank credit which, in turn, may have driven prices up. I am not trying to misrepresent your position, I am trying to find out what it is.

Mr. KEYSERLING. I incline toward the view that it is more—I do not want to say better or more fruitful—it is more the way I approach it than the way you approach it. Either way may be right. I start approaching it from the other end and moving backward; you start approaching it——

Senator DOUGLAS. You approach it from the standpoint of the demand for bank funds, I think, and you seem to say that— I do not want to misrepresent your position, but that position if pushed to its ultimate conclusion, is that if the demands are made upon the banking system for more bank funds, it is the function of the banking system to respond by creating the funds, otherwise it would check the expansion potential. That makes the banking system a purely passive instrument, adapting itself to changes in the demands for loan capital.

Mr. KEYSERLING. I do think, Senator, that under the general economic conditions prevailing at that time, and prevailing now, while the banking system is not entirely passive, it is appreciably more passive than your position indicates. In other words, I do think that, with the general outlook as it was mid-1950, with the prospect dangling before the country of a vastly expanding defense program, with businessmen's energies being directed toward the servicing of that program and the realizing of the market opportunity, which actually or speculatively it would create, then in the nature of our economic system and, I think, this gets back to the question that Congressman Bolling asked, ways would have been found to service that dynamic desire of business to increase production; and if you believe that that level of productive increase was too high or that level of capital formation was too high, then I would suggest that the ways which could have been found quickly to curb it would have resided more outside of this particular technique than within this particular technique; if, on the other hand, one is not prepared to say that the level of investment and capital formation and productive build-up was too great during that period, then I do not think hat the net result was bad; and if one is prepared to say that it would e been the same whether or not we had this expansion of bank it, then I say that under that particular hypothesis the expansion k credit did not have much to do with the end result, and that it nd result which conditioned the economy and the strain on and the price level.

DOUGLAS. Mr. Keyserling, an increase in investment in the , and the increase of production in the larger sense, as I e accounted for by one or all of three factors: (*a*) A he amount of unemployment so that men otherwise to work on resources otherwise not occupied with ity.

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On the 1st of July 1950, 5.2 percent of the labor force was unemployed; on the 1st of March 1951, 3.4 percent were unemployed, a decrease of 1.8 percent. Let us say there was a 2 percent greater utilization of the labor force.

(b) The second factor that would operate would be a more effective utilization of an existing stock of capital and labor which might also be used; but (c) this refers not to the general index of production but to investment—you could have a decrease in the amounts consumed and an increase in the amounts invested by a temporary diminution of the standard of life of the American people.

Now, it is precisely this which, I think, also occurred during this period of which, I am very frank to say, I cannot think the Council of Economic Advisers or the administration did pay proper attention to.

During this period we had an increase in wholesale prices of 17 percent, an increase in the cost of living of 8 percent. This meant that those living on annuities and fixed incomes had their purchasing power diminished proportionately; it also meant that those receiving interest in fixed money terms had their incomes reduced proportionately; it meant that salaried workers, whose incomes move very sluggishly in response to changes in the cost of living, had their real incomes reduced almost proportionately.

It meant that the unskilled workers, who tend to be unorganized, had their real incomes reduced, and that the organized workers, while protecting themselves better during this period than in previous periods, lost ground during the intervening time.

Now what I think happened, therefore, was that through this policy the real standard of life of large segments of the American people was decreased, and these gains were transferred to speculators in the community who, out of the abundance of their funds, could invest some of them, yes, and also spend some in night clubs and in Florida, I think that we had a great blow inflicted upon large groups of the American people.

Because the chain of causation was difficult to follow, the connection between the purchase of the bonds by the Federal Reserve at the beginning of the process, and the increase in the cost of living at the end was not seen by the people, and apparently was not seen by the pilots on the ship. I am saying that though the soundings were being taken, the depth of the channel presumably being known, the location of the ship being plotted, nevertheless the ship in this respect was allowed to run on the ground.

Mr. KEYSERLING. Senator, there is a lot in what you said there so that I would like to call your further attention to some aspects of it.

Senator DOUGLAS. Certainly.

Mr. KEYSERLING. The first comment I will make explains why I am a little skeptical of these juxtapositions in point of time. From what you just said—and I am sure you do not intend it that way, it is just that your statement was not qualified enough—do you mean to contend that the general consequence of a rising price level in the American economy at all times is to either reduce the standard of living or to shift the availability of resources to the people in the direction of what you call the few speculators as against the many? Would you state that?

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Senator DOUGLAS. That must be accompanied by an increase in production; and even then it will result in a decrease in the standard of living of those with fixed incomes or relatively fixed incomes.

Mr. KEYSERLING. Yes, but that is a separate question which goes——

Senator DOUGLAS. Well, it is part of it, and the classes which I detailed are quite large in number. If you take old people, retired people, if you will take recipients of interest, if you take salaried workers, if you take unskilled workers, if you take large sections of the organized workers, you get the majority of the American people, and there is a transfer of incomes from these people to speculators who purchase commodities at lower prices which they can later hold for higher prices, so that there is a great internal shift in the distribution of incomes, even though you may have this 5-percent increase in the total level of production. I am willing to say, possibly, that you did get a 2-percent increase in production through inflation by a decrease in the unemployed. I am willing, possibly, to admit that.

I would say that was purchased at a terrific price, at a great diminution of the cost of living of the vast majority of Americans. Without being self-righteous—and it is very easy for a senator to be self-righteous—I have not felt that the Council was sufficiently concerned with this problem of inflation and the evil consequences thereof, and that you look at times on an increase in the price level with the same kindly eye that you look upon the increase in the index of production, whereas the two are very different things.

Mr. KEYSERLING. Senator, since you made one remark there recently just now, which is personalized, although in no sense personal, I am sure, I think that the Council of Economic Advisers has been very much concerned about inflationary trends, and I think that we have, rightly or wrongly, been in the forefront of those advocating a range of affirmative measures to contain inflation.

Senator DOUGLAS. You have in everything except the essential steps. You advocated specific controls but no control over the general supply of money.

Mr. KEYSERLING. Senator, that gets back to the question of our not agreeing as to what is the essential factor.

Senator DOUGLAS. It should have been.

Mr. KEYSERLING. Let me point out that various points of time in the past 6 years can be selected where, if one simply looks at the juxtaposition of events, you can make quite as conclusive a case that this was not the central factor as if you select this particular period of time to show that it was.

Now, getting back to the question of the stabilization of prices, we are very much concerned about the rising price level, and we have at no time looked at it with an acquiescent eye. As a matter of fact, rightly or wrongly, we proposed rather drastic measures as far back as 1946.

Senator DOUGLAS. What did you propose from 1950 to 1951?

Mr. KEYSERLING. From 1950 to 1951?

Senator DOUGLAS. Yes.

Mr. KEYSERLING. We proposed higher taxation; we proposed selective——

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Senator DOUGLAS. In which I supported you. I think I was one of nine members of the Senate who voted for higher taxes on a crucial roll call.

Mr. KEYSERLING. I hope we can keep you with us on that, Senator.

Senator DOUGLAS. I congratulate you on being right on that point. [Laughter.]

Mr. KEYSERLING. And we proposed price and wage stabilization.

Senator DOUGLAS. Of individual items; that is, price control on individual items.

Mr. KEYSERLING. As distinguished from what?

Senator DOUGLAS. Well, taking individual items, fixing price ceilings on individual items.

Mr. KEYSERLING. If that is what you mean by price control, yes.

Senator DOUGLAS. Yes, certainly.

Mr. KEYSERLING. Yes.

Senator DOUGLAS. But you did not propose placing any restriction upon the total quantity of money.

Mr. KEYSERLING. Senator, I think you have fairly well established the fact that I do not ascribe to that factor the degree of importance that you do.

Senator DOUGLAS. I am afraid I have absorbed too much of the time of the committee, and Congressman Bolling wants to ask a question.

Representative BOLLING. My memory may not serve me, but my impression was that the first request that came from the administration to the Congress, after Korea, dealt largely in the field of credit, of all kinds; am I not correct in that memory, that it included proposals for credit controls that were bitterly complained about as completely controlling the credit of the country?

Mr. KEYSERLING. Well now, Congressman, let me say this—and I know that you will join with me in it, and so will Senator Douglas—I think he and I are going to agree on the first thing today—you know some poet said, "Earth bears no balsam for mistakes."

I am not here to claim either that I never made mistakes or that the administration never made mistakes or that the Congress never made mistakes, and I do not want to go into a review of who made the most mistakes the fastest; but the Congressman is generally correct, that long before we got into the area in this new situation of direct controls, we emphasized the importance of certain kinds of general controls, not only higher taxation. It was not only higher taxation, but we also recommended, and I think I have been delinquent, Senator, in not mentioning this sooner, because I do not think that the difference between us is as great as would seem to be, we were not apathetic to the value of some general restraint upon the monetary stream and upon lending through these general devices.

Senator DOUGLAS. Then there was a connection, after all, between them?

Mr. KEYSERLING. What is that?

Senator DOUGLAS. Then you did think there was a connection after all between the total quantity of money and the price level?

Mr. KEYSERLING. Why, of course, there is a connection.

Senator DOUGLAS. Well, now we see it and now we don't.

Mr. KEYSERLING. I never said there was no connection. I have not said there was no connection, Senator. But we proposed various re-

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serve plans directed toward reconciling this kind of general restraint with certain other objectives of national policy and of national need, which seemed to us equally important.

The basic difficulty I have with the proposition as you state it, Senator, is, first, it would seem to me that you ascribe to this particular device a relatively greater weight than I do, and that I place more reliance on a wide range of devices in proportion.

Second, that you do not weigh at all the fact that every particular economic tool has points of disadvantage as well as points of advantage. In other words, taxation has points of advantage; it clearly has points of disadvantage. It is repressive of initiative, which is always a bad thing per se.

Price control has points of advantage and points of disadvantage; selective credit controls have, as the chairman very quickly pointed out, advantages and disadvantages, and quite correctly so; and so has this general measure.

Now, the only thing I am saying is, let us take each of these measures and not get exuberant about any one of them; let us weigh the advantages and disadvantages of each of them; let us recognize that with respect to any of them the advantages at a particular point of time may outweigh the disadvantages or vice versa, and let us try to build a blended program which uses each in just proportion, but does not try to claim—because I think it is claiming too much—that any one of them is the central conditioning factor or the central salvation factor.

Representative PATMAN. May I interrupt there for just a moment? This discussion has been on a very high plane—in fact, I consider it a very high intellectual and professional plane. I personally have enjoyed it very much, and am glad that the discussion went on as it did. We do not want to retard it; we want to encourage it.

We must hear Mr. Blough too, and we cannot do it this morning.

I have conferred with Mr. Wolcott and Mr. Bolling, but I have not conferred with Senator Douglas because he has been busy asking the questions, but we would like to have a meeting tomorow morning here in this room and continue this discussion and have the same two witnesses before us. If we do not get through tomorrow morning we will continue it in the afternoon. Will that be satisfactory to you?

Senator DOUGLAS. Oh, perfectly.

May I thank the chairman for the complete impartiality and courtesy with which he has conducted these hearings and in permitting me to ask certainly more than my arithmetical share of questions. There is just one final thing.

Representative PATMAN. It has been very interesting and enlightening to me.

Senator DOUGLAS. I have just one final question, and I promise this will be the end. What are the disadvantages of a flexible system of support, such as has been adopted since last April? What have been the disadvantages? If there are grave disadvantages, perhaps, it should not have been adopted since April of 1951, and, perhaps, if there have not been disadvantages, the question will come, might it not have been desirable to have adopted this system before April of 1951?

Mr. KEYSERLING. Should I attempt to answer that now or should I cogitate upon that until tomorrow?

Representative PATMAN. Suppose we wait until tomorrow.

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Mr. KEYSERLING. I can do it now, but I will be glad to wait until tomorrow.

Representative PATMAN. There is an amendment up on the Floor soon after 12 o'clock, and it involves the Small Defense Plants Corporation.

Mr. KEYSERLING. Mr. Chairman, may I make just one comment? I want to make it perfectly clear to the members of the press and others here that in saying there have been advantages and disadvantages in this I have not said that this particular step was undesirable. I just want a careful appraisal and analysis of it and, as a matter of fact, I do not think we have had enough experience with it to be sure, but I would like an opportunity tomorrow to appraise the advantages and disadvantages; but I do not want to be misunderstood to have said that I am at this point condemning that experimental effort to see the consequences of a somewhat different policy from the one which pertained before.

Representative PATMAN. Just a moment, if you please. Since we did not get to Dr. Blough, his prepared statement which has been distributed will not be released now; it will not be released until he testifies tomorrow.

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

(Whereupon, at 11:50 a. m., the joint committee recessed to reconvene Thursday, March 13, 1952, at 10 a. m.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

THURSDAY, MARCH 13, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON
GENERAL CREDIT CONTROL AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:15 o'clock a. m., in room 1301, New House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman (chairman of the subcommittee), Senators Douglas and Flanders, and Representative Bolling.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

Mr. Keyserling, I would like to ask you a few questions. You mentioned yesterday the expansion of industry in 1951, describing it as the year of the greatest expansion in history, I believe.

STATEMENT OF LEON H. KEYSERLING, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS—Resumed

Mr. KEYSERLING. Yes, sir.

Representative PATMAN. Isn't it a fact that a large part of the money or the capital used for expansion in 1951 was from retained earnings and depreciation?

Mr. KEYSERLING. Yes; a good part of it was, Mr. Chairman. As a matter of fact that has been a phenomenon of the whole post-World War II period not only in 1951 but in 1948 which was another year of heavy business investment.

The portion of investment which was carried by retained earnings as against borrowing was higher than in pre-World War II periods of rapid industrial expansion.

Representative PATMAN. Our committee made an investigation of that. To the best of my recollection about three-fourths of the capital expenditures came from retained earnings and depreciation and obsolescence deductions. Isn't that enough to cause some concern, Mr. Keyserling?

Mr. KEYSERLING. The Council of Economic Advisers, in its various reports commenting on the interrelationship among business investment and the price and profit structure and the picture on borrow-

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ing, had occasion, I believe first in 1948 to point out the thought that possibly too large a portion of the funds for investment were what we might call financing currently out of the price structure.

That was one of the reasons why we thought in 1948, as I recall, that a somewhat lower price structure and a somewhat lower level of general profits after taxes would have been consistent with supporting an adequate level of business investment.

Representative PATMAN. In other words, whenever you get your capital from the price structure, you are compelling the consumers to pay your cost of expansion in the prices that they pay for products. That is correct, isn't it?

And one witness referred to it before a committee that I was on some couple of years ago as costless capital, and I thought it was a good phrase that expressed exactly what it is, costless capital.

In other words, concerns that are big enough in the particular field in which they are engaged to raise prices at will can get their capital by increasing their prices, and in that way it becomes costless capital.

And the reason I am concerned about it is that I do not see how a small independent merchant or a small manufacturer can possibly have an equal break or an equality of opportunity, we will say, in an economy which permits his big competitor across the street to get his money through an increase in prices, and thereby get costless capital to run his operation, when the small independent must go to the market and borrow his money and pay the going rate of interest on it. Doesn't it occur to you that there is possibly a problem there that should receive some attention?

Mr. KEYSERLING. Yes, there is a problem there, Mr. Chairman and members of the committee, and I have a problem here. On the one hand I don't want to talk too much. Some of the papers have said I talk too much. Maybe I do.

Representative PATMAN. The committee is not complaining.

Mr. KEYSERLING. Good. In the very nature of things, the kind of questions which you are asking, and properly, require considerably analytical attention. I would like to make a few remarks about the point you raise.

In the first place, as I look at the economy, I look first at what I call the ultimate economic consequences. The ultimate economic consequences that any economy is engaged in is the production of goods and services and the allocation of resources.

Consequently, tax policy, price policy, credit policy, and other policies are merely instruments; the ultimate objective which we seek is—under a free system as we understand it—the maximization of our technology and our manpower toward expanding production accompanied by stability, although that does not mean a static economy. It means a stable rate of progress such as our technology can accomplish, rather than fits and starts or booms and busts.

And we look at the problem of the allocation of resources, which means how much of our resources are at a particular time going into business investment, capital formation, how much is going into ultimate consumption, how much is going into Government programs, from the viewpoint of how well allocation of resources accomplishes two purposes. First, a stable and growing economy; and, second, certain other national objectives which we must serve.

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For example, the defense program does not add to a stable and growing economy. That is not why it is undertaken. It is one of the burdens we must carry.

On the other hand, in the question of business investment and immediate enjoinment of goods and services, you have to maintain a balance. It seems to me that is the central problem of our economy, because if investment moves too fast relative to consumption you can get what some people call overproduction, and what others call underconsumption. I don't care much about the terms, and you have an investment boom followed by a decline.

On the other hand, it is possible in an economy to get overconsumption, which means in the final analysis that you are living too richly in the present and not thinking enough about building up your plant and equipment.

Now, what I look at ultimately in an economy at any time is whether those relative activities seem to be bearing a healthy relationship to one another. When you come over to the question of money flows, whether you are talking about it in terms of income within the economy—and tax policy and credit policy and price policy and wage policy all have impact upon those money flows—I don't look at it from the viewpoint of the money flows as a thing in themselves, but rather how they seem to contribute to the wise and intelligent support of the intelligent use of our resources.

Now, the basic question I would ask with respect to the question you have raised is, first, have we been getting over the last few years a sensible allocation of resources between business investment and ultimate consumption.

And, second, have we been getting it through a series of tools which are within the limits of our free system the best way of getting it, or would other ways seem somewhat better, or does getting it in that way have certain counterbalancing defects to set off the benefits achieved?

Now, on the first part of the question, I incline toward the view in general and over-all, although there have been some excesses, that particularly since the advent of the Korean outbreak we have not been overdeveloping our productive facilities as against immediate consumption, because I think that in the long run that is the way to build the kind of strength that we need to carry this kind of security burden, and I think we are going to have to carry it for a long, long time.

Therefore, I would not be prepared now to support the thesis which I supported in other periods of prosperity: that we ran the risk of having overinvestment at the expense of underconsumption.

In fact, frankly I incline toward the view—and some of my friends have thought that I have left them on this—that over the past year or two and on into the next year or two we have been enjoying and are going to enjoy a somewhat higher level of consumption than seems to me consistent with the world responsibilities that we face, and the part of our resources that we ought to devote to carrying those responsibilities.

Now, when you come to the question that you have raised as to whether the method by which business investment has been financed—namely, partly out of borrowing, partly out of the price structure,

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partly out of accumulated reserves, and partly out of profits—whether the post-World War II trend of financing a larger part of business investment out of sources which financed a smaller part before World War II is desirable or undesirable, I would not have any positive judgment on that. And, even if I had a positive judgment, it might be wrong.

I think it requires a lot more analytical observation. As I say, the Council inclined toward the view at least before the defense emergency that too large a share was being financed out of the current price structure and out of current prices, and that the effect of that prior to the Korean emergency was commencing to face us with the problem of whether at that high price level relative to the consumer demand in the economy we were going to run into one of the more or less traditional periods of overproduction or possibly more appropriately stated underconsumption. That was our view prior to the Korean emergency.

Now, when you get into the Korean emergency, it changes the situation a bit because the whole question of the balance between investment and productive equipment and current consumption shifts, for the reasons I have given.

So, I am not so sure now as I was then—frankly, as I was in 1948—that this is an unhealthy tendency. I still incline toward the view taking into account all the factors, including the factor of maintaining a clear road for small business as well as for large, taking into account that we must think of the future as well as the present, that I would like to see somewhat more of the financing of business investment out of borrowing made available on terms that can be supported not only by the large concerns but by the small, rather than financing too large a part of new business needs out of price increases and an administered price system based on what the traffic will bear. That is a long answer.

Representative PATMAN. That is all right, I think it is a good answer, and I can see on the side of justification that it is possible that the concerns would not be able to raise the capital necessary to have the production that is needed for our economy, unless we permitted something like that. That is to be considered too.

Although it is in the direction of concentration of industrial power, and in the direction of monopoly eventually; yet in an emergency, if you cannot get capital otherwise for the purposes of industrial expansion, possibly it is justified. I don't know. I am seeking the answer.

But normally, under normal conditions and normal times, my horseback opinion, is that it is a very dangerous thing to permit. I think we should look carefully into it.

Now, I am anxious to have this discussion continued about these Government bonds. Yesterday Senator Douglas was asking you about the good things about pegging the market and the bad things about pegging the market. If Senator Douglas is ready to continue on that, I will yield to him.

Senator DOUGLAS. First, let me say, Mr. Chairman, that I think I took much more than my arithmetical share of the time yesterday.

Representative PATMAN. I was going to yield to Mr. Bolling, but he said he had to go to a committee in a few minutes. And it would be all right, although I realize that it is probably Mr. Bolling's time, for you to go ahead.

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We are all very much interested in the questions that you ask and the discussion in general, and we are certainly glad for you to continue, and we are delighted to listen to you.

Senator DOUGLAS. At the end of the session yesterday, I asked Mr. Keyserling if he would state what he regarded as the disadvantages of the so-called accord reached approximately a year ago between the Federal Reserve and the Treasury.

That accord, as we all know, instead of providing for the Federal Reserve buying an unlimited quantity of Government bonds in order to maintain the price at a fixed price of slightly above par, it provided for only limited support of the Government bond market, with the understanding that, if this required the price of Government bonds to fall off slightly, then that risk should be taken.

Now, that was done and the total quantity of Government bonds held by the Fed. is now slightly less than what it was a year ago.

The Government bonds have not fallen off very appreciably. They have fallen, I believe, to somewhere in the 97's. The Treasury increased the interest rate of long-time refunding from 2½ to 2¾.

The price level has been relatively stable with some decrease in wholesale prices, though the cost of living to consumers has gone up a few points due to the prior increase in wholesale prices and as these goods have moved downstream been reflected in higher costs to the consumer.

In other words, we had a reversal of the policy which had been adopted before. This reversal of policy has not been accompanied by any catastrophic reduction in the price of Government bonds.

It has been accompanied by a diminution or by a recession of the increase in the price level, and it has also been accompanied, as you well know, by great industrial expansion.

Now, in view of these apparently obvious advantages, I wondered if you would be willing to state for the record what you regard as the disadvantages of the flexible support policy.

Mr. KEYSERLING. Well, in order to do that, again I think I would like to ask the committee for the privilege to make a rather systematic analysis of this problem, because I think it falls into numerous parts. Of course, I would like to answer questions at any time in that analysis, but it is rather a complicated question.

Representative PATMAN. I assume that will be satisfactory Senator.

Senator DOUGLAS. Certainly. I will try not to be captious by interruptions, and any questions that I raise will be for clarification.

Mr. KEYSERLING. I will try to do a better job on the answers than I did yesterday, Senator.

Senator DOUGLAS. You did all right.

Mr. KEYSERLING. First of all, I want to clarify the position which I yesterday took. I want to make a differentiation based on one of the questions which Senator Douglas asked me.

Senator Douglas asked me whether prior to the accord I had recommended, or the Council had recommended, a change in the policy as commonly understood before the accord. I stated that I had made no such recommendation, and I stated that if the decision had been in my hands I would not have made the change.

I want to make two things clear in connection with that, because it has been subject to some misinterpretation in the press, inadvertently.

In the first place, that statement on my part yesterday, and repeated

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today, was nothing new. The Council of Economic Advisers twice a year publishes reports embodying its views on the economic situation and what policies and what changes in policies should at particular times be considered by the President and the Congress.

Now, it is a matter of record that in the January 1951 Report of the Council of Economic Advisers, 2 months, approximately, before the accord, we did not recommend that change, so that what I said yesterday and what I said today is simply repeating the fact, the known fact, that the Council of Economic Advisers was not among those advocating this change.

Senator DOUGLAS. Mr. Keyserling, would it be unfair of me to ask another question?

Mr. KEYSERLING. No question is ever unfair.

Senator DOUGLAS. Well, they sometimes are. Would you be willing to state whether you favored the continuation of the policy which the Federal Reserve then followed, buying an unlimited quantity of bonds in order to maintain the price at the interest rates then charged?

Mr. KEYSERLING. If it does not seem a distinction without a difference or the splitting of a hair, I think there is a difference between not advocating at a particular time a basic change in policy and feeling necessarily that the then pertaining policy is essential to be maintained.

The difference is that my general view is that in an economy as complex as ours the weight should be on the side of doing what has been done, unless a moderately strong case can be made for making a change. Therefore, I would not want to say that, because we had not recommended this particular change, we had our hearts or minds set against it; that we believed it would be dangerous to make it.

I would say, rather, that we did not recommend it because, on the complexion of the situation as we then analyzed it, we did not regard it as of central importance. We regarded other things as of more importance, and we concentrated our fire on what we thought were the important things.

Now, I think I can illustrate that a little further by further clarification. I think that position is entirely consistent with what I said yesterday at the end of the discussion and which was not completely understood in all quarters.

The fact that I did not and that the Council did not before this accord affirmatively recommend it should not be interpreted to mean that I am now taking the position that the accord was undesirable; and that distinction, I think, is so clear that it needs no further elaboration.

In the first place, it was something new, and something new will always have differing opinions prior to its testing as to what its consequences are going to be.

At no time subsequent to the accord have I expressed a view challenging on over-all balance the fact that up to now I am willing to concede that the Federal Reserve Board and the Treasury, in working out this accord, not only did what they thought was best, but I am not prepared to say that what they did was wrong.

On the question of whether what they did was right, I simply say that the period which has elapsed between then and now is not conclusive on that point, and I will come to that further in the course of some of the other things I have to say.

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Senator DOUGLAS. You are going to list some of the disadvantages which affect——

Mr. KEYSERLING. I am coming to that, Senator. I just want to make my position clear: that my position now on the accord is that I am not prepared to challenge what the Treasury or the Federal Reserve Board did; and, if I were prepared morally to challenge it, I would do it.

If I have any defect, it is my willingness to state what I think, and I am not bound by any edict from anybody as to following any particular line. I am not now, and I never have been.

Broadly speaking, I hope the committee will assume that the views which I have expressed privately—and I think I am entitled to express views privately to the President—are in accord with the views which have appeared in our published reports. That is the way I have always been, and at the time when I can't be that way I won't be here. There may be other reasons why I won't be here.

Now, coming to the question that Senator Douglas has raised about my attitude toward the advantages and disadvantages, I had not intended yesterday to compress that within the limits of an analysis of the advantages and disadvantages of this particular accord.

Although I do not want to duck, I will get into it, but I did not feel that I could discuss that question in fairness to myself without pointing out that the basic issue I have raised is not with respect to the advantages and disadvantages of this mild change which has been tried for a short time, but rather the question of how effective this particular device of monetary policy can be in seeking the objectives sought for it, what it can do, what it can't do, what its limitations are, what its dangers are.

And most importantly, not that it should not be used among other things, but that I believe that in the current situation it is one of he relatively moderate and relatively minor things which may be used among many dealing with the subject both of stability and growth.

The second point I want to make in a general way, and then I will get down to specifics, is that we cannot in questioning, in analyzing the effect of a policy—we have to bear these things in mind: first, its objective.

I take it that the stated objective of this particular policy as expressed by Senator Douglas—and let me see if I get it correctly—is to contract the base, if not to contract to hold level, to hold level rather than to permit the expansion of——

Senator DOUGLAS. As a matter of fact, I have been trying to keep my own views somewhat out of this. I did not think that we were examining my views. I am not saying that we should contract the economy. I did not say that the Federal Reserve should sell Government bonds and reduce the money supply.

I merely questioned whether the Federal Reserve should have expanded the money supply from June 1950 to March 1951 as much as it did. I don't believe it should have, and I would like to point out that when the accord then went into effect, the unlimited purchase of Government bonds stopped and no catastropic consequences seem to have been incurred.

I want to say it is not my view that you should enforce a contraction, a reduction in prices, and create unemployment. That is not my contention at all.

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It is natural that we should not expand money supply faster than the index of physical production, taking into account the velocity of credit, and the aim is that so far as possible we should have a stable price level so that savings can proceed within a stable price level and not out of the inflated profits coming from price increases.

Mr. KEYSERLING. Senator, I think that if I had completed the unduly long sentence upon which I had started it would have become clear that I was going to state the proposition as you stated it, but be that as it may—and I do not want to intrude your views into my discussion of my views, so let me try to restate it in general terms.

The argument advanced for the utilization of this particular policy under discussion seems to me to run as follows: That by repressing, whether by preventing the expansion or by cutting back, the availability of a base for loans, that will have an effect upon the volume of loans; that the volume of loans, in turn, has an effect upon the price level; that it is a desirable objective to hold the price level, or at least to prevent it from moving forward in rapid inflation. And that consequently this policy under discussion is a basic device for stabilizing prices.

More specifically, in the particular period between the middle of 1950 and the accord of March 1951, that if this device had been used, presumably in about the combination that it was used since then or in some more extreme combination, it would have stabilized prices, or conversely, that the main reason for the price increase between the middle of 1950 or late 1950 and March 1951 was the failure to use this particular device for these particular reasons.

Now, I think broadly speaking, that is about the position of those who advocate this policy and its extensive use. Now, I say in connection with that the following considerations have to be taken into account: First, does the advocated policy accomplish the objective sought?

Now, that in itself is a difficult question, because we have a complex economy with many factors operating. I do not want to take the time of the committee with the examination of a chart which shows that unless we resort to independent analysis periods can be shown where you have had converse movements of prices and expansion of credit or prices and expansion of bank reserves, and so forth and so on.

But I will say that you have periods when different conclusions are indicated, if you take these different factors. So you have to resort to independent and additional analysis besides the mere juxtaposition of two events to prove or draw a judgment about cause and effect. Therefore, it is a difficult problem.

But there are other problems besides. The other problems are these, and I will state the problems and then come back to the factual analysis of them. The other problems are these:

First, even if it is admitted that a particular economic policy will accomplish, and does accomplish, the stated objective, and even if it is admitted that the stated objective is sound, you have the question of whether it generate other consequences which may not be so desirable.

I want to address some attention to that, but first I want to give some specific examples of that in the field of economic policy, which I did in my opening statement.

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Certainly, since taxation is repressive, you could completely restrain an inflation, or at least I think you could, by making taxes so heavy that people just did not have enough money to force up the price of available supplies, so that if one were looking simply at cause and effect in a situation where the cause and effect is, I think, as clear as in this case, and if one were looking solely at the objective of restraining price rises, one could say, Why go through all this bother of an infinite complexion of economic policies which need to be reconciled and understood by the public? Why not just slap on enough taxes to do it.

Well, the fairly obvious answer, it seems to me, is that you have to ask the question what other consequences would result, and what are the other objectives of economic policy.

The other consequences or result would be that the taxes at that point, although I am not prepared to say at exactly what point, would become so repressive that they would not only hold down prices, they would hold down initiative, they would hold down public support, they would hold down the growth of production, they would hold down the support of the people for the Government policies as a whole, which is absolutely basic.

Now, I do not want to make this tedious by giving other examples, but I could take almost any single element in economic policy.

Take price control. If you want to stop price rises, why not have a price-control law which is so tough and which has so many enforcement agencies that it just says prices can't increase. I think that is technically feasible.

I think if all the resources of the Government which are being put into a variety of economic programs were put solely into price control, you could hold the price level that way, but you would have other consequences.

In the first place, I do not believe that an absolutely frozen price system is consistent with those adjustments within our economy on the production side and on the resource side that we must retain, unless we are prepared to accompany price control by the kind of absolute control of manpower and materials and other things, which is a completely controlled system, which I am against.

In other words, you have to allow some fluidity in the price structure so you can't use price control excessively because it has attendant consequences which outweigh its benefit when you get to a certain point. So you have to consider not only whether policy A assures result A, but what policy A does with respect to result B, result C, and result D if it is pushed far enough to accomplish result A. That is the second point.

The third point I make is that in addition to all of that after defining what you are trying to do, you have to consider not only whether the policy will accomplish your result, but whether in view of its collateral consequences there are other ways of accomplishing the result, at least as to point of emphasis, which seem to give more hope or more promise based on experience and analysis—and we must use both—in view of the whole situation.

Now, the only main point that I am making about this particular phase of monetary policy is that I ask the committee to look at all of those phases of the problem.

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If, after looking at all of those phases of the problem, it comes up with a clear and crystal finding, A, that the price stabilization between February of last year and now is mainly attributable to this policy; B, that the policy if continued for that purpose and pushed much further—and I think it would need to be to achieve the same purpose under a different set of facts—has no collateral effect measured against other policies, then I would say take this policy and go to town with it.

But, on the other hand, if it is shown you need a mixture or variety of policies on this situation, and if you try to ascribe a weight to them on the basis of analysis, then I think the committee ought to consider that.

With that foundation, my general approach, which I think cannot be as confining as a simple vigorous demonstration of a particular policy moving from A to B to C—because there are other policies at play and other objectives at play—let us look at it more specifically.

First of all, what are the objectives of economic policy that we are trying to accomplish?

I still feel, first of all, that most important for a period of partial mobilization over an enduring period of time where we are allocating 18 to 25 percent of our national product to a noneconomic purpose, to a wasteful economic purpose, to a wasteful purpose in terms of economics, although we must do it for reasons of national security, but it is not economically productive, it is a true burden upon the economy, as distinguished from a burden simply measured by dollars or by price changes, the defense program is a true burden upon the economy, it is most important to realize as to the defense program that in the final analysis it can be supported out of nothing but production. Only production can support guns and tanks and airplanes and the other things we have to do.

Senator DOUGLAS. Would you resent an interruption?

Mr. KEYSERLING. No, sir.

Senator DOUGLAS. Did I understand you to say that price changes were not a burden on the economy?

Mr. KEYSERLING. No; I did not say that. I said that in the final analysis the burden of the defense program on the economy is primarily the resources it diverts from other purposes.

Senator DOUGLAS. You did not mention price changes?

Mr. KEYSERLING. I think I made some reference to it, simply to indicate that I would——

Senator DOUGLAS. You say an over-all increase in prices is a burden on the economy?

Mr. KEYSERLING. Sometimes it is and sometimes it is not, but I want to discuss that in some detail, Senator. I think sometimes it is and sometimes it is not. That is just the point I want to make.

Now, therefore, in the complexion of the economic policies that we use at this time, we must place heavy weight on this productive factor.

Now, let us set against this productive factor the theory of this particuular type of monetary control as I understand it, and not only as I understand it, but if I have not misquoted some of the people, such as Goldenweiser and Sproul and others, whose views I set forth in my statement, I would think there is rather common consent on this point.

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The general theory of this particular device is that through, I don't like to say contracting, because the Senator says he does not want to contract, he wants to restrain, but let us say through placing certain restraints on the money supply you ultimately bring about less pressure on prices.

However, it seems to me that the authorities are in relative agreement that in order to bring about that pressure on prices, I mean a downward pressure or a restraining pressure—

Senator DOUGLAS. Again I want to protest. I am not saying that the price level should necessarily fall. My point is simply that we should try to prevent it from rising appreciably; that the stability of the price level should be the goal.

Mr. KEYSERLING. I would agree with that, although I am not quite sure that some aspects of the price structure do not need to fall if we are going to get some harmonious——

Senator DOUGLAS. I am speaking of the general price level.

Mr. KEYSERLING. The general price level. Anyhow, whether you speak of it in terms of preventing it from rising or from restraining it, the general theory nonetheless is, as I undestand it and as the authorities seem to concur, that for this particular device to be used toward that purpose, it has to be pushed to the extent where it results in a general decline in production and employment.

Senator DOUGLAS. I must protest that you might have picked out quotations from Mr. Sproul and Dr. Goldenweiser to this effect, but certainly that is not my position nor is it I think a general position of the advocates of merely limiting the purchase of Government bonds by the Federal Reserve.

I want to make it clear that those are not my positions and I do not believe they represent fairly or in any representative fashion the point of view of those who seek to stabilize the general price level through credit and monetary control.

Mr. KEYSERLING. Let's illustrate that by a test, Senator. Could the pressures upon the price level in the period between the middle of 1950 and March 1951, the period to which you correctly direct attention, could the pressures upon price levels during that period have been restrained more than they were restrained without reducing either the level of consumption, the level of business investment, the level of employment, the level of expansion in plant and facilities, and so forth?

Senator DOUGLAS. Are you going to argue that question or merely raise it?

Mr. KEYERSLING. It would be rather novel to me because I haven't observed it in the commentators'——

Senator DOUGLAS. Are you saying that a stable general price level would restrain consumption, would result in unemployment, and so forth? I would be much interested if that is your point of view.

Mr. KEYSERLING. No; that is not what I am arguing. I think a stable price level is consistent with that, but I say that under the expansion of consumption and investment and inventory accumulation, in other words the rapidly expanding use of resources which actually took place during that period, I do not see how price increases could have been prevented without restraining some of those resource uses.

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Senator DOUGLAS. Let me ask you this further question. To the degree that these added purchases were made by drawing on savings, that could have proceeded outside of the commercial banking system. The question is as to whether we should have added to these other factors this increase of $10 billion in commercial loans.

Would the increase in prices have been as great if the issuance of bank loans had been more restrained, on the presumption that the issuance of bank loans would have been more restrained if the reserves had not mounted and the reserves would not have mounted if the Federal Reserve System had not purchased the bonds?

I am not contending that general flow of money solely determines individual prices. I am not ruling out the possibility of drawing on accumulated savings.

I am merely saying that the total supply of bank loans does affect the general level of prices, and that when you expand bank loans, that has an effect on the general price level if it is not accompanied by a corresponding increase in physical production.

Mr. KEYSERLING. Senator, in the period under review, my departure from you is not as great as you think it is, but it is important in one vital respect.

I am not arguing that the general expansion of credit or the general expansion of bank loans under the conditions prevailing during that period did not have any effect upon prices. What I am saying is that the only way a restraint upon that factor could have had an appreciable result upon the price level would be if it were carried far enough to restrain the demand of the people for the acquisition of resources.

Senator DOUGLAS. Let me ask you this question——

Mr. KEYSERLING. Let me illustrate that a little bit. Let's illustrate that in various areas.

Suppose—not suppose because it actually happened. In the period between November 1950, and early 1951, people in the New York area felt that because they had heard that there was going to be—and this is not a limited illustration; it can be generalized into a lot of what was happening—felt that in the view of this Chinese intervention and the thought that it might result in this or that or the other thing, and their vivid recollection of past shortages, they flooded the department stores and started buying more pillow cases and more bed sheets, and that on a broad scale was an important factor in the particular kind of price inflation spurt which occurred at that time.

Now in the absence of price control, I say that in the short run—and I am talking here mostly about short-run consequences—whether those people ran in to buy those pillow cases by drawing down upon their savings, or whether they ran in to buy them by saving less, or whether they ran in to buy them because of an expansion of credit, is not the prime factor in the price increases in those areas at those times. They were trying to buy more pillow cases.

Now all I am saying is that if you try to trace through how a contraction in the general monetary supply through this device would impact upon those sources of inflation, all I am saying is that for it to do that—and I do not deny that there is a connection and that it could do that—you would have to push it far enough to accomplish certain other things at the same time, and that on net balance they would have been undesirable in that period.

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Senator DOUGLAS. Mr. Keyserling, I am not blaming you for this because I know I interjected in your argument once or twice, but the original question was directed to the period since the accord.

What bad results in your opinion has that accord had? What disadvantages have occurred as the result of it?

I wonder if you would be willing to turn your attention to this period subsequent to April 1951 a period of almost a year under which we have operated with this accord. That was the question that I hoped you would answer yesterday.

Mr. KEYSERLING. Yes, sir; but there is a direct connection between the two.

Senator DOUGLAS. Time is somewhat limited, and half an hour has passed since you started the discussion. You have not yet come to it.

I say it is not entirely your fault because I have twice interrupted, but if we could at least declare a truce for the time being on the period prior to the accord, would you be willing to move to the period since the accord?

Mr. KEYSERLING. Yes, sir; but let us consider this, Senator, and I want to say that I hope you will not take exception to this.

Frankly I think—and this is consistent with the whole argument I am making—that one of the disadvantages of the accord—and I want to emphasize again that I am not saying on net balance it was undesirable—is the extent to which on a Nation-wide basis people have claimed for it more than it has accomplished.

Now I think that is a very important issue of economic policy, and you can't separate that from the claim that the absence of the accord before February was responsible for the price increases before February.

Senator DOUGLAS. Remember this is politically——

Mr. KEYSERLING. No, sir; I am not talking politically.

Senator DOUGLAS. I want to use it as an illustration. We always run into this question when any character comes up for appraisal. We may say, "Well, he is not as good as he is cracked up to be," but that is not my question. What positive faults are there in the man and what are the positive faults in this accord? That is the question I am asking.

Mr. KEYSERLING. Senator, if you are willing to say that the accord has not been——

Senator DOUGLAS. Oh, no, no, not at all. I am merely saying I want to know what are the positive faults of the accord, what evil consequences or bad consequences have followed in its wake. You said it had advantages and it had disadvantages. Well, now I want to hear the disadvantages. I have yet to hear any disadvantages.

Mr. KEYSERLING. Senator, I do not want to be in any respect captious about this, but I cannot avoid the consequence of this observation: That if I have rheumatism and a doctor tells me that drinking a glass of water will cure me of that rheumatism, and I drink a glass of water, and later I feel better, I do not think that the sole question is whether the glass of water did me any harm.

There is also the question of whether that doctor should be allowed to go around the country saying that drinking a glass of water is a cure for rheumatism, and I think that that is an essential part of this discussion.

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Senator DOUGLAS. Wait a minute, you said that the accord had advantages and disadvantages.

Mr. KEYSERLING. I think one of the disadvantages——

Senator DOUGLAS. What are the disadvantages?

Mr. KEYSERLING. I think one of the disadvantages—and I will come to others—is that it has led people to say on the basis of a juxtaposition of events which are not cause and effect, that this policy is the central core of price stability in this kind of mobilization period.

Now that has very important consequences, because it has a bearing upon the extent to which we rely upon tax policy, it has a bearing upon the extent to which we rely upon price and wage controls, it has a bearing upon the extent to which we rely upon select controls, and therefore it has a bearing on the whole thing. So I say again that the question of whether or not the accord has led some people to over-appraise its significance has a direct bearing upon the value of the accord.

Senator DOUGLAS. Are there any positive disadvantages?

Mr. KEYSERLING. Coming to the positive disadvantages, I would like to amplify it a little bit by saying that I have never said basically that this particular accord had demonstrated positive disadvantages, but that to carry the accord to the point where it would have to be carried to operate as a major stabilizing factor, it would have profound disadvantages.

Senator DOUGLAS. Has it had any disadvantages to date?

Mr. KEYSERLING. Well, it has had the one I mentioned, which I think is significant.

Senator DOUGLAS. Aside from that?

Mr. KEYSERLING. I think that it exercised some unstabilizing and uncertain influences.

Senator DOUGLAS. In what respect?

Mr. KEYSERLING. Well, I think it caused interest rates to move upward.

Senator DOUGLAS. I think that is true. The interest rate has risen from 2½ to 2¾ percent on Governments, and there has been an upward movement in interest rates generally. Do you regard this increase of interest rates as sufficiently serious so that the accord should be discontinued?

Mr. KEYSERLING. No; I have at no time taken the position that the accord should be discontinued.

Senator DOUGLAS. To what extent would the policy have to be carried to have other injurious effects besides a rise in the interest rates?

Mr. KEYSERLING. Senator, I would first have to discuss the question to what extent it would have to be carried to have beneficial effects, because the basic point I am making——

Senator DOUGLAS. Then, do you think it has had any beneficial effects?

Mr. KEYSERLING. I do not think that it has provable and substantial beneficial effect except that other things being equal, to use a phrase which you used yesterday, Senator, other things being equal, I think it is very much better for the Treasury and the Federal Reserve Board to be appearing to the public in the light of reconciling their views than to be in conflict.

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Senator DOUGLAS. In other words, the advantages have been psychological rather than economic.

Mr. KEYSERLING. Well, I do not think there is any clear line between the two. I would say that that is perfectly logical with my general position, because since I say that these milder variations in this particular policy do not have very much effect on the economy, I would much rather not see the Federal Reserve Board and the Treasury fighting about an issue which seems to me not so important as many other economic issues with which we now have to deal.

Senator DOUGLAS. On balance have the beneficial effects been less than the disadvantages in policy?

Mr. KEYSERLING. I would be inclined to say that up to the present time the beneficial effects have outweighed the detrimental effects.

Senator DOUGLAS. That is, the harmony between the Federal Reserve Board and the Treasury has been more important than the rise in interest rates?

Mr. KEYSERLING. Up to the present time I would say on balance that that would be my view.

Senator DOUGLAS. Suppose you could have obtained harmony by the Federal Reserve Board adopting the policy of the Treasury so that you would have had harmony with the diametrically opposite policy.

Now, in that event you would have had harmony plus stability in interest rates, and so, therefore, according to your reasoning, it would have been still more beneficial, would it not, because you would have added to the lower interest rates the advantage of harmony.

Mr. KEYSERLING. I am not saying——

Senator DOUGLAS. By the method of logic that seems to follow. You say that the disadvantage of the record is that it has raised interest rates, and I grant you that. I think that should be granted. It increased interest rates slightly. That is a disadvantage.

But you think that is outweighed by the harmony between the Federal Reserve Board and the Treasury. Now, if the accord had not been concluded, if the Reserve had continued its previous policy of buying unlimited quantities of Government bonds, let us grant that the interest rate would probably remain lower, and you would also have had harmony; so I would think you might argue that instead of offsetting one against the other, the two would be added and would reinforce each other.

The only conclusion I can draw from your statement is that it would have been still better if the accord had not been reached.

Mr. KEYSERLING. I have not said that, and I did not think——

Senator DOUGLAS. It follows implicitly from the contents of your argument.

Mr. KEYSERLING. No; you draw that conclusion only because—I think there are certain limits on logic in this situation, too, for reasons that I gave yesterday. You can follow logic within a narrow framework which precludes from consideration a lot of things that ought to be in that framework before you start using logic. Logic is simply a tool.

Senator DOUGLAS. Would it not have been better not to have had the accord?

Mr. KEYSTERLING. Senator, I have said on balance looking at it now, that I think the accord has had some net benefits.

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Senator DOUGLAS. Simply because the Treasury finally gave in?

Mr. KEYSERLING. I did not say simply because of that.

Senator DOUGLAS. You said the harmony outweighed the raise in the interest rate. The harmony was produced by one side yielding to the other. Up to March it had been the Reserve which had yielded to the Treasury. Subsequent to March it was the Treasury which yielded to the Federal Reserve.

Mr. KEYSERLING. Senator, my basic position is that if one looks only at the changes which have thus far been made, my analysis is that their effect upon the economy has not been large.

Now obviously you disagree with that. We have been over that ground. You think that it had a profound effect upon the price level between the middle of 1950—I mean not having that accord—between the middle of 1950 and February of 1951. I do not think so.

You think it has had a profound effect upon the price level between March of last year and now. I do not think so.

Now we can go over that on a more factual basis. But the main point I am making is that, since I do not think that the mild permutation between the situation before the accord and the situation after the accord has had this profound effect upon the economy, then I think there is room for saying that one of the major concerns here up to this point is whether two agencies of Government, of public power, if you do not want to call it Government, concerned with the policy which up to this point and within these limits does not seem to me to have had any great effect one way or the other, stand before the people in trying times as able or unable to reconcile their differences.

And I am glad they have reconciled their differences, and I think it is a net factor of a favorable factor.

Senator DOUGLAS. May I interrupt? Do I understand your position that the limited purchase versus unlimited purchase of Government bonds has very little effect on the general price level?

Mr. KEYSERLING. It depends on the quantity of purchase and the time of purchase and the terms of purchase and what else is happening in the economy at the time.

Senator DOUGLAS. I am referring to one period in which the Reserve purchased $3½ billion of Government bonds from June 1950 to March 1951. As I understand it in your judgment that did not have much effect on price level.

Mr. KEYSERLING. That is my judgment.

Senator DOUGLAS. And from the period April 1951 to March 1952 the Federal Reserve Board has not purchased additional quantities of Government bonds, in fact it has slightly diminished its holdings. Do you say that has not had a steadying effect on prices, that there is no indication that the increase in prices during the previous period, and the relative stability of prices during the latter period have been tied to the bond purchase policy of the Reserve?

Mr. KEYSERLING. I think that in both periods it has had some very slight effect.

Senator DOUGLAS. But not appreciable?

Mr. KEYSERLING. Taking this last period first, I think that the basic reasons for price stability since March 1951, I would place them in this order——

Senator DOUGLAS. I am trying—well, I will let you complete your statement. I do not want to interrupt.

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Mr. KEYSERLING. I would say that since March 1951 the basic reasons for price stability have been the following. First, while there was an inflationary spurt caused largely by inventory accumulation and by rapidly advancing consumer buying after the Chinese intervention——

Senator DOUGLAS. Are we speaking of the period July 1950 to March 1951 now?

Mr. KEYSERLING. I am speaking of the period from March 1951 until the current time.

Senator DOUGLAS. Which is a period of comparative price stability.

Mr. KEYSERLING. Yes, sir; and I was starting to say that while there had been this inflationary spurt after the Chinese intervention, nonetheless it is my view not only now but was my recorded view going back to the first Korean assault and to the second, that in the long pull over the next few years as of from then the basic size of the defense program and its basic pace in a period of partial mobilization, related to the then productive power of our economy, the supplies then available in our economy, and the likelihood of productive expansion over the next year and a half, was such that in the long run the inflationary pressure strain of the defense program would not be great.

Now that is what has happened and that is the main factor. You are asking why prices have been stabilized since March of 1951.

Senator DOUGLAS. Now would it be improper for me to ask, whether the stability of prices has or has not been aided then by the cessation of purchase of bonds by the Federal Reserve?

Mr. KEYSERLING. It has been aided, but if I were to list the eight reasons which I would ascribe for price stability, I would list that seventh or eighth, not first.

Senator DOUGLAS. Then I take it your position is that changes in the money supply in these last two periods at least have had very little effect upon the price level, that is from July 1950 to March 1951, a period of advancing prices when one policy was followed, leading to an expanded money supply that is, and the period April 1951–March 1952 when prices have remained relatively stable and Federal Reserve holdings of securities have remained relatively stable?

Mr. KEYSERLING. If I were listing the eight reasons for rapid price increases between the Korean aggression and February of 1951, and the reasons for the relative price stability between February 1951 and the current time, if I were listing the six reasons or the eight reasons for that, I would list this particular reason in the degree that that policy was used as about seventh or eighth, and not as first.

Senator DOUGLAS. The issue is very clearly joined then.

Representative PATMAN. Would you indicate what the seven or eight are?

Mr. KEYSERLING. I would say first the basic relationship between our productive capacity and the demands upon our resources.

Senator DOUGLAS. May I interject there. The index of unemployment was 5.2 percent the 1st of July 1950, and it fell to 3.4 percent in February 1951, or a decrease of 1.8 percent, so that there was a transfer of idle labor.

It is at present I believe 3.4 percent, for February 1952, so that it has since remained constant.

Now I grant that possibly a price increase did play a large factor in the reduction of unemployment by 1.8 percent.

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My point is this: That the increase in production was about 10 percent and that therefore the greater utilization of idle resources accounts for only a small fraction of the increase in physical production.

Mr. KEYSERLING. No; I did not say that the greater utilization of idle resources was the main factor in the increase in total production. I think part of the increase in total production has been due to increased productivity.

Senator DOUGLAS. Why was the increase in productivity dependent upon the increase in the money supply? That is, could not the increased productivity have occurred without such a large or rapid expansion of the money supply?

I think that we need to be wary of assuming that because productivity increases, it increases because of governmental policy.

Now the truth of the matter is there has been this long time of increase in porductivity at the rate of 3 percent a year more or less irrespective of Government policy.

Government policy may dampen it down, or may accelerate it somewhat, but the long-time trend proceeds in Republican administrations, as well as in Democratic administrations and so on, and I think frequently there is an error in assuming that because productivity has advanced, it is due to governmental policy.

Sometimes it is like the fly on the axle of the chariot wheel in the Roman chariot race who at the end of the race got down off the wheel and said, "See what a long distance I have traveled."

Mr. KEYSERLING. Well now, Senator, I did not say that the increase in productivity was due to Government policy, although I think that has been a factor in it, and I did not say that the increase in productivity was due to the increase in the money supply.

I simply started to enumerate the reasons why I think there has been relative price stability from March 1951 until the current time, and I do think that the first and most important of those reasons—and I was just parenthetically stating why the increased production had taken place—is that in March 1951 the general level of production had been raised very far above what it was at the time of the Korean outbreak.

There had been expansion in basic productive capacity, there had been expansion of various other kinds of output, and if you want the figure in uniform prices of the changes in the gross national product during that period, I will read them.

Senator DOUGLAS. I have them here. I would prefer not to use gross national product because there are all kinds of inadequacies in that figure. I prefer to take the index of physical production.

Let the record show there was an increase in the Federal Reserve index of industrial production from 200 in June, 198 in July to 219 in March 1951, or an increase of about 10 percent, but nearly all of this occurred in the single month of August—when there was a jump of approximately 6 percent.

Mr. KEYSERLING. Well, anyhow I would say the first and foremost factor in the price stability over the past 12 months has been the increase in production, measuring the productive level during that period with the productive level at the outset of the Korean trouble.

In other words, I do ascribe to the realization of our productive capacity a very, very important role in preventing or avoiding price inflation.

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Now a second factor, the factor of second importance which in a sense relates to the first, because production must be measured against utilization of resources, the fact is—and I say this not critically but descriptively—that the actual pace of the take of the defense program, as we all know, has in actuality been slower than was contemplated by the business community and by the Government when estimates of the economic outlook were made in late 1950 or in early 1951, so that you have had two complementary and interdependent factors playing.

First, a great increase in total production, and a particularly large increase in the strategic areas of shortage, which had a good deal to do with the inflation.

Second, and at the same time, a pacing of the defense programs take upon the economy considerably slower than had been contemplated.

I am not saying that critically or in terms of praise. That depends and I do think that the first and most important of those rea- it has been a factor in the economy. Those are two factors. Now let's move on to a third factor.

I think a third factor has been the excellent judgment displayed by the Congress in raising taxes.

Now, the fact that the Congress has not been willing to raise taxes still further has tended to obscure the fact that never before in peacetime history did a Congress do so realistic and forthright a job in increasing taxes as much as it did between the original Korean outbreak up to the present time.

I think on a comparable basis and allowing for the differences in the circumstances, that they did a much more commendable job this time than in World War II. Now, I think that is an immensely important factor in the effect upon price structure.

We have imposed a very heavy additional tax burden upon the American business community and upon the American people. That is factor No. 3.

I think factor No. 4—and when I get below 3, I am not as clear as to the order of the importance, I mean whether it is 4, 5, 6, or 6, 5, 4. Let us say another factor in the fourth category is the level of saving.

Now, of course you may say that the level of saving is affected by these other steps which are taken, and there you get into a circular process as to whether price control promoted savings by making the people feel that they were not going to have to buy against price increases, or on the other hand that savings made price control effective because if the people had tried to spend more price control could not have been effective.

I think it is interrelated, and I would not want to claim excessive partisanship toward the relative weight of the two factors.

But anyway, partly due to the abundance of supplies, partly due to the restocking which took place in the end of 1951, partly due, whether desirably or undesirably there has been a sense of decreasing urgency about the pace of the defense program—and I state that merely objectively because I do not want to be implied as criticizing it one way or another—anyway, partly due to all those factors the American people have over the past year been saving at a fantastically high rate.

I won't say abnormally, because I do not know what norms are in this kind of time, but anyway fantastically high by past measure-

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ments, and I would ascribe to that a very important influence upon price structure.

Next, I think that price and wage controls at least in a short period of time have had a very important effect on it, because while I agree with those people who say that it is not the most basic remedy, and while I agree that it cannot in the long run contain prices, if the other conditions are not favorable, yet I think that the statement that price and wage stabilization for a period of time deals simply with the effects and not the causes is an understatement.

I think that in the dynamics of the way collective bargaining works, the way price policy works, that you get a push upon prices not only from the demand side but also from the cost side.

I think, for example, taking a current example, that if you were to have excessive wage increases—I do not want to get into the question of what would be excessive, because agencies of Government are now wrestling with that problem, but the illustration serves anyway—if you were to have excessive wage increases in the steel industry, I think under current conditions that could give a very important fill-up to the inflationary trend.

And getting back to the relationship between that and these other policies, I hardly see just how monetary policy within doable ranges could have any direct and quick impact upon that urgent situation arising in the steel industry.

So I would put price and wage stabilization at least for a time as an important contributing factor in the fifth or sixth category.

Then I think the allocation of materials is extremely important. I think whether scarce materials are wisely or foolishly allocated among various claimants, the pacing of that, how well it is figured out, how it is done, that has a very important effect upon the price structure both in direct economic terms and upon the sense which it produces in the business community either that they are going to be in great trouble or not in great trouble, depending partly on how intelligently that job is done.

Now somewhere within that range at that point I would put the effect upon the general price structure, under these times, of the permutation in monetary policy of the size and character which have been undertaken and which it seems to me either the Federal Reserve Board or the Treasury would be willing to undertake in view of all the circumstances now prevailing. That is about where I would place it.

Now I am perfectly willing to concede that it has some effect, and I am perfectly willing to concede that if that particular device were pushed far enough, just as if taxes were pushed—by "far enough" I mean too far—just as if taxes were pushed too far or price control too far, it could have a compelling effect.

But then I move over to say that within the range of that policy as it has been operating, I would enumerate it as one of the factors but certainly not the controlling factor.

Senator DOUGLAS. You would put it almost at the bottom.

Mr. KEYSERLING. I would not range it as high as the others that I have mentioned.

Senator DOUGLAS. You have said you would put it at the very bottom of all these factors.

Mr. KEYSERLING. Well, I could mention some others that I would put even lower.

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Senator DOUGLAS. You mentioned six or seven that are higher. What would be lower?

Mr. KEYSERLING. Well, I think that under the current situation exhortations to people not to ask for higher wages or to be wise in their price policy, I would put that lower.

Senator DOUGLAS. I would agree with you on that point.

Mr. Chairman, the witness has taken some time in replying to my questions. I think I should now fade out.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Keyserling, the first question that I have is one to which I am very anxious to get a full answer, but I am aware that the question may be a lengthy one. But I want a rather long answer and I am aware that it will take you back over some territory that you have already covered.

I raised the question with Mr. Martin the other day, that between 1942 and 1945 the Federal Reserve increased its holdings of Government securities by $22,000,000,000, and the consumer price index moved up four-plus points.

During the period between 1946 and 1950 there was a net increase in the Federal Reserve holdings of about $5.9 billion, and the consumer price index moved up 40-plus. Now the periods of time are not exactly comparable and I made no effort to make them exactly comparable.

I am aware that you have already discussed some of these things, but I would like to get for my own mind your ideas of the differences between the two situations.

What were the factors that maintained comparative stability in the 1942–45 period, and what were the factors that made prices raise so fast in the other period?

Mr. KEYSERLING. Well, I will try to answer that as briefly as I can, but the most important part of my response is this: that the facts which you have cited showing at various times an inverse trend in these different elements is a factual illustration of what I was stating generally.

I find that some business economists, labor economists, and others have slipped into the habit of starting with a thesis and then it does not require very great intellectual ingenuity to take a long-term chart in a complex economy and pick out periods where A caused B, and where A was the sole cause of B.

I just don't believe that. I believe that that is almost never true. And the only concern I have about the attempted correlation between the monetary policy between the middle of 1950 and March 1951, and the attempted correlation between March 1951 and the current time, in juxtaposition to the price structure, is that it is an oversimplification,

I do not say that it has no validity. I do not say that it was not one factor, but there are many other factors.

Now, the citation which the Congressman has given simply gives factual illustrations of points in time where very different things happened under a different complex of factors. Now, you asked what were the reasons for that.

I do not want to bore the committee with a discussion of the whole economic trend of World War II or even of the 1946–47 period, but I would say simply that in World War II it was demonstrated that

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even with the allotment of 50 percent of our resources, approximately, to war production as contrasted with a 20-percent range now, meaning a greater strain upon the economy, that even with that and even with a tax policy which in that time I think took an inadequate amount of excess purchasing power out of the economy as against borrowing, and even with financing of about half of the war effort through borrowing, even with all those things which were much more extreme than anything we have had in recent times, nonetheless, as you point out, there was achieved for a long period of time quite a large degree of price stability, which seems to me to indicate at least—and I do not want to prove too much for it—that we cannot single out as the determining factor in price stability a factor which was not present at that time because at that time the Federal Reserve Board did support the Government bond market and at that time it did follow the policy of taking up these obligations as they occurred.

Now, I do not mean by that—and I want to take a moderate position on that—that an even better job might not have been during World War II if a somewhat more flexible policy similar to the one now in effect between the Federal Reserve Board and the Treasury had then maintained. Maybe that would have been still better. I am not arbitrary on that.

I simply say that it is one factor in the picture and does not seem on analysis to be the major factor within the range of what is doable in that area now.

Now, I also think that during that period of World War II we would have been better advised to have collected somewhat more in taxes, although I do not believe you can be on a pay-as-you-go basis in a total war, because we did, through not doing that, give the people the impression, including our working groups, that they were increasing their real incomes because they were getting more wages at a stable price level, but the only reason they were registering that gain was because they were not allowed to spend the money.

If they had tried to spend the money, the increased production of civilian goods was not underneath it, and, consequently, when they did try to spend the money after the war, that, among other things, forced up the price of those goods.

So I think it was in that sense a suppressed inflation, and I won't say it was a subterfuge, because on balance I don't know—you certainly could not have financed the whole war out of taxation, and maybe the right balance was struck, but if that was the right balance we had to pay the cost for it in postwar inflation.

Now, whether the cost in postwar inflation was on net balance a greater cost to our economy than the cost of a different system of taxation during the war, I don't think any man can answer. I think it takes an awful lot of analysis. It is a terribly difficult question.

So much for the World War II period. Now, coming over to the other period that you refer to, Congressman, the 1946–47 period, there were a lot of factors operating then.

I think personally that the direct controls were demolished somewhat too rapidly in that period. I think the backlog of demand for a tremendous accumulated nature of war-created shortages was an immensely important factor.

We had practically full employment at high and growing wage levels. We had a large accumulation of savings, and all of those

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things in combination forced the price level up rapidly during that period.

If we had wanted to hold the price level reasonably stable during that period, I think we would have had to defer the demolition of price and wage stabilization, and I think we would have had to have a higher tax program.

But there again that brings me to the other point that Senator Douglas raised about price trends and gives me an opportunity to discuss the third phase of the main point I made.

As you recall, I said three things. I said first that in weighing a particular policy device, one has to ask first will it accomplish the objective claimed for it, namely, in this instance, how much effect will it have upon price stability.

Second, if it will accomplish that objective, what are its collateral consequences and what are alternative methods of accomplishing that objective.

But third, and perhaps most important of all, is the question: Is that objective the sole or the predominant objective in the economy?

Now, let us apply that to the question of prices. There is a great inclination to the view that price stability is our primary economic objective. I do not attribute that to you, Senator.

Senator DOUGLAS. I would say that it is a prime objective. Yes, I would be very glad to say that.

Mr. KEYSERLING. I think it is one very important objective.

Senator DOUGLAS. I would say it is a primary objective.

Mr. KEYSERLING. I would agree that it is a prime objective, but I will say that in the operations of the American economy, particularly when since no election on our part we have had these great shifts in the problem with which we have had to deal, I do not know just how one could equate what degree of price stability would be consistent under our system with the other things we have had to do at the same time.

In other words, let us look at the situation going back to 1950. In 1949 we ran into a recession. Some people thought that was going to be quite serious, others did not think so. In other words, it was the first important postwar testing of the stability of our economy.

In 1950 we started recovering from that recession, and there was some ambivalence in the situation then. In the middle of 1950 we got a different burden.

Now frankly I do not think economists, including ourselves or others, have really moved on to an adequate analysis of at just what point price trends equate with other objectives. In other words, to what extent would the productive changes between 1950 and 1952 have been the same if we had had absolute price control.

My inclination is to think that on balance, through not having absolute price control, the productive advantages outweighed the somewhat lesser stability. I cannot prove it but that is my inclination.

Second, there needs to be further analysis of the relationship between the changes in the general price level and how those changes affect resources and incomes throughout the economy. I would say that if it could be shown—this is a theoretical picture to illustrate the point, Mr. Chairman and members of the committee—that a change in the price level was accompanied by an apportionment of resources throughout the country which apportioned to each group exactly the

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same additional number of dollars, manifestly you would be working with more chips but you would be back where you started from.

Therefore changes in prices either upward or downward affect the economy adversely in one of two ways.

Either they produce a certain redistribution of resources which in the long run affects economic stability, because things get out of balance, or they produce a social redistribution of benefits which we as a nation do not think is consistent with fairness or justice, and they may do a complexion of those two things.

But it does not follow from that automatically that a generally rising price level in the United States always produces the changes in an undesirable direction. I would be prepared to say that rapid upward spurts of prices at particular times do produce these consequences in an undesirable direction, and I, of course, am not arguing against but rather for a firm stabilization program, and a rounded stabilization program.

But I do not think that price is the only thing that we can look at in the economy in determining economic policy. And consequently when you prove that a monetary policy if pushed far enough would hold the price line—and I think it would, any policy if pushed far enough would—you have to examine what the consequences of pushing the policy that far would be not only upon prices but upon production, upon the allocation of productive resources, which is vitally important in this defense period.

And the main point I made on this monetary issue is that if it were pushed far enough, actually to hold the price line, not to hold it now, because I think many things are holding it now, but if it were actually pushed far enough actually to hold the price line, not to hold it now, sion and March 1951, if it alone were relied upon or almost entirely relied upon, if it were pushed far enough absolutely to hold the price line, it would have to be pushed so far that in its consequences upon the national debt, upon the financing thereof, upon changes in interest rates, upon productive incentives and upon the allocation of resources, then it would produce lots of other things that nobody would want to countenance.

And that is the essence, Congressman, of my whole position here.

Representative BOLLING. Mr. Keyserling, our military build-up program places its major emphasis not just on the production of hardware but on the production of productive facilities and the development of production facilities. We could have used two techniques in achieving that.

One would obviously have been direct Government construction, the other was the one we chose, private expansion, with various aids and assistances. Where could that private expansion come from in credit terms other than through an increase in credit available?

Mr. KEYSERLING. I think that there would have to be some increase in credit available to produce so rapid an expansion as has occurred.

Representative BOLLING. This is the question that I am not at all clear on. You have said several times that the diversion of productive capacity for military defense purposes is in a sense completely negative from an economic point of view.

Is there a difference in the negativeness between the production of hardware and the creation of new production that does not produce hardware for some time? Do I make that clear?

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Mr. KEYSERLING. Yes, there is a big difference and there is also a difference between the production of end fighting weapons and the production of facilities for their production. Let us take both of those points.

First of all, when I said that a military program while necessary on grounds of national security does not add to our economic strength or our productive facilities, I was referring to fighting weapons.

I was not referring to that part of what is sometimes called the security build-up which consists in the production of productive facilities, because most of those productive facilities, as we learned after World War II, can be substantially transformed to the production of civilian goods. Now that is the first part of the question.

In other words, I would not apply the comment that the military build-up is not economic and in an economic sense wasteful, although it is necessary on grounds of security, I would not apply that to the expansion of a steel plant even though the expanded output of that plant for the time being goes into the increased production of military end items, unless one said that that would be a net loss after the defense program because we would then have a disutilization of those facilities.

I think as a nation we have got to find ways to use those facilities and can.

As a matter of fact, I do not think that in any of the important areas of the expansion of productive facilities the expansion has moved much if at all above the correlated factor with what the need in that area would be anyway within a few years if we are going to have a high-level employment with a growing labor force and improved technology.

Now coming to the second question as I understand it, of course the inflation strain of the expansion of these productive facilities is mostly while they are being built, because while they are being built they are not even adding to the flow of goods, so that the balance is entirely negative during the time they are being built, but that is true of any building effort.

Where you are building a productive tool, you haven't got it until you build it. That is true of a fighting weapon, and you have to strike a balance, and that is why I think the problem of allocation of resource use is the central question of this whole mobilization program, the central question.

How much of your resources are you going to put into fighting weapons as against plant build-up, plant build-up as against civilian supplies, how long it takes to get the plant before you get the benefits of it, and so forth, and so on?

And it is just because I think that that is the central question that I have raised these questions as to whether general monetary policy is the kind of weapon which addresses itself to these adjustment problems.

Now, again I am forced to say—I am not saying don't use this weapon, but I am saying—when you look at the nature of the problems, your problem of expanding production, your problem of getting this allocation of resources, your problem of priorities—after all, a defense mobilization is a problem of national decisions on which things you want to do first when you can't do everything—and so forth, and so on, if I list those problems and then listed the range of weapons to deal with them, I would not put this particular weapon near the top be-

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cause of its generalized character and its corollary consequences if it is pushed too far.

Now, that does not mean it should not be used at all any more than it means that the other weapons should not be used at all. I think they should be used in blend.

The Council of Economic Advisers from the very beginning has not been an opponent but an advocate of general credit and monetary restraints.

We have proposed various increases in reserves toward that end as one way of trying to reconcile that problem with the problem of the management of the national debt, and, as I here again say and want to emphasize, I would not as of this time list myself, for whatever it is worth, as being opposed to the accord that was reached, and I would not list myself as saying that on net balance as of now its benefits have not outweighed its disadvantages.

I think its benefits have slightly outweighed its disadvantages. I am afraid of it mostly because of the excessive things claimed for it.

Representative BOLLING. In the last part of your statement two things came up that I want to pursue a little. You speak of the generalized character of the effect of monetary policy. Would you expand on what you mean by that?

Mr. KEYSERLING. I mean that it does not operate to produce the selective kind of expansion and contraction which is so important to a defense mobilization.

In other words, you see we have got to distinguish various situations. A large body of economic policy and a large body of the thinking about economic policy grew up during times when you were thinking of (a) dealing with a general depression or (b) dealing with a general inflation, and then the policy very simply ran as follows:

If you are in a generally depressionary situation, let's lift prices, lift the money supply, lift the general level of demand—let's lift everything and get out of this trough.

Now in the typical inflationary situation—and by the typical inflationary situation I do not mean one that we have had typically. I think it is more a stereotype than anything actually that has happened. That is regarded as the converse of the situation I have described.

We have too much of everything. We are rising too fast. Let's cut everything down. You decrease the money supply. You try to push the price level downward, and so forth and so on.

Now, the point I am making is that the kind of long-term partial defense mobilization which we are now confronting does not fit into either of those two categories. It presents us with entirely novel kind of problems, and the novelty of the problem arises from the fact that manifestly we are undertaking at one and the same time a rapid expansion of some very important things, and to support it, a rapid contraction of other very important things.

We must rapidly expand military weapons, we must rapidly expand the industrial mobilization base to increase our total strength, and we must correspondingly contract insofar as we haven't got the resources to do both, housing, automobiles, and other things.

Therefore I say that a general policy which was properly conceived to produce and be effective through a general contraction of economic activity finding its way quickly into all the crevices of the

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economy cannot be used very vigorously and very far-reachingly in this kind of situation.

It can be used to exercise some dampening effect, and I am not against that. But it cannot be used as strongly as advocated by those who proposed it in an entirely different framework because we haven't got the problem that they were thinking of when they developed over the years that particular branch of theory.

That is what I mean when I say it is a generalized weapon.

Representative BOLLING. You mentioned previously the question of supplemental reserves. Do you have some specific suggestions on that at this time?

Mr. KEYSERLING. I do not have specific suggestions at this time, partly because I really haven't gotten very much into the techniques of the relative merits of the different types of reserves. We have from time to time advocated authority in the Federal Reserve to increase bank reserves.

I understand that the current position of the Reserve Board is that they do not want that authority at this time because they do not feel that they should use it at this time. And I do not have any specific reserve plan now to advocate.

Representative BOLLING. I raised this question with Mr. Martin the other day. In view of the inevitable legislative lag, and the possibility of our needing an additional tool in this field, is it psychological reasons that make it unwise to ask for the tool at this time?

Mr. KEYSERLING. I do not intend to say that it would be unwise to ask for it at this time. I simply say that it is my understanding that the operating agency feels that way and that I have no specific plan to offer.

I would be prepared to say in response to your general question that it has always been my general view—and I think the view of the Council—that in this kind of fluid situation it is very bad to try every few weeks or even every few months to revise your kit of tools to what the outlook looks like for the next few weeks.

And it would be the part of wisdom for a discretionary agency like the Federal Reserve Board to have a wide amplitude of tools that it could rather quickly draw upon in view of the legislation lag.

Representative BOLLING. Senator Flanders.

Senator FLANDERS. Mr. Keyserling, would you think it an oversimplification to say that in the absence of direct controls, prices respond to the relationship between the money supply and the production?

Mr. KEYSERLING. Oh, definitely they do, particularly if by "money supply" you mean not the static volume of money but its turn-over and so forth and so on.

Senator FLANDERS. Yes; it is the availability of the money supply?

Mr. KEYSERLING. Oh, yes, definitely.

Senator FLANDERS. Now would you also say that price-and-wage controls are effective primarily in the short run, or do you feel they can be effective in the long run over periods in which the relationship between the money supply and production is leading toward inflation?

Mr. KEYSERLING. I think that the question of what is in the short run and what is in the long run, Senator, would be differently defined

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by different people. I mean some people would say that 2 years is in the short run, others would say 3 and others 1.

Senator FLANDERS. What would you say?

Mr. KEYSERLING. I would not be as sure as some people are, but I would say this:

That it has been my view from the beginning that if we are embarked upon many years of partial mobilization, taking into account the economic problems and the psychological problems and the problems of public consents, that I would go light in the long run on price-and-wage controls, and try to work toward a productive situation where within a reasonable short period of time they could be taken off. That is my general position.

Senator FLANDERS. Now, in giving your low rating to monetary controls, are you giving a low rating to the effect of money supply in this balance between money and goods?

Mr. KEYSERLING. No; because in the first place, in giving this low rating to money supply, Senator, I want to restate something that I think I said when you were not here.

I am giving a low rating only within an assumption that the monetary authorities, for reasons that seem to me important, could not push monetary controls to their logical or extreme conclusion.

In other words, if the monetary authorities were willing to produce extreme changes in interest rates, in the availability of credit and in the money supply, I would certainly not then give a low rating in terms of its effect upon the price structure.

I think if you pushed it far enough, you could bring the price structure downward through that method probably more quickly than in any other way.

Senator FLANDERS. Now, would you say that there was any difference in that relation, that is, that pushing it to the extreme is dangerous; in that respect does the money supply differ from any of the other factors that you have mentioned? Isn't any tool pushed to its extreme dangerous?

Mr. KEYSERLING. I agree with that.

Senator FLANDERS. You see, I am trying to find out why you put the money supply so low when it is apparently a prime factor in the equation.

Mr. KEYSERLING. Well, first of all I would say that I gave specific illustrations in different areas of economic policy where tax policy and price policy were equally susceptible to disability if pushed too far. Now, in my rating I simply said this:

I said that I thought—and this is a matter of judgment—that as applying particularly to the period between March 1951 and now—and I have been talking not about the application of monetary theory in that connection but about the application of the specific change that was made, which was a minor change—I said that on my evaluation that that minor change, I thought, had had less influence upon price stability during this period than such things as the direct controls, the increases in taxes which have taken place, the fundamental increase in production which has taken place, the allocation of materials in accord with certain criteria, and I think I mentioned the others.

Senator FLANDERS. Let us go back to another period. Would you feel that in the period after June 1950 that the money supply factor

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was satisfactorily handled, that is, that not using it was the thing to do?

Mr. KEYSERLING. I think I said to Senator Douglas that looking backward I was not prepared to stand on the ground that it would have been undesirable to have made this change represented by the accord somewhat sooner.

In other words, I am not taking the position that the accord was made precisely at the right time, that if it had been made sooner it might not have made its contribution to stability.

I am simply taking the position—let's put it this way—that if the accord had been made in the middle of 1950 rather than in March 1951, I still think, although I cannot prove, that much or most of the price inflation which took place between the Chinese intervention and February 1951 would have occurred anyway, because of the other powerful factors at work.

Senator FLANDERS. I may say that in questioning I think, or perhaps I made a statement instead of questioning, both Mr. Martin and Secretary Snyder raised the question as to whether monetary control alone sufficient to have stopped the price rise would not have been destructive.

I believe that an endeavor to completely negative the price rise by monetary controls alone would have been destructive. To that extent, if that is your position—and I think it is—I find myself agreeing with you, but I cannot agree with the low position you have given the monetary policy in this series.

I judge that of the things you have given that you rate only exhortation lower, and that is low indeed. It seems to me you cannot give so low a position to one of two primary factors.

Mr. KEYSERLING. Well, Senator, you may be right on that, but if I sought to move them around and to put one of the others at the bottom, take for example tax policy, I would find it very hard to put that at the bottom.

And in the short-run situation, frankly I would find it very hard to put price and wage stabilization at the bottom because I think in this the short-run situation, that it is very important.

Senator FLANDERS. On tax policy, for instance, I take it that you feel that increased taxation necessarily and universally is anti-inflationary?

Mr. KEYSERLING. No, sir, not at all.

Senator FLANDERS. I just want to see you pull that down just a little.

Mr. KEYSERLING. Well, I am glad you are helping me do that.

Senator FLANDERS. Is that your position?

Mr. KEYSERLING. No; that is not my position at all. I say the tax policy, as well as other economic policies, illustrate the point that they have competing effects, and that some of the effects are good and some are bad.

Insofar as taxation is generally repressive, it always has to that extent a competing bad effect. There are certain things you do not want to repress. You do not want to repress reward for effort, but on balance you have to do some of it.

Now, I think, not getting to the point of whether it is an arbitrary figure of 20 percent, 19 or 21, taxation can reach the point where its repressive effects far outweigh its beneficial effects, and I think it can reach the point where on net balance it may be inflationary.

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Senator FLANDERS. Would you consider that there are any of its effects which immediately affect prices unfavorably? Take excise taxes, for instance, do you consider it inflationary when a fur coat has added to it the price of the excise tax?

Mr. KEYSERLING. No, I do not.

Senator FLANDERS. Or when gasoline has added to it the price of an increased excise tax?

Mr. KEYSERLING. I find the gasoline question a little harder because I regard a fur coat as a luxury and I do not know whether gasoline is a luxury or not in our economy. Clearly, in one sense it is not, but clearly the extent of its use is involved.

Senator FLANDERS. Now, I am led into a little byway by this last remark. If you consider inflationary only price rises in necessities, then why should the Stabilization Administration cover the whole water front of luxuries, necessities, and every other blooming thing there is?

Don't you find yourself at odds with them in that if you think that inflation relates primarily to necessities?

Mr. KEYSERLING. Well, in the first place, Senator, trying hard not to quibble, I do not think I said that I never regarded price rises in luxuries as potentially inflationary. I think price rises in luxuries could be inflationary, and therefore I did not say categorically that I would never try to restrain price increases on luxuries.

I did try to convey the general impression that the restraint of price increases on luxuries, such as fur coats, seems to me less important by far than the restraint of price increases on necessities.

Now, I go one step further than that and say that I would incline heavily toward the view that in a long-range defense mobilization the effort involved, the complexity involved, the general spirit involved in trying to price-control all luxuries far outweighs the benefits.

Now, I want to fair about that, and you realize the position I am in. That is my general position.

I would not want that to be interpreted as a judgment on any particular price action being taken by OPS, because they are an operating agency and they are closer to it than I am.

But my general view is—and I have expressed it many times—that for a partial mobilization of long duration, price controls should be selective rather than covering the whole economy. And I have never followed the argument for this kind of situation that if you control anything you have to control everything.

Senator FLANDERS. I have a number of other questions I could ask, sir, but I do not think they are of great importance.

I presume that you have already explored—I have not been here all the time—the apparent speaking with two voices in your section B, formulation of fiscal and monetary policy, pages 849 and 850 (committee print entitled "Monetary Policy and the Management of the Public Debt"). Page 849 at the end of the third paragraph from the top:

> Nevertheless, we do not question the desirability of making monetary policy chiefly the responsibility of an authority having some degree of independence from all Government departments and agencies engaged in borrowing or lending.

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While at the end of the third paragraph on the next page there is this sentence:

The President, as Chief Executive and head of the executive branch, is the only one person in the Government in whom this power of policy coordination can be lodged.

Now do you see any conflict between those two statements?

Mr. KEYSERLING. Senator, I do not see a conflict between the two statements, but I do not think that the two statements provide an answer to the question or to the problem.

I do not think there is a conflict between saying that the Congress in its judgment may set up one agency directly within the executive structure, as for example the Treasury, and that the Congress in its judgment may set up another agency such as the Federal Reserve Board outside the executive structure, which is the first statement, and saying that when the Congress does that, nonetheless, particularly in times of urgency the President as the chief coordinating executive officer must try to lend the influence of his office, using that word in the proper sense, to deal with the problem of coordination among those agencies, since they both profoundly affect the economy.

And I think the Congress at times has recognized that, because the Congress at times, having set up executive departments and having set up the Federal Reserve Board, has in certain statutes given certain functions in part to an executive officer under the President and in part to the Federal Reserve Board.

For example, the power to deal with the problem of housing shortages in this current situation has been given by the Congress in part to the Federal Reserve Board—and I say this not critically—in part to the Housing and Home Finance Administrator, in part to Mr. Wilson.

Now clearly in that decision the Congress has recognized, (*a*) that it wants to use all of these facilities, and (*b*) that there is a relationship among them. And once that is done, it necessarily does impose upon the President some degree of responsibility of coordination. So I think the two answers are consistent.

Now, let me get to the part of my comment that says that they did not answer the problem. I do not think that the problem of how one reconciles quasi-independent agencies, independent agencies—the term "independent agencies" of course has been used in a lot of different ways. There are a lot of agencies that are called independent agencies that are within the executive structure.

I do not think—of course that is a political science question rather than an economic question—that question has been completely resolved, particularly for an emergency period of this kind.

Senator FLANDERS. I noted in the questioning of both Mr. Snyder and Mr. Martin that those gentlemen steered off from any clear expression of principle such as asking the Congress to decide or anybody else to decide which was paramount, the stability of the prices of Government securities or the stability of the dollar, and apparently it figured out as near as I could make out, to this statement.

That given the Secretary of the Treasury of the particular characteristics and the experience and ability, and given a board repre-

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sented in a chairman of the particular person or characteristics and experience and ability, we might be assured that there would be no trouble.

That seemed to be the result which both of those two gentlemen asked us to accept as the solution certainly to the present situation and presumably for all future situations. Do you think that is a good solution?

Mr. KEYSERLING. Senator, I think that in the current situation—the only way I can state whether I think it is a good solution is to use a technique which I tried on something else. If I were making the decision now, Senator, I would leave it about as it is.

I would leave it about as it is and rely upon the Treasury and the Federal Reserve Board to continue to work this thing out. That is the import of my prepared statement, that that seems to me to be the most prudent of solutions available at the current time.

Now, on the long-range question which, as, I say, is one of the political science or of the structure of the organization of public power, that is more difficult.

One of the reasons that it is more difficult is that, as I said in my statement, in my prepared statement, the argument for independence may be based—and let me say I am not applying this particularly to the Federal Reserve Board, because I will get in a situation here where this general discussion will seem to be my view. I want to state categorically that in the current situation my view would be that the most prudent course would be to let things go as they are.

Now, talking about the subject of independence not as related particularly to the Federal Reserve Board but more generally, it rests upon a variety of grounds which I think it is worth saying something about.

One ground on which it rests is that if an agency is vested with very important functions vitally affecting the whole economy, it should be free of political influence.

I have never been able to see where that argument applies more to one agency than to many other agencies that I could name which most assuredly profoundly affect the whole economy and I believe that the argument that bodies exercising powerful public functions should be free either of the Congress or of the President on that particular ground falls down under our system.

I have not been able to differentiate between one power and another. I think that there is no power more vital than the question of our national defense or under the current situation, as I pointed out yesterday, the allocation of scarce materials which affects the very life and death of businessmen or of all industries, or the question of what kind of prices you make hundreds of thousands of businessmen charge or what kind of wages you make millions of workers accept.

Those are also enormously important powers over the economy, and they are equally susceptible to improper pressures. And if you are going to make the argument on that ground that a particular function should be independent, it just seems to go to the whole question of the philosophy of our system, so I cannot follow that argument very much.

Then you come to the argument of whether as a matter of practical fact you can have one important economic function free-wheeling in times like these as against others.

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There it is my general view—and I think implicit in the Employment Act and in the concept of the Council of Economic Advisers—that an effort has to be made to reconcile these policies, certainly the policies of the Treasury and of the Federal Reserve Board need to be reconciled, using that term in its just sense of trying to arrive at a harmonious solution of a problem on which both are vitally affected.

I get back to my initial point that for that process of reconciliation I as an observer would say with the present situation taking into account all the factors they can move further in that direction by trying to work together than by having a new legislative definition of their respective functions.

Senator FLANDERS. Thank you. I would like, Mr. Chairman, just to make a brief commentary on this without asking further questions.

From the testimony of Dr. Keyserling and the testimony of others and from my own thinking on the subject, it seems to me that the two things that are primary are the money supply and the production.

I see the limitations in using money supply, the monetary policy as the sole agent of stabilization because it is very liable to affect the production adversely if carried to its extreme limits, but I would still make it primary, of equal importance with production.

I would say that savings was an element in monetary policy. I would say that taxation, the taking away of the available money supply, is an element of monetary policy, and I would find monetary policy a coequal with production at the top of this list. That is just simply a statement of my position.

Mr. KEYSERLING. Mr. Chairman, might I just make one brief comment. That the definition of monetary policy by Senator Flanders, with which I do not disagree particularly, was not the one I used in placing it lower on the list.

In other words, if you embraced taxation and savings within that scope, I would certainly bring it to the top of the list and——

Senator FLANDERS. Would reduce the money supply available for the purchase of goods?

Mr. KEYSERLING. Oh, yes; taxation reduces the money supply, and when I placed this monetary supply at the bottom of of the list, clearly I was not including taxation. I was talking more to the particular type of monetary devise which had been mostly discussed here during the 3 days.

But if you say that the money supply means the available spending funds, and the taxation is one important method of reducing it, then I would agree with you, and under that definition put it at the top of the list.

Senator FLANDERS. Let us compromise, if we can, by moving it up three or four spaces on your list, even in its narrow sense, but I do not want to push that matter too far.

Representative BOLLING. Mr. Murphy, do you have any questions?

Mr. MURPHY. I just want to ask one question, Mr. Keyserling.

The Douglas committee in its report 2 years ago included a statement that it believed it would militate against the purposes of the Employment Act rather than work in favor of them if the United States should return at this time to a free domestic convertibility of its currency into either gold coin or gold bullion.

What would be your reaction to a reaffirmation of that position in the report of this committee?

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Mr. KEYSERLING. Well, in the first place, I do not like the statement that a return to the free convertibility—the gold standard, isn't that what you are referring to?

Mr. MURPHY. That is correct.

Mr. KEYSERLING. I do not like the statement setting that in juxtaposition to the Employment Act, because the statement of the Employment Act is so broad that it is really a statement of objectives for a stable and growing economy, and I do not like it said that it is the Employment Act which stands in the way of this.

I would put it on a broader ground and say that it would be in accord with my judgment that a return to that at this time would be inconsistent with the interests of the American economy, taking into account its stability, its growth, its monetary and debt management problems, its current defense problems, taking them all into account. In other words, taking into account our interests as a nation, I would not be in favor now of a return to the gold standard.

Mr. MURPHY. The particular phrase in the Douglas report which I was groping for is as follows:

> We believe that to restore the free domestic convertibility of money in gold coin or gold bullion at this time would militate against rather than promote the purposes of the Employment Act, and we recommend that no action in this direction be taken.

You agree with the conclusion but you would place it on a broader ground than the Employment Act?

Mr. KEYSERLING. Yes.

Mr. MURPHY. That is all.

Representative BOLLING. Mr. Keyserling, thank you very much in behalf of the committee. The committee is now in recess until tomorrow at 10.

(Whereupon, at 12:20 p. m., the subcommittee recessed to reconvene at 10 a. m., Friday, March 14, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

FRIDAY, MARCH 14, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:10 o'clock a. m., in room 1301, New House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman (chairman of the subcommittee), Senator Douglas; and Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

Mr. Wiggins, we are delighted to have you as a witness this morning. It happens that I have known Mr. Wiggins for a number of years, and I do not know of a more versatile business and industrial leader in the United States than A. L. M. Wiggins.

I have had the pleasure and the privilege of visiting with him in his home town and in his home State, and I know something about his many fine civic and patriotic connections, and the wonderful work he has done as just a good American citizen, and I personally value his views highly, and I am glad that he has favored us with his presence here.

Not only has he been a leader among the small-business groups of different types, but he is a leader among the banking group as well. In fact, he was a past president of the American Bankers Association, which itself is quite an honor, as we all know.

Mr. Wiggins, do you have a prepared statement?

STATEMENT OF A. L. M. WIGGINS

Mr. WIGGINS. Mr. Chairman, I have a prepared statement, and with the permission of the committee I would like to file this statement and then more or less summarize informally some of the points that I have undertaken to make in more detail in the statement, if that would be satisfactory.

Representative PATMAN. That will be satisfactory. You may proceed.

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If you do not mind, I will get someone to read the first two paragraphs for you, or you can read them. I want the committee to know something about your connections. Suppose you go ahead and read them, if you will.

Mr. WIGGINS. My name is A. L. M. Wiggins, of Hartsville, S. C.

I am chairman of the boards of directors of the Atlantic Coast Line Railroad Co., the Louisville & Nashville Railroad Co., and several smaller associated railroads. I am also chairman of the board of directors of the Bank of Hartsville, Hartsville, S. C., capital stock $100,000, and president of a small nonbanking trust company.

For the larger part of my business career I have been a director and manager of a number of small-business institutions engaged in finance, merchandising, agriculture, and manufacturing, and newspaper publishing.

From January 1947 to July 1948 I was Under Secretary of the Treasury. In this capacity, one of my duties was to assist the Secretary of the Treasury in the management of the public debt and, in particular, to maintain liaison with the Board of Governors of the Federal Reserve System, and other representatives of the open-market committee.

Senator DOUGLAS. You had an interesting time, Mr. Wiggins.

Mr. WIGGINS. Quite interesting, sir.

Representative PATMAN. All right, you may proceed if you desire. If you wish to yield for questions, that will be satisfactory.

Mr. WIGGINS. My discussion, gentlemen, is more of the practical approach, based on the experience that I have indicated.

The questionnaires and the answers that were sent out and received, in my opinion, constitute the most valuable collection of thinking in the field of money, in money management, problems of debt management, and other collateral questions that I have found anywhere.

I have read the entire 1,300 pages of this report since it was published about—since I got a copy about 10 days ago, and it is very instructive and illuminating, and I congratulate the committee on the character of the questions.

I wish to confine my discussion to three areas, and one of them, Mr. Chairman, is a relatively small one, and I might dispose of that first, which would be in inverse order to the statement.

The question has been raised about the ownership of stock in the Federal Reserve banks. I think it might be well if I disposed of that first, and then the other two are related and are really more important.

The question has been raised as to whether or not the stock of the Federal Reserve banks should be owned by the Government instead of by the member banks. In my opinion it should not be owned by the Government.

The Federal Reserve banks represent a combination of Government and private business under which the control is vested in the Government. But it is through the ownership of the stock by the banks that the Reserve System mobilizes the services of able individuals as directors. These men represent private enterprise and represent the public, and while the control is vested in the Board of Governors almost entirely, at the same time these directors bring the viewpoint of business, industry, and agriculture and banking to the officers of their banks. I think that it is highly important for

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the Reserve banks to maintain close touch with conditions prevailing in their respective districts, and this is the only official relationship of the Federal Reserve System with business, agriculture, and industry.

The members elect, it is true, part of the board, the Board of Governors appoint part of the board, and if the Government owned the stock there would be no particular basis on which member banks would select men to serve on the boards of these respective banks. In fact, I think the relationship should be encouraged rather than discouraged, and I have been able to find no sound reason for the Government to acquire the stock in the Federal Reserve banks unless the ultimate objective is to destroy the independence of the System and make it merely a Government bureau.

Now, that is all the comment, Mr. Chairman, that I had on that particular point.

Representatives PATMAN. I want to ask you one or two questions on that point, Mr. Wiggins.

Do you consider the Federal Reserve System is a public institution?

Mr. WIGGINS. So far as the—yes; it is a public institution.

Representative PATMAN. A public institution? You do not consider the amount of stock owned by the commercial banks as sufficient to give them control of the institution?

Mr. WIGGINS. The stock ownership, in my opinion, has nothing to do with the control. It is a peculiar type of stock that earns only 6 percent. The owners of the stock have no interest in the earnings of the bank beyond the 6 percent dividend they get.

Representative PATMAN. And they have only paid in 3 percent.

Mr. WIGGINS. Well, they get 6 percent on the amount paid in.

Representative PATMAN. Yes, they get 6 percent.

Mr. WIGGINS. Six percent on the amount paid in. They have paid in only half of the par amount of the stock.

Representative PATMAN. In other countries of the world, do you know of another country where the central bank is not owned by the government?

Mr. WIGGINS. At the moment, I do not.

Representative PATMAN. I think the fact is, Mr. Wiggins, that in all countries the central bank is owned by the government, and in this country I do not consider that the commercial banks own the Federal Reserve banking system because they have that token amount of stock, which is so small and insignificant compared to the business done by these institutions; you agree with that, do you not?

Mr. WIGGINS. That is right.

Representative PATMAN. It is too small to consider that they would have any supervisory power by reason of the ownership of that small amount of stock which gives them a 6 percent dividend each year?

Mr. WIGGINS. That is correct, sir.

Representative PATMAN. Yes. That is all on that particular question I would like to ask. I believe you said that covered your discussion of that?

Mr. WIGGINS. Yes.

Senator DOUGLAS. May I ask a question?

Representative PATMAN. Yes.

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Senator DOUGLAS. There has been some information from New York that many of the private bankers would like to assert a claim to the residual earnings of the Federal Reserve System. What is your feeling on that?

Mr. WIGGINS. I think the residual earnings belong to the Federal Reserve Banks; it is part of their capital structure, and should be owned by the banks, the Federal Reserve banks, I mean, and that the member banks, the stockholders, should have no interest in those residual earnings.

Senator DOUGLAS. Well, at present, as I understand it, by a decision of the Federal Reserve they have voluntarily turned over 90 percent of the net earnings to the Government. Now, there have been some groups in New York saying that since the private bankers own, as as they say, the Federal Reserve bank, they should receive these net earnings, which run up to around $200 million a year. In your judgment, should those go to the private banks or should those earnings continue, as now, to go to the Government of the United States?

Mr. WIGGINS. I think unquestionably they should remain in the Federal Reserve banks for disposition either to the Govrenment or to be added to surplus, as they may see fit.

Senator DOUGLAS. You would say that the decision as to these matters should be left to the Board of Governors of the Federal Reserve System?

Mr. WIGGINS. It raises a question as to whether the amounts paid by the Federal Reserve banks to the Treasury should be fixed by some statutory provision or not. I have sometimes thought that the particular vehicle used by the Federal Reserve was open to some question. I think it could be done by statutory enactment if Congress disagreed with the policies followed by the Federal Reserve.

Senator DOUGLAS. Suppose the Federal Reserve Board were to distribute these earnings to the owners of the stock in the the Federal Reserve banks, and turn these earnings back to the private banks rather than to the Government, would you feel that that was a wise policy?

Mr. WIGGINS. I do not.

Senator DOUGLAS. You think it might be advisable for Congress to try to prevent that policy from being carried into effect, by statutory enactment?

Mr. WIGGINS. Senator, I am not certain, but my recollection is that the law now provides a limitation of the dividend to 6 percent.

Representative PATMAN. It is cumulative but maximum; and section 16 of the Federal Reserve Act provides a means for levying a franchise tax for the Federal Government and I think it is necessary that that be done. I do not think anyone should contest that right because, after all, it is the credit of the Nation that is being used by these banks. The small amount of stock that has been invested would not support the huge credit structure of the 12 Federal Reserve banks. It would be just nothing; it would just be a fly speck. It would not be anything, and so I do not see how any person who is familiar with the situation would contend that—how much do they have invested now, about $200 million, the commercial banks?

Mr. WIGGINS. I do not have the figures; I can look it up.

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Representative PATMAN. It is around $200 million, and that would mean if they were entitled to that money they would get a hundred percent dividend every year using the Government's credit.

(The paid-in capital of the 12 Federal Reserve banks totaled $237 million on December 31, 1951.)

Senator DOUGLAS. My question is this: Is there anything in the statutes which would forbid the Board of Governors of the Federal Reserve System from distributing the earnings to the owners of the stock rather than turning the earnings over to the Government?

Representative PATMAN. I think that is a good question to look into.

Mr. WIGGINS. It is my understanding that the law provides a limitation of 6 percent; I would not be positive.

(A letter from Chairman Martin covering this point appears on p. 910.)

Representative PATMAN. All right, you may proceed, Mr. Wiggins.

Mr. WIGGINS. In order to conserve the time of the committee, I direct the remaining statement to an area that has two angles: one is the problems of restraining inflation and, in particular, the use of the machinery of the Federal Reserve System, including open market operations for the control of credit; and the second one is the operation of the Federal Reserve System and the Treasury Department and other Government departments and agencies in the fields in which they have a common interest, and I will treat both of those along together because they are closely related.

In my statement I have given figures showing what happened to the deposit structure, debt structure, and the ownership of Government securities by commercial banks during the war period. Those figures are familiar to the members of the committee, and I will not repeat them.

Those figures indicate, however, certain facts or reflect certain situations that are significant, highly significant, and I will list a few.

One, that the total of the Federal Government debt increased to an amount during the war period that exceeded all other debt, public and private; two, that in order to sell successfully Government securities during the war period, a rigid interest rate structure was maintained by agreement between the Treasury Department and the Federal Reserve System, and this rate structure was maintained until the middle of 1947.

Third, that about one-third of the increase in the public debt resulting from deficit financing found its way into the commercial banks, thereby multiplying the money deposit supply, and this added, of course, to the inflationary developments that were, in part, the result of the war conditions.

Fourth, that the purchasing value of the dollar has declined in large measure during the war period, between January 1, 1940, and the last date I have, January 1, 1951, about 45 percent; and five, that at the end of 1945, Government securities constituted 57 percent of the assets of all banks; and, six, as a result of the support of the Government in financing the war and the scarcity of other desirable investments, many investment institutions found their position at the end of the war overbalanced in investments in Government securities,

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an unbalanced portfolio, and seventh, that as a result of the campaigns for the sale of bonds, the ownership of the public debt became widely distributed with the result that a substantial majority of American families became owners of Government securities, many for the first time.

These facts indicate that following that period there would, of necessity, be considerable adjustment in the investment position of many institutions, including banks and of individuals.

Another factor, of course, was the vast accumulation of liquid wealth on the part of individuals throughout the country. That has been estimated at the present time as some $200 billion, and, of course, this liquid wealth is always a factor in any of our considerations because if it should become dislodged and move into the spending stream it could have a tremendous effect on our economy. It is there, and it is a question of how—whether it is going to stay there or whether some substantial parts may become dislodged through various conditions.

It is against that background of the build-up in Government debt, deficit financing, and all of the other factors that I have mentioned, and many others, that the Federal Reserve System has had to perform its difficult functions in providing stability in the financial system, and also that those factors were of an inflationary nature, either actual or potential.

Now, at the end of World War II there was general fear that we were going into a period of recession, and many actions were taken to prevent that. The wartime pattern of interest rates was maintained until the middle of 1947 and at that time it was felt on the part of the Treasury and the Federal Reserve that the time had come to relieve our economy of this strait-jacket of interest rates and begin to move toward some freedom in the market.

Now, it happened at that time that the Federal Reserve was maintaining a rigid buying rate of three-eighths of 1 percent on bills, and the Treasury Department was selling certificates at the coupon rate of 7/8, 1-year certificates. They began to move to raise those rates, and step by step they were raised during the summer of 1947.

Senator DOUGLAS. You are referring to the short-time rates?

Mr. WIGGINS. The short-time rates.

That program continued during the summer and fall of 1947, and it encouraged banks and other investors to buy short-term securities because of the higher rates, and the hope was that it would take some of the pressure off of the demand for the long-term bonds which were then selling at about 104 for the 1967–72, or a yield of about 2¼ percent.

However, the demand for the long-term bonds continued; there was an absence of investment in the long-term investment field at that time, and so it seemed that the stage was set for really a "bull" market that might put the interest rate down to 2 percent.

I speak of that with some confidence because I was sitting in the middle of it there in the Terasury, and participated in the policy discussions in the Treasury and with the Federal Reserve at that time.

Unfortunately, at that time the Federal Reserve System did not own any long-term Government bonds—substantially none. But the Treasury in its various investments, had a substantial amount of

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long-term Government bonds, and so, by agreement, and with full understanding and with a common purpose between the Federal Reserve and the Treasury Department, the Treasury made available to the Open Market Committee long-term market bonds which they sold from day to day in an effort to meet the demand and to prevent a further decline in the rate as being desirable in the public interest.

I emphasize that somewhat, Mr. Chairman, because the feeling, the thinking, seems to be abroad that the Treasury has always opposed any increase in the interest rates, and here was a period in which the Treasury very positively not only favored an increase in interest rates but took vigorous action to put the rates up. It was not so much a matter of putting the rates up as keeping the prices of Government bonds from going through the roof. And so we sat there in the Treasury, and from day to day made available to the Open Market Committee these long-term Governments and some days they would sell a hundred million dollars of it, which is a lot of money in Hartsville, S. C.; and it amazed me to see how the market absorbed these tremendous amounts of long-term Government bonds with so little effect on the interest rate or the price.

We sold during that period a billion and a half dollars of these long-term bonds, and still the pressure was there.

Senator DOUGLAS. Did the Federal Reserve buy any of these for itself?

Mr. WIGGINS. No, sir; they sold them for the account of the Treasury on the market.

Senator DOUGLAS. And did not buy any for themselves?

Mr. WIGGINS. No, sir.

Now, at the end of that period we found, after consultation with investors, that there was still an unsatisfied demand for long-term bonds. It seemed to me that they thought that the Government would never want to borrow any more money or nobody else, so in agreement with the Federal Reserve, and working it out, both on a staff level and policy level, the Treasury issued an 18-year, 2½ percent nonmarketable issue. They sold about a billion dollars worth, and that mopped up all the loose money around in the investment markets. As a proof of that, within weeks the investors who needed to adjust their portfolios looked around to sell some long-term Governments that they owned, and found that there was no money available in the investment market and, as a result, the price—the pressure on the other side quickly developed. The Federal Reserve during that later period bought bonds because of the tremendous offerings in the investment market of long-term Government bonds, and the curious thing to me was that some of those who had bought the bonds a few weeks before at 104, with the 2¼ yield, within a period of a few months were selling the bonds at 102 on down to 100 and a fraction, and taking a loss on it. But that is what happened; and it was during that period that the Federal Reserve bought a great deal of the long-term bonds at increased interest rates that finally got up to 2.48, which was just—kept the bonds just slightly above par, 100¼, I believe. This shows how quickly a situation can reverse itself; and I have often wondered if we did not oversupply the market with Government bonds in our efforts to bring the prices down, and choked it too much, because the situation reversed itself so quickly. The Federal came in, in order to provide an orderly market, and bought a great many bonds.

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Now, they continued to reduce their buying price slowly, and then on the famous December 24, 1947, the bankers having accused them of giving them a very poor Christmas present, the Federal Reserve reduced its buying rate to just a little above par, resulting, of course, in a substantial loss to many investors who had bought those bonds at a premium.

Another interesting factor is that between the middle of 1947 and the middle of 1948, when all of this movement of rates took place, in which the Treasury and the Federal Reserve were seeking to get to what we called at that time a breathing market as against the old rigid market, but not an absolutely free market, because you could not go from one to the other too quickly—there had to be an intermediate step—during all this period, and in spite of all of the purchases of long-time bonds by the Federal, between June 30, 1947, and June 30, 1948, in spite of all these transactions, the ownership of Federal securities by the Federal Reserve System actually declined a half billion dollars.

We hear much about the great purchases by the Federal Reserve of long-term bonds during that period. We do not hear much about the fact that actually it was a buying and selling program in which the net result was a reduction of Federal Reserve holdings of Government securities during that period.

What happened during that period was that the holdings by commercial banks declined 5,400,000,000, the holdings of insurance companies declined a billion eight, the holdings of savings bonds by individuals went up a billion six, the holdings by trust funds went up $3 billion, and the total debt declined 6 billion.

I would like to make this observation: That not only did this big reversal in the market take place within a few weeks' time, and was unanticipated both by the Federal Reserve and the Treasury, I think I am safe in saying, and all of this churning around in an effort to get to a breathing market, which we accomplished to some extent—to a considerable extent—particularly in the short-term field—the situation changed again by 1949; and, whereas, most of the efforts of that period were directed both by the Federal Reserve and the Treasury to restrictive objectives, anti-inflationary objectives, by 1949 the situation had changed again to the point that the Federal Reserve, in its money market management and credit control found it necessary to take steps of an expansive nature.

For instance, they reduced the stock margin requirements from 75 to 50 percent, installment credit terms were liberalized, and the reserve requirements of banks were reduced during that period by 4 percentage points on demand deposits, and 2½ percent on time deposits. That, of course, was during a period in which it looked as if we might be going into a recession, and was done for that purpose, and properly done.

So, I come back to the proposition that action, reaction—to take an action, you do not know just what reaction is going to happen. Sometimes it is a great deal more than you have anticipated, and sometimes it is not at all what you anticipate. But in any event I would like to make the point that during that period there was the highest degree of cooperation between the Federal Reserve and the Treasury; their objectives were largely the same. The only differences that arose, frankly, were that the Federal thought we should move faster, with

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more shock effect of these various moves, and the Treasury Department thought that in an operation of that magnitude, with the widespread ownership of the debt, that the proper policy would be to move step by step and slowly make the transition. That is the only difference of viewpoint. Both had the same ultimate objective.

Now, coming back to the changes taking place in 1947 and 1948, the important factor—one highly important factor—in that period was that we had a budget surplus of 2 years.

Senator DOUGLAS. You were fortunate in being in the Treasury during a period when the wartime tax rates had not yet been greatly reduced, and when expenses had fallen off.

Mr. WIGGINS. That is correct, sir.

Senator DOUGLAS. It was only accidental that this happened during the period of the Eightieth Congress. [Laughter.]

Mr. WIGGINS. At any rate, the effect of a budget surplus at that time was terribly important in all of the monetary and debt management operations that went on.

Now, gentlemen, I come to this observation, which I hope will be accepted in the same spirit in which I give it: that many of the difficulties of the Treasury Department in its debt management, and of the Federal Reserve System in monetary control and credit restraint stem from the actions of Congress.

The principal difficulty is the fiscal situation that is created when Congress appropriates for expenditure amounts of money substantially greater than it provides taxes to cover. If Congress were sufficiently interested in inflation as a primary objective——

Senator DOUGLAS. In restraining inflation.

Mr. WIGGINS. How is that?

Senator DOUGLAS. In restraining inflation.

Mr. WIGGINS. In restraining inflation, it would under inflationary conditions provide a budget surplus instead of a deficit.

I recognize all of the difficulties involved, of course, but I am stating a principle.

It is an axiom that under inflationary conditions expenditures should be kept at a minimum. However, many appropriations, laws, and policies of Government are of a definitely inflationary character.

To illustrate, and I am sure I am not embarrassing the Senator——

Senator DOUGLAS. I am turning my eyes down in proper modesty.

Mr. WIGGINS. To illustrate, we have but to recall the historic effort of Senator Douglas to eliminate or reduce many of the appropriations under the rivers and harbors bill in 1950 for projects of little or no real value, and the failure of the Senate to respond to his sound arguments for a reduction in the appropriations.

Senator DOUGLAS. Mr. Wiggins, I want to thank you for this compliment, but I also want to say that while the Congress is frequently at fault in the matter of these appropriations, I do not think you should absolve the executive branch from its share of responsibility. This frequently, is even greater because whenever any proposal is made to reduce an appropriation the proper administrative official immediately declares that we are plunging a knife into the operations of Government, and the whole weight of the executive department is thrown against anyone who tries to make the cut.

The officials of the department or agency in question will call you up on the telephone and remonstrate with you, and then in about an

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hour you begin to get telephone calls from people in your own State, and the inference that I draw from all this is that the departments have their groups of outside friends with whom they get in touch, and the heat is turned on you. Then, if your effort to make a reduction seems to be reaching serious proportions, the President always rushes to the air waves and declares that a foul blow is being struck either at the security of the country or the welfare of the people of the United States, and the cry is taken up by the administrative bugle men, who proceed to pour on their reports from downtown, and issue press statements. The result is that you face not merely the political interests of your colleagues, but you also face the mass power of the executive agencies of the Government. In this present situation, when the President has submitted a budget which, on the administrative side, calls for a deficit of 14½ billion, with no remonstrance from the Council of Economic Advisers—no remonstrance that has been published, at least, and I see Mr. Keyserling and Mr. Blough in the room—and when any proposal comes to cut a specific appropriation, it is promptly labeled by the Secretary of Defense, the Secretary of State, or the Cabinet official involved, as tampering with the security of the Nation; they assert that not a dollar can be cut from the defense appropriation, not a dollar from foreign aid, and we will hear the same piteous song whenever each and every item is taken up.

While I can well understand the desire of a former Assistant Secretary of the Treasury, who has suffered at the hands of Congress, to get in a polite dig at the Congress—and we certainly have our faults—still, in all justice, I think, having leveled your guns at us, now that you are a private citizen you should turn them in the direction of the Treasury itself, 1600 Pennsylvania Avenue, and the old State, War and Navy Building, where the Executive Offices of the President are now located.

So, after this barrage upon our position on Capitol Hill, will you also level your artillery fire on Pennsylvania Avenue?

Mr. Wiggins. Senator, I am not attempting to say why these things happen; I am stating them as actual facts that add to the difficulty of the monetary authority.

Senator Douglas. That is true; but behind the reluctance of Congress to cut is the opposition of the administration toward cuts.

Representative Patman. If I am any judge of the temper of Congress now, it will come more nearly to balancing the budget this year than it has in 10 years.

Senator Douglas. And then listen to the cries from downtown.

Representative Patman. Well, there are a lot of cries that will be ignored.

Mr. Wiggins. However, I think, gentlemen, we might observe that the executive departments spend no money that Congress does not appropriate. I think that is a fair statement.

It also might be pointed out that laws and Government policies that tie the support of agricultural prices to changes in the prices of industrial products, on the one hand and, on the other, escalate industrial hourly wages on the basis of the increase in the cost of living, that this combination constitutes a system of built-in inflation that results in progressive deterioration in the purchasing power of the dollar.

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I am not questioning the advisability of either of these. I am stating that they do have an inflationary impact.

It is also true that administrative agencies of Government, particularly in the lending and guaranteeing field, frequently follow policies and programs that add to inflationary pressures.

Senator DOUGLAS. Would you excuse a slang comment? "Now you're talking."

Mr. WIGGINS. These facts add up to the insistent and continuous need for a coordination of the policies of the Congress and of the administrative agencies if an anti-inflationary policy is to be effective. They also bring out the point, and I am reading this, because I want to be exact, I am afraid I will get off the beam if I ad lib—they also bring out the point that the problems of restraining inflation are involved in the actions of Government on many fronts and that while, at the same time, efforts are being made by the monetary authorities to restrain inflationary pressures, other actions by Government are directly inflationary and make difficult, if not impossible, the success of the efforts of the monetary authorities in the limited areas in which they operate.

I have made the observation here that the basic difficulty in combating inflation is that in actual practice most people who say they are opposed to inflation, actually embrace programs for personal profit or benefit that are highly inflationary; and my theory is that a dam cannot be built that will successfully restrain the forces of inflation if sections of it are missing, no more than a dam will hold back the water of a river if the dam is full of holes.

Many people consider the device of raising interest rates as the principal means for controlling inflation, the principal effective device. Such a proposal is painless to most people, and profitable to many, and while this is a most desirable device as a part of an over-all program, it will not do the job alone, and in my opinion, it is highly overrated.

I then have a discussion here of the effect of increases in short-term and long-term rates. I think most of these fact are well recognized, namely, that increases or decreases in short-term rates do not restrain the borrower, and being to the benefit of the lender, do not deter the lender from making loans.

The principal value in the short-term field affecting banks primarily, is the lack of funds to lend, and that is the point at which the open-market operations of the Federal Reserve are most effective.

However, there is a limitation there due to the fact that the commercial banks own, as of December 31, 1951, a large amount of short-term Governments that are running off within a year, $33,000,000,000 worth, so that increases or decreases in interest rates, the buying and selling of short-terms, is not much of a deterrent to a bank that has bills coming due every week.

It can merely collect its money when the bills come due and not buy any more and, of course, a small increase in the short-term rate does not affect the price of that security so much as it does in the long-term field.

Now, in the long-term field the effect is different because a relatively small increase in the rate has a substantial effect in the price, just as in the 1947–48 changes in rates of one-quarter resulted in a decrease in the price of nearly $4 on the hundred. So, I would say,

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that a rise in rates and a reduction in price on long-term securities does affect the lender who must take the loss if he sells his bonds to get money to make loans for some other purpose, and if he must lose $3 or $4 on the hundred to do that, that is a deterrent to his selling those bonds.

It is not much of a deterrent to the borrower, and being a borrower myself I speak with some personal knowledge, where you need the money for an essential purpose, particularly for a defense purpose, you must have the money, if the rates are a quarter higher you pay the quarter higher, and I must admit that you get some satisfaction in knowing that that comes off as an expense, of which Uncle Sam absorbs 52 percent, which somewhat softens the blow, but it is not too serious a deterrent to the borrower as it is to the lender.

Senator DOUGLAS. What about the borrower of long-term capital funds for private investment? A rise in the interest rate there will diminish the quantity of capital demand, will it not, on the part of industrial companies?

Mr. WIGGINS. I think unquestionably that is true, Senator, in the case where there is a discretionary situation in which you are planning a 20- or 40-year program, as to whether you do it now or whether you do it later. I think the difference in interest rates, particularly with public utilities that have a narrow margin, that they will adjust their programs, depending on the cost of the money.

Senator DOUGLAS. That is right.

Mr. WIGGINS. Now, I mentioned that the discount rate of the Federal Reserve was a very effective instrument in the earlier years when we had a smaller debt, and it is a useful instrument, but not as effective as it formerly was, particularly while the banks own such a large amount of short-term governments.

The question has been raised about reserve requirements of member banks. Of course, increasing reserve requirements reduces the capacity of the bank to lend, and that is the nerve center of making loans because it affects the availability of funds.

The present reserve technique, however, creates a great many inequities; it is a somewhat brutal method, an ax method, and in spite of a rate classification based on two types of deposits and different sizes of cities, in order to try to reduce the inequities, it is highly questionable whether the present classification base is suitable for the present banking system. I doubt it very seriously.

Many studies have been made as to the desirability of changing the base for reserve requirements, and one suggestion has been made that it be done entirely on a classification of deposits. That plan would also have some inequities, as any plan of reserve requirements would have, but it might be highly effective in the use of reserve requirements as an instrument of credit control.

I think if any change is made in the base of reserve requirements it requires a great deal of further study, and any change, of course, should be made at a period of relative monetary ease, so as not to disturb the financial situation too much.

Now, the objections that I have found among banks to the use of that device—to the Federal Reserve using it, one objection is that when the Federal Reserve increases reserve requirements, in effect, it merely means transferring earning assets from the member banks to the Federal Reserve, because if a bank has to part with some of its

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Government securities to get the cash for the additional reserves, and then the Federal Reserve takes the cash and puts it in Government securities the net effect is that it transfers the earnings from the member bank to that extent. It has been suggested that these excess reserve requirements might be required in the form of Government securities. I do not think that proposition has too much merit because it merely would make the bank, in some cases, an unwilling owner of a certain type of Government security that would be used for that particular purpose. It would, in part, overcome the objection that these excess reserve requirements deplete the earnings of the bank.

Another device has been suggested that reserve requirements above a safety level—and I think banking thought generally is that reserves are for two purposes, one, a safety factor; and the other a device for controlling the credit and the money supply in the markets—the other suggestion was that on required reserves above the safety level, the Federal Reserve pay interest to the member banks so at to overcome the objection of transferring earning assets by increasing reserve requirements.

I would like to point out, however, that the use of reserve requirements with banks as a vehicle of credit control—it applies only to banks—does not directly affect other lenders who, in many cases, are competing with the banks in making loans. It is an arm that restrains just the banks, and only slightly indirectly restrains their competitors who are out, in many cases, for the same type of loans that the banks are making.

Senator Douglas. You mean building and loan associations, and insurance companies?

Mr. Wiggins. Yes, sir.

Now, to move on and to broaden the base a little bit, I raise the question of the major governmental policy, as expressed in the Employment Act of 1946, questions about which were asked in many of the questionnaires. That act, of course, is specifically directed at employment.

It also provides that an objective of the policy shall be maximum production and purchasing power, and all of this done "in a manner calculated to foster and promote free competitive enterprise and the general welfare."

Now, while the emphasis is on employment, recognition is given to the maximum purchasing power. I think the inference of most people is that it means real purchasing power and not dollar purchasing power; and I personally think it is terribly unfortunate that in the wording of that act it does not contain a specific statement of objective of national policy to maintain long-run monetary stability.

Frankly, I do not think that the recent history of the legislative and administrative departments of Government yields convincing evidence that the guiding policy has been one of maintaining long-run monetary stability.

I have tremendous respect for the American dollar, for the integrity of it, and consider the depreciation and discount of that dollar as a threat to our national welfare and the welfare of the rest of the world.

Throughout history, disasters in varying degrees have always, almost always, followed periods of serious inflation.

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In spite of that statement, I think we must recognize that under the necessity of World War II the Government had to borrow vast sums of money; that there was need for quick expansion of military facilities and production, and that these required a substantial expansion of the monetary supply. There was no other way to do it.

Now, in restrospect it appears to some that the money supply was increased too much and, of course, if we had financed more of the war from nonbank borrowing we would have increased the monetary supply less, but the question we are dealing with now is the monetary supply as it exists, and whether it is too great or too little or about the right amount. Some think it is too great.

On the other hand, in terms of the vast outlays for the defense effort that are being made and are in contemplation we may find that the money supply is not too great, and we may find it necessary from time to time even to expand it some.

My own views are that the economic policy under present conditions should be directed against inflation through appropriate action by Government on every front, including Congress and the administrative departments while, at the same time, avoiding as much as posisble actions that will have serious adverse effects in other areas, and avoiding, so far as possible, rigidities in the operation of the private-enterprise system.

Selective controls and allocation of materials appear to be essential in such a program, but the application of such controls should be subject to administrative flexibility so that they may be adjusted, dropped, or increased as the needs of the situation develop.

It would be a mistake to place entire reliance or too much reliance on the use of interest rates through monetary management to control inflation. The need is to deal with the problem on every front under a consistent and coordinated policy of Congress and the executive departments.

Senator DOUGLAS. Mr. Wiggins, I do not want to take up too much time, but I would like to make it clear that those of us who believe in the essential need for monetary management do not so much emphasize the interest rate as the supply of bank credit. In other words, we aim to get price stability through the maintenance of the supply of money and credit in relationship to the volume of production rather than depending upon changes in the interest rate.

I mention this because I think the advocates of monetary management have in some cases stated their case badly in merely emphasizing the interest rate, and because this has been used as sort of a whipping boy by the opponents of what I would term anti-inflationary monetary management.

Mr. WIGGINS. Of course, Senator, the practical effect is that the Federal Reserve, if it refuses to buy Government securities and thereby supplies the banks with increased money, increased reserves, the effect is bound to be that the price will go down and the interest rate will go up.

Senator DOUGLAS. Yes, that may and probably will be an effect. The country will then have to choose whether it prefers a stable price level even though that may mean rising interest rates or whether it wishes stable interest rates even though that entails rising prices, and that is really one of the fundamental issues at stake.

Mr. WIGGINS. Yes.

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Senator DOUGLAS. I am very glad you bring it out.

Mr. WIGGINS. Now, in this connection I think we must consider as an important factor a somewhat unpredictable thing that I like to call human behavior. Officials of the Federal Reserve frequently refer to the psychological effect of an action taken rather than the actual economic or monetary effect, and it is an important factor, as we all know, particularly in a country like this, where we have such vast resources, along with a great degree of freedom to use those resources pretty much as we want.

I would like to give one illustration that his impressed me, namely, that at the beginning of 1951 I think all of us generally agreed that inflationary pressures would likely be rather strong in 1951, and it did not develop to the extent that most people anticipated, and one of the most important factors, in my judgment, was a curious phenomenon that developed between the first and second quarters of 1951, in which people shifted from spending to saving. I note that whereas the disposable personal income between those two quarters went up, at an annual rate of 5 billion, personal savings increased between those two quarters at an annual rate of 11.6 billion.

I mention that because, so far as I know, it was an unpredictable human behavior that few, if any, anticipated, so that this factor of how people react to given things is still an unknown field to the human mind, and so, in the light of the fact that a vast majority of American families own Government securities, when we deal with the price and interest rate on Government securities we are dealing with a factor in which the possible action of large numbers of people needs to be considered.

I developed a strong respect for the size of the national debt when I was in the Treasury, its proportion to all debt and its widespread ownership, and all the factors involved. To me, it is an atomic bomb, chain reaction, in the minds of the people. I do not think it is necessarily one that is going to explode in our face, I want to be quick to say that; I think it can be handled successfully and satisfactorily, and I think it can be raised to a much larger amount under war necessity with perfect ability on the part of this country to service it.

But, after all, the public debt is based on the confidence of the people in it, which is one factor; and, second, the productive capacity of this country to service it, and there is little question about the latter, and we must, by all means, preserve the former.

However, any disturbance to that confidence is a matter of serious concern and, again, I hope the Members of Congress will not misinterpret me and my motive when I say that many individual owners of Government securities and potential buyers are concerned over the vast expenditures of Government, some of which they consider unnecessary or even wasteful and, particularly, when, in spite of heavy taxes Government expenditures promise to exceed Government revenues.

Others look with concern on the decline in the value of the long-term securities below par. I might say that in 1947, 1948, neither the Federal Reserve nor the Treasury thought in terms of long-term securities going below par. That has been a later development, and these individuals who are concerned somewhat with the decline of $3 from a hundred to 97, they are always concerned with how much

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more decline may take place through the decision of the monetary authorities as to the price of those securities.

I think, however, there is more concern about the deterioration in the purchasing value of their savings bonds and savings accounts in banks and life-insurance policies than with the $3 drop in the price of long-term Government bonds. I emphasize, Mr. Chairman, that all of these factors enter into the reactions of human beings as to what they might do, and we must consider at all times not only the economic and financial effects of actions taken in debt management and monetary management but what the human behavior that will result from that might develop.

I would like to add again that I found the highest degree of cooperation between the Federal Reserve and the Treasury while I was there, and I might say the finest sort of devotion on the part of the Federal Reserve officials to their public duties, and a spirit of public service on the part of both that when these problems arose in which there were differences of viewpoints, that the spirit of what is the best thing in the public interest to be done under the circumstances was the catalyst that usually resolved those differences.

Now, there are some people that think that in the exercise of discretionary administrative policy of national importance there should not be any difference between top officials, but if they occur there ought to be some supreme authority of law or the Chief Executive should dictate what the answer is, the policy to be followed.

I think it is highly important within the executive departments of Government for there to be that degree of coordination of policy, and so I support the proposal that an advisory council be set up by Executive action, not by law—it is not needed by law—and I might say that in 1947 and 1948 at times there were informal groups set up to deal with certain areas of credit and money, and it was found to be a useful agency.

The purpose of this advisory group would be to exchange information and views for coordinating administrative policy.

And while I think it would be desirable for the Chairman of the Board of Governors or his representative to sit with this group, I do not believe that he or the Federal Reserve Board should in any degree be bound by any decisions reached by such administrative advisory group.

On the other hand, the Board of Governors should give tremendous weight to any decisions or conclusions reached by such an administrative policy group, because it is assumed that that group represents the combined judgment of top administrative officials as to the proper policies to be followed.

However, the Federal Reserve System has specific statutory duties that involve semijudicial decisions that are based not only on tangible factors but intangibles, and in my opinion they could not conscientiously discharge their duties if bound by the dictates of the executive department of Government.

And while I think it is highly desirable for the Chief Executive to coordinate policies within the executive departments, I think it would be highly improper for him to dictate actions to be taken by such semijudicial bodies, for example, as the Federal Reserve System or the Interstate Commerce Commission, Securities and Exchange Commission, or similar bodies.

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He should communicate his views directly or through such a coordinating advisory group within the executive department to the Federal Reserve System, and they should be aware at all times of the factors involved in administrative decisions.

But to subordinate a semijudicial and an independent body set up by Congress to the directives of the Chief Executive, in my opinion would destroy the effectiveness of such agencies. As I have indicated, usually the differences between the Federal Reserve and the Treasury are resolved.

In the first place there are not too many, and most of those that turn up are resolved, and it is only occasionally that a serious difference develops.

And in my opinion, in spite of the fact that an authoritarian set-up would get the results definite and directly, that it would be too high a price to pay to lose all of the benefits of our basic principles of checks and balances among thinking men in trying to find answers for difficult problems in such fields as monetary management and debt management.

And I should also like to make this point, gentlemen: That we should recognize that no man and no group of men dealing with the various problems of our public debt and monetary system are omniscient. Too many factors are involved, not only economic and financial but in the realm of possibilities of human behavior for any one man or any group to know all the answers.

And I think it would be a catastrophe if we were to make the Federal Reserve System merely an administrative agency of the executive department of this Government.

However, I would like to raise this red flag—I don't like to use the words "red flag"—but this warning that the history of central banking, as was brought out earlier by the chairman, is that central banking cannot get too far away from the policies of Government too long; and that while central banks historically have won battles against the Government, they have always lost the war.

That is history and that is the condition throughout the rest of the world. Now, gentlemen, I have a summary here, but I think that I have covered the field, and in the interest of time——

Representative PATMAN. Well, we will insert the whole statement in the record, Mr. Wiggins.

Mr. WIGGINS. Thank you very much.

(The prepared statement submitted by Mr. Wiggins reads, in full, as follows:)

STATEMENT OF A. L. M. WIGGINS BEFORE THE SUBCOMMITTEE ON GENERAL CREDIT CONTROL AND DEBT MANAGEMENT OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT

My name is A. L. M. Wiggins, of Hartsville, S. C.

I am chairman of the boards of directors of the Atlantic Coast Line Railroad Co., the Louisville & Nashville Railroad Co., and several smaller associated railroads. I am also chairman of the board of directors of the Bank of Hartsville, Hartsville, S. C., capital stock $100,000, and president of a small nonbanking trust company.

For the larger part of my business career I have been a director and manager of a number of small-business institutions engaged in finance, merchandising, agriculture, and manufacturing. From January 1947 to July 1948 I was Under Secretary of the Treasury. In this capacity, one of my duties was to assist the Secretary of the Treasury in the management of the public debt, and, in par-

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ticular, to maintain liaison with the Board of Governors of the Federal Reserve System and other reppresentatives of the open-market committee.

In the interest of conserving time my statement will be limited largely to three areas of questions raised by this committee.

In this connection I wish to congratulate this committee and its staff on the preparation of the comprehensive and searching questionnaires which were sent to governmental agencies, economists, and financial institutions and their representatives. The replies constitute a wealth of financial literature, objective reporting, keen analysis, frank opinions, and constructive suggestions in the field of finance, money, banking, debt management, and fiscal affairs.

The three areas which I wish to discuss are:

(1) The problems of restraining inflation, and, in particular, the use of the machinery of the Federal Reserve System, including open-market operations, for control of credit.

(2) The operations of the Federal Reserve System and the Treasury Department and other Government departments and agencies in fields in which they have a common interest.

(3) The question of ownership of the stock of the Federal Reserve banks.

A brief review of certain factual background is necessary as a basis for discussion of items (1) and (2):

During the 6-year war period from the end of 1939 to the end of 1945, money in circulation quadrupled from $6 billion to $26 billion. During the same period, bank deposits increased from $56 billion to $121 billion, or a total increase in money supply from $63 billion to $148 billion. During this period the ownership of Government securities by the banking system, including Federal Reserve banks, increased $97 billion.

During the six calendar years 1940–45, inclusive, the gross public debt increased $231 billion, or five times. During the same 6-year period, expenditures of the Government exceeded receipts in the conventional budget by the amount of $210 billion.

In the calendar 5-year postwar period, 1946–50, inclusive, Government debt was reduced $22 billion, largely through the use of excess cash balances from the Victory loan in 1945 and the use of a net budget surplus of $1 billion during this period. During the same period, as a result of debt reduction and the use of trust funds, the debt was managed so as to reduce the holdings of Government securities by commercial banks and the Federal Reserve banks by nearly $32 billion. Certain significant facts should be observed:

(1) Total Federal Government debt increased to an amount that exceeded the total of all other debt, municipal and private.

(2) In order successfully to sell Government securities during the war period, a rigid interest-rate structure was maintained by agreement between the Treasury Department and the Federal Reserve System and this rate structure was maintained until the middle of 1947.

(3) About one-third of the increase in the public debt resulting from deficit financing found its way into the commercial banks, thereby multiplying the deposit-money supply. This added substantially to inflationary developments that were, in part, a result of war conditions.

(4) The purchasing value of the dollar in terms of the cost of living declined between January 1, 1940, and January 1, 1951, by 45 percent.

(5) At the end of 1945, Government securities constituted 57 percent of the total assets of all banks.

(6) As a result of their support of the Government in financing the war and the scarcity of other desirable investments, many investment institutions found their position on December 31, 1945, overbalanced with investments in Government securities.

(7) In response to campaigns for the sale of bonds, the ownership of the public debt was widely distributed, with the result that a substantial majority of American families became owners of Government securities, many for the first time.

It is clearly evident from the above facts that at the end of World War II there was need for a substantial readjustment of the investment position of many investors, particularly institutional. When and as opportunities were presented for a better diversification of investments and for securing a better rate of return, they found it necessary to sell Government securities. With commercial banks holding nearly $91 billion of United States Government securities on December 31, 1945, of which a substantial proportion was in short-term maturities, they had abundant resources which any one bank could convert into

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reserves through the sale of the securities or by permitting them to run off as they fell due.

Another development of the war period was the large accumulation of personal savings, a substantial part of which consisted of liquid assets. It is estimated that at the present time liquid assets owned by individuals, of which a substantial part is represented by Government securities, aggregate a total of some $200 billion. These savings may be dislodged and find their way into the spending stream.

It is against this background, of which I have mentioned only a few factors, that the Federal Reserve System has had to perform its difficult functions of providing stability in the financial system. Practically every factor in the situation contributed to inflationary pressures, actual or potential.

Following the cessation of World War II, there was general apprehension throughout the country of a postwar recession. Due to prompt measures taken by Government, a recession did not materialize, but our economy promptly moved into increased production and employment. During this transition period, however, it was felt that the wartime pattern of interest rates should be maintained so as to avoid any disturbance that might hinder the transition from a wartime to a peacetime economy. By the middle of 1947, our economic machine was forging ahead, inflationary pressures had developed, and, in the absence of a demand for loans by business and industry, investors were reaching for Government securities at higher prices and at declining rates.

I wish to discuss some of the actions of the Treasury Department in debt management in which I had a small part, as well as actions taken by the Federal Reserve System in monetary and credit control in that period.

As a result of numerous conferences between Treasury and Federal Reserve officials in the second quarter of 1947, there was agreement that the time had arrived for the removal of the wartime rigidities of the fixed pattern of interest rates that had been maintained for Government securities. As a result of this understanding and common objective, the Federal Reserve discontinued its policy of a fixed buying rate of three-eighths of 1 percent on Treasury bills and the Treasury Department, in its refunding operations, began gradually to raise the rate on 1-year certificates from seven-eighths of 1 percent. This program continued during the summer and fall of 1947 and encouraged banks and other investors to purchase short-term securities at the better rates rather than reach for the longer bonds at premium prices which netted a return at that time of about 2.25 percent. Simultaneously, a program was being carried out to relieve the pressure of investment funds on the long-term bond market. At that time, the Federal Reserve System owned practically no long-term Government bonds and, therefore, in its open-market operations was unable to supply the market with that type of investment. The Treasury Department, however, held large amounts of long-term bonds in various investment accounts. After consultations and discussions, both at a staff level and at a policy level, between the Treasury and the Federal Reserve and in full agreement, the Treasury Department, through the open-market committee of the Federal Reserve, sold large amounts of long-term Government bonds so as to fill the demand and to prevent a further decline in the long-term interest rate. During this period, the Treasury sold $1.5 billion of long-term bonds. However, the amount was not adequate to satisfy the demand nor to increase the market yield on such securities. Thereupon, the Treasury Department, after consultation with the Federal Reserve and with full agreement on the part of both, sold a nonmarketable 18-year issue in the amount of $1 billion. The purpose of this sale was to mop up any remaining investment funds that were exerting upward pressure on the market. The entire program was anti-inflationary.

In a matter of weeks the situation reversed itself. Other desirable forms of investment became available to investors at better yields than long-term Governments and investors finding themselves bare of funds began unloading long-term Governments on the Federal Reserve in substantial amounts. It was a curious phenomenon that many investors who were eager buyers of long-term Governments on a 2¼-percent yield basis should so quickly become eager sellers at a higher interest rate and at some loss. The Federal Reserve moved promptly to stabilize the situation and found it necessary to make large purchases of long-term Governments. It was during this latter period of 1947 that the Federal Reserve, in consultation with the Treasury, began to reduce its buying prices slightly and, on December 24, 1947, made a substantial reduction in the price it was willing to pay for long-term Government bonds. It was thought that this somewhat drastic reduction might serve to stabilize the market at the new

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level. Such did not prove to be the case. Under the needs of many investment institutions to obtain funds for other investments and out of the fears that had been generated by the reduction of the prices at which the Federal Reserve was willing to buy long-term Government securities that further price reductions might be ahead, a large volume of long-term Governments was sold by investors and purchased by the Federal Reserve.

In the meantime, the rate on short-term Governments continued to rise as a result of the coordinated policies of the Federal Reserve in its open-market operations and of the Treasury Department in its debt management program. At the increasing rates on short-term securities, investors other than the Federal Reserve were large buyers. The result was that between the middle of 1947 and the middle of 1948, the Federal Reserve purchased large amounts of Government bonds through its open-market operations, but at the same time, reduced its holdings of bills, notes, and certificates with the net result that its total holdings of all Government securities actually declined during the period by half a billion dollars.

During the same period the holdings of Government securities by commercial banks declined $5,400,000,000, the holdings by insurance companies declined $1,800,000,000, savings bonds held by individuals increased $1,600,000,000 and holdings of United States Government agencies and trust funds increased $3,000,000,000 and the total gross debt of the Government declined $6,000,000,000.

It is interesting to observe that whereas the principal monetary and debt management policies in 1947 and 1948 were restrictive and designed to be anti-inflationary in effect, we find that in 1949 the Federal Reserve found it necessary to take steps of an expansible nature. Stock-market margin requirements were reduced from 75 to 50 percent, consumer installment credit was liberalized and reserve requirements of banks were reduced during a period of several months in 1949 by 4 percentage points on demand deposits and 2½ percentage points on time deposits. It was during this period that there was some evidence of a business recession. It might be questioned whether or not the nature, the methods and the extent of the restrictive measures taken in 1947 and 1948 may have contributed to the necessity for contra actions in 1949.

At this point I would like to emphasize the high degree of cooperation between the Treasury and the Federal Reserve System during 1947–48 in a common objective to remove the rigidities of the wartime pattern of interest rates and to bring about some degree of freedom in the money markets. Naturally there were some differences of opinion between the Treasury and the Federal Reserve as to details of the various moves that were required to accomplish this objective, the principal difference being that the Federal Reserve, on the whole, thought it desirable to increase interest rates faster and with a more shocking effect on the market, psychologically as well as actual, while the Treasury position generally was that in an operation of such magnitude and involving a Government debt structure that represented more than half of all the debt outstanding in the United States, the reduction in the market value of Government securities through Government action should be made slowly, step by step, and adjusted to conditions as they might develop during the program. I believe it is generally admitted in the financial world that the shift in 1947–48 from the rigidity of the wartime pattern of short-term interest rates to what we called at that time a "breathing market" was accomplished with a minimum of adverse repercussions.

It should also be pointed out that the program of increasing long-term interest rates during that period through the sale to the market of long-term Government bonds was possible only because the Treasury Department had in its investment accounts large amounts of such bonds which it turned over to the Open Market Committee for sale. Here was evidence of the high degree of cooperation between the two agencies for a common objective.

It should be kept in mind that an important factor in the situation during this period was a budget surplus in the fiscal years 1947 and 1948 aggregating $9 billion. This surplus served not only to reduce the debt, but its use in extinguishing bank-held Government securities served also to reduce inflationary credit pressures by reducing bank reserves. A budget surplus simplifies the problem of restraining inflationary credit, whereas a substantial budget deficit multiplies inflationary credit pressures.

Many of the difficulties of the Treasury in debt management and of the Federal Reserve System in monetary control and credit restraint stem from the actions of Congress. The principal difficulty is the fiscal situation that it created when Congress appropriates for expenditure amounts of money substantially greater than it provides taxes to cover. If Congress were sufficiently interested in re-

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straining inflation, it would, under inflationary conditions, provide a budget surplus instead of a deficit. It is an axiom that under inflationary conditions expenditures should be kept to a minimum. However, many appropriations, laws, and policies of Government are of a definitely inflationary character. To illustrate, we have but to recall the historic effort of Senator Douglas to eliminate or reduce many of the appropriations under the rivers and harbors bill in 1950 for projects of little or no real value and the failure of the Senate to respond to his sound arguments for a reduction in that appropriation.

Also, it might be pointed out that the laws and governmental policies that tie the support of agricultural prices to changes in the prices of industrial products on the one hand, and on the other escalate industrial hourly wages on a basis of the increase in the cost of living—this combination constitutes a system of built-in inflation that results in progresive deterioration in the purchasing power of the dollar.

It is also true that agencies of Government, particularly in the lending or guaranteeing field, frequently follow policies and programs that add to inflationary pressures.

These facts add up to the insistent and continuous need for a coordination of the policies of Congress and of the administrative agencies if an anti-inflationary policy is to be effective.

They also bring out the point that the problems of restraining inflation are involved in the actions of Government on many fronts and that while, at the same time, efforts are being made by the monetary authorities to restrain inflationary pressures, other actions by Government are directly inflationary and make difficult, if not impossible, the success of the efforts of the monetary authorities in the limited areas in which they operate.

The basic difficulty in averting or combating inflation is that while people generally are opposed to inflation in theory, in actual practice many embrace programs for personal profit or benefit that are highly inflationary.

A dam cannot be built that successfully will restrain the forces of inflation if sections of it are missing, no more than a dam will hold back the water of a river if the dam is full of holes.

Many people consider the device of raising interest rates as the principal means for controlling inflation. Such a proposal is painless to most people and profitable to many. While this is a desirable device as part of an over-all program, it will not do the job alone and, in my opinion, is highly overrated.

Small increases in short-term interest rates have some value psychologically but actually produce little credit restraint. The short-term borrower, if funds are required for a necessary purpose, is not deterred by a small increase in rate. The short-term lender is not deterred but may be encouraged to make loans when his rate of return is increased. The real deterrent to the short-term lender is the lack of funds to lend and it is in this area that open-market operations of the Federal Reserve System are most effective. One difficulty in curtailing such funds is that a bank with large holdings of short-term Government securities may secure reserves by allowing its securities to run off at maturity. As of the most recent date for which figures are available, December 31, 1951, short-term Government securities held by banks, other than the Federal Reserve, amounted to $33 billion. A small increase in the interest rate on such securities has little effect on the decline in price and such decline may be more than offset by the higher rate obtainable from a loan. So long as the commercial banking system owns such a substantial amount of short-term Government securities, the effectiveness of a slightly increased short-term interest rate will not be too important in reducing the acquisition of reserves by banks.

On the other hand, a small increase in the interest rate on long-term Governments reduces prices substantially and is a deterrent to the sale of such securities because of the loss involved. It is more effective in restraining the lender, who must take a loss in the sale of his bonds than it is on the borrower who needs the funds, particularly under present tax laws where the larger part of the increased interest cost to the borrower is absorbed by the Government through reduction in the taxpayers' taxable income.

The discount rate set by the Federal Reserve was an effective instrument of credit control in the earlier years of the system. While it has an important place in present-day operations, it has limited effectiveness so long as the banks own large amounts of short-term Government securities.

Reserve requirements of member banks of the Federal Reserve System constitute an effective brake on bank lending. Increasing reserve requirements reduces the capacity of a bank to make loans. However, the reserve technique creates many inequities and is a somewhat brutal method of securing results.

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In spite of a rate classification based on a combination of two classes of deposits and on different types of cities, which device attempts to eliminate some of the inequities, it is highly questionable whether the present classification base is suitable for today's banking conditions. Studies have been made over a period of years of the desirability of measuring bank reserves entirely by classifications of deposits. Such a plan would also have within it some inequities, but might be highly effective in the use of reserve requirements as an instrument of credit control. If any change is made in the base on which reserves are required, it should be carefully designed and should be instituted in a period of relative monetary ease.

The objection of banks to reserve requirements that are higher than may be needed for safety are that such reserves are nonearning assets of the banks but are earning assets of the Federal Reserve System. An increase in reserve requirements merely transfers earning assets from the member banks to the Federal Reserve.

It has been suggested that reserve requirements be changed so that only part of these reserves would be required in cash and part in certain types of short-term Government securities on which the owning banks would receive the interest. This proposal is of doubtful merit. In effect, it would force some banks to become unwilling holders of a particular type of Government securities. Another suggestion has been made that when reserve requirements are above certain percentages of deposits that the Federal Reserve banks should be required to pay interest to the member banks on the excess reserves required.

It should be noted that the use of reserve requirements as a vehicle of credit control, applies only to banks and does not directly affect other lenders—some of whom compete with banks in making loans.

Any discussion of the problems of dealing with inflation raises the question of over-all major policy under the directive of the Employment Act of 1946. While this act specifically provides for a national policy as to employment by creating and maintaining "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," it also states as an objective of the policy to promote maximum "production and purchasing power," and all of this to be done "in a manner calculated to foster and promote free competitive enterprise and the general welfare." Emphasis in this policy directive is on employment, but recognition is given to the need for maintaining maximum purchasing power. Although the inference is that what is meant is real purchasing power, which requires relative stability of the dollar. I think it is unfortunate that the wording of this act does not contain a more specific statement of national policy to maintain long-run monetary stability.

An examination of legislative and administrative history of the Federal Government for the past few years does not yield convincing evidence that the guiding policy has been one of maintaining long-run monetary stability.

I have tremendous respect for the American dollar as one of the most important single factors in the world today. The integrity of the dollar must be preserved. Any depreciation or discount of that dollar is a threat to our own national welfare and the welfare of the rest of the world. Throughout history, disasters in varying degrees have almost always followed periods of serious inflation.

However, there can be little doubt that under the necessity of the Government borrowing vast sums to finance World War II and the need for quick expansion of military facilities and production, that a substantial increase in the monetary supply was required. It may now appear in retrospect that the money supply during the war period was increased to a greater degree than was desirable. If it had been possible to place a larger proportion of the public debt in the hands of nonbank holders and less in the banking system, there would have been less increase in the monetary supply.

The question now is whether or not the money supply is too great in terms of the needs of the present defense effort. At times, this appears to be the case, but, on the other hand, in terms of the vast outlays that are being made and are in contemplation, we may find that the money supply is not too great. In the meantime, we have the practical problem of restraining inflationary pressures and dealing with the money supply as it now exists. Credit needs for the defense effort must be filled while, at the same time, it is highly desirable that inflation be restrained.

My own views are that economic policy under present conditions should be directed against inflation through appropriate action by the Government on every front, while at the same time avoiding as much as possible actions that

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will have serious adverse effects in other areas and avoiding so far as possible rigidities in the operation of the private enterprise system. Selective controls and allocation of materials appear to be essential in such a program, but the application of such controls should be subject to administrative flexibility so that they may be adjusted, dropped or increased as the needs of the situation develop.

It would be a mistake to place entire reliance or too much reliance on the use of interest rates through monetary management to control inflation. The need is to deal with this problem on the broad front under a consistent and coordinated policy of Congress and the executive department of Government.

To deal with this problem on the monetary front alone is to ignore the many areas of inflationary pressures other than in the field of credit and monetary supply.

In this connection, there is an intangible factor somewhat unpredictable that we might call human behavior. The officials of the Federal Reserve System frequently refer to the effect of actions which are taken as psychological rather than economic. This factor is one of tremendous import in a country in which people have such vast resources along with a large degree of freedom to use these resources as they desire.

As an illustration, there was general agreement among economists at the beginning of 1951 that inflationary pressures throughout the year would be strong. Such did not develop to the extent anticipated. Almost no one anticipated the abrupt change that took place between the first quarter of 1951 and the second quarter in the shift from spending to saving on the part of individuals. Disposable personal income increased between these two quarters at an annual rate of $5 billion, yet personal savings increased at the rate of $11.6 billion. Personal savings more than doubled between these two quarters both in dollars and in percent of disposable income. The sudden shift from spending to saving on the part of the people did much to cool off the pressure on prices of consumer goods.

In dealing with the public debt and changes in prices of Government securities, we should keep in mind the fact that a substantial majority of the American people owns Government securities and reacts to developments that affect the value of such securities, even though the savings bonds held by most individuals are insulated against price decline. I have a tremendous respect for the size of the national debt, its proportion to all debt and its widespread ownership. The ownership of that debt is based on the confidence of the owners in the Government. Any disturbance to that confidence is a matter of serious concern. Fairly, I think it might be said that many individual owners of Government securities and potential buyers are concerned over the vast expenditures of Government, some of which they consider unnecessary or even wasteful, and particularly when, in spite of heavy taxes, Government expenditures promise to exceed revenues.

Others look with concern at the decline in the value of the long-term securities below par. Many of them do not understand economic theory, but do understand the fact that whereas they paid $100 for a long-term Government bond, it is now worth only $97, and are concerned with the possibility of a much further decline in prices. They also have concern over the deterioration in the purchasing value of their dollar investments made in recent years, whether in savings bonds, bank savings accounts, or life insurance. In a free country in which we have universal and quick communications, we must deal with the factor of human behavior and public reactions to current events. All of these considerations have a bearing on the sale of Government securities, particularly to individuals.

While in the Treasury, in 1947–48, I came to have tremendous respect for the officials of the Federal Reserve System and their devotion to public service. In dealing with intricate problems of monetary control and debt management, about which, at times, there were different viewpoints and different evaluations of the effect of proposed actions, there was always evidence of a desire, fully shared by the officers of the Treasury Department, to resolve such differences in the interest of the general welfare. The spirit of public service was the catalyst in the presence of which all discussions of policies and measures were considered.

There are those who believe that in the exercise of discretionary administrative policy of national importance, there should be no differences of views among top officials and if they occur, a supreme authority of law or the Chief Executive should dictate the policy to be followed. Generally speaking, it is of highest importance that even though differences of opinion are to be expected among thinking men, effective results in carrying out a policy cannot be achieved

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in the executive department of Government unless there is a coordination of effort among the various departments and agencies under a common policy. For this reason, I support the proposal that an advisory council be set up, by executive action, headed by the Secretary of the Treasury, and including the various executive agencies of Government dealing with credit and money, for the purpose of exchanging information and views and for coordinating administrative policy. While it would be proper and desirable for the Chairman of the Board of Governors of the Federal Reserve System or his representative to be a member of this group, he should not necessarily be bound by any policy decision reached by the group. The Board of Governors of the Federal Reserve System should give tremendous weight to any conclusions reached by such a policy group because it is assumed that any decisions reached will represent the combined judgment of top administrative officials as to proper policies to be followed in fiscal, monetary and credit affairs. However, the Federal Reserve System has specific statutory duties that involve semijudicial decisions that are based not only on tangible factors but intangibles and they could not conscientiously discharge their duties if bound by the dictates of the executive department of Government.

It is proper and desirable for the Chief Executive to coordinate the activities of Government that are under his direction under a common policy but, in my opinion, would be highly improper for him to dictate actions to be taken by such semijudicial, independent bodies as the Federal Reserve System, the Interstate Commerce Commission, the Securities and Exchange Commission or other similar bodies. I think that he has the right and duty, however, to communicate his views to such agencies and that these views should be received with respect and careful consideration. However, to subordinate semijudicial and independent bodies set up by the Congress to the directives of the Chief Executive would destroy the effective value of such agencies.

Recognizing the differences of viewpoint on desirable action may arise between the Treasury Department and the Federal Reserve, a proper question is how such differences may be resolved. Fact No. 1 is that the differences are few. The second fact is that almost without exception such differences are reconciled. This is done through discussion and agreement and sometimes through compromise, but always in a spirit of trying to find the right answer in the national interest. It is my firm conviction that such a method of dealing with common problems between an agency of Congress and an executive department is of the essence of democratic government. In some cases, the results are not as definite nor as effective as they would be with an authoritative set-up under which one might be subordinated to the other or both directed by a supreme authority. However, in my humble opinion, this is a cheap price to pay for the preservation of the basic principle of checks and balances in a democratic government.

We should recognize that no man and no group of men dealing with the vast problems of our public debt and our monetary system are omniscient. Too many factors are involved, not only economic and financial, but in the realm of the probabilities of human behavior for any one man or group of men to know all of the right answers.

It would be a catastrophe to weaken or destroy the independence of the Federal Reserve System as a semijudicial body by making it merely an administrative agency subordinate to the Treasury Department or subject to direction by the Chief Executive. On the other hand, the officials of the Federal Reserve System should give every consideration to the problems of the Treasury Department, the difficulties of managing the huge public debt and major governmental policies. It is my understanding that such is the present policy of the Federal Reserve System. It might be pointed out that the history of central banking throughout the world is tragic evidence that such institutions lose their independence if their actions are inconsistent with major governmental policies. Central banks win battles against government but governments always win the war.

Summarizing:

(1) The needs for financing World War II and the multiplication of productive facilities to carry on the war resulted in a huge increase in the public debt and in the money supply.

(2) While the larger part of such increase was necessary there remains a question as to whether or not such money supply is more than is desirable for a peacetime economy.

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(3) The result of the increased Government debt and increased money supply was to depreciate the purchasing value of the dollar—another name for inflation.

(4) The results of the sale of large amounts of Government securities were: (*a*) to create an unbalanced investment situation on the part of many institutions that required a later liquidation of part of such securities; (*b*) to fill the banking system with a large volume of short-term Government securities which made funds available to any bank not only through sale but also by allowing such securities to run off as they fall due; and (*c*) to make the vast majority of the people of this country holders of Government securities either through direct ownership or indirectly by institutions.

(5) The policies of Congress have been, on the whole, inflationary not only during the period of World War II but since. Congress, under the Constitution, is charged with the responsibility for regulating the value of money. It has the powers to perform this function and should be held responsible for substantial changes in the purchasing value of the dollar. It should be recognized that Congress, over a period of time, represents the will of the people.

(6) The public generally, while opposing inflation in principle, actually desire a certain amount of inflation as it may affect their particular interests. It is but natural that the farmer should want higher prices for farm products, the workingman higher wages for his services, the businessman higher profits, and the lenders higher interest rates. All of these objectives are inflationary except to the extent that higher interest rates are contra-inflationary.

(7) Congressional inflationary actions in the presence of the large monetary supply and the huge Government debt have added to the difficulties of the Treasury Department in debt management and, in particular, have multiplied the difficulties of the Federal Reserve System in its money market management directed toward restraining credit.

(8) Under certain conditions, there is conflict between monetary control and debt management. The almost continuous necessity for refunding maturing obligations and the frequent need for borrowing money in the management of the debt require a considerable degree of monetary stability for successful accomplishment. Proper monetary management at times necessarily requires actions that disturb the money markets. The objectives of proper debt management to preserve confidence in the public debt and permit its orderly handling are essential to the national welfare. On the other hand, monetary management that seeks to adjust the credit situation to changing needs and changing conditions is also highly desirable in the public interest. Decisions in both fields are highly complex and are based not only on known financial and economic factors but on the uncertainties of the future, including the factor of human behavior. No man or group of men can, with precision, correctly evaluate all of the factors involved in debt management and monetary management.

(9) With the widespread ownership of the public debt among individuals, the attitudes of people toward the Government debt constitute an important consideration of the possible public reactions to actions taken. Serious reductions in the prices of Government securities are disturbing to many people.

(10) The basic consideration in monetary management and debt management is that so far as possible they should be consistent with each other in spite of the fact that they have different primary objectives. A high degree of close cooperation and coordination is necessary between the two in the interest of both. The greatest care should be exercised that: (*a*) Actions in one field should not seriously disturb operations in the other field; (*b*) that careful consideration should be given to the long-run adverse effect of actions taken to accomplish immediate desirable objectives; and (*c*) in view of the intricacies of the problems involved in debt management and monetary management and the necessity for the exercise of judgment that is based not only on known factors but unknown factors and with changes in conditions beyond the control of monetary authorities, that there should be no mandate or directive by law that would restrict the necessary freedom of actions for proper debt management and monetary management.

(11) The close working together by the Treasury Department and the Federal Reserve System has resulted in a high degree of cooperation in which differences have been minimized. It is in the interest of both that actions of one should not be contrary to the objectives of the other. While admitting that thinking men will not always agree on every specific action to be taken in the field of monetary control and debt management, it is far more important in terms of our democratic system of checks and balances that the freedom to disagree be-

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preserved rather than to destroy the independence of either the Treasury or the Federal Reserve System in working out problems common to both. Neither should the Federal Reserve System become subordinate to the executive department of Government nor should it be allowed to take over the functions of that department.

The third item in my discussion is on the question of ownership of stock in the Federal Reserve banks. The stock in these banks is now held by the member banks. This stock carries a fixed dividend and the stockholders have no interest in any earnings of the banks in excess of the amount required to pay the dividend. The question has been raised as to whether or not in view of the fact that the Federal Reserve is controlled by the Government, the Government should also own the stock of the Federal Reserve banks.

I can see no reason why the ownership of the stock by the Government would provide any governmental control not now exercised or available. The only advantage to the Government in such ownership would be to receive the dividend on the investment of the Government to acquire this stock. The difference in the dividend and the cost of the money with which to buy the stock is not of sufficient amount to have an important bearing on the question. If the Government owned the stock of the Reserve banks, the implications would be that the Reserve System was merely an executive agency of the Government, such as the RFC for instance, and subject to Executive direction.

The Federal Reserve banks represent a combination of Government and private business under which control is vested in the Government. It is through the ownership of the stock of the Reserve banks by member banks that the Reserve system mobilizes the services of able individuals as directors of the regional banks. These men represent the private-enterprise system and the public.

Although the powers of the directors of the Federal Reserve banks are limited and although the control of the policies of the banks is vested in the Board of Governors, at the same time these directors bring a viewpoint of banking, industry, agriculture, and business to the officers of their respective banks that is valuable to the Reserve banks in maintaining close touch with conditions prevailing in their respective districts. The Federal System has no other direct official relationship with business, commerce, and agriculture except through the boards of directors of the various Reserve banks. Such relationships constitute a highly desirable feature of the Federal Reserve System.

Member-bank ownership of the stock in the Reserve banks not only gives the banks an opportunity to vote in the election of six of the nine directors of each bank, but affords a relationship in which bankers have a direct interest in the functioning of the Reserve System. To divest the member banks from this stock ownership would result in losing a valuable asset of support to the System and an interest on the part of banks and other businessmen in the System's operations.

The operations of the Federal Reserve System are so intimately related to commerce and industry and the operations of the chartered banking system that it is highly desirable in the national interest that such relationships be encouraged rather than discouraged. A basic concept of the Federal Reserve System is to serve the local needs of every area of the Nation by diffusing operations through regional and branches of regional banks. If the participation of public representatives as Reserve bank directors elected by the banks were eliminated, we would then have only a concentrated bureaucratic direction of the System by the Board of Governors. Such would not be in the public interest.

I can find no sound reason for the Government to acquire the stock of the Federal Reserve banks unless the objective is to destroy the independence of the System and make of it merely a Government bureau.

Representative PATMAN. I will state that you have given the best reason for the continuance of the token ownership by the commercial banks of the Federal Reserve System that I have heard given, the most logical reason for it.

Mr. WIGGINS. Thank you very much, sir.

There is some more detail in my statement, Mr. Chairman, than I gave.

Representative PATMAN. Mr. Wolcott? Senator Douglas?

Senator DOUGLAS. I want to compliment the witness on his extraordinary able statement. It is indeed one of the ablest statements which I have ever heard on the subject.

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Mr. WIGGINS. Thank you very much, sir.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. No questions, Mr. Chairman.

Representative PATMAN. I will ask two or three questions of Mr. Wiggins.

You know, the Comptroller General in the General Accounting Office usually audits and has control of the auditing and general supervision of the bookkeeping of public agencies. Do you believe that the General Accounting Office should be given the power to audit the books of the Federal Reserve System and the Federal Reserve Board?

Mr. WIGGINS. Mr. Chairman, I can see no particular objective except to give another agency some more work, and they would probably want another appropriation to do it. The Federal Reserve has an effective internal audit, and I do not know what would be accomplished by it or what the desirable objective is.

Representative PATMAN. It costs as much money to have a private audit as it would for the Government auditor.

Mr. WIGGINS. I really am not familiar with the type of audits that the Federal Reserve make except that I know they do have a very elaborate system of audit of their own.

Representative PATMAN. The question involved here is they audit their own books, whether or not that is a good policy.

Mr. WIGGINS. I am strong for an internal audit regardless of whether you have another auditor or not. I think it is the most effective means of controlling a business, with a unit of the same business, an independent group charged with the same responsibilities that some other auditors would perform.

Representative PATMAN. Another question on annual appropriations. Most of the agencies of the Government and public bodies depend upon Congress for annual appropriations. In that way they are under the direction and scrutiny of what you might call their master, the Congress.

Would you be in favor of the Federal Reserve System turning in all of its receipts like most of the other agencies do, and receiving money for their support and salaries, maintenance, and operation from a budget like other agencies are required to do?

Mr. WIGGINS. Frankly, I would not want to run that business if it had to be done that way. I think that the type of operations of a huge banking system, that the men at the head of it should be given the authority to run it without requiring an appropriation of Congress for their detailed expenses and costs.

I do not know how you would cover the losses that they might take on Government securities. It would be an expense of the operation. That certainly could not be covered by statute, I mean by any particular appropriation. I think they ought to have the freedom that they now have, Mr. Chairman.

Representative PATMAN. Of course, so far as independence is concerned, Mr. Wiggins, the Supreme Court receives its annual appropriations from Congress.

It is a coordinate branch of our Government, and it is just as independent, I believe, as any part of our Government can possibly be, and they certainly have not found it to be any handicap, and it seems to be a part of our traditional system, but the question is whether or not we should make an exception in this case. Take the executive branch

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of the Government. It is dependent upon Congress for every dollar under their control and every dollar that they spend.

Mr. WIGGINS. That is true.

Representative PATMAN. So the argument that it destroys the independence of the agency I believe is somewhat weakened by the experience of the executive and the judicial branches of our Government.

Mr. WIGGINS. The Federal Reserve System, however, is an income-producing operating business, and I think is entirely different from such operations as the courts, where it is a matter of expense.

The Congress does fix the salaries of the members of the Board of Governors, which I think is proper, but it does not fix the salaries of the presidents of the Federal Reserve banks, and I think many Congressmen might think when you came to appropriating an amount that would be necessary to employ the type of ability that is required for the president of a bank, that the salary would be too high.

I am afraid that Congress would not appropriate adequately to get the type of personnel that we now have in the Federal Reserve System, and in my opinion it needs the best men that can be found.

Representative PATMAN. Without arguing the question with you, Mr. Wiggins, Congress has been rather liberal with the Supreme Court for instance. They receive rather liberal salaries and allowances and retirement benefits, and if you add it all up, I suspect it would amount to about as much as the presidents of the respective Federal Reserve banks receive.

Mr. WIGGINS. I think the Supreme Court, Mr. Chairman, is a holy of holies that we regard with such high favor that we ought not to compare this banking system with the Supreme Court. It might be compared with something else.

Representative PATMAN. And so far as its status as a revenue-bearing agency is concerned, we should keep in mind, too, that all its revenues are by reason of its holdings of United States Government securities.

Mr. WIGGINS. And the note-issuing privilege.

Representative PATMAN. Yes; using the credit of the country. If you want to put the Supreme Court in a comparable situation, you can just turn over $20 billion worth of Government bonds and say, "All the interest on that money you can use to run the judicial system," and then put the rest of it back into the Treasury.

Mr. WIGGINS. My opinion, Mr. Chairman, is that if the Congress is not satisfied with the way the Federal Reserve System is run, then they might take over the functions of appropriating and requiring the receipts to be brought into the Treasury, but the practical facts are that you need as presidents of some of your Federal Reserve banks the ablest financial brains in America; and you have got it, in my opinion.

You are competing with the presidents of banks that pay salaries that are very high in terms of the salary that a Congressman gets.

Senator DOUGLAS. There we come to a point, namely, that the salaries of members of the Federal Reserve Board are appreciably below the salaries of the presidents of the Federal Reserve banks, although the position of the Federal Reserve Board is really much more important in framing general policy than the operating heads of the banks.

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Would you favor increasing the salaries of the Federal Reserve Board?

Mr. WIGGINS. I certainly would. I think it is a shame that those men receive the salaries they get when they occupy a position of such importance in our whole economy, when you have to draw from a source of the kind of men you want, men who receive salaries several times as great.

I do not think that in some cases you will get that type of man with salary alone. In some cases you have that type of man already on the Federal Reserve Board where the salary is less important to him than a sense of serving the Government.

Senator DOUGLAS. You are aware of what happened when some of us tried to increase the salaries of members of the Federal Reserve Board from $15,000 up, I believe, to $22,500.

The record is perfectly clear that the Federal Deposit Insurance Corporation with all its influence injected itself in the situation and said, "You can't increase the salaries of the Federal Reserve Board unless you increase ours. We are as important as they are."

And I am sorry to say that a large proportion of your fellow bankers went along with the Federal Deposit Insurance Corporation, because my files are full of telegrams from the bankers of my State protesting against an increase in the salaries of members of the Federal Reserve Board. Now I hope that you can use your influence with your fellow members of the American Bankers Association on this question.

Mr. WIGGINS. Well, the question of comparative salaries is always raised when you change anybody's salary. It is a tough problem in business, of course, with your own personnel.

Senator DOUGLAS. I was greatly disappointed in the attitude of the Federal Deposit Insurance Corporation.

Representative PATMAN. Mr. Wiggins, we thank you very kindly sir.

Mr. WIGGINS. Thank you, gentlemen.

Representative PATMAN. Mr. Wiggins, will you come back just a moment please. I forgot to call on Dr. Murphy and Dr. Ensley and ask if they wanted to ask any questions.

Mr. ENSLEY. I have no questions.

Representative PATMAN. Dr. Murphy?

Mr. MURPHY. I have only one question. The Douglas report 2 years ago said:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against rather than promote the purposes of the Employment Act, and we recommend that no action in this direction be taken.

What would be your reaction if this committee reiterated that statement or some variation of it in its report? Would you comment on that, Mr. Wiggins?

Mr. WIGGINS. Would you mind reading the heart of that? I did not quite hear you, Mr. Murphy.

Mr. MURPHY (reading):

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against rather than promote the purposes of the Employment Act, and we recommend that no action in this direction be taken.

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That was stated in the Douglas report 2 years ago. The question is, Do you think it would be a constructive thing for this committee in its report to reaffirm that position?

Mr. WIGGINS. There are a number of people who toy with the idea of making gold convertible to cure many of our economic ills.

I am ashamed to admit that I wrote a treatise on gold about 30 years ago and I hope it will never be read or discovered, because what I said at that time is so foolish today that I am ashamed to admit that I wrote it.

In my opinion if there is any substantial demand or advocacy of making gold freely convertible, I think it might be well for the committee to express itself somewhat along the same lines as it formerly expressed itself. I personally think that making gold freely convertible would only result in transferring the hiding of the gold in the ground at Fort Knox to hiding it under the mattresses and in the socks over the country.

I think if you really want to deflate, Senator—we were talking about deflating—if you would announce on a certain day that anybody can go to any bank in the country and get all the gold they want, I believe in 3 hours why the gold supply would disappear.

Some people do not agree with that, but I have asked some of the advocates of convertibility of gold what they would do if they had the right to convert their money into gold, and I think uniformly everyone has said, "Well, I would get all I could get and I would put it away in a good, safe place."

I do not go along with any proposition at the present time under the present world conditions to make our gold supply convertible freely.

Senator DOUGLAS. You do not agree with the apparent meaning, therefore, of an eminent candidate for the Presidency who declared that he wanted a solid American dollar with a modern gold standard.

Representative PATMAN. I think you would have to define what is meant by a "modern gold standard."

Senator DOUGLAS. Strike my query from the record.

Representative PATMAN. No, no.

Well, thank you very kindly, Mr. Wiggins.

Dr. Blough, we are glad to have you as our witness. Do you have a prepared statement?

STATEMENT OF ROY BLOUGH, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. BLOUGH. Mr. Chairman, the opportunity which the committee gave the Council to respond to the committee's questionnaire has given me plenty of opportunity to explain my views on the subject under consideration. There is one point, however, I think on a rather central problem, that may not stand out as clearly as might be wished. I have prepared a statement on that point.

If it meets with your approval, I would like to have that statement appear in the record, and to have the committee's indulgence for me to summarize very briefly the points involved, after which I shall be happy to address myself to whatever questions the committee may wish to ask me.

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Representative PATMAN. Without objection, that will be satisfactory, Mr. Blough.

(The prepared statement submitted by Mr. Blough is as follows:)

THE DILEMMA OF MANAGING A LARGE PUBLIC DEBT IN A PERIOD OF INFLATION

The hundreds of pages devoted by individuals and agencies to answering the questions submitted by your committee testify to the many facets that mark the relationship between monetary policy and the management of the public debt. It is obvious that I can deal with only a small segment.

There would seem to be three general kinds of problems involved in this subject of the relationship between monetary policy and the management of the Federal debt. At the center is the economic problem of how to manage a very large Federal debt with the least harmful influence on the economy. This economic problem comprises several problems that are more specific, among them, how to manage the Federal debt without contributing to inflation, how to manage the Federal debt without contributing to deflation and depression, and how to manage the Federal debt without causing a monetary crisis.

A second kind of problem might be designated the problem of policy, or more specifically, the problem of choosing among desirable objectives. There are many desirable objectives for the Nation, among them being the promotion of the defense program, the expansion of production and productive capacity, the maintenance of a relatively stable price level, the achievement of a fair distribution of income and wealth, the promotion of individual freedom, and the advancement of the economic security of our citizens. To some extent, these objectives can be advanced simultaneously. Often, however, it is necessary to choose among them—to weigh the advantages of a little more of one against the disadvantage of a little less of another. A rapid shift from a civilian economy to a mobilization economy, for example, might have been difficult to achieve without some increase in prices.

The third kind of problem may be designated the organizational problem. This is the problem of how to allocate the powers of Government in such a manner that the economic methods used and the policy decisions made will to the greatest extent possible promote the national interest.

The problem to which I wish to direct my remarks is the first of these three, namely, the economic problem of how the public debt can be managed with the least harmful and most beneficial results for the economy. More specifically, I wish to deal with the problem of managing the Federal debt without contributing to inflation.

PROBLEMS PRESENTED BY A LARGE PUBLIC DEBT

The Federal debt, which on December 31, 1951, totaled $259.5 billion, is one of the most important economic facts of our time. This Federal debt is 45 percent of the total net debt, public and private, outstanding in the United States today. The largest debt owed by any other governmental agency is $3.2 billion of gross debt owed by the city of New York. The largest debt of any business organization to come to my attention is $3.6 billion. During the year 1952, it will probably be necessary for the Federal Government to refinance over $35 billion of the Federal debt in addition to the $15.6 billion of Treasury bills which are turned over four times a year. The Secretary of the Treasury has indicated that because of the Federal deficit, it may be necessary, in addition, to borrow from the public as much as $10 billion in new funds during the calendar year 1952. The magnitudes of these operations are so much vaster than those involved in private financing, and the Federal Government is so different from a private business, that there is no reason to believe that all the rules applicable to private financing can or should be applied to Federal debt management.

The Federal debt is a stubborn fact that has a bearing on all economic policies. We cannot get rid of the debt, at least not in our lifetimes, so we must learn to live with it. A basic fact in considering problems of monetary policy and debt management is that every dollar of the Federal debt at all times must be held by someone. The amount of the debt may be reduced by increasing revenues or reducing expenditures, but the remaining debt is going to be held in some fashion whether by individual investors, corporate investors, commercial banks, or Federal Reserve banks.

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Under most economic conditions, a large public debt presents no problem for monetary policy; indeed, under some conditions, the debt can serve as a useful tool. Under the following circumstances, however, a difficult problem arises in using monetary policy to stabilize the economy while managing the public debt: (1) When there are substantial issues maturing currently that require refunding, or when additional borrowing is necessary because revenues are insufficient to cover expenditures; and (2) when demand for goods and services has pushed employment and production to so high a level that any additions to demand will not result in greater production but will give rise to inflationary pressure; and (3) when the combined total of demands for loanable funds by Government and private borrowers is in excess of the supply of loanable funds available from the voluntary savings of individuals and corporations. Conditions of this character have existed during much of the time since the Korean attack in June 1950. They exist in the main today and they promise to become accentuated over the next 12 months or so because of the large Federal deficit which we shall soon be incurring.

It is well to bear in mind that it is the relation of spending (including consumer spending, business spending, and Government spending) for goods and services to the supply of goods and services which is the biggest factor determining prices. All kinds of financial transactions, including the increase in the money supply (of which a minor fraction is currency and the major fraction is bank deposits) affect prices only as they result in a an increase or decrease in spending or a decrease or increase in the supply of goods and services. For example, the effect on prices of an increase in bank reserves cannot be accurately forecast either as to amount or as to time. The result depends on many other economic steps. The results can be more readily forecast in a period of inflation than in one of deflation, when there may be no further steps at all, at least not for months or years, but even in a period of inflation the timing and amount of the consequences are uncertain. In all discussions of the effect of monetary and debt transactions, it is necessary to follow through to the effects on actual spending and on the actual supply of goods and services.

The economic dilemma that is presented when the demands for loanable funds exceed the supply in a period of full employment is suggestive of the parlor game of musical chairs, in which there are less chairs than people. In musical chairs, there would be no game if the number of people and the number of chairs were the same, but in the situation just described regarding the Federal debt, the number of players and the number of chairs must in some manner be made the same. The problem is how to restore equilibrium between the supply and demand of loanable funds while maintaining price stability in maximum degree. Either an equilibrium must be achieved between the supply of loanable funds and the demand for loanable funds, or some kind of rationing of loanable funds will have to be carried on by action of either the lenders or the Government.

INCREASING THE SUPPLY OF LOANABLE FUNDS

To achieve an equilibrium between the supply of loanable funds and the demand for loanable funds, it is obviously necessary either to increase the supply or decrease the demand. The supply of loanable funds can be increased by persons and corporations increasing their savings. Since the spending of the loan is offset by reduction in spending by the saver of the money, the result is not inflationary. Another method of increasing the supply of loanable funds is for persons and corporations to loan funds which they formerly held idle. In this way, the velocity of circulation is increased and spending is increased; the result is inflationary. The lending power of banks can be increased by enlarging commercial bank reserves through an inflow of gold, rediscounting with Federal Reserve banks, or the purchase of Government securities by Federal Reserve banks. The lending power conferred by bank reserves can be increased by reducing reserve requirements. Lending power can be decreased, of course, in the reverse ways by raising reserve requirements, by an outflow of gold, by paying off rediscounts, and by the sale of securities by Federal Reserve banks.

There are conditions under which an expansion in the supply of loanable funds is not inflationary. As just mentioned, if savings are being simultaneously increased, an increase in spending growing out of increased loans will not create additional inflationary pressures. Moreover, to the extent that the economy is growing with respect to the physical volume of production or trade, a larger supply of money is required to carry on the increased volume of business at the existing price level. Expansion in the supply of money or increase in the velocity

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of its use that is not in excess of such additional needs does not increase inflationary pressures. Otherwise, however, if an increase in lending power is actually followed by an increase in loans and if this, in turn, is followed by an increase in spending by consumers or businesses for goods and services, inflationary pressures are added to the economy. Whether price increases will actually result depends on what measures are taken to hold down spending elsewhere in the economy through such measures as taxes, rationing, priorities, and allocations, and so on.

The fact that inflationary pressures are increased at one point or from one cause, therefore, does not mean that actual inflation must result. However, it is clear that bringing about an equilibrium between the demand and the supply of loanable funds by increasing the supply of loanable funds through the expansion of bank reserves is likely to add to inflationary pressure and thereby to make the problem of preventing inflation more difficult to solve.

It is for these reasons, of course, that stress is placed on the desirablity of avoiding the indefinite expansion of the holdings of Government securities by the Federal Reserve banks. But Government spending financed by selling securities to the public in exchange for idle funds also is inflationary. The hope of achieving an equilibrium between the supply of and demand for loanable funds through an increase in the supply of funds lies in the increase in real savings. To increase real savings is, of course, easier said than done.

EFFECTS OF A RISING INTEREST RATE

The second method of bringing equilibrium between the supply and demand of loanable funds is to decrease the demand for such funds. One way to do this is to permit the interest rate to rise. The chief way in which permitting the interest rate to rise brings about equilibrium between the supply of and demand for loanable funds is by causing some prospective borrowers to drop out because of the increase in the cost of the loans to them. Clearly, as the cost becomes higher and higher, more and more borrowers will find the expense of borrowing too great for them to undertake.

Many persons have taken the position that the problem of the public debt is solved when the Federal Reserve System ceases to buy Government securities. In fact, however, this is only the beginning of the problem. It is all very well to say that the Federal Reserve must not buy the securities, but the stubborn fact is that it is absolutely necessary that someone buy them. How is this to be done when there is a bigger demand than supply for loanable funds? Presumably, the Federal Government can, if it will, outbid other borrowers of funds who do not have the same imperative necessity to borrow, by offering high enough interest rates. Clearly, if only the interest rate is to be used to cut down the private demand for loans, the Federal Government cannot stop short of outbidding other borrowers. This might be a serious matter, since the highest marginal rate which the Treasury had to pay on the last dollar it borrowed would tend to set the rate pattern for the whole of the Federal debt, which, as previously noted, is nearly as large as all the private debt put together. Thus, the interest rate paid on this tremendous volume of debt obligations would tend to be determined by how rapidly a rise in the rate of interest drove other borrowers out of the market or discouraged lenders from loaning to the other borrowers.

If this course is to be followed, it becomes very important to know whether the Federal Government will have to bid very high to refinance its loans and to borrow what new money it will need. I do not know how high the interest rate would need to go, but several factors may be indicated. A rise in interest rates may affect the market for loanable funds by affecting the supply and by affecting the demand. As previously indicated, only increases in the supply of funds that result from increased saving avoid being inflationary. It is not generally believed by economists that moderate increases in rates of interest have a substantial stimulating effect on the level of saving. There are forces working in both directions that tend to offset each other.

The second effect of rising rates of interest is on the demand for loans. This is a very crucial question, since if the demand for loans is very elastic in relation to interest changes, a small rise in interest rates may suffice to restore equilibrium between the supply and demand of loanable funds, while if the demand is very inelastic, a very large rise in interest rates might be necessary to reduce demand sufficiently to bring about an equilibrium. When demand for loanable funds is decreased by an increase in the rate of interest, it is of course

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important that this decrease not be in those sectors that are vital for the promotion of the defense effort.

We cannot approach the present situation as a normal one in which only traditional economic techniques will be sufficient to meet the problem. The expansion and diversion required by the defense program, the tremendous volume of private capital formation, and the heavy anticipated Federal deficit combine to make this a special situation which may call for special measures.

It may be useful to run over briefly the different demands for loans. As previously stressed, Government loans cannot be reduced at all by debt management; somehow or other, Government must get the money and, unless other measures are to be used to prevent the market from being entirely "free," the Government must be prepared to outbid the interest rates that other borrowers would pay. The demand for speculative loans would be very slow to drop out, because the interest cost is a very small element among the factors determining speculative purchases. The demand for loans to carry inventories would also be very slow to decrease as interest rates rose, because again the rate of interest is a very small part of total cost, especially when the risks of the operation are considered part of the cost. The demand for loans to finance the purchase and production of machinery, tools, and equipment would be relatively slow to respond, because again interest is a small proportion of cost for items of equipment which are written off or depreciated at a relatively fast rate of speed. The demand for loans to finance industrial and commercial construction would presumably be reduced to a greater extent, since the interest rate is a relatively important factor in determining the profitability of the operation. This is true also of residential construction, since the amount of rents that home owners can pay is dependent on their wages and other income, and as interest rates rose, demand would fall off. It should be pointed out, however, that with respect to the present situation the limits on the amount of construction (industrial, commercial, and residential) have been set in recent months not by the aggregate demand of borrowers but by the supply of scarce materials. Even at higher interest rates the demand of borrowers would likely have continued sufficiently great to take up all of the available supplies of materials. It is not clear how long this will continue.

On the basis of the above analysis, there is good reason to conclude that it might very possibly happen that an increase in interest rates of a moderate character would have an insufficient effect in reducing the private demand for loans. In that case, the Federal Government would be obliged to face the prospect of outbidding private demand for loans with even higher rates of interest.

It may be urged that although an increase in the rate of interest would have relatively little effect in reducing the demands of borrowers for loanable funds, the lenders would ration their supplies of funds in such a way that the Government would receive what it required. The argument has been made that an important reason why insurance companies, for example, have been loaning money in the private market instead of to the Federal Government is that the companies have certain contracts which they must fulfill, and that the rate of interest offered by the Government is not enough to satisfy the needs of the companies in fulfilling these contracts. It has been argued that a small increase in the rate of interest on Government securities would make them attractive to the insurance companies, which under those circumstances would be willing to buy from the Government instead of loaning money in the private market. Likewise, it has been said that banks have certain earnings expectations, and that when these are satisfied, the banks will be willing to lend to the Government instead of lending the funds to private borrowers.

While it may be granted that there is a short lag while the appetites of lenders are temporarily satisfied by an increase in the rate of interest, it is not human nature for this satiation of appetite to continue. As a matter of fact, the rates of interest which some observers said last winter would be satisfactory for insurance companies are being said now not to be satisfactory. An increase in interest stimulates the appetite instead of satisfying it. If private borrowers are willing to pay more for their loans, I can see no reason to expect that private lenders will not take advantage of the higher interest rates and force the Federal Government to keep raising its bid in order to place its securities in the hands of private holders.

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DISADVANTAGES OF LARGE INCREASES IN INTEREST RATES

The point may be made that there should be no objection to the Federal Government increasing its interest rate bids as high as may be necessary to outbid enough of the private borrowers to assure that the Federal debt will be held without inflationary consequences. Can this view be accepted?

If the interest rate necessary for the Federal Government to outbid private borrowers were a permanent equilibrium interest rate, there might be little objection to the Federal Government engaging in such competitive bidding. But this means that we would expect the country for a long time to come to be in an inflationary situation. We would expect the rate of demand for loanable funds to be so much in excess of the supply of saving that the cutting off of demand for construction and for machinery, tools, and equipment for the longer run would be desirable. There are countries where this is, indeed, the outlook, and where a rising interest rate is a recognition that capital investment must be slowed down regardless of the desirability of industrial expansion, simply because the rate of saving is too small. But this is not the outlook in the United States. This Nation has a tremendous capacity for saving. It does not have the capital shortages that a war-ravaged Europe or an underdeveloped Asia, Africa, or South America may have. Already financial writers are professing to see deflationary dangers ahead after 1, 2, or 3 years. Over the longer run, in my opinion, this is a high-saving economy and a low-interest-rate economy. That is, savings will be made in large volume, in my opinion, and to keep them invested in real capital, as they must be if unemployment and depression are not to threaten us, the interest rate that is paid for the use of savings will have to be to a relatively low one. If this be the case, the problem is not one of seeking a long-term equilibrium rate of interest but of achieving a short-term equilibrium (which in the absence of other action might require a high rate of interest) followed by a long-term equilibrium which would require a low rate of interest.

But why is this situation a matter of any concern? Why not have high interest rates now and low interest rates when we need them? The difficulty is that interest rates in the past have not adjusted downward with sufficient rapidity to meet the changing needs. That adjustment requires a process of reeducation to a lower interest rate standard. The average yield of Aaa corporate bonds in 1932 was higher than in 1929. It took a long time after 1932 for interest rates to fall substantially, and positive action on the part of the Government was involved. Do we want to educate lenders to a high interest rate only to have to go through another slow process of reeducation to lower rates? Of course, the Government could engage in direct lending at such a time and thus break the interest rate structure. But most of us, I am sure, would like to minimize such activities by Government. We shall be much surer of having the needed lower interest rates when they are required for a healthy economy if they do not rise too high during the intervening period.

Another reason for avoiding high-interest rates is that the continually rising interest rate which might be necessary for the Government to outbid the market might result in placing actually less securities in the hands of the public than if a lower interest rate had been maintained. This might happen for two reasons. First, the declining value of Government securities might cause investors to avoid investing in Government securities for the future, because of the capital losses suffered in the past and present. Second, investors might reason that an increase in the rate of interest would be followed by still further increases and that therefore they might as well wait until later before buying any intermediate or long-term securities. Relatively little is known about the probable behavior of Government security holders under various possible circumstances. The situation is not one, however, in which bold experimentation can be lightly undertaken. With about half of the total debt of the Nation in the form of Federal securities, the development of a disorganized market could be a major disruptive force. The action which then might be required by the Federal Reserve to restore financial order might involve larger purchases of Government securities than a flexible support program to maintain stability. It is not convincing to argue that market supports were discontinued and that the fear of security market disorganization proved to be a bogey. Support was not discontinued, and was handled with great care and skill. Moreover, the more difficult financing problems have not yet been faced.

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Another result of higher interest rates would be, of course, that the cost of servicing the public debt would rise. No one will question the undesirability of unnecessarily increasing the tax burden on the public. On the other hand, no one will question that if the only way to maintain stability is through a higher rate of interest on the Federal debt, it would be far cheaper for the country to pay the higher taxes than to experience the inflation. But in view of the uncertain effects of rising interest rates and the possibility that other methods can be used to prevent inflation, it is understandable that a substantial increase in the interest rate is not to be viewed wtih complacency.

It should also be mentioned that much of American financial strength rests on a foundation of the values of Federal securities. The substantial declines in the values of those securities that would accompany substantial increases in interest rates might have very repressing effects on types of financial and business operations necessary for the sound functioning of the economy especially in the defense mobilization period.

OTHER METHODS OF RESTRAINING PRIVATE DEMAND FOR LOANS

I want to make it clear that I do not defend any particular level of interest rates as being the correct level. It may be, moreover, that under the circumstances we face, the equilibrium level will not involve much if any increase in interest rates. But for the reasons mentioned, large increases in interest rates would have undesirable effects, and it is necessary accordingly to review other possible ways of reducing the demand for loanable funds and of inducing lenders to prefer Government securities to private loans.

The problem in short is one of finding ways to reduce private loans in order that the Government's debt may be held without undesirable increases in the rate of interest and without an inflationary expansion of credit. There is no easy comprehensive way of achieving this result, but there are a number of different methods which, when combined, may add up to a considerable total. Allocations and cut-backs in materials available for civilian use, restrictions on commercial construction, and other methods of reducing activity operate to cut down the need for borrowing. Specific credit controls by reducing the amount loaned and speeding up repayments operate to cut down the demand for loanable funds with respect to purchases of consumer durable goods and of houses. Willingness of banks and other institutions to lend has been diminished through voluntary credit-restraint programs that bring the social and moral pressure of the whole industry to bear on its individual members. Price controls reduce the desire to engage in speculative transactions and help to hold down the requirements for working capital.

In the actual management of the public debt, it should not be assumed that any one of the methods of achieving an equilibrium between the supply and demand of loanable funds must be or should be followed to the exclusion of the others. In practice, it may be found necessary and desirable to make some use of all of the methods, and possible to do so without inflationary pressures resulting. The policy of supporting the market for Government securities that seems to me best suited for the uncertain type of situation we face is the flexible policy of the type which I understand is being followed by the Federal Reserve System. This kind of support keeps large holders from readily monetizing their holdings; it does not preclude active support of the market when this seems necessary or desirable; it helps prevent the kinds of fluctuations in Government security prices that would make difficult the sale of future issues; and it should prevent seriously hurtful market confusion and economic disruption.

In closing, I would like to repeat that monetary policy and debt management are by no means all there is to the problem of economic stabilization or its solution. The inflationary problem is one of holding down total spending, not simply that relatively small part which is financed by increases in debt, public and private. A well-balanced stabilization program using all the other measures at the disposal of the Government should go along with a monetary and debt management policy that itself should be to the largest practicable extent noninflationary, despite the handicap placed upon it by that basic inflationary influence, too little revenue to match expenditures.

Mr. Blough. The problem with which my statement is concerned is the dilemma for policy that arises in a certain combination of circumstances. The circumstances are:

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1. An economy experiencing full employment or under inflationary pressures.
2. A large Federal debt.
3. A considerable volume of refinancing or, what is worse, new borrowing to be undertaken.
4. An excess of demands for loanable funds over the supply of loanable funds available from the voluntary saving of individuals and corporations.

Now under those circumstances we have a situation much like the parlor game of musical chairs in which there are more players than there are chairs. There is more demand for loanable funds than there is supply from the voluntary savings of individuals and corporations.

The difference is this: That in musical chairs there would be no game unless there were more players than chairs, while in monetary policy and debt management, the number of chairs and players must be made equal by some method.

The central requirement in any solution to this problem is that all of the Federal debt must be held by someone at all times, whether by individual investors, corporate investors, institutional investors, commercial banks, or Federal Reserve banks. That is a very vital necessity in any thinking about this subject.

One method for achieving the equilibrium between the supply and demand of loanable funds is to increase the supply. Any method of increasing the supply of loanable funds, assuming a strong demand for funds, increases inflationary pressures unless it is accompanied by an addition to saving through contraction of spending.

This increase is greatest of course when new money that is bank deposits, is created to increase the supply. This is the reason for concern about the purchase of Government securities by the Federal Reserve System, since this may add to the reserves of the banking system and permit the expansion of bank deposits and the money supply by several times the amount of the increase in reserves.

Since I am very deeply concerned with the problem of inflation, I believe it is important to avoid the expansion of the supply of loanable funds as much as possible consistent with a high level of production, but I would like to stress the point that to say that the Federal Reserve should not buy Government securities is no solution to the problem, but only a way of raising the problem, because someone must hold the securities.

The second method of bringing about an equilibrium between the supply and demand of loanable funds is to allow interest rates to rise. It may be presumed that at some point an increase in the rates of interest will cause enough demand for loanable funds to drop out so that the securities of the Government can be placed without requiring an expansion of loanable funds through the increase in bank reserves or otherwise.

There are two major questions here. One question concerns how high the interest rate would have to go in order to cut down the private demand for loanable funds by a sufficient amount to produce an equilibrium. I explain in my statement why I am rather skeptical about the effectiveness a moderate increase in interest rates would have in reducing the private demand for loanable funds.

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The second major question is what harm a high interest rate would do. These matters are discussed in the statement, and I will simply refer to them in the summary.

A third method of bringing about an equilibrium in the supply and demand of loanable funds is to reduce their demand in other ways than through higher interest rates.

The allocations and restrictions in connection with the shortages of material imposed on civilian production, especially investment, when combined with price control may cut down the demand for loans to an important degree.

Price control itself, if effective, reduces the desire for speculative activity and the need for large working capital. Voluntary credit-restraint programs bring the moral pressure of the whole industry to bear on individual bankers and other lenders in holding down their loans. And there are no doubt other methods of achieving this result.

In practice it seems likely that all three of these methods will be used to bring about the equilibrium of supply and demand. Some expansion in the bank loans and money supply can take place without actual inflationary results.

Moreover, to the extent that inflationary pressures may develop because of the difficulties of financing a large deficit in completely noninflationary ways, it is possible to use the various other elements in a general stabilization program to prevent inflation from actually occurring.

The most helpful step, which would not solve the problem but would be very helpful, would of course be to eliminate the deficit and to achieve a budget surplus.

Mr. Chairman, that is the end of the summary of the statement which I have filed with the committee, and in order to expedite the work of the committee, I am ready for any questions that you may wish to ask.

Representative PATMAN. Mr. Wolcott, would you like to ask any questions?

Representative WOLCOTT. No, thank you.

Representative PATMAN. Senator Douglas?

Senator DOUGLAS. Not at the moment.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Blough, I would like to get clear in my own mind what would happen if the Treasury faced a substantial refinancing or new issue if a percentage of that issue found no market whatsoever.

Mr. BLOUGH. What has always happened in the past under those circumstances is that the Federal Reserve System has come to the rescue and has taken up the part of the issue which found no placement anywhere else.

Representative BOLLING. What I would be interested in is what you feel could happen if the Federal Reserve refused to move in and take up that part of the issue.

Mr. BLOUGH. That would depend on the Congress. My own judgment would be that in an aggravated case the independent Federal Reserve System might very shortly thereafter lose its independence through adverse congressional reaction.

Representative BOLLING. You arrive at that conclusion very rapidly but what I am trying to do is to clear in my mind the dilemma that

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would be faced. It is entirely a theoretical question because, as I understand it, it has never happened, but what would the alternative be?

Mr. Blough. To answer your question I would like to refer to the developments between June of 1950 and March of 1951. While I could approach your question without doing so, I believe it may be helpful to deal with that period, since the same general problem is involved, although of course that is not the question you asked.

Representative Patman. It was going to be asked anyway. Dr. Murphy expected to ask you that question, so you may go ahead.

Mr. Blough. It is the same point, one difference being that at that time there was no new financing going on. There was, however, a considerable amount of refinancing, with a weekly turn-over of bills, of something in the neighborhood of $1 billion a week, and certain other refinancing. We had a balanced budget, so the situation was in that respect easier than it will likely be later on.

On the other hand, people were in the grip of a very powerful urge to buy things. I can't stress that point too much; there was a fear that we were going into an all-out war, and a widespread desire to buy things before supplies became short and prices rose. Individuals and businesses bought in advance for later use, hoarding in some cases. Businesses stepped up production and sought to increase their inventories. There was really a very tremendous pressure to buy things and to get the funds with which to buy.

Now how could businesses and people get funds with which to buy things under these circumstances? Well, in the first place many of them had their own funds. They had currency and bank accounts which they could draw on. The economy was very liquid.

The velocity of circulation increased substantially during this period. That increase in velocity might have been considerably greater than it was if funds could not have been secured by borrowing.

In the second place, it was possible to borrow from the banks, thus adding to spendable funds through increasing the supply of money.

It is at this point that Federal Reserve action becomes important. Suppose that the Federal Reserve had during that period refused to buy any securiites from the banks. What might have happened? I would like to use a rather homely illustration which I hope will clarify rather than obscure my point.

Suppose a thousand people urgently desired to go from Washington to Baltimore. This represents the powerful effort to buy goods, which I have mentioned. There are several roads to Baltimore. One of the roads that enables people to go to Baltimore—to spend in buying goods—is the action of the Federal Reserve in buying Government securities. This gives people spendable funds and at the same time enlarges bank reserves, thus increasing the lending power of the banks.

We might say well, we will stop that road to Baltimore. But that does not necessarily mean that the thousand people are not going to get to Baltimore, because, in the second place, there would be the possibility that the banks, if they wanted to increase loans, would discount their paper with the Federal Reserve, that is, borrow from the Federal Reserve.

Senator Douglas. Short-term Government bonds?

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Mr. BLOUGH. I am thinking of any of those kinds of assets which the Federal Reserve will take for rediscount. I am not at this time thinking about short-term Government securities but of any assets of the bank on which the Federal Reserve bank will lend its money, thereby increasing bank reserves and expanding the lending power of the banks.

But the Federal Reserve does not have to discount this paper, as I understand it. It could either say no to the member bank or raise the discount rate to a prohibitive level. While that is quite possible so far as abstract economics is concerned, we must not forget that in setting up the mechanism of rediscounting Congress indicated that the purpose was to accommodate the needs of commerce and business.

Senator DOUGLAS. Yes, but Dr. Blough, I want to point out that this might apply in the case of commercial paper but the Federal Reserve was certainly not set up in order to provide a dumping ground for short-term Government securities. Carter Glass was very specific on that point in the debates.

Mr. BLOUGH. I have not said anything about short-term Government securities, Senator.

Senator DOUGLAS. As a matter of fact isn't it true from the testimony that Mr. Martin gave I think, that the increase in discounts by the Federal Reserve had been discounts of short-term Governments, not commercial paper. I believe he said that discounting of commercial paper had fallen into disuse more than he would like.

Mr. BLOUGH. That as a matter of fact I think is correct, but I believe most of the banks hold adequate short-term commercial paper if they wanted to use it as backing for their discounts, so that there certainly is this possibility.

But whether or not the basis for the discount is the short-term paper or the short-term Government security, my point is this: That the loans which were being demanded at that time were business loans and that under the statute, an important function of the Federal Reserve is to accommodate commerce and business. I am simply suggesting the heavy pressures from the business community that would be brought to bear upon the Federal Reserve if it refused to accommodate commerce and business by discounting paper presented to it by member banks.

But suppose the Federal Reserve was adamant and refused to discount the paper. Well, there is still another road to Baltimore, to continue the illustration. The banks were holding then, as they are now, large quantities of short-term Government securities, some of which were maturing almost continuously. The banks could have allowed these short-term securities to run off, demanding cash instead of resubscribing, thereby increasing the amount of their cash.

Now that in itself would not increase their reserves, to be sure, but it would increase the cash assets of the owners of the securities.

Senator DOUGLAS. How would the Treasury pay for these short-term securities?

Mr. BLOUGH. The Treasury would in that case be obliged to get the funds wherever it could get them.

Senator DOUGLAS. Where would it get them?

Mr. BLOUGH. It could get them from one of two sources. It could attempt in this period of tremendous pressure on the part of all bor-

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rowers for funds, to outbid the market for them and thereby get the funds and pay them to the holders of the maturing securities.

Senator DOUGLAS. It would raise the interest rate?

Mr. BLOUGH. Whatever interest rate was necessary and under those circumstances I suggest the interest rate might have been very high.

Or the Federal Reserve might take the short terms off the Treasury's hands, in which case the Federal Reserve would be again adding to the reserves of the member banks.

Suppose the Federal Reserve refused to take any of the short-term securities? So far as I know this has never happened, but suppose it did happen. Then, at last, all of the roads to Baltimore have been closed except the one road of using the funds that people already have, with greater velocity. There is no way the Federal Reserve or anyone else can stop that.

Now, perhaps the existing funds at the higher velocity would meet the need for spending power, in which case, perhaps, there would be no problem. But to carry my illustration to the end, it seems to me very likely that on this road, which might be much too narrow, the thousand people could become so involved in trying to get ahead of each other as to cause a riot. In other words, if the Federal Reserve had been adamant at all points, it may well be that a major financial and monetary crisis would have arisen.

And if a major financial and monetary crisis arose under those circumstances, either the Federal Reserve would come to the rescue and straighten things out again as best it could at that late date, or, to repeat my earlier thought, I wonder how long the independence of the Federal Reserve System would be permitted to continue by the Congress of the United States. This does not mean that Federal Reserve open-market operations cannot be used with considerable effect, or that the earlier adoption of the accord would have made no difference in the inflationary movement. My point is that shutting off expansions in the supply and velocity of money is not an easy or simple matter.

The same general line of reasoning can be applied to the kind of situation which we might expect to face in the future, but with several changes in the circumstances. On the one hand, we probably would not have that tremendous pressure for funds to support spending that we had during the months from July 1950 to March 1951.

I certainly hope that we do not enter a period of that kind again. If we do not, that will be a change on the good side. The situation would be more orderly and more capable of being handled.

On the other hand, of course, a large deficit is anticipated. If that deficit is realized, the problem on the financing side will be much bigger than it was in 1950.

I do not think the dire possibilities that I have mentioned are at all likely to occur, but to be logically complete we must consider them.

Representative BOLLING. As a matter of fact in this case all roads do not lead to Baltimore. They lead to the Federal Reserve.

Mr. BLOUGH. All but one, and that is the road of increasing the velocity of circulation. I do not think that road should be underestimated in an economy as liquid as our economy is with its tremendous volume of currency and bank deposits, and the large amounts of near moneys that are available. I do not think we should underesti-

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mate the effects of increases in velocity that might occur under the pressure of tremendous desire for increased funds.

Representative BOLLING. Mr. Chairman, I have another question which stems from that, but since this is a whole in itself, if any of the other members had questions on this, I would like to see them have the opportunity to present them at this time.

Representative PATMAN. Any comments?

Representative WOLCOTT. I have a general question. I do not know whether they want to answer it offhand or not, but I found myself the day before yesterday at a loss in what I think Senator Douglas characterized as a semantic wilderness.

I am just a plain unadulterated Member of Congress here without too much knowledge of economics, and most of the people's representatives are not educated in economics and financial matters. I would hesitate to go back to my people and try to explain to them the recommendations of the Council of Economic Advisers as to just what we can do to stop inflation.

Now can somebody, either you or Mr. Keyserling or somebody representing the Council, in very brief understandable language give the recommendations of the Council of Economic Advisers as to what must be done to prevent further inflation, recognizing I think as we all do that we do have inflation.

Mr. BLOUGH. Congressman, I would be glad to try. These comments represent my personal views, but I believe they are also the views of the Council.

We look upon inflation as a problem of spending against supply, spending being Government spending, consumer spending and business spending for goods and services, including building up inventories, buying new equipment and new construction, and so on. When the spending is in excess of the——

Representative WOLCOTT. Wait just a minute. Let's not go into that any further. I think we all recognize that as the problem. You have stated in your last paragraph as follows:

> In closing, I would like to repeat that monetary policy and debt management are by no means all there is to the problem of economic stabilization or its solution. The inflationary problem is one of holding down total spending, not simply that relatively small part which is financed by increases in debt, public and private. A well-balanced stabilization program using all the other measures at the disposal of the Government should go along with a monetary and debt-management policy that itself should be to the largest practicable extent non-inflationary, despite the handicap placed upon it by that basic inflationary influence, too little revenue to match expenditures.

That to me is a statement of our problem. Now I want to know what the Council suggests as a remedy, as a solution to the problem.

Mr. BLOUGH. I see I started my answer at too basic a level.

Representative WOLCOTT. Is it more taxes, is it less spending, and in what fields can there be less spending and how can we increase taxes, if that is the position?

I would like to have you put one, two, three in simple terms your recommendations as to what we might recommend to the Congress, what we should do here as a matter of administration that will solve this problem.

Mr. BLOUGH. I think you will find, Congressman Wolcott, that the views of the Council have been expressed in the reviews of 6-month periods, and they involve the following points in the program. First,

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there is spending. Obviously Government spending is very largely the genesis of the problem at the present time.

Representative WOLCOTT. Why should it be? Please explain how Government spending affects the value of money?

Mr. BLOUGH. All the different kinds of spending put together—if the total is in excess of the supply of goods when people are fully employed, the demand being in excess of the supply drives prices up.

Representative WOLCOTT. Again, can we have an answer to the question as to why spending on the part of the Government or why deficit financing results in inflation?

Mr. BLOUGH. I think that what happens is this. Suppose you had a fully employed economy with the Government spending $40,000,000,000.

Then with the Government spending $40 billion, and with business spending and consumer spending—all the spending added together is taking all of the goods and services which all of the people are producing working at a high level of employment and a high level of plant operations.

Now suppose that the Government undertakes an additional program, that involves, let us say $20 billion additional spending. This $20 billion is used to buy goods and services of various kinds. It is used to pay military personnel, to buy tanks, planes, food, clothing, build military bases, and so forth.

That $20 billion is added to the spending that is already taking place by the Government and business and consumers. But there is no increase or very little increase in the supply of goods to meet this increase in demand of $20 billion on the part of the Government.

Unless some way is found either to increase the supply of goods without also increasing consumer and business spending or to decrease such spending, we will inevitably get an inflationary pressure.

Representative WOLCOTT. That is fundamental. Now what do you suggest is the remedy?

Mr. BLOUGH. Since increased expenditures give rise to the problem, if it were possible to reduce expenditures, as I said before——

Representative WOLCOTT. What does the Council recommend by way of reducing expenses? In what field do we reduce expenses?

Senator Douglas has said every time we try to cut expenses, from the White House down we have a barrage of protests, so that apparently is not the practical solution so long as we are going to be faced with executive opposition, that probably is not the practical way of solving this problem.

Mr. BLOUGH. There has been a good deal of reduction of nondefense expenditure in the past 2 or 3 years. It is possible there could be more. The very large part of this problem, however, is in the military side.

Representative WOLCOTT. You say it is possible. What can you recommend in that field to us?

Mr. BLOUGH. I am not qualified to make recommendations in the military field. I am sure you will find plenty of people who will recommend specific points to cut.

Representative WOLCOTT. People in Government?

Mr. BLOUGH. Some people in Government but no doubt mostly people outside of Government.

The budget process, Congressman Wolcott, as you know cuts down the request for appropriations and expenditures by many billions of

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dollars before these programs ever get to the Congress, so that all of the work which has gone before to cut down and hold down expenditures never is observed by the general public, which sees only the figure that is presented to Congress, and which always looks larger in total than anyone would wish.

Representative WOLCOTT. It is getting larger and larger all the time.

Mr. BLOUGH. The only figures that are getting larger and larger are the military expenditure figures. Even the military appropriation request figures are lower this year than they were last year.

Representative WOLCOTT. But still we have inflation.

Mr. BLOUGH. We have inflation because——

Representative WOLCOTT. We are raising more money than we ever raised before.

Mr. BLOUGH. But we are not raising enough to meet——

Representative WOLCOTT. Is that your point, you have got to raise more by taxes? In other words, have we got to continue throughout the next 8 or 10 years to siphon off inflation through taxation, and if so where do we reach the saturation point?

Mr. BLOUGH. My point is that the source of the problem is in military expenditures, and the amount of those expenditures is determined to an overwhelming extent by forces pretty much outside our control.

Representative WOLCOTT. That contemplates a continuance of debt——

Mr. BLOUGH. Not necessarily, sir. Higher taxes can prevent an increase in debt and also reduce inflationary pressures. In order to cut down private demand, the most positive way is of course to take funds out of the private economy through taxation.

This has the advantages that it pays the cost directly, immediately through taxes, does not add to the debt, and does not give rise to some of the problems we have been talking about.

It cuts down on private spending, and that is the natural and normal way for cutting down inflationary pressures growing out of governmental spending. It has been the accepted way used in the United States throughout our history.

Representative WOLCOTT. Now at what point in this tax structure do we arrive at the floor of diminishing returns due to a discouragement of production expansion to keep pace with our expanding economy?

That is the problem and the thing that has bothered me. If industry, individuals, agriculture have to get their capital out of earnings, how much of their earnings can we take before we destroy the capital structure which is the foundation that has built this production expansion, which we all agree is necessary to keep pace with an ever expanding economy?

Mr. BLOUGH. You ask for the point of diminishing returns for the tax system as a whole. I don't know the answer to that.

Representative WOLCOTT. I think you should find the answer. Unless we just give encouragement to a lot of the platitudes in respect to the desirability of siphoning off this inflation through taxation, I think we had better find out before we go any further as to whether we perhaps have not reached the point now where we are discouraging production expansion to keep pace with our expanding economy, because if we have done that then, of course, any increases that we have legislated in taxes last year and in the future under your recom-

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mendation might be inflationary, by prohibiting us from producing sufficiently to meet the demand occasioned by the increase in savings and purchasing power.

Mr. BLOUGH. Congressman Wolcott, perhaps I might have been better advised to say what I think we do know about tax limits rather than to start out by saying that I don't know what the specific point is.

Representative WOLCOTT. I want to get away from that idea. I think the Council of Economic Advisers should put in a very orderly manner and very simple terms their recommendations as to what the Congress, what the Federal Reserve, what the Treasury and all the rest of them, should do to prevent inflation. I think that is what we are here for.

Mr. BLOUGH. I would like to follow up on the point about the limit of taxes. I said I do not know where that limit is, but I intended to go on immediately to say that there is no evidence that I can observe at the present time that during this period of very large Government spending we have reached or in any way closely approached the limit with regard to the burden of taxes in general.

There are two kinds of problems. One is the distribution of the burden, the other is the total burden.

Neither the distribution nor the total burden seems at the present time to be interfering with the accumulation of large amounts of funds by businesses, the reinvestment of those funds in businesses, and a very high level of industrial growth and expansion. The signs are not there that taxes are interfering with the growth of the economy.

Now, certainly we must have in mind the danger that they might interfere with the growth of the economy, and I am not saying that if the expenditures were to be greatly reduced the present level of taxes would not interfere with the growth of the economy.

Representative WOLCOTT. Do you think we are getting enough production now to meet nondefense demands and the military demands?

Mr. BLOUGH. The increase in production is not being limited by the willingness or financial ability of business to expand. There are always exceptions, of course.

In the soft-goods industries there could be somewhat greater production if consumer spending were higher. In the hard-goods industries materials also are an important factor limiting production. In the defense industries there could be a somewhat larger and more rapid increase of production if plants and facilities were more quickly available. They have to be constructed. There are some important shortages.

Representative WOLCOTT. You have got facilities in the automotive industry to produce at least 40 percent more than they are producing now. You have a very serious unemployment situation in Detroit and in some other areas in the United States.

We can't convince any of the members of the CIO or the AFL out in Detroit that something serious is not happening to them.

Mr. BLOUGH. Congressman Wolcott, until we have reached the point where we have an adequate supply of these materials, we will have to shut down somewhere. In other words, this is a process of diverting——

Representative WOLCOTT. Now you bring up the availability of materials. We are told repeatedly that the big bottleneck is in cop-

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per and there isn't any particular shortage of sheet and wrought steel. Warehouses are so full of it that they have difficulty finding places to store it.

Mr. BLOUGH. It seems to have been discovered only in the last couple of weeks, and only in some specific items.

Representative WOLCOTT. It was discovered by me last fall. A Toledo warehouseman came to me and said, "We don't know where we are going to put another ton of steel. We can't dispose of it."

There are a lot of steel warehousemen out there who are finding it difficult to warehouse this steel. They would like to move it into industry, and the men employed in industry would like to have this steel moving into industry, but that is an entirely different situation.

It is a little outside the scope of our discussion here, perhaps, but you haven't come up with a suggestion yet. What is the one phase of your program that you would recommend to stop inflation?

Mr. BLOUGH. I have already talked about two methods that are involved in inflation.

Representative WOLCOTT. Taxation?

Mr. BLOUGH. That, of course, is a very fundamental method, and some people think it would be enough all by itself.

We have recommended credit restraints; both the general control of credit and specific methods of restricting the use of credit in purchasing durable goods and new houses and in stock market operation.

Representative WOLCOTT. As to discounting, the Federal Reserve has all the authority it needs in that field, and they have not been able to agree yet on recommendations with respect to increasing bank reserves. As a matter of fact, I think Mr. Martin indicated that increased reserve authority probably would not be advisable.

I know here a few months ago when we asked him about the reserve situation, whether they needed any additional legislation, they could not agree as to the advisability of it or how much, so it seems as though somebody has abandoned the idea of shutting off credit by either arranging rediscount rates, reserve requirements, and yet they all admit that the pressures on inflation have been lessened by the actions taken in firming up our money policy.

And I think it is quite generally agreed that if we do not do something to firm up the dollar here, pretty soon it is going to have an effect upon the world economy, and I might say, to be a little dramatic about it, this world has no hope of peace unless the American dollar is firmed up pretty quickly.

Mr. BLOUGH. Let me proceed with the list that you have asked for. Firming up the American dollar is stopping inflation, that is all.

One of the methods of credit control is the increase in reserve requirements. The Council has favored an increase in reserve requirements.

Another method is the allocation of materials to those needs which are most important. Such allocation is desirable not only for promoting the defense effort and for building up the productive power of the economy but it is desirable also to prevent the pressure of competing demands in the markets by businesses trying to get these materials and bidding the prices way up. So allocation and priorities is an important anti-inflationary method.

Another method of restraining inflation, of course, is the direct controls, price control and wage controls, which were put into effect a

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year ago this last January, and which were, I think the turning point in this inflationary movement.

Representative WOLCOTT. You say that the Federal Reserve takes the attitude that bonds issued ought no longer be monetized, increased its rediscount rates, and discovery that to support the Government bond market above par was inflationary, so they discontinued that.

They maintained that that was the cause, but you fellows in government, if you can't get together on the causes of inflation, how do we in Congress expect to solve the problem?

Mr BLOUGH. I don't think there is any inconsistency.

Representative WOLCOTT. We have had this controversy between the White House and the Treasury on one side, and the Federal Reserve on the other, as long ago as the Douglas committee met. We got together, I thought, in a pretty good way.

As a matter of fact, Senator Douglas surprises me. When he first came into the Senate here I had some pretty crazy ideas, I find now, about what his policies might be.

Senator DOUGLAS. You are becoming a better Democrat every day.

Representative WOLCOTT. We are getting so close together that I am either becoming a better Democrat or you are becoming a better Republican. Anyway, we found ourselves so closely together in that report that instead of filing a minority report I just dissented to some minor technicalities in a few footnotes.

Yet we recognized this same problem 2½ years ago. We thought that by cracking some heads together we might be able to get somewhere, and I do think we had some executive sessions between the Treasury and Federal Reserve, and two years afterward they met their accord.

I would like to think that the accord machinery was started at that time. Two years afterward they met in this "accord." What further should be done in addition to that accord to stabilize our economy, stabilize our money?

Mr. BLOUGH. May I clean up one or two loose ends that have gotten away in the previous discussion?

I said I thought it was the imposition of the wage and price controls in January of 1951 that was the turning point. Before that time there was a tremendous psychological churning, a mass movement of demand for goods.

People had been talking about price and wage controls. There was an expectation that they would be put on. Prices were being pushed up, not only because of demand and supply factors, but in order to get ahead of whatever the control would be.

Wages had been pushed up also for the same reasons. There was a fever in the air. The price and wage freeze did, I think, put a psychological freeze on the public mind.

It was then discovered that inventories had been built up very rapidly, that war shortages were not going to be felt as soon as had been anticipated, and that instead of shortages there were plenty of things to be bought. The Federal Reserve action, which came about the same time, unsettled the investment side of the market, and I think all of it worked together toward quieting down the inflationary movement.

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In my opinion, the turning point in this movement was the freeze of prices and wages in January, but I do not think that view is inconsistent with recognizing a measure of benefit from the action which took place a little later on by the Federal Reserve.

Representative WOLCOTT. I do not want to take any more of the time of the committee, but I do wish that I could have an answer to my questions.

This committee is trying to work very closely with the Council of Economic Advisers. Make some definite suggestions as to what we might recommend to the Congress in our report by way of a program which will stop this inflation. If you do not, the value of the dollar having already dropped 6 percent in the last 18 months, with the impact on defense spending coming up sometime in the next couple of years, we can anticipate over the next 3 years a further drop in the value of the dollar of about 12 percent, bringing the value of the dollar down to 40 cents.

That is the problem we are confronted with here and we have to find a solution to it. I think you owe it to us members who are not ecoonmists who find it rather difficult to understand what you are talking about, to put in very simple terms what we can do to stop inflation.

Mr. BLOUGH. May I say that I do not share alarmist expectations about further rises in prices.

It seems to me our adjustment to the military program is fairly nearly completed. I do not anticipate the kind of increases you have suggested.

Representative WOLCOTT. Right there, do you think that in the next 2 or 3 years that we are not going to have any more inflationary pressure than we are having at the present time?

Mr. BLOUGH. I did not say that.

Representative WOLCOTT. What was the import of your remark?

Mr. BLOUGH. The import of my remarks was that my hope, my expectation is that we will not have serious inflationary pressure.

Representative WOLCOTT. What is your opinion?

Mr. BLOUGH. My opinion is—of course no one knows what is going to happen—we will not have nearly as strong inflationary pressures over the next 2 years as we have had in the last 2, assuming no international flare-up.

Representative WOLCOTT. Are the pressures going to be greater or less than they are at the present time?

Mr. BLOUGH. At the present time we are in a rather—the word "lull" has been used. I have used it myself. There is a sideward movement in business. I am somewhat disturbed about the impact of the deficit which will begin to show up in new borrowing before very long.

Representative WOLCOTT. That is what I had in mind. If we continue this policy tying the value of our money to debt, we might expect we will have to indulge in deficit financing between $10 and $20 billion in the next 3 years, with the influence deficit financing has had on the dollar, then how can we avoid further depreciation in the value of the dollar?

Mr. BLOUGH. In the relation to the total budget, those amounts will not be nearly as large as they may seem in absolute terms. But the Council has indicated the desirability of higher taxes.

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Representative WOLCOTT. You recommend that we raise taxes by $10 billion?

Mr. BLOUGH. No. If I recall correctly, we recommended that taxes be raised by about $5 billion at this time. There can be some noninflationary borrowing.

Representative WOLCOTT. You would still have deficit financing by $5 or $6 billion.

Mr. BLOUGH. Suppose the deficit should amount to as much as $14½ billion, which is the figure in the budget. I don't know how much it will be; that is pretty far ahead to look. The budget has to look far ahead.

Suppose the deficit amounted to $14½ billion. About $4½ to $5 billion is received by the trust funds in excess of the payments from the trust funds. That leaves roughly $10 billion.

If Congress accepted the President's recommendation for an increase in taxes of $5 billion, that would leave $5 billion to be borrowed in the open market.

Senator DOUGLAS. Why not cut expenditures by $5 billion?

Mr. BLOUGH. If Congress decides that can safely be done, I would not object.

Senator DOUGLAS. What I very frankly object to in the report of the Council of Economic Advisers is that it did not indicate the need for cutting expenditures. I know it is difficult for one branch of the executive to criticize the actions of another branch of the executive, and so I can quite well understand the difficult position in which the Council was placed.

But if you offered advice to Congress as well as to the Executive, which I understood Mr. Keyserling said he regarded as a proper function of the Council, we would like to have you offer advice to us with that same degree of frankness which you undoubtedly exhibit to the Executive.

Representative WOLCOTT. Will you put in the record language which I can understand as to your recommendations?

Mr. BLOUGH. We can try again, if you wish, Congressman Wolcott, but I think if you will examine the answers I have given to your questions during the last few minutes, you will find that I have given a list of measures which, if adequately followed through, would bring this inflationary pressure under adequate control.

Senator DOUGLAS. Is this a cruel question? In your capacity as an adviser to Congress now, do you advise Congress to cut expenditures by $5 billion or would you prefer not to answer?

Mr. BLOUGH. I always like to answer your questions, Senator, whenever I can. Let me say that I consider myself completely at liberty to discuss with Congress economic trends and developments, the effects and implications of governmental policies, and the different ways in which various policy objectives can be achieved. I am very pleased to have an opportunity to do this, and I try to do it in as objective a manner as my basic attitudes permit. However, in view of the budget-making process, a definite recommendation on expenditures, it seems to me, is advice that I can more properly give to the Executive than to Congress.

Senator DOUGLAS. I want to say there is no moral wrong attached to your not advising us on this matter.

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I would like to point out moreover that this is the situation which we are placed in: that the Council of Economic Advisers when it offers advice to the Congress does not ever feel it can offer advice contrary to the recommendations of the Executive.

I think we have now put our thinking on an extremely important point of Government structure, which means that once the decision is made by the Executive, the Council of Economic Advisers, whatever advice it may have previously offered, the Executive then cannot go contrary to the decision which the Executive has taken and Congress therefore has to proceed on its own.

Representative BOLLING. Isn't there another factor involved there? The Council of Economic Advisers is not the agency that advises the Executive as to the level that is necessary for military expenditures.

Yet its problem when that level is in its judgment going to have the effect of seriously damaging the economy, it then would come within its perview to indicate that the level of expenditures was damaging to the economy, but to that degree they are not the agency that makes the decision by any means.

Senator DOUGLAS. That is correct, it is the President who makes the decision.

My point is that once the decision is made, then the Council of Economic Advisers apparently cannot offer to us the same frank advice which I hope they offer to the President.

Representative BOLLING. But they could be considered to be in a position of having indicated implicitly that they did not think that the economy was going to be damaged by a controlled deficit of $5 billion. There could be very serious areas of disagreement in that.

Senator DOUGLAS. That is right.

Mr. BLOUGH. I am prepared to say that I think there is no serious problem in managing a cash deficit of $5 billion under these circumstances.

Representative WOLCOTT. They should be a little more explicit in their recommendations.

Senator DOUGLAS. Well, Congressman, as you know, Senator Benton and I have prepared a supplemental opinion to the report of the congressional committee proposing a reduction in expenditures of 7.6 billions and an increase in revenues of 2.4 billions to balance the budget. I hope we can get your support.

Representative WOLCOTT. You surely can on the reduction of expenditures. I might have to take another look at your recommendations to increase taxes.

Senator DOUGLAS. With the reduction in expenditures that would leave a deficit of about 2½ billion, and if a deficit of 5 billion does not seem too serious to Mr. Blough, I am sure a deficit of 2.5 billion is only half as serious.

Mr. BLOUGH. It is less than half as serious in my judgment.

Senator DOUGLAS. This is a very grave question. I do not know that it is the fault of the Council, but I think it indicates that the Council in the political nature of events becomes primarily an adviser to the President, and cannot be as frank an adviser to the Congress.

Representative BOLLING. Perhaps, Mr. Chairman, it would not be inappropriate to suggest that the chairman of the Council comment on that.

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Representative PATMAN. Yes; I think it would be a fine thing. Would you like to, Mr. Keyserling?

Mr. KEYSERLING. Yes; I would like to comment.

Representative PATMAN. Suppose you pull your chair up next to Dr. Blough. We would like to have your comments.

STATEMENT OF LEON H. KEYSERLING—Resumed

Mr. KEYSERLING. Yes, I want to comment on two things. First, on the question that Senator Douglas has raised as to the role of the Council, and whether or not it is in a position to express itself frankly.

Senator DOUGLAS. Frankly to the Congress that is.

Mr. KEYSERLING. To the Congress, and second on the question raised by Congressman Wolcott, which I think is very pertinent.

As to the first question, I have always felt that I should comment as frankly to the Congress as to the President.

I have always felt that if the President on any fundamental matter of economic policy which as a public servant of integrity I felt departed from my—I am using the personal pronoun here because I do not want to involve my colleagues in this—I have always felt that if the President in any recomendations which he made to the Congress on economic policy departed from the advice that we gave to him to the point where a public servant of integrity felt that he was fundamentally repudiated, that such public servant ought to resign and not give the color of his approval to the recommendations of the President.

Now of course that involves questions of degree. Nobody would claim that a man of integrity in the Government service resigns every time the President adopts some variation from his suggestion, because that is the proper nature of the Presidential office.

But I have felt that basically on major matters people in our position are really in no different position from an adviser in another field, in the field of international policy, in the field of what is needed to protect the country, and that we should stand before the Congress in the same light that we stand before the President as men of integrity willing to support anywhere advise that we give anywhere, insofar as it does not violate confidence.

Now coming to the second point—if I have not covered that point fully——

Senator DOUGLAS. Let me listen before I ask a question.

Mr. KEYSERLING. Now coming to the second point, the second point has to do with the Economic Report submitted to the Congress in January which set up certain proposals with respect to the disposition of our resources between public spending and private endeavor, and that gets into the substantial question, Senator—and I will try to be very frank with you on that—the question of public spending and the deficit.

My view is that an inflationary situation is caused when an effort is made to use our total resources more rapidly than resources are available for their use. That effort is made through spending.

Consequently the inflationary pressures increase as the effort to spend increases faster than production increases, and I think that this is implicit in the general definition here of inflation, trying to do too

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much too fast, trying to take more out of the economy by way of enjoyments than the economy is producing by way of goods and services.

And that is why I have always believed, and I think Congressman Wolcott would agree, that in the long run the solution to the inflationary problem is to do as much as you can to expand your output, use your technology and not cramp it through excessive controls.

Now in the short run, after the middle of 1950, I would say that the inflationary situation rose for these reasons, and I covered them in the beginning of my prepared statement:

The Nation was trying to do three things, three basic things: Use resources for the building of capital equipment by private industry. That is what I refer to as investment in the broad sense.

Use resources for consumption, which is the second great purpose, and use resources for Government outlays, including an expanding security program, which is the third great purpose.

I think the inflation occurred because the Nation was trying to use resources for the total of those three purposes in excess of what the economy would support at its then available productive capacity and, consequently, well, there are lots of ways you can state it. You can say demand exceeded the supply, or the effort to spend money exceeded the available flow of goods, and that caused the inflation.

Now the way to deal with that situation in the final analysis gets down to one thing. Until you can solve the problem through production, which you can't in the short run, you must cut the demand.

Now the next question is where do you cut the demand, and it is in the approach to that question of where you cut the demand that I begin to make some suggestions which are rather novel to some phases of economic thought, although they are I at least think sound.

When a government undertakes through a series of policies to cut demand, it must consider national priorities. That is the essence of it.

When the Government is undertaking to cut demand, whether through a cut in public demand through the reduction of public outlays, or through a cut in private demand through higher taxes, or through a cut in private demand through reducing the volume of house construction, it must consider national priorities.

In other words, it can't say that as a matter of national priority the appropriate first cut in demand is always public outlays.

Now I think as a general statement this is self-evident, because otherwise you would say we should cut the defense program to zero before we attempted to make any cut in private demand through national policy, and nobody would say that. So it comes down to a matter of the priorities which the Congress as the ultimate arbiter of national policy wants to apply in cutting down demand.

It has been my personal view that far from—I do not want to introduce a political note in this—far from cutting Government spending being a hard thing, I think there are some harder things politically than cutting public outlays for national defense, and I think personally that some of those harder things are what might well be considered in this situation.

For example, it seems to me that the level of general consumption by the American people in 1950 and 1951 was too high as measured against our resources and what it seems to me we need to do to help make our contribution to world security. Therefore, since you asked for frank advice—and it may be wrong—I will give it to you.

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I think the first thing that should have been considered constantly from 1950 until the current time is whether there should not have been more of a cut in the level of consumption. Now, that is not politically easy to do, and I am not giving you——

Senator DOUGLAS. How would you do that, through an increase in taxes?

Mr. KEYSERLING. A variety of ways. I think an increase in taxes is very important if the taxes are imposed at the right points.

Representative WOLCOTT. Rationing?

Mr. KEYSERLING. I do not think the shortages were great enough to entail the administrative difficulties of rationing. If the shortages were great enough, yes, but I do not think they were.

Representative WOLCOTT. They have not developed yet?

Mr. KEYSERLING. No, sir, not to that extent but I would say that the first thing that I would advise you—of course, that is predicated on a judgment noneconomic in character as to whether the world situation calls for a big security program.

Senator DOUGLAS. Dr. Keyserling, what about the possibility of a reduction in governmental expenditures? Can you say that every dollar is necessary to national security? What about wastes in the civilian branch and what about wastes in the military branch?

Mr. KEYSERLING. I think I am addressing myself to that problem and will cover it a little more fully, but I am saying one cannot automatically say, since the problem is one of national priorities—and I think that proposition is incontestable—that by definition you should make all of the reduction to the level of total demand which can be supported by the output of the economy in reduced public outlays before you consider reduced private outlays.

Now, if you have an economy which is producing $320 billion of goods and services and $200 billion of that, roughly, is in personal consumption and $60 billion of it or $70 billion of it, roughly, is in public outlays, and $50 billion or $60 billion of it, roughly, is in private gross capital formation, I think you have to look at all three of them and to say in terms of the priority of our national purposes, admitting that you have got to cut somewhere and probably cut everywhere, what types of cuts will do us the most good and the least damage in the long run.

Now, by those criteria—and I do not think the criteria can be seriously challenged—I would say where we have made our greatest error thus far is in trying to be too easy on cuts in consumption.

And that I would feel that we were safer as a nation and still adequately supplied with the good things of life if we cut a little more heavily on that before we cut too heavily on foreign aid and the defense program.

Senator DOUGLAS. You would favor an increase in taxes more than a reduction in expenditures?

Mr. KEYSERLING. I would not automatically assume in terms of true economic and national security that a cut in the amount of our resources going into security was preferable to a diminution of our resources going into consumption.

Senator DOUGLAS. Are you defending the position that there is no waste in Government?

Mr. KEYSERLING. No, but I think there is waste also in private outlays.

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Senator DOUGLAS. I understand, but we have little control over private outlays and lots of control over——

Mr. KEYSERLING. You have tremendous control over private outlays. Take the question of capital formation. Now, as a matter of fact, Senator, when you identify as one of the main areas for economic policy this monetary policy, that is directed toward contracting the availability of funds for private outlays. It does not affect the volume of public expenditures.

The volume of public expenditures is determined by appropriations and authorizations by the Congress, so you yourself have identified the importance of private outlays in this inflationary situation. Now I am saying this——

Senator DOUGLAS. I do not want to use this verb, but why do you move attention to everybody except the governmental budget which is before us?

Mr. KEYSERLING. I am not moving attention away——

Representative BOLLING. Mr. Keyserling, before you proceed, I would like to interject at that point. I do feel very strongly a rather exaggerated amount of attention is paid to Government expenditures as opposed to the attention paid to these other approaches.

Mr. KEYSERLING. I want to carry it a little further, Senator, and I do not think that either my originally prepared statement or what I want to say now goes against the point that you should attempt to squeeze waste out of Government outlays, and I want to say a little bit more about that. But I am trying frankly to answer Congressman Wolcott's question.

I am saying that, begining in the middle of 1950 we had an inflationary situation because we were trying to do three things in total too fast against our resources.

The total of business invesment, of public spending, and of consumption was too high, and the only way you could have avoided the inflation and the only way you can avoid its recurrence is not letting the total of those three things get higher than our resources can support. And you have got to face that problem.

Representative WOLCOTT. Wasn't the overproduction between Korea and 1951 due largely to the threat of allocations?

Mr. KEYSERLING. I did not indicate an overproduction.

Representative WOLCOTT. I thought you did.

Mr. KEYSERLING. Overbuying.

Representative WOLCOTT. I have been under the impression that you have all agreed more or less there was an overproduction in the first 8 months succeeding Korea, which filled up our inventories and filled up the pipelines to the point where the impact of defense spending was not felt.

Mr. KEYSERLING. I think there was an overaccumulation of inventories, certainly.

Representative WOLCOTT. Then there was an overproduction, wasn't there?

Mr. KEYSERLING. Well, there was an overultilization of resources for that purpose. I think if those resources had been used instead to build more plant capacity or to build more end fighting weapons, we would have been better off, yes.

But the point I am making is, let us take the business investment as one example of it. One of the very important factors in the inflation

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during the time that prices were moving upward—and I would like to say something about the question of whether we are still in that situation—we had in the first half of 1950 a $44 billion level of business investment. We had in the second half of 1950, as I recall, a $54 billion annual rate.

Now, of that $54 billion in business investment, $5½ billion was net inventory accumulation, which was too high. You take that off, you have still got $48½ billion, which was very high.

Now I say that one part of the problem of controlling inflation was to consider as a matter of national policy whether the allocation of resources to that purpose, which I consider one of the three sides of the triangle, was too high on some scale of national priorities. I think you have to have a scale of priorities whenever you start cutting anything.

I am inclined to think it was. In other words, I think for example that a million and a quarter houses in 1950, 1,100,000 houses in 1951—nobody knows better than Congressman Wolcott that I am a housing enthusiast, but I think measured against our total resources in that period, that it was too much, and I say that I would rather see that cut some more than to see our defense build-up cut.

Representative WOLCOTT. Yet you found in the economic report that we would have to produce, what was it, a million and a quarter houses for the next 10 years to meet the normal——

Mr. KEYSERLING. That was an estimate of the need for high-level employment prior to the emergence of this new defense situation, Congressman.

Representative WOLCOTT. You found also it should be cut to 800,000 or 850,000 this year, but you insisted—talking now about cutting Government expenses—that the same number of public housing units be constructed under an 800,000 unit program that you built last year under 1,100,000.

Mr. KEYSERLING. As I recall, Congressman, the number of public-housing units per year is somewhere in the neighborhood of 50,000 or less, and the very point I would make on this is that as you cut the total product, you have to consider more closely the priorities of national need.

Representative WOLCOTT. Wait, we should not have gotten into this, but do you think the Government can build houses with less material than private enterprise?

Mr. KEYSERLING. I think when you cut the housing output from a million and a quarter a year to 850,000 a year or 600,000 a year, you have got to be even more careful that the very limited supply goes where it is needed most.

Representative WOLCOTT. You say it is needed most in public housing or private housing?

Mr. KEYSERLING. I would say that workers moving into crowded defense areas are less likely to be suitable to home ownership and to paying the current costs of home ownership and current rentals of privately built housing than the mass of the population which is necessary to consume a million and a quarter units of housing.

Representative WOLCOTT. I wish you had not brought up this question of housing.

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Senator DOUGLAS. I was just about to say that this beautiful friendship which has been sprouting between us is now being strained to its very limits.

We will give a little relief to the hard pressed Keyserling for a moment to say we contemplated the level of public housing for the slums a little over 200,000, and the total housing production of 1,250,000 units. Now we have accepted a cut to 50,000, one-fourth of this figure, when the total number of private units goes down from 1,000,000 to 750,000. We have accepted a cut of 80 percent where there has only been a cut of 25 percent on private housing.

Now you would like to abolish this completely. You live in a beautiful residential city in between the Lakes there at Port Huron, but you go into any major city in the country and you will find the slums rocking the population away, so on this point please, Jesse, don't disturb this new found alliance between us.

Representative WOLCOTT. I want to mention that this mansion in that very beautiful city is almost a mile away from the river, and it probably would be comparable to many of the slums in other cities. I find it difficult to maintain a $5,500 valuation on it.

Senator DOUGLAS. I would suggest, Jesse, if we want to keep in closs alliance on this matter, don't push Mr. Keyserling too far on this public housing.

Representative WOLCOTT. He says in his economic report there were 75,000 started last year and there should be the same number of public housing start this year, although he is cutting the over-all production of housing units from 1,100,00 to 800,000.

I can't reconcile the fact that percentagewise it should be a greater percentage of public housing units this year than there was last year.

Mr. KEYSERLING. Congressman Wolcott, I have been talking about the allocation of scant resources, and for the benefit of some of the Members of Congress who have not been here as long as you have, I just want them to know that you and I discussed this housing question at considerable length at various times.

Representative WOLCOTT. 1937, 1939, and then it went to sleep until the Eightieth Congress came in.

Mr. KEYSERLING. I will come back to the housing thing, but I would like to spend a minute on the general idea I was developing and addressing to the Congressman's question.

I am simply saying that, when we found we had a new security burden, the size of the security burden, the pace at which our private capital formation was proceeding, and the pace at which consumption was proceeding, was during that inflationary period higher than we could support. We could not do all those things at once so fully.

Now I think that insofar as the Congress is dealing with national policy, is has to decide on a basis of priorities which things it is best to cut first or to exercise pressure to cut first in the interest of the Nation.

Now I am perfectly willing to admit, as a believer in the enterprise system, that where other things are equal, you should cut Government spending first, because other things being equal, if you can accomplish result A through private spending or through public spending, you cut the public spending first.

But all public spending is based on the theory that you are accomplishing certain things in that way that you can't accomplish through

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private spending. That is the only justification for any public spending.

Therefore I say the basic question that has to be decided is what do you think we can better afford to cut, the amount of resources being consumed by the security program, the amount of resources being consumed by the industrial build-up, or the amount of resources being consumed by 155,000,000 consumers generally. That is the first issue of national policy.

Now when you address yourself to that issue, then you have the next question: How do you do it? And that is where you get to the tools.

Now I happen to think we should have placed more restraint upon $54 billion of capital formation, for one thing. What are the tools available for that purpose?

Well, taxation is a general tool that helps to do that, and consequently we were in favor of higher taxes.

Specifically, the so-called selective controls are another method of doing it, and that is why we were for some of the selective controls to cut down on the volume of housing.

Allocation of materials is another way to do it, and that is why we were for some of the allocation controls, again to cut down on the volume of housing and some other nonessential things.

So much for the business side. You have taxation, you have allocations, you have limitations on the use of materials, and you have this tool on which Senator Douglas has placed emphasis, and I want to say again that I think that is a tool that can be used in moderation to cut down on excessive business boom.

The only point I made about it is that if you push it too far, you are likely to cut down on the general increase of production or the general expansion of productive facilities on a nondiscriminating basis.

Senator DOUGLAS. Is this a cruel question, Mr. Keyserling? If so, I do not wish to play the part of Torquemada, but do you advise reduction in the total expenditures of the Federal Government?

Mr. KEYSERLING. Let us take that bit by bit. Senator, one of the things——

Representative WOLCOTT. You mean these are the trees in the semantic wilderness now?

Mr. KEYSERLING. No. One of the things that stirs me on this is that I read with enormous admiration the Senator's article in the New York Times of a few weeks ago, and and first few pages of that particularly, pointing out the size and pace of the Russian military build-up. The more recent figures which have come out point to the fact that they are putting 30 percent of their more limited resources into a military build-up, and all the cogent arguments which you there advanced make me feel that the allocation of our resources to national security is not too high against our wealth and strength as a nation.

Now I think that is a separate question from the question of waste. I think that if by specific examination you can find that the amount of national security which is being produced for $50,000,000,000 or $55,000,000,000 can be produced for $40,000,000,000 or $45,000,000,000, of course that should be done, and I commend the Senator and I commend Congress and I commend anybody who is trying to do that.

But I do not think that this is the same thing as saying that we can get along with less security or that automatically a reduction of

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funds allocated for security from fifty or fifty-five to forty or forty-five is going to produce that kind of economy. It may just produce less security.

I think they are two separate questions in the field of national security just the same as in the field of private outlays. My basic position is that I do agree that through better procurement policies, better scheduling policies, and more intense pressure on the part of the Congress, which I applaud, that the military can get a lot more per dollar spent, and that if they got a lot more per dollar spent, they could get a given volume of security with several billion dollars less.

But that seems to me to be confused with the quite separate question of whether we are allocating too much of our productive resources to national defense. There you can't apply an economic judgment. You might call it a policy judgment, you might call is a subjective judgment. There I happen to feel that we are not; and that, on the contrary, what we are not foregoing enough of is in civilian enjoyments on a lush level and all kinds of private capital formation, and I would regard that as a very important guide to policies in these times.

I would like to see more efficiency and competence in the security outlays combined with a larger net allocation of our resources to security in the broader sense, because I think we can do that without carrying the consumption level of 155,000,000 people below very well-sustainable levels, and without carrying business development below levels very consistent with building up our productive strength and our tools and our equipment.

Now, of course, that is a noneconomic judgment, but the Senator asked me to express frankly my views on this subject.

Representative PATMAN. Do you have any other questions, Mr. Bolling?

Representative BOLLING. I think mine have been covered.

Representative PATMAN. Mr. Douglas?

Senator DOUGLAS. No.

Representative PATMAN. Mr. Wolcott?

Representative WOLCOTT. No.

Senator DOUGLAS. Senator Flanders could not be here today. He asked that it be stated for the record he has read your statement, Dr. Blough, and he commends it.

I don't believe I have any further questions. We want to thank you very much for your attendance and your answers to our questions and for the statement that you have filed for the record; and we thank you, too, Mr. Keyserling.

(The statement referred to is as follows:)

SUPPLEMENTARY STATEMENT BY LEON H. KEYSERLING

Although the subcommittee was most generous in the time allotted to me in my appearance before it on March 12, 13, and 14, I find upon reading the record that a further amplification of my views may be helpful to the subcommittee, to the Joint Committee on the Economic Report as a whole, and to other interested parties. Consequently, I have prepared this supplementary statement for insertion in the record at the end of my testimony.

Limited scope of issues raised during my testimony

During my 3 days of testimony before the subcommittee on March 12–14, practically no questions were asked me covering the whole range of credit and monetary policy. Consequently, my views were not elicited concerning the important role of monetary and credit policy in general; and my testimony should not be construed to minimize this role.

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Instead, the central question placed before me was how much importance should be attached to the particular and limited change in monetary policy represented by the accord of March 1951 between the Treasury and the Federal Reserve Board, specifically with reference to its effect upon prices. My testimony before the subcommittee was addressed to the assertion, or at least the intimation, that it was the absence of the policy represented by this accord that was largely or mainly responsible for the serious price inflation between the Korean aggression in mid-1950 and March 1951, and that it was the presence of the accord of March 1951 that was largely or mainly responsible for price stability thereafter. My testimony converged upon the point that I do not believe that this particular accord device, to the extent that it was actually used, was among the more important factors explaining the shift from inflation to stability.

The main line of questioning directed to me was based, as I understand it, upon this thesis: That the Federal Reserve Board's support of Treasury obligations on an inflexible basis during the period between the Korean aggression and March 1951, prior to the accord, made possible and resulted in a large increase in bank reserves; that this large increase in bank reserves in turn made possible and was responsible for a many times larger increase in bank loans; and that this large expansion of loans correlated almost exactly with and was mainly responsible for the increase in prices. This thesis, as I understand it, holds that much or most of the inflation during this period would not have taken place if the accord had then been in effect, and similarly that the adoption of the accord in March 1951 has been a powerful or predominant factor in the maintenance of price stability since then.

In disagreeing with this thesis, I have not taken and do not take the position that sufficiently drastic use of monetary policy does not importantly affect the price level. Clearly, it does. Further, I agree that the Federal Reserve Board during this period between the Korean aggression and March 1951 could have departed sufficiently drastically from the policy of purchasing Treasury obligations to have drastically affected the volume of bank loans and thus to have reduced business spending and attempted spending sufficiently to have had a very important effect upon the restraint of price inflation. For example, if the Federal Reserve Board had refused absolutely to purchase Government bonds, it would have had an enormous effect upon the whole economy and upon the price level, until that policy was reversed.

However, my position in my testimony was based upon my belief that, if the accord between the Federal Reserve Board and the Treasury had taken effect immediately after the Korean aggression, it would not have operated under all the conditions then prevailing in the economy to have changed the degree or nature of Federal Reserve Board purchases of Treasury obligations sufficiently to have affected bank reserves enough to have restrained the volume of loans enough to have had much effect upon business spending and attempted spending. And as the effect upon business spending and upon the amount of funds that business would have had available to try to spend (i. e., competitive bidding for scarce goods) would in my judgment have been slight, the effect upon total inflationary pressures at that time would have been very slight because inflationary pressures were coming also from intensified consumer buying and from the prospect of rapidly accelerating Government spending.

Correspondingly, my belief that the accord of March 1951 has been far less responsible than other factors for the price stability since that date, is not based upon the idea that a drastic contraction of the money supply or of bank reserves or of loans does not affect prices. It is based instead upon the belief that the variant between what the Federal Reserve Board did during this latter period under the accord, and what it would have done in the absence of the accord, did not under all the factors then pertaining have an important enough influence upon bank reserves or loans to affect prices substantially. I ascribe the price stability since February 1951 predominantly to factors other than this accord.

This appraisal on my part that the mild variant in Federal Reserve policy has not been the basic factor in the sharp inflationary movement after the Korean aggression, or in the price stability since March 1951, should not be equated with an assertion that drastic changes in monetary policy or in bank reserves or loans would not substantially affect the price level. I have made no such assertion.

I do believe that a change in monetary policy, drastic enough to have had a substantial effect upon price inflation during the period from the Korean aggression to March 1951, would have had damaging effects outweighing the beneficial effects, as I shall subsequently develop in this supplementary statement. But I

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do not believe that there would have been such a drastic change in monetary policy immediately after the Korean aggression even if the accord had been put into effect at that time, and I do not believe that the accord has represented any such drastic change in monetary policy since it has been put into effect.

This should not be taken to mean that I condone the price inflation between the Korean aggression and March 1951. I deplore this price inflation as much as anyone else, and believe that more effective measures could have been taken, and should have been taken, to restrain it. But I believe that the measures which would have accomplished this restraint, without damaging consequences outweighing the beneficial consequences, are predominantly outside of the mild variant in monetary policy represented by the accord.

It is on this narrow ground that I disagree with the thesis that the absence of the accord was basically responsible for the price inflation between the Korean aggression and March 1951, or that the adoption of the accord has been basically responsible for the price stability since that time. Other factors seem to me to have been predominantly responsible for the price situation in both periods.

Reasons why I do not believe that the accord, as actually employed, has had much effect upon prices

I conceded in my testimony that the adoption of the accord in March 1951 may have had some slight effect upon the control of inflation since then, but a lesser effect than a number of other factors. Correspondingly, I stated the view that the absence of the accord was not an important factor in the sharp price inflation during the months immediately following the Korean aggression, and particularly the Chinese intervention.

My reasons for believing that the absence of the accord had little to do with the price inflation during the earlier period are as follows:

The inflationary pressures between the Korean assault and March 1951 were caused by a total of spending and effort to spend available funds, by business, by consumers, and by Government, in excess of our productive capacity to try to satisfy all these demands without price inflation. The price inflation arose in response to all of these sources of demand, and not just from one of them. To have avoided the price inflation, it would have been necessary to reduce the total demand, and probably to reduce each of the three main segments of demand to which I have referred.

If the accord had been in effect between the Korean assault and March 1951, it would not have reduced Government spending, or consumer spending by much. The main issue is whether it would have reduced business spending and efforts to spend (i. e., use of available funds for competitive bidding). I do not believe that it would have reduced business spending or efforts to spend by much, because even with the accord business in the main would have found the funds under the circumstances then prevailing to capitalize upon the economic outlook as it was then appraised by business.

Of course, there is a correlation between business loans and business spending and efforts to spend; there is a correlation between business loans and bank reserves; and there is a correlation between bank reserves and Federal Reserve Board purchases of Treasury obligations. But establishing this correlation does not give the whole picture, because many other factors were at work in the total situation.

If the accord had been in effect in late 1950 and early 1951, the Federal Reserve Board might have purchased less Treasury obligations, but nonetheless the rate of purchase would have had to be very high. If the Federal Reserve Board had purchased less Treasury obligations there would have been a smaller expansion of bank reserves, but not correspondingly smaller, because reserves could be created in other ways. If there had been a smaller expansion of bank reserves than actually took place, there might have been a smaller amount of loans, but not as much smaller, partly because business could have procured some loan funds in other ways. If there had been a contraction of total loans to business, business spending might have been somewhat reduced, but I do not think it would have been reduced very much because of the amplitude of business financial resources and because of the great incentives to business at that time to exploit the prospects offered by the emerging defense program. And if business spending and attempts to spend had been lower, the inflationary pressures would have been less, but not correspondingly less, because of the importance of other types of spending. Taking all of these factors into account, it seems to me that the inflationary pressures would not have been greatly different during the period under consideration if the support policy of the Federal Reserve Board had then been

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modified to the slight degree that it was in fact modified by the accord of March 1951.

My belief that the accord, if it had been in effect in late 1950, would not have been a powerful deterrent upon the over-all level of business activity and spending is supported by the fact that the expansion of bank loans and of business spending, particularly for plant and equipment, continued after the accord.

Correspondingly, I do not believe that the adoption of the accord in March 1951 ranks high on the list of factors which have contributed to price stability since that time. After the accord, as I have stated, bank loans and business investment continued to expand, and it is not ascertainable whether they would have expanded at a much more rapid rate if the accord had not been put into effect. The fundamental business outlook, and trends of the defense program, particularly the expansion programs, have primarily conditioned the level of business investment and other spending. As I said in my testimony, I would rate the accord as being less responsible for the past year of price stability than the expansion of production, the rephasing of the defense program, the higher rates of taxation, the increase in voluntary savings, the selective credit restraints, and the price and wage stabilization program.

Further, let us not confuse monetary policy in general with the particular device represented by the accord. Certainly monetary policy could be so drastically used as to affect the price level profoundly. The only point I am making is that one particular monetary device, namely, the accord, has not been the main reason for price stability since March 1951, and its absence was not the main reason for price instability before then. Clearly the accord has had no appreciable effect upon the level of Government spending or upon the size of the Federal deficit, and yet at times some ascribe to these two factors the controlling effect upon the degree of inflation.

I have rarely seen an economic analysis which ascribed either the inflation from late 1950 to early 1951, or the stability since March 1951 to the particular monetary device represented by the accord. Most of the analyses which I have seen, made by economists and others, tend to enumerate about the same causal factors as I do, in about the proportion and blend that I have stated them.

Significance of correlation between bank loans and price trends between Korean aggression and March 1951

For the reasons which I have indicated above, I do not believe that bank loans would have been sufficiently affected during this period to have had an important effect upon prices even if the accord policy had then been in effect. I think that even if the accord had been in effect under all of the powerful economic forces then prevailing, the Federal Reserve Board policy of supporting Treasury obligations and its consequences upon bank reserves would not have been changed drastically enough to affect bank loans very much, and that consequently the effect upon business spending and attempts to spend would not have been substantial enough to have substantially altered inflationary pressures.

A separate and distinct question raised during my testimony was whether, because in this particular period there was an increase of 18 percent in bank loans and an increase of 16 or 17 percent in prices, the conclusion should be drawn that the increase in bank loans was almost the entire explanation of the increase in prices, and that an exact correlation between the two is established as a guide to national policy. I do not accept this conclusion. The fact that A and B took place in approximately the same quantitative degree during a short space of time is not sufficient to establish a theory of cause and effect or to derive national policy. During the period running from 1946 to 1951 there were times when a rapid expansion in bank loans and in the monetary supply was not accompanied by a rise in prices, and also periods when a rise in prices was not accompanied by an expansion in bank loans and in the money supply. Sometimes, in fact, the trends moved in opposite directions. For example, the upward sweep of bank loans during 1951, and particularly the second half of 1951, was about as steep as during 1950, although 1950 wholesale prices rose very sharply and during most of 1951 wholesale prices moved moderately downward. To take another example, there was an upward movement of the money supply during the last three quarters of 1949, and a downward movement of wholesale prices. To take still another example, bank loans increased enormously from the beginning to the end of 1948 while the money supply was approximately the same at the end of that year as at the beginning of the year. From the third quarter of 1946 to the second quarter of 1947

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wholesale prices increased enormously while the money supply changed very little. From the middle of 1946 to the end of 1951 the money supply, with the 1946 average as the base, increased from a little over 100 to about 115, while bank loans increased from a little over 100 to about 210. I do not cite these figures to establish any particular theory of cause and effect, but merely to show the danger of oversimplification.

If someone wanted to ascribe cause and effect predominantly to a different set of factors, one could show that the stabilization of prices started with the price and wage freeze of February 1951 and has been maintained since then. An overenthusiast for price and wage controls could make the argument that the price inflation from late 1950 to early 1951 was caused predominantly by the absence of price and wage controls, and that the stability thereafter was caused predominantly by the existence of price and wage controls. I do not ascribe the change-over from inflation to stability to price and wage controls, or to any other single factor. Many factors were at work in both periods. It is intellectually possible to prove almost any causal relationship that someone has made a predetermination to prove, because in our changing and flexible economy some period of time can be found when there is a coexistence of almost any A and almost any B.

The fact that there is no clear and precise correlation between the expansion of bank loans and rising prices, especially in the short run, strengthens my belief that the minor change in the volume of bank loans which might have resulted if the accord had been adopted right after the Korean aggression would not have had much effect upon the resulting inflationary price trends.

Would it have been desirable, and by what means, to reduce the volume of business spending and attempted spending during the months immediately following the Korean aggression?

It seems to me to be skipping a step to consider how business spending and attempted spending might have been reduced during the inflationary period under discussion, without first asking the question as to how much it would have been desirable to reduce business spending during that period, as against the alternative of reducing other types of spending such as consumption. My own view is that more stress should have been placed upon the reduction of consumer buying, because much of the business spending was necessary to build up our productive strength. In short, we should analyze what kind of spending it would have been desirable to reduce, before appraising the relative worth of various measures.

I readily admit that it would have been desirable during the period under discussion to have had a somewhat lower level of total business spending, since some of that spending was excessive and not necessary to the build-up of our productive strength. For example, there was excessive inventory accumulation. But here also the analysis to be meaningful must ask what kind of measures should then have been used more extensively than they were in fact used to reduce business spending. On this question, I make these three points: (1) That the mild variant in Federal Reserve policy represented by the accord of March 1951, if it had been adopted in the fall of 1950, would not have reduced business spending very much for reasons that I have stated above; (2) that if the particular monetary device reflected by this accord had been pushed far enough to have had a profound effect upon business spending under the conditions then prevailing, it would undesirably have upset debt management and the general economy, and impaired essential production without being selective enough to weed out the undesirable rather than the desirable types of investment; and (3) that the measures which would have been desirable somewhat to reduce the level of business spending and attempted spending during this period would have fallen mainly outside of the device represented by the later accord. Still more use of higher taxation, selective controls, allocation of materials, limitation orders upon inventory accumulation and upon nonessential construction, would have been essential to repress further the level of business investment; and price control would have tended to reduce speculative inventory accumulation.

Limitations on drastic use of monetary policy during early stages of defense build-up

While I have expressed my belief that the Federal Reserve Board would not under any circumstances have altered the monetary policy sufficiently to have had a major effect upon price inflation in the period immediately after the Korean aggression, I of course admit that a drastic variant in that policy would have affected not only the price structure but also the whole economy very

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greatly. But it is my view that so drastic a policy, if it had been countenanced, would have had disadvantages far outweighing its advantages.

Such a drastic policy would have thrown confusion into the financial markets, impaired confidence on the part of ordinary holders of Government bonds, and raised most difficult problems of debt management. Perhaps more important, for such a drastic policy to have impacted greatly upon the price level, it would have had to exercise a repressive effect upon the general level of production and employment. This would have run counter to the prime objective of a rapid build-up of our productive strength, which I have regarded as absolutely essential to meet the burdens imposed upon us by the international situation. Further, I believe that this impact upon production and employment would not have been selective enough to repress the nonessential or wasteful types of private economic activity, consistent with retaining stimulae to the essential or desirable types of expansion.

The general use of monetary policy to fight inflation through the process of general economic contraction, whatever might be said for it under different circumstances, is not suitable to the economic strategy of the mobilization program. That strategy has been based upon rapid expansion of certain vital productive facilities, accompanied by counter-balancing contraction in other areas, and combined with the general purpose of expanding the total production of the economy as the labor force grows and as technology and productivity advance. To reconcile this sound strategy with the containment of inflation requires a much more highly selective variety of restraints upon the economy than are consistent with the generally repressive effects of monetary contraction along theoretical or classical lines. General monetary policy, to be sure, can be used mildly to take the edge off excessive ebullience of inflationary sentiment. But it cannot be used drastically without taking the edge off essential productive advance. The basic weapons for fighting inflation in a mobilization period should be consistent with the accomplishment of mobilization.

Nor is it at all clear that drastic restraints upon the money supply, which would have forced prices downward or prevented them from rising, would have had a beneficial effect upon the general standard of living or upon income distribution, even if we conceded these to be desirable or attainable objectives during the early defense period. Not nearly enough analysis has been devoted to this question by economists and others. If drastic restraints on the money supply affected the price level without disturbing maximum production and employment, it could have little effect upon the general standard of living, unless it resulted in a higher level of consumption by diverting more resources away from the defense build-up and from the business build-up. I do not know that it would accomplish this diversionary effect upon resources, and if it did, I would question the desirability under current conditions for reasons which I have already stated fully. On the other hand, if a drastic repression of the money supply reduced production and employment, which it is at least arguable that it might do, then I believe that it would reduce the general standard of living, and, based upon past experience, I think that it would also have an unfavorable impact upon the distribution of income. That is why it seems to me inadequate to try to appraise the economic significance of a trend upward of the money supply or of prices, or a repression of the money supply or of prices, without tracing through to the ultimate effect of these trends upon our economy and our people. The ultimate effect depends upon the level of production and employment, and upon the distribution of resources and of incomes at any given level of production and employment. That is why I believe that the most fruitful economic analysis should commence by looking at these considerations, and then appraise various economic tools, monetary and otherwise, in terms of their impact upon these considerations.

In appraising economic developments, price trends should be evaluated in the context of other trends

Just as insufficient analysis has been directed to the ultimate effects upon the economy of a drastic monetary policy, I likewise believe that there is a strong tendency to evaluate economic developments excessively in terms of price trends, to the neglect of other very important matters.

There has in general been a rising price level for a considerable number of years. During this period, as shown recently by a study of the National Bureau of Economic Research, published in part in the New York Times, there has been a distinct trend toward a larger portion of the national income in real terms going to those in the lower parts of the income structure. As national production and productivity have expanded greatly, these groups have benefited most,

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not by dragging others downward, but by they, themselves, moving upward. It seems, also, that this change in the income structure, aside from its effect upon the reduction of poverty and hardship, has helped to make the economy more stable with respect to the maintenance of high levels of employment and production.

It may well be argued that it would have been still better if the great advance in total production and employment, and in per capita productivity and standards of living, which has occurred generally during the past 20 years, had been accompanied by a stable price level rather than by a generally rising price level. But this argument does not meet the question of whether, in the dynamics of the American economy, a stable rather than a rising price level would have been consistent with the great productive advances which have taken place. Economists may range themselves on either side of this question; but the established fact in any event is that we have had a rising price level, and that this has been compatible not only with productive advances which have exceeded the most sanguine expectations, but also with improvements in the income structure from the viewpoint of equity and the reduction of poverty and hardship.

It is true that the fixed-income groups have been adversely affected by rising prices. For this reason among others, I have always favored vigorous programs to prevent rapid price inflation. But even on this question of the fixed-income groups, there has been insufficient analysis of the actual situation by economists and others. How many people are in the fixed-income groups in the sense of not having shared in the rising standard of living over a long span of years? Insofar as they have not shared, would it be more feasible to improve their lot by supplementing their money incomes, and would this cost the economy more or less than the steps which would have to be taken to raise their standards of living by forcing a decline in prices? And if the price level were forced downward by drastic monetary or other measures, what proportion of the fixed-income groups would be more hurt by such a deflationary policy, through unemployment or otherwise, than other income groups would be hurt? In short, what would be the net effect upon the economy?

I am inclined strongly toward the view that a reasonably stable price level should be the objective of national policy, with advances in national production equitably reflected by increases in money incomes. But while a stable price level seems to me highly desirable, we should guard against the easy assumption that it should always be maintained regardless of other economic objectives; and we should certainly be on our guard against measuring the desirability or undesirability of economic trends and developments as a whole solely by whether the price level is stable or moving upward or downward.

This problem now seems to be very important, because there is evidence that the popular tendency to rivet attention upon price trends has tended to distract attention from other vitally important factors in the economy. For example, I believe that, in the current world situation, we would do better to place relatively more emphasis upon marshaling our productive strength and keeping it fully active, and relatively less emphasis upon controlled stabilization, although both are important. In the long run, I think this change in emphasis would result not only in a richer and stronger economy, but also in a more stable economy. It would also result in a more effective release of the peculiarly dynamic energies of the American enterprise system, and would provide a basis for more unity and less discord and friction among the great functioning groups in the economy with respect both to private and public economic policies.

Further, I would not accept without a great deal of qualification any statement that it was the rising price level after the Korean aggression which depressed the standard of living of most of the American people since the defense program started. We have been operating at relatively full employment, and relatively full utilization of our current resources. If the general standard of living has been reduced, or prevented from rising as it otherwise might, it has been because the defense program and the business build-up have commanded a larger share of our total production than they would in more normal times. There is no monetary device or anything else which can provide for the people as high a standard of living as they would be able to have, at full employment, if the defense program and the business build-up took a smaller proportion of our resources.

I think the proper thing is to tell this to the American people, so that they will not labor under the illusion that they can have their cake and eat it, too. Considering the importance of the business build-up, and the importance of the security program, I think that the American people should be told that their standard of living has been kept remarkably high during the past 2 years, and not

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that it has been excessively reduced. Measured against the world situation, the American people in the main have not had great sacrifices imposed upon them. Further, I think it in the interest of the American people in the long run to put relatively more resources for a time into the business build-up, and relatively less into the expansion of consumption. By increasing our productive strength, we shall in the long run be able to support and enlarge our current standard of living even if the defense burden remains high. There is no other way to do it.

This is not an argument in favor of price inflation. The point I am making is that the general standard of living could not be higher without sacrifice of the defense program or of the business build-up, because our resources are not limitless and they have been used fairly fully during the past 2 years. And of course, I agree that a rapid upward sweep of prices, particularly when it runs ahead of increases in production, is highly undesirable by almost any test. The rapid upsweep of prices in the period after the Korean aggression was clearly undesirable. The Council of Economic Advisers, and I personally, have constantly urged a strong and comprehensive anti-inflationary program whenever the country has been confronted with current or prospective inflationary pressures, because there are many valid and necessary objectives which such a program can well serve.

The economics of public spending under current conditions

I should like to amplify my testimony with respect to my attitude toward the size and character of public spending during the defense emergency. This involves also the question of balancing the budget, and of the Federal deficit.

There are really two issues involved here: First, what economic activities we conduct as a Nation, and second, the method we use to finance these activities. There is a relationship between these two issues, but they need to be analyzed separately for the sake of clarity.

I believe that in the United States, with our abundant resources, our maximum economic strength and progress depend primarily on how we use these resources. We should use these resources to maximize production and employment, without excessive strain, because the more we produce the more we have. In order to do this, we must allocate resources sensibly among three great purposes, which are (1) capital formation and development by business of our productive facilities through the investment process, (2) immediate consumption by 155 million people, and (3) Government programs, mostly national defense under current conditions. If any of these three uses gets seriously out of balance with the others, the economy is weakened.

Practically all Government spending, aside from when it is spent in a period of depression to enlarge the total of economic activity, is based upon the idea that utilization of a part of our resources through this degree of Government spending is of a higher order of national priority than if these resources were utilized through business spending or through consumer spending. If the judgment is correct that the Government spending serves a higher priority of national need than would otherwise be served, then as a generalization the spending is justified. Otherwise, and to the extent that it fails to meet this test, it is unjustified.

The question of whether Government spending since the Korean outbreak has employed resources which it would have been in the Nation's interest to employ through private spending, turns primarily upon whether the resources absorbed through Government spending have cut excessively into the resources and incentives available for private business activity, or cut excessively into the resources available for immediate consumer use or into the funds that consumers have had available with which to obtain goods and services. I shall not repeat here the facts cited at length in my opening prepared testimony. These facts seem to me to demonstrate conclusively that, in 1950 and 1951, and prospectively for the years immediately ahead, diversion of resources through Government spending has neither deprived business of the ability and the desire to build up our productive facilities and perform its other functions at an extraordinarily high rate of growth, nor deprived consumers in 1950 and 1951 or prospectively in the years immediately ahead of a very high standard of living indeed. In fact, if world conditions should necessitate a larger security program short of total war, the facts show clearly that even that large a program could be well reconciled with a very healthy allotment of resources both for business development and for consumer satisfactions.

So, by this basic test, I think that the level of public spending predominately for national defense, is consistent with the maintenance of a strong economy,

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and with the achievement year by year of an even more productive and therefore even stronger economy.

There remains, of course, the question of whether the level of public programs, including national defense, is so high as to perform functions which have a lower order of priority than would be served by the private use of the same resources. This, necessarily, is a matter of judgment and not subject to much qualitative analysis. All I can say here is that it is my belief that the security program is not absorbing more of our resources than would be prudent in view of world conditions, and, consequently, since there is also the fact that our economy is being kept strong despite the security program, I would not now favor a sizable reduction of the security program. As to public programs other than national security, I incline to the belief that in the main they are serving needs of the Nation and of our people of at least as high an order of priority as the needs that would be served if the resources were used in some other way. Obviously, there will be wide varieties of opinion about this.

There is also the question of whether the size of public outlays contributes to inflationary pressures. Manifestly, there is such a contributtion, because the inflationary pressures have resulted from excess demand at given times relative to available supplies, and Government spending has been a large part of this demand. But that only brings us to the point of deciding what types of demand should be cut first, and in what amounts, to avoid or reduce the inflationary pressures. This again, at least insofar as national policies are involved, is a matter of national priorities. My own reasoning is that it would have been better for us as a Nation, during the inflationary pressures augmenting from the Korean aggression to early 1951, to have cut back more on private business outlays for nonessentials and on consumer outlays than to have had a slower security build-up which would have been the main way to cut back much on public outlays. The same criteria would apply to consideration of how to reduce inflationary pressures in the future as they may appear, until the defense build-up reaches a point which gives us a larger measure of security in a troubled world than we have thus far attained.

As a matter of fact, not enough attention has been paid to the relative magnitudes of private and public spending, and to the relative size of he changes in these magnitudes, in connection with the inflationary problem. For example, comparing the second quarter of 1950 with the first quarter of 1951, personal consumption expenditures rose from an annual rate of $188 billion to an annual rate of 208 billion; gross private domestic investment rose from an annual rate of 48 billion to an annual rate of 60 billion; and purchases of goods and services by the Federal Government rose from an annual rate of 21 billion to an annual rate of 32.4 billion, with expenditures for national security rising from an annual rate of 17 billion to an annual rate of 28.8 billion. It should be clear from these figures, quite aside from the question of national priorities on which I have placed so much stress above, that restraints upon the use of resources by others than the Federal Government is quite as important to the inflationary problem as the restraint of Federal outlays. Yet one would think, from some discussion in some quarters, that attention should be directed almost solely to the matter of Federal outlays.

Moreover, there is need for closer analysis of how much of a cut in Federal outlays, or in fact in total outlays throughout the economy, would be necessary even if the avoidance of inflation were our only national problem. I submit that the events of recent months have tended to vindicate the views I expressed much earlier, that the American economy had the productive power in the long run to carry the kind of security program being contemplated without great or excessive inflationary or other strain. Price stability has been maintained for more than a year, and both wholesale and retail prices are now tending downward. Employment is not too high, and unemployment is by no means too low. There is definite slack in some parts of the economy, and many businessmen fear, I believe erroneously, that a general slack will become pronounced before very long. Through the productive expansion programs, many of the basic material shortages of not long ago have practically been overcome. The effective workweek is relatively low, certainly as contrasted with the World War II situation. The technology and other resources available for the further expansion of production lead to the conclusion that, unless the economy gets excessively slack, we will increase our total output by well over 5 percent per annum during the next few years short of a total war.

All in all, I cannot see anything in the current economic situation or outlook to justify the conclusion that the security program must be slashed in order to

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avoid dangerous inflation. On the contrary, I believe that the now proposed security program can be fully maintained consistently with the maintenance of price stability, if we hold on to and keep in good working order the variety of anti-inflationary tools which are now in active use. I think it would be most imprudent now to get rid of these tools, because some new international incident or some other cause for a change in the psychology of businessmen or consumers could result in a new wave of buying similar to that which took place after the Chinese intervention.

In summary of this phase of my argument, of course Federal spending and security outlays should be reduced if they are serving needs which as a Nation we should be serving on a smaller scale. But the proposition that, independently of this, or even recognizing the magnitude of the international danger, we should reduce our own defense build-up or the Mutual Security Program in order to protect our economy from danger, is a proposition to which I cannot subscribe.

Since we clearly have the productive resources to support what we are now trying to do, this brings me to the second phase of the analysis: How should what we are trying to do be financed? In other words, what would be preferable, a reduction in expenditures or an increase in taxes?

I believe that an increase in taxes of about $5 billion at this time could be imposed, if wisely apportioned, without having a dampening effect upon the level of business investment and the level of consumer enjoyments which we ought to try to sustain during the defense emergency. I will not labor this point, because it seems clear that for all practical purposes the Congress has already arrived at a decision not to increase taxes along these lines. I yield to this decision, because the Congress is the appropriate body to decide such ultimate issues of national economic policy.

But it does not automatically follow, even assuming no increase in taxes, that such inflationary pressures upon the economy as would result from the size of the deficit created by the expenditure program recommended by the President, would outweight the dangers involved in slashing our own defense program or the Mutual S curity Program.

The size of the Federal deficit is not the only factor bearing upon the degree of inflationary pressures. Based upon the analysis of the whole economic outlook which I have made above, it seems to me that a deficit of the size in prospect, if taxes are not raised and expenditures not cut appreciably, would not be inconsistent with the maintenance of a stable price level through the anti-inflationary program now in effect. This conclusion is based in part on the fact that developments since January would indicate now a smaller estimate as to the size of the prospective deficit than the estimate which was made in early January. The conclusion is also based in part upon the fact that, even at current tax rates, a budget balance could be achieved within a year or two when the defense build-up will have passed its peak and when the productive output of the economy at reasonably full employment will have further increased a great deal. It is based also upon the observation that many other factors besides the budget affect the degree of inflationary pressures.

There remains, finally, the question of the size of the national debt. If other things were equal, it would be desirable to reduce that debt. But the world situation being what it is, I cannot reach the conclusion that an increase in the national debt by 5 to 10 billion dollars a year, or even somewhat more, would confront us with unmanageable problems, in view of the fact that we have the resources to increase our national product by about $20 billion a year without strain, and in view of the fact that such an annual increase in productive output would be about three times the total annual carrying charges on the national debt.

None of what I have said should be taken to minimize the seriousness of a deficit or of an expanding national debt, but merely to set these factors in the perspective of the whole economy and all of the urgent problems with which we must deal.

Interest manifested by the Council in Government economy

A question raised during my testimony as to whether those members of the Council appearing before the subcommittee had any recommendations to make to the subcommittee as to how or where the budget submitted by the President might be cut, prompts me to the following clarification of my position.

The Council of Economic Advisers as a whole, and I as well, have constantly emphasized that the outlays of the Federal Government in these times should be held to the lowest levels consistent with the hard effort we are now making

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to improve the security position of the free world, and with other essential national purposes. It would not be correct to assume, because I did not urge before the subcommittee that the President's budget as submitted to the Congress be cut drastically, that I have not been interested or active in trying to help to hold down Federal outlays to the lowest safe and prudent levels in these times. Before the President submits his budget to the Congress, there are months of detailed and searching study, examination, consultation, and advice. In this process, the Council of Economic Advisers participates. And in this process, huge cuts have taken place in the estimates made by various departments and agencies. It is a matter of common knowledge, for example, that the estimates for defense outlays contained in the President's budget as sent to the Congress are tens of billions of dollars lower than the estimates made by some defense officials. I would make a rough calculation that the total of the estimates originally submitted to the Bureau of the Budget and to the President by all the agencies and departments of the Government were many tens of billions of dollars higher than the total in the final budget as submitted by the President to the Congress. In this budget-making process, the Council of Economic Advisers has had its chance to exercise, and has exercised, its influence in the direction of economy. The proper time for us to exercise this influence is before the President submits his budget to the Congress, rather than to come before congressional committees and take issue with the President's budget in open hearings. This is true for reasons that I try to set forth fully in this statement, in my discussion of the relationship of the Council of Economic Advisers to the President and to the Congress. So I hope the subcommittee will not think that the members of the Council and I, personally, are not interested in proper economy, and have not exerted great efforts to help achieve it, just because I have not responded to the invitation to point out to the subcommittee how much or where the President's budget could or should be cut.

But I would not be frank if I left the idea, by way of indirect intimation, that I think the budget ought to be slashed but am not in a position to say so here. Broadly speaking, I have already participated in the considerations leading to the formulation of the budget, and, broadly speaking, I think that it is not out of line with our national needs and our economic ability to serve these needs without weakening our economy.

This issue turns primarily upon the size and pace of our security program, both domestic and international. I read with enormous admiration Senator Douglas' article in the New York Times of a few weeks ago, particularly the first part of it which pointed to the size and pace of the Russian build-up of their offensive striking forces. The most recent figures which have come out indicate that the Russians are putting above 30 percent of their resources, which are much more limited than ours, into their military build-up. I cannot bring myself to believe that the proportion of our total productive resources which the budget proposes that we allocate to national security is too high, measured against our wealth and strength as a Nation and our further productive capacity. The dollars requested for national defense are one measurement of the size and pace of the program.

Relationship of the Council to congressional committees

Senator Douglas raised certain questions concerning the degree of freedom with which members of the Council of Economic Advisers can express their views to congressional committees, since the Council is advisory to the President. The Council of Economic Advisers is established by law in the executive branch of the Government, in fact in the Executive Office of the President, and its members are appointed by the President and confirmed by the Senate. The main duties of the Council, as defined by the Employment Act of 1946, are to study economic trends and the economic outlook and also national economic policies and programs, to advise the President with respect to these matters, and to assist the President in the preparation of his Economic Reports to the Congress which deal with these matters and contain a comprehensive program of specific recommendations to encourage the stability and growth of the economy under a system of free competitive enterprise. The phrasing of the statute also set forth for the Nation as an objective the promotion of maximum employment, production and purchasing power.

It is thus clear that the members of the Council are employees of and advisers to the President, and that they are not employees of and advisers to the Congress in the same sense.

But this does not mean, in my opinion, that the members of the Council cannot or should not testify before, cooperate and consult with, and in a sense

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give advice to, committees of the Congress, just as this is done by heads of other agencies in the executive branch, and even other agencies in the Executive Office of the President such as the National Security Resources Board, who are appointed by the President and confirmed by the Senate under statutes defining their functions and responsibilities, and who are employees of and advisers to the President in the sense that they work under his direction as members of his "official family" and may, of course, be dismissed by him.

The Economic Report of the President to the Congress is prepared by the President with the assistance and advice of the Council of Economic Advisers, just as presumably a message appraising the international situation and recommending international policies is prepared and transmitted to the Congress by the President with the assistance and advice of the Secretary of State and his staff; just as presumably a message appraising our security needs and making recommendations for defense outlays is prepared and transmitted by the President to the Congress with the assistance and advice of the Secretary of Defense and other people in the Defense Establishment; and just as presumably heads of other agencies not of Cabinet rank advise and assist the President in the same way when he sends appraisals and recommendations to the Congress in the field designated for the operations of these other officials by statute.

In all of these cases, under the way our Government now operates and has generally operated, none of these officials except in rare instances makes available to the public or to the Congress the nature of the advice he gives to the President while he is assisting and advising the President in the preparation of such Presidential messages and the recommendations contained therein; and likewise, it is only in rare instances that such officials make it known to the public or even to the Congress if there is a variance between the advice they give to the President and the extent to which the President follows that advice and conforms to the recommendations contained therein in the messages sent by the President to the Congress after getting that assistance and advice. Nonetheless, after the Presidential message in question and the recommendations contained therein are sent to the Congress and to the congressional committee or committees concerned therewith, it has been practically the universal custom and is entirely appropriate for those officials whose statutory responsibilities make it clear that they have been advisers to the President in the field covered by such Presidential message and recommendations to appear before such congressional committees, to discuss and analyze the matters involved, and in fact to amplify and support the recommendations made by the President and the analysis underlying them. In addition, it has been the almost universal custom and entirely appropriate for such officials to appear before congressional committees and to make analyses and give advice in the fields in which they operate under statute, even when this has not been preceded by a Presidential message covering the specific matters before the committee.

In appearing before committees of the Congress in this role, I cannot see where the Council of Economic Advisers is doing any different or appearing in any different light from what is done by heads of other agencies working in different fields. And I have never seen any valid reason why the members of the Council, in view of the statute under which they operate and the nature of their role, should follow a contrary course or differentiate between themselves and the heads of the other agencies to whom I have referred above. Certainly, the distinction cannot be that the members of the Council deal with economic problems, because many heads of many other agencies deal with economic problems, or even predominately with economic problems.

That this construction of the Council's role is correct is supported by the legislative history of the Employment Act, by the expressed views of some of the legislative sponsors of the act, by the fact that the Joint Committee on the Economic Report and other congressional committees have frequently invited the members of the Council to appear before them for this purpose, and by the fact that doing so is in accord with the Council's responsibilities as defined by the President. More important, it is in accord with the whole tenor of the American system of Government, and I believe it a good and healthy thing that public officials should be subjected to the questioning and testing of their views by congressional committees, particularly when these public officials have been appointed and confirmed under acts of Congress to deal with the very subject matters which these committees are considering and to help in the preparation of the very reports and recommendations which the President sends to these committees.

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The next phase of the question is whether the members of the Council are in a position to express themselves frankly and fully to congressional committees, in view of the fact that they are advisers to the President, and in view of the fact that the advice and recommendations that they give to the President may at times not be exactly the same as the advice and recommendations which the President transmits to the Congress. There has been considerable interest in this subject, and I am glad of this opportunity to express my views.

I believe that members of the Council of Economic Advisers are in exactly the same position, with respect to expressing themselves frankly and fully before congressional committees, as any other agency heads of integrity who have advised the President in important fields in which the President makes recommendations to the Congress. Under our system, no responsible official in such a position, while working for the President, parades before the public or before congressional committees the differences of viewpoint that there may be between himself and the President on matters under consideration by the Congress. If these differences are minor in character, the responsible public official does not feel entitled to the luxury or self-satisfaction of having the President agree with him in every detail; Government could not function if that were expected. But if the President, in his recommendations to the Congress, were to depart from the analysis and advice given him by the official in question to the extent that it could be regarded as a fundamental repudiation of that official's views, the official of integrity should resign where under all the circumstances he believes it in the national interest to do so. But it seems to me incorrect to say that a public official in this kind of job can place himself in open conflict with the President for whom he works, and at the same time stay on the job. Obviously, also, a man of integrity should resign if the President for whom he works should ask him to go before a congressional committee or anywhere else and stultify himself by making analyses or supporting policies which this official believes to be against the national interest.

The view has been expressed in some quarters, that members of the Council of Economic Advisers, in order never to be faced with a choice based upon the situations described above, should solve the problem by advising the President but by refusing to appear before congressional committees to analyze and support those recommendations by the President to the Congress which are in accord with the advice they have given him. I can see no more reason why the members of the Council should duck their basic responsibilities by so doing than why other officials should thus avoid their responsibilities. Under our system, if it is to function and if congressional committees are intelligently to process reports and recommendations sent to them by the President, there must be and there always has been someone from the executive branch available and ready to come before the congressional committees and to work with them in the customary fashion. With respect to analyses and recommendations sent by the President to the Congress in those areas of economic policy which are the province of the Council as defined by statute, if the members of the Council are not the proper persons to come before the congressional committees for this purpose, then who are the proper persons?

If my analysis is at all correct, it seems to me that for a member of a congressional committee to raise a question about my freedom to be frank, or whether I agree with recommendations made by the President, or whether after the President has sent up recommendations I am estopped from expressing my own views, is the same as asking that question of the head of some other statutory agency of Government appearing before a congressional committee.

My own answer to the question is as follows: I always have and always will try to speak frankly and deal fairly with congressional committees. I ask the subcommittee to assume what is in fact the truth, that the analyses and recommendations which I make to it are consistent with the analyses and recommendations which I make to the President. So long as the recommendations made by the President to the Congress conform in the main to the recommendations which I have given him, I feel privileged and duty-bound in appearing before a congressional committee to give my reasons for supporting those recommendations. If the President were to fundamentally repudiate my views as to what is in the Nation's economic interest, and were to send recommendations to the Congress in basic conflict with them, then I would resign. That situation has not arisen. At all times, consequently, I hope this subcommittee will feel that the analyses and recommendations I present to it represent my honest convictions. I would not present them if they did not.

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I hope that the subcommittee will excuse the length at which I have covered this subject, but it goes to the heart of the relationship between the Joint Committee on the Economic Report and the Council of Economic Advisers, and I feel strongly about it.

Representative WOLCOTT. Mr. Chairman, I will not be able to be here next week, but I assure you that I will follow the hearings.

Representative PATMAN. Next week we will have our hearings in 362 Old House Office Building. That is the caucus room, the third floor of the Old House Office Building. Our session will commence at 10 o'clock in the morning.

The first day, March 17, we will have Mr. Marion B. Folsom and Mr. J. Cameron Thompson, of the Committee for Economic Development; Mr. W. L. Hemingway, of the American Bankers' Association; and Mr. John F. Fennelly, of the Investment Bankers' Association. That is for Monday.

We will stand in recess until Monday morning at 10 o'clock.

(Whereupon, at 1:05 p. m., the subcommittee recessed to reconvene at 10 a. m. Monday, March 17, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

MONDAY, MARCH 17, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:10 a. m., in the caucus room, Old House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman, Senators Douglas and Flanders, and Representative Bolling.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

We will hear first from Mr. Marion B. Folsom, representing the Committee for Economic Development. Mr. Folsom is chairman of the board of trustees of the Committee for Economic Development, treasurer of the Eastman Kodak Co., a member of the Board of Directors of the Federal Reserve Bank of New York, formerly a member of the board of directors of the Buffalo branch of that bank, and a member of the Advisory Committee on Social Security, which advised the Social Security Board and the Senate Finance Committee in connection with the comprehensive revision of the Social Security Act in 1939.

Mr. Folsom, we will be very glad to hear from you.

The statement which you furnished the committee last Thursday or Friday has been furnished to each member of our committee—I went over the statement myself yesterday. You may proceed.

STATEMENT OF MARION B. FOLSOM, CHAIRMAN, BOARD OF TRUSTEES, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. FOLSOM. Mr. Chairman, Mr. Thomson is also appearing with me today, and I would appreciate it if the committee would give us an opportunity to go through our statement, both, first, and then you can question us later, because many of the questions you might ask me will probably be answered in Mr. Thomson's statement.

Senator DOUGLAS. That is probably a wise request.

Mr. FOLSOM. I am appearing this morning in my capacity as Chairman of the Committee for Economic Development.

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The Committee for Economic Development is an organization of businessmen and educators formed to study and report on the problems of achieving and maintaining a high level of employment and production within a free economy. Its research and policy committee issues from time to time statements of national policy containing recommendations for action which, in the committee's judgment, will contribute to maintaining productive employment and a rising standard of living.

I am pleased to have the opportunity to appear here, along with Mr. Thomson, to discuss CED's views on monetary policy at the request of your committee. CED has regarded the problem of monetary policy as one of the four or five basic problems involved in the efficient operation of a free society. In 1948 the committee issued a statement entitled "Monetary and Fiscal Policy for Greater Economic Stability," in which we presented our general recommendations in this field. We have also published two research reports by Dr. E. A. Goldenweiser, who was Director of Research of the Federal Reserve Board from 1926 to 1945. We are submitting copies of our policy statement and Dr. Goldenweiser's books for the use of the subcommittee and its staff.

For the past 2 years a CED subcommittee under the chairmanship of Mr. Thomson has been studying the difficult problems of monetary policy in an attempt to make our recommendations more complete and definite. We hope to issue a policy statement on this subject later this year. Pending issuance of that statement our remarks here must be regarded to some extent as our individual views, although I believe we can represent fairly accurately the current thinking of our committee members.

In our work we have consistently approached the problem of monetary policy as part of the problem of maintaining economic stability—of avoiding serious depressions and serious inflations. Certainly before this committee I do not need to elaborate the tremendous importance of economic stability to the welfare of the American people and to the survival of the American free society. The Joint Committee on the Economic Report, like the other mechanisms of the Employment Act, was created because of the great national concern over instability of our economy. Since the end of the war we have escaped serious unemployment—the aspect of the instability problem that was most feared 6 or 7 years ago. But we have had enough recent experience with inflation—the other aspect of the instability problem—to remind us that the problem has not been solved.

We have found, in CED, that whenever we approach the problem of economic stability, and from whatever angle we approach the problem we come quickly to the question "What can monetary policy do?" The fact that your committee has twice undertaken to study monetary policy suggests that you also have found monetary policy to lie close to the heart of the stabilization problem. The national interest in monetary problems, so much in evidence in the past few years, is not a theoretical or academic interest. It is a practical interest in the problem of stabilization—specifically in the problem of inflation. I suppose this is obvious. But I point it out because unless we remember what our practical interest is we are in danger of getting off the track in an area that is the subject of so many traditional slogans and so much subtle theorizing.

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Reasonable judgments about monetary policy for economic stability cannot be reached by looking at monetary policy alone. Monetary policy is, of course, not the only instrument of national policy that affects and can be used to promote economic stabilization. Each of these instruments has certain difficulties and limitations. If any one of these instruments is examined by itself these difficulties are likely to appear overwhelming. The conclusion is likely to be that the difficulties of this particular instrument are so great that we had better seek stability by other means—that is, by means whose difficulties we have not explored.

Specifically, if we look at monetary restriction alone as a means of preventing inflation we see certain difficulties:

(*a*) There is considerable disagreement among experts about the effectiveness of monetary restriction in preventing inflation;

(*b*) Monetary restriction may have unsettling effects upon capital markets;

(*c*) Monetary restriction is likely to raise the interest charge on the Federal debt.

These difficulties might lead one to the conclusion that monetary restriction should play only a minor part in the restraint of inflation, and that reliance should be placed instead on other measures, such as budget policy or direct controls. This conclusion would be unjustified. The alternative to monetary restriction also involves real costs and risks, which must be considered in deciding on the role of monetary restriction.

One alternative is higher taxes. But there is uncertainty as to how effective higher taxes above the present level would be in restraining inflation. The taxes might be passed on in higher prices or might simply reduce saving. Higher taxes will weaken incentives to produce and may cause serious inequities. Moreover, it is only realistic to recognize that higher taxes are unlikely to be adopted.

Another alternative is reduction of Government expenditures. I am confident that Government economy should and can make a great contribution to economic stability in present circumstances. But here again action to the extent needed is difficult to achieve.

A third alternative is direct Government controls over prices, wage rates, investment, and production. How much contribution such controls can make to stability is uncertain. Direct controls are difficult to administer at best, and would be likely to break down if unrestricted credit expansion were permitted greatly to increase the purchasing power of businesses and consumers. In any event, I am certain that whatever is accomplished by these controls will be purchased at great cost to efficiency and economic growth and to the freedom of our economic system.

And so we come back to monetary restriction, not because it is easy or without costs but because its difficulties look less formidable when compared with the alternatives. The stabilization problem is a problem of getting a reasonably adequate result out of the use of a number of imperfect instruments in a balanced combination. It is our belief that in such a combination monetary policy will always have an important role to play.

The relative emphasis to be placed on different instruments depends upon the circumstances. Considering only inflationary situations, the

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reliance upon direct controls should probably be greater in a time of complete mobilization than in a period of limited mobilization like the present. Also we should probably rely more on budget policy, specifically on budget surpluses, in a period of normal budgets than in a period of extraordinarily large budgets.

I should like to indicate briefly what seems to us a balanced combination of instruments to be used to prevent further inflation during the present defense program.

First, we believe that direct price and wage controls have only a stop-gap function in the present situation. They can help us temporarily to avoid some of the consequences of failure to use other measures adequately. Such support as there is for direct price and wage controls stems from the belief that they are necessary, not from the belief that they are good. But surely whether or not such controls are necessary depends upon what is done by other means—notably by fiscal and monetary policy. It is the function of these other means to create a situation in which we are reasonably safeguarded against serious inflation. It is the function of direct price and wage controls to disappear when that situation has been created.

Second, we believe that balancing the cash budget is a desirable and achievable goal of fiscal policy. A balanced cash budget would make an important contribution to the avoidance of further inflation. It does not, of course, provide a guarantee against inflation; much depends on the type of taxes imposed, the size of the tax burden, and the strength of the inflationary forces. In addition to its anti-inflationary effect, we believe that adherence to the pay-as-you-go principle is desirable in order to preserve one of the few forces now working in the direction of Government economy.

The real question in most people's minds is whether the budget can be balanced. It appears to us realistic to estimate that on a cash basis revenues from present taxes would fall about $7 billion short of expenditures for the programs proposed in the fiscal 1953 budget. We believe that approximately this amount could probably be cut from the proposed expenditures without reducing the real content of the security programs or interfering with other essential Government functions. We have tentatively estimated that about 4 billion of this total saving could be achieved by more rigorous screening of military requirements and specifications and by more efficient military procurement.

Senator DOUGLAS. Mr. Folsom, I must ask pardon for breaking the rule which you wanted to lay down at the beginning, to say that great minds move in the same channel. It so happens that in the economic report of our Joint Congressional Committee on the Economic Report I make an identical estimate of $4 billion to be saved out of the military budget, so I am delighted that we move together.

Mr. FOLSOM. I might say, sir, that we originally had ourselves set at 6 billion, but upon further study we had to raise it up to 7 billion.

As I say, we believe that the fiscal 1953 cash budget could be balanced without a tax increase. However, we do not have sufficient information about the military programs, which are the core of the problem, to be sure that this is the case. By the time the hearings on the military appropriations are completed Congress should have a much firmer judgment on how much can be saved. If it should be the judgment of Congress that an amount large enough to balance the

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budget cannot be saved, consideration should be given to the enactment of a broad-based consumption tax.

Given a balanced cash budget, it should be the function of monetary policy to prevent the existence of any significant excess of total demand for goods over the supply. In case the cash budget is not balanced, monetary restraint will become more difficult but may be even more important. Under the head of monetary policy I include not only the use of the Federal Reserve's powers but also the management of the Federal debt and other steps taken by the Government to promote saving.

It will be noted that the function assigned to monetary policy is a residual one, and the precise degree of monetary restriction called for is uncertain. No one can tell just how strong inflationary pressure will be in the next year or 18 months. Therefore no one can tell just how much anti-inflationary action is required. It is necessary and proper that this uncertainty should be concentrated on monetary policy. One of the great advantages of monetary policy is that it can be flexibly adapted to changing economic conditions. Tax rates and expenditure programs, on the other hand, must be decided for a period at least 12 months ahead, and after a considerable period of deliberation. It is an efficient division of labor between monetary policy and budget policy to plan in advance for a balanced budget and to leave to monetary policy the task of shorter-period adjustment to variable and unforeseeable economic conditions.

We believe that this task, of working alongside a balanced budget to prevent further serious inflation, is within the capacity of monetary policy. More important we believe that the costs of such a policy will be less than the costs of the alternatives—which are more inflation, more taxes, or more reliance upon a price-wage control system working against strong pressure. The costs of monetary restriction are usually thought of in terms of the effects upon interest rates. These costs are not likely to be large unless the inflationary pressure is great—greater than now seems probable. But if the inflationary pressure is great, the value of a restrictive monetary policy, and the costs of the alternatives, will be correspondingly great.

In his reply to this subcommittee's question about the economic objectives of the Treasury, Secretary Snyder listed as number 7 "to hold down the interest cost of the public debt to the extent that this is consistent with the foregoing objectives," and included among the foregoing objectives "to use debt policy cooperatively with monetary-credit policy to contribute toward healthy economic growth and reasonable stability in the value of the dollar." I think this is a sound appraisal of the position of low interest costs among the objectives of national policy.

Also it is important to note that we have now crossed the bridge of allowing Government bonds to fall below par. During the past year we have demonstrated that it was not necessary for the Federal Reserve to peg prices at some predetermined level, that Government bonds can stand on their own feet, and that we can have a genuine market in Government securities with none of the catastrophic consequences that were once predicted. It seems probable that financial markets and investors are fairly well adjusted to the prospect of some variation in the prices of Government securities. If anti-inflationary monetary

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policy should result in some further decline of bond prices this is less likely to produce a financial panic or similarly extreme result than was the first drop below 100 a year ago—assuming, of course, that care is taken to maintain orderly market conditions. This means that we can carry on a flexible monetary policy with more confidence.

Mr. Thomson will discuss the problem of carrying out an effective monetary policy, and I want to make only one general observation on that subject. We believe that the existing powers, techniques and organizational arrangements are adequate for the performance of the function of monetary policy. This does not mean that improvements may not be possible. We should keep an open mind on that subject. But it means that deficiencies in powers, techniques and organization have not been the main cause of inadequacies in monetary policy in the past and are unlikely to be the main cause in the future.

The main problem is to get a wider agreed understanding of the potentialities, functions, and methods of monetary policy. Without such an understanding no changes of techniques or organizations can prevent a vacillating and ineffective policy. With such an understanding, present arrangements can work very well. Forward steps in money and debt policy during the past year have been due to improved appreciation of the fundamental issues. The investigation conducted by the subcommittee under Senator Douglas made a major contribution to this improvement. We are confident that the present investigation will make a similarly important contribution to better understanding and thereby to better policy.

Thank you, Mr. Chairman.

Now, if Mr. Thomson can present his statement.

Representative Patman. We shall be very glad to accede to your request that the two of you be heard before yielding to questions.

Our next witness is Mr. J. Cameron Thomson, also representing the Committee for Economic Development. He is chairman of the Committee for Economic Development's committee on monetary, fiscal, and debt policy, and president of the Northwest Bancorporation of Minneapolis.

Mr. Thomson, we shall be very glad to hear from you.

STATEMENT OF J. CAMERON THOMSON, CHAIRMAN, COMMITTEE ON MONETARY, FISCAL AND DEBT POLICY, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. Thomson. Thank you, Mr. Chairman.

I would like to throw in one sentence at the beginning and say that I appear here with a lot of humility and a desire to be helpful, and I hope we can do that.

It is a pleasure to accept your invitation to appear before this committee on behalf of CED. As Marion Folsom has indicated, we have found the problems of monetary policy exceedingly difficult. The materials you have already published have demonstrated that the work of your committee will contribute a great deal to our study, and we are happy to participate in your investigation.

Mr. Folsom has described our general approach to the problem of monetary policy. I should like to comment on three critical aspects of this problem:

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1. The effectiveness of monetary restraint, possible limitations on monetary restraint set by the existence of a large public debt, and the possible use of new tools to surmount these limits.

2. The implications of a flexible monetary policy for public debt policy.

3. The position of the Federal Reserve System within the Government.

In the light of these things, I also should like to say something about the problems of the next 2 years.

Before I turn to these specific points may I make one general observation. The question before your committee is not one of disagreement on technical points of interest only to scholars or of disputes between Government agencies. The question is the survival of our free society. Can we be confident of the survival power of our free society if we cannot control inflation without authoritarian methods? And can we be confident of our ability to control inflation without authoritarian methods if we are not able to control our monetary system effectively?

We believe that monetary restraint can make an important, even indispensable, contribution to preventing inflation. The methods by which monetary restraint operates have been explained in many of the replies to your questionnaires. Banks and other financial institutions find it more difficult or more expensive to obtain funds to lend. The availability of credit to borrowers from these financial institutions is reduced, which may involve an increase of interest rates. Some of these borrowers become unable or in some cases unwilling to carry out expenditures they had planned.

Even individuals and businesses who are not borrowers are affected. They find that the market value of assets they hold, such as bonds, is lower and the inflow of cash to them is reduced by the indirect effects of the restraints on bank lending. It becomes more difficult or expensive for these individuals and businesses to finance expenditures out of their own funds, even if they had not planned to borrow.

I believe it is generally agreed that this process goes on. However it is sometimes argued that the effects are marginal, applying to only a small fringe of transactions, and therefore the conclusion is that they are unimportant. In my opinion this conclusion is mistaken. If we look at the $350 billion of expenditures that buy the gross national product we see relatively little of it that would be directly affected by monetary restraint. But the problem of inflation is not the whole of this $350 billion. The problem is in an unsatisfied margin of demand, usually relatively small. We can have inflation when the gross national output is $350 billion and the demand for output is $355 billion. This gap of $5 billion can produce a large inflation as the excess expenditures produce larger incomes that produce larger expenditures, and so on. The effectiveness of monetary policy must be judged in relation to this unsatisfied margin. Judged in this way, I believe it is very important.

It is sometimes maintained that while this may all have been very true in the past it is no longer true, chiefly because of the large size of the public debt.

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It is said that their holdings of public debt give the great lending institutions so much liquidity that they are largely protected against the Federal Reserve's monetary restraints. I think this is a mistaken conclusion. The fact is that our lending institutions have become more closely concerned with the Government bond market because of their large holdings of Government's. This would mean, and I believe it to be true, that they are increasingly sensitive to the changes in the market that the Federal Reserve can bring about.

In the second place, it is argued that not only the lending institutions, but people and business generally have acquired such large amounts of liquid assets that for the most part they are in no need to borrow. They seem to be beyond the reach of credit restraint. Again there is an element of truth. But it is true also that while some parts of the economy have become less dependent upon outside financing, others have come to rely on credit to an increasing degree. Installment credit and housing credit, for instance, are much more important today than formerly. Also, as a banker I know that even though a business may have no need to borrow, it usually still has to watch out for its liquidity. A tightening of credit makes itself felt not only among borrowers, but all over. And, finally, I cannot see how one can conclude, from the high degree of liquidity that the public debt has provided, that credit restraint should be abandoned. If the danger of inflation is greater owing to the debt and greater liquidity, credit control would seem the most natural means of dealing with the situation.

I could go on citing still further arguments that have been put forward to show that credit policy today cannot work. But to all of them my reaction is the same as to those already mentioned. They point to something that is quite true in itself, but they do not draw what seems to me the proper conclusion. What all those arguments show, and what I think is undeniable, is that the circumstances under which monetary policy must work have altered very much during the last 20 years. But they quite fail to show, in my view, that it is any less essential today than it used to be, and they overlook the new opportunities for its success that have arisen.

The main argument usually advanced against monetary restriction is not that it will not work but that in the process of working it will do serious damage. Therefore it is said that monetary restriction must be stopped short of the point to which it might be effectively pushed in the interest of curbing inflation.

I am pleased to note in the replies to your questionnaires that there is no longer much sentiment for rigid pegging of bond prices. Some people may think that abandoning par support for 2½ percent bonds a year ago didn't do much good; but no one can say that it did any serious damage. And now that par has been left behind, no one is urging that we go back to it. Par has lost whatever symbolic value it may have had. Moreover no one is suggesting a new peg at 98 or 96⅞. The whole idea that one could say that there is one best interest rate that will continue to be best forever has been seen to be irrational; and beyond, of course, you affect all lenders, including the banks, as well.

However, I think I see in some of the replies to your questions the development of a new philosophy. This is the philosophy of the stable bond market. What this seems to imply is that monetary

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restraint can be used in a period of inflation provided it does not involve allowing bond prices to fall below the bottom of some predetermined range. Such a policy becomes important only if an inflationary situation arises in which anti-inflationary monetary policy would involve a decline of bond prices below the predetermined bottom. But if such a situation does arise we would find ourselves back in the same old box—unable to make a free decision about how far to pursue monetary restriction and finding monetary policy locked in more and more securely the longer we stay in that position. If this is what is meant by a stable bond market policy, I do not believe it solves the problem of orderly adjustment of monetary policy to changing economic conditions.

I think the answer to the question "How far should we go with monetary policy?" is like Abraham Lincoln's answer to the question about how long a man's legs should be. Monetary restriction, in combination with budget policy, savings policy, and other appropriate measures, should be adequate to prevent inflation. The problem, as Mr. Folsom has pointed out, is the problem of the right combination. When in an inflationary situation we decide not to push monetary restriction further we should be deciding to do more of something else. The right combination will vary from time to time and can only be judged by evaluating costs and benefits.

Beyond this I can only urge that in appraising the costs of monetary restriction we should not be frightened by bogeymen. We should not exaggerate the fragility of our financial system. It is sensitive but sturdy. We should not exaggerate the difficulties of Treasury financing in a moving bond market. It has been done before and the Treasury is doing it successfully now. We should not exaggerate the significance of the interest burden. The Secretary of the Treasury has clarified this matter in his reply to the committee. We should not fear that secular stagniation is around the corner, requiring perpetually low or zero interest rates. We should not think that persons who receive interest are less entitled to their incomes than those who receive other shares in the national income.

I think that if these considerations are borne in mind we will find an important and active role for general credit policy.

If we do not follow this course, if we soft-pedal credit control, we probably shall have to put up either with more inflation, or with more direct controls over prices, wages, and materials. Quite likely we shall have to put up with more of both. I think we are all agreed that inflation is a great evil, and that direct controls are alien to our way of life and should be used as little as possible. This is one of the reasons why I think it is so important for us in our present situation to make vigorous use of credit policy, particularly those instruments usually referred to as "general credit policies," that is, open market operations, discount rate, and flexible reserve requirements. These tools of policy, though they may sometimes hit hard, do so through the process of the market. They do not involve direct interference with the actions of individuals and businesses. The same cannot altogether be said of the so-called "selective" instruments of credit policy—chiefly over consumer and housing credit under regulations W and X. These do involve some interference, even though of a rather impersonal kind. For this reason they should, in my opinion, be regarded as subsidiary devices upon which we do not

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want to rely too heavily or too long. In our present defense economy, however, there is special need to guide credit and resources to the most important users and to limit their use by others. Under these unusual conditions, the selective instruments can usefully complement our general credit policies. The use of these powers must be flexibly adapted to changing conditions and the Federal Reserve should have sufficient authority to operate in this flexible way.

As times change, supplementary tools of credit policy may need to be added. The Federal Reserve in effect now has several new tools. Among them are regulation X, which relates to construction credit, and the revived regulation W, relating to installment purchase credit.

For further powers I see no urgent need at this time. I think so particularly because open market operations have now been revitalized through the removal of the peg. I do not favor, therefore, proposals made in recent years for secondary reserve requirements in the form of Government securities, nor for reserves against different types of assets. The main goal of these devices was to insulate the Government securities market to some extent against a tightening of credit for private borrowers. It was thought that this might be a way of getting back to a flexible rate policy in the private money and capital market, without causing equal fluctuations in Treasury obligations. In my opinion it is doubtful that such devices could have been effective so long as the bond market was pegged.

Meanwhile, the policy of par support for Government securities has been abandoned. No extreme repercussions have been felt, as had been feared by many. There seems to be less need now for adopting such protective devices, even though the principle of seeking to insulate the Government market has some merit, as I explain later.

Both the securities reserve requirement and the asset reserve plan would mean a major change in our credit system. They would make it less flexible and less well able to serve the needs of our growing economy. And the compulsory holding of Government securities under such plans might well have a bad effect upon people's attitude toward the public debt in general.

The voluntary credit restraint program is, as its name implies, a voluntary organization of our private financial institutions aiming to hold down the use of funds for nondefense purposes. It operates under standards set by the Federal Reserve, and represents something quite new on our financial horizon. Its efforts in fighting inflation are a real contribution. But beyond that, it has done something else that is very worth while. Through its work, the financial sector has come into close working contact with monetary policy. Perhaps this will mark the beginning, in this country, of the closer relationship between the market and the monetary authorities, that has proved so fruitful in some foreign countries.

I should now like to turn to the relations of debt management to a flexible monetary policy. That the debt, and decisions about its rates, maturities, and related factors play a very powerful role in the market is obvious. This influence results, in the first place, from the sheer size of the debt. The Federal debt now amounts to close to 50 percent of the sum total of all public and private debt in this country. It further results from the fact that refunding operations keep the Treasury almost constantly in the market for large amounts.

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Finally, the debt's influence results from the fact that the Federal Reserve must, if unsettlement and conflict are to be avoided, create market conditions that will put the market in line with the decisions made about the debt.

This calls for the closest cooperation between the Treasury and the Federal Reserve. Their cooperation must be of a kind that does not infringe upon the Treasury's primary responsibility for the public credit. It must insure, at the same time, that the Federal Reserve can carry out its statutory obligations in the regulation of money and credit. In this joint venture of the two agencies, it seems to me that the main burden of day-to-day cooperation falls mainly upon the Federal Reserve. It must maintain an orderly market for Government securities. It must also maintain conditions in the market that permit the Treasury to raise the funds it needs. The burden of cooperation for the longer run, on the other hand, rests more heavily with the Treasury. It must shape its financing decisions in the light of market trends and in harmony with the monetary and credit policies of the Federal Reserve.

I do not believe that in adapting itself to the market and taking account of the Federal Reserve's policies, the Treasury would be in conflict with its duty to protect the public credit. The public credit does not depend upon the market quotation of Government bonds. Neither does it rest upon anything so changeable as the current interest of investors in buying these bonds. This is largely a matter of market trends and of the comparative attraction of other investments. If any single thing can be regarded as the outstanding symbol of the soundness of the public credit, it is the value of the dollar. A flexible debt policy does not by itself guarantee the value of the dollar, but without it we shall surely suffer inflation.

The interests of the Treasury and the Federal Reserve might be easier to reconcile if the Government securities market could be insulated to some extent against the fluctuations that a flexible credit policy produces. I do not believe that we can accomplish anything like complete insulation. Nor do I favor those methods of insulation that would involve compulsory holding of securities by banks or other holders. But some progress can perhaps be made by the use of nonmarketable issues. An example of this was the offer of 2¾ percent nonmarketable bonds in exchange for long-term marketables that the Treasury made as part of the unpegging operation. Study by the Treasury of what more could be done in this direction without unduly restricting the flexibility of monetary policy, seems to me worth while.

Finally, it seems to me that the coordination of debt policy with monetary and credit management would benefit if the Treasury would give its principle of "tailoring issues to the needs of investors" a broader meaning. As it is now, the Treasury seems to feel that it cannot sell long-term bonds because there is no demand for them at the rates it would be willing to offer. Other competing investments, it is said, are too attractive. But this policy may have a very unfortunate consequence. It almost inevitably leads to concentration on short-term financing at a time when it is important to sell long-term bonds in order to absorb some of the investment funds that feed the inflation. The expansion of short-term debt, even though it

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may not immediately increase bank-held debt, does carry a greater threat of inflation.

The CED has gone on record as to the importance of a proper countercyclical debt policy. In our view, the aim should be to shift debt out of the banks during times of expansion, thereby reducing the volume of money. In times of contraction, the opposite should be done. An effort to sell long-term Government bonds now would work in this direction and would be well worth while. With adequate preparation, and at competitive interest rates, I think such an issue would have good prospects of success.

What I have to say on this question of how the Federal Reserve System should be related to other parts of the Government, and the internal structure of the system, is brief. I do not think it any less important for that. On the contrary, it is the heart of the matter. It is not a matter of technical points, but primarily one of principles and convictions.

The basic issue obviously is the independence of the Federal Reserve System. The Federal Reserve System is exercising a governmental power—the power to issue and regulate money. This power is given to Congress by the Constitution, and certain parts of that power have been delegated by Congress to the Federal Reserve. The nature of the power is such that Congress has had to give the Federal Reserve a large measure of discretion.

The problem then arises of assuring that this great power is exercised in the general public interest and is not used to serve short-run, sectional, departmental, or personal interests. This is what I mean by the independence of the Federal Reserve System—the maximum insulation from short-run and narrow pressures. The most important aspect of this problem is inflation, which has been the bane of monetary systems that are not sufficiently insulated from such pressures. There is agreement that inflation is contrary to the general public interest. But at least in the short-run, policies that lead to inflation or permit inflation are convenient for many people or groups. A major reason for the independence of the Federal Reserve System is to insulate it from pressures for inflationary policy.

The Federal Reserve System as now organized is, in our opinion, an effective way of achieving responsible independence of monetary policy. The authority is lodged in a Board, to reduce the possibility of domination by the special viewpoint of any one person. The Board members are given a long term of office to reduce the possibility of domination by the appointing power. At the same time the public character of the Board is well established, basically by the fact that the system is the agent of the Congress and can be abolished or altered in any way by Congress.

I think the present fact is that the Federal Reserve System cannot follow a policy that runs counter to any generally held public belief about what monetary policy should be. If anything, the Federal Reserve has been unduly sensitive to opposing views that do not really represent any widely held conception of the public interest. The Federal Reserve began to exercise its independence only when it became clear that the course it wished to follow had a large measure of public support.

We consider it of the utmost importance not to reduce the independence of the Federal Reserve System. More than that, we be-

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lieve it important to encourage the Federal Reserve in the exercise of its independence.

This is not to deny in the least the need for cooperation and consistent action by the Federal Reserve and the Treasury. But this cooperation should not be sought by subordinating the indpendence of the Federal Reserve in the exercise of the responsibilities granted to it by Congress. It should be sought in a more general understanding of the common objectives of monetary policy and debt management and by continuous interchange of ideas between the two agencies.

In the last analysis, if there are differences of opinion, the Federal Reserve must exercise its own best judgment, constantly recognizing that it is responsible to the public, through the Congress, for the wisdom of that judgment.

There have been a number of suggestions for the establishment of an interagency council to coordinate monetary policy and debt-management policy and possibly other aspects of economic or financial policy. As usually proposed the council would include the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of the Treasury, and the heads of the Budget Bureau, the Council of Economic Advisers, and perhaps other agencies such as the Securities and Exchange Commission. It is difficult for me to see what useful purpose would be served by such a council and I can see a possible danger arising from it. Every agency will naturally wish to consult with other agencies whose work is closely related to its own. Opportunities for such consultation already exist and are used without the necessity for a formal council. In view of this fact, what would be the function of the council? It would be difficult to escape the interpretation that establishment of a council by statute or Executive order was intended to achieve something beyond consultation—namely, the subordination of each member's responsibility to the consensus of the members of the council. This would be inconsistent with the independent responsibility properly assigned to the Federal Reserve by the Congress.

Two other suggestions in this area I also view with skepticism. These proposals aim, respectively, to place the Secretary of the Treasury on the Board of Governors of the Federal Reserve, and the Chairman of the Board in the Cabinet. Although the goal is better cooperation and a higher status for the top man in the system, the result would, I fear, be a loss of independence for the Federal Reserve not compensated by real advantages. The Treasury and the Federal Reserve have ample opportunity for close contact. I do not see much benefit in formulating this at the top level, but I do see the dangers. What is needed, it seems to me, is more intimate and frequent contact particularly at the staff level.

Cabinet status would involve the risk of converting the chairmanship into a political office. This would be too high a price to pay for closer contact with the "inner circle." Access to this circle is important, but a man of standing and ability, I believe, can usually create this contact in his own way.

The suggestions I have mentioned so far, even though in most cases I question their merit, do point up one important need. That is the need for strengthening the Federal Reserve System inwardly, in order to make it more effective in its outward relations. The most effective means to that end, in my view, is the reduction in the number

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of members of the Board of Governors, from their present seven to five. That would make the Board a more effective body, and would give it a better chance of attracting and holding top-caliber men. Whatever else can be done to make Board membership more tempting—including salaries less out of line with what good men can earn elsewhere—would also help.

There are two more proposals for streamlining the system, each the opposite of the other. One suggests that the power of the open-market committee, which handles open-market operations, should be transferred to the Board. The Board would then have in its hands all the monetary powers of the system. The other proposes that all the powers of the system be concentrated in the committee. Since the majority control of the committee rests with the members of the Board—the minority membership consists of Federal Reserve bank presidents—the change would be one of emphasis rather than of substance. I believe that the existing division of functions, which is based on historical development, has worked well. It gives representation to a wide variety of views and experience. It is not particularly logical, but it has the weight of tradition and experience on its side. There seems to be no strong reason for changing it.

The next 2 years may present a severe test of our ability to manage our financial affairs. A sizable deficit threatens. While CED believes that the deficit can and should be avoided, there is danger that it will not. If it is not, then the extent of the damage will depend largely on the manner in which the deficit is financed. This will pose once more in severe form the problem of Treasury-Federal Reserve cooperation. A few words about the financial outlook are, therefore, very much to the point in this discussion.

If the budget is not balanced, we shall have to look for the least harmful means of financing a deficit. In addition to the deficit, we shall in any case have to finance the seasonal swing in tax revenues, which will hit a low during the second half of each calendar year. We shall further have to finance the "attrition" in the outstanding debt, that is, the cashing in of maturing securities whose holders reject the usual exchange into new securities. The seasonal swing can probably best be financed by sale of tax-anticipation notes or bills, a device successfully used by the Treasury so far. The attrition will probably be heaviest in maturing savings bonds.

I believe that a savings-bond program better adapted to the current situation could materially reduce this attrition and make an important contribution to Treasury financing and economic stability. One need is for a new educational program, more fundamental and more intensive than the present effort. Another need is for a new bond, which should reflect the rise of interest rates that has occurred since the present savings bonds were devised.

A new model bond is essential if a new savings program is to arouse public interest, and an increase of rates would help to demonstrate the renewed importance that the Government attaches to saving. The step taken last year to offer more attractive terms for continued holding of savings bonds beyond their 10-year maturity was in the right direction, but did not go far enough.

The overriding principle in financing in this period should be that on no account must we go back to the practice of pegging the market.

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I would not be too concerned over a limited amount of financing through banks, and about some expansion of Federal Reserve credit to make this possible, so long as the Federal Reserve retains control over the amount. But to peg the market means to give control over bank reserves and money supply to the holders of securities. We must not again put ourselves in that position.

In addition to this main principle of obstaining from pegging the market our aim should be to get as much of the money as we can from nonbank lenders, and as much of it as possible for medium and long-term periods. I am happy to note that the Treasury has made a move in the direction of longer maturities with its recent offer of a 7-year bond. To obtain long-term money in larger amounts it may be necessary for the Treasury to put in its bid well ahead of the actual date of financing. Many of the big institutional investors now commit their funds far in advance. I believe it would be sound policy for the Treasury to make arrangements right now that would assure the placement of a long-term issue this fall. At a competitive interest rate such an issue should offer good promise of success.

In addition, the coming financing will no doubt call for a well-diversified offering of securities. As I stated earlier, I am in accord with the Treasury's policy of tailoring its offerings to fit the needs of investors. But this tailoring should mean that rates as well as types and maturities are set in line with the market.

The principles that I have suggested for any financing that may be ahead will have the effect, I believe, of keeping down inflationary pressures. They will involve a somewhat higher interest cost, at least for a time, than would short-term financing relying mainly on bank credit. But the cost is small compared to what we would stand to lose through inflation.

Our general position may be briefly summarized. We believe that a flexible monetary policy operated by an independent Federal Reserve System can make a major contribution to reducing economic instability. This important instrument cannot be effectively used unless all branches of the Government and the public understand in general how monetary policy works. We are confident that the work of your subcommittee, like the work of its predecessor subcommittee under the chairmanship of Senator Douglas, will be a major step in the development of a successful program for the avoidance of serious inflation or depression.

Thank you.

Representative PATMAN. Thank you, Mr. Thomson.

Senator Flanders has been identified with the Committee for Economic Development since it was organized, I believe, back in 1942. Was it not 1942 when it was organized?

Mr. THOMSON. Correct.

Representative PATMAN. Senator Flanders, of course, is a very valuable member of our committee.

I wonder if you wanted to ask any questions, Senator Flanders, of either or both of these gentlemen, who will yield to questions at this time?

Senator FLANDERS. I do not know which one of the two to address myself to.

In these hearings so far, I have been trying, among other things, to formalize, at least in my own mind, the new relationships between

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the Treasury and the Federal Reserve Board. About as far as I can get is that it depends on the personal ability of the Board, whose policies now find expression in Mr. Martin, and the personal ability of the Secretary of the Treasury, whose staff and other policy bodies find expression in the personality of Secretary Snyder to get along with each other.

That is not anything that seems quite satisfactory to depend upon for times in which either of those gentlemen might be somewhere else, either above or below.

Is there anything that you could suggest for putting that policy in some more definite form for the guidance of future generations?

Mr. FOLSOM. Well, I will attempt to briefly answer that and see if Mr. Thomson has anything to add.

I do not see how you can legislate on the matter any more than you can legislate on the question of forcing cooperation between the executive department and Congress.

You have separate agencies, and a lot depends upon the personalities involved. I think we are building up an experience though which certainly should be a guide in the future, to help these two organizations work more closely together, but I do not see any way in which you can build up any rigid set of rules forcing them to do it. I think, as we go along, you will find the staffs down the line in the Treasury and Federal Reserve working together more closely than they have in the past. I think if you do that you can get away somewhat from the personal element of the two top people involved.

Mr. THOMSON. My answer, Senator, is by way of emphasis of what we have said. We have been gradually evolving our system of monetary controls. There has not been as much understanding even upon the part of the banking fraternity as there ought to be.

These hearings on the controversy over the Federal Treasury accord have materially increased the understanding. As we have gone along in this defense program, we have seen the dangers of resorting to totalitarian methods to accomplish things, and we have seen that there is an alternative. I think the public has become better informed as to the choices there are.

Now, with that better education and with the statements here by the two men involved, the record has been made, and I think that you do not need any statutory powers. I agree with Mr. Folsom on that. I think furthermore that those organizations are going to be more alert to meeting their own responsibilities, and yet cooperating, and I think that the public is going to be more alert to make sure that if they do not agree that the Congress or the public make itself felt.

Senator FLANDERS. You are saying then that there is no chance at the present of developing a manual and that, perhaps, no manual for these operations could ever be written; is that what you are saying?

Mr. THOMSON. I agree with that, and I think if I could ask you a question from your experience as head of the Federal Reserve Bank of Boston, you would probably agree.

Senator FLANDERS. Well, that definitely limits the preciseness of any report that we may make, Mr. Chairman. All we have in front of us in this particular situation is the ability of two institutions to work together, and they are not able to tell exactly how they do it, for the benefit of the future generations. At least that is the way I size up the situation.

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There has been some discussion as to the relative position which monetary policy holds in this business of stabilizing prices and controlling inflation. The Chairman of the President's Economic Council rated it No. 7, with only one less effective method, and that is the method of exhortation to everybody to behave; that was No. 8, and monetary policy was No. 7.

I conclude from what you have been saying, both of you gentlemen, that you rate monetary policy a little higher than No. 7.

Mr. FOLSOM. Yes; we would rate it much higher.

Senator FLANDERS. Yes.

Representative PATMAN. Pardon me, Senator, I thought the interest rate was No. 7 in the Treasury's statement.

Senator FLANDERS. No; I am speaking about the Chairman of the Economic Council.

Representative PATMAN. Excuse me.

Mr. THOMSON. If I might add something to what Marion has stated, it seems to me the question that is raised is as to how you act. Now, your authority for administration is in the President, and he has all these agencies and their advice at his disposal, including the Council of Economic Advisers.

You analyze the situation at the moment; you have all these various tools; and the President makes his recommendations that come to your committees. You may have to use a combination of these to meet a given situation. Not any one thing can be used for all purposes or for all times. Our position is that monetary controls not only have had more effect than Mr. Keyserling indicated—we disagree with that—and two, that we strongly urge that monetary controls, in principle, are more consistent with the maintenance of the American system in that they apply general restraint rather than specific, and do not lead to more authoritarian methods of control.

I might add right now, Senator, I would think that monetary restraint is necessary to use from now on because we have gone as far as we can with taxes, and we can hardly expect savings to increase much above the present rate, which is very high, so if we could have any real inflationary pressure developing from now on I would think we would have to depend more on monetary and credit restraint than we can on the other tools, because they have already been used.

Senator FLANDERS. Now, to go back into past history a bit, not very far, do you think that the application of monetary controls in the period after June 1, 1950, would have resulted in a material brake on prices, in the wholesale price market? Do you think it could have been safely applied with sufficient force to have kept that price level from rising at all or rising appreciably?

Mr. FOLSOM. I do not think anything we would have done could have prevented some price rise after Korea because that was due to the psychological factor of people rushing ahead and buying and business rushing in to buy for inventories which created such big demand. I do not think anything we could have done could have prevented a price rise.

On the other hand, I think if we would have adopted more of the policy of monetary control and credit restraint, such as we did last year, I feel confident myself we would not have had as much of a price rise as we did have. How much we would have had nobody can say, maybe half. This is not hindsight, because CED came out

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with a statement entitled "Economic Policy for Rearmament" very soon after Korea, in August of 1950, in which we urged four different steps for controlling inflation. We stressed very strongly this very question we are talking about now—a general credit control. At that time we urged very strong action by the authorities to hold back credit and monetary expansion; among other things, removing the peg on Government securities. We pointed out how you could not exercise real restraint on credit and monetary expansion if you had the peg system working; that would offset anything that was done in the other direction.

So we felt at that time that it should have been adopted, and I think it is fair to say that had it been adopted earlier we would not have had so much of an increase in price, although I think we would have had some increase, rather than the increase that we had.

Senator FLANDERS. Well, you do not say that we can hold a level price line indefinitely through drastic application of monetary policy?

Mr. FOLSOM. No; I think you have got to take into account other factors as well.

Senator FLANDERS. And does that mean the application of advice and counsel——

Mr. FOLSOM. Most of the advice works in the wrong direction and I think one of the troubles in the past has been that people have been talking so much about inflation.

Senator FLANDERS. I note in Mr. Thomson's statement a suggestion of some changes in terms of the savings bonds and among those changes in terms was a higher interest rate. Are you prepared to advise us or advise the Treasury just what that rate should be?

Mr. THOMPSON. I am not prepared on a specific rate.

I think that the rates should be higher than they are at the present time and I specifically suggested that when you get through with these hearings and come to some consensus on the question of monetary policy—I do not say you have got to wait until the hearings are over, but go and determine what that rate ought to be. It should be at a higher rate.

Mr. FOLSOM. I would like to comment briefly on that. I have given some study to that myself.

It must be realized that the money situation is different from what it was before, say 10 years ago. For instance, short-term money then was three-eighths of 1 percent and now it is 1¾, and Government securities that were going at seven-eighths percent are now 2 percent and longer-term Government securities that were then 2.4 are now about 2¾.

At that time a Defense bond was a very attractive bond. Well, now, with present conditions it is no longer attractive, especially in the earlier years. For instance, if you cash in a Defense bond now after holding it for 2 years you get just about 1-percent yield. If you had money in a savings bank you would have had 2 percent, and in some cases, 2½ percent. You have to hold your Defense bond 3 years before you get as much as 2 percent. So, they are really ont of line with present-day conditions.

Senator FLANDERS. And you want to make them in the earlier years comparable with the savings bank.

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Mr. THOMSON. I would say that they should get 2 percent very quickly, perhaps the first year, and then gradually up to 2½ percent to 3¼ percent, and then I think you would have an attractive security.

Senator FLANDERS. One other question, Mr. Chairman, that I would like to ask, and that is: What part does or should the directives which were established when this committee was set up play in Treasury and Reserve Board policy, that is, the maintenance of a high level of production and employment?

Now, as I remember, that, as an objective, was not in the original Federal Reserve Bank Act, nor, I think, has it ever been specifically stated in any succeeding legislation; but, as a criterion for the operations of the Federal Reserve Board, do you think it is in there implicitly, even though not stated, in general objectives, or do you think it should not be an objective of the Federal Reserve bank policy?

Mr. FOLSOM. Well, it certainly should be an objective. I imagine it is implied now.

I think Governor Martin indicated in replying to the questionnaires that the 1946 act set up those objectives as Government policy. I see no objection to having it spelled out more specifically in the legislation relating to the Federal Reserve, but I do not think it is necessary.

Senator FLANDERS. Thank you.

Representative PATMAN. Alternating between the House and Senate for our question periods, I would like to ask if Mr. Bolling has some questions.

Representative BOLLING. Mr. Thomson, in your prepared statement, beginning at the last line on page 1, you say:

> Can we be confident of the survival power of our free society if we cannot control inflation without authoritarian methods?

Could you define for us what you mean by authoritarian methods?

Mr. THOMSON. I would say direct controls in peacetime border upon authoritarian methods. I would say that selective controls as against general controls, except in emergencies, border upon authoritarian methods.

Representative BOLLING. Why, Mr. Thomson, are they authoritarian when there is not an emergency and not authoritarian in an emergency? I do not want to quibble, but I am concerned about those words.

Mr. THOMSON. Why, in a war emergency you concentrate on the objective of winning the war, and you have to do that regardless. You will sacrifice human life on the battlefield, and the conditions are outside of your control, and you have to be sure of the things, too, that you do at home.

Now, in the peacetime economy the basic factor is to accomplish the results of, say, the Employment Act of 1946 or the defense program and maintain standards of production and particularly the strength of the free economy you are trying to protect.

Therefore, we ought to lean over backward in keeping away from anything that tends toward direct and arbitrary controls.

Representative BOLLING. Without making the point too ridiculous, would you say, for example, it would perhaps not be authoritarian to use controls at a time when you were drafting men?

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Mr. THOMSON. Well, drafting men—I would rather confine it to a direct war effort than to drafting men because you are talking about universal military training in peacetime, for instance, and I think the connotation there might be that somebody might say that applies to universal military training consideration in peacetime.

Representative BOLLING. Now, would you consider the voluntary credit restraint program as falling into the field of exhortation or something more than exhortation?

Mr. THOMSON. I think it is certainly in the field of moral suasion. I think more particularly, though, that voluntary credit control is an example of combining Government and Government supervision in monetary policies and private enterprise, to maintain the benefits of private enterprise and yet accomplish the result.

Representative BOLLING. Yet it is essentially in the field of exhortation, you think?

Mr. THOMSON. It is more than that. I would say the practical effect of it was more in the control field than the exhortation field.

Representative BOLLING. Now, do I understand correctly that the voluntary credit restraint program is designed to give flexibility to an instrument which is otherwise generally inflexible?

Would you say in a situation such as the one we are in today, when it is pretty obvious that we need credit—perhaps additional amounts of credit—still the experience of the last 13 or 14 months might indicate that our problem is not only to have credit but to see to it that that credit goes where credit is most useful? Presumably that is the purpose of the voluntary credit restraint program; it is a technique to make that credit supply available to the best application of credit.

Mr. THOMSON. That last part of your question, I think, is the answer.

Representative BOLLING. And that would in itself, this flexibility of a general policy, necessitate dealing with the dangers or weaknesses of the system?

Mr. THOMSON. Well, I think it is an example—but I do not think it necessarily of itself would deal with the dangers or weaknesses of the system.

Mr. FOLSOM. I would just like to comment briefly.

There have been statements before your committee that there was danger in monetary restraint or monetary credit control in that it would interfere with war production.

I do not think there has been any case where the lack of credit has slowed up war production. We have all sorts of methods of taking care of that. We have the accelerated depreciation and we also have the V-loan, which is designed just to help industries expand their plant; and I do not think that any bankers are going to hold up credit to any concern engaged in war production.

Also, I do not think that the monetary policy is quite as inflexible as some state.

This means that you exercise some restraint on credit as a whole but, although you cut down somewhat on the credit, it is still going to be up to the individual banker to decide whether he is going to make a loan or not make a loan, and certainly you have all the flexibility you need there.

Representative BOLLING. Well, my point is, it occurs to me that you might have so much flexibility in the present situation that loans may

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be made for undesirable purposes from the point of view of the country as a whole. It is certainly conceivable in the present situation that if credit were wisely restrained you might take it out of some field where it was not needed so that it would go where it was needed, for the defense of the Nation.

Mr. FOLSOM. I do not think that you will find any case where they could not get credit for defense, especially when they have added devices to encourage loans for defense purposes.

Representative BOLLING. Well, but you have the actual situation where there is the complaint that credit was made too ready, to an extent where it was going not only toward defense but also toward things that were entirely unnecessary.

Mr. FOLSOM. We think that the most important problem now is to control inflation rather than credit for defense industry. There is no problem with defense industry.

Representative BOLLING. It seems to me that we are arguing on different facets. You say there is no situation where defense industry would not have credit. At the same time, there is the implication there is too much credit——

Mr. FOLSOM. Too much credit for other parts of the economy.

Representative BOLLING. Well, that was my only point. Now, in your statement, Mr. Thomson, as I remember it, is the recommendation that the Board be reduced from seven to five members. You also say that whatever else can be done to make Board membership more tempting, including salaries less out of line with what good men can earn elsewhere, would also help.

Now, Mr. Martin suggested the other day that perhaps a 6-year term would serve the purpose of getting in people more readily, because it was a term which a man might be willing to take out of his private life.

Senator Douglas raised the point that you could very easily put the Board in a situation where all of its members had been appointed by the then President.

Did your statement that the Board members should be reduced to five in number carry with it the idea that the terms should be reduced too?

Mr. THOMSON. We did not put in the reduction of term. I personally see no objection, although I think something could be said on the fact that 6 years may be a little bit short. We did not put it in. We included the reduction in the Board to five men and then indicated that you should do whatever is necessary to get better men, including paying better salaries, that that might get some result.

I can see some results in getting quicker change in standards if you get it to 6 years. Of course, that might be a little short, and 14 might be a little long—but we did not put it in.

Mr. FOLSOM. I think it was pointed out that there was not one case where a person actually served 14 years yet.

I would say, cut it down somewhat. One reason is that it is a handicap in appointing an older person because you would not want to appoint a person of 51 because he would be 65 at the end of that 14 years. So, I would suggest 8 or 10 instead of 14.

Representative BOLLING. Thank you.

Representative PATMAN. Senator Douglas?

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Senator DOUGLAS. Mr. Chairman, you have sacrificed so much to my questioning that I think I will waive, and——

Representative PATMAN. Well, I am not sacrificing anything, Senator Douglas. I am profiting by the questions and answers. I only have a few questions, and I will be glad to ask them after you are finished. Yours do not conflict with any of my questions, I am sure, and if it does, it is all right anyway.

Senator DOUGLAS. First, let me say that I approve of the general nature of these two statements. There are no questions, certainly, which I might wish to raise which would be adverse to the general stream of the testimony given this morning.

I take it that you feel that the so-called accord under which the Federal Reserve is not obligated to maintain at par the price of Government bonds has been on the whole beneficial.

Mr. FOLSOM. Yes, sir, I do.

Senator DOUGLAS. Because it has freed the Federal Reserve of the obligation of buying large quantities of bonds on the open market, and hence dampen down the rise in bank reserves and the increase in bank loans.

Mr. FOLSOM. Yes, sir.

Senator DOUGLAS. And on the whole you believe this policy should have been adopted earlier?

Mr. FOLSOM. Yes, sir.

Senator DOUGLAS. That happens to coincide with my own belief. Of course, it is always difficult to speculate in past motives, but do you have any information as to why the Federal Reserve Board did not adopt this policy earlier and how it was that they summoned up their courage finally in the winter of 1951?

Mr. FOLSOM. No. I imagine it was due to the fact they did not want to run against the position of the Treasury at that time. I do not know whether the Treasury changed its mind and therefore did not object so much to the proposal of the Federal or not, but I do know it was discussed at length from early Korea up to the time it was done, and I know there are lots of people in the Federal Reserve System that felt the action should have been taken much earlier. I think it was just a question of getting up the courage to do it.

Representative PATMAN. If you will pardon me, Senator Douglas, I think on page 11 of Mr. Thomson's statement you will find the answer, where he said:

> I think the present fact is that the Federal Reserve System cannot follow a policy that runs counter to any generally held public belief about what monetary policy should be. If anything, the Federal Reserve has been unduly sensitive to opposing views that do not really represent any widely held conception of the public interest. The Federal Reserve began to exercise its independence only when it became clear that the course it wished to follow had a large measure of public support.

I assume what is meant there is that the Douglas committee gave them a lot of support. I imagine it gave them a feeling of security.

Senator DOUGLAS. Well, I would like to accept that credit, but our committee reported some 6 months before Korea and if our report had an effect, it was a very delayed effect.

Mr. FOLSOM. I might say, however, that if the Federal Reserve is going to function as it should, very often it will have to take action that does not have popular support.

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Senator DOUGLAS. Well, I think that perhaps the moral support in Congress which some of us helped to develop made the Federal Reserve feel stronger in its position than it had previously felt.

Mr. FOLSOM. I think at that time it did have fine support——

Senator DOUGLAS. And it stiffened the backbone of the Federal Reserve and enabled an innate desire for the virtues of life to come to fruition more fully than otherwise would have been the case. Is it not possible, therefore, that in the tension between the Federal Reserve and the Treasury, that this might have given the weaker party more backbone?

Mr. FOLSOM. I do not know what you have in mind, Senator.

Senator DOUGLAS. Well, I have in mind the fact that possibly congressional committees with all of their toughness and, at times, vigorous methods of cross-examination may have played a part in strengthening the will of the weaker party.

Mr. FOLSOM. Yes; I think that is undoubtedly so.

Mr. THOMSON. I think, on the record, Senator, that these two sets of hearings have done a great deal and these records that have been made have made a public record that bankers and students and others can study and apply to a particular situation.

I think that these hearings may come out as indicating more definitely that Congress is in favor of the Federal Reserve holding its independent position and, this having been up before two committees, undoubtedly they are going to have more education, they are going to have more backbone, they are going to have a feeling on the part of the agency that it has been studied by Congress and that they ought to go ahead and meet their responsibility and do it.

Senator DOUGLAS. But really the fundamental question of policy involved, it seems to me, is that in the past the Treasury has always stressed the importance of a low interest rate. It has felt that the maintenance of a low-interest rate was more important than the maintenance of a relatively stable low price level.

Do you subscribe to that analysis of mine?

Mr. THOMSON. Well, the Treasury has taken the position before Congress that they favor this continued low-interest rate. I think it has been a mistake. I think that the Treasury's position before this committee changes that previous statement of theirs. I think that has been all to the good, I think that they have brought their position out and I hope that the public and the banking fraternity and the agencies get the impression that flexible interest rates on the Government debt are a part of the maintenance of a free market which we ought to be for in this country except in real emergencies.

However, I do not think that the public has been fully aware of the fact that low interest rate on the Government debt and therefore somewhat lower taxes is not the whole story because there are offsetting factors.

One is the inflationary situation and another one is the higher cost of insurance and another is the general inequity of the whole thing.

I do not think that the low interest rate case has yet been put up in terms of alternatives and in terms of the net cost to the citizens.

Mr. FOLSOM. I might add I have indicated in my statement the reply that the Secretary of the Treasury made to your committee, in which he listed the low interest rate as No. 7 on his list, with others

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as more important, and I think there you will find a very correct statement of the relative importance of the objectives.

Senator DOUGLAS. Well, now, let me ask you this question, which I think seems to follow:

Is the maintenance of a comparatively stable price level more important even though it may entail more restriction in the total amount of credit than there otherwise would be?

Mr. FOLSOM. Yes, because I think the dangers of inflation and the trouble that inflation causes to such a large part of the population are so great that they should be our main concern, to try to stabilize and maintain the purchasing power of the dollar.

Senator DOUGLAS. As a matter of fact, the low interest rate has saved the Government $300 million during this last year, but the increase of 10 percent in the cost of living during the succeeding year plus the increase of 16 percent in the wholesale price has probably cost the Government in a given year on the basis of the present budget at least $10 billion, so that the losses to the Government alone through inflation have on this basis been 30 or 40 times what the losses would have been due to a raise in the interest rate.

Mr. FOLSOM. Yes.

Senator DOUGLAS. Do you think the general public understands the connection between the open-market operations of the Federal Reserve Board and the movement of the general price level?

Mr. FOLSOM. No, I do not think they have much idea of it.

Senator DOUGLAS. Do you not think an important job of education could be done in that field?

Mr. FOLSOM. I think it can be in this whole field of monetary policy. I saw a questionnaire the other day about inflation and what causes inflation and what should be done, and there was no mention of monetary or credit policy.

Senator DOUGLAS. It is true, is it not, that the purchase of Government bonds by the Federal Reserve creates added reserves among member banks?

Mr. THOMPSON. Yes, sir.

Senator DOUGLAS. Would you say that is true, Mr. Folsom?

Mr. FOLSOM. Surely.

Senator DOUGLAS. Under the Reserve System the increase in the reserves of the member banks makes possible a sixfold increase in the loans which member banks can make to private borrowers.

Mr. THOMSON. That is correct.

Senator DOUGLAS. And so their lending capacity increases and therefore in practice, assuming an active demand for loans, as their reserves go up loans will go up, although not necessarily in the precise theoretical ratio of 6 to 1. But this increase in loans, other things being equal, leads to an increase in prices, because of the increase in the quantity of money offered for goods so that unless there is a commensurate increase in physical production the result is inflation.

Now, do you think it is timely or important that it should be made clear to bankers and businessmen and public officials, and the general public?

Mr. FOLSOM. Yes, sir. I think the bankers and businessmen understand it pretty well now. I think all of the discussion going on in the last year has caused a lot of people to know more about it, but I think we have got a long way to go yet insofar as the general public is concerned.

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Senator DOUGLAS. What about public officials?

Mr. FOLSOM. I think we could all stand a little more education.

Mr. THOMSON. We were talking, before the hearing started, about how available these reports are going to be made. I think along the lines you are talking about these reports ought to get very widespread circulation. I am going to get some for each officer in our corporation.

Senator DOUGLAS. You mean these volumes, these two [indicating]?

Mr. THOMSON. That is right; because they put together a lot of valuable information and you have drawn out answers from people that have not been had in recent years. The record of the two hearings is the best source of information as to the developing monetary policies of the country and the value of these powers, and I believe they should get as wide a circulation as possible.

Senator DOUGLAS. What would you say about the contention that if the Reserve stops the purchasing of bonds in the open market that the banks, in order to build up their reserves, will send in commercial paper through the Reserve for rediscount and that the Reserve will be compelled to rediscount this paper, and the only weapon will be a rise in the interest rate and that this rise in the interest rate when passed on to the bank will not have a deterrent effect?

Mr. FOLSOM. But, you still have got a little leeway in the reserve requirements——

Senator DOUGLAS. Would you be ready to use higher reserve requirements?

Mr. FOLSOM. I think it depends entirely on the circumstances at the time. It is pretty hard to make a statement.

Senator DOUGLAS. I had thought that your idea was somewhat adverse.

Mr. FOLSOM. Yes. We were not very much in favor of increased reserve requirements. As a matter of fact, you do not have very much further to go, but it is a tool that can be used under certain circumstances.

Mr. THOMSON. Raising the bank reserve requirements would not affect other than bank lenders, it would only affect the banking industry.

Senator DOUGLAS. We have these proposals on the reserve requirements. You have rejected now the proposal for a secondary reserve in the Government bonds.

Mr. THOMSON. Very definitely.

Senator DOUGLAS. What would you say to a change that would permit additional percentages of the reserve to be required on additional increments to the total loans? Do I make myself clear?

Mr. THOMSON. Yes.

Senator DOUGLAS. Freeze the existing level of reserves at, say, 14, 20, 24 percent, but provide, let us say, 18, 24, 28 percent for reserves upon further increments of bank loans.

Mr. THOMSON. Well, we have taken the position in this statement against that policy. The reserve requirements, we think, are the least important of the tools that the Federal Reserve has got to work with today.

If you continue open-market operations, if you continue the general public education, if you continue the voluntary credit restraint program which has an educational value as to the policy on bank lending, I think you will do the job without introducing an element

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which may be relatively ineffective and could do some harm because it is too arbitrary.

Senator DOUGLAS. I am a little puzzled by your present statement because of a recent question I addressed to Mr. Folsom about the open-market operations, namely, whether the banks might circumvent selling of Government bonds as a device for increasing reserves by presenting commercial paper for rediscount by the Federal Reserve, which would have to accept them and then the reserve would hold down credit expansion only through a rising discount rate. Then I raised the question—which he did not disagree with—whether a rising rediscount rate would have much effect upon borrowing and if it does not, we would have to rely upon the alteration of the reserve ratio, which you now attack to hold down credit expansion. So that taking the testimony of the two of you together, your position seems virtually to vitiate the Federal Reserve policy.

Mr. FOLSOM. No, I did not——

Senator DOUGLAS. Well, I hope that you will clarify your position.

Mr. FOLSOM. I did not intend it that way at all, I did not answer your question about increases of rediscount rate—I think in those conditions it would be quite in order to raise.

Senator DOUGLAS. You think it would be effective?

Mr. FOLSOM. I think it would be. But, as you know, there is very little commercial paper that comes for rediscount. Most of it is Government securities, and I do not think that that situation is going to change at any time soon, but assuming it does change, then your answer would be an increase of the rediscount rate. That is very sensitive, and it would go down along the line, psychologically as well as otherwise.

Senator DOUGLAS. Let me ask a legal question. Do you understand that the Federal Reserve has the same optional power in rediscounting short-term Government paper that it has as to whether or not to rediscount short-term Government papers?

Mr. FOLSOM. As far as I know.

Mr. THOMSON. I would have thought so.

Representative PATMAN. You mean direct purchases?

Senator DOUGLAS. No; rediscounts.

Representative PATMAN. Direct purchases are restricted to $5 billion, anyway.

Senator DOUGLAS. Well, I think this is a very important technical question, whether the Reserve has the discretionary power in rediscounting short-term Government paper presented by the banks. It does not seem to have discretionary power in connection with ordinary commercial paper.

Well, now, do you think that a slight rise in the interest rate will have much of a deterrent effect upon short-term borrowing?

Mr. FOLSOM. I think it was effective to some extent when it was raised the last time.

Senator DOUGLAS. What has helped to puzzle me is that the cost of interest is relatively an insignificant fraction of the total cost of doing business and when you get an increase in the rediscount rate, that is, a change in the secondary degree, then you still further diminish the increase as an absolute effect.

Mr. FOLSOM. Of course, there is a psychological factor there besides, as I have indicated. It is an indication that the authorities are

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going to begin tightening up on credit and therefore there will be less credit available and that they have taken steps, and this is one step in that direction.

Senator DOUGLAS. But it is not tightening up on credit, it is merely raising the price.

Mr. FOLSOM. Well, they will be expecting that they will tighten up credit, of course, and I think in the long run it does.

Look what the Bank of England did. They jumped from 2½ to 4 percent. Undoubtedly that is going to have a very pronounced effect, psychological as well as on the amount available—and people will not pay those higher rates.

Senator DOUGLAS. Well, if it was a long-term investment, then I can see how with respect to long-term investment decisions, increases in the interest rate would have a tremendous effect upon people going into certain ventures which, let us say, might pay out at 3½ percent interest but will not pay out at 4½ percent; and, therefore, the indirect effect of an increase in the short-term rate on the long-term rate might be important, but I have never quite seen an important direct effect of a rise in short-term interest rates in restraining commercial loans.

Mr. FOLSOM. Well, Mr. Thomson has made a lot of loans. Maybe he could comment.

Mr. THOMSON. If I could just comment, my thinking about it from the practical standpoint is that if the Federal Reserve were to create more reserve so the banks had more opportunity to loan more money——

Senator DOUGLAS. By purchase in the open market?

Mr. THOMSON. Yes. My impression is that the bank I am familiar with would not take advantage of the opportunity.

They would not do it for two reasons. One, because bank loans are already high in relation to the capital, and because the voluntary restraint program operates in the moral suasion field. You are not supposed to think in terms only of what you can do, but also in terms of curtailing credit to control inflation, and also you are supposed to be thinking and giving consideration to the defense effort.

But if the banking system as a whole were expanding loans and the Federal Reserve raised the discount rate, I think that raise would be effective from two angles.

One is that it gives notice that the Federal Reserve thinks that consideration should be given to an excessive expansion of credit; and secondly, there is the actual cost factor. A rise in interest rates generally affects long-term commitments more than short-term, but eventually there is an effect on short-term.

That is the practical effect as I see it from the standpoint of banking.

Senator DOUGLAS. There was one statement you made which I was not quite certain about. Did you say it was an exception to the general rule or a part of the general rule that a rise in that rate would not cause them to lend more?

Mr. THOMSON. I do not think the banks generally would take advantage of the opportunity today to extend their borrowing six times the amount of increased reserves supplied by the open-market operations.

Senator DOUGLAS. If the Federal Reserve were to buy bonds and increase the bank reserves, does it then matter, because you say the

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banks would not lend it out—so why are you so concerned about the restraint?

Mr. FOLSOM. He is not——

Mr. THOMSON. I am not concerned about any restraint.

Mr. FOLSOM. He is not concerned right now. That does not mean he would not be concerned in the future.

Senator DOUGLAS. Well, now, you finally come down really to a reliance upon the restraint of the private banker and not a reliance on the available total amount of bank credit which they could lend.

Mr. THOMSON. Well, no; your basic statement was that the Federal Reserve open market would create more reserves and I am assuming that the way they would do it is more effective.

Senator DOUGLAS. If they buy more bonds they create more reserve.

Mr. THOMSON. Yes.

Senator DOUGLAS. And make it possible for the bankers to lend more and if the bankers lend more, that tends toward inflation. You think the banks will not lend more?

Mr. THOMSON. They will not take advantage of the present opportunity to extend to the full limit under present conditions.

Senator DOUGLAS. So it really would not matter very much if the Federal Reserve did go out and buy bonds?

Mr. THOMSON. Oh, I would not say it would not matter. It is a question of degree.

Senator DOUGLAS. Then, what about all this discussion of yours——

Mr. THOMSON. Well, I was trying to spell out the practical application of what you are saying, and that is that if the rediscount rate, if you get a condition under which the Federal Reserve does extend the buying power of the banks in the open-market operations and the banks do take advantage of it, then the rediscount rate would operate. The rediscount rates do not operate when relatively few banks are borrowing.

Senator DOUGLAS. I understood you to say the rediscount rate would only operate if they cut down on open-market operations, but if the Reserve stopped buying bonds as it has during the last year, then the only way the banks can build up their reserves is through either short-term Government paper or commercial paper for rediscount, so that the raising of the rediscount rate would be an alternative or would be a supplementary line of defense to back up certain policies in buying in the open market, but if——

Mr. THOMSON. That part of your sentence where you said raising the rediscount rate is a supplementary power I think is a correct statement.

Senator DOUGLAS. That is all.

Representative PATMAN. Mr. Folsom, I would like to ask you several questions, if you please.

You mentioned about a more efficient military-procurement policy. What do you think about the Government separating procurement generally from the military, in other words, have strictly civilian groups composed of people who are supposed to know, who are experienced in manufacturing and procuring and marketing and distribution generally, in charge of the procurement for the armed services?

Now, I realize that a graduate from West Point or Annapolis is certainly qualified to do what he is trained to do and he is the very

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best in that line in the world. But I do not think that it necessarily qualifies an officer to get the best deal for the Government in dealing with people whose business it is to sell or to distribute the goods that they manufacture.

What do you think about giving consideration to separating the procurement from the military?

Mr. FOLSOM. I have not given that much thought, that particular question.

I should think when it comes to procurement that most of the supplies that are available in the market, the ordinary consumption goods and a lot of the supplies that the Government must buy and the services must buy in the open market—I think that it would be desirable to separate the functions and put them in charge of procurement agencies, just the same as an ordinary business concern, a manufacturer, would have a purchasing department.

Representative PATMAN. You mean that the larger concerns, the larger private corporations have their own separate purchasing departments.

Mr. FOLSOM. Yes, that is right, and they keep in close touch with all of the factors that operate in supply. Of course, they have to have engineers on their staff who understand all these things, but it is a separate function and I think that it might work out very well in the armed services.

On the other hand, it might be difficult in the case of some items such as planes and complicated things of that sort. Whether they would gain there or not I do not know. But I do think that a good part of the procurement program could be separated and then they would get a more efficient program.

Representative PATMAN. Of course I realize that there are some exceptions, such as in the scientific field, including things like the Atomic Energy Commission and certain parts of our program for the Air Force; but generally you think it would be a good thing to at least consider it?

Mr. FOLSOM. It certainly should be studied very carefully. I do not know whether you could change right now without causing great difficulty in the military program.

Representative PATMAN. But you think it might at least stop this present policy of buying the same commodity at one price in one place and at a different price in another place, clear out of line.

I noticed that, taking an article such as shoes procured by the military, where a pair of shoes would be $4 from one manufacturer and $6 from another, and $8 from still another. I am not trying to give the exact amounts but it was quite a variation. That kind of thing you believe would be eliminated?

Mr. FOLSOM. Well, if they had one centralized procurement office it would be very simple because they would have one agency set-up through which they would have to buy.

Representative PATMAN. And now it is not centralized.

Mr. FOLSOM. Not only that, but you have got agencies competing with each other.

Representative PATMAN. Now, do you believe that the Employment Act of 1946 sets forth a good economic policy for the Government and for the country?

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Mr. FOLSOM. Yes, I do, and I think some of the replies to the questionnaire brought out that there was not much in it about preventing inflation, but I think it was implied all the way through. I think on the whole the objectives are very well stated.

Representative PATMAN. Well, in taking care of the general welfare, of course you have to prevent inflation.

Mr. FOLSOM. Yes. But you did specify quite a few other things. If you are going to write it over, I think it might be well to put down as one of the main objectives preventing inflation.

Representative PATMAN. Yes. Of course, a bank can do a lot in the way of preventing inflation but they cannot do very much in the way of curing deflation——

Mr. FOLSOM. No, except that if you hold down inflation you help prevent deflation and——

Representative PATMAN. Of course, it is not the fault of the bank, which can pull a string but cannot push it. I recall that on February 27, 1932, Mr. Hoover made the effort to get the banks to extend more credit and asked Congress to pass a bill, which Congress did, permitting the banks to put up anything to get Federal Reserve notes, even their own promissory notes, to get credit, but still it did not do any good.

Mr. FOLSOM. The business concerns just did not want to borrow it.

Representative PATMAN. That is right, because they did not have the earning capacity, they did not have the real backlog of purchasing power. That is really what caused it, they did not have any purchasing power.

Now, with regard to regulation W, do you think that regulation W should be continued for another year?

Mr. FOLSOM. Yes.

Representative PATMAN. Do you agree, Mr. Thomson?

Mr. THOMSON. Yes.

Representative PATMAN. And regulation X?

Mr. FOLSOM. The same way.

Representative PATMAN. Now, last year during the whole year there was only an extension of about $300 million in credit through all of regulation W. Does that not seem rather small in the over-all credit structure, to be controlling and regimenting, $300 million, taking into consideration too that these people who make these sales have something at stake, they want to collect their money for what they sell and they are not going to make terms that will not permit the purchaser to pay back; so you have got a restraining influence there.

Mr. FOLSOM. Well, I do not think it is really as important as the general credit control, but in certain times it is quite effective, and if you have a normal amount of business being done and on top of that you add a big increase, extend installment credit, that adds that much pressure to the inflation.

Representative PATMAN. I do not know what the facts are but I imagine that even the banks of one city like Chicago or New York put out at least two or three times that much in credits.

Mr. FOLSOM. I think that is true.

Representative PATMAN. And it was awfully small, this $300 million. I just wondered about the value.

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Mr. FOLSOM. Well, I think it is a tool that the Federal Reserve should have. Whether or not they would exercise it would depend on conditions and it should be used flexibly at some times to increase rates and other times to cut down.

Representative PATMAN. Now, you gentlemen have impressed the thought upon us that we should have an independent Federal Reserve System. I agree with that. I agree that we should have an independent Federal Reserve System. I am opposed to any system where Members of Congress or the executive branch of the Government, including the President, would have any power to pressure, to compel the extension of credit. That would be bad, and I do not want that, and I do not know of anyone else that wants it.

But in the exercise of that independence do you not think it is absolutely necessary that there be a close coordinating arrangement between the Treasury and the Federal Reserve System and that they should at all times work together constructively?

Mr. FOLSOM. Yes, sir.

Representative PATMAN. There must be a coordinating working arrangement there.

Mr. FOLSOM. Yes, sir; as close as you can get it.

Representative PATMAN. And in the absence of that, if they were to fail to do that, then Congress should take some action, should it not, Mr. Folsom?

Mr. FOLSOM. Well, I think it depends on circumstances. I cannot foresee a situation developing where if it was very important they will not get together and work out some sort of a compromise.

Representative PATMAN. It was mentioned the other day when Mr. Bolling asked Dr. Blough the question what would happen if the Treasury were to put out an issue of bonds and it was not fully subscribed and the Federal Reserve banks failed to take up the amount that was not subscribed. Dr. Blough said that would very quickly end the independence of the Federal Reserve System.

What do you say about that?

Mr. FOLSOM. Well, I cannot see such a situation, where the Federal Reserve would sit by and have an issue fail.

Representative PATMAN. You do not agree they would do that?

Mr. FOLSOM. No.

Representative PATMAN. Well, I do not think they would, either, but I think something would happen very quickly if that were to happen.

Mr. THOMPSON. Congressman, may I just add to your remarks on regulation W and its effect on consumers. Consumer credit control affects nonbank lenders as well as bank lenders, and I do not think it was related only to its effect on banking.

Then, on the other point of the Federal Reserve not letting an issue fail, our report indicates that we do not recommend any formalization of that necessary coordination——

Representative PATMAN. You mean any law compelling them to do it?

Mr. THOMSON. That is right; yes.

Representative PATMAN. Of course, it is suggested that we consider putting the Secretary of the Treasury on the Board like he was at one time, when as you know the Secretary of the Treasury was Chairman

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of the Federal Reserve Board and also on that Board was the Comptroller of the Currency.

Do you gentlemen agree with that?

Mr. FOLSOM. Certainly.

Representative PATMAN. Dr. Goldenweiser has advocated, I believe, under the sponsorship of your very fine organization, the CED, that one member of that Board should be from the Cabinet of the President. Now, do you gentlemen subscribe to that?

Mr. FOLSOM. No; we do not agree with that. We think that might interfere somewhat with the independence of the Board.

Representative PATMAN. Well, did not your organization put the book out?

Mr. FOLSOM. When we engage an expert, an authority like Dr. Goldenweiser, to make a research study, we do not censor at all what he puts in a book. It is his own personal recommendations, and not a recommendation of ours, our committee. So we are not responsible for his recommendations, although in general we are in agreement with the general principles—but in the particular case we disagree.

Representative PATMAN. You did not take any action, did you?

Mr. FOLSOM. No; except our statement here.

Representative PATMAN. There was no action taken by the committee in opposition to the recommendation of Dr. Goldenweiser?

Mr. FOLSOM. I do not think in opposition; but our recommendations do not include that point, though.

Representative PATMAN. Do you consider the Federal Reserve System a public institution, Mr. Folsom?

Mr. FOLSOM. Yes, sir.

Representative PATMAN. And do you agree with that, Mr. Thomson?

Mr. THOMSON. Well, an unusual public institution.

Representative PATMAN. Do you believe that the amount of stock that the commercial banks hold in the Federal Reserve banks which I believe aggregates about $241 million, do you believe that that gives the bankers a right to say that they are the owners of the Federal Reserve System?

Mr. FOLSOM. It is a very limited ownership and actually it works out in practice that the relationship is quite different from the relationship in the ordinary stock company.

Representative PATMAN. It is not intended to be ownership.

Mr. FOLSOM. No.

Representative PATMAN. Mr. Wiggins made the suggestion the other day in I think a most reasonable and logical argument for continuance of that stock ownership that because of that the bankers would be more interested in that system and the System would get the benefit of their counsel and advice and experience and their services.

Mr. FOLSOM. Yes, there is no question about that.

Representative PATMAN. But as far as controlling and having an effect in the capital structure, it does not mean anything.

Mr. FOLSOM. No.

Representative PATMAN. Because it is too small.

Thank you.

Dr. Murphy, would you like to ask some questions?

Mr. MURPHY. In the report of the subcommittee 2 years ago the recommendation was made, that making our money convertible into

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gold coin or gold bullion would militate against, rather than promote, the purposes of the Employment Act and the subcommittee recommended that no action in this direction be taken.

Looking to our report, do you believe that a reaffirmation of that recommendation would be constructive?

Mr. FOLSOM. Yes, I think it would.

Mr. THOMSON. I do not believe that the installation of gold convertibility at this time is practical because in my judgment you cannot have an effective gold standard unless you also have freedom of exchange and an opportunity to trade back and forth so as to enable you to make the gold standard effective. Furthermore, you have to have more cooperation than there seems to be any prospect of getting today among governments, to make sure that they live up to the spirit of what gold is intended to mean. Therefore, I agree that this is not the appropriate time to do it.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. I think that the Committee for Economic Development is certainly to be congratulated for encouraging academic freedom of its research staff and its economic consultants, in fostering and promoting publications such as that of Dr. Goldenweiser, even though the committee might itself differ in some minor or major aspects.

Representative PATMAN. I will read from the most recent report, just a paragraph from the Report of the Joint Committee on the Economic Report which was filed a few days ago, March 12 to be exact, about military procurement. We discussed that in the committee and they made this recommendation:

> The committee also suggests that the appropriate legislative committees look into the possible efficiencies and economy which might be achieved by placing the procurement of military items in the hands of a trained civilian board. As a corollary it might prove desirable to establish a corps of civilian reviewers to examine military specifications with a view to substituting less critical and less expensive materials where possible and set cost standards which would permit savings without sacrifice of service.

Mr. FOLSOM. I particularly endorse the second part as well as the first part because I hear so many complaints by the business people about the type of specifications that they get, and if they had the opportunity to produce only a certain article, they could produce a lot more and save a lot.

Representative PATMAN. Now, on the subject of specifications, it was brought out by a member of this committee of five appointed by President Truman last year, who are making their report now, about scarce materials that the military is insisting upon copper being used in the making of a certain product when recent discoveries and experiments demonstrate conclusively that steel could be used just as well as copper, but the military will not yield on that point because they just state that they have always used copper and they will not take anything else.

So, in special classifications, it would be important to have that review.

Mr. FOLSOM. Well, among the production engineers in industry you have a very ingenious and skillful group that can show the military quite a lot, I think.

Representative PATMAN. And we should not expect the military to do those things, it is not their business.

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Mr. THOMSON. We will have a report next month in regard to our budgetary position and we are going to deal specifically with some of the points you raised and we will make sure that you get copies because I think it will cover those points.

Representative PATMAN. We will look forward to getting them. We have two other witnesses for this afternoon—Mr. Hemingway and Mr. Fennelly. I wonder if it would be all right to hear them this afternoon, if it would inconvenience them too much to ask them to come back at 2:30. The committee will stand in recess until 2:30.

(Whereupon, at 12:05 p. m., a recess was taken, to reconvene at 2:30 p. m., of the same day.)

AFTERNOON SESSION

Representative PATMAN. The committee will please come to order.

Mr. Hemingway, will you please come around.

Mr. Hemingway, for the record and for the members and the staff, I will give this information about you.

Mr. Hemingway is the chairman of the advisory committee on special activities of the American Bankers Association; he is a former president of the American Bankers Association; he is chairman of the executive committee of the Mercantile Trust Co. of St. Louis, Mo.

Mr. Hemingway, we are glad to have you here today. I believe you have a prepared statement?

STATEMENT OF W. L. HEMINGWAY, AMERICAN BANKERS ASSOCIATION

Mr. HEMINGWAY. Yes, Mr. Chairman.

Representative PATMAN. If you would like to proceed with your statement until you have finished before any questioning, it will be all right, or whatever you prefer to do. If you want to yield for questions, that will be up to you.

Mr. HEMINGWAY. I think that will probably be the most expeditious way, Mr. Chairman.

Representative PATMAN. It will be satisfactory with the committee. You may proceed.

Mr. HEMINGWAY. As a background for a discussion of credit and credit control, it is well to review the structure of the banking system as it operates today through 20,000 banking offices, including about 5 000 National banks and almost 10,000 State banks, in addition to 5,000 branch offices. Only a score of banks are large metropolitan institutions with deposits of $1 billion or more, but there are over 11,000 banks with deposits of less than $5 million. Each of these institutions has its board of directors made up of men regarded as business and professional leaders of the community, representing every type of local activity. These men are well informed regarding the conditions and needs of their towns and cities. They are interested in community growth and development. The men and women who are serving on the official staffs of the banks are doing a better job today than ever before. In the last 15 years more study has been given to the underlying purposes of their calling, as well as to the techniques of operation. This is illustrated by the number of banking seminars held each year by banking groups in conjunction with universities and

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colleges throughout the country. The American Institute of Banking which has been in operation for 52 years has nearly 40,000 students receiving basic education in banking, business and related fields through almost 400 local AIB groups throughout the United States. In addition, several advanced schools of banking in various sections of the country are conducted by trained educators and bankers. These schools are attended by bank officers activity at work in their banks who take time off each year to attend these courses in practical banking and applied economics.

This year over a thousand men holding positions ranging from assistant cashiers and assistant trust officers to presidents and board chairmen will attend the classes of the Graduate School of Banking of the American Bankers Association at Rutgers University. The instructors will include well-known professors of law, philosophy, economics, and business management, and representatives of government, as well as distinguished bankers who will give the younger men the benefit of years of banking service. So, I saw that never before have the officers of our banks been as well equipped to perform the services expected of them as at this time.

Furthermore, never have the banks generally been in a better position to serve the people of this country. During the great depression, the weak banks were either strengthened or eliminated. The system was thus prepared to deal with the tremendous operation of World War II which was made easier by the smooth functioning of the banking system in supplying the financial and related services required by industry, agriculture and government in support of our military forces. At the same time, the banks greatly eased the financial problems of the Treasury by using their facilities to sell bonds to the public.

Also, the needs of the individual and small business men are being served better than ever before. Today most banks throughout the country have a department or officer devoted to the making of personal loans of all types. This is just an illustration of how the banking system is a living, working and effective part of the free enterprise system.

The banking system is very flexible. The credit facilities, such as those I have described, can be expanded to encourage production and consumption when it is in the national interest to do so and they can be contracted when the danger of excessive credit expansion becomes evident.

There is another group of banks, mostly in the northeastern part of the country, that are also rendering a fine service to our people. They are the mutual savings banks. There are over 500 of these banks and they hold $21 billion of the savings of the people. These banks perform a very valuable function but, as they are not a part of the system which contributes to the expansion and contraction of the money supply, they are not included in these discussions.

One of the questions that we were asked to consider is that of general credit controls. This of course leads at once to the question as to who will do the controlling and what methods will be used. Prior to the creation of the Federal Reserve System in 1913 the credit machinery, like Topsy, "had just growed." The issuance of credit was subject to few regulations and there was no central banking system.

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Most of the regulations under which the State and National banks operated related largely to statutory provisions and not to the general supply of credit.

Following the money panic of 1907 the feeling throughout the country was that our currency was inelastic and our credit system was inefficient because it produced shortages of credit at critical times and abnormally high rates of interest, thus creating a burden on industry and agriculture. After extensive study and hearings the Federal Reserve System began to function, the eyes of most people were still turned toward the evils of the contraction of credit, rather than the dangers of inflation. It was only after the First World War that the managers of the Federal Reserve System began to realize the necessity for careful management of the credit mechanism to help maintain a sound credit situation. This problem has become increasingly more difficult as time has passed. It has been especially aggravated in recent years by the tremendous expansion in the national debt due to World War II and its aftermath which, together with nonessential spending, has produced the powerful inflationary forces that are now at work.

If we are to retain the free-enterprise system with the freedom of the market place, general credit controls involving use of the rediscount rates of the Federal Reserve banks and operations of the open-market committee are superior to any other implements of credit regulation. The use of these measures requires the kind of judgment and skill that can only be found in men who are students of the whole economic scene and who are as nearly impartial as is possible for man to be. In reaching their decisions they must not be influenced by political considerations or the pressure of any selfish business or other groups. It seems to us that the only way that the right decisions can be made is to have a board, such as the Federal Reserve Board, made up of competent men familiar with financial practices of the country and the operations of industry and agriculture to such an extent that they can perform their duties courageously and intelligently in the public interest. It is also just as important that the administration of the 12 regional Federal Reserve banks, which are in close touch with the credit scene in their localities and which are represented on the open-market committee, should be constituted in the same way.

We favor general credit controls over other methods because they are within the American tradition and do not place Government dictation over the individual credit relationships between lenders and borrowers. General controls provide the closest approach to democracy in credit. The first of these controls—the rediscount rate—can be made an effective instrument of credit policy. It can have an important psychological effect on borrowers and lenders. It serves as a warning signal that credit policy is being either tightened or relaxed. The effect of a change in the rediscount rate is country-wide. It can be felt from the small hamlet to the great financial centers.

The second method of general credit control is open-market operations. The history of the financing of World War II and the postwar period emphasizes the importance of the operations of the open-market committee. We recognize that these operations must take account of the large national debt and the necessity for its intelligent management. At the same time they must be conducted in a way that will not only preserve the soundness of both private and public credit

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but also safeguard the structure of monetary values through careful attention to their effect upon the money supply. Although the fiscal position of the Treasury at times may not be in keeping with the course the Federal Reserve and the open-market committee must pursue for properly managing the money supply, we have seen recently that by friendly cooperation and sympathetic understanding by each of the other's problems a sane program can be adopted.

In the final analysis, the Treasury should recognize that it must go into the market as a borrower and not as a printer of money through the debt-creation mechanism. This means that it is dependent upon prevailing and prospective conditions of supply and demand for funds in a money market that is geared to a sound credit policy. At the same time the Federal Reserve must recognize the needs of the Treasury in its refunding and new borrowing operation. Admittedly, this is not an easy process, but with men of good will and experience the result achieved through proper cooperation should be constructive.

The third method of general credit control is through changes in bank reserve requirements. It is our opinion that the use of bank reserve requirements to regulate the supply of credit is a very poor weapon. It is like using a meat ax when a rapier is desired. The change in reserve requirements usually necessitates a complete readjustment in the program of each of the member banks. Such changes should seldom be made and only under conditions that require it.

Furthermore, the effectiveness of changes in reserve requirements has been demonstrated in the past to be limited, as they have been offset by open-market operations to preserve orderly conditions in the market for Treasury obligations. It also should be observed that changes in reserve requirements directly affect only the banks, and do not curtail or expand the lending power of those institutions and other nonbank investors which have become such important factors in the money market with the growth of the Federal debt. The rediscount rate and the operations of the open-market committee, on the other hand, are like instruments in the hands of a skilled surgeon, and we know from experience how effective and useful they can be.

We have greater confidence in the effectiveness and democratic nature of these general controls, as contrasted with selective credit controls which are intended to regulate credit for specific purposes. It has been our feeling always that selective credit controls should be used only in great emergencies, such as wars. Even through mechanical yardsticks for credit extension may be adopted, directives by any official or board in Washington telling lenders to whom they should lend and for what purposes would lead to the destruction of the free-enterprise system, because credit is the life blood of economic activity.

The borrower must have freedom of choice as to when and how he may borrow, and the lender must have freedom to determine whether it is to the best interests of his institution and the public it serves to accept the application. These decisions should be made within the framework laid down by general credit policy, and not under dictate of selective credit regulations or credit-rationing techniques.

There is another method of credit control which is now in use and which has proven to be quite effective. It is the voluntary credit restraint program, which was inaugurated by the Federal Reserve Board under the authority of the Defense Production Act of 1950. The re-

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ports from the committees show that the constituent members, such as insurance companies, investment bankers, and commercial bankers have given loyal support to the program. They have helped to direct their funds to useful and constructive purposes necessary for the defense effort and essential activities, and to avoid speculative loans. It is difficult to measure the precise effect that the program has had upon the financial business of the country.

However, we believe that the voluntary credit restraint program has proven most effective and that it has provided an answer to those skeptics who decried the idea that a voluntary program could be successful. This program has preserved the flexibility of the free market, and at the same time has helped to minimize the inflationary impact of essential defense financing. Equally as important, the program has developed in commercial bankers a feeling of responsibility in passing upon loan applications that they should consider, in addition to the usual test of credit worthiness, the effect of the loan upon the public welfare. If a loan that is sound in other respects is not in keeping with the apparent needs of the times, it is declined under the principles of the voluntary credit restraint program. In this way, credit resources made available under a general credit policy can be apportioned in a voluntary, democratic manner to those uses which are required under the defense program, while the inflationary impact of speculative uses of credit is avoided.

The other question which we have been asked to consider is: "How should monetary policy be formulated?" To answer this question it is necessary to understand the meaning of the words used. Obviously, monetary policy is not intended to regulate the operations of the economy. We do not view monetary policy as a procedure through which some governmental official, body, or agency might issue a law, edict, or regulation that would dictate the limits and requirements within which the financial machinery of the country is to operate. Such a method would be repugnant to the free-enterprise system. We view our economy, rather, as one in which millions of people must have the choice of decision, and such actions should not be fettered by regulations. In order to achieve the best functioning of this free-enterprise system, a stable currency is essential and the monetary policies adopted by the central-banking system should be designed to contributed toward the establishment and maintenance of such a stable currency. In this manner the central-banking system can help to prevent severe deflations and inflations. It should be realized, however, that monetary policy alone cannot be employed to stabilize the economy. It is important that no prearranged rules of operation should be adopted within which business must function. Monetary policy cannot be decided in advance. The economic factors involved are so complex that each decision must be made in the light of current and prospective circumstances. As the economy generates inflationary or deflationary tendencies that show signs of becoming injurious in character, Federal Reserve operations should be taken with a view toward correcting them through the instruments of general credit control.

We do not believe that fiscal policy can be used effectively and properly as a means of formulating monetary policy. Such a procedure would have real dangers. Except for refunding of outstanding debt, the fiscal operations of the Government should be confined to

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the collection of enough taxes to pay for its proper expenses, and the adjustment of the supply of money to the country's needs should be left to the Federal Reserve. Fiscal operations are also concerned with the character of Treasury borrowing, involving decisions as to maturity of Treausry obligations and placement of the debt in the hands of nonbank investors. But it is apparent that as a means for influencing the money supply the components of the budget are too crude and too slow to provide the delicate touch that our highly sensitive money market requires, and with the Federal budget in balance, the collection of taxes on the one hand and the expenditures on the other should not be the basis for fixing a monetary policy. The vast sums going in and out of the Treasury should be handled with minimum disturbance to the money market, but the fluctuations caused by these operations are of a seasonal and temporary nature and are not sufficient to be the basis for a monetary policy. We recognize, however, that sustained deficit financing by the Treasury over a period of time has decided inflationary effects. Deficit financing makes the problem of formulating a sound monetary policy more difficult. If the Treasury is forced to come into the market to secure new funds because a Federal deficit requires it, the balance in the money market becomes more delicate. Under these circumstances earnest cooperation between the Treasury and the Federal Reserve becomes even more essential.

If the situation should lead to a compromise with what can be considered as sound monetary policy, it should serve as a warning to the Congress that the deficit financing is producing an unhealthy situation that can only result in a further weakening of the soundness of money and credit. For that reason, we believe that fiscal policy must not be used to influence monetary policy. In the long run, there can be no compromise with sound monetary policy.

Under these circumstances, we feel that monetary policy should be in the hands of an impartial body of experts created by the Congress, and which is responsible to the Congress. We appreciate fully that regulation of the supply of money should not be left to the banking interests. The only supervisor, naturally, that can represent all of the people is the Federal Government. It is also just as clear to us that the executive branch of the Government should not be given the authority to control the supply of money and credit. It is only natural that it might be more responsive to pressures that may be inconsistent with sound money policy.

Impartial consideration, free from such pressures, is essential in these matters. The organization of the Federal Reserve System appears to have solved this problem by providing a nonpolitical set-up through which Government is represented by its appointees to the Board of Governors, while banking, business, agricultural and public groups are given the opportunity to participate through directorships on the 12 Federal Reserve banks.

Admitting that mistakes have been made in the operation of the System and that there will be imperfections that must be corrected from time to time, we are convinced that Congress has created perhaps the best system that can be devised for our country's needs.

When approaching questions of this nature, we must never lose sight of the unique characteristics of the American economy which set it apart from the economies of other countries. Our political heritage

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of a Federal Government operating side by side with State governments, and our traditions in the democratic approach to the use of money and credit cannot be treated lightly in considering how the structure of monetary regulation should be erected. We must bear in mind that from the earliest days of our Nation's history, the public has always been wary of concentration of money power and has insisted upon democracy in banking. That is why we have a system of 15,000 individual, locally managed banks instead of a network of branches of only one or two banks, and why our central banking system was conceived as a set of regional Federal Reserve banks instead of one central bank as is the case in foreign lands.

Our present Federal Reserve organization recognizes these traditions and circumstances. At the same time, it takes into consideration the need for regulation of the supply of money and credit in the public interest. The position of the Federal Feserve Board is a position of power. In the long run, the public would be equally wary of the misuse of that power as it would if such power were being exercised by private interests not in the general welfare.

That is why we are firmly convinced that the Federal Reserve must be nonpolitical and independent. In order to function properly, it is necessary that the members of the Federal Reserve Board be men of high character, equipped, by study and experience, to fulfill the tasks that are imposed upon them. Such men have served in the past and are now serving on the Federal Reserve Board. We believe that confidence in a board such as this can and should be maintained because it can then be responsive to the general needs of a sound economy and not to political demands.

We strongly support the principle of an independent Federal Reserve System. We define "independent" as "not being subservient to political influences on the one hand or pressure groups from business or any other field on the other hand, but as being at all times sympathetic to the needs of all groups in our Nation, including the requirements of the Federal Government."

It will not always be easy for the Board to operate in this independent way, particularly when it may become advisable to put on the brakes in order to assure sound money and credit. It is only human for people to want to see business grow and expand from day to day. But sound business growth must be distinguished from the temporary stimulus created by monetary inflation and speculation. Even when inflation reaches more advanced stages and the danger of a crash is imminent, the cry in some quarters will always be for more money and lower rates of interest. Few enjoy taking bitter medicine and the contraction in the supply of money and credit that may be necessary to control dangerous inflationary forces is always resented in some quarters and is popular nowhere. Therefore, the men who must make these decisions should be given to understand that they will be supported as long as it is clear that no selfish interests are being served. We shall give our full support to the role of the Federal Reserve System as long as these principles are diligently and courageously observed.

Representative PATMAN. You have a very fine statement, Mr. Hemingway. I read it over yesterday, and I followed you as you read it today.

Mr. HEMINGWAY. Thank you, sir.

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Representative PATMAN. Senator Flanders, would you like to ask any questions?

Senator FLANDERS. On page 6, Mr. Hemingway, the first full paragraph, you say that you have—

greater confidence in the effectiveness and the democratic nature of these general controls—

and you say—

even though mechanical yardsicks for credit extension may be adopted, directives by any official or board in Washington telling lenders to whom they should lend and for what purposes would lead to the destruction of the free-enterprise system.

We have had some testimony here to the effect that directed-credit controls are better from the standpoint of maintaining production, particularly in the defense or war situation, and that general credit controls, being general, do not adapt themselves to the requirements of a particular situation.

What have you to say with regard to that?

Mr. HEMINGWAY. Well, I think our answer to that is that if you are in a war economy that any plan that will help promote defense should be adopted, and, perhaps, by selected controls in time of war you could see that the defense plants got the credit that was needed; but we are speaking now of the present where, as we understand it, there are ample funds for all needs.

Senator FLANDERS. And yet, I believe in here somewhere you spoke in a friendly way of the voluntary credit controls which, as I understand it, you make some distinction between defense production, on the one hand, and speculation on the other.

Mr. HEMINGWAY. That is correct. We try to cut out all speculative demands.

Senator FLANDERS. So, it would seem to me, that you were willing to have some form of selected credit controls, but want to do it yourself rather than have the Government do it; does it not figure down to that?

Mr. HEMINGWAY. Well, it does, to that extent, that during this inflationary period it was thought that by having the voluntary controls it would be more flexible and be more helpful to the defense program than by having rigid controls.

Senator FLANDERS. Now, on page 8 you say you do not believe that fiscal policy can be used effectively and properly as a means of formulating monetary policy. That, I think is understandable. In here somewhere I got the impression that you do not think much of fiscal policy as a whole for the maintenance of a healthy condition of the economy except from the standpoint of the budget balance; that is, the balanced budget is the desideratum of fiscal policy—at least, I got that impression.

You would not have, then, in your thinking any room for the compensatory effect of deficit financing during a period of deflation, and the opposite, of repayment of credit borrowed during a period of inflation?

Mr. HEMINGWAY. No, Senator; we do not subscribe to that theory, which sounds all right in theory, but in practice it has not worked out.

Senator FLANDERS. Then you would say that no matter how deep the depression, you would still favor the balanced budget?

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Mr. HEMINGWAY. I would say it would depend on the circumstances at the time; but looking at it over the experience of the last 20 years, we think it would be much better to attempt to balance the budget every year, because we have had now—how many, 17 unbalanced budgets out of the last 20 years.

Senator FLANDER:. And some of those have been years of inflation.

Mr. HEMINGWAY. Oh, yes.

Senator FLANDERS. But when you say "we" do you believe you are speaking for the American Bankers Association?

Mr. HEMINGWAY. I think so; yes, sir.

Senator FLANDERS. That is, you cannot conceive of any depth of depression in which you would want to have a very largely unbalanced budget?

Mr. HEMINGWAY. I do not think that the membership of the American Bankers Association would subscribe to that theory. Now, I do not say that there would not be some particular year in which under unusual circumstances they might but, as I say, we have listened to the theory about filling up the valleys and cutting off the peaks, but wè have never found the time come to cut off the peaks.

Senator FLANDERS. Would you be surprised if this committee, on the whole, and if other groups of citizens and economists felt that in the interest of carrying out the charge given to us by legislation, which is that of maintaining employment and production, we would be willing to see an unbalanced budget in one direction at certain times, and in the other direction at others?

Mr. HEMINGWAY. Well, personally I would regret to see you take that course, because I do not think you would ever reverse it. You have not reversed it for the last 20 years.

Senator FLANDERS. I might say that that has been no fault of mine.

Now, let us see, I think I had one other point here. At one point you stated that you felt that monetary policy should be completely in the hands of the Federal Reserve.

Over here at the top of page 9 you speak of situations in which the balance in the money market becomes more delicate. You say, "Under these circumstances, earnest cooperation between the Treasury and the Federal Reserve becomes even more essential."

Are you emphasizing both independence and cooperation?

Mr. HEMINGWAY. Yes, sir; I am trying to, in rather an awkward way, perhaps, but what I am trying to say is that when it comes to the final analysis. we think that the Federal Reserve should have the responsibility of bringing about as healthy a money market as they can, the supply of money in the market, and that the Treasury should adapt itself to a healthy money market rather than the Federal Reserve trying to adapt the market to suit the ideas the Treasury might have.

Senator FLANDERS. As you may have noted, we have questioned quite carefully both the head of the Treasury and the head of the Federal Reserve Board. and cannot get them to agree to anything more than cooperation. Neither of them is now willing to say that they should take the lead and be the final arbiter.

Mr. HEMINGWAY. Well, we are very fortunate to have those two men in the position they are in because we believe they will cooperate and are cooperating; but in the event there should be changes in the personnel, and they did not see eye to eye, we think, as a general rule,

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that I tried to state a moment ago, that the Treasury's financing should be fitted into the money market as created by the Federal Reserve Board, rather than the reverse being true.

Senator FLANDERS. Yes.

My last question, Mr. Chairman, will be with reference to page 11 where you say:

> It will not always be easy for the Board to operate in this independent way, particularly when it may become advisable to put on the brakes in order to assure sound money and credit.

That is on the inflationary side.

> It is only human for people to want to see business grow and expand from day to day.

That is natural, of course.

But what troubles me, if I may say so, in this document is that there seems to be no recognition in it of the terrific human problems with which we are faced in depressions. It is not simply a matter of expanding business at that time, but it is a matter of having employment for the unemployed; and I could wish, sir, that there had been in it some reference to proper fiscal and monetary policies for periods of depression.

Mr. HEMINGWAY. Well, we are in such an inflationary period that our mind was really running to the problems of inflation, and we do not see in the immediate future any danger of the kind of depression that would need that support.

Representative PATMAN. Mr. Bolling.

Representative BOLLING. Mr. Hemingway, do you believe that the Federal Reserve Board is now independent?

Mr. HEMINGWAY. Well, I think it is to a large degree independent; yes, sir.

Representative BOLLING. How do you suggest that it might be made more independent?

Mr. HEMINGWAY. By a recognition on the part of the Congress that when the final decision came as to what the monetary policy should be, that the Federal Reserve Board will be the ones to decide.

Representative BOLLING. Is that not now the way the statute is written? Is not the authority for the decision now in the hands of the Federal Reserve Board, clearly?

Mr. HEMINGWAY. Well, I cannot answer that, sir; I have not looked at the statute lately; I do not know.

Representative BOLLING. I think that is all, Mr. Chairman.

Representative PATMAN. Mr. Hemingway, you mention on page 5 of your statement that the Federal Reserve must recognize the needs of the Treasury in its refunding and new borrowing operations.

Do you mean by that if the Treasury were to put out an issue, and it should fail to be subscribed 100 percent—part of it was not subscribed—that the Federal Reserve should come to the aid of the Treasury and take care of that issue and keep the issue from failing?

Mr. HEMINGWAY. Well, I think it would depend on what the issue is. If the Treasury should put out today, for example, a moderate amount of long-time bonds, we will say, at 3 percent, and offer them to the public, I see no reason why the Federal Reserve should step in. I think the Treasury could take what is subscribed.

Representative PATMAN. But I am talking about a case where suppose they have put out an issue of 3 percent, and only 90 percent of it

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was subscribed. Do you believe that the Federal Reserve should come in and take care of the 10 percent?

Mr. HEMINGWAY. No; I do not think they should put it out that way. I do not think they should put any substantial amount or fix the figure. They should offer it for subscription, and take what the people subscribe.

Representative PATMAN. Take what is subscribed?

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. Your statement over here, I think, is an excellent one, on page 9 about—

> We feel that monetary policy should be in the hands of an impartial body of experts created by the Congress, and which is responsible to the Congress.

That is very fine. Then you say:

> We appreciate fully that regulation of the supply of money should not be left to the banking interests. The only supervisor, naturally, that can represent all of the people is the Federal Government.

Then you say:

> It is also just as clear to us that the executive branch of the Government should not be given the authority to control the supply of money and credit. It is only natural that it might be more responsive to pressures that may be inconsistent with sound-money policy.

I do not take issue with you on either one of those statements.

Suppose we arrive at a point where we are in a depression instead of inflation. Then the banks cannot make loans because the security offered to them is not good, the concerns have no ability or capacity because of the lack of purchasing power of the people; there are lots of unemployed, millions of unemployed, and it is necessary to put a shot into the arm of our system in some way to revitalize it, get it started back on the track, to put money into circulation so that it will have velocity and bring business.

How would you do that, Mr. Hemingway?

Mr. HEMINGWAY. Well, I think the best way to do it would be to institute the public works program of things that had been held up that were needed.

Representative PATMAN. In other words, have a backlog of public works projects all ready, serviced so far as engineering is concerned?

Mr. HEMINGWAY. Well, I think you have them pretty much all the time, do you not, Mr. Chairman?

Representative PATMAN. That is right; I think so.

Along that line, do you not think it would be well if the Government were to consider taking all these projects and—recognizing now that we are going to need more transportation in the future, and more water transportation and more electricity, and more of the basic things—plan now to start those projects just as soon as there is the least unemployment. Instead of putting them in the budget, where you pay for them out of current expenses, since these huge dams will last maybe 200 or 300 or 500 years, why would it not be desirable to consider amortizing them over a period of 50 or 75 or 100 years, and just pay a small amount each year out of current expenses to pay for them?

Mr. HEMINGWAY. Well, Mr. Chairman, I go along with you on the highways and projects of that kind, but I do not when it comes to the Government operating electrical plants, for example.

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Representative PATMAN. I did not say the Government would be operating them, Mr. Hemingway.

Mr. HEMINGWAY. I misunderstood you.

Representative PATMAN. I did not say that.

Mr. HEMINGWAY. I misunderstood you.

Representative PATMAN. I just said to have them.

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. That came up here when Mr. Charlie Wilson was in here testifying before the full committee. That very question came up, and I think Senator O'Mahoney asked him the question, and he said, "What would you do, Mr. Wilson?" I am just quoting, in effect, now what he said: "Would you first decide who was going to operate these projects or would you build them first, knowing their need, and then decide who would operate them?"

And Mr. Wilson said, "I would build them first."

Now, do you not think that is a pretty good answer, knowing that in the future we have got to have more electricity, we have got to have more water transportation, that we ought to go ahead and make arrangements to build them, and fight the question out later if it is to be fought out at all?

Mr. HEMINGWAY. Well, at the moment we have full employment, and if you undertook to build them you would make the inflation worse today.

Representative PATMAN. I did not make myself plain. I said to have them ready so that when there is the least noticeable unemployment sufficient to cause distress——

Mr. HEMINGWAY. Yes, I would subscribe to that.

Representative PATMAN. That is where those projects would be carried out.

Mr. HEMINGWAY. Yes.

Representative PATMAN. You subscribe to that.

Mr. HEMINGWAY. Yes.

Representative PATMAN. You agree then with Mr. Wilson, too, where it is necessary to build them, and then fight out the question of who is to operate them?

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. Because our expanding population, I think, is going to need these things much faster than we will provide them under our present programs.

Mr. HEMINGWAY. Yes; I think so.

Representative PATMAN. I think we ought to be ready, as you say, and put them right into effect.

Now, this argument here that you make on page 9 impresses me. Maybe we should consider a lifetime board rather than a board of 10 or 12 or 14 years. Why not have a board that is set up like the Supreme Court, it is on there for life? Then, they are not under pressure from the Executive, the Congress, or the interests which happen to be the bankers, in this case—they are not subject to influence of either; they are just separate and apart—the Supreme Court of Finance, we will call it, and cannot be influenced.

Would not that really be possibly preferable to a short tenure of office?

Mr. HEMINGWAY. I would agree to that; yes, sir.

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Representative PATMAN. Of course, they would always have over them this threat that if there should develop a poor economic situation in our country with lots of unemployed and lots of distress, and there was need to do something to bring the country back, and the Employment Act of 1946 was not carried out as the President and the Congress thought it should be carried out, in cooperation with the Federal Reserve Board, the Congress by a majority vote could change that. If we happened to have an obstinate, contrary board, that just would not do what was necessary to help the country come back, why then, something could be done about the board.

Mr. HEMINGWAY. That is right.

Representative PATMAN. In other words, they would be skating on pretty thin ice to resist the administration in power that was trying to do something to bring the country back.

Mr. HEMINGWAY. I think so; yes, sir.

Representative PATMAN. You mentioned here about branches of the banks, about the fact that they are locally managed banks instead of a network of branches of only one or two banks. What is your feeling about a branch banking system, Mr. Hemingway? Do you believe in a branch banking system or are you opposed to it?

Mr. HEMINGWAY. Well, I think it depends on the customs of the area. Now, I happen to live and have lived all my life in the area where branch banking is not permitted, and I have operated under it, and I think very comfortably and satisfactorily.

Representative PATMAN. Is that a constitutional prohibition in your State?

Mr. HEMINGWAY. Yes, sir.

There are other States where it is permitted, and they seem to get along very well with it, too.

Representative PATMAN. We had some unfortunate experiences in the depression with some branches, as I recall, particularly up in the Detroit area.

Mr. HEMINGWAY. Well, we had unfortunate experience with all kinds.

Representative PATMAN. That is right, with all of them; but those, you know, when one of them fell, all of them fell.

Mr. HEMINGWAY. Well, yes. In the country as a whole, I would be opposed to branch banking.

Representative PATMAN. In Texas we have a constitutional prohibition against branch banks.

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. But the system has grown up there in recent years, which appears to me to be absolutely in violation of our Constitution and our law, of permitting what is called affiliate banking; that your bank, for instance, could go out, and with yourself and two or three other people close to you, put up the majority of the stock in a suburban bank, and it would be an affiliate to your bank, and for all practical purposes be part of your bank.

Is that permitted in Missouri?

Mr. HEMINGWAY. We have a statute in Missouri that permits a trust company organized under the trust company laws to own one bank.

Representative PATMAN. One bank?

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. You mean outside of its home office bank?

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Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. In other words, one branch?

Mr. HEMINGWAY. It could have one branch; but the Federal Reserve Board will not permit it, and those who are members of the Federal Reserve System do not enjoy that privilege.

Representative PATMAN. Do you see any difference between branch banking or affiliate or chain banking?

Mr. HEMINGWAY. Well, of course there is a difference; but as between the two I think it would be better to have the straight-out branch banking.

Representative PATMAN. It would be better?

Mr. HEMINGWAY. I would think so, yes.

Representative PATMAN. The other is a distinction without a difference except it could be more devastating.

Mr. HEMINGWAY. Except you have an organization a little more cumbersome, and it would seem to me it would not perform as efficiently as if it had the outright branch.

Representative PATMAN. Would you consider that as a kind of a roundabout way of evading the branch banking law?

Mr. HEMINGWAY. Well, it is a way of getting an additional office, yes, no question of that.

Representative PATMAN. In other words, it would be considered by you as a violation of the spirit of the constitutional provision in your State?

Mr. HEMINGWAY. Well, it would be, not for a trust company, but for any others it would be.

Representative PATMAN. That is right, Mr. Hemingway. I know you are thoroughly familiar with the Federal Reserve banking system, and therefore, I should be free to ask you any questions about it because of your long experience.

The banks in the St. Louis area, what is the number of your Federal Reserve district? Is that No. 10?

Mr. HEMINGWAY. No. 8.

Representative PATMAN. No. 8.

Now, you have a lot of banks in that area that are member banks.

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. What obligations and responsibilites do those member banks have in that membership?

Mr. HEMINGWAY. What obligations?

Representative PATMAN. Yes, sir; and responsibilities.

Mr. HEMINGWAY. Well, we enter into a membership agreement with the Federal Reserve Board, and in that membership agreement we agree to abide by the rules and regulations of the Board, and to permit the Federal Reserve bank to examine us—I am speaking now of a member bank.

Representative PATMAN. Member bank of the Federal Reserve System.

Mr. HEMINGWAY. Which is not a national bank.

Representative PATMAN. That is right. Of course, a national bank is compelled to come under it.

Mr. HEMINGWAY. Yes; you are speaking of the State bank members.

Representative PATMAN. Yes; that is right.

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Mr. HEMINGWAY. So we come under the same requirements as a national bank, practically; and the advantages that we derive from it are the same as those of a national bank.

Representative PATMAN. As the head of your bank in St. Louis do you feel like your bank has any financial responsibility to the Federal Reserve System?

Mr. HEMINGWAY. I do not believe I understand that question, Mr. Chairman.

Representative PATMAN. Well, is there any danger of your having any financial loss by reason of your membership?

Mr. HEMINGWAY. The only possible loss we could have would be for us to be required to pay in the balance due on our subscription.

Representative PATMAN. That is 3 percent?

Mr. HEMINGWAY. That is 3 percent.

Representative PATMAN. That is the limit that could be asked of you to pay?

Mr. HEMINGWAY. Yes, sir.

Representative PATMAN. And you have no other financial obligations or responsibility that you can think of at this time or know of? In fact, I am quite sure that is it.

Mr. HEMINGWAY. No; we have none.

Representative PATMAN. Three percent—I wonder why that other 3 percent was never paid in? Of course, it is really not needed, I guess, is the reason.

Mr. HEMINGWAY. Well, you may remember at that time the capital stock was paid in in gold.

Representative PATMAN. Yes; I remember reading about it.

Mr. HEMINGWAY. I do not know that this is a fact, but I imagine that they got about all the gold they wanted, and so did not call for more.

Representative PATMAN. As a matter of fact, the stock does not mean much in the Federal Reserve system, does it, Mr. Hemingway?

Mr. HEMINGWAY. Well, it means this to us: That we have a voice in the operation of the bank; it is not a very loud voice, but still we belong.

Representative PATMAN. But, as you said here, the banker should not have a controlling interest in it.

Mr. HEMINGWAY. That is correct.

Representative PATMAN. And that stock—some of the witnesses have testified, at least I got this from their testimony, this inference, that it was more of a token subscription, and did not enter into the solvency of the institution in any substantial way.

Mr. HEMINGWAY. That is right.

Representative PATMAN. It is very small compared to the tremendous amount of business that these banks are doing.

Mr. HEMINGWAY. That is right; yes.

Representative PATMAN. In fact, the last year, I do not know what the total business was, but I imagine they ran up to between $1 and $2 trillion.

Mr. HEMINGWAY. A very large volume of business.

Representative PATMAN. Yes.

There is no liability then, financial responsibility, that you know of except to pay in that other 3 percent, if called upon?

Mr. HEMINGWAY. That is correct.

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Senator FLANDERS. I have one more question.

Representative PATMAN. Go right ahead, Senator.

Senator FLANDERS. One question came to my mind, which I have thought about in past months, but has not previously occurred to me during this hearing: It has seemed to me that the most foolproof business operation in the world was that of the Federal Reserve banks when they were pegging the bond market. They were required to buy when stuff was low, and were required to sell when their product was high.

Do you know of any more foolproof business operation in the history of the universe?

Mr. HEMINGWAY. I do not know, Senator.

Senator FLANDERS. What I have wondered is, as to whether under the more flexible conditions under which we are now working, there may come a time in which the agreement between the Treasury and the Federal Reserve Board, their cooperation, might result in some losses in their open-market operations.

Can you conceive that that would ever take place?

Mr. HEMINGWAY. Yes, I think they might; they might have some losses in their open-market operations.

Senator FLANDERS. Well, that really is an important change, is it not?

Mr. HEMINGWAY. Yes.

Senator FLANDERS. I just wanted to ask that question. I am not sure as yet of all its implications, but it seems to me that there might be something there.

Now, may I have your indulgence for about 2 minutes more?

Representative PATMAN. Certainly, sir.

Senator FLANDERS. This is a digression and a diversion. When you were suggesting, Mr. Chairman, the idea of having the members of the Federal Reserve bank given a lifetime appointment, like the Supreme Court, there came to my mind an idea which has been in my head for some time of giving the Supreme Court an 18-year appointment, with a lifetime salary, throwing them into a reserve after they are through for assignment and use.

Now, that would give every presidential term two appointments so that every President was assured of his due influence on the characteristics of the Court, which seems to me to be highly desirable; but that is aside from our subject, and I just throw that out because I think I would like to have somebody else think that over besides myself.

Representative PATMAN. I think it is very appropriate, Senator Flanders. I think you are hitting at something that has had me worried for a long time. You know, just like Mr. Hemingway said, this should be controlled—the Federal Government has the responsibility of all this—the Federal Government. Now, what worries me is whether or not the Federal Government has enough responsibility in it after the Secretary of the Treasury and the Comptroller of the Currency were taken off the Board. Up until that time they had their contact there.

Senator FLANDERS. Yes.

Representative PATMAN. There was a contact. In other words, the Government's side was always presented at the table where the decisions were made, but after that that is not true; and I am just as interested as anyone in seeing a free, independent Federal Reserve Board,

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but I want a connection there to where the public, the public's own welfare, will be looked after, the public's good; I want it considered. I do not want it to be said that you should have push-button control by an executive of the economy. I am against that, any kind of push-botton control, I do not want that. But I want the public interest always considered by people who are charged particularly with that duty.

Now, I know that members of the present Federal Reserve Board are charged with that duty, but are they in the same way that a Cabinet officer, who is selected by a President who is elected by the people? I am just wondering if we should not have some connection there that is sufficient to the point where if the policies put into effect were devastating and disastrous to the country that the party in power could not be held accountable and responsible for it, just the same as if they made a mistake on foreign policy. I do not know how far we can go there and keep the independence of the Federal Reserve Board, which I am anxious to preserve, but I do want some connection there to hold the party in power responsible for policies and practices that are devastating and destructive of the entire country.

Mr. HEMINGWAY. Mr. Chairman, I have watched the operation of the Federal Reserve System from its beginning, and I have a feeling that the present arrangement is, perhaps, the best that we have ever had; that is to say, you have the Chairman of the Federal Reserve Board, and the Secretary of the Treasury with such relations that they can sit together as two friends and discuss a problem that is mutual, and come out with a good conclusion.

Now, it does not mean that either one is going to dominate the other. If you put the Secretary of the Treasury on the Board, as he was in the beginning, he has a dominating influence by reason of the prestige of his position, and it is pretty hard for the members of the Board to oppose him. Whereas, if you have it independent, with the understanding that they are to cooperate as they do today, I believe you would get the best results.

Representative PATMAN. Let us analyze and evaluate this first suggestion of yours, that it would be difficult for the other members of the Board to take a position in opposition to the Secretary of the Treasury; let us see now if it would be.

Now, they are appointed for 14 years, and they are not responsible to the Executive after their appointment; you know that and I know that, too.

In other words, they do just exactly as they want to, and they should: the President should not carry——

Mr. HEMINGWAY. They are human beings, Mr. Chairman.

Representative PATMAN. Why, certainly.

Mr. HEMINGWAY. They are here in Washington, and this Secretary of the Treasury is the right-hand man of the President, and all the power and prestige of that office comes into the council chamber.

Representative PATMAN. But you see some very independent people on these different boards and courts, you know, they are appointed by the President; and they go contrary to the President when they feel that he is wrong. It is not unusual at all, but it seems to me to be the general rule, which it should be.

Mr. HEMINGWAY. But, you see, today the United States Government is the biggest borrower in this country. It owes more money

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than all the people in the country put together, so that the Secretary of the Treasury is liable to be a little bit biased in the operation of his Department.

Representative PATMAN. Yes, I can see that point; that certainly is worthy of consideration.

Senator Flanders mentioned that the unbalanced budget did not come about not by reason of his votes and since he mentioned that, I want to state that the same thing applies to me; because although I have the name of being quite an inflationist, I suspect my record on a balanced budget is about as good as any Member of the United States Congress, House or Senate.

Mr. HEMINGWAY. I am glad to hear that.

Representative PATMAN. Well, I have fought for price controls—you see, I was in there fighting for them when it was very unpopular to do it on price controls during the war, and I voted even against the excess profits tax repeal. I felt that we should have that money for 1 or 2 years to pay on the cost of the war.

I was against all tax reduction bills in the Eightieth Congress; and while I voted for appropriations, I voted for tax money which I felt was the only honest thing to do to try to pay those bills, because I think it is not as honest as a government can be to continue to have deficit financing, and I think it is very damaging to the economy of our country, and I am intending to vote against it, as Senator Flanders is.

Mr. HEMINGWAY. I am glad to know that the American bankers are in such good company.

Representative PATMAN. Of course, at one time when the economy of our Nation was rather low and I felt like they needed money in circulation, I was an advocate of a bill, which they said was a printing-press-money bill, and it passed Congress, you know, a couple of times; but I was not by myself there. You see, the country was in a bad condition, and we needed this money out, and I think you will find that the leaders, even in the present House and Senate, supported that, too; about 90 percent of the Members of the House and Senate voted for it at one time or another; and they did not construe it as printing-press money by bringing out the bills because at the time of the depression, you see, we have got to have money out. That is the reason I asked you that question a moment ago.

But I want to assure you that I am not an inflationist, and I am for a balanced budget, and I do not want any push-button control of the Federal Reserve Board by the President or anybody else; and I am anxious to have an independent Reserve System, but I want that responsibility in the public interest.

Mr. HEMINGWAY. I am glad to have you say that.

Senator FLANDERS. I feel moved to ask that if anyone looks up my record, after my statement, to examine my record, to look at my record as a whole, rather than on any third Thursday——

Representative PATMAN. Well, opponents will do that; of course, it is in the interest of your opponents, and you expect them to do what is in their interests.

Do you have any further questions, Mr. Bolling?

Mr. BOLLING. No.

Representative PATMAN. Dr. Murphy?

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Mr. MURPHY. I would like to ask you, Mr. Hemingway, a triple-barreled question, and I will give you all three barrels at once, because I believe it will help you to give an integrated answer.

The first barrel is as follows: Whether you believe that earlier monetary action of the nature of the Treasury-Federal Reserve accord would have stopped the inflation between the outbreak in Korea and the succeeding March, or would it have slowed it down to quite an extent? To what extent would that price rise have been obviated by early monetary action?

The second barrel is, what were the forces which actually did bring about the leveling off? It has been suggested, for example, that it was due almost entirely to the new and stronger monetary policy. It has also been suggested that it was due almost entirely to price controls. Again, it has been suggested that it was due principally to the revulsion of the economy against an earlier buying wave.

What I would like is your evaluation of these forces, as to which were the most powerful.

Finally, the third barrel is this: We now have a more flexible and a tighter monetary policy than before. Do you feel it is just about right for today's conditions, or should it be a little tighter or a little easier; that is, do you believe that today's policy is correctly adapted to today's conditions?

Mr. HEMINGWAY. Well, I will answer your third question first, Dr. Murphy.

From what I have been able to see, I think the present policy is accomplishing what is wanted. From our observation now we have got things now in pretty fair balance. I do not know how long it will stay that way; it may turn one way or the other.

The other questions are pretty difficult to answer. I have this feeling, that after the outbreak of the Korean war that nothing would have stopped a certain amount of buying. The money was in the hands of the people, and they were afraid that there would be a shortage of goods, so they went in and bought, and there was no way to stop that.

Now, it is possible that a tighter money market might have prevented some manufacturers and merchants from increasing the inventories as much as they did; that is a matter that no one can tell. It is purely a matter of surmise; but I am certain that there would have been a tremendous amount of buying because the people had the money; it was in the banks, in their safe-deposit boxes, and in their pockets.

Now, the first question, as to when it would have been advisable to tighten up the money after Korea, is pretty hard to say, there was one condition there that the Secretary of the Treasury and the members of the Federal Reserve Board, the Open Market Committee, had to consider, and that was the danger of a foreign war.

You remember how all this talk existed about Russia, how we might get into that difficulty, and they wanted to be very careful that they did not do anything that would shake the credit in the Government's security markets, because they might be called on to finance a tremendous war, and it was not an easy question to decide. Whether it was decided right or wrong, why, that is just a matter of opinion.

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I think, perhaps, after the feeling had grown that the danger of imminent war was over that they might have acted a little sooner and, perhaps, have stopped some of the inflation.

Mr. MURPHY. That leaves us with the middle barrel, so to speak; that is, the causes of the actual leveling off which did occur a year ago. To what extent do you believe it was due to the imposition of price and wage controls, to what extent due to the new monetary policy, and to what extent did it just happen? Was it because the previous buying wave had been overdone and there was a revulsion on the part of the people?

Mr. HEMINGWAY. I do not feel competent to evaluate those, Dr. Murphy. It is purely a matter of surmise and opinion, and I have no way of determining that.

Mr. MURPHY. But you think each probably was a cause?

Mr. HEMINGWAY. I do think they each were a contributing factor.

Mr. MURPHY. I have one more question: The Douglas committee, in its report 2 years ago, included the following statement:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against rather than promote the purposes of the Employment Act, and we recommend that no action in this direction be taken.

That was included in the Douglas report 2 years ago.

Do you believe it would be constructive for this committee to reaffirm that in its report?

Mr. HEMINGWAY. Well, I would rather leave that subject a little more open. I am a great believer in the gold-coin standard. I would like to see this country get back to it as quickly as we can, but I think that it would be a mistake to undertake it until two things have been settled: One is that the international situation is improved to where we think there is no likelihood of a big war; and the other is that the Congress of the United States is balancing the budget. When those two things would happen then I think we ought to rapidly take up methods of reestablishing the gold-coin standard.

Mr. MURPHY. That is all; thank you.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. I have no questions.

Representative PATMAN. Any more from you, Senator?

Senator FLANDERS. No.

Representative PATMAN. I certainly thank you, Mr. Hemingway.

Mr. HEMINGWAY. Thank you, Mr. Chairman.

Representative PATMAN. Mr. Fennelly, please identify the gentleman with you.

Mr. FENNELLY. This is Mr. Robert Craft, vice president of the Guaranty Trust Co. of New York, and he is chairman of the Investment Bankers Association Committee on Governmental Securities.

Representative PATMAN. Your name is John F. Fennelly, and you represent the Investment Bankers Association, and you are a partner, I believe, of Glore, Forgan & Co., of Chicago, and former president of the Investment Bankers Association, former instructor in money and banking at Columbia University; and coauthor with W. L. Crum and Lawrence Seltzer of Fiscal Planning for Total War, under the sponsorship of the National Bureau of Economic Research in 1942.

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STATEMENT OF JOHN F. FENNELLY, INVESTMENT BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY ROBERT CRAFT, VICE PRESIDENT, GUARANTY TRUST CO. OF NEW YORK

Mr. FENNELLY. That is right.

Representative PATMAN. We are glad to have you, Mr. Fennelly. I believe you have a prepared statement?

Mr. FENNELLY. Yes, sir; I have.

Representative PATMAN. Would you like to finish it before yielding for questions?

Mr. FENNELLY. I think it would be a little easier, Mr. Chairman.

Representative PATMAN. All right; whatever you desire, we shall be very glad to accede to your wishes.

Mr. FENNELLY. Thank you, sir.

Mr. Chairman and members of the committee, at its annual meeting in December 1951 the board of governors of the Investment Bankers Association adopted a resolution requesting an opportunity to appear at these hearings with a view to expressing for the record the convictions of its membership with regard to the vital problems now under consideration by this committee.

The investment banking industry is seriously worried by the continued and long-range inflationary trends in the economy. A really effective anti-inflationary program calls for a concerted and united attack on several fronts. It calls for the teamwork of the executive, the Treasury, the Congress, and the Federal Reserve System. It must embrace:

(1) A really sincere move for economy in Government through the curtailment of nonessential expenditures.

(2) A level of taxation sufficiently high in rate and broad in base to produce, in combination with curtailed expenditures, a budget balance.

(3) A willingness on the part of the Treasury to offer its securities at sufficiently competitive rates to attract the funds of nonbank investors.

(4) An independent Federal Reserve System free to follow a truly flexible policy of credit action.

The members of the Investment Bankers Association are the middlemen between borrower and lender. We have a responsibility to each, but we are concerned mainly with the savings classes of the country represented by insurance-company policyholders, savings-bank depositors, pensioners, trust beneficiaries, and thrifty individuals. It has been through individual saving and investment that our free-enterprise system and present way of life have been made possible. The savings of the individual represent the lifeblood of our economy. If the incentive to save were destroyed, our present system could no longer be preserved. In our opinion, there is nothing that would eliminate the savings incentive more rapidly and completely than a further depreciation in the purchasing power of the dollar. Encouragement to save, in our opinion, can best be achieved in an atmosphere of stability in the currency and the economy, an atmosphere in which the preservation of the buying power of the dollar will foster a rising standard of living.

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We recognize that credit restraint or credit control cannot nullify inflationary pressures in areas of the economy over which financial institutions and Federal Reserve authorities have no direct control. The regulation of credit can only check one source of inflationary pressures. In today's economy, however, one of the greatest potential dangers to further inflation is inherent in the expansion that has taken place in the money supply. Basic in this whole problem is the fact that from the end of 1939 to the end of 1945, the huge increase that took place in the money supply for the most part has been frozen into the economy. There has now been superimposed the present huge defense program.

In our judgment, this problem of the money supply can best be dealt with by a Federal Reserve System free from political control and free to pursue a flexible and vigorous monetary policy coordinated with fiscal and other policies directed toward counteracting inflationary forces.

In an inflationary period, the primary objective of the Federal Reserve System should be to restrict the availability of credit. Banks, insurance companies, and other holders of Government bonds should not be provided with an artificial market in which funds can be obtained to make loans for whatever purpose they choose or to engage in speculative commitments that tend further to add to an inflationary money supply. The policy of credit restriction should be tempered only to the extent that it is necessary to maintain orderly conditions in the Government securities market.

During a period of credit restraint, lower bond prices and higher interest rates naturally result and these factors have a real bearing on credit-extension policies of financing institutions. Losses in bond accounts are a substantial deterrent to selling, and, at that point, loan applications are much more carefully scrutinized as to purpose than they would be if the funds to lend could be obtained in pegged markets.

Parenthetically, Mr. Chairman, I should like to emphasize that point because I have not seen it emphasized in these hearings before, that the very fact of the decline in bond prices is in itself a very restrictive influence in checking the extension of credit.

This background of thinking prompted the Investment Bankers Association to adopt the following resolution at its December meeting:

RESOLUTION

The Investment Bankers Association strongly supports the maintenance of a Federal Reserve System whose policies are independent of the executive branch of the Government and are guided by the responsibilities delegated to the System by Congress—a Federal Reserve System free to pursue the principal purpose for which it was created—the regulation of the supply, the availability, and the cost of money with a view to contributing to the maintenance of a high level of employment, stable values, and a rising standard of living.

Important progress toward the restoration of an independent Federal Reserve System has been made since the accord was reached between the Treasury and the Board in March of 1951. During the past year we have had a flexible open-market policy resulting in a more realistic approach toward controlling the availability of credit.

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Nevertheless, it is our view that the present accord represents an uneasy truce.

It is our sincere conviction that there is nothing inherent in the respective functions of the Treasury Department and of the Federal Reserve Board which must lead to conflict between these two agencies. In our opinion, the recent controversy was primarily an outgrowth of unsound policies of debt management by the Treasury during the past 10 years.

One of the original errors, it seems to us, was the creation of Federal savings bonds which were made redeemable on demand at fixed prices. As long as the amount of such bonds outstanding was relatively small they did not constitute a serious problem. This situation was radically changed, however, during World War II by the development of these savings bonds into the chief vehicle for individual investment in Government securities. There was thus created a tremendous demand liability which has made the Federal debt structure exceedingly vulnerable to changes in iterest rates.

We do not mean to imply herein a criticism of Government savings bonds as a satisfactory medium for individual investment. We merely wish to emphasize the inflexibility of a debt structure with a large percentage of the total in the form of a demand liability frozen to a fixed interest rate.

The second serious error was the failure of the Treasury to take advantage of the opportunity to accomplish a major funding of the short-term debt during the immediate postwar years. I felt so strongly on this subject that I addressed a letter on October 22, 1946, to Mr. Edward F. Bartelt, Fiscal Assistant Secretary of the Treasury, from which I should like to quote the following excerpts:

> In brief, I am convinced that the United States Government is confronted by an urgent need, and, at the same time, a golden opportunity to fund a substantial portion of its huge short-term debt. The immediate objective of such a funding operation, of course, would be to convert as large a portion as possible of the short-term obligations now in the hands of commercial banks into long-term bonds in the hands of nonbanking investors.
>
> In stressing the urgency of this need I wish first to point to the analogy between the position of our Government and that of a private corporation which has incurred short-term bank indebtedness far beyond its ability to retire in the normal course of business. To even the most elementary student of business finance, the highly vulnerable position of such a corporation would be obvious. Equally clear would be the urgent need for a funding of this excessive debt into long-term obligations, or its retirement through the sale of capital stock at the earliest practicable opportunity.
>
> * * * As long as we have outstanding such an enormous mass of floating debt our whole financial structure will remain in jeopardy. This danger is further highlighted by the current unsettled state of world affairs and the possibility of another major war. Certainly if we regard it necessary to spend more then $13 billions annually in direct military preparation—

parenthetically, that seems awfully small now—

> the need should be equally obvious to put our financial house in the strongest possible position to withstand any storms.

In discussing objections to a program of debt funding, I also called attention in my letter of October 22, 1946, to the widespread belief that our so-called money managers had finally learned the secret of doing anything they desired with interest rates. I said:

> This confidence is causing many to ignore the underlying conditions of demand for and supply of capital which must always be the long-term determinants of interest rates. * * * It is difficult to conceive of a more dangerous fallacy,

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and one more certain to cause disillusionment when the demand for capital once more becomes heavy in relation to supply. It is, of course, true that central banking authorities can influence long-term interest rates by manipulating the money market. It is equally true, however, that in a period of vigorous capital expansion such manipulation must produce inflationary results in the short run and prove self-defeating in the long-run. The present complacent attitude has arisen as a result of a long period of subnormal capital demand, during most of which time gold was flowing on balance toward the United States. It seems highly probably to me that we shall witness a reversal of these conditions sometime during the next few years. At that time the combination of a vigorous demand for capital and a heavy outflow of gold will cause some hasty revisions in the current theories of money management.

At present, conditions are not nearly so favorable for a funding operation as they were 5 years ago, and the interest cost would be considerably greater. Although, as the Secretary of the Treasury pointed out here the other day, some progress has been made in transferring Government debt from bank to nonbank holders, the need for a vigorous funding operation continues urgent.

It is a problem which will have to be faced sooner or later, regardless of cost, if we are to preserve the credit of the United States Government. Moreover, until the Federal debt structure has been placed on a thoroughly sound basis, there will always remain the danger of recurring friction between the Federal Reserve Board and the Treasury Department.

In supporting the maintenance of an independent Federal Reserve System, we by no means are making this synonymous in our thinking with isolation. As stated previously, the Federal Reserve and the Treasury should work in close liaison and sincerity. We believe that frank consultation between both groups will produce mutually desirable objectives and we are encouraged by the degree of cooperation between the Treasury and Federal Reserve authorities that has been manifested during the past year.

At the same time, if an impasse should develop at some future date, we can find no better expression of our views as to the manner in which policy disputes should be reconciled than to quote from the recommendations of the subcommittee of the Joint Committee on the Economic Report study in January 1950, which stated in part:

> It is the will of Congress that the primary power and responsibility for regulating the supply, availability, and cost of credit in general shall be vested in the duly constituted authorities of the Federal Reserve System, and that Treasury actions relative to money, credit, and transactions in the Federal debt shall be made consistent with the policies of the Federal Reserve.

We further subscribe to the view that the advantages of avoiding inflation are so great and that a restrictive monetary policy can contribute so much to this end that the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be preserved even if the cost should prove to be a significant increase in service charges on the Federal debt and a greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes.

Representative PATMAN. Thank you, Mr. Fennelly.

Senator Flanders, would you like to ask some questions?

Senator FLANDERS. Yes.

Mr. Fennelly, you speak of the creation of Federal savings bonds which were made redeemable on demand at fixed prices as being an original error. Do you find that any great amount of support exists

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for that suggestion that the creation of the savings bonds was an error?

Mr. FENNELLY. I do not know that I do, Senator, but that does not mean that I do not still think it is an error. I would regard it——

Senator FLANDERS. One with God is a majority.

Mr. FENNELLY. I beg your pardon?

Senator FLANDERS. I say, one with God is a majority; if you are with Him, then you are right.

Mr. FENNELLY. I am not trying to place myself with God, Senator, but I think if I am right on this score, I think I am right; I do not have to get a vote on it.

I want to make perfectly clear what I said. It has nothing to do with the quality of those bonds for investment purposes; but the very size of a demand obligation of that kind introduces a very serious element of inflexibility into the Federal debt, and I think, it seems to me, that is quite clear that it does.

Senator FLANDERS. I wish, Mr. Fennelly, that you would criticize from your standpoint the point of view that I have had on those savings bonds. It seems to me that they go to one class of investors; the other types of bonds go to another, and since the inexperienced investor was protected, I then felt that we should not fear to allow the types of bonds, notes, and bills which went to the experienced investors to fluctuate more or less at the will of the market. It seemed to me that the necessity for pegging them was decreased by the fact that they went into, on the whole, skilled hands, and that we had protected the unskilled.

Mr. FENNELLY. Well, you protected them against changes in the interest rates, you mean, Senator, do you not, now?

Senator FLANDERS. We had protected them, as distinguished from that serious drop in the Liberty bond after the First World War, which was such a tremendous distress to hundreds of thousands of patriotic citizens, without particular experience in Government securities or any other kind. The Federal savings bonds protected them from any such tremendous loss as the Liberty-bond holder had to go through. On the other hand, the experienced investors, it seems to me, choose or indicate a willingness to go through whatever the hazards of investment and changes in interest rates and changes in the market value of bonds might turn out to be.

Mr. FENNELLY. Well, Senator, if I understand your question, and I think I do, certainly we provided protection for them. My question is not whether we provided protection for them against market fluctuations but pointing out the cost at which we provided such protection, that the cost was the great element of inflexibility in our debt structure, and certainly it seems clear to me, because whenever any discussion has come up over the question of fluctuating interest rates, the question as to what will happen to the bonds on the redemption of the savings bonds has been very foremost in most people's minds in thinking about it.

Senator FLANDERS. Well, the refunding, you say?

Mr. FENNELLY. No; I say what I say is that merely to emphasize my point, whenever there has been a question in the change of interest rates in Government bonds or general interest rates, the possibility of that causing heavy redemption in savings bonds has been an important consideration in all people's minds.

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Senator FLANDERS. Yes.

Mr. FENNELLY. And I say that emphasizes my point that it is an element of serious inflexibility in our debt structure.

Now, that is the only point I feel like making, sir.

Senator FLANDERS. You do not feel, I take it from the language you use, that the protection of the unskilled investor, and the consequent strong campaign for selling them which thereupon becomes possible, is a sufficient reason for the development of that kind of a savings bond?

Mr. FENNELLY. I am very doubtful about it, Senator. I recognize it is a complex question, but I am exceedingly skeptical of the wisdom of making that as important a factor in our whole debt structure; I really am. I would like to point out that you speak about the loss to the holders of Liberty bonds. There was no loss to the holders of Liberty bonds if they held them for maturity. There was no loss to a holder of savings bonds if he holds it to maturity. It is the intervening market fluctuation that is the question here.

Senator FLANDERS. You will remember that there were times after 1919 when the holder of a Liberty bond might be in financial difficulties, and that being the case, he looked for a market for his bonds, sold them at what he could get, and there were so many of them that the price dropped way down.

Mr. FENNELLY. That is perfectly true.

Senator FLANDERS. In other words, individual difficulties led to widespread distress.

Mr. FENNELLY. That is possible, yes.

Let me give you this analogy, if I may, Senator: I am an investment banker and an issuer of stocks and bonds. What would you think of a corporation that issued a funded debt, let us say, of $20 million due in 20 years, but which was always redeemable on demand? Would you think that corporation was in sound shape? Would it be attractive for the investor?

Senator FLANDERS. Of course, you have a very different situation here with regard to these bonds, these saving bonds. You have the situation of trying to get the maximum investment from the ordinary citizen into them for various reasons, first, the financing of the war, and, second, to withdraw purchasing power from the market and so control inflation. I am frankly a little bit surprised that your point of view is so strongly on the side of thinking that those bonds were a mistake.

Mr. FENNELLY. Thinking that they were what, sir? I did not hear it.

Senator FLANDERS. That the bonds were a mistake, at least, in the quantities in which they were created, and so on.

Mr. FENNELLY. Well, I do think so, sir.

Senator FLANDERS. I have one or two other questions, Mr. Chairman.

Representative PATMAN. Go ahead, Senator.

Senator FLANDERS. In a flexible market in which interest rates are allowed to rise and fall, and in consequence the security prices rise and fall, are you concerned seriously about the effects on the portfolios of the various types of investors, that is banks and insurance companies, and so on?

Mr. FENNELLY. I am concerned, Senator, if the commercial banks, which accept demand deposits, carry too heavy a proportion in rela-

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tion to their capital structures in governmental securities, and that is one of the reasons why I think it is so important that as much as possible be done in the way of a funding operation to pull those securities out of the hands of commercial banks into the hands of nonbank investors. I am not concerned about the fluctuation of bonds in the hands of insurance companies.

Senator FLANDERS. That is a long-time——

Mr. FENNELLY. They buy them for maturity, sir.

Senator FLANDERS. They buy to hold.

Mr. FENNELLY. Yes.

Senator FLANDERS. And if they want simply temporary investments for liquid funds pending investments, they buy short-term paper.

Mr. FENNELL. That is correct.

Senator FLANDERS. Yes.

Now, are refunding operations, in your judgment, made more difficult by the relaxing of the price supports?

Mr. FENNELLY. Why, yes, I think in this sense, that any time that you cease having a pegged market you require the Treasury to go into the free market competitively and to that extent you make it more difficult, but I think it is the proper function of the Treasury to issue its securities in a free market.

Senator FLANDERS. Nearly everyone else, Mr. Fennelly, has come forward with a budget-balancing proposal. CED has had one, the United States Chamber of Commerce has had one, individual Senators have each had their own, for instance Senator Byrd and Senator Douglas.

May I inquire whether the Investment Bankers Association has come forward with a budget-balancing proposal?

Mr. FENNELLY. Well, as such I do not believe they have, Senator. We have a Federal taxation committee that is always battling for reform in Federal taxes, lower taxes; but they have not prepared such study as have the CED and some of the other agencies on the budget.

Senator FLANDERS. Then you are not prepared, there has been no vote which has been taken, and you are not prepared to subscribe to any of these various budget-balancing proposals?

Mr. FENNELLY. Well, I would like to say this, Senator. I do not think I am as strong a believer as you are in the idea of a compensatory budget.

Senator FLANDERS. May I just remark that you and I have known that for some time.

Mr. FENNELLY. For some time we have. I have subscribed more to what Mr. Hemingway said as to the difficulty of balancing the budget at any time. It is a hard thing to do.

Senator FLANDERS. That is all; thank you.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Fennelly, in your statement you say:

> Important progress toward the restoration of an independent Federal Reserve System has been made since the accord was reached between the Treasury and the Board in March of 1951.

Now, if my understanding is correct, there has been no change in statutes.

Mr. FENNELLY. No; there has not been. I did not mean to imply there has been.

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Representative BOLLING. Well, before the accord why was not the Federal Reserve independent, in your judgment?

Mr. FENNELLY. Well, I think they were independent if they cared to exercise their duly legislative authority or—well, for some reason of which I am not aware, they apparently did not care to stand up on their hind legs and fight for it. That is the only answer I can make.

Representative BOLLING. Then, do I gather from that that independence in this case would be that they were independent when they did things you approve of, and were not independent when they did not?

Mr. FENNELLY. No; I do not think that is a fair question either, Mr. Bolling.

Representative BOLLING. That would seem to be the tendency in this particular statement——

Mr. FENNELLY. Well, I cannot agree with you on that. They were given certain rights and authorities, as pointed out by this report of the joint committee which we quote, and if they did not exercise that authority, I do not think I am giving a bias to my statement by saying so.

Representative BOLLING. No. There is no change, however, in the rights and authority?

Mr. FENNELLY. None at all.

Representative BOLLING. Then you feel that there is a change necessary in the present statute to secure their independence?

Mr. FENNELLY. No; I do not think so, Mr. Bolling. I do think that it was a mistake that they continued to help maintain a pegged market and therefore continued to exercise inflationary pressures in the money market. That seems to me quite clear. I agree with you that they had the authority, the legislative authority to act if they had chosen to do so.

Mr. BOLLING. That is all, Mr. Chairman.

Representative PATMAN. Dr. Murphy.

Mr. MURPHY. Mr. Fennelly, you said in your statement that it was dangerous for a bank—and I take it the implication was that it is dangerous to a bank's soundness—to hold too large an amount of Government securities relative to its capital funds. Do you mean Government securities in general or long-term Government securities?

Mr. FENNELLY. I mean primarily long-term Government securities. As long as a bank's credit is concerned, obviously there is less risk in holding short terms, and therefore I would not say that short terms were per se a danger to a bank's solvency. I do not think—well, go ahead, that is all.

Mr. MURPHY. I am still confused because it has always been my view that short-term Government securities from the standpoint of safety were the safest investments a bank might possibly make.

Mr. FENNELLY. Well, I do not disagree with that. However, there are two sides to this thing. One is the side of the safety of the bank and the other side is the matter of inflationary control, and I want to be sure I do not mix them up in either your mind or my mind.

I do think that the bank holding large masses of short-term Government securities, for it to have in this currency and credit system, is an element of further inflation, and that to remove those from the banks by a funneling operation tends to be deflationary or anti-inflationary in its effect.

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Mr. MURPHY. But, insofar as the position of the particular bank is concerned and its ability to meet its obligations to its depositors and others, it is pretty hard to conceive of any better security than short-term Government obligations.

Mr. FENNELLY. No; I do not think you could.

Mr. MURPHY. One more question: You speak in your statement of the dangers of a large floating Government debt and you compare it with a private corporation and say that any student of elementary finance would recognize the danger of such a situation, and coming to the corporation you say that the danger to the corporation is that they might not be able to fund the private obligations—the bankers might not consider their obligations credit worthy.

Now, would you describe more particularly the dangers you have in mind in the case of the Government?

Mr. FENNELLY. Well, I think that the difference—I think the point you are trying to make is a difference in degree.

Now, certainly, if you run into an international crisis you will probably be able to fund your debt at some level or some term, but it certainly is a lot more difficult to fund a large lump of short term in the middle of an international crisis than when everybody is calm and the budget is balanced and everybody has a great deal of confidence in the credit of the country.

Mr. MURPHY. You think there is a possibility of a situation in which the Government would be unable to sell its short-term obligations because the bankers did not consider its obligations credit-worthy?

Mr. FENNELLY. No; I would not want to say, and I do not think it is quite correct that I mean that. Short-term obligations you can sell, but I think that you have complicated your debt structure terribly, you have made it more difficult and cumbersome to handle and you have just created for yourself very serious fiscal difficulties in constantly having to turn that debt over, and it is much more difficult to do it—you may get less favorable terms at one time than at another.

Mr. MURPHY. Well, is there any type of difficulty in a large, floating debt other than that which you have already described?

My point is this, that it is not a difference in degree but it is a difference in kind. Evidently, however, you do not agree with that statement.

Mr. FENNELLY. I think I do, if I understand you. There is a difference of degree rather than a difference in kind.

Mr. MURPHY. No; it is my belief that it is a difference in kind, and I am merely wanting to bring out the point that you consider it to be a difference in degree.

Now, are there any other difficulties other than those you have just brought out—for example, its contributing to greater inflation?

Mr. FENNELLY. Well, you can always do it, Dr. Murphy, I am sure, by purely inflationary methods of financing. It seems to me that is exactly what is involved. You can always turn over your short-time debt if you care to do it but the effect is purely inflationary financing in times of crisis.

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Mr. MURPHY. But would it be inflationary to refund a short-time debt with an equal amount of new debt?

Mr. FENNELLY. To continue to do it; yes.

Mr. MURPHY. That is all; thank you.

Representative PATMAN. Thank you very kindly, Mr. Fennelly.

We will meet again tomorrow morning. Our witnesses will be Seymour Harris, of Harvard University, and Aubrey G. Lanston, of the Aubrey G. Lanston & Co., United States Government security dealers.

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

(Whereupon, at 4:25 p. m., the subcommittee recessed, to reconvene at 10 a. m., Tuesday, March 18, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

TUESDAY, MARCH 18, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE OF GENERAL CREDIT CONTROL AND
DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:10 a. m., in the caucus room, Old House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman (chairman of the subcommittee), Senator Douglas, and Representative Bolling.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

We have with us this morning Dr. Seymour E. Harris, professor of economics at Harvard University. Dr. Harris is the editor of the Review of Economics and Statistics. He conducted in that Review last August an excellent symposium on the causes of the post-Korean inflation and the best methods of combating inflationary pressures under present circumstances. Dr. Harris is the author and editor of numerous books. He has himself referred to the Harris Book-of-the-Month Club.

Dr. Harris, we are glad to have you, and we look forward to hearing your testimony.

STATEMENT OF SEYMOUR E. HARRIS, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. HARRIS. Congressman Patman, I would like to suggest that I offer my statement, which is fairly long, for the record, and that I try to underline the major points and to try to bring home my general position which, I think, is a little unorthodox.

I would also like to have the privilege of making a few corrections by correspondence of a few arithmetical errors in the statement.

Representative PATMAN. You have that permission.

Mr. HARRIS. I must say that it took me a long time to plow through most of those two long volumes, and I tried to do that before I wrote my statement.

I would like to start by saying it is a little surprising to me that monetary policy should have become so fashionable once more at

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this particular time. I say this in view of the fact that the record of monetary policy over the last 35 years has not been a particularly impressive one, and I say this because of the fact that this is a time when we can use much more effectively alongside of monetary policy a great many other weapons, and particularly, fiscal policy and various kinds of controls.

I would like to impress upon the committee the fact that if you look back into the history of the relationship between money and prices one concludes that there has been too much emphasis on the increase in the supply of money and also too much emphasis on monetization of the debt as a great sin or economic evil.

For example, from 1800 to 1950 there has been an increase in the total supply of money of 3,600 times. In this same period there has been an increase in the rise of income—very roughly—of only 400 times, and yet, relatively speaking, the rise of prices has not been large, and it is also true that the increase in population was only 28 times.

I want to underline the fact that the increase in the supply of money was nine times the increase in the rise of income, and this is explained partly by the fact that the increase made possible a monetization of the economy, and it is explained partly by the fact that people, as they get larger incomes, tend to hold a larger proportion of their income in the form of cash or bank deposits.

In general, our monetary policy over these 150 years has been satisfactory. The monetary authorities, as a rule, have not stifled the economy, with one very important exception, namely in the years 1875 to 1900 when we had a perverse monetary system, a monetary period when there tended to be a demonetization of the debt rather than the reverse.

I would also say that it is a fortunate thing for the American economy that the traditionalists have not had their way—and by the "traditionalists," I mean the people who established the Federal Reserve System and, in general, established this system on the theory that bank assets should primarily be commercial assets.

For example, if one looks at the period 1914 to 1951, on page 3 of my statement, one would find that in these 37 years, there was a rise of deposits of $132 billion or an increase of almost eight times; but the increase in loans was only $37 billion, three times; the increase of securities was $66 billion, or 18 times; the increase in prices wholesale was a little bit more than a hundred percent, and also the cost of living was more than that, roughly about one and four-tenths.

The important point to note is that the major explanation of this increase in the supply of money, which was consistent with an increase of national income of between eight and nine times, and a rise of prices of not much more than one time, that this increase in the total supply of money was largely made possible by the monetization of the debt.

I, therefore, from this history draw the conclusion that one must be a little cautious about attacking or criticizing monetization of the debt. I do not mean to say there might not be too much monetization, but I do mean to say that we may carry this theory against monetization of the debt altogether too far.

If you look ahead you see a somewhat similar situation, because if you look ahead, for example, and assume, as many economists have,

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that the next 20 to 30 years there will be a doubling of the national income, and if you assume that the price level will rise only 50 percent, which is the rise from 1925 to 1950, and even if you leave out of account the fact that——

Senator DOUGLAS. Dr. Harris——

Mr. HARRIS. Yes, sir.

Senator DOUGLAS (continuing). You know I have great esteem for you as an individual, do you not?

Mr. HARRIS. Yes, sir; I am not sure of that, but I have great esteem for you, Senator Douglas, anyway.

Senator DOUGLAS. That is reciprocal, but I hope you do not accept too easily this idea of the 50 percent of the rise level over 25 years.

Mr. HARRIS. Yes, sir; I accept—well, I have great faith in the Federal Reserve Board on some issues, at any rate, and the Bureau of Labor Statistics, and I simply accept their figures as being——

Senator DOUGLAS. I mean for the next 25 years.

Mr. HARRIS. Oh, Senator Douglas, I am being conservative here. What I am arguing, you see, is that we are going to have an increase of no more than 50 percent. If we have a greater increase then my argument becomes so much stronger, that is the only point I am making.

Senator DOUGLAS. Well, do you look forward with indifference to a rise of 50 percent in the price level in the next 25 years?

Mr. HARRIS. Well, Senator Douglas, I would be happy if we did not have it over the 25 years; but if I were guessing, and I would not be surprised if you were guessing, we would agree that the increase is likely to be more than 50 percent.

Senator DOUGLAS. If you believe this is inevitable, then, of course, there is little you believe can be done in opposition to it; but I had hoped that we could revive a spirit of doubt and skepticism in your heart, and from there you would move to vigorous opposition.

Mr. HARRIS. Well, Senator Douglas, you know I have always been an anti-inflationist, but I want to present some of the arguments for inflation, and I think as we go on, you may differ more seriously with me.

Senator DOUGLAS. This was just skirmishing, then?

Mr. HARRIS. Yes.

Well, in anticipation of this skirmish, Senator Douglas, I took two sleeping pills last night so that I would be on my toes, but unfortunately it did not work as well as I had hoped.

The point I was trying to make, Senator Douglas, was this: I am not saying that if I had my choice in running this country that I would set out to have a price rise of 50 percent over the next 25 years. All I was saying was that it is a conservative estimate to assume in view of all of the institutional factors making for inflation that we would have an increase of prices of only 50 percent in the next 25 years, which matches our 1925 to 1950 record.

The point I am making is that on that assumption, and leaving out of account the possibility or the probability that as incomes rise the proportion of money held in relation in income would rise, as it has in the past, leaving that out of account, then you need $540 billion of money by 1975 as against $180 billion, that is, in all kinds of deposits, in 1951.

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The conclusion I draw from that is simply that some way must be found if the economy is not going to be stifled or at least depressed by inadequate supplies of money, that some way must be found to provide on these assumptions $360 billion worth of additional money; and I suggest that the growth of commercial loans is not going to do the job on the basis of what has happened in the past and, therefore, we have to depend primarily on monetization of the national debt.

Representative PATMAN. Will you pardon me, Doctor?

Mr. HARRIS. Yes, sir.

Representative PATMAN. It occurs to me that you are putting your finger on something that has given me lots of concern, the fact that our money is practically all based on debt.

Mr. HARRIS. Yes, sir.

Representative PATMAN. And if we do not go in debt fast enough we do not have enough money; is that right?

Mr. HARRIS. That is my general position, Congressman Patman.

Representative PATMAN. And expressing concern that possibly we will not go in debt fast enough to have sufficient money?

Mr. HARRIS. I am expressing concern that some way must be found for the banks to buy assets, and in view of their past experience in the buying of assets, in view of the fact that our major financial needs are met out of profits, that the way in which this increase of money and the purchase of assets is likely to come about, if it comes about at all, is through the monetization of the national debt.

Senator DOUGLAS. Mr. Harris, would it embarrass you if I make a comment at this point, or would you prefer to have me wait?

Mr. HARRIS. Senator Douglas, I wish you would, because it is more restful to have these interruptions anyway.

Senator DOUGLAS. I would start off by asking if you thought this increase of 50 percent in the price level was inevitable.

Mr. HARRIS. No, I do not say that, Senator Douglas; I say it is most likely.

Senator DOUGLAS. Then you advocate a policy of monetizing the debt, which will make it inevitable.

Mr. HARRIS. No, I think that is——

Senator DOUGLAS. Whereas, if you did not monetize the debt, it would not be inevitable.

Mr. HARRIS. I think that is an unplanned misrepresentation of my position.

Senator DOUGLAS. It is not my plan, but I thought that is what you said.

Mr. HARRIS. What I was saying was that if you have the 50 percent rise in prices, and my projection or informed guess is that we will have more than that, that if we do, and the economy of the country increases by a hundred percent over the next 20 to 30 years, then we will require $540 billion of deposits, and that these deposits will not be forthcoming unless we monetize a large amount of debt.

Senator DOUGLAS. Well, if you did not monetize the debt the prices would not increase—at least not as rapidly—and by monetizing the debt you then make it possible for prices to increase. It seems to me that there is a certain degree of——

Mr. HARRIS. Let me say that I think that is a fundamental difference between us, Senator Douglas. I have been reading the New York Times' history of these hearings, and I am sure they are most inade-

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quate, but I think one of the differences between us is the following: That you assume that the causal factor is an increase in the supply of money, and, by the way, if you pour water out today, I hope it will be Scotch.

Senator DOUGLAS. I have not any.

Mr. HARRIS. But, in any case, my argument, you see, is you have, for example, great pressure on our economic resources, great shortages of raw materials. I have heard that the Truman committee on materials is now estimating that we need a hundred percent more of raw materials in the next 25 years. You have these very inflationary wage policies and farm policies, and the net result is that tremendous pressure on your monetary system, and my argument simply is: One, that the monetary system cannot yield to this pressure. I mean, you might argue—I am sure as you would—that it should not, but, as a matter of fact, in terms of its political strength and in terms of the history of the country, I think we would be wrong to assume that if these pressures for higher prices or more money prevailed that the monetary authority will be courageous and strong enough to meet this difficulty.

So I say the increase in supply of money results from the peculiar demand situation.

If I might talk about your water in the glasses, what you assume is that the size of the glass remains the same, and I assume the glass rises in cubic content.

Senator DOUGLAS. By a happy coincidence, it rises as rapidly as you pour water in.

Mr. HARRIS. Well, Senator Douglas, I think——

Senator DOUGLAS. I do not mean to interrupt you.

Mr. HARRIS. I am glad you did, and you know that I am a devoted follower of yours. I think in some of these issues——

Senator DOUGLAS. I am a very devoted personal friend of yours, so we can exchange compliments.

Mr. HARRIS. Then I think we can disagree without any bad feelings, and I am sure we will.

Now, if I may resume this argument, so far what I really said is, looking backward or looking forward, I do not find that monetization of the debt is a great evil, although I can well see that it might go too far.

Now, if you look at the past inflation, what do you find? I worked up some interesting figures here, which a good historian like Professor Douglas, Senator Douglas—I do not want to demote you, Senator—over the years 1800 to 1952, and the 1952 figures are estimated, this is what has happened.

There has been a rise in population of 28 times; there has been a rise of national income of 400 times; there has been a rise of Federal outlays of 8,500 times.

The total Federal expenditures from 1789 to 1952 were $815 billion, but the total Federal expenditures for all purposes in the last 12 years were $648 billion, or almost 80 percent of all outlays.

The average annual expenditures of the Federal Government from 1940 to 1952 were 50 times the average of the preceding 150 years, and the annual income, 1940 to 1952, was 12½ times that of the average of 1789 to 1933.

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Senator DOUGLAS. You do not say that it is because the expenditures of the Federal Government have risen, that the annual income has risen?

Mr. HARRIS. I certainly do not say that, Senator Douglas. I am not trying to say that, Senator Douglas, but I would not say the opposite, that the increase in Federal expenditures had nothing to do with the rise in national income.

I wanted to point out that relative to income, as large as these Federal expenditures have been, they are only four times as great as in 1789 to 1939. Now, this is serious and I am not trying to minimize the seriousness of the present level of Government expenditures, especially in an inflationary period; but the point I am trying to bring home is the following: that in four major mobilizations our total expenditures were $528 billion, or 65 percent of all expenditures over the 163 years, and that throughout our history, war and associated outlays were $656 billion, or 80 percent of all expenditures; and the rise of debt in these three major wars was 92 percent of the peak debt in February 1946.

Why did I present these figures? I presented these figures to show that there was a terrific pressure on the economy in the last 12 years, something way beyond anything we ever had before, and that in view of these tremendous pressures telescoped within a short period of time, the rise in price level of 90 percent is not a bad record, and I would not blame either the Federal Reserve or the Treasury or their failure to get on, as a major factor in this particular rise of prices.

I simply say that when you have this terrific pressure on your resources, this unusual demand, it takes a monetary authority beyond anything we have seen on our planet to deal with this problem.

Now, so much for the history over this long period of time. I would like to suggest one other relevant point. I compared three wars—the inflation in these three wars, our three major wars, the Civil War, World War I, and World War II. I compared our inflation in these three wars, correcting for the proportion of resources going to war, and I discovered that in World War II the increase in the cost of living on the basis of these more or less uniform bases, the increase in the Civil War was 14 times what it was in World War II, and in World War I it was four times what it was in World War II.

Now, what conclusions do I draw from these figures? I draw the conclusion that, on the whole, we are doing a better job with inflation than we used to, given the amount of resources that are going into war, and I explain that better job not in terms of improved monetary policy, although I think to some extent we have had improved monetary policy, but I discuss this problem and explain it in terms of other anti-inflationary weapons, in World War I particularly, the greater use of taxation and savings programs; in World War II, particularly, taxation, savings programs and controls, not primarily any great improvement in our monetary techniques.

If you take the pre-Korean episode, about which I shall say something in a minute, that is, 1945 to 1950, I would say the rise of prices here was almost inevitable, irrespective of any practical monetary policy, and this is explained, for example, by the activation of monetary supplies which, in itself, reflects the backlog of demand, and which also reflects the tremendous supply of liquid assets built up in war.

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I believe the Treasury made an estimate that business acquired $185 billion in this postwar period, and only $15 billion were derived from the banks.

Now, I say that under that kind of pressure with the Nation, both consumers and producers determined to spend because they had been denied during the war, with these large liquid assets available, I cannot conceive of any monetary policy that would have prevented a substantial inflation. We might not have had a 33-percent rise in these 3 years, but we very well might have had a 20- or 25-percent rise, if we had, perhaps, a much more vigorous monetary policy.

I am not denying that the Federal Reserve banks might have sold ten or fifteen billion dollars' worth of their securities if they had no obligations to the Government-bond market, and destroyed or greatly damaged our economic system, but I think if you look at the figures on page 5 at the top, you will notice that consumer prices rose by 33 percent, national income rose by 31 percent, which is not a bad record right after the war; that actually the Reserve-bank credit outstanding fell by 25 percent—I believe the figures were $6 billion—which is a tremendous deflationary open-market policy which, of course, largely offset an inflow of gold and an inflow of currency.

The actual supply of money changed very little; but what happened was that the banks expanded their loans by 99 percent, reduced their investments by 28 percent, and these were roughly equal figures in terms of billions of dollars, and life-insurance companies and banks disposed of $34 billion of their United States Government securities.

Now, the general picture is, I think, some attempt on the part of the system to deal with the inflation problem. Undoubtedly it was hampered to some extent by the Treasury; but I must confess, on the basis of the past history, I would say that the Federal Reserve reminded me of the youngster who has been given a good kick by his boy friend, and is pretty badly beaten up, and having been pretty badly beaten up, suddenly, fortunately, his parent appears and then, of course, as soon as the parent appears the youngster says "Let me get at him."

Now, I think a good part of Federal Reserve policy in the postwar period can be explained by an analogy of that kind, and I say that largely on the basis of the record, and I say there, Professor Douglas, or Senator Douglas, you and I agree to some extent.

Senator DOUGLAS. You mean it is psychological frustration?

Mr. HARRIS. No, I mean if you take the history of the Federal Reserve System, their one great courageous episode was in 1920, and I would say in 1920 this was a courageous episode, but it was not handled too well. It brought about a serious collapse. I think since the episode, and also the 1937 episode the Treasury keeps talking about, that the Federal Reserve is a little cautious about really taking violent or strong measures to deal with a situation which would run counter to the wishes of the majority of the public and the majority of businessmen.

Senator DOUGLAS. It seems to me the majority of the public run up against the wishes of the Secretary of the Treasury?

Mr. HARRIS. Well, I would say if you look at the history of inflation in the postwar period, there are many indications—and I regret this myself, being a college professor—there are many indications that the public wanted some inflation; and I might say, Senator Douglas, that

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I am going to say a word on behalf of inflation, just to be different, in a minute. Perhaps you will let me say it now, although I have it in my notes a little further along.

Inflation, of course, is a bad thing, in general, and I do not think many of us approve of inflation and, on the whole, there is generally opposition to inflation.

If you look over our American history I am not sure that inflation has done us an awful lot of harm—perhaps the greatest harm in the last 10 years—because when a country is short of capital, inflation is an obvious way of getting necessary supplies of capital.

Senator DOUGLAS. How so?

Mr. HARRIS. Yes, sir.

Senator DOUGLAS. How so?

Mr. HARRIS. Well, need I explain to you, a distinguished professor of economics and the president of the American Economics Association, the famous Robertsonian book on banking policy and price level? I am sure you have read that.

Senator DOUGLAS. Yes, I have, and I would be very much interested to have this developed in the record.

Mr. HARRIS. Well, simply that if you manufacture money you increase the total. Supposing you start with a position of fairly high employment or, perhaps, medium employment. Obviously if you start with a position of very high employment the net effect is going to be inflation with very little increase in output. But supposing you start at the bottom of the business cycle. It is difficult to increase your total monetary resources; you want to start some place, some business enterprise, or if you consider the case of a country that is generally underdeveloped, as the United States was in a good part of the nineteenth century, here the way to deal with the problem, in part, is to manufacture large supplies of money, and to manufacture these supplies of money, the recipients then use this money to buy resources and complete with others, and to some extent they produce more resources, to some extent they wean these resources away from other people who cannot compete on a price basis.

Senator DOUGLAS. There is just the point. When you have a considerable volume of unemployment, the addition of money does put idle labor to work with idle resources, and I have never opposed that policy. But when you have comparatively full employment, then what happens is, as you say, inflation.

Mr. HARRIS. Yes.

Senator DOUGLAS. The result is a decrease in the standard of living for those on fixed incomes and an increase in business profits, a large proportion of which is invested. I think what you say is true. It does lead to increased savings and increases in lavish and extravagant expenses. But I would hardly think that would be favored as public policy, because, if I may say so, it amounts to robbing by governmental action those living on comparatively fixed incomes and the salaried groups for the benefit of the enterpreneurs, and I certainly had never thought that that was the avowed policy of this administration.

Mr. HARRIS. Senator Douglas, I cannot speak for the administration, but let me——

Representative BOLLING. Before you go on, Professor Harris, that point has been raised a number of times, and it is one of the things I want to hear some comment on. Say in a full-employment situation

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you have this increase in money supply. What is the impact on that situation of the productivity factor? For example, how much capital can be effectively used even in full employment to further increase the productivity of that fully employed labor force?

Mr. HARRIS. Well, let me answer, Congressman Bolling, both you and Senator Douglas this way: I think one has to distinguish different kinds of periods of full employment. I think if, for example, you look back to 1940–41 you had an inflationary episode that is rather remindful of what we had in the post-Korean period—especially the first 8 or 9 months—and this, in terms of months, and so on, was a very serious inflation, I would say.

Now, one thing that inflation does in such a period is that it offers additional rewards to people who are unemployed. They not only take on new jobs which they would be very glad to do, being unemployed, but they have an additional incentive in that they have an incentive to move somewhere else, and this incentive increases if their rate of pay increases.

If you look at the 1939–45 situation, what do you see? You see actually there was supposed to be 10 million people unemployed; therefore, if you put 10 million people to work, that would solve your problem. But actually we put 20 million people to work. In other words, what may seem to be a full-employment economy is not really a full-employment economy if you talk in terms of how many more people you can get onto the labor market ready to work if you increase the rewards to some extent. I think that has happened to some extent in the Korean episode also; otherwise I agree with what Professor Douglas said, leaving that factor out of account, and I, as an old OPA man, used to argue this all the time, namely, that you do not increase total production by giving price increases to businessmen when you are fully employed. But I want to point out that that is not a complete argument when there are still a great many resources that might be pulled in and yet are not really considered members of the labor market, and so forth.

Senator DOUGLAS. Wives, young people, old people.

Mr. HARRIS. That is right. I do not think you and I would disagree on that, Professor Douglas.

If you look on page 6, here you have—I put down just for convenience—changes in the rate of increase. As a matter of fact, if 1951 were put on, it would be quite clear that the rate of return on United States long-term Government bonds has gone up considerably. I think the figure is about 2.71 right now.

I put this on largely to just suggest, as I see it, the history of Federal Reserve policy during this postwar period, and very briefly, since I am sure you have had an awful lot of this, and I do not consider myself an expert on these details—I am more interested in tying this up with the whole general picture—but in 1948 you actually have, as I recall, about $10 billion worth of securities, long-time securities, purchased by the Federal Reserve, and in 1949–50 maybe five or six billions of long-term sold; and in the recent episode there has been a tendency to buy Government securities.

I am just pointing out here one of the difficulties the Federal Reserve runs up against. They are interested in a dear money policy, and yet, of course, they try to keep up the price of long-term bonds on the theory of an orderly market.

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It is also interesting that when you get a depression or a recession, as we did in 1949, this is a period when the Federal Reserve sells a very large quantity of Government securities, which is contrary to what, I am sure, Professor Douglas or Senator Douglas and I learned when we took money and banking many, many years ago, but it shows some of the difficulties the Federal Reserve gets up against when they try to deal with this kind of a situation of trying to control the price of Government securities and, therefore, because they try to control the price of Government securities, doing things that you might say are contrary to the general interest.

What I am doing here to some extent is arguing against my own position, as I am sure Senator Douglas would point out in a minute.

Senator DOUGLAS. I was just about to do so.

Mr. HARRIS. Well, I just put this out in a perfectly—I am not trying to build up a particular case; I am trying to present the relevant aspects.

Now, let me jump to another problem which I deal with on pages 8 and 9 of my statement, and that is, some aspects of the monetization of the debt.

There are a great many people, you know, who feel that we should have had a tremendous tax program, that our Government securities should not have been sold to the banks during the war period.

Of course, Mr. Murphy who, I think, is probably the outstanding expert on the national debt anywhere in the country—and who annoys me a great deal since he wrote a book on the national debt right after mine, and took away part of my market—but I think Mr. Murphy will agree that if you look at the general position of the national debt during the war, that you could not have sold, say, $200 billion worth of Government securities during the war or if you assume that there was no price increase and hence less outlays so that you could have sold even 150 or 160 billions of securities at rates anywhere near 2 percent.

The point I am trying to make is that in order to dispose of this quantity of securities you have to have a rise of prices, and better, a rise of income, and I would, for example, say that if by some miracle in the war period we could have increased our income without any change of prices by 50 percent and, therefore, raised our income up to roughly a hundred billion dollars, and then under those conditions we would have had a national debt charge which would have taken 12 to 15 percent of the national income, which is a very serious matter, no matter how you look at it, as compared to the 2 percent that it takes today and, therefore, from that viewpoint one might argue that the inflationary aspects of money, however lamentable on other grounds, does at least have a wholesome effect, first, of making it possible to sell more securities at a reasonable price and, second, to some extent reducing the burden of these securities.

One could say, for example, Where would we be today if we had a $250,000,000,000 debt and a $70,000,000,000 income, as we did before the war? In a sense the burden of the debt has been cut by three-quarters, by virtue of the kind of policies that brought about higher prices and more output and, Senator Douglas, I associate part of that rise in output with some rise of prices.

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I am sure in 1940 and 1941 we would all agree that the rise of prices had a wholesome effect in bringing people and resources into our war economy.

Now, a word about compulsion. I put this in after reading a statement that Senator Douglas made, and I would like to argue this with him a bit, but he may not like to argue this particular point.

Senator Douglas, I think you objected to the idea of using compulsion in the Government security market, that this seems unfair. I think a great many people feel that this is morally wrong; why should the Government in this manner try to control the price of its securities?

Well, in the first place, we must not forget that ever since Alexander Hamilton this has been done because any authority that has the right to manufacture money, in a sense has a right to issue securities against the will of the people; and what is more, there is discrimination in favor of this authority because this authority alone is in a position always to pay off its debt.

It is also true that if you look at the whole history of our monetary system and banking system, a very large part of the total issues of Government securities are really sold by virtue of compulsion. The Federal Reserve banks, the Government agency funds, and even the commercial banks in a sense are required to hold Government securities as liquid investments. So that I would say that whatever the moral issues are, the fact is that compulsion has had a long history, and I am not at all sure if the Government has the compulsory right to raise taxes that it is too large a step from this to ease the financial problems of the Government by giving some form of discrimination to Government securities; and from this I would take the old, what is now a hackneyed, line, especially in view of the fact that the life-insurance companies and the banks disposed of something like $40 billion worth of these securities and purchased $50 billion of other assets which, to me, suggests a lack of responsibility in these matters. I would say by virtue of all of this that there is a good deal to be said for the monetary authority requiring financial institutions to hold secondary reserves in Government securities, and if this were done the problem of general control over credit would be eased a great deal.

Now to come to the free-market problem: I think there are a great many people who have a, perhaps, excessive veneration for the free market. I have a certain amount of veneration, but it is subject to some reservations. The people who venerate the free market are, to some extent, the same people who say the way to deal with this kind of problem is through monetary policy, because monetary policy is a general attack. It does not deal with the problems of rationing or anything, it does not provide for regimentation or anything of that sort. And if you are a believer in the free-pricing system, the free-market system, then the argument is "Let us depend almost exclusively or at least largely on monetary policy as a means of dealing with inflation."

Now, how much truth is there in this? Well, as a matter of fact, as I look over Federal Reserve policy I would say that the most effective Federal Reserve policy is the policy not of general approaches to the market situation, that is, open market operations, higher interest

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rates, and so forth, but rather their voluntary restraint program, the rationing of credit in various ways, which is certainly part and parcel of a controlled economy, and which is a discriminatory method of banking or monetary control.

I do not mean to say for a minute that these rationing programs and general credit programs are really as effective as they might be, particularly the rationing program; and, if I might put in a plug, since I happen to be chairman of the Committee on the Textile Industry appointed by the New England Governors, I would like to know why under this temporary restraint program, which provides that new construction should not be allowed, where it replaces existing capacity that is able to do the job, and in view of the fact that there must be at least 20 percent excess capacity in the textile industry, why does the authority, under the voluntary restraint program, allow textile mills to be built when there is excess capacity in both North and South? I merely am suggesting that even the rationing program has its weaknesses.

Now, my point, of course, is that now we have other means of dealing with this problem. Monetary policy has a function. I think the function should be largely these kinds of particular controls.

I think that if you look at the general picture of monetary policy in recent years, and then see what was done by alternative policies, I would be inclined to argue that, on the whole, the major gains originate in other areas, and should do so.

I myself have not argued that controls ought to play a terribly important part in the present emergency, at last short of full-scale war, but I think controls play a significant part.

I think, for example, the allocation of economic resources of short resources, resources under the CMP—which, I understand, is sometimes called confusion made more permanent—under this CMP program it is perfectly true that nonessential demand is excluded, and this is an anti-inflationary program. If you cannot get a particular item you cannot produce a particular kind of good.

Now, then, you have fiscal policy, which is tremendously more important than it used to be. Back in 1914 the banks had 4 percent of their assets in Government securities. The last figures I saw were something like 36 percent. The Government now takes 30 percent of the total national income; it was not long ago when all governments took less than 5 percent.

Under these circumstances, fiscal policy is bound to play a much larger part than it ever did before. Insofar as these other weapons can be used—and fiscal policy shares with monetary policy a general nonregimentation approach—then to that extent we can expect less of monetary policy, and why we should expect less of monetary policy, I will say in a minute.

If you look at the 1945–50 situation with the rise of prices of 33 percent, the major point is that much more important than any change in the supply of money, which was very small, was the increased use of money. We had an increase of turn-over of something like 28 percent in these years, and to give you some indication of what actually happened, from 1946 to 1949 the rise of gross national product over 1942–45 was $174 billion for the 4 years over the four war years; but what happened to consumption and investment? Consumption and investment rose by $340 billion or twice as much as the rise of gross

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national product. This underlines the importance of the backlog and the importance of the pressures.

If you look at the situation in 1950 where there has been a good deal of talk about a rise in bank credit—about a rise in bank rates, and where to some extent there has been an increase in rates—and I might point out it is a unique experience—I think you might justify some increase in rates, but I want to point out to you it is a unique experience for the United States monetary authority to introduce a higher rate policy at the outbreak of a great crisis, and at a time when the United States Government has to refund $50 billion a year of old securities.

I am not arguing that one could not put up some case for this increase in rates, but I do want to point out it is a rather unique experience.

What are the other difficulties of monetary policy these days? Why should we go easy on monetary policy? Well, of course, one important reason—and this is, I suppose, something that could be corrected by the Congress—is that such a large part of the lending increasingly is done by institutions and persons not subject to control.

To some extent this was dealt with by the various regulations W, X, and so forth, but it is still true that your insurance companies, nonmember banks and, particularly, governmental organizations over a period of 5 or 6 years have averaged $5 billion a year of new loans or guarantees, that the presence of these organizations make it increasingly difficult to deal with the problem of credit control.

I would also like to point out that there are other weapons that are available, as I have done before, and that these, of course, play a very large part.

The fact that the pressures are concentrated over a short period of time makes it more difficult to adapt the required monetary policy. I could give you an example of the European situation.

Now, in Europe recently there has been a tendency to use general credit—the general credit approach—perhaps more so than in the United States, especially in the last year or so. On the whole, despite that fact, you have a rise of prices in Great Britain of about, since 1949, 2½ times as large as in the United States, and in France about 3½ times as large; and yet here the major weapon was monetary policy.

Europe used monetary policy in this way because to some extent their controls had been dulled and because there was great resistance to a rise of taxes.

I think I would say this in favor of general credit policy: I would say that a case could be made out for it where you have a very large excess in total supply of money. If your supply of money increases by 5 or 10 times, compared to prewar as against our 3 times without any large rise of prices, and then you try to ration credit, you run into all kinds of difficulties; and I say that under those circumstances the proper approach might very well be a greater dependence upon general credit measures because it is difficult to say to a consumer, for example, "You cannot buy a television set," when the banks have a tremendous amount of surplus money available.

If the charge is made that the main explanation of the change of price history since February 1951 is a change in monetary policy, I would like to point out that in the year 1950 taxes and savings fell by $2 billion and national product rose by—I am afraid my figures

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are wrong here—a substantial rise of gross national product. In 1951, instead of a fall in taxes and savings of $2 billion, there was a rise of taxes and savings of $16 billion.

I would hazard the guess that the rise of savings had very little to do with the rise in the rate of interest and, particularly, these savings that were going into Government securities, because they were not going into Government securities.

And I would, also, point out that despite the rise in the rate of interest of one-half of 1 percent this investment went up from $48 billion to $58 billion. And this does not suggest to me a very effective monetary policy.

I would say it would have been much better if some of these investments came in 1957 and 1958.

Now, Mr. Chairman, if I could in 5 minutes summarize my position, I will get ready for the darts that Senator Douglas will throw in my direction.

Senator DOUGLAS. No poisoned darts, I assure you.

Mr. HARRIS. I have argued that one can overemphasize the dangers of increasing supplies of money; that on the basis of history, on the basis of informed guesses concerning the future, there is something to be said for more money.

I would, also, argue the case for inflation may be overdone, though as I look back over American history I would be much happier if our inflation had been 45 percent, rather than 90 percent in the last 12 years. But I think some inflation was a necessary condition for putting so many people back on the job.

Similarly, I argue that the monetization of the debt, so far as the future goes, is also not the evil it has been made out to be. And if I were put in a corner and had to say, would you or would you not have monetization of debt, I would say, by all means, let us have it, and a good deal of it.

Now with regard to the difficulties of the monetary policy, I simply say there are other potent weapons available, and that in view of these weapons and their increased importance that we ought to devote less of our energies to the monetary policy, particularly, general credit control.

I am not nearly as critical of the other types of monetary policy.

In view of the fact that the major assets of the banks have tended to be in recent years public securities and not loans, and in view of the fact that the banks generally favor their customers, any general credit measure tends to have an unfortunate effect on the price of Government securities. And when the Federal Government is responsible for close to one-third of the economy, this is a serious matter and one must not forget there are a thousand billion dollars of assets in this country, a large proportion of which are influenced in price, and, therefore, our whole financial system, by any change in the rate of interest.

I also point out the difficulties of a monetary policy, because of the tremendous increased importance of nonbanking lenders, because of the vast supply of liquid assets which are an aftermath of war and accompanying greater use of money.

There was a point I forgot to make before. I think this is a point that Professor Douglas would be sympathetic with.

I hope you will forgive me for always calling you professor.

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Senator DOUGLAS. That is all right. I feel very complimented.

Mr. HARRIS. If we introduce a voluntary restrain program or any kind of a program to excessively restrict the supply of money we do favor the have's against the have not's, the large-business enterprise that has plenty of cash against the small-business enterprise. And I would like to point out that in the Jacksonian period, when the average businessman was a small-business man, in general, he was in favor of inflation and the expansion of monetary supplies, but it is a different story today when the entrenched businessman is well prepared to cooperate in a program of restricting credit and making it more difficult for the newcomers to get in.

I also point out that the relationship between the rate of interest and the price of all assets, that if a monetary policy is used—and it should be used—I would put much greater emphasis on the rationing programs and not nearly as much on general credit, in view of the overall effects of general credit, and the difficulty of this policy being too precise in its effects.

In view of the importance of the Government economy, this becomes a very important issue.

I also pointed out that so far as any practical increase in the rate of interest goes, the effects upon saving which are largely tied to income and price prospects, and on investment on the whole, so far have not been very large, and in any inflationary period they are not likely to be very large.

And, finally, I do want to make the positive point that a monetary policy has a place, but the place varies with conditions, with the importance of other controls, with the importance of the Government bond market. And if we use a monetary policy and depend less on general-credit policy, this will be made easier by the use of a secondary reserve principle.

And, finally, let me say that my general position is that the monetary machine, in general, responds to these pressures of higher wages, of higher prices of imports, of more trading, or Government needs, rather than being the instrument that brings about these inflationary factors.

Representative PATMAN. Senator Douglas.

Senator DOUGLAS. I have taken more than my share of the time so that I think I shall yield to Congressman Bolling.

Representative BOLLING. It will actually be more interesting if Senator Douglas would start out.

I have a few questions.

Do you happen to have any rough figure as to the proportion—you mentioned a large proportion of loans, credit that exists in the hands of nonbanking institutions, insurance companies, nonmember banks and Government institutions.

Mr. HARRIS. I could be corrected on this. I am pretty sure the Government agency figure is around $30 billion, including guarantees. The life insurance companies assets may be of the order of—I have looked for the figures, I did look at them when I originally wrote this paper—of something over $60 billion. It is in the range of $60 to $65 billion.

Representative BOLLING. You brought out in your discussion that that type of credit is less affected, relatively, by the actions of the Federal Reserve and more indirect effect, presumably. Would you

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discuss what methods are more effective in affecting that type of lending and credit?

Mr. HARRIS. Of course, to some extent these organizations are influenced by general credit. There is no doubt about that.

In the two volumes that your committee published, I might say parenthetically, I thought they were the most interesting documents I have seen in this field since 1914. They contain a tremendous amount of valuable information. But in that particular document I notice that a good many of the insurance companies did say that once it was made clear that there would be fluctuation in the price of Government securities, they were less disposed to take losses and, therefore, to that extent less disposed to sell securities and make loans.

So I would not say for one minute that there was not some relationship between these two.

It is also perfectly true, as pointed out by a president of the American Bankers Association, at a point when there was a serious inflation in the postwar period—actually there were only $5 billion worth of new loans made by the member banks of the Federal Reserve System and $15 billion in this one year made by others. That is the kind of problem you run up against.

Representative BOLLING. I would like a longer answer to that. What techniques will be more effective in handling that particular problem?

Mr. HARRIS. As far as the Government agencies go, of course, that lies with the Congress, limiting the amount of funds they have or, perhaps, more carefully directing what they do, as Senator Douglas, to some extent, has been responsible in the control of the RFC.

Of course, as you all know, there are attempts on the part of all of these agencies to work together, particularly since this voluntary restraint program was introduced, so that none of these governmental agencies should, for example, be more liberal than the financial private agencies.

I would say that an offhand suggestion would be—and I think this is very difficult—I suppose from a constitutional viewpoint, because I understand the life insurance companies operate by State charter—of course, the life insurance companies, also, have a tremendous amount of public support, and naturally, because of the kind of work they do—I was not impressed by their defense of their 1948, and later policy of selling Government securities in large quantities, because they found mortgages and business loans and business securities and municipal securities more profitable. It is quite true that you can in a capital society, not blame any insurance company for doing this, in a sense, but it seems to me there ought to be some technique by which the freedom to dispose of these assets, especially since these assets provide a tremendous amount of profit for these insurance companies, and did in the war period—some technique ought to be developed—I do not know what it is—perhaps the lawyers could think of one better than I could—for not allowing complete freedom on the part of nonbanking lenders to dispose of Government securities.

Representative BOLLING. On this question of the voluntary credit restraint program it seems to me that in that we are resorting largely to exhortation. You cited an example of the textile field.

Mr. HARRIS. Yes.

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Representative BOLLING. I have been unable to find any generalized indication of how effective or ineffective this technique is, but the question disturbs me a good deal, because in one field, and examples of which are regulation W and regulation X, we have a compulsory program, and in the other field which, apparently, is a least or perhaps more important we have a voluntary program of self-administration.

What are, in your judgment, the possible specific alternatives to a voluntary credit restraint program which is essentially self-administered?

Mr. HARRIS. I think that is very good. That has bothered me a good deal. Why should Textron get an $8 million permit, both to get the steel and, also, the credit, say, to put up a plant? And why should some poor man who has just made enough money find it very difficult to get a television set?

There is an element of discrimination here. There is no doubt about it.

I have often argued that, unless you assume that it is the job of the Government to determine the ethical behavior of individuals and keep them from getting into debt, there is something to be said against consumer credit control. Unless you ration credit all along the line. Otherwise, there is a form of discrimination against the little fellow.

Representative BOLLING. Thank you. That is all I have.

Representative PATMAN. Do you believe that regulation W should be continued for the next year?

Mr. HARRIS. That is consumer credit?

Representative PATMAN. Yes. You just mentioned consumer credit. I thought I would ask you about that.

The Defense Production Act will be up for consideration soon, that is, the continuance of it.

Mr. HARRIS. Yes. That is a difficult question to answer, because you have to do a certain amount of crystal gazing.

It is quite clear that the market for a good many of these items is pretty soft at the present time.

It seems to me that the difficulties arise in trying to guess how fast the defense program is going to pick up. And if the defense program picks up sufficiently it might be a mistake to ease up too much on consumer credit, but I would like to see the consumer credit program accompanied by a fairily widespread control of credit along these lines.

Congressman Bolling said that the voluntary restraint program is a voluntary program. Of course, there is an element of compulsion there.

Representative PATMAN. Unquestionably.

Mr. HARRIS. I know of a case of a Congressman and if you do not mind I will not mention his name, who was very much disturbed in his district because he could not build a plant which he was very anxious to have built. He went to the Defense Mobilization people and they turned him down, he could not have the steel, or something of that sort. He went to them largely to get some relief on the credit item, and he thought that Mr. Wilson might put pressure on the Federal Reserve.

The Federal Reserve did yield under pressure and allow it, that is, the plant to be built.

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I was going to drop Woody a note on this particular episode, and get the information. If this were true, I would pass this information along to some of the New England Congressmen, hoping that they would see that this particular error was not repeated.

The question is a difficult one to answer, Congressman Patman.

I will say on the grounds of equity there is a lot to be said for dropping it. On the grounds of the kind of difficulties that the city of Detroit has had, there is something to be said for dropping it. But, on the other hand, if the inflationary pressures rise in the second half of 1952—I went to a conference not too long ago where the weighted average of all of the Government economists—this was late in 1951—as regards the 1952 situation was a 4 percent rise in prices. Well, 4 percent is not too serious, but I would rather see it 2 percent rather than 4 percent in the present situation. And if we are going to have a 4 percent rise with the present consumer credit control, I would be inclined to keep it and try to broaden that kind of control as much as possible.

Representative PATMAN. I assume that you do not consider it so important at this particular time when it should be sort of a shotgun in the corner, and be available in the event it is needed?

Mr. HARRIS. You mean consumer credit?

Representative PATMAN. Regulation W.

Mr. HARRIS. I think that it is a good approach on the whole. My suggestion is that there is an element of unfair treatment among various citizens.

Representative PATMAN. I am sure there may be some discrimination there, and some favoritism, and necessarily so, in any rigid control measure.

Mr. HARRIS. I just wanted to say that I did not mean to say that this is administered unfairly by the Federal Reserve. This is one regulation that hits consumers against another regulation.

Representative PATMAN. I am not charging they are unfair about it at all.

You mentioned a while ago how difficult it is for smaller concerns to get credit.

I was impressed with some recent information that I saw in connection with the joint committee report about the industrial expansion the past year. Three-fourths of the expenditures for industrial expansion came from retained earnings and depreciation.

What chance has a small businessman against what could be considered capital that does not cost the other fellow anything except through increasing his prices?

Mr. HARRIS. I agree with you 100 percent. I was trying to make the same point.

You remember I quoted some figures which the Treasury presented. I am pretty sure that the figures were $185 billion of expenditures on plant and equipment and only $15 billion came from the banks.

Representative PATMAN. Out of $185 billion?

Mr. HARRIS. Out of $185 billion. They are in those two volumes that you published.

Representative PATMAN. That is along the same line that these figures disclose.

Mr. HARRIS. Yes; that is right.

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Representative PATMAN. That is rather disturbing to me, and I am sure it is disturbing to you.

Mr. HARRIS. Yes.

Representative PATMAN. It would not be long at that rate until our country will be composed of large concerns, and the little concerns will be fewer in number, instead of more and numerous, as they should be.

You suggested that we need so much money. Suppose we were to decide, that is, the experts of the country, who are smart enough to do it—I am not—as to how much money we need right now to carry on our economy. And suppose they were to decide that we will at all times need in the future, at least, say $200 billion. I believe the supply is around that now.

Do you see any reason why the Government should not consider transferring a large part of that or a substantial part to the Federal Reserve banks and thereby let the interest flow back into the Treasury and have a circulating medium upon which people are not paying interest all of the time, rather than based entirely upon debt like it is now and paying interest on it?

Mr. HARRIS. I think, of course, if the country, say, needs $200 billion, in view of the general price picture, I would not be inclined to argue that they need much more than they have now.

There is always, of course, the question of the interest that the banks get. And I would myself argue to some extent that the banks have taken over from the Congress the right to create money and determine the value thereof, because that is a right that is given to Congress, but I think the way this problem ought to be judged—you remember Father Coughlin used to use the argument, a long time ago, that the banks were crooked, because they were getting interest and not doing anything—I do not think myself that there is too much to that, but I think the point is that the banks do have certain privileges. But they have to compete for capital and as long as they give the kind of services that they give, and the kind of abilities required, and the risks required, they are entitled to a fair return.

Of course, the Government does save the interest on the $30 billion of currency outstanding, but these $30 billion are what the public wants to hold in cash. And you know it was not very long ago when the figure was just a few billion dollars. And as the income rises, the amount will increase.

If you should try to put this money out and redeem some other kind of money, and the public wants to hold cash in bank accounts and not greenbacks or Federal Reserves notes, then the money would just come back and it would be pretty difficult to force it on the public.

Representative PATMAN. I do not understand your statement that, of the $30 billion, approximately, now outstanding in circulation, no one is paying interest? Of course, to the extent that it is the minor coins, the silver, or the old United States notes, that is true, but the other money, the Federal Reserve notes, someone had to borrow that money to get it in circulation.

Mr. HARRIS. The member banks had to use some of their reserves.

Representative PATMAN. Yes.

Mr. HARRIS. For this purpose. And to that extent they can lend less, but you might also argue that the Federal Reserve, by buying

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up Government securities, provided the member banks with this particular reserve.

Representative PATMAN. I did not bring up the question as an attack on the banks. I do not join any statement that Father Coughlin made some years ago. I do not share that. The banks rendered a great service in time of war.

Mr. HARRIS. I think it is a logical and sensible one.

Representative PATMAN. They have done that in time of war, as well as in time of peace. I am not making any attack on them. It is just a matter of looking at the question from the standpoint of this——

Mr. HARRIS. As I understand your point, your point is that the country has to have, say, $200 billion worth of money. Why would it not be better if all of these $200 billion were out in the form of greenbacks? And the Government, you see, would get $200 billion worth of revenue. Well, the point is that the public does not want $200 billion worth of greenbacks. They want deposit accounts.

Representative PATMAN. You did not understand me, Dr. Harris. I did not advocate that at all. I did not suggest that. I suggested credit, instead. In other words, the same orthodox way it is done now, except by the Federal Reserve banks, instead of the commercial banks.

Mr. HARRIS. There is something in that. The suggestions were made during World War II that it was silly to sell these Government restricted bonds to the commercial banks. Why were they not sold right off to the Federal Reserve, and then if the Federal Reserve puts out too much cash, by spending this money, you could increase reserve requirements or something of that sort. I think a reasonable argument might have been put up for this.

Representative PATMAN. I suggested to the Ways and Means Committee that the bonds should be sold to individual investors. Naturally, that is the best place to put these bonds. Then after you have sold all that you can there, and to the insurance companies—and you must sell them to the banks, because the banks create the money to buy the bonds—to give consideration, after the banks have acquired a certain amount of Government bonds, to then let the Federal Reserve banks buy them instead.

Mr. HARRIS. Then you sterilize any resulting increase of cash.

Representative PATMAN. That is right.

Mr. HARRIS. If I remember, in one place Professor Musgrave—as a matter of fact, maybe in this symposium that you mentioned—made a somewhat similar suggestion. I think he made it a number of years ago. I do not want to tag this onto Professor Musgrave, but I am pretty sure that he made it.

I think your suggestion has something to be said for it. Of course, it does run into the general problem of competition with private enterprise. These banks are established to do this particular job, and as long as they are established the question arises whether you are going to take this business away from them.

Representative PATMAN. This is an abnormal job—that is, I consider it—that is, the question of national defense and preparedness.

Mr. HARRIS. That is right.

I have another suggestion which is perhaps something like that—that since the banks are a semipublic utility—certainly a public utility in the same sense that any public utility is—after all, they serve all

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of the industry—you might very well argue—and they do, virtually, a riskless business under the Federal Deposit Insurance Corporation—that they might, in general, do these services for the Government at cost, and that within the limits their profits should be commensurate with the particular kind of business that is done. As a matter of fact, I am not sure of this, but their profits now are not terribly high. They may be 7 percent of capital, but I would not be too sure of that. I looked that figure up the other day.

Representative PATMAN. I would not consider them excessive. For member banks before taxes about 14.5.

Mr. HARRIS. Yes.

Representative PATMAN. One year—I think it is 1951—we have the exact figures here——

Mr. HARRIS. There is not any question——

Representative PATMAN. I realize that we cannot get along without banks, and I want enough banks to serve the public needs, and I want them independent. I do not like to see these branch and chain banks and things like that. Do you agree with me on that?

Mr. HARRIS. Yes. I think, on the whole, the less concentration the better. That has been the American principle.

I would say this: That if you have a controlled economy—if, for example, we should have a military program for the next 25 years which required fairly comprehensive controls, it would probably be easier to afford these controls if you had, say, a dozen banks. That is one reason the British have done an excellent job of this kind of rationing of credit, because they have a limited number of banks, and they all have their branches. But I think it is much more of a difficult problem to have branches in the United States than in Great Britain, and I would, myself, not particuarly favor an expansion of the branch system.

Representative PATMAN. The net profits, on page 569 of the first volume, 1951—this is preliminary—were 14.5 percent for net current earnings, but net profits were 7.7 percent.

And the year before it was 13.2 percent for net current earnings, and 8.3 percent for net profits. And the year before 12.2 and 7.6 percent.

I do not think that anyone is kicking, at least I am not, on the profits of the banks at all. I realize that we must have them. They are rendering a good service and, especially in time of war as well as in time of peace. They have to make money.

Mr. HARRIS. I would say that when you have a little time you ought to have a chat with Mr. Murphy. He could tell you more about these problems.

Representative PATMAN. I have had many chats with him. He has kept me on the track during these hearings, the best he could. I hope that he is successful as we go along from day to day. Without him we could not get along with this investigation or with this hearing.

Senator DOUGLAS. I have only one comment and one question.

The comment is that I think you minimize unduly the evil effects of inflation. I can remember the old days when low wages and great inequality of incomes were justified on the ground that we would thereby get more investment from the concentration of income in the hands of a few at the top and hence more rapid development of industry.

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I think at certain stages of our development that may well have been true.

I think that was the policy of the United States Government for many years to follow. Sometimes this was conscious, sometimes it was unconscious. And it was possible to follow it because the people who suffered from the fact were inarticulate and scattered. The wage earners were not organized. A goodly percentage of them were immigrants who were having trouble in adjusting themselves to the country and they were not politically articulate.

A considerable proportion of them were also farmers who, in those days before the Farm Bureau, were not organized.

So that it was possible to have a series of business policies and governmental policies which certainly did not mitigate inequality and which, in my judgment, fostered it, on the whole.

But this ignored the human costs to the wage earners of the cities. And the people on the other side of the railway tracks were human beings, just the same as the business leaders. Not only did this trickle-down policy ignore the effect on the city workers; it also ignored the human costs to the farmers out on the plains.

Fortunately, from my point of view, there was a change in the political climate. And in the last 20 years we have not only had much greater productivity but a much lesser degree of economic inequality, with results that have on the whole been good.

The people who benefit from inflation are obvious—speculators and active aggressive business groups. These are people who have money, who go to the night clubs, and whose money has a high rate of circulation, so to speak.

But the people who suffer from inflation are these modern groups of the inarticulate, the old people on annuities, living in a period of life which by definition carries with it a diminution of energy. They suffer. Their real purchasing power is diminished. They feel aggrieved, but they are unorganized. Their vital energies are diminished. They are not politically articulate.

Among them there are widows who have been left sums of money by their husbands. They themselves, perhaps, are not aged, but they are cut loose without a family life. They suffer. But they are politically inarticulate because they are inexperienced, they are isolated, and they do not see the chain of causation. No one sees the chain of causation. Yet they suffer very much.

The white-collar group, who are forming more and more a larger proportion of the population, clerical and mercantile and professional services—this group suffers, but by definition they are not organized. They are highly individualistic.

So the sufferers from inflation are diffused, unorganized, and inarticulate. And the connection between the modern-day inflationary policies and their results is much more indirect than in the old days of the Civil War when Secretary Chase started printing greenbacks. Then you could see the Government printing money. You could go down here to the Bureau of Engraving, and you could see the presses turning it out, and you could fix responsibility. But now it is very difficult to fix responsibility.

The Treasury puts the squeeze on the Federal Reserve Board. The Federal Reserve Board buys bonds in the open market. But the average person does not see the connection between that beginning and the

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inflation, the end product. He does not see that the purchase of these bonds increases bank reserves, that the increased bank reserves lead to further bank loans, that the increased bank loans tend to lead to inflation, and therefore the chain of causation is obscured.

It is increasingly possible for the inflationists to operate unnoticed, never to be discovered, and, indeed, always to have an alibi saying, "Well, we are in favor of direct price controls." Thus they can ride with the hounds and run with the hares at the same time. They can feed the fires of inflation, get the support of the inflationists; and then, since the connection between their acts and final results cannot be made popularly known, they can emerge as the great defenders of the consumer by advocating direct price controls.

I know you are intellectually, a very honest man. And that is not said in any double-edged compliment at all.

These are the terrible costs that inflation works upon innocent people. Should we not consider those costs along with the increased savings which you may get from taking real purchasing power away from these groups and putting it in the hands of the speculators and the active business groups of the community?

Mr. HARRIS. May I make a comment on that?

Senator DOUGLAS. Surely.

Mr. HARRIS. Because I agree with you. I do not want my paper or statement to be interpreted as a proinflationary statement.

I simply say really two things: One is that, whether we like it or not, there are inflationary pressures. Wage policy, for example. That, in view of those pressures, you are going to have a certain amount of inflation, and it is very difficult, if not impossible, for the monetary authorities to deal with that.

The second point I make is that a minimum amount of inflation is necessary under certain conditions to get our required resources. For example, if you have a 10 percent increase in output, I think a 2 percent inflation is a worth-while price to pay for it, but, if it is a 10 percent inflation and a 2 percent rise of output, I am dubious.

Senator DOUGLAS. Those are just the figures that I used in my colloquy with Mr. Keyserling. We put, roughly, an additional 1.8 percent of the unemployed to work between June 1950 and March 1951. I would be willing to grant that the inflation, perhaps, partially caused that diminution of unemployment, and the expansion of employment led to increased production. But I fail to see how you can credit any further increase in productivity to the expansive credit policies.

What we had was an 8-percent increase in the cost of living and a 2 percent diminution in unemployment.

Let us examine the proposition that the other 6 percent was increase in productivity. Roughly, 3 or 4 percent of it was due to the inevitable movement of economic progress.

Another 3 or 4 percent may have been possibly a percentage due to overtime. And the rest was dissociated from an expansive credit policy.

My own feeling is that in that period, from June 1950 to March 1951, we had too rapid an increase in the price level. We tend to forget these forgotten unorganized people who, as I have said, are the principal sufferers of such a price rise. There is also danger that, as the groups which were formerly inarticulate, labor and farmers, be-

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come more strongly organized, they will join the inflationary groups and the inflationary forces, and then all of the organized groups in the community will be inflationary. Then the inarticulate public which will pay the costs will be the unorganized and the politically ineffective. I do not think it is the function of government or of the Federal Reserve to yield to pressures if those pressures are adverse to the public interest.

You may say it is inevitable that they do that. Well, you know the old story of the Maine farmer who was walking down the road, looking very dour. Someone said, "Why are you looking dour? Why are you looking so sad?" He said, "I am going down to Bangor to get drunk; and, gosh, how I do hate it."

As we think of the possible intoxication of the inflation, it does not help very much if we go with a sour countenance, so long as our feet move in that direction. But I might say even a sour countenance would be better, in that it would offer hope for the future, than if we go toward inflation with a song on our lips, as I thought you might have done this morning, since my impression was that you felt that inflation was coming and it was not such a bad thing.

I hope that you will not take that personally. I thought that, if my impression of your position were translated into the Maine idiom, it would be, "I am going down to Bangor to get drunk; and, gosh, what a beautiful feeling it is going to be."

Mr. HARRIS. I would not want you to interpret my remarks as you did in the last sentence.

Senator DOUGLAS. Perhaps that was unfair.

Mr. HARRIS. I would simply say that I am afraid inflation is coming. I would not be afraid if it were a small amount, and that a small amount of inflation, not particularly in the next few years, but over the years when you need an increase in the total amount of resources to be employed, probably does more good than harm.

And I quote you those figures of American history. I still think that the amount of inflation we have had, with very few exceptions, has not injured the country when you consider the tremendous economic gains that have accompanied it.

Representative BOLLING. Will the Senator yield?

Senator DOUGLAS. Surely.

Representative BOLLING. The point that he brought about some people who hunt with the hounds and run with the hares, I think, is very valid.

What I am about to say does not at all apply to the Senator, but I would like to point ou that that technique of being on both sides of the fence at the same time could work the other way, that a great many people who say most strongly that they favor monetary policy as a method of controlling inflation are those who fight with every other weapon in an attempt to restrain inflation. So it cuts both ways.

Senator DOUGLAS. That is correct.

Mr. HARRIS. I think that is a very important point, Congressman Bolling. I think that is one of the dangers of putting excessive emphasis on a monetary policy.

Senator DOUGLAS. I would gladly discuss the fiscal policy, but our chairman made the correct ruling in the beginning that we were not to discuss the fiscal policy but merely the monetary policy and debt

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management. So that is why we have had a somewhat restricted view here.

Representative PATMAN. I do not know that that would be objectionable, Senator Douglas, if you want to discuss it.

Senator DOUGLAS. Not at all. The title of these volumes is "Monetary Policy."

Representative PATMAN. I will admit that it is on the verge. Maybe it is a little bit over, but if you want to ask about it, why, it will be all right.

Senator DOUGLAS. I think, on this point of the fiscal problem, Professor Harris and I would be in very close agreement on that.

Representative PATMAN. Would you like to make any comment about the present organization of the Federal Reserve Board? Do you suggest any changes, or leave it be set up like it is?

Mr. HARRIS. I might say that Professor Douglas and I do agree on the importance of supplementing or integrating fiscal and monetary policies.

On this question you raise, it is a very difficult problem.

I have watched the Federal Reserve for many years. I do have some idea of how it operates and the organization, and so forth.

If I may say quite frankly, one of the things that bothers me about the Federal Reserve—and I do not think this is intentional—I think the people that run this, and the people I know who are the governors, or the presidents that I know of the banks, are, on the whole, a pretty good group, but the thing that bothers me a good deal—that is one of my other objections to excessive emphasis on monetary policy—is that the people who run this particular organization are likely to become a little bit too much oriented to the banker's viewpoint.

It is perfectly true that the rules and regulations and how the people are picked, and so forth, do not necessarily mean this is going to be so.

I think generally there are a couple of bankers on the Board. I think there is some request, at least, that two be put on by law. I do not think that is on the statute books yet.

I do not think it is nearly so true of the Board as it is of the banks.

I think the Reserve banks in general, because of their close contact with the member banks, their attitude toward interest rates, and so forth, is largely subconscious, is likely to be influenced by their close relationship to the bank.

After all, President Wilson had an awful fight to make the Federal Reserve Board a public organization. This was considered quite radical at that time. Attempts to put too much emphasis on monetary policy may jeopardize the interests of the public in favor of the banks.

This is not meant in any sense as derogatory of the bankers. I think the bankers in general do a very good job. They are just as worthy citizens as any other group.

But the point is that they run this system to a considerabl degree; for example, they have considerable control of the Open Market Committee. My own guess is—it is only an impression—that the presidents of the Reserve banks and the Open Market Committee are likely to be more able people than the Board. I think that is partly a matter of pay. It is partly a matter of the way the whole thing is set up. Thus the Board members are often political appointees.

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So in a stuggle for authority, and so forth, I think it can very well happen that the banking interests play too large a part as against the public interest.

How that is to be corrected is beyond me.

It is quite clear to me that the Reserve banks ought to have representation on the Open Market Committee because they do the operating, they know the peculiar conditions in their own communities. And it is true that the Federal Reserve Board has exclusively certain powers that are important, and yet I do have a feeling—it may be pure prejudice on my part—that there is a little too much authority that represents or reflects the interest of the banking community in this whole picture.

Representative PATMAN. Are there any other questions, gentlemen? Dr. Murphy, would you like to ask some questions?

Mr. MURPHY. No.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. No.

Representative PATMAN. Thank you very kindly, Dr. Harris. I know we will be helped by your testimony, and we appreciate it.

Mr. HARRIS. Thank you.

(The prepared statement of Seymour E. Harris reads in full as follows:)

MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

(Statement by Seymour E. Harris before the Joint Congressional Committee on the Economic Report, Tuesday, March 18, 1952)

Credentials: I am professor of economics at Harvard University, the author of 25 books, inclusive of Twenty Years of Federal Reserve Policy, the National Debt and the New Economics, Inflation and the American Economy, and the Economics of Mobilization and Inflation. I am or have been an adviser of seven Federal departments and agencies and am now chairman of the committee on the New England textile industry appointed by the Conference of New England Governors.

MONETARY POLICY

1. It is odd that in the years when monetary policy was considered virtually the exclusive weapon for dealing with inflation, the monetary authority achieved anything but a good record. The pattern was failure to act soon enough and the use of the ax when the scalpel might have been adequate.

2. Now when there is a much greater awareness of the possible contributions of fiscal policy, when Government receipts and expenditures account for a substantial part of national income, and when income and control policies loom larger, the emphasis has shifted back to monetary policy.

MONEY AND INFLATION

3. The monetary authority tends to become concerned over the large growth of monetary supplies. Over a period of 150 years of American history, the rise of monetary supplies has exceeded that of income and population. The respective rises were roughly 3,500 times for money, 400 times for national income and 28 times for population.

4. Fortunately, the monetary authority, even though concerned over increased monetary supplies, did not stifle the economy—with some notable exceptions—by excessive restrictions on monetary expansion. The reason was lack of authority and (later) lack of courage and popular support. The fact is that the country grew up to its monetary supplies. Indeed, there were periods, e. g., the last quarter of the nineteenth century) when the monetary system was rigid and perverse in its behavior. Additional money was required not only to monetize the economy and finance the growth of the Nation, but also to provide the additional cash which the people want as their standards of living rise. Thus we can explain a rise of money greatly exceeding the increase of income. We

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should not forget, furthermore, that part of the added supplies of money financed inflationary episodes which are characteristic of economies with shortages of capital. In a developing economy, inflation serves a useful purpose, if not carried too far, in providing needed capital.

5. Had the traditionalists had their way (and these include even those who inspired the Federal Reserve System and were the precursors of the anti-monetization-of-debt school, Senator Glass, Professor Willis, and leading bankers), then the country would have been starved for money in the years since 1914. Only war and the growth of national debt vanquished these supporters of the theory that bank deposits must grow only with commercial loans. They failed to see that recourse to commercial lending does not necessarily give the country the money it needs.

6. Here are some rough figures for 1914 to 1951, inclusive. They show the importance of the monetization of the debt and the associated rise of deposits and of national income, the last only in small part reflecting inflation.

It will be observed that the major increase of assets (and especially proportionately) has been in securities and that national income rose eight times as much as prices. (Cost-of-living figures are not too reliable for the earlier period but a rough estimate points to an increase of income of six times as much as in the cost of living.)

All commercial banks: Deposits, loans, securities, and national income, 1914 and June 1951

	Rise, billions of dollars	Rise, number of times
Deposits	132	7.6
Loans	37	3.1
Securities	66	17.8
Prices, wholesale	----------	1.1
National income	246	8.6

Source: F. R. B.: Banking and Monetary Statistics, Federal Reserve Bulletin, Historical Statistics of the United States, 1789–1945, and the Economic Report of the President, Jan. 1, 1952.

A WARNING TO THE MONETARY AUTHORITY ON MONETARY RESTRAINTS

7. I repeat, had the orthodox view prevailed, the financing of the tremendous growth of the country since 1914 would not have been possible, or at the very least, monetary policy would have greatly hampered the growth of the country.

8. A we look ahead and anticipate a doubling of the national income in 20 to 30 years, it will be necessary to provide large additional supplies of money. Even if we assume that the ratio of deposits to income would not increase as it has in the past, and if we assume the 50-percent price rise over 25 years that has occurred since 1925, the country would need $540 billion of deposits, as against $180 billion in 1951. (This assumption of a 50-percent rise of prices over 25 years is a conservative one in view of the threats of war, the pressures on raw materials, the institutional upward pressures on incomes.) Where is this money to come from if the debt is not monetized? In the years of spectacular upward trends from 1914 to 1951, loans accounted for but $37 billion of the rise of deposits of $132 billion.

THE PAST INFLATION AND MONETARY AUTHORITY

9. It is well to be clear that the major explanation of inflation in the forties and in earlier periods has been war, preparation for war and the aftermath of war. Under the pressure of diverting large resources to the military in a short period, the Government necessarily has recourse to inflationary policies.

10. In the years 1800–1952, the following occurred:

(1) The rise of population has been 30 times.

(2) The rise of national income 400 times.

(3) The rise of Federal outlays 8,500 times.

(4) Total expenditures, 1789–1952 (1952 estimate), $814.6 billion.

(5) Total Federal expenditures for all purposes, 1941–52, $647.6 billion, or 79.6 percent of all outlays.

(6) Average annual expenditures of the Federal Government, 1940–52—50 times the average outlays in 1789–1939.

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(7) Annual income, 1940–52—12.5 times that of the average of 1789–1933.

(8) Hence relative to income, annual Federal expenditures in 1940–52, relative to 1789–1939, were four times as great.

(9) Expenditures in course of four major mobilizations, $527.7 billion, or 65 percent of all expenditures over 163 years.

(10) War and associated outlays, 1789–1952, $656 billion, or 80.5 percent of all expenditures.

(11) Rise of debt in course of three major wars, $256 billion, or 92 percent of peak debt in February 1946.

11. These figures suggest that the expansion of money, the rise of Federal outlays and of Federal debt are largely related to war, that the heavy incidence of these outlays has been in the last 12 years, that in view of these great pressures, the inflation has been surprisingly small.

12. What I am trying to underline is the point that the inflation of 90 percent in the last 12 years has been small in view of the vast expansion of Federal outlays. In fact in the war period, the inflation (corrected for proportion of resources going to war) was but one-fourth that of World War I and one-fourteenth that of the Civil War. These figures suggest a good record in the war period. The record is even more impressive if the pressure on wages is considered. In the Civil War, average hourly earnings rose one-third as much as the cost of living; in World War I, 1.4 times as much as the cost of living; in World War II, almost twice as much. A fairly vigorous fiscal policy, a large expansion of output related to the unemployment in 1939, a reasonably effective control system all contributed to the improvement.

13. The postwar and pre-Korean inflation which was 1½ times that of the war inflation, may be associated with the premature freeing of markets before the economy had an opportunity to grow up to the increased monetary supplies and not primarily to monetary policy or conflict between the Reserve Authority and the Treasury.

THE 1946–50 EPISODE

14. Over the 5 years preceding the Korean war, the major changes were as follows:

	Percent
(1) Consumer prices (1945–50)	+33
(2) National income (1945–50)	+31
(3) Reserve bank credit outstanding (December 1945—June 1950)	−25
(4) Deposits and currency (December 1945–1950)	− 1
(5) All banks, loans (December 1945–1950)	+99
(6) All banks, investments (December 1945–1950)	−28
(7) Life insurance company investments in U. S. Government securities (December 1945–1950)	−34

15. In general, despite a reduction of $6 billion in Government securities held by Reserve banks, the price level rose by 33 percent. The banks were able to maintain their credit outstanding because the pressure put upon the banking system through sales of assets by the Reserve banks and Treasury surpluses and redemption of debt merely offset gains of cash associated primarily with an inflow of gold and currency notes.

16. Banks tended to increase their loans as they disposed of Government securities. In 5 years, the rise of loans was $30 billion and the reduction of investment in Federal issues $28 billion. In addition, insurance companies reduced their holdings of Federal issues by $7 billion. In these 5 years, insurance companies increased their total assets by $19 billion, the major increases being in securities of business and industry ($14 billion) and mortgages ($9 billion).

17. The failure to stem the inflation may be explained by the maintenance of reserves by banks and the large expansion of lending by nonbanking lenders. Banks and insurance companies increased their loans, etc., by about $54 billion.

18. With the national debt at the end of 1950 $22 billion less than at the end of 1945, the banks inclusive of the Federal Reserve and the insurance companies had disposed of $41 billion of Federal Government securities.

19. An indication of the trends is reflected in changes in ownership of Government securities.

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Changes in ownership of Federal debt, December 1945 to June 1951

Total outstanding (interest bearing)	—23.4
Held by banks (inclusive of Reserve banks)	—33.5
U. S. Government accounts	+14.0
Individuals	+ 1.9
Insurance companies	— 7.0
Others (savings banks, corporations, State and local government, etc.)	+ 1.3

Source: Treasury Bulletin.

PRESSURE ON THE SECURITY MARKETS

20. Despite the support given by governmental institutions and the redemption by the Federal Government, the market weakened.

Rates, 1946–50

	1946	1947	1948	1949	1950
Long-term U. S. Government bond	2.19	2.25	2.44	2.31	2.32
Medium-term U. S. Government bond	1.11	1.26	1.52	1.35	1.45
Industrial bond yield	2.60	2.67	2.87	2.74	2.66
U. S. Treasury bill rate	.38	.60	1.04	1.10	1.22

Source: International Monetary Statistics, August 1951.

21. The following is worthy of observation:

(1) The long-term rate rose by 11 percent from 1946 to 1948 and then declined by 54 percent from 1948 to 1950.

(2) The largest rise of yield was in short-term rates.

(3) Over the period 1946 to 1950, a rise of yield on long-term Government bonds of 6 percent is to be compared with one of by 3 percent for industrial bonds—suggesting the reduced support of Government securities.

22. From 1945 to 1951, the computed rate of interest on Treasury issues rose from 1,935 to 2.27 percent, or about one-third of 1 percent. But the rise was concentrated on short-term issues—Treasury bond yields increased from but 2.31 to 2.32 percent, whereas Treasury bill yields rose from 0.381 to 1.569 percent. The average rate rose primarily because all rates increased, a factor that more than offset a moderate decline in the proportion of short-term issues, that is, in the securities that pay relatively low returns.

23. The relatively small rise of yields on long-term securities is to be explained in part by the Federal Reserve policy of raising rates by selling short-term issues and buying long-terms. Thus from the end of 1946 to the end of 1948, the Federal Reserve purchased net $10.2 billion of bonds and sold $10.2 billion of bills, certificates, and notes. From 1948 to 1950, however, the Federal Reserve disposed of bonds ($6 billion) and purchased short-term issues ($4 billion), nevertheless the bond in the Federal Reserve portfolio were 22 percent of all securities held at the end of 1950 as against 3 percent at the end of 1946. The narrowing of the margin between short-term and long-term issues occurred (from 1.81 to 1.16 percent differential between long-term Treasury bonds and Treasury bills) despite the fact that bills and certificates were percentagewise only one-half as important in the total of marketable securities at the end of 1950 as in 1945.

24. Not only does the Federal Reserve tend to support long-term issues while they are raising short-term rates; but while they tighten the market by raising reserve requirements, they insulate the Government bond market by purchasing securities. Thus in 1948, the Authority increased reserve requirements, Nevertheless the Reserve banks purchased $800 million of Government securities in all and $8.1 billion of long-term securities. Here is a technique for hardening rates but sparing the long-term market. Early in 1951 also, the Reserve banks purchased bonds when the reserve requirements were raised.

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SOME ASPECTS OF THE MONETIZATION OF THE DEBT

25. In the dispute over rates, the Federal Reserve early in the war objected to the low rates and was more disposed toward raising rates as a means of attracting nonbanking investors than was the Treasury.

26. In the discussion of the gains of lower rates, associated with support of the Government security market by adequate expansion of money, against the losses of higher prices, attention is almost invariably concentrated on the high costs of inflation to both the country and the Treasury. Indeed, it is said the Treasury may gain $1 billion in savings on interest; but against this, we must weigh the losses in higher prices of goods and services purchased.

27. But we should consider the gains to the Treasury of income, as well as losses from higher costs. For example, compare the $70 billion of prewar income with the $275 billion income of 1951. At least half of this rise is to be associated with an increase of prices directly, and indirectly with the favorable effects of higher prices on output. It is well to note that for a transition from 10 million unemployed and the attraction to the labor market of 10 million others, ready to work in response to higher rewards, an increase of prices of 5 percent per year may be a necessary condition. With the resultant higher incomes, the Treasury may raise $40 billion as easily in 1951 as $5 billion at 1936–39 incomes.

28. It would be interesting to conjecture at what cost the Government might have been able to dispose of $200 billion of securities during the war, if monetization of the debt were precluded. Surely even if we assumed that at stable prices, incomes would rise by 50 percent and total income would settle roughly at $100 billion, few would agree that the $200 billion of issues could be sold even at 6 percent average return. (Even if allowance were made for the savings in public outlays of $50 billion associated with stable prices, it is extremely doubtful that the issues could have been sold at less than 6 percent.) It will be recalled that in World War I, unaccompanied by considerable monetization of the debt, the rate of interest rose from 4 to 6 percent. The annual cost of the debt at 6 percent would then be $15 billion or 15 percent of the $100 billion of national income (or with a saving of $50 billion, the cost would be 12 percent) as against less than $6 billion or 2 percent today. It is important that relative to today's income the national debt of only one-sixth to one-seventh as burdensome as it would be relative to prewar incomes. Had orthodox views been followed, the relative burden would have been much greater.

29. For these reasons, I would suggest that opposition to monetization of the debt may be carried too far. The mistakes may well lie in the failure of financial institutions to assume their responsibilities vis-à-vis the Government securities market. In view of the fact that Government plays a larger part in the economy of the Nation; in view of the fact that over a period of many years Government securities have provided the banks with a major part of their incomes, in view of the fact that the banks have usurped the function of creating money allocated by the Constitution to Congress, the financial institutions ought to take more seriously their responsibilities toward Government securities.

30. It is not clear that the reduction of securities by about $40 billion and an increase of other assets by about $55 billion over a period of several years by banks and life-insurance companies reflect an adequate sense of responsibility. Such extreme revisions of portfolios invite measures to compel the banks to hold Government securities as part of their reserves against deposits.

31. The Government uses compulsion in raising tax money. To some extent it now uses compulsion to force purchases of Government securities—e. g., through Government trust funds, through requirements of liquidity imposed on banks. It would be no large step from these measures to requirements that banks hold a designated proportion of securities against deposits. Then the banks would not be in a position to embarrass the Treasury as they have in the postwar period.

THE FREE MARKET APPROACH

32. Undoubtedly the recent reemergence of monetary policy as a major factor in policy stems in part from the importance now attached to reliance on the automatic movements of the market. On this theory, as money becomes excessive and commodity prices rise, the way out is a rise in the rate of interest and resultant reduced supplies of money.

33. This case for monetary policy is weak. The money market is not a free market. Authority determines supply, and the direction of the flow of money. In particular through purchases of Government securities by Reserve banks, by

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commercial banks and by Government institutions, an element of preference and compulsion enters. Money is directed into particular channels not only as suggested above but also through various programs of rationing. For example, loans of member banks in 1951 rose by 7 percent, of commercial loans by 13 percent, of real estate loans by 7 percent, whereas consumer loans declined slightly and security loans by more than one quarter. Clearly here the banks relied primarily not on price changes but upon rationing.

MONETARY VERSUS OTHER APPROACHES

34. In the debates over monetary policy in the 5 years preceding the Korean war a case could be made out for vigorous use of monetary policy, and at intervals vigorous monetary policy was used, notably in 1948. In 1946 there was much disagreement between the Treasury and the Federal Reserve but, in view of the general fear of a postwar collapse, the strength of the Treasury position at that time is not to be denied.

35. I believe that it would be difficult indeed to prove that weakness of monetary policy accounted for the rise of prices of 33 percent in this period. Large accumulations of liquid assets, substantial backlogs of demand on both consumer and capital account, failure to maintain controls until the backlog of demand and a substantial part of the excess of liquid assets were absorbed—these largely explain the rise of prices.

36. What happened is amply suggested by the following figures:

Rise of gross national product, etc., 1946–49 over 1942–45

	Billions of dollars
Rise of gross national product	174
Rise of consumption	240
Rise of gross private investment	100

37. Availability of cash and other liquid assets weakens the monetary authority. On this score, note the importance of the activation of money and deposits. By 1951 the average rate of turn-over of deposits was 28 percent above that of 1945 in New York City and in other leading cities. From 1949 to 1951 the expansion in the use of deposits was greater than that in the supply of deposits and currency. All of this suggests that the monetary attack, even if much more vigorous than it was likely to be as evidenced by our history, would have been confronted with serious obstacles.

38. Of special significance here is the fact that business can expand substantially without the help of the banks, or even of security markets, the latter influenced to some extent by monetary policy.

39. Thus in 1950 gross private investment amounted to $49 billion. New issues were but $4.4 billion. Out of profits and depreciation business provided $30 billion; from the outside, $19 billion, a substantial proportion of which was from bank loans.

40. In 1951, despite a reduction of the net increase in bank loans from $11 billion in 1950 to $7 billion, gross private investment rose from $49 billion in 1950 to $59 billion in 1951. Corporations relied somewhat more on bank loans and new issues than in 1950; and the large expansion in investment occurred despite the dear-money policy introduced.

MONETARY AND RELATED POLICIES AFTER JUNE 1950

41. What is particularly perplexing is the sudden enthusiasm for a dear-money policy immediately following the outbreak of the Korean war. It must be unique in American monetary history for the monetary authority to introduce a stringent policy at the outbreak of war; all the more surprising is the introduction of this policy when the Treasury is embarrassed by the need of undertaking vast refunding operations related to the last war. Naturally the Treasury has been greatly embarrassed in its refunding operations by the Federal Reserve policy.

42. It is particularly striking that this enthusiasm for monetary policy and the free market should emerge at a time when the Government was embarking on control of income, prices, supply, and demand of commodities in short supply, and in a period when fiscal policy has come to be increasingly important.

43. In Western Europe, controls had lost their edge and taxation had reached levels where further increases were meeting great obstacles. The result was

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a greater emphasis upon monetary policy than in the United States. But the results were not satisfactory. Thus, from 1949 to the end of 1951, wholesale prices rose by 15 percent in the United States, 43 percent in the United Kingdom, 52 percent in France.

44. Monetary policy should, indeed, contribute toward containing inflation. But it is important in view of the weight of financial institutions over which the Reserve authority has little control (financial institutions other than member banks increased their lending in one postwar year by three times as much as member banks, $15 billion as against $5 billion), in view of the large supplies of liquid assets extant, and the relative independence of many spenders (e. g., corporations), the unimportance of interest rates for other spenders (e. g., the Government), in view of the limits on practical rises of rates, in view of the burden put upon the price level of increases of income, of the spectacular rise of prices of imports—for these reasons it is important that too much reliance should not be put upon monetary policy. Insofar as monetary policy is used, it is wise to protect the Government bond market.

45. Income control, a rise of taxes, reduction of nonessential spending, control of prices in deficient markets, allocation of commodities in short supply—these should contribute greatly to the control of inflation. In the absence of these general and specific approaches, major attacks through monetary policy are likely either to be ineffectual or to starve the monetary system unwisely. Thus if farm income and wages rise inordinately, restrictive monetary policies are likely to have unfavorable effects on output. It is then necessary to allow a moderate rise of prices, and if incomes rise, monetary starvation will tend to depress prices and output.

46. It is well to note that the correctives in 1951 when prices rose less than in 1950 may be associated with many factors other than monetary policy, e. g., the decline in prices of imported goods, the restraints imposed on wage and price increases, the control of demand for scarce commodities, the control of nonessential investments (feeble as this policy was), and especially the rise of savings (a correction of overspending in 1950), and the gains of taxation. Note especially the small contribution of personal taxes and savings in 1950; the large improvement in 1951 (three-fifths of the rise of gross national product), and the small diversions to Government in 1950 and the large ones in 1951.

Changes, 1950 and 1951

	Billion of dollars	
	1950	1951
Gross national product	19½	26¼
Government purchases, goods, and services	−1	+21
Personal taxes	+2	+8
Savings	−4	+8

Source: The Economic Report of the President, Jan. 1, 1952.

GENERAL AND SUMMARY

I. Is monetary expansion and monetization of the debt sinful?

Throughout most of the discussion of the relation of credit policy and debt management, there seems to be an underlying assumption that monetary expansion and monetization of the debt is sinful. This is not my view, although I would readily admit that there can be too much money, too much inflation, and excessive solicitation for the price of Government securities, which in turn may account for excessive creations of money.

Our history does not support the orthodox view. Over 150 years of our history, the supply of money has grown by 3,500 times, income by 400 times, and the population by 28 times. Yet we have not suffered from galloping inflation. And with few exceptions we have experienced steady and even spectacular gains in our standard of living.

From 1914 to 1951, the major increase in bank assets was in Government securities. In this same period, the growth of commercial loans was equal to but about one-quarter that in deposits.

Without the monetization of the debt and the accompanying expansion of money it is difficult to envisage the expansion of money which fueled a rise of

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income of six to eight times as large proportionately as that in prices. It is well to compare the aid given a growing economy through monetization of the debt in this period with the restraints imposed in the last quarter of the nineteenth century through a demonetization of the national debt.

In the absence of all-out war, this country may well experience a rise of real national income in the next 20 to 30 years of 100 percent. In view of the growth of institutional pressures of an inflationary type, a rise of prices of 50 percent in the next 25 years is a conservative projection. On these assumptions the country would need to increase total currency and deposits from $180 to $540 billion. Where is the money to come from if not from monetization of debt? Surely trends in commercial loans (79 percent of assets in 1914 and 42 percent in 1951) and in public securities (4 and 36 percent, respectively) do not point in the direction of expansion of commercial loans as the sources of needed supplies of money. In these estimates, I make no allowance for the rise of the proportion of money to income. (From 1800 to 1950 monetary supplies increased about nine times as much as income.)

From all of this, I conclude that the objections to monetization of the debt are overdone.

II. Monetary expansion and the burden of the debt

Almost invariably the discussion of pros and cons of monetary policy and debt management stresses the greater cost of inflation to the Treasury than the gains in reduced interest. These are certainly relevant considerations.

But there is another side. At what rate of interest and at what income could the Government, for example, have been able to obtain $200 billion through nonbanking sales of securities? The roughest kind of estimate shows that the burden of the national debt at the resultant much lower national income in the absence of debt monetization would have been from 12 to 15 percent of national income instead of the current 2 percent.

We should not forget that moderate inflation is a necessary condition for adding 20 million to the employed numbers; that monetization of the debt is the path to inflation and that the resultant inflation in itself contributes toward higher prices and higher output and a reduced burden of debt. At 1952 incomes of almost $300 billion, the national debt is only one-quarter as costly as it would be at 1939 incomes, and if allowance is made for impact on interest rate of inflation of money, perhaps only one-sixth to one-eighth as burdensome. At the $300 billion income the Government can probably raise eight times as much taxes with no more sacrifice than out of the $70 billion prewar income.

The record in the post-Civil War period was not so good. The Government paid off three-quarters of its debt at an average price level one-third less than at time the debt was incurred.

This is not to deny that an average annual rise of prices of 4 percent instead of 8 percent from 1940 would have been preferable, the major rises to occur in periods of under-employment.

III. Monetary policy fashionable again

It is rather surprising that monetary policy should become fashionable once more at this time. The increased importance of fiscal policy; the need of using some controls, particularly income, price, and supply; the unusual supply of liquid assets (of $175 billion of corporate financing in the last 6 years, bank financing accounted for but $15 billion, or 8 percent); the unusual slack in the use of money (a rise of deposit use of 28 percent since 1945 has been a much more important factor than increases in the supply of money); the increased importance of nonbanking lenders; the greater independence of commercial banks (with $20 billion of short-term securities convertible to cash at maturity); the impact of general credit measures especially on the large portfolio of Government securities; the failure of savings and investments in Government securities to respond to fractional rises in the rate of interest (investment up from $49 billion to $59 billion in 1951 and the expansion of savings associated with higher incomes, reaction to excessive spending in 1950 and moderation in price rises, not with higher interest rates)—these and other considerations suggest the obstacles to a rebirth of monetary policy.

IV. Price increases

I am not inclined to blame the Federal Reserve or the Treasury for a rise of prices of 33 percent from 1945 to June 30, 1950, or of 47 percent to the end of 1951.

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Once controls were removed, the large accumulation of liquid assets, the substantial backlog of demand, both of consumers and producers, the inflationary wage and farm policies, the pressures on the economy of the new armament program—all of these were bound to raise prices. No practical monetary policy could have prevented a substantial rise of prices, in part because monetary policy must reflect national needs and desires. (For this reason, incidentally, I am not so enthusiastic a supporter of an independent monetary authority as many seem to be.)

In this connection, the vast expansion of war outlays accounts largely for the rise of prices. Over our entire history our outlays for war (and related) were $656 billion, or 80.5 percent of total Federal outlays of $814.6 billion, and in the last 12 years, Federal outlays (primarily associated with war) have accounted for 79.5 percent of all outlays over 163 years. In view of the proportions of the outlays, our inflation history in the forties and especially in World War II has been surprisingly favorable. In fact, despite the fact that hourly earnings in World War II rose much more than prices relative to earlier major wars, the increase of prices was but one-fourth that of World War II and one-fourteenth that of the Civil War, when allowance is made for the proportion of resources going to war.

In the postwar period, the rise of prices occurred despite the fact that the Federal Reserve disposed of $6 billion net of securities, a really major operation, and despite the fact that the computed rate of interest on Government debt rose by more than one-third of 1 percent, or close to 20 percent.

V. Some aspects of the support of the Government security market

It is frequently said that the Government security market should not receive special favors. The fact is that it has always had special supports, not the least of which is the certainty that the authority entrusted with the creation of money is certain to meet its dollar obligations. Investments in Government securities by trust funds and Federal agencies (about $45 billion), by the Federal Reserve ($23 billion), by financial institutions ($87 billion) are to a greater or lesser extent compulsory. Even the commercial banks must hold Government securities to cover liquidity requirements.

In purchasing Government securities, and especially long-term securities, the Monetary Authority also supports the Government security market and even at a time when "dear" money policies are in vogue. Perhaps the major tools of money control of late have been not general credit control but rather restrictions on particular types of credit. In this manner also the Monetary Authority tends to support in a negative way the market for Government securities: Money diverted from consumer credit, housing credit, and speculative security markets facilitates investment in public securities.

Perhaps the major complaint of the Treasury should be registered against the financial institutions which disposed of $40 billion of public securities in the postwar and increased their earning assets by $50 billion. These movements jeopardized the Government security market and raised the question whether financial institutions do not have special obligations to the Government security markets, and especially since they derive their authority to create money from the Government.

It is frequently said that the reversal of the marked inflationary trends in 1950 and early 1951 spring from the Treasury-Federal Reserve accord of early 1951. I am not convinced. I note the large investments of 1951, and especially the maldirection (textile plants are built in the South when there is much excess capacity in both North and South). I note the greater effectiveness of direct monetary controls than general credit policy. I note the contribution of wage and price control, allocations, etc. I note that in 1950 G. N. P. rose by $19½ billion and personal savings and taxes declined by $2 billion. In 1951, G. N. P. rose by $21 billion and personal taxes and savings rose by $16 billion.

CONCLUSION

We are too much concerned about monetary expansion and monetary policy.

We are too much concerned about the monetization of the debt.

We tend to underemphasize the importance of support of the Government security market.

We tend to forget that monetary policy like all other anti-inflationary tools must reflect the wishes of the people.

We tend to underestimate the gains of modest inflation and of monetization of debt as well as the good inflation record in view of the pressures exerted. History is not on the side of orthodoxy.

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Monetary policy must continue to play a part, but with greater emphasis on rationing of credit.

Representative PATMAN. Our next witness is Mr. Aubrey G. Lanston. Mr. Lanston is president of Aubrey G. Lanston & Co., Inc., dealers in United States Government securities. Mr. Lanston was formerly head of the Government bond department of the First Boston Corp.

Mr. Lanston, we are delighted to have you here. We are looking forward to hearing your testimony. I believe you have a prepared statement.

Mr. LANSTON. Yes. With the permission of the committee, may I have Mr. Leroy M. Piser, vice president in charge of research, sit with me?

Representative PATMAN. That is all right. Would you like to read your statement before yielding for questions, or would you like to file the statement and comment upon it, like Dr. Harris did, or just whatever you would like to do we are willing to agree with that.

Mr. LANSTON. You are very kind.

I have a prepared statement that would take me about one-half hour to read. I believe I can high-light it in a space of 20 minutes, and if I may, I will do so.

Representative PATMAN. That will be fine. You may proceed.

STATEMENT OF AUBREY G. LANSTON, PRESIDENT, ACCOMPANIED BY LEROY M. PISER, VICE PRESIDENT IN CHARGE OF RESEARCH, AUBREY G. LANSTON & CO., INC.

Mr. LANSTON. Mr. Chairman and members of the subcommittee, many have commented on the public service rendered by the committee's publication of two volumes on the subjects of debt and money management, on the exceptional work of the staff headed by Dr. Murphy, and on the high quality of the replies. It is a real achievement.

I do not represent any group, the views I express will be my own, and I shall be as brief as possible.

My approach is from the premise that you are seeking the best practical solution to the problems that arise from the necessity to manage a huge public debt, in a way that will be consistent with sound credit policy, particularly during a period of strong inflationary pressures, a high level of national production, full employment, and a Federal deficit.

Before entering into a discussion of six major points, may I list certain obvious facts so you will know I have not overlooked them?

(*a*) The Federal Reserve is charged with responsibilities for the availability, use, and cost of its credit, and, therefore, its decisions affect the cost of all credit, including that available to the Treasury.

(*b*) We have a large public debt, and changes in its ownership can have an important bearing on the money supply.

(*c*) The public debt must be held by someone.

(*d*) If the public, including bank and nonbank investors, wishes to divest itself of Treasury securities, only two other buyers may be found; one is the Treasury, if and to the extent it has a cash surplus, and the second is the Federal Reserve.

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(e) When the Treasury has an approximate balance or incurs a cash deficit, and the public wishes to divest itself of Treasury securities or is unwilling to fully absorb Treasury deficit financing, there is only one buyer—the Federal.

It is from such simple and obvious premises that some suggest a seemingly logical conclusion, namely that the Federal Reserve must underwrite Treasury financing and support the Treasury securities market in the present circumstances and under a variety of others. If such generalizations had to be accepted, it then would follow that the Federal Reserve could not achieve any notable credit restraint in circumstances such as those we face. Much, and persuasive economic philosophy, and some authoritative professional opinion may support this or similar general conclusions.

It is my belief that the Federal Reserve plays a measurable and constructive role in our efforts to maintain a stable economy. At times this may be through negative action, that is, of insuring that its credit does not add unnecessarily to an enlargement of the money supply during an inflationary period. At other times, its actions may be more positive and direct.

It is vital that the Federal Reserve be free and be encouraged to exercise judicial judgment.

Obviously, the Federal Reserve must take fully into its deliberations the impact of its policies on the psychology and actions of holders of Treasury securities. A high degree of cooperation between debt and credit management is insurance of this but, in the final analysis, Federal Reserve officials must make decisions with respect to the availability, use, and cost of money in a judicial capacity and considering the manner in which the resultant credit policy will affect the economy as a whole. In this, the cost of money to the Treasury, in the Federal Reserve Act, that the judgments of Federal Reserve officials be independent of narrow political considerations. The cardinal principle of our control over the money supply is that we treat money as the servant, and not the master of the people.

Two congressional directives along certain lines could insure that this will remain in the case:

One, to the Treasury: The Treasury shall avoid setting terms and conditions on its securities that, in the opinion of the Federal Open Market Committee, might require the Federal Reserve to use its powers in a manner inconsistent with its credit objectives.

Two, to the Federal Reserve: It is the will and intent of the Congress that the open market transactions of the System shall be conducted solely in conformance with its credit objectives, as these are determined by the Federal Recerve Board or the Federal Open Market Committee, after full consideration of desirable public debt ownership, and open market transactions in Treasury securities shall not be used except during periods of extreme emergency, either to sustain any particular rate of interest on Treasury financing or any particular level for Treasury security prices.

Senator DOUGLAS. I welcome your support of the so-called Douglas resolution, which certainly asserts the primacy of the Federal Reserve Board in open market operations and credit policies, and which directs that the Treasury shall adjust its debt management policies in the light of this directive. I appreciate your support for this resolution very much.

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Mr. LANSTON. Thank you. [Continuing statement:]

Further, the credit policies of the System shall be conducted in a manner that will permit the normal functioning of the Nation's banking and credit activities to be administered by private hands, through instruments and by methods that are impersonal in their application.

The remainder of my remarks are confined to six points, and the first concerns certain economic objectives of the Treasury for debt management. The Secretary, when he outlined his Department's general economic objectives, stated it was Treasury policy to direct debt management so as to counter any pronounced inflationary or deflationary pressures, and to provide securities to meet the current needs of various investor groups. In my opinion, these two objectives are contradictory when inflationary or deflationary pressures are strong.

For example, during a boom such as the present, institutional investors generally feel they "need" shortest term Treasury securities with which they may retain a high availability of funds. Yet, it is in such circumstances that the Treasury, as stated by a Federal Reserve Bank president, should follow a debt management policy which "aggressively seeks to channel directly into Government hands a substantial part of the savings which accumulate in a period of full employment, high national income, and relative scarcity of goods."

The "needs" of individual investors during a boom are less easy to predict. On the average, the chances are individuals will believe they do not need additional Treasury securities. They may prefer to reduce their holdings. Savings bond sales and redemptions tend in some degree to confirm this.

The economic objectives of the Treasury during a boom, therefore, should be—

(*a*) To seek additional nonbank institutional investment in its securities by offering relatively high-rate long-term bonds, that is, bonds which offer a rate of return that is equal to the current income requirements of these investors; and

(*b*) To persuade individuals to place current savings in Treasury securities that will assure them of no loss of principal by offering rates of return that make it expensive to hold cash, and which thereby may reduce the attractiveness of spending above-average sums for goods and services.

In the other extreme of business conditions, one of depression, institutional investors generally believe they have a convincing need for the highest income Treasury securities they can obtain. This generally means long-term bonds. Yet this is a time when institutional investors should be seeking to revitalize plant and equipment expenditures in order that these may contribute to an expansion in national production and employment. Long-term Treasury securities sold to these investors during a depression may prove to be temporary investments as private capital demand expands. Short-term, low-yield Treasury offerings would be better suited to the needs of the economy, both at the time, and later when institutional investors may wish to transfer such assets to private credits.

Individuals, subject to lower wages and increased unemployment, also will feel the need for the highest income they can get from Treasury securities, even though, in the aggregate, they may be net sellers. The needs of the economy would call for a divestment of

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past savings and a reduction in current savings. This could be encouraged by a reduction in the rates of interest paid on savings bonds and the like.

The economic objectives of the Treasury during a recession, therefore, should be—

(*a*) To encourage institutional investors to be most aggressive in expanding private credit, by offering largely only short-term, low-rate Treasury securities; and

(*b*) To encourage individuals to divest themselves of past savings and to reduce current savings by lowering the rates of interest paid on savings bonds and the like.

Other kinds of business conditions, ones that are less extreme than a boom or a depression, will be characterized by variable degrees of both inflationary and deflationary forces. In such in-between conditions the Federal Reserve credit policy is less apt to aim at either strongly restraining or expanding objectives. Under these circumstances, the mutual aims of the Treasury and the Federal would permit greater leeway to debt management in achieving what may be deemed a desirable debt structure. The chances favor that major changes in ownership would not be sought by either the Federal or the Treasury, and wide shifts in ownership would be unlikely to be initiated by the public. Consequently when the business condition might be characterized as one that was neither a boom nor a depression, the Treasury might offer short, intermediate, and long-term securities.

It seems clear to me, therefore, that if the Treasury is to counter strong inflationary or deflationary forces it should provide securities that are suited to the economic needs of the period.

I recall many years ago, when, as a Treasury official, I held some responsibility with respect to Treasury financing, that the Treasury's objectives were to finance the debt at costs appropriate to the circumstances of the time and to the amount needed. This, I believe, remained the Treasury's objective as to interest costs up to 1942. It is one that is particularly suited to the current problems and should be preferred under all conditions to an objective of holding down the interest cost at the expense of other far more important goals.

My second point concerns the impact of various moves in debt and credit management on the Treasury security market.

The impact during the period ending April 4, 1951, was adequately covered in the responses received by the committee. In summary it seemed the Federal underestimated:

(1) The degree by which its methods of handling the market would increase the desires of investors to sell Treasury securities,

(2) The inefficacy of losses (within the pattern of a 2½-percent rate) as a deterrent to the sale of Treasury securities, and

(3) The degree by which the origination of a small creeping increase in interest rates would invite (*a*) sales by most investor classes of all but the shortest-term Treasury securities, (*b*) an increased preference for short-term securities, and (*c*) an increase in the demand for private capital and credit based upon the expectancy of increasing borrowing costs.

The changes in reserve credit outstanding during that period may be summarized as follows:

From June 22, 1950, through April 4, 1951, factors which affect reserve balances but which are more or less beyond the control of

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Federal Reserve officials caused member bank reserve balances to decline by $2.3 billion. Reducing things to very simple terms, the purchase by the Federal Reserve of a like amount of Treasury securities from the commercial banks, or a slightly larger amount from other holders, was required to restore the reserve balances of the banking system.

During this period, however, the Treasury had a cash surplus of approximately $8 billion, a substantial part of which might have been used to redeem securities held by the commercial banks. For example, had the Treasury been able to apply $6 billion to such redemptions, the amount of Federal Reserve purchases of Treasury securities might have been reduced to $1.3 billion or thereabouts.

As a practical matter, the upset conditions in the Treasury security market and in the minds of investors resulted in a diversion of some measurable portion of the Treasury's cash surplus to the redemption or purchase of nonbank holdings of Treasury securities, and to that extent the Treasury was prevented from reducing private bank deposits.

Federal Reserve holdings of Treasury securities rose by about $3¼ billion during the 9 months, apart from about $2 billion purchased as a result of increases in the percentage of required reserves.

At this point I would like to note an important distinction that should be made as to the inflationary potential that follows from the extension of credit by nonbank lenders and its extension by the commercial banks, when Treasury securities must be sold in each case and the Federal Reserve is the buyer of these securities.

When nonbank lenders extended $1 billion of credit which required the sale of a like amount of Treasury restricted bonds then, since the Federal Reserve was the major buyer, the chances favored the following results: (*a*) an increase of $1 billion in commercial bank deposits, (*b*) an increase of $1 billion in Federal holdings of Treasury securities, and (*c*) an increase in the excess reserves of the member banks of between $800 million and $850 million.

Now let us assume that instead of the nonbank extension of credit the same $1 billion had been loaned by the commercial banks. Then the result would have been: (*a*) The same increase of $1 billion in commercial bank deposits; but (*b*) an increase of only from $150 to $200 million in Federal holdings of Treasury securities; and (*c*) no change in the excess reserves of the member banks.

In other words, to the extent the private credit demand was met during this period by nonbank lenders who had to sell an equal amount of Treasury restricted bonds, the base was laid for a multiple expansion of credit by the banking system, although the commercial banks were not involved in either the loan or the security transactions.

You may be interested in a table that we have prepared which shows the degree of success experienced in Treasury financing since "the accord," and, in order to shorten my remarks, Mr. Chairman, I would like, with your permission, to include in the record a table which will show the success or lack of success in handling in Treasury financing since the accord.

Representative PATMAN. Without objection, that will be included in the record at this point.

(The tabulation entitled "Treasury Financing Since the 'Accord'" is as follows:)

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Treasury financing since the "accord"

Date	Called or maturing issue	Amount outstanding	Held by Treasury and Federal Reserve banks	Publicly held	Sold to Federal Reserve banks	Turned in for cash	Public rejection		Public acceptance	
							Amount	Percent	Amount	Percent
June 15, 1951	2¾-percent bonds of June 15, 1951–1954	1,627	[1] 1	1,626	215	110	325	20	1,301	80
	1¼-percent notes of July 1, 1951	8,445	[1] 1,848	6,597	895	437	1,332	20	5,265	80
Aug. 1, 1951	1¼-percent notes of Aug. 1, 1951	5,351	[2] 1,601	3,750	54	135	189	5	3,561	95
Sept. 15, 1951	3-percent bonds of Sept. 15, 1951–55	755	[3] 0	755	0	172	172	23	583	77
Oct. 1, 1951	1¼-percent notes of Oct. 1, 1951	1,918	[3] 5	1,913	62	86	148	8	1,765	92
Oct. 15, 1951	1¼-percent notes of Oct. 15, 1951	5,941	[3] 4,243	1,698	389	67	456	27	1,242	73
	1¼-percent notes of Nov. 1, 1951	5,253	[3] 3,033	2,220	113	265	378	17	1,842	83
Dec. 15, 1951	2¼-percent bonds of Dec. 15, 1951–53	1,118	[4] 0	1,118	42	55	97	9	1,021	91
Mar. 1, 1952	2½-percent bonds of Mar. 15, 1952–54	1,024	[4] 63	961	292	102	394	41	567	59
	1⅞-percent certificates of Apr. 1, 1952	9,524	[5] 3,191	6,333	658	658	1,316	21	5,017	79

[1] Apr. 30, 1951.
[2] June 30, 1951.
[3] Aug. 31, 1951.
[4] Nov. 30, 1951.
[5] Estimated Feb. 13, 1952.

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Mr. Lanston. My third point concerns the definition that is given, in practice, to official purchases and sales made in the interests of maintaining orderly market conditions. I believe the tendency may be, as it has sometimes been in the past, to slip from the requirements of an orderly market into a kind of official intervention that might be described as "flexible support."

In the response of the Federal Reserve Board, an orderly money market is described as one where there is an "absence of precipitate, disruptive instability," and an orderly Treasury security market as one without "air pockets * * * where there is a degree of continuity between demand and supply at going or moderately changed prices." Further, orderly markets "preclude erratic movements of prices and yields of securities that have no justification in terms of general economic and credit conditions, but they do not preclude broad movements that reflect changes in basic underlying forces."

We need to keep any official intervention in the market to a minimum for several reasons. First, there is the danger that the continuity of the private demand and supply may be suspended. To the degree this occurs the price level of Treasury securities becomes artificial. If the artificiality is on the high side of prices, the result is to increase the number of potential sellers and to decrease the number of buyers.

The most important consideration has to do with new Treasury financing. If new offerings are priced against an artificial price level, the chances of a successful sale to the public are decreased and the need for standby, or underwriting, purchases in the market by the Federal Reserve is increased. Once the latter are started, they must be continued until the success of the offering is assured, irrespective of the resultant increase in the money supply and the undesirability of any increase.

Prior to the financing of World War II, the Treasury didn't try to prejudge the market for its securities, that is, it didn't announce, out of the blue some morning and to the surprise of most investors, that it was offering a 5–7 year 2⅜-percent bond. The Treasury first would decide the amount it wished to raise, and the general terms of the security. It then made a preliminary announcement along those lines and stated the approximate size of the financing.

This permitted investors to reflect in the market their idea of the suitable coupon rate and terms. In other words, the Treasury financed against a market that was prepared for the offering, and it was enabled, by the free character of the market, to set terms and provisions that would not require Federal Reserve purchases.

Once the Federal is launched on such purchases, it endeavors, as you know, to make offsetting sales so that the net change in the reserve balances of the member banks is kept under control. In the past year or so, this has been accomplished by the sale of issues with a shorter term than that of the new offering. The trouble with these so-called underwriting purchases in the market, and the offsetting sales, is that the liquidity of investors is increased more or less at their option, and the problem of having someone, other than the Federal Reserve, hold the debt tends to be renewed with each successive maturity.

In other words, each increase in the volume of Federal Reserve purchases introduces a corresponding increase in the artificiality of the market and this, in turn, makes it difficult to achieve successful sales of new Treasury offerings without continuous Federal purchases

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in the market. Consequently, the maximum purchase (or sale) of Treasury securities by the Federal Reserve should be the minimum required to maintain orderly market conditions.

Fourth, I want to comment briefly on the increased interest costs that may be (1) a corollary of aggressively seeking to channel into Government hands a substantial part of the savings of the people in boom periods, and (2) a consequence of an effective credit policy.

Of the $260 billion of debt outstanding as of November 30, 1951, United States Government accounts, mutual savings banks, savings and loan associations, insurance companies, individuals and other investors held $154 billion. This block represented the bulk of the longer-term and the redeemable debt.

The Federal Reserve and commercial banks and business corporations held $106 billion, most of which was short-term or comparatively so.

The interest cost on the long-term and on the redeemable debt, therefore, represents predominantly interest payments that are made directly to, or for the benefit of the great mass of the people, a mass so large that it may be said these interest payments are made to the American people.

The following figures were calculated rather roughly, and are based on earlier and more careful computations made a couple of years ago which I have not had time to bring up to date, but I believe they represent reasonable appraisals.

If, over the next 10 years, the debt was refunded into fairly substantial amounts of long-term bonds at a 3 percent rate, with savings securities at comparable rates, and with a fairly substantial withdrawal of publicly held debt for the use of the Government funds, the increase in the annual interest payments would be about as follows:

(1) On the nonmarketable debt about $450 million,

(2) To the Treasury funds about $250 million, and

(3) On the publicly held long-term marketable debt about $250 million (or a total increase in the cost of the debt held outside of the banks and business corporations of about $1 billion). But, this increase in interest payments would mostly be made directly, or indirectly, to the mass of the people and not to any special groups.

The larger portion of the debt held by the Federal Reserve and commercial banks and business corporations is short-term in character, and its cost of interest will fluctuate. In periods of boom or inflation its cost might well be higher than it is today, and in periods of recession it undoubtedly would be less.

The alternative, as it seems to me, to increases in the interest cost of the debt that follow from appropriate debt management is a larger increase in the cost of Government and a decrease in the purchasing power of everyone's dollars.

The fifth point concerns the organization of the market for Treasury securities and the departure from impersonal dealings in Federal open-market operations. Except for Treasury and Federal Reserve

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operations, the market for Treasury securities is made by the actions of large and small investors in the purchase and sale of Treasury securities of all types. Dealers are the intermediaries through which the transactions in marketable securities take place, and the dealers fall into two groups (*a*) those who endeavor to make such transactions a principal or important part of their business, and (*b*) those whose transactions are on a smaller scale or represent a subsidiary operation. Dealers in group (*a*) are referred to as Government security dealers, and number about 20 firms, including the bond departments of some large commercial banks. More than one-half of these dealers transact business on a Nation-wide basis. Their customers run the gamut of Treasury security holders and include the several thousand organizations which comprise group (*b*).

A dozen, or thereabouts, of the Government security dealers make a primary market in money-market securities, such as Treasury bills, and almost as many regularly make a primary market throughout a cross section of Treasury notes and bonds, other than restricted issues. I would say that no more than six dealers regularly make a primary market in restricted bonds, those which were the principal source of concern prior to the accord.

A primary market is one where the prices quoted by a dealer represent those at which he will buy or sell for this own account, in reasonable amounts, as the customer elects. By and large, a reasonable amount may run from $1 million to $5 million in Treasury bills and from $500,000 to $1 million in long-term bonds. Frequently, however, primary-market dealers will accommodate larger transactions at the market.

The activity of investors throughout the country is transmitted quickly to the Government security dealers and, particularly, to those who make primary markets. The willingness of such dealers to buy or sell for their own accounts helps to impart to Treasury securities that measure of ready marketability the investor values and the credit of the Government reserves.

The Government security dealers obtain in this process at first hand the reactions of investors of all types to the various policy decisions that are made by the Treasury with respect to debt management, and by the Federal Reserve with respect to bank credit, and to the manner in which such policy decisions are executed. Some of the methods, techniques, and judgments of investor reactions in the execution of these policies had results that were the opposite of those intended and aggravated already undesirable situations, although such repercussions were sometimes foreseeable.

With respect to the relationship of the Federal Reserve to the dealers, may I have the permission of the committee to insert in the record an article which appeared in the New York Times Sunday edition of March 9, 1952?

It goes into the matter fairly fully.

Representative PATMAN. That will be inserted in the record at this point.

(The article referred to, appearing in the New York Times of

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Sunday, March 9, 1952, is as follows:)

[The New York Times, Sunday, March 9, 1952]

"OPEN MOUTH" RULE ENDS IN UNITED STATES BONDS

MARTIN TELLS CONGRESS GROUP LAPSE OF PEGGING PUT DEALS ON IMPERSONAL BASIS

By Paul Heffernan

It is now becoming clear that when the Treasury's outstanding bonds first sold below par last year the decline in prices to discount levels in the market did not represent only the termination of fixed-price support by the Federal Reserve System.

It meant too, the end of the central bank's so-called open-mouth operations—that is, attempts of Federal Reserve officials and employees to influence the sales, purchases, or the market standing of Treasury securities through significantly worded public statements or through "words to the wise" communications through dealers to institutions with heavy holdings of Government bonds.

Moreover, it meant also the end of the Federal's relating its sales and purchases of Treasury securities—the system's traditional tool for influencing business by swelling or shrinking the available quantity of credit—with "selective" or "qualitative" considerations; that is, with considerations bearing on the identity of the other parties to the System's operations, on investors' reasons for buying or selling, and on the use to which they might want to put the money.

As part of its reply to the Patman (House of Representatives) subcommittee's questionnaire on monetary policy, the Federal Reserve Board has just revealed to Congress how "moral suasion" and lack of "impersonality" came to creep into the System's open-market operations while the System was coping with problems posed by the pegged market in the inflationary postwar period.

MARTIN OUTLINES POLICY

However, the Reserve Board's statement, as presented to the congressional subcommittee by Board Chairman William McC. Martin, Jr., clearly disavows any intention to deviate in the future from the straight and narrow path of impersonality. The Martin statement suggests, too, that the deviations during the period of the pegged market may not have been effective at all times, and may even have boomeranged in a direction opposite to what was intended. Here is the Federal Reserve's pledge to the Patman committee:

"Now that the Federal Open Market Committee is not following a policy of pegging prices of Government securities, it is general policy and practice of the System to conduct open-market operations solely on an impersonal or objective basis without attempting to influence through personal contact or other methods of moral suasion market decisions of investors in Government securities."

The Martin pledge follows upon a discussion of a related question—why the Open Market Committee confines its dealings in Treasury securities to a small number of "recognized" security dealers.

There is nothing in the Federal's reply to this question to indicate that the present recognized dealer set-up, which, like the moral suasion and lack of impersonality, grew out of the central bank's abandoned war-finance commitments, is in for any change. Congressional promotion of small business may be all right to spread defense contracts; and the concentration of big business may be a proper occupational concern for the Department of Justice. But when it comes to maintaining markets in Government bonds it is clear that the central bank doesn't want many customers, and doesn't want any small business at all. As a result the commissions generated each week by changes in the System's $22,500,000,000 Government securities portfolio are shared by only 10 investment houses, 5 of them investment banking or discount specialists and the rest major commercial banks with dealer departments.

QUALIFICATIONS OF DEALERS

Of five qualifying conditions within the control of recognized dealers, two are related to financial resources, namely: (1) The volume and scope of business and the contacts such business provides; and (2) financial condition and capital at risk.

The others are related to such consideration as integrity, knowledge, capacity and experience, and willingness to make markets under ordinary conditions.

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A sixth and final condition hedges significantly the Board's assertion that its aims are to conduct its operations so as to promote the effective functioning of the market mechanism, not to replace that mechanism. This sixth qualification is as follows:

"The reliance that can be placed on such person to cooperate with the bank and the Federal Open Market Committee in maintaining an orderly market for Government securities; to refrain from making any recommendations or statements or engaging in any activity which would encourage or stimulate undue activity in the market for Government securities; and to refrain from disclosing any confidential information which he obtains from the bank or through his transactions with the bank."

If this qualifier is to hold over as indicated, the much-touted free market for Government bonds, so far as the market-making activities of dealers are concerned, can be only as free as the central bank will permit. Extraordinary market conditions, undue activity, and orderly market are things no recognized dealer would dare define himself.

GOVERNMENT DEALERS LIMITED

Of the thousands of investment houses and banks that transact business in Government securities, only about 20 are Government dealers—that is, enterprises willing to keep bonds in inventory. During the war period the Reserve System sponsored the formation of a dealers' group, whose members shared in the System's open-market operations. In recent years, however, the dealers of smaller financial resources and of limited market-making capacity were dropped, regardless of their experience in the business or reputation in the trade. The Federal Reserve has never formally made known the names of the qualified dealers out of a professed wish to avoid any public act which might be interpreted as disadvantageous to or a reflection upon the dealers who were not qualified.

The recognized dealers at present are:

New York:
- Bankers Trust Co.
- Chemical Bank & Trust Co.
- C. F. Childs & Co.
- C. J. Devine & Co.
- Discount Corp.
- First Boston Corp.
- Guaranty Trust Co.
- Salomon Bros. & Hutzler.

Chicago:
- Continental Illinois National Bank & Trust Co.
- First National Bank of Chicago.

Unrecognized dealers, who maintain markets of varying extent, and who compete more or less regularly in the public sealed bidding for the weekly issues of Treasury discount bills, are as follows:
- James S. Baker & Co.
- Bartow, Leeds & Co.
- Blair, Rollins & Co., Inc.
- Briggs, Schaedle & Co., Inc.
- Harvey, Fisk & Sons.
- Aubrey G. Lanston & Co., Inc.
- New York Hanseatic Corp.
- William E. Pollock & Co., Inc.
- R. W. Pressprich & Co.
- Charles E. Quincey & Co.
- D. W. Rich & Co.
- J. B. Roll & Co., Inc.
- Schroder, Rockefeller & Co.
- J. G. White & Co., Inc.

Mr. Lanston. The terms under which the Federal Reserve Bank of New York recognizes dealers more or less prevent public statements by any recognized dealer as to practices that involve (*a*) elements of selectivity in security transactions, (*b*) identification to the

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New York Federal Reserve Bank of the customers who wish to see or buy, and (*c*) information why the sale or purchase was desired.

The resulting personalization of Federal open-market transactions was acknowledged in the response of the Chairman and Vice Chairman of the Open Market Committee. The reactions of Treasury security holders to these practices ranged from tacit acceptance, to annoyance, to considerable resentment, and stimulated more selling of Treasury securities than it discouraged.

The response of the Chairman and the Vice Chairman states it is the desire of the Federal Open Market Committee to conduct all of its transactions on a completely impersonal basis, and now that the policy of pegging Government securities is not being followed this is the general policy and practice of the system.

The statements, made jointly by the two senior officials of the Federal Open Market Committee are and must be considered as definitive. Since the private market is the instrument through which Federal Reserve transactions in Treasury securities are to be maintained on an impersonal basis, and since an increased reliance on the primary markets made by dealers followed from the cessation of fixed or minimum price support by the Federal Reserve, a review by the Federal Reserve (*a*) of the degree of encouragement it offers to such dealers, (*b*) of its organization for the conduct of open-market operations when these are necessary, and (*c*) of its relationship to Government securities dealers, in general, might have some constructive results.

Finally, may I illustrate by examples the type of Treasury securities that I believe would attract a maximum demand from the public, and which are consistent with the points of view I have expressed.

First—the savings bonds.

I believe they should more closely approximate, in design and terms, a savings deposit, something the mass of savers is familiar with and which might eliminate the need to explain "scales of redemption prices," "yields to maturity," and the like.

It is necessary to withhold from the rest of the money supply that portion of the world war deficit that was financed by savings bonds. It becomes necessary, therefore, to aim at two seemingly incompatible goals, namely, to compete for private savings and at the same time to protect the private savings institutions.

Finally, it seems necessary to provide for flexibility in the rates of interest to be paid so that these may be made consistent with changes in the objectives of debt and credit management.

Therefore, I would offer, in substitution for the series E bond, a savings certificate that is issuable and redeemable at par, on suitable notice. The rate of interest would be adjusted semiannually by public notice.

If such a security were to be offered now, the rate of interest would be attuned to current economic conditions but whatever the rate, it would apply to only the first 6 months' interest period. The rate of interest to be paid in succeeding interest periods would be determined in the light of the economic conditions then prevailing. For example, the rate of interest to be paid for the 6 months beginning January 1, 1953, might be unchanged, or be decreased or increased by one-fourth percent or by one-half percent or by whatever seems the most appropriate.

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Holders of the outstanding series E bonds should be permitted to convert these into the new savings certificate.

New purchases for cash should be limited so as to assure protection to private savings institutions against large withdrawals of deposits.

The idea of seeking to preempt the funds of nonbank investors during periods such as these holds a lot of appeal. I would offer in the very near future two issues of long-term unrestricted bonds. One might be a 25-year bond, callable in 20 years, bearing a 3 percent interest rate and the other really long-term bond maturing perhaps in 50 years, callable in 40 years, and bearing an interest rate of 3¼ percent. The combination would enable the Treasury to test the preferences of investors (1) for the lower rate issue of shorter term and (2) for the higher rate issue of quite long term.

Primarily, the offering would be for the purpose of encouraging maximum purchases from nonbank institutions. To that end, the Treasury should accept subscriptions for immediate delivery and subscriptions for forward delivery with the latter timed to coincide with periods when the Treasury's balance otherwise would be at a low level, such as August 1 and November 1, 1952.

The prospects for a favorable result would be vastly improved if it became public knowledge that in periods of boom and inflation the Treasury would seek to sell the maximum of high-rate securities and during periods of depression it would be basic policy to concentrate new issues in the short-term area.

With the combination of a new savings certificate and of the marketable bonds, I believe the Treasury would be able to raise substantial sums from the public with a corresponding reduction in the necessity of bank financing and the resultant increase in the money supply.

In summation, it seems to me that: (1) For debt management to be able to counter strong inflationary or deflationary forces it should provide securities that are suited to the economic needs of the period.

(2) Purchases or sales of Treasury securities by the Federal Reserve for the purpose of maintaining orderly market conditions should be confined to a minimum.

(3) The cost of interest on the public debt represents payments made largely to a cross section of the American people, and if an increase in the costs follows from debt management that aims to counter strong inflationary forces effectively, this is to be preferred to the alternative costs of a larger increase in the cost of Government and a decrease in the purchasing power of everyone's dollars.

(4) The increased reliance on the primary markets of Government security dealers that followed the cessation of fixed-price support for Treasury securities, suggests that a review by the Federal Reserve of the conduct of Federal open-market operations and of its relationship to the dealers in general might have some constructive results.

(5) Properly designed Treasury securities, offered for immediate and future delivery, which will aggressively seek the savings of individuals and the funds of nonbank institutions, would substantially reduce the necessity for bank financing, which increases the money supply.

Most important of all, if money is to remain our servant and not our master, Federal Reserve officials must be encouraged to discharge their responsibilities with consideration only for the economy as a whole.

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Representative PATMAN. Do you have any questions, Congressman Bolling?

Representative BOLLING. No questions.

Representative PATMAN. You realize, of course, Mr. Lanston, the importance of a very close working relationship between the Treasury and the Federal Reserve Board?

Mr. LANSTON. Very close, sir.

Representative PATMAN. How would you do that, and at the same time not make one entirely subservient to the other?

Mr. LANSTON. I think the matter of subservience, Mr. Chairman, is a kind of a trick phrase that we have fallen into. Certainly, the Treasury has the responsibility for debt management, but when it comes to the question of whether the terms set on new Treasury issues would impinge upon the responsibilities of the Federal with respect to credit policy, then I think we more or less, you might say, have the chips down on the table. I do not think it is necessary, in the first place, for the Treasury to exercise its responsibility to this extent. I do believe it is necessary that the Secretary be able to obtain at first hand the thinking of the individual members of the Open Market Committee, something that heretofore has not been available to the Secretary, and that it is desirable for each member of that committee to become more familiar at first hand with the thoughts of the Treasury with respect to the needs of debt management. It was for that reason that I suggested in my response that the Secretary become a member of the Open Market Committee.

Representative PATMAN. Which would mean, of course, for all practical purposes a member of the Board.

Mr. LANSTON. Well, not necessarily. I have read the responses of the council and recall that they noted that although the division of powers between the Board and the committee was somewhat illogical they recommended no change in it. It is odd to have such powers divided, but my idea was that the Secretary would be a member of the Federal Open Market Committee.

Representative PATMAN. Really, do you not believe that the Board should be composed of the members constituting the Open Market Committee? In other words, put them in on the whole show, and not just part of it?

Mr. LANSTON. The members of the Board are members of the Open Market Committee.

Representative PATMAN. I know the seven members of the Board are, but five members of the Open Market Committee are not members of the Board.

Mr. LANSTON. Are you asking me whether I think the Open Market Committee should consist only of the Board?

Representative PATMAN. No; whether or not they should be members of the Board. In other words, have a Board of 12 members instead of a Board of 7.

Mr. LANSTON. If you mean, sir, that we would have a Board of 12 members instead of the Committee, that is, we would eliminate the bank presidents who have the closer contact with the public, I do not.

I lived in Washington for a long time, and during the 6 months I was in the Treasury a chap came in from Riggs Bank and he said, "You have not changed."

I said, "What would make me change?"

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His reply was, "You are in the Government now at the brass level and that changes people."

I laughed but since then I have noted a tendency that when one occupies a high position in Washington there is a temptation to lose a bit of the feel of the rest of the country. Perhaps this is because when people come to Washington they may sometimes—shall we say—tend to be less than fully frank in stating their views. I think there is a very real advantage, Mr. Chairman, in reflecting into the Federal Reserve's decisions the so-called outside point of view. Of course, if you put the Secretary on the committee you then increase the protection to the Government's point of view, in any en bloc voting, in that you would have eight members who directly represent the Government and only five bank presidents who may be more likely to be imbued with the points of view of the private economy. I think that is the way I prefer to answer your question.

Representative PATMAN. I can see why the presidents of the larger Federal Reserve banks should be on the Open Market Committee, because they do most of the work in connection with the open-market operations, do they not?

Mr. LANSTON. I am not a member of the committee, so I am not in a very good position to say that.

Representative PATMAN. I mean, they should have a better knowledge of the whole, over-all economy.

Mr. LANSTON. I think a fair answer to that, sir, is that the presidents of the Federal Reserve banks generally have a good opportunity to feel the pulse of what you might say is the business life of their community. It probably is also fair to say that they perhaps are a bit too far away from the security market problems of the committee.

I noticed that the bank presidents in their reply stated they attend committee meetings uninstructed and as individuals and in the committee, as in all committees, it is the power of the personality of the individual backed as he may be by knowledge of the facts of a situation that measures his stature in the committee. The knowledge and facts of the open-market operation are not available to the other bank presidents to the same extent as they are to the president of the New York bank.

Representative PATMAN. Are there any questions, Dr. Murphy?

Mr. MURPHY. I have one question, Mr. Chairman, with respect to the relationship between the Treasury and the Federal Reserve, particularly, in determining the interest rates on new securities.

Is it a correct interpretation of your viewpoint that in the periods between offerings it is the prerogative of the Federal to adjust the market in accordance with the requirements of monetary policy, but that after the Treasury has launched on a new offering which was in line with the market at the time it was launched, that it would be the—I grope for a word and the only one I find is "duty"—of the Federal Reserve to see it through?

Mr. LANSTON. I do not know, Dr. Murphy, whether the question is asked against the background of the far past, the more or less immediate past, or the present. The answer would be different in all three of those. If you are asking me for what I think the relationship to be, then I can give you that very easily.

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Mr. MURPHY. Let us have it as to what it has been, what you think it should be, and what you think it will be.

Mr. LANSTON. With respect to the far past, I have in mind the thirties. I know what the situation was in 1934 because I sat in on the meetings with respect to Treasury financing and Mr. Morgenthau expected me to have a point of view. We used to have some pretty high and handsome debates as to what the terms and the porvisions of Treasury financing should be, but no decisions were made on the premise that, if the issue was priced too thin, the Federal Reserve would render sufficient support to make the issue appear a success. I grant that the background of business and so forth was different but, as we sat around the table, the only questions were "Is this issue right?" "Is it too rich, is it apt to sell at too high a premium, and so forth?"

There was one in March or April of that year that attained an inappropriately high premium and there was considerable dissatisfaction with that result.

With respect to the more recent past, I think the concept with regard to Federal Reserve support has been different. The appraisal of the market, that is, the terms and provisions of new issues, may have contained some of the aspects of an ivory tower appraisal. A number of groups were asked "What shall we do?" This does not always ascertain what attitude the particular institutions represented may take toward a contemplated offering. Yet this is the view that is most important.

In other words, and while I have not attended such meetings recently, I believe the result is to produce only general points of view. This, backed by the premise that the Federal will feel it is incumbent upon them to support the new issue and the market during the financing tends to thin pricing and this produces an increased need for Federal Reserve support.

The type of result you can get may be illustrated by the last financing. In that instance an issue of 2½-percent bonds of approximately $1 billion outstanding was refunded. Nine hundred and sixty million dollars of the maturing obligations were publicly held. The Federal bought $292 million during the financing, and the public redeemed $100 million for cash. This is large-scale support, on a percentage basis.

In my opinion, it indicates that a good correlation between the Federal and the Treasury may not have existed, and in any event it illustrates the necessity of pricing new issues sufficiently rich to avoid support of this proportion.

I think the pattern of the future should be that of the thirties. The market should be prepared by a brief announcement of the general character and size of the Treasury's offerings. The terms to be set may then be measured against a market that has been prepared for the weight of the new offering. In setting the terms these should not be skinned down to above minimum on the theory that if they prove to be too thin the Federal will insure the success of the financing by open-market purchases.

Such an approach is in my opinion ill advised and unnecessary. I do not believe that the job of financing the debt today is as large a problem as it is sometimes made to appear. Indeed, I believe that the financing that I was called into the Treasury to assist, the financing that was contemplated in December 1933, was a more difficult task

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than that which faces the Treasury today. At that time, the program called for raising $1 billion a month in new cash at a time when we weren't used to throwing billion-dollar figures around.

Of course, if the market is properly prepared by primary announcements and the terms set by the Treasury seem appropriate to the market in the view of both the Treasury and the Federal Reserve and later it is obvious a major miscalculation has been made, the Federal Reserve should take steps to prevent too large a cash drain on the Treasury where the issue is a refunding and to minimize too drastic a failure in the case of a cash offering.

On the whole, however, the test of the pricing by the Treasury and the Federal, prior to the final announcement should be, "Is this issue virtually certain to stand on its own feet?" If there is the slightest doubt, and Federal Reserve support would run contrary to the requirements of the prevailing Federal Reserve credit policy, then the terms to be announced should be made more generous.

Representative PATMAN. Thank you very kindly. We will recess until 10 o'clock in the morning.

(Whereupon, at 12:25 p. m., the subcommittee recessed to reconvene at 10 a. m., Wednesday, March 19, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

WEDNESDAY, MARCH 19, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE JOINT
COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:05 a. m., in the Caucus Room, Old House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman (chairman of the subcommittee); Senators Douglas and Flanders, and Representative Bolling.

Also present: Glover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order. Two or three of our members are not here, but they are on their way. Since they have already received the written statements of the witness, we feel at liberty to proceed. They will be in shortly.

Our first witness this morning is Mr. Malcolm Bryan, president of the Federal Reserve Bank of Atlanta.

Mr. Bryan, will you come around, please?

Mr. Bryan is the former vice chairman of the board of directors of the Trust Co. of Georgia, formerly vice president and earlier head of the research department of the Federal Reserve Bank of Atlanta, a former member of the staff of the board of governors, formerly professor of economics at the University of Georgia, and now is president of the Federal Reserve Bank of Atlanta.

Mr. Bryan, we are glad to have you, and we look forward to hearing your testimony. Do you have a printed statement? I believe you have.

Mr. BRYAN. I do, sir.

Representative PATMAN. That has been furnished to all the members.

Mr. BRYAN. Yes.

Representative PATMAN. You may proceed as you desire.

STATEMENT OF MALCOLM BRYAN, PRESIDENT, FEDERAL RESERVE BANK OF ATLANTA

Mr. BRYAN. I would prefer if it is permissible to read the statement.

Representative PATMAN. It will be perfectly all right. You may proceed.

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Mr. Bryan. Mr. Chairman and gentlemen of the committee, I appreciate the opportunity of appearing before this subcommittee. The issues it is considering are far-reaching, complex, and of the utmost gravity, not only to the parties immediately concerned but to every citizen.

The management of money is of paramount importance to our economic well-being and social stability. Because of its importance—so great, indeed, that defense, public order, and justice are measurably related to it—the periodic examination of monetary policy is a basic right and duty of the Congress; and the discharge of its responsibility by a qualified, objective body, such as this subcommittee, is entirely to be welcomed.

Let me speak, then, to some of the issues that your chairman has said are pertinent to this hearing:

The Congress has created a central banking organization, the Federal Reserve System, as its most important single agent in the field of monetary management. As your chairman has wisely remarked, the Congress has created an agency because the Congress, which is itself charged with constitutional responsibility for money—

> * * * is not organized in such a manner that it can effectively manage monetary policy from day to day or even from year to year. If it were * * * it would not be well organized to perform its fundamental deliberative tasks under the Constitution.

The Congress has created the System in the form of a banking organization because the money supply, under modern conditions, so largely consists of bank credit.

The Federal Reserve System, as a central banking organization, has only one fundamental power, the power to create and to extinguish bank reserves, either through its own investment account or by lending to commercial banks, and thus to influence the supply of money. All other powers are merely incidental or facilitating.

The power of the System is directed to an equally fundamental purpose. The idea of central banking, in our country and our time, is the use of monetary powers to increase the stability of a free economic system—not stability in a static sense but of an expanding sort that reflects a rate of growth sustainable within the limits of our manpower, materials, equipment, and economic arts. Accordingly, almost by definition, central banking endeavors in the public interest to prevent the costly distortions that appear in an economy as a result either of large deflationary or large inflationary movements.

The meaning of this is that the central bank must lean against the breeze both in times of boom and inflation and in times of depression and deflation, no matter how strong the wind. Since a certain control over the supply of money is, essentially, the only power that a central bank possesses, the further and more explicit meaning is that the Federal Reserve System, endeavoring to adjust its policy to the strength and direction of the gale, must take restrictive measures—must reduce the supply of its credit or make its credit more expensive and less attractive—in time of boom and inflation; and it must take expansionary measures—must increase the supply of its credit or make its credit less expensive and more attractive—in times of deflation and depression.

If the central bank does not so act, then I am unable to see much purpose in central banking. A central bank—I have the Federal

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Reserve System in mind—that commits itself to an undeviating policy, regardless of the business cycle, abandons the fundamental premise on which central banking is based, namely, that credit expansions and contractions are casually related to the inflationary and deflationary convulsions of the economic system. If a policy is to be undeviating, through thick and thin, so that the supply of credit money is to be constantly expanded or constantly contracted, without reference to the prevailing economic situation, then I think that we can find easier devices than central banking.

This seems to me worth saying because central banks, including the Federal Reserve System, have often accepted responsibilities incompatible with their fundamental idea as I have stated it. For instance, the Federal Reserve System, in company with most of the central banks of the world, has been charged in times past with the responsibility of maintaining, through thick and through thin, the fixed convertibility of gold and credit money, so that holders of metal could always obtain currency or deposits, and holders of currency and deposits could always obtain metal. That responsibility, as we all learned the hard way, proved incompatible with the fundamental and overriding idea. Latterly, many have assumed that a similar responsibility of the Federal Reserve System as a central bank is to maintain the fixed convertibility of Government securities.

That will not work, either. It will not work, as with the convertibility of gold, because it commits the central bank to a thick-and-thin policy; it affects the creation and extinction of central bank credit without reference to the business cycle; it contradicts the fundamental idea of central banking, to-wit and in repetition, the idea that economic stability should be promoted by discouraging the expansion and use of the money supply in times of boom and inflation and by encouraging such expansion and use in times of depression and deflation.

I am aware that the fundamental idea of central banking is nowadays challenged by some, not effectively challenged, I think, but challenged. It is said, for example, that economic expansion and the control of inflation by monetary means cannot be accomplished together. It is said that monetary instruments are obsolete and ineffective and that newer and better instruments, such as selective and direct controls, are available. It is said that the cost of carrying the public debt precludes the use of monetary means of inflation control; that central banking will not be able to prevent economic fluctuation, anyway. And so on.

I do not believe that there is any real contradiction between an expanding economy and the control of inflation by restraining the expansion of credit money. On the contrary, I believe that the allocation of our manpower, materials, and real capital can be best accomplished by controlling inflation, precisely by monetary means, and that in the longer run, consequently, the greatest expansion of goods and services is thus accomplished.

Whenever an economic fluctuation has caused or is causing the appearance of unutilized resources of labor, plant capacity, and materials, then it is obviously in point to expand the supply of money and to make borrowing and the use of money attractive. But when manpower, plant capacity, and materials are fully utilized so that increases in the money supply through credit expansion merely serve to bid up prices—in other words, to cause an inflation—then the lim-

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iting factor to the production of goods and services is the stringency of manpower, capacity, and materials, not money. An increase in the money supply in such a situation does not add to the economic well-being or the strength of our country. If it did, then the modern age of miracles would be at hand.

If it be objected that, even so, some fractional net increment to the production of real goods and services is induced by running an inflationary fever, then I would simply reply that such additional production is gained at a wholly excessive cost to the productive efficiency of our economic and social institutions. The subsequent loss of production will shortly be far greater than any immediate and apparently expedient gain.

The additional production stimulated by inflation is achieved at the expense of applying a perfectly savage and discriminatory tax upon all those who have or must make savings in the form of money. The small additional production is thus gained at the cost of discouraging savings and the holding of savings in money forms. Since our economy is built to function, and function efficiently, around savings in money forms, the small production increase induced by an inflation has, on its expense side, the disruption of the economic organization—just as soon as savers catch on to what is happening, which they shortly do—and the further effect of inducing a high rate of money expenditure at exactly the time when it should be curtailed.

An inflation causes a severe misallocation of economic society's resources of real capital. The earnings of companies and industries come to depend not only on their operating efficiency but also on extraneous and uneconomic considerations. They are greatly affected by the existence or nonexistence of inventory mark-ups; by the existence of large- or small-plant accounts, with depreciation on an historical-cost basis; by the ease or difficulty with which their particular prices ride the crest of the advancing price wave or are inhibited by custom, law, or coinage units; and by the inclination of consumers, thinking they have a plethora of money, to engage in luxurious or ill-considered expenditure.

Thus, companies that are losing money and should be curtailing their expenses and watching their production efficiency, imagine that they are making it; companies that are earning a meager return on their capital imagine themselves earning a satisfactory return; and companies earning a satisfactory return imagine that they are getting rich.

Senator DOUGLAS. Like Army fitness reports, in other words, Mr. Bryan.

Mr. BRYAN. All these are inclined to expand or to expand faster than they should, to relax their control of costs, to pay handsome bonuses, and to call in the decorators to refurbish the president's office. Just so, companies and industries whose earnings are restrained by the opposite working of the same factors will either not expand at all or expand less rapidly than they should.

The fact is, either a large inflation or a large deflation simply makes a mess of real capital allocations in any economic system. By destroying money as a reliable measure of real value and real earnings, such inflationary or deflationary developments induce capital commitments in ways that do not and cannot survive the long-run test of society's need for various goods and services in a market in which

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consumers are permitted voluntarily to choose the goods and services they desire.

We sadly discover this fact afterward, of course, when idle plant and equipment begin to appear and, in their train, the enforced idleness of manpower and materials incident to the dreadfully slow and painful process of readjusting capital commitments. Since economic society, even in such a relatively rich country as the United States, has no real capital to spare—there are still a lot of poor people—any wastage of real capital through inflation is the gravest of injuries. It far outweighs, in my judgment, the temporary fractional increases of production that may be gained by running an inflationary temperature.

There are those who believe that selective credit controls, credit rationing, direct allocation of materials and manpower, price controls, and other devices of this kind, are desirable and satisfactory substitutes, in an inflation, for general credit restraint. The contention is that general credit control is a sort of blunderbuss instrument, clumsily affecting decisions throughout the whole economic system, whereas selective, direct, and administered controls can be precisely and simply adjusted to secure a desired and specific result.

To such views I take firm exception. I am willing to concede that there may be some circumstances in which a particular, direct control instrument may be momentarily helpful. But I also believe that the burden of proof is always upon those who seek to use administered, direct controls; that their attractiveness is generally very superficial, even in situations that are apparently exigent; and that they cannot function satisfactorily to stop inflation unless they are accompanied by general credit restraint.

The administered, direct control of economic affairs is theoretically neat and precise, but its neatness and precision necessarily and immediately evaporate in administrative practice. The administrator promptly finds his controls producing collateral effects that he could not foresee; and his direct control on that score has no advantage, net, as against monetary management. Actually, because the control at the beginning is established for the purpose of affecting the economy by seizing hold of only limited segments of economic operations, the control must usually be severe, and the collateral repercussions more unforeseeable and hazardous than in the case of general credit restraint, which spreads its effects more evenly, in the first place, and allows the economy in its millions of facets to make adjustments that are individually small and therefore easier.

The simplicity of administered, direct controls also evaporates in practice. The economic system daily involves millions of decisions by firms and individuals, decisions that cannot be efficiently and quickly made except with regard to the immediate economic and business environment of the firm and the individual. The administrative apparatus can have neither the detailed background, nor full enough information, nor the infinite business experience necessary to a wise adjudication of these particularized decisions; and yet it is upon the efficiency of these millions of particularized decisions that the total efficiency of the economic system depends. What is more, the administrative apparatus cannot have the flexibility needed to cope with the economically necessary changes and adjustments that occur from hour to hour and from day to day; and yet it is upon this flexibility

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that the total and continuing efficiency of the economic system also depends. Accordingly, the administrative direct control, of whatever sort or character, is compelled to proceed by rule and rote, and the administered, direct control, so logically neat in its theory, becomes in practice the blunderbuss instrument. The proponents of direct controls and critics of monetary management, in my opinion, have this matter exactly backwards.

In any event, if a selective credit control could prevent an expansion of credit to finance a particular segment of the economy, its selectivity must shortly disappear in the absence of general monetary restrictions. If one segment of the economy is restrained in the presence of cheap and unrestricted credit, then the money or credit simply flows into other segments of the economy, which in turn must be controlled—and in turn—and in turn.

Senator DOUGLAS. Do you agree then with the water analogy, Mr. Bryan?

Mr. BRYAN. Brilliant, Senator.

In an inflationary situation, in the absence of restraint by general monetary means, there can, in the end, be no such thing as a selective control.

The effectiveness of central banking powers in accomplishing the fundamental purpose that I have stated has been greatly disputed. I am tempted to believe that much of the dispute arises in the minds of those who are beguiled by the thought that they could administratively run the economic system better than it can be run by the democratic process of a free market. In any event, I note that much of the dispute is self-cancelling; for, on the one hand, the opinion is advanced that an increase in the cost of credit is ineffective, and, on the other hand, that it is too effective. It is argued, on the one side, that a small increase in the cost of credit will have no restraining effect, and, on the other side, that a large increase in the cost of credit will have altogether too great an effect.

The pedestrian fellow who might like to aim a few well-chosen words in defense of monetary management and central banking is thus left with a moving target, which my military friends tell me is fine tactics. For my own part, however, I wish that the critics of monetary management would make up their minds. In the meantime, I suspect that monetary management, used with timeliness and courage, can be more effective in aiding economic stability than has been commonly supposed by many people in many times and places.

When a central bank, in an inflationary situation, reduces the supply of its credit or makes the use of its credit more expensive, it does not act for the purpose of raising interest rates. Obviously, however, if the central bank reduces the supply of its credit available in the market, or makes the terms of its loans more restrictive, then interest rates will rise.

Equally obvious is the fact that the rise in interest rates, in turn, dampens down the demand for funds and the use of funds in bidding for society's real resources. If the rise in interest rates did not so act, if there remained, in short, a continuous excess of demand over supply, the increase in interest rates would be unlimited, even with a small reduction in the availability of funds. Actually, of course, this does not happen, as we well know from long experience, which should,

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I think, dispose once and for all of the notion that the cost of money has no influence on the demand for it and the use of it.

The central bank operations by which the availability of credit is reduced and the cost of credit is increased influence decisions in many ways. Here and there a man or a business decides that money, after all, may be valuable and that he will save more of it. Here and there a trust committee decides that it may not be wise to run so frantically after instruments conveying real property and that it might be wise to retain a little more cash or put a little more money, say, into Government bonds. Here and there a businessman takes a more cautious and less excited view of the economic prospect. A treasurer of a company calculates his financing charges on a project, as against its yield and the hazard of capital depreciation, and decides that the lessened difference between the cost and yield makes it less attractive than he had originally thought, and either reduces the project or abandons it altogether.

The treasurer of a company that has been frantically cashing its Government bonds finds himself a little embarrassed to go before his board of directors and tell them that he has a bit of a capital loss in the portfolio; so, instead, he talks about the attractiveness of bonds at their new yields and suggests that it might be wise not to turn the bonds in to get new cash, but rather to restrict the company's lending activity. Perhaps a municipal bond house becomes a little less enthusiastic in encouraging the city fathers to take on a new swimming pool or a yacht basin, or to replace the old street lights with a new and more ornamental variety. The effects are many, subtle, geographically dispersed, and, curiously, even unobserved even by those who deal with them daily or are affected by them.

The contention that big changes in the availability and cost of credit will have big and catastrophic effects and little changes will have no effect seems to me entirely irrational. It should surely be agreed that in war-torn and poor countries changes to very high interest rates may be necessary to induce the savings required for the rebuilding of real capital equipment and to prevent inflation by making money saving more attractive and consumption less attractive. But I would presume nothing of the sort for a country such as the United States, with its relatively vast supplies of consumer goods and services and its relatively vast supply of real capital. Likewise, while I would not contend that the effects of changes in the terms on which credit is granted will be exactly proportional throughout the whole range of the interest-rate scale, it does seem to me more rational to believe that little changes will, in general, be associated with little effects and large changes with large effects.

The notion that the powers and instruments of central banking must not be used in this country because of the cost of carrying the public debt, one of the more obtrusive developments of our generation, seems to me to be a sad case of getting first things last and last things first. As has been aforetime noted by many people, a saving at the public debt spigot, if it must be done by inflationary credit expansion, loses a good deal more at the bung; for the Treasury spends many more dollars for goods, services, and supplies, the cost of which is quickly affected by inflationary price increases, than it does on carrying the public debt.

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But the main point lies in another direction. The cost of servicing the public debt is not a cost to the Treasury except in a bookkeeping sense. The real cost is on the taxpayer, through taxes, or on the saver and holder of money, through inflation. We can take our choice, and neither is pleasant. But I believe, as I have made abundantly clear, that the real costs of inflationary finance are altogether excessive. With the money cost of servicing the public debt running at about one-fiftieth of the gross national product, I think there is a great lack of perspective, an abandonment of all sense of proportion, in emphasizing a fractional increase in public debt service as a reason why inflation should not be curbed by restraining general credit expansion, which I believe to be the most appropriate instrument for inflation control.

Senator DOUGLAS. Mr. Bryan, with a requested budget of $85 billion, that will be approximately 26 to 27 percent of gross national product, and about 30 percent of net national income; whereas, as you say, the debt service charges only amount to about 2 percent.

Therefore, it follows arithmetically that an increase of 10 percent in the cost of the goods and services which the Government buys would be about 12 to 15 times more serious dollarwise than an increase of 10 percent in the rate of interest.

Mr. BRYAN. I think so, sir.

Senator DOUGLAS. That is in comparison with an increase of one-tenth in the rate of interest.

Mr. BRYAN. There are those who are insistent in pointing out that central banking cannot create perfect economic stability. They particularly suggest, for example, that a central bank, however cheap and attractive it may make its credit in time of depression, simply cannot force people to use money if they do not wish to spend it, lend it, or invest it. That is correct, though the implications of this type of argument are much overdone, I am sure. Still, if it is intended simply to say that there are and will be fluctuations in the general level of economic activity and that these fluctuations cannot be totally controlled by central banking, then the point, I think, should be instantly conceded. Nor is central banking likely to save us from our folly if elsewhere we deliberately adopt policies destructive of a free and competitive economy.

I, for one, believe that a certain fluctuation in the level of economic activity is probably the one constant factor in a free economic system and that, even in the regimented economies of police states, it is not eliminated but only concealed. Quite aside from the mechanics of the economic system, which are by no means completely observed, understood, or predicted, there are times when people regard all prospects as fair and all risks as worth taking. And there are other times when people rush themselves into panic and take a dim view of the entire economic universe. Then, too, political and military events, and other developments outside the limits of our own economy, often have a massive and unpredictable impact upon our own activity.

So I would want immediately to concede that central banking cannot create perfect stability, merely pausing with a reminder that nothing in this work here below is ever perfect and to urge a certain skepticism against other formulas that are alleged to promise Elysian results. But I would insist that the monetary controls involved in central banking, wisely and courageously used, can contribute much to stability as

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I have defined it and can, at the very least, dampen down erratic economic oscillations arising from monetary causes.

Senator DOUGLAS. Mr. Bryan, would you say that fiscal policy could have a very appreciable effect in offsetting depressions?

Mr. BRYAN. Yes, I think so, sir.

Senator DOUGLAS. And also in checking undue monetary expansions and price rises if managed wisely?

Mr. BRYAN. I would, sir.

Senator DOUGLAS. Under the compensatory theory of expenditures and receipts?

Mr. BRYAN. Correct; I would agree with that.

The implication, so often made nowadays, that central banking, because it cannot promise a perfect result, is a useless and vestigial remainder from an earlier day fatigues me considerably. Much of the reasoning on this score is like the argument that the fire department should be abolished because it cannot prevent a smallpox epidemic. I am reminded of the man who had a good wife. She was a bright conversationalist; she could dance the polka; she was a good cook and housekeeper; she was cautious about his money; and withal, she performed the housewifely duty of periodically cautioning him against making a spectacle of himself in public. Still, he wanted to divorce her, because, last time she tried it, the poor girl could not lift the piano.

I do not think that central banking can lift the depression piano all by itself. I do think that it can carry the piano bench, the music rack, the music, and its end of the piano. That's enough to expect.

I think I should also confess that a lot of economics seems to have been invented and that I am a little behind-hand, unfortunately, on the full text of the latter-day revelation. So I am still able to believe that one of the best ways of avoiding the next depression lies in preventing a preceding inflation. I have found that lassitude usually follows a fever, and that a good way of avoiding a hangover is to be less boisterous the evening before.

Senator DOUGLAS. Was this lesson learned from experience or by observation?

Mr. BRYAN. Yes, sir. [Laughter.]

As your chairman has noted, another basic issue connected with monetary policy involves the machinery for its formulation. This issue appears in minor degree as a question of whether or not the organizational structure of the Federal Reserve System has been wisely conceived and articulated in its several parts. The issue also appears in major degree as a question of whether or not the Federal Reserve System should be made responsible to the executive rather than to the legislative branch of Government.

The answers to these questions seem to me quite clear. I shall try to state them with the candor that this subcommittee would wish, and as cogently as I can.

If we were now to design a central bank established on the basis of principles promising most for its long-run success in serving the national welfare, we would almost certainly endow it with certain major characteristics. We would want it established for wholly public purposes and to be publicly accountable for its performance, and so arranged that it would be likely to take a long-run and not a short-run view of the general welfare. In connection with the national welfare, we should want the central bank to be sensitive to the interests

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of the American people, not only as represented by the institution called government but also to their interest as represented by the successful functioning of a myriad of private institutions and individual efforts, in a word, to economic society as a whole and not to any particular institution or segment of it.

Doubtless we would want the central bank to possess a considerable apparatus for the mobilization of economic and monetary intelligence; to be open to discussion and admonition from all quarters, public and private; and to guard its policy-making decisions against erratic and capricious or interested judgments. So we would want its policy-making vested in a group large enough that a variety of temperaments, professional experience, business and governmental background, and geographic environment could be represented. I believe we would want the officials of the central bank to be as able as could be mustered to its service; freed by their manner of selection from narrow political considerations; subjected to constant scrutiny of their performance; and yet given sufficient continuity in office to enable them to profit by experience. We would want our central bank to have no built-in bias either to borrowers or to lenders; but, because it must deal with credit, we would want it to have an intimate knowledge of the processes of banks, banking, and the financial world. Finally, I suspect, we would remember that wisdom is not geographically concentrated and, also remembering the size, diversity, and democratic character of our country, we would want a central banking system to be regionally representative.

These are characteristics, I think, that reflective men would desire in an American central bank if it were now to be established. To mention these characteristics, however, is almost to describe the Federal Reserve System. The distribution of authority in different degrees throughout the system; the combination of a central governmental body and decentralized public bodies; the diverse opinions and judgments that are blended into final decisions; the consideration given to regional as well as national factors in reaching policy decisions; the local interest and cooperation accorded the regional arms of the system; and numerous other characteristics all combine to support, to my way of thinking, the idea that the Congress has done an altogether excellent job of establishing an American central banking system, unusual, to be sure, in form and structure, but thoughtfully put together in a way representing a prudent and long-run view of the national interest.

It is sometimes enticing, of course, to believe that a much greater degree of centralized authority in the Federal Reserve System, vested, say, in some highly skilled central banker or executive official of Government, might operate better and more quickly. The feeling is wholly natural, and I have myself been sometimes bemused by it when I have been unable to impress other officials of the system with the complete wisdom of my own opinions.

I think we can all agree, however, that such an organizational structure would be wholly at variance with the democratic character of our country; and, in any event, the risk is simply too great. Our Heavenly Father may have blundered in this matter, but, for reasons known only to Himself, He did not concentrate all wisdom in one place, or in one head, or a few. The democratic process of legislative and public scrutiny, and policy-making decisions resulting from the impact of

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many minds from many places, influenced by many considerations, will sometimes be slow and cumbersome and produce a result rather less than the heart's desire. But I, for one, believe that in the end it is more efficient and effective, and in the long run—and not too long, either—is better calculated to serve the national interest than more centralized and concentrated types of organization that seem to gain some advantages by losing other and, I think, greater advantages.

The subcommittee will have noticed, naturally, that in speaking of the characteristics we would want in an American central bank, I have not mentioned a mandate under the law. And yet I do believe that there must be a mandate that is clear and precise with reference to all of those things in which precision is possible, and that is at least clear as to purpose in those more general areas where precision of definition is not possible. If a central bank does not have a fairly clear mandate creating an understandable norm by which policy can be judged fairly and justly, it will surely be misjudged, unfairly and unjustly.

I have, myself, tried to state my understanding of the central bank's fundamental objective, but I believe that in this country we have now reached a point where the Congress might well reconsider, either by itself or through a monetary commission, the legal mandate of its central bank. I say this with full understanding of the immense difficulties of the task. But, even if, after such consideration, the law were left wholly unchanged, I think that the discussion would be immensely valuable in promoting understanding in the central bank itself, in the Congress, and in the public generally.

Senator DOUGLAS. Are you acquainted with the so-called Douglas-Flanders resolution?

Mr. BRYAN. It could not have escaped me, sir.

Senator DOUGLAS. As you know, that resolution stated that the Federal Reserve decisions with regard to open-market operations and credit policies should predominate and that questions of the management of the public debt should be subordinate to—the policy decisions of the Federal Reserve, especially when there was involved the matter of stabilizing prices. Without wishing to push you on this question, do you have any general opinion about this resolution which you would like to express?

Mr. BRYAN. Senator, would you let me reply to that in a brief form now, and, if it comes up later in what the statisticians call the long form. My answer is, "yes."

Representative PATMAN. Have you given consideration to the policy set forth in the Employment Act of 1946, Mr. Bryan? I have not read your statement all the way through, and if you discuss it I will not insist on it now.

Mr. BRYAN. I have given consideration to it, sir. I wonder if I could be permitted to defer it until the statement is concluded. I would appreciate the favor very much, sir.

Representative PATMAN. Certainly.

Mr. BRYAN. Be all that it may, the real nub of the question currently involved in the formulation of monetary policy is whether or not the Federal Reserve System, wisely and in the long-run public interest, should be made responsible to the executive branch of the Government. It is my firm opinion that such a step should not be taken. I have a single, sufficient reason.

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The Congress has been compelled in the public interest to fulfill its constitutional responsibility regarding money by regulating the terms and conditions under which money can be privately created, either through the mechanism of note issue, as in early days, or, as time has gone on, through the mechanism of deposit credit. But if it is necessary to protect the public against the unlimited creation of credit money by private financial institutions, history shows conclusively that the public interest must be similiarly protected against a like abuse of the power to issue money by government itself, or, what amounts to the same thing under modern conditions, access to bank credit on its own terms. For the executive agents of government, be it remembered, are hardly ever merely passive observers of the financial scene.

Quite the contrary. They appear actively in the money market as persistent borrowers bidding for the funds that private individuals have saved or can be induced to save. If, as I believe to be true, a major objective of monetary management is to maintain the dollar as an effective and efficient measure and store of value and thereby to promote stability in the economy, then, as a matter of common sense, the adjustment of the money supply for the purpose of achieving these ends dare not be jeopardized by allowing one borrower, however important and persistent, access to bank credit on conditions determined solely by himself.

This is dangerous business. Unless the Executive could be permanently counted on to exercise an almost superhuman will power, he could scarcely be expected to resist the temptation to supply at least a part of his needs by the easy and apparently painless device of expanding bank credit, rather than by recourse to the more difficult method of taxation or to the more troublesome method of attracting to himself, through borrowing, the voluntarily surrendered real savings of the citizenry. I think it only prudent to judge that, sooner or later and inevitably, the borrowing Executive will yield to the temptation to set terms and conditions so favorable to himself that savers will not voluntarily surrender their funds; and then, with the greatest of good will and with no sense of malice or of evil intent, he will seek to find his supply in new issues of credit money.

This is particularly dangerous business in a democratic society if it wants to remain democratic. For as soon as Government makes itself financially independent, both of the taxpayer through borrowing, and of the saver through an expansion of bank credit, it destroys a chief barrier against the almost unlimited aggrandizement of the state at the expense of the citizen. First the power of the legislative branch and then, finally, the whole process of obtaining the consent of the governed would one day founder on the fateful decision to allow the Executive to commandeer the people's savings—no doubt in small measure at the beginning, but in ever larger measure as the procedure became habitual and irresistible—either through the less subtle mechanism of currency issues or the more subtle mechanism of bank credit. **If my opinion in this matter be deemed ill-founded or excessively fearful, let me refer to the fact that modern dictators, everywhere and uniformly, have used control of the banking mechanism in order to subvert the power of legislatures and parliaments and to divorce themselves from the restraining judgments of their peoples.**

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And so, gentlemen of the committee, my opinion on this fundamental issue is that it would be neither prudent nor in the long-run public interest for the central bank to be made responsible to the Executive. Such an arrangement would, in my opinion, violate the whole American conception of the function of the Executive in our governmental structure.

The founders of the Republic were thoughtful men. They were at pains to reserve sovereignty to the people of the United States, to divide the exercise of sovereign powers lest some single agency of the sovereign should be able to bring the readily of power into its own hands, and were careful to place control of the purse in the legislative rather than in the executive branch. I deem this arrangement to have been very wise; for, in simple truth, gentlemen, the centuries-long struggle of peoples to bring the power of taxation under their own control and, likewise, to protect themselves and their money against an occasionally malicious, but often merely whimiscal and ill-considered, abuse of the sovereign power is one of the longest and most savage struggles in the history of our civilization. We should not forget.

If we will but maintain them, our conceptions and basic arrangements are calculated to give us in the future, as in the past, a monetary policy that is unlikely to be perfect—nothing ever is—but, being open to constant legislative and public examination, one that is likely to possess the negative merit of not persisting stubbornly in motal error, and the positive merit of improving as knowledge improves. If I be reminded that practically all the countries of the world have made their central banks responsible to the borrowing, executive agents of government and that we in the United States are not quite in fashion, then I can only reply that the monetary chaos exhibited in many countries of the postwar world is a sufficient admonition to us to think in the light of things eternal rather than in the light of the most recent high style.

Speaking with equal candor on the specific problem of the American central bank, the Federal Reserve System, I should like to point out that the Congress has placed in the Executive the duty of advising it on the choice of those American citizens the Executive considers worthy of being charged with basic responsibility for the Nation's monetary policy. The Executive performs this duty through his nomination of the members of the Board of Governors of the Federal Reserve System, and that Board, in turn, is equipped with powers adequate to make its policies the System's policies. I deem this relationship of the Executive to the Federal Reserve System to be entirely sufficient.

Thank you for your patience.

Representative PATMAN. I assume you are willing to answer any questions the committee members desire to ask you?

Mr. BRYAN. I will try, sir.

Representative PATMAN. Senator Flanders.

Senator FLANDERS. First I would like to compliment you, sir, on the scale and the tightness of the logic which you have displayed in this document.

Mr. BRYAN. Thank you, sir.

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Senator FLANDERS. I think it is in many ways an extraordinary document, suited to convince anyone, temporarily at least, against his will; I think as a matter of fact, it is better than that.

Now, you made a plea for a general as distinguished from a specific credit control. Does that mean that you are dubious about the usefulness of regulation W and X?

Mr. BRYAN. Sir, that is a question, of course, on which I would like to squirm and fidget, but will not. It does mean I am dubious about their usefulness as a permanent or continuing instrument of policy.

Senator FLANDERS. Well, now, by "continuing" do you mean regulation W or regulation X in continuous operation under varying specifications, or would you give it a clean bill of health if W and X were brought in only in emergencies?

Mr. BRYAN. I would prefer the emergency procedure, sir.

Senator FLANDERS. You still would not look on it with a kindly and benignant eye, even though brought in only in emergencies?

Mr. BRYAN. I would want the emergency to be grave.

Senator FLANDERS. Is our present emergency grave enough?

Mr. BRYAN. Sir, I suspect that if I were in your position, and in which I had to vote on it, I would vote for its limited and temporary continuance.

Senator FLANDERS. You would set a legislative limit on it of so many months or years on its authorization?

Mr. BRYAN. If I had to vote on it, I would, sir.

Senator FLANDERS. All right.

Now, we have another form of specific credit control in operation. That is the so-called voluntary control, concerning which Mr. Powell will speak to us later.

Do you disapprove of that as not being general?

Mr. BRYAN. I would prefer, sir, that in view of the fact that Governor Powell is to testify that I could be excused from extensive questioning on the voluntary restraint program.

In general, however, in trying to be responsive to your question, I would say that I have serious misgivings about hortatory methods, but I want to add that the program has been very valuable in inducing in the minds of commercial bankers and other lenders a very thoughtful and reflective attitude toward their lending activities.

Senator FLANDERS. You profess a low opinion of hortatory methods. I do not know whether you were here, but Mr. Keyserling had also a low opinion of hortatory methods; he ranked them as No. 8, and he ranked monetary controls as No. 7, so you agree 50–50.

Mr. BRYAN. No, sir; I assure you that the range of agreement would be substantially less.

Senator FLANDERS. There was evidently some fault in my statistical analysis of the situation.

Mr. BRYAN. I refer the statistical method to Dr. Murphy.

Senator FLANDERS. One element of this voluntary control is applying the criterion of whether a given extension of credit helps the war effort—excuse me, I did not mean to use that word "war"—the defense effort.

Now, there is a fairly definite criterion for selective credit controls. Would you not under present conditions consider that that criterion was a reasonable one? I am still keeping you in Mr. Powell's field, and I believe you asked to be excused.

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Mr. BRYAN. Yes; I would like to be excused from that field, sir.

Senator FLANDERS. Then I will not question you on that.

I became interested in the effectiveness of changes in interest rates during the thirties when we had almost the lowest imaginable interest rates and the lowest imaginable use of money.

What have you to say about the correlation between interest rates and the use of money and the effectiveness of low interest rates in encouraging the use of money under such conditions as we experienced at that time?

Mr. BRYAN. I must say, as noted in my paper, that if you put in the phrase "under such circumstances and in such situation"—referring to the thirties—the low interest rate will not move the piano.

Senator FLANDERS. You are accompanying this on the piano, I see.

Mr. BRYAN. Yes, I am, sir.

Senator FLANDERS. Is that not a rather large admission on your part? I can give you a way out, but I want your way out.

Mr. BRYAN. Well, I would be glad to have any help, sir, that you can offer. I am not at all proud in such matters.

Senator FLANDERS. Well, if you have not any way out I can suggest that——

Mr. BRYAN. Well, if you will.

Senator FLANDERS. I can suggest that you have already referred in your document to the necessity for primarily controlling deflations by controlling inflations.

Mr. BRYAN. Correct.

Senator FLANDERS. And I presume you would say that if we had properly controlled the preceding inflation that the situation in which interest rates, no matter how low, did not induce investment, that situation would not have taken place; is that your answer or mine?

Mr. BRYAN. Well, yes; that would be in part my answer, sir, plus an attempt that I think would be too long here to list the elements of what I would call shock prevailing in the economy during the whole period of the thirties.

We went through, after all, from 1929 to 1932, one of the most savage deflations in the history of this country, and it was accompanied—I do not know how to describe it—but not merely a collapse on the part of the economic system through a misapplication of capital previously, but by an actual diminution in the money supply through bank failures, and that diminution was quite substantial.

In such situations, particularly when these banks that had survived had been able to reduce their expenses so radically and drastically, there was no pressure on them to make use of the cash that the Federal Reserve System supplied. There were those factors plus, I think, some others, rather more technical.

I would hope desperately, sir, that we would have sense enough, with the aid of revelation, to avoid any such thing in the future; that is the——

Senator FLANDERS. When you say "revelation" are you referring to divine revelation?

Mr. BRYAN. Yes, I am, sir.

Senator FLANDERS. I join with you, sir.

Now, the next point that came to my mind was the balance of judgment on your part between the desirability of a concordat, on the one

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hand, and a mandate, on the other. We have been examining the parties to the concordat, the Treasury Department and the Federal Reserve Board, and have been unable to get from them any clear statement of the principles on which it is operated.

In general, it comes down to the fact—it has seemed to me, at least—that these two gentlemen get along together very well, and the less that is said about it the better. I take it, sir, that you feel that the responsibilities can be and should be put in more or less definite form, is that your point of view?

Mr. BRYAN. Sir, it is.

Senator FLANDERS. Well, that is the answer to that one.

Mr. BRYAN. I can speak at length on that point, but I would prefer not to.

Senator FLANDERS. Well, in a sense, your manuscript was speaking on that question.

Mr. BRYAN. Yes.

Senator FLANDERS. The last question, Mr. Chairman, I wish to ask relates to the limitations of monetary policy in controlling inflation.

One question that I have asked the others I will also ask you: Given the situation in the minds of businessmen and in the minds of the citizens, looking back on experience in the previous war, would it have been possible, following Korea, to have applied monetary policy effectively to keeping that inflation within narrower limits instead of causing it to, particularly in the wholesale prices, go up to the point that it did?

Mr. BRYAN. Sir, it would be my belief that it would have been possible by means of monetary policy, as the most desirable means, not totally and rigidly to have controlled that inflationary development, but to have held it within narrow limits, and to have done so without danger to the production of the economy for defense and defense-related items.

Senator FLANDERS. That is, of course, the point at which the mandate given to this committee comes in. We are asked to stabilize employment and production, and you feel that a more drastic application of monetary policy would have held the price level within a narrower limit of fluctuation without interfering with production and employment?

Mr. BRYAN. I do, sir.

Senator FLANDERS. There is one other limitation, possible limitation, of monetary policy or, for that matter, any other kind of policy, that I wish to question you on.

In times of full employment, when both wages and prices are not subject to the ordinary market controls, can monetary policy or anything else restrain inflation without reducing employment and production?

Mr. BRYAN. Senator, I am awfully sorry to admit it, but there was some point, some qualification there, that I did not quite get the impact of.

Senator FLANDERS. All right.

Representative PATMAN. Suppose you have the reporter read it back.

Senator FLANDERS. I think, perhaps, I can state it more clearly. Let us say that we have a situation of full employment or even, as we had

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at times during World War II, of overemployment, in that people were brought into production who did not normally belong there. That supposes a practically limitless demand for the goods produced. The overemployment, with no background anywhere of unemployment, seems to present ideal conditions for wage demands; the limitless market for the goods produced seems to present unlimited possibilities for price increases, so that it seems to me that when you get to that point you have a condition which is very hard to control by monetary or any other means, except an endeavor to do so by price and wage controls.

Do you feel that monetary policy is applicable in a situation of that sort?

Mr. BRYAN. I do, sir, and feel that it is the only real remedial policy. A situation of that sort, as I see it, sir, may be very stubborn and intractable, but in such a situation you must somehow or other reduce the expenditure of funds in excess of the production of real goods and services.

Our only choice then is the choice of instrument by which we do it, namely, by direct controls or by monetary controls, and it is my belief that the best way to restrain the expenditure of funds in such a situation is to make the use of borrowed funds, on the one hand, more expensive and less available and, on the other hand, to make the saving and the holding of money in monetary forms more attractive. That would be my point of view, sir.

Senator FLANDERS. Those means, however, do seem to lead directly to decreasing production and decreasing employment.

Mr. BRYAN. I would hope that we would sometime be wise enough to use these means in precisely the right amount. I am not certain that, considering the fallibility of human wisdom, we shall ever get there, but I should hope that we would be able to restrain the expenditure of funds, sir, to exactly the right amount, so that all we would be doing would be restraining the excess expenditures and not curtailing them below the physical capacity of the country to produce real goods and services.

Senator FLANDERS. That is another expression of the hoped-for revelation.

Mr. BRYAN. Precisely, sir.

Senator FLANDERS. Thank you.

Representative PATMAN. Representative Bolling.

Representative BOLLING. Mr. Bryan, do you feel that manpower, plant capacity, and materials were fully utilized on the day that the North Koreans attacked?

Mr. BRYAN. The answer to that, sir, as I would have to give it, would go something in these terms: That the excess capacity and the unutilized manpower, to wit, unemployment, were not very large at that time; that we were producing within reasonable range of our top capacity, and that the test of the judgment was that, in order to get a very limited increase in real production, we had to inflate the price level. That would be my approach to it, sir.

Representative BOLLING. How do you feel about the basic decision made by the Congress, by the Government as a whole, as to the best way to approach a period such as that in which we now find ourselves, and which some indicate may last for many years, a garrison economy,

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a semimobilized economy, a period which is not peace and yet which is not all-out war? The basic decision was, in general, to attempt to maintain approximately the level of civilian consumption, taking into account the need to expand to meet the increasing needs of an expanding population while, at the same time, increasing productive capacity to the point that we very much strengthened our posture of defense. How can you tie the two thoughts together, that our capacity at the time was largely and fully utilized when, at the same time, the decision, which was apparently generally concurred in, was that we must have some resources from which we could obtain a greatly increased production over a relatively short period of years?

Mr. BRYAN. Well, sir, I do not know how good a job I can do of reconciliation, but I would say in answer to that, simply this: That if we must take—and I fully concur—a very much larger percentage of our total national product for the use of the military, then it seems to me that there is, practically speaking, no possibility of doing that job immediately, except by deducting substantial amounts from civilian use of resources, both for consumption and capital purposes, and that that, sir, must be done by one of two ways: Either the tax route or by borrowing the real savings of the citizenry.

Representative BOLLING. Do you feel that we have actually reduced civilian consumption to an appreciable degree at the present rate of capital formation or the rate of capital formation in the last year or so, with the indices indicating real consumption, civilian consumption, standing up very high?

Mr. BRYAN. That, of course, is correct, provided our figures reliably represent the true situation. I personally, without being able to prove the point, sir, would suspect that there has been a great deal of waste in this last year and a half, which waste masquerades as real production and consumption in our figures. I come to that conclusion only upon the basis of observation.

Representative BOLLING. What kind of waste do you mean?

Mr. BRYAN. Well, sir, if you will pardon me——

Representative BOLLING. On the consumption side or on the Government side?

Mr. BRYAN. Let me speak, sir—no, I am not now speaking of the Government. Without naming names or anything of that sort—after all, there is the case of the man who gets so excited that, without getting an architect or a building permit, he starts putting up a building, and goes up two stories and finds he is outside the building line and has to tear it down—production or waste?

There is the case of an industry that goes all out, calls in laborers, orders new plant and equipment, and within 12 months is flat on its back. Efficient use of resources or inefficient?

There is the case of a business firm that gets so excited that it orders several hundred thousand dollars worth of machinery and finds out that, by and large, it has ordered the wrong machinery, and has it stored in the warehouse. Production or waste?

I can cite an example or two of waste in my own case, of which I am ashamed.

So I am not, sir, totally impressed that we got so much real production as we thought we did.

Representative BOLLING. Now, back to this question of full utilization: I have been interested in the question that is raised by the defini-

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tion of full utilization because, for example, a subcommittee of this joint committee did a study on the underemployment of farm families. It seems to me there was an indication of 2½ million people engaged in farming who were underemployed. If an individual were employed in that way would he fit within a category of full utilization? Statistics on employment, in other words, can be very deceptive. It appeared that way to me, and I wondered if you agreed.

Mr. BRYAN. Sir, I do not know just how I can answer that, nor quite what the point is that you desire me to answer. The only comment I could make on it is this: That in any statistics of underemployment there is one truth that, from the human standpoint, is often overlooked. There are a lot of people who like it that way.

I, for instance, have a little cottage in the mountains of north Georgia. I am sure that a great many of my friends in that county appear in the statistics as underemployed, but they like it that way, for the most part, and you have to offer them perfectly fabulous rewards to get them to undertake full employment and, may I say, sir, that I frequently envy them.

Representative BOLLING. Well, the only point that I was attempting to get at is this: It seems to me that both through that factor and also through the question of applying improvements in technology to present operations we could start out in a period of full utilization statistically and still have tremendous room by the application of capital and other things to increase our productive capacity.

Mr. BRYAN. Over the long pull; yes.

Representative BOLLING. Mr. Keyserling raised the question the other day that I thought interesting, and you have sort of touched the edge of it. He spoke of a triangle, one side of which was capital formation, one side of which was Government expenditure, and the other side of which was consumption expenditure, and indicated his belief that, perhaps, our emphasis had been exaggerated in our approach to this whole problem; that in the situation in which this country found itself that we might better have put more emphasis on the cutting of consumption in the third area of the triangle.

I wonder if you would agree with some of the implications of that, which are pretty obvious?

Mr. BRYAN. I would want to know where we were going with that statement before I committed myself on it, sir.

Representative BOLLING. You can define where we are going.

Mr. BRYAN. It would be easy, of course, offhand to agree, but I would also want to say that the ideal way of freeing resources for defense would be to cut down not merely consumption—marginal elements of consumption—but also on marginal elements of nondefense capital expansion and, doubtless, sir, on some marginal elements of Government expenditure.

Representative BOLLING. That answer leads me to the final question that I have: How is general credit control going to achieve that?

Mr. BRYAN. Well, sir, obviously a general credit control, as I have tried to say, curtails all through the economy—I wonder if the committee will excuse me if I use the words—"marginal commitments." I notice that some of the replies have avoided that word by using "fringe commitments" as a semantic substitute; and I suspect maybe that is less offensive, but what I think you will have by a restraint of credit

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are a series of marginal reductions of the sort that I tried to list in my paper.

I have seen that kind of curtailment at work; it is not theory with me. I was in a commercial bank watching it for 5 years, and I was looking to see whether I could trace the effects; and it was perfectly obvious that you could trace the effects if you were watching for them.

You would have men make decisions to expand or not to expand upon the basis of whether they thought credit was going to be available, whether they thought the interest rate was higher than they should pay, and upon such similar considerations.

Representative BOLLING. If credit is generally restrained by voluntary credit restraint to an effective degree, you could very easily find the country in a position where for good sound reasons the picture on profitable venture looked better in the field of civilian consumption, particularly after a period of contraction in civilian consumption by allocation and other means, to the point where the alternative, faced by the Government, would be to give permission for this credit to flow in the wrong directions or the necessity of paying rather terrific premiums in the taxpayers' money to get defense production.

Now, whether or not they are premiums, I would cite as examples, the program of certificates of necessity for accelerated tax amortization which, obviously, seems to be inflationary; various subsidies in the areas of mining, and so on, and it seems to me there is very serious danger that the choice might ultimately become that rather difficult one.

I wonder if you will comment on that one?

Mr. BRYAN. Yes, I will comment, and I will try to comment candidly by saying two things; that is a conceivable situation, in which the overwhelming desire of consumers to spend money so stimulated the production of consumer goods and services, and investment in consumer industries that the Government might be under extreme difficulty within a limited supply of credit, in getting defense production.

But, secondly, I should like to say that I do not believe that in the area where we were after Korea or are now, of a garrison state, that that was or is a real and present danger.

A banker, after all, is a peculiar sort of animal. He likes to lend money to people who have orders and are going along and will, he trusts, repay him.

Now, the very instant the war situation came on, if we had had effective general credit restraint, I think that we would have found very quickly that the best borrowers coming into banks were the borrowers with defense orders, and that in a good many cases the civilian goods producing industries would have been curtailed by a reduction of credit brought about by their less favorable prospects.

Accordingly, I would have assumed that there would have been, under a program of credit restraint, an ample supply of credit for defense purposes, particularly from the repayment of old loans. Now, wait a second, I mean with the tax increases we have had.

Representative BOLLING. Well, I do not think I will pursue this much further. I would like to make a comment at this point.

It is not my impression that what you described is actually what happened in the period of post-Korea. My impression was there was a substantial reluctance, and it seems to me a very reasonable reluc-

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tance, on the part of interested business to move in the direction of the production of military hardware. I think it was an entirely understandable reluctance because of our complete inability to know what the future holds, but I am under the impression that it may be that we were already in a situation where rather high premiums have had to be paid in the form of cost-plus contracts, and so on, for defense production.

I am not at all clear in my mind that what you describe as possibly happening did happen.

Thank you very much.

Mr. BRYAN. Could I make just one brief comment, sir?

Representative BOLLING. Yes.

Mr. BRYAN. I think that I would agree that what I described as a possibility is not what actually happened because of the circumstances that credit was so freely available and bank reserves were built up so greatly that vast amounts of speculative commitments in inventories of television sets, refrigerators, and all that sort of thing, were stimulated and the use of manpower and materials by civilian-goods industries was in fact encouraged, not curtailed. You had a vast stimulation of the consumer goods industries and the durable consumer goods industries that, well, I do not believe could have happened if we had had a restraining credit policy.

Representative BOLLING. You do not believe it could have happened if we had had a restraining general credit policy?

Mr. BRYAN. It could not have happened to the extent that it did happen.

Representative BOLLING. Could it have been prevented to a substantial degree unless we had techniques and tools supplemental to a general credit restraint?

Mr. BRYAN. Well, I hate to appear rigid and too dreadfully orthodox on this matter, but I believe, sir, that it could very largely have been prevented by a general credit restraint.

After all, it was a number of months before defense production became a substantial segment of the economy. Practically all the inflation in the second half of 1950 was related to private, nondefense spending, and the credit expansion of the period was also.

Representative BOLLING. That is all, Mr. Chairman.

Representative PATMAN. Senator Douglas.

Senator DOUGLAS. Underneath a good deal of the questioning this morning has been the issue as to the degree to which we should use monetary and credit policies, and in the background fiscal policies, to obtain full employment; and that, of course, raises the question as to what is full employment.

Mr. Beveridge, in his celebrated book, said that full employment existed in England when unemployment did not exceed 3 percent. In other words, he set 3 percent as the average amount of seasonal and transitional unemployment in England, and that unemployment above that figure from other causes constituted less than full employment. He maintained that it should be the aim of government to force unemployment down from any figure that was in excess of 3 percent in order to get full employment.

Now, if we were to adopt a similar policy in this country, and if we were to say that monetary and credit policy could not reduce seasonal and transitional unemployment, would you set that figure

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of seasonal and transitional unemployment in this country at 3 percent or at a higher figure?

Mr. BRYAN. Sir, that gets me into a statistical field in which I think I ought very honestly to confess I am not sufficiently expert to give any value to my opinion.

I would suspect—this is merely a suspicion—that that is cutting it mighty thin.

Senator DOUGLAS. Well, then, pardon me if I make a comment. It seems to me beyond question that seasonal unemployment is higher in this country than in England because of the greater yearly fluctuation in the weather. The English climate moves within a 50° variance, but I believe Minneapolis has a variance of 140°, and this has a powerful effect, of course, on seasonal fluctuation. Similarly, our society, being less caste-ridden, is more subject to greater style variations.

So that I would strongly suspect the seasonal fluctuation and our transitional unemployment to be greater than England's since ours is a more dynamic economy, and it follows from this dynamic quality that a larger percentage of industries are getting out of kilter, in any given time, than in England. Therefore, our 3 percent would be altogether too low a figure for this country.

My own belief is—and this may be beside the point—that somewhere between 5 and 6 percent would be much truer as a measure of allowable seasonal plus transitional unemployment before "less than full employment" is reached in this country.

It follows, therefore, and this has grave bearing on our problems, that if you would try to force unemployment down below 5 or 6 percent by fiscal or credit policies, the result would be, in all probability, an appreciable inflation. This also has a bearing upon the problem which the Federal Reserve faced in July of 1950.

It was brought out in the testimony that the average percentage of unemployment as of the 1st of July, 1950, was 5.2 percent; and that this was forced down to 3.4 percent by March of 1951. There was a reduction of 1.8, or approximately 2 percent. But bearing out the point that you made—which has also been my own feeling, although I don't want to be dogmatic about it—this was obtained at too great a cost. It was obtained at an ultimate increase of 10 percent ultimately in the cost of living, and of 16 percent in the wholesale price level and that, therefore, we purchased this increase in employment at too high a price ultimately.

Others may say that in the emergency the increase in employment of 2 percent was thoroughly justified, and that no price would be too high.

Now, there is one other question that I would like to ask. Do you think the banking fraternity knows the process by which open market purchases by the Federal Reserve cause prices to rise, if other things are equal? In other words, does the banking fraternity understand the processes of banking?

Mr. BRYAN. Senator Douglas, after all I have been a commercial banker, you know.

Senator DOUGLAS. Well, you were a college professor.

Mr. BRYAN. I know that, too.

Senator DOUGLAS. And in a good university.

Mr. BRYAN. Yes; thank you, sir. I admit that with a sense of honor.

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I think, sir, that we can vastly underestimate the degree of sophistication that is creeping into the banking fraternity, the investment fraternity, and the public, with regard to these matters.

Senator FLANDERS. When you say "creeping into it"—excuse me—did you mean something insidious? [Laughter.]

Mr. BRYAN. No, sir; I do not mean that. That was an unfortunate turn of language, sir.

After all, there has been a lot of discussion in the Congress and press in recent years. The Federal Reserve System and the colleges, plus the school of hard knocks, have made a great many people very acute as to what is happening in the financial world; the publication of the Federal Reserve Bulletin, the reviews of the banks have caused a lot of people to follow statistics, whether to their weal or woe, I do not quite know. The result is you would find all over the Sixth District a great number of people, the managers of the portfolios in all of the larger banks, frequently the head of the trust department, you would find the municipal bond houses, you would find members of the trust committees, you would find even in smaller places a great number of people who are very acute on this bank reserve business.

You might be interested to know that just the other day I talked to a man from north Florida who told me and demonstrated that he had already read 600 pages of the committee print.

Senators FLANDERS. Is he overemployed or underemployed? [Laughter.]

Mr. BRYAN. He may be slightly underemployed, sir, but apparently he likes it.

Senator DOUGLAS. Well, Mr. Bryan, about 25 years ago—it may have been 30 years ago—I read a little book by Walter Leaf, who was then the president of one of the Big Five, I think the London and Middlesex Bank in England, who was also a Homeric scholar. This book had a chapter on commercial banking, and the first sentence began, "Commercial banks do not create credit."

Then I attended some lectures at the University of London, where Edwin Cannan was lecturing, and he laid it down as a fundamental tenet that commercial banks did not create credit, and anyone who said that commercial banks did create credit would promptly be failed; and his disciple, Mr. Gregory, for some years solemnly maintained the position that banks did not create credit.

I have heard bankers in this country in the past defend the same proposition.

Now, here you have the center of the banking fraternity of the world 30 years ago, the head of one of the Big Five banks, a highly cultivated and highly able man, insisting that in the case of commercial banking all the banks did was to lend out money which had previously been deposited but they caused no net creation of monetary purchasing power.

It seemed to me that only a very inadequate intellectual would state that. I was a young man at the time, but I must confess that I was shocked by the statement and my belief in the superiority of the British intellect had a very healthy and salutary correction at that point. But you think nevertheless there has been a lot of progress on this?

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Mr. BRYAN. I think there has been a tremendous progress in the understanding of the whole process. I would not say to you, sir, that every banker in my district understands how the banking system gets its reserves, and it is reasonable that he should not, because unless he comes to borrow at the Federal Reserve bank he does not see the process.

Representative PATMAN. Senator Douglas, will you permit an interruption there, please?

Senator DOUGLAS. Yes.

Representative PATMAN. I am compelled to leave soon, as you know, and Senator Douglas has agreed to serve on here as chairman during the morning session. But there is just one question I want to ask him. I have a number, but I can settle for one.

I would like to write you a letter, Mr. Bryan, and ask you some questions, and I am sure that will be all right with you?

Mr. BRYAN. Surely.

Representative PATMAN. I want to ask you what you think about the policy set out in the Employment Act of 1946?

Mr. BRYAN. Sir, I wholly approve of the policy as a statement of policy; but, I believe, sir, that we will, as in a statement of all other policies, have to learn a good deal about how to make it work.

I am a little afraid, sir—this is being very candid—that for reasons indicated by Senator Douglas there may be an implication of built-in inflationary bias, as we have interpreted the act or tended to interpret the act, up to now, but I want to make very clear that I approve of it as a statement of policy of our Government of all branches.

Representative PATMAN. Thank you very kindly, sir.

Senator Douglas, will you take over?

Senator DOUGLAS (presiding). Is it not true that when the Open Market Committee buys Government bonds it creates credit with which the bonds are purchased, pays for them by check, and that these checks are then deposited, either directly, or indirectly, by the banks in the Federal Reserve System and thus build up the reserves of the member banks?

Mr. BRYAN. I would think that would be a description of the process.

Senator DOUGLAS. Well, you see that going on in your own bank, is that not true?

Mr. BRYAN. Surely.

Senator DOUGLAS. When the reserves increase, the lending capacity of the banks increased, is that correct?

Mr. BRYAN. Certainly, their whole ceiling of liquidity, their ability to lend, their judgment of risks——

Senator DOUGLAS. Those are vital assets, so that the tendency is for loans to increase as reserves increase?

Mr. BRYAN. There may be some circumstances as, to wit, in the 1930's when that would not be true but normally and over the long run, yes.

Senator DOUGLAS. Yes. These increases in loans by member banks will take the form of creating deposits, is that not correct?

Mr. BRYAN. Correct.

Senator DOUGLAS. The loan will be made in the form of a deposit which the bank creates?

Mr. BRYAN. Ordinarily.

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Senator DOUGLAS. So that the total supply of bank credit is expanded?

Mr. BRYAN. Correct.

Senator DOUGLAS. The total supply of monetary-purchasing power is increased.

Mr. BRYAN. Yes.

Senator DOUGLAS. If this increase proceeds at a greater rate than the increase in the index of production, the result is inevitably an increase in the general price level, is that not right?

Mr. BRYAN. Well, let us not put, sir, without any disrespect to my colleagues, too much weight on the index of production; let us simply say that if it increases faster than our ability to increase real goods and services, you have got an inflation.

Senator DOUGLAS. Yes. But I do not know quite how you measure services; I have always been puzzled by that.

Well, now, do you think this fundamental relationship is understood by the banking fraternity, first; by the general public, second; and, third, by legislators and public administrators?

Mr. BRYAN. Senator, let me say simply that I think they have had a very, very great education in the past 5 years. To what degree——

Senator DOUGLAS. Do you think they showed any sign of profiting from it up until March 1951? Is not the record up to that point almost invariably one of making the wrong decisions? Here you have the Federal Reserve Board with a high-priced, competent group of experts, with over 35 years of experience as a central reserve bank, and yet you find them from July 1950 to March 1951 buying $4 billion worth of securities, inflating bank reserves which are then used to expand loans.

Has this increased knowledge on the part of the Federal Reserve been recently acquired, or did it exist prior to this time? When did their economic education commence? What a high price this country has paid for it.

Mr. BRYAN. I wonder, sir, if you would excuse me from answering that question?

Senator DOUGLAS. Well, your silence speaks very eloquently. I think it is an indication that no institution will criticize itself. We like to criticize the Executive, the Executive likes to criticize Congress, but we are just so busy reforming the Executive that we do not reform ourselves, and I think there should be a profound feeling of humility on the part of the Federal Reserve Board——

Mr. BRYAN. Sir, I think that in the committee——

Senator DOUGLAS (continuing). And contrition——

Mr. BRYAN. Well, Senator, I would like to say——

Senator DOUGLAS (continuing). And penance, and atonement.

Mr. BRYAN. Sir, I was not a part of the Federal Reserve System during those years, but I wish fully to identify myself with the policy and the Reserve system and then to agree that we should make an act of contrition, do penance, and exhibit a firm purpose of amendment.

Senator DOUGLAS. That is fine.

I understand the excuse was that they were seduced. [laughter.] I remember an opinion of the United States Supreme Court in the

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case of *Massachusetts* v. *Mellon*, I believe, in which the judge who handed down the opinion said:

And if it be objected that Federal aid will seduce the independence of this State, this design can be frustrated by the simple device of not yielding.

Have you any comments to make on that opinion of the Supreme Court?

Mr. BRYAN. It is very cogent and very clear.

Senator DOUGLAS. I have no more questions.

Dr. Murphy?

Mr. MURPHY. No questions.

Senator DOUGLAS. Dr. Ensley?

Mr. ENSLEY. No.

Senator DOUGLAS. I want to congratulate you on your very brilliant testimony, the most exciting and most cogent and, to my mind, the most satisfying testimony that we have had. I am more and more convinced that you were trained at a good university.

Mr. BRYAN. Thank you, sir. I will admit it with a sense of honor. I should say, sir, that I thank the committee and that I think it is engaged in an extremely important work. I would like to ask a privilege. I would like to ask the privilege of filing with the committee a supplemental statement with reference to a question that is, I believe, quite important, namely, the question as to whether or not the Reserve System should be put under audit and budgetary control.

Senator DOUGLAS. I will be very glad to have you do that, and you will separate that as between the question of audit and that of budgetary control.

Mr. BRYAN. Thank you.

Senator DOUGLAS. Thank you, sir.

(The supplemental statement referred to above is as follows:)

SUPPLEMENTARY STATEMENT OF MALCOLM BRYAN, PRESIDENT, FEDERAL RESERVE BANK OF ATLANTA ON AUDITING, BUDGETING, AND APPROPRIATIONS CONTROL OF THE FEDERAL RESERVE SYSTEM

The expenditures of the Federal Reserve System are properly of interest to the Congress. The Board of Governors and the Reserve banks derive their powers from the Congress; 90 percent of the System's net earnings go to the Treasury; and the Government is, by law, the residual legatee of the System. The skill, efficiency, and prudence with which the System manages its household are thus matters for review and, if necessary, for admonition by the Congress.

Because the Reserve banks perform a large array of services for banking, business, and the general public, which services account for most of the expenses of the Reserve banks, it is entirely appropriate that the business community and, in fact, the individual citizen should also take an interest in the economical and efficient performance of the System's services. They have a vital, even though general interest, in the way the money is spent.

I entirely welcome this interest. It seems to me, likewise, that the Congress must have been unusually sensitive to this interest—and to the problem of prudently handling money expenditure—in the very drafting of the Federal Reserve Act. For I know of no legislation drafted with a carefulness equally calculated to enforce a very responsible attitude toward the proper relation of expense to the function performed and the relation of expense to the efficiency of operating service.

The nature of the public function and the character of the business services to be performed by the System gave the Congress a unique opportunity to do two things at once: To place both the governmental and operating branches of the System outside the influence of political patronage, and, above all, to subject the Reserve banks in their operating and business functions, not to the necessarily remote and approximate controls of government but to the infinitely more

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severe comparison with successful competitive business. This was the sort of opportunity that Congress does not usually have in endeavoring to effect a responsible expense attitude in connection with most public functions; and Congress quite evidently realized and took advantage of the opportunity. The System is under no pressure to improve the position of any political figure or political party by increasing its expenditures and its undertakings; the operating officers of the Reserve banks are not under pressure to increase expense but to diminish them.

The Board of Governors, a strictly governmental agency, is charged with the duty of examining the Federal Reserve banks. It passes on their budgets and through examination and other measures reviews their expenses in detail; and sees to it that their undertakings are directly related to the public responsibilities of the System. The regionalization of the Reserve banks with a responsible body of directors, themselves elected from the responsible, managerial levels of banking and business, has the calculated effect—as is well known to officials at the Reserve banks—of enforcing a constant cost consciousness in the minds of Reserve bank operating officers. It also subjects those officers to the criticism and observation of men who, by reason of their own business success, have had to be deeply sensitive to waste and quite able to recognize a cost or a waste when they see it. And, in this connection, let me observe that efficiency requires not only honesty in an accountiny sense, and honesty of purpose, it also requires the experience and talent necessary to recognize a wasteful cost when met in the middle of the street at high noon.

I should like further to point out that there is an often overlooked function of the System's regionalism. The uniform functional accounting in the several Reserve banks and branches inspires a savage and continuous efficiency contest among the Reserve banks. If a department shows up out of line, the bedeviled president has got to get it corrected, and fast; and as soon as he gets that one buttoned up, and begins to relax, some fellow half a continent away invents some new and better operating scheme, maybe in some other department, and the whole business starts over again, each president trying to put the monkey on the other president's back. Speaking to the committee very confidentially, I have found that this is a game you can't possibly win, but every president—lamentably including myself—will go on playing it until he drops in his tracks. There is no way of getting out of it. And that is as it should be.

Anyway, there can be no reasonable exception to the thought that the expenses of the Board of Governors and of the Reserve banks are an appropriate field both of congressional and public interest. I am unaware that such an exception has ever been taken by any official of the System. The System has always reported its expenses to Congress, and there is no reason now why the Congress should not, through an appropriate committee, suggest additional details or expense breakdowns that in its judgment might be useful. Speaking for myself as a Reserve bank president, I would have no objection whatever to an inspection by a competent group of management engineers familiar with the best practice in the field of commercial bank operations; and I suggest commercial bank operations because the comparison would thus be direct and rigorous.

I feel free to make this suggestion because of my experience not merely in Reserve bank administration but, for some years, as an active participant in commercial bank management, and, for more years, as an observer of commercial bank and governmental operations. Permit me to point out, in this connection, that if the subcommittee feels that the Reserve banks are ineffective and inefficient in their housekeeping and business functions, then the subcommittee is in a fortunate position. The Federal Reserve banks use many of the same machines that are used in commercial banks and Government departments. It should not be too difficult a task for a competent, objective group of management engineers to determine our relative efficiency. Some of our operating departments are quite comparable to departments in commercial banks and government. Other single operations are comparable. For instance, commercial institutions, Reserve banks, and Government departments make tremendous uses of punch card processes. It ought not to be too difficult, therefore, for a competent investigating body to determine whether or not the Reserve banks take a responsible view of cost control.

To say, however, that the expenses of the Board of Governors and of the Reserve banks are an appropriate concern both of the Congress and the public is not to say that either the Board of Governors or the Reserve banks should be put under the audit review of the General Accounting Office, or the budget review or control of the Bureau of the Budget, or under congressional appro-

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priation. Quite the contrary is the case. All three procedures would be useless and expensive or dangerous, despite the excellence of the work of the General Accounting Office in cases where it can function more appropriately. Let me explain my opinion, first dealing at some length with details, because details are important in arriving at a judgment, and then, finally, with a fundamental consideration.

1. If audit review by the General Accounting Office were to be simply a verification of assets and liabilities, then the procedure would be useless and expensive. It is useful in the case of those Government functions where the nature of the function is such that the men performing it are not by training, background, or business experience expert in the technical processes of auditing and audit procedure or prepared to understand its importance. It is useful where there is no other available means of scrutiny or, even more important, no other available means of invoking an effective sense of responsibility.

Obviously, however, such statements are not applicable either to the Board of Governors or to the Reserve banks. The very nature of the responsibilities of the members of the Board, and particularly of the Reserve bank officials, and the manner of election of certain of the directors of the Reserve banks, automatically brings to the fore a considerable body of men having the most intimate familiarity with auditing practices and procedures, and an acute sense of the importance of auditing the financial accountability. Still further, to make assurance doubly sure, the bank auditing departments, responsible to the directors and not to the operating officers, are reviewed by the examiners of the Board of Governors, their methods checked, and their work largely repeated. Thus there is an independent audit of the banks by an expert governmental agency, represented by an expert body of men over whom no president and no director and no auditor of a Reserve bank has the slightest influence or control.

As I can assure the subcommittee on the basis of banking experience, no director of a large bank, if in his right mind, would for an instant assume the responsibility that he must assume without a continuing audit by a department of whose expertness he were completely assured and whose responsibility is to the board of directors and not to the chief operating officer. For such reasons, an audit by the General Accounting Office would not permit the elimination of the continuous auditing process by a Reserve bank directors' own auditing department nor would it obviate the necessity for substantial, periodic examinations by the Board of Governors in the discharge of its statutory responsibilities for supervision of the Federal Reserve banks.

So far as an assets and liabilities verification is concerned, then, the intervention of the General Accounting Office to supersede the Board of Governors and the directors' auditing departments simply makes no sense. The fact is, since the auditing of every type of business institution has its own peculiar problems and procedures and requires a very substantial background of particular experience, the System and the General Accounting Office would be put to considerable expense over a period of years in training and developing in the General Accounting Office a group of men competent in the field of bank audit. Let us remember that there are auditors and auditors; and an auditor expert in a post exchange or the textile business, say, may be an amusing and awkward amateur in a bank, and vice versa. One of the first things usually necessary in finding a rabbit is to know that you are looking for a rabbit and to have seen a rabbit before.

Since the General Accounting Office has nothing to contribute to the System in a mere assets and liabilities verification, the proposal that the office be brought into the audit procedure makes sense if, and only if, the audit is to be extended beyond the verification to the allowances or disallowances of expenses, the interpretation of law, and the creation in the General Accounting Office of a very substantial discretionary and quasi-judicial power over the Board of Governors and the banks: the power to harass, if nothing else. This is, as it must be, the true inwardness of the proposal. If there be doubt that this is the real meaning, then it will be of help to examine the imposing array of legal-looking books containing the decisions of the Comptroller General. There will then be no doubt in anybody's mind that the activities of the Comptroller typically extend (as they are intended to extend) far beyond any conception of asset and liability verification and into an extraordinarily broad field of quasi-judicial interpretation and discretion.

It may be, indeed, that the Congress would desire such an arrangement in the General Accounting Office with respect to the Federal Reserve System. If so,

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then that issue should not be debated on the grounds of an audit but on its substantive merit. It should be determined by the Congress that in its opinion the General Accounting Office (1) has sounder business judgment than is likely in the long run to prevail in the boards of directors of the Reserve banks; (2) is likely in the long run to possess a greater sense of responsibility than the directors of those banks; (3) is likely in the long run to have sounder business judgment and a greater sense of responsibility than the presidents of those banks; and (4) is likely in the long run to possess sounder business judgment and a greater sense of responsibility than the Board of Governors of the Federal Reserve System, itself an agency of Congress and directly responsible to it. These are the conclusions, apparently harsh and boldly stated but entirely necessary, if an element of discretion over the Reserve System is to be placed in the General Accounting Office.

2. Budget control of the System by the Bureau of the Budget need not be discussed at length. Its end effect, whether by budget recommendation or budget review, would be to place the control of the System in the hands of the executive branch of Government. The power to harass is the power to destroy. I have elsewhere said that, in my opinion, the executive branch of Government is no place for a central bank and no place, therefore, for the Federal Reserve System. This is again an issue that needs to be debated on its merits, with a full understanding of its eventual meaning.

3. The subjection of the System to the appropriations control of the Congress would appear to be a convenient method of reviewing its expenditures. Such a control method is the more attractive because, while it has only a limited applicability to efficiency—i. e., expense as related to the amount and value of service performed, it is the only type of control available to the Congress with respect to most governmental functions. Its defects with respect to the Federal Reserve System are apparent and grave:

(*a*) It would promptly bring Congress under severe pressure to pay for political services by jobs in the System. I state this point crudely and bluntly, but it is true and might as well be said. There was full recognition of the point when the System was being designed by the Congress, and in the early days of the System, recognition both on the part of the overwhelming majority who thought that the System should not be subjected to patronage pressure, nor the Congress with respect to it, and on the part of those few who felt that the Nation's central banking organization was properly a patronage outlet.

(*b*) The System would be confronted with the task of justifying appropriations in relation to business operations in which a very high level of technical competence is necessary to an appraisal of their efficiency or inefficiency. This would present the Congress, in a peculiarly acute form, with a difficulty that it is finding constantly more troublesome and more appalling as Government extends its operations into fields having business characteristics. The Congress would find itself relying on the technical competence and judgment of the System, as at present, or acting without a technically expert and competent basis of judgment, in which case both the Congress and the System would clearly be worse off, or it would find itself hiring its own experts.

The last alternative, which is in reality the only out if the Congress desired to maintain objective and independent judgment, itself confronts a troublesome problem. Real experts in bank operations for large banks are rather rare birds. They are not created overnight; and when a man has had the years of experience, the analytical capacity, and a talent for the infinitely vexing detail necessary to acquire true competence in the field, there is an ample opportunity for him in private business at salaries the Congress is unlikely to pay.

(*c*) The appropriations process would effectually alter the substance of the System's regional organization even though the form remains. In the not very long run the change would surely result in increasing rather than reducing the expense of the System.

Remember that the businessmen members of the boards of directors of the Reserve banks, elected by the member banks, are men who, by the manner and source of their election, are successful in the management of business affairs. And remember that the other three directors, appointed by the Board of Governors, while often appointed for qualities of mind and distinctions unrelated to business success, do not obtain appointment unless they, too, have exhibited great qualities of responsibility, leadership, and prudence.

Now, to tell these men that in the fields of expense control, operating efficiency, and sense of responsibility, fields in which they have special competence and distinction, to tell them that they are to have no responsibility and no authority:

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that a far from the scene and necessarily inexpert appropriations body, or even expert accounting office, is more able or more responsible * * * that simply means that these men will shortly drift away from the System. Their time and talent and influence will be unavailable to the System; and when the drift away has occurred, even if the form and ceremony can be maintained, which I doubt, their successors will be fifth-, sixth-, and seventh-rate men, the sort of men to whom idle honors are the stuff of life. When that time comes, then, I think, the Congress will have occasion to pray over the expenses of the Reserve System.

(*d*) Whatever may be said, though, about the losses that one day will occur through the loss in quality of Reserve bank directors, the point must be made that the appropriations control of the Federal Reserve banks will almost immediately and substantially add to the operating expenses of the Reserve banks. This is true because of the nature of their operation. Appropriations control is only partially and vaguely related to what we are after, namely, expense control in relation to the volume and quality of service performed. Furthermore, the operating heads of the banks, once placed under appropriations control, would be compelled by the very character of appropriations control, and acting with a full sense of responsibility, to create in the banks a considerable margin of idleness time.

The exact truth of this assertion should be fully understood. Speaking out of my own experience, how would I react if I, as president of the Federal Reserve Bank of Atlanta, were to be placed under an appropriations control? Why would an appropriations control not serve to increase efficiency but to diminish it?

In a commercial bank, or any competitive operation in which survival rests upon the public's voluntary purchase of services and the efficiency of the organization in providing the services at a price the public is willing to pay, success depends only in part on the annual budgeting of expenses or the annual estimation of revenues. Such budgetary estimates are useful but only in a very broad sense, as a sort of first approximation to the problem of planning . Typically, even the best-managed competitive undertakings, with magnificent records of success and splendid efficiency, make substantial errors in their projections of revenue and expense; and the comptroller of a company who had to rely on such annual projections might not be worse off than he would be without them, but he would be in a sad case so far as an effective control of operating efficiency is concerned. Efficiency is neither measured nor effected by budget or appropriation control. Such controls should be utilized only when no better instrument is available. They are appropriate when the nature and structure of the establishment is such that the duties to be performed are largely nonfluctuating and therefore capable of planning on an annual or longer-range basis, as in a public highway department, or when the operation must continue to exist regardless of idleness time, as in the case of a fire department, or when the expense is in the nature of general overhead.

Where those characteristics did not exist—and they exist in very limited degree in the Federal Reserve System—then there are far more effective methods that are not usually available to the Congress but were, in fact, available in the case of the Federal Reserve System and were effectively utilized. It is in point to refer again to the scrutiny by a nonpolitical agency of the Congress, the Board of Governors; to the competition among the Reserve banks; to the nonpolitical character of their organization; and, above all, to the subjection of Reserve bank organization to the scrutiny and responsibility of men who are neither self-appointed nor politically minded, men whose training and experience enable them to recognize an efficient or inefficient operation when they see it. Simply from the standpoint of efficiency, this is infinitely better than anything that could be accomplished through appropriations control. Let's see how it has worked in the Federal Reserve Bank of Atlanta, a story that every other Reserve bank could tell with mere variation of detail.

The Atlanta bank's peak of wartime employment, at the head office and branches, was 1,661 employees. In the fantastic wartime boom of check clearings, bond issues, currency provision to the business community, payroll provision to the armed services, and so on, people had to be hired whether they were efficient or inefficient, whether they could work only a few hours a day, and whether they could be with the bank for only a month or less. After all, troops must be paid; checks must be sorted and routed; and people who have bought savings bonds get awfully weary of the process unless they can get the bonds in their hands.

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But well before the end of the war the operating officers of the Federal Reserve Bank of Atlanta were tightening down. Month after month the employee roster was reduced until, just pre-Korea, it was 922. That figure was about 28 percent above the prewar high, but, because of the tremendous growth of the South, the transactions through the bank had expanded in far, far greater ratio. How was the reduction accomplished and the gain in efficiency attained?

It was accomplished, first of all, by seeing to it conscientiously that employees were dropped as volume dropped. It was accomplished by all the little devices that operating officers use when they are conscientious in the first place, under the close observation of a competent board in the second place, and know, in the third place, that they will be praised for efficiency, not blamed, and that their own grade and pay will not be reduced or affected by the number of employees at their command. It was done by studying jobs, job lay-outs, work flow, machines, machine lay-outs, by training programs, by constant supervision, and by the morale that increases in an organization when malingerers are—how shall I say this pleasantly?—told that they should pursue their ease somewhere else.

I have no hesitancy in boasting about this performance, for I was not there. The credit goes to others.

We now come to Korea and the months thereafter. New tasks then performed for Government departments or the Congress and the spasmodic increase of currency and clearings business forced an increase of 130 employees in the space of a few months' time, a number now leveled out and being reduced by the same old process. If not, well, remember that I have a group of highly competent businessmen breathing down by neck. They review the employee roster every month; they exercise salary control; they observe departments from time to time and I know that they know an inefficient operation when they see one.

Here is a point of importance, for it explains to the committee why I, as a Reserve bank president, would be compelled to operate the bank a good deal more expensively if under appropriation control. I would have to face the fact that a large volume of the business going through a Federal Reserve bank must go through and be cleared daily. It cannot wait until next month or next week or even until tomorrow. I should also be compelled to face the fact that the volume of those transactions can and does fluctuate rapidly in accordance with the business situation. When the volume declines, the bank must immediately quit hiring employees as resignations occur, and dismiss the least efficient. Conversely, when an increase occurs, the bank must immediately bring more personnel into the shop.

Confronted with all these prospects, the operating head would be compelled to hide in the appropriations request a minimum of 10 percent and probably nearer to 15 or 20 percent of idleness time in the personnel roster, and to defend the request to the last ditch. That much idleness time would be necessary so that a miscalculation in the volume of business flowing through the shop would not, in an upturn, find the bank unable to deal with it.

Without attempting to be facetious but only in an effort to state the problem in the concrete terms in which it would be bound to arise in the day-to-day operations of a Federal Reserve bank, imagine the necessity of my having to write some such letters as these:

Lieutenant General ——— ———,
Commanding, Third Army Headquarters,
Fort McPherson, Atlanta, Ga.

My Dear General: Colonel ——— ———, your finance officer, has presented the usual request for payroll money for the troops under your command at Fort Benning.

I regret very much that I am unable to furnish this money, and that fact is a source of great embarrassment to me and will be, I know, a great disappointment to your troops.

The fact is, the tremendous and wholly unexpected increase in currency transactions in the Sixth Federal Reserve District in the past several months has entirely exhausted the Reserve bank's appropriation for currency sorters and verifiers.

I have, of course, appealed to the Congress for a deficiency appropriation, and there is every reason to suppose that it will be granted. However, as you know, my dear general, these matters take time—there is an especially great press of business before the Congress at this session—and it will be some weeks before the appropriation can be acted on and the bank can hire the necessary clerks.

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In such a circumstance, I have no choice but to suggest that you inform your troops quite frankly that they can hardly expect their pay before late August or the 1st of September.

Very respectfully yours,

——— ———, *President.*

Or we might imagine a circular something like this:

April 4, 1952.

To All Member Banks, Sixth Federal Reserve District:

At the time, some 21 months ago, when the Federal Reserve Bank of Atlanta prepared its budget requests for presentation to Congress, we made the most careful estimates of our requiremnts for clerical and supervisory help in the transit department. The tremendous increase in check transactions throughout the country, however, now causes us to be short some 28 people in that department.

Fortunately, while we cannot sort and clear the checks you are sending us, we are able for the present to store your checks in the basement, which is dry. Please be assured that hereafter our budget requests will be ample for all possible contingencies.

In the present situation, we firmly commit ourselves to the equitable policy that has always characterized the Reserve bank: when we can clear these cash letters we will take them up in exactly the order in which they have been received.

In the meantime, of course, you are familiar with our Circular Z-1, in which it is provided that we are not responsible for any loss occasioned by our failure to route incoming cash letters promptly on receipt.

Very truly yours,

——— ———, *President.*

Such letters are only to be imagined. They are, of course, unthinkable. It would be totally necessary that they be avoided, and the avoidance could be accomplished in only two ways. Either the Appropriations Committee would be compelled to place substantial discretion in the Reserve banks and the Board of Governors, which is where we came in, or the budget would have to contain a substantial percentage of concealed idleness time.

To be sure, when idleness time is mentioned, there is a pertinent question. Could not the General Accounting Office, for example, or some representative of the Appropriations Committee, or the Budget Bureau come to the Reserve bank in Atlanta and see that the president had concealed idleness time in his personnel roster? The answer to that is, "Yes; provided he were competent enough." But, even if it were found, how else could the problem of carrying an unexpected peak load be solved under an annual appropriation control?

4. Thus far the discussion has involved a truism and many important details. The truism is that the housekeeping expenses and the efficiency of the Federal Reserve System, as well as its monetary policy, are properly matters both of public and private interest.

The details have been important to understanding. They have, indeed, been related, in effect, to establishing what I deem to be a clear distinction between the Federal Reserve System and typical Government departments, or Government corporations exercising public functions, a distinction that was recognized by the founders of the Federal Reserve System.

There is a good deal of confusion on this point. The confusion exists because the working of the System is difficult to comprehend by anyone who has not had an intimate familiarity with the actual day-to-day and month-to-month operations of a Federal Reserve bank, together with the spirit and tradition of the System.

The uniqueness of the System lies not in the fact that the System has earnings. So do many Government corporations and departments. It lies not in the fact that the Reserve banks carry on operations having business characteristics. Many Government departments and corporations also have such characteristics, although the chief operating functions of the Federal Reserve banks have them more clearly and precisely than most Government departments or corporations. The distinction between the Board of Governors and other Government departments lies not simply in the importance of the System's function as the agent of Congress in the management of the Nation's money supply. The Congress has established other Government departments of tremendous importance to the Republic, although the importance of the Reserve System to the weal and woe

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of the American people can hardly be overestimated. The distinction seems to me, so far as the prudent accounting of money expense and the efficiency of operations are concerned, to lie in these considerations:

That the nature of the banking operation automatically brings forward in the Board of Governors, the Board's staff, and the officials of the Reserve banks men intimately familiar with the practices and importance of money accountability;

That the universal recognition of the importance of money management gave Congress the opportunity of divorcing the governmental branch of the System from political consideration;

That the operating characteristics of the System gave an opportunity for the regionalization of the Reserve banks and produced a keen rivalry in operating efficiency between the Reserve banks;

That the regionalization of the Reserve banks and their banking function gave an opportunity for a wholly nonpolitical election of local directors who, by the manner of their election and their qualification for office, are and must be deeply sensitive to the rigorous standards of efficiency prevalent in private business;

That there is sufficient similarity between operations in the Federal Reserve banks and commercial banks to enable them mutually to observe and benefit from the best operating practices of each;

That all of these factors combine to put the responsible officials of the System in a position in which they have nothing whatever to gain by wasteful expense or by new or bizarre activities under the allegation of public service, and to place the responsible officials of the Reserve banks, wherein 96 percent of the System's expenses occur, not only in the position of gaining nothing by increasing expenses but, indeed, under continuing pressure to reduce them.

Such an organizational opportunity, not merely to induce but to enforce a prudent regard for expenditure responsibility, is not often presented to the Congress. It rarely exists, if ever, with respect to Government departments and corporations. So the uniqueness of the System should be remembered.

Although these characteristics of the System are extraordinarily important, if I had the honor of being a member of this subcommittee, I would base my decision regarding the wisdom of outside verification audits, expenditure budgeting, or appropriations control on a far more fundamental consideration. I would consider whether outside audits, budgets, and appropriations, one or all of them together, created a fundamentally consistent relationship between the legislative branch of government and its central banking organization.

Let me here go back to the wise words of a most distinguished public servant. When he took office as the first Comptroller of the Currency of the United States, the Honorable Hugh McCulloch wrote a great letter of advice to banks and bankers, saying, among other things, that if they found an officer imprudent and reckless in his private affairs, fire him, even though the money he wasted was come by honestly—a letter that, had it been heeded, would have saved our country so much of tragic history.

The point that Hugh McCulloch was making is as old as the ages. It is the point that a prudential and fiduciary relationship to assets or to income, whatever else may be its pitfalls and hazards and troubles, simply cannot be squared with extravagance, waste, and recklessness in the private affairs of the trustee. And it is better not to make the attempt, for, as Hugh McCulloch also observed, there is in the end no way to prevent a thief from cheating you—as I add, of your time, your energy, and your happiness, if nothing else—and no way to prevent a reckless man from wasting your substance. There is no remedy for a reckless and imprudent banking officer save to have done with him once and for all.

Let us illustrate the matter. If you gentlemen and I were now to establish a trust account, say, for some entirely worthy purpose, we might well seek out a bank to hold, invest, and administer the funds that we wish to place in trust. We would then wish to know something of the bank's reputation; we would undoubtedly look at its statement; we would inquire as to its trust procedures; note that it was audited; give it some directions in the trust instrument we drew up; ask that statements be furnished us at intervals; and, in order to form our own judgments, go in from time to time to talk to the trust officer in charge of the account.

If we then discovered that our account was to be assigned to a trust officer we believed privately reckless and imprudent, there would be but three remedies: to insist that our account be placed under the management of another trust

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officer, to place it with some other institution, or to manage it ourselves. But none of us would beguile ourselves with the thought that the trust relationship would be a happy and successful one if only we were to bring in our own firm of auditors to verify the bank's assets and liabilities, or our own comptroller to make its annual budget, or to approve the trust department's payroll and expense vouchers. The source of our uneasiness in the situation would be so grave, so entirely fundamental, that it simply could not be remedied by such mechanical devices.

Now, the Federal Reserve System in its management of the Nation's money supply is the repository of what is probably the greatest trusteeship in the world's history. It has certainly the greatest fiduciary responsibility ever granted by the Congress. If this System, established and articulated with scrupulous care, which itself possesses the highest sense of money accountability, with auditors and independent counterauditors checking each other, cannot now be trusted in the management of its privy purse, so that it must be set upon by still further auditing, then we have, in a sickening plunge, descended from the sublime to the ridiculous.

So, if I had the honor to be a member of this subcommittee, I would reflect that, if I did not have the time to check on the work of the System's auditors or its budgeting, cost control, and operating efficiency, neither would I have the time to check the judgment and competence of another auditor who audited the System's auditors. I would reflect that confidence must ultimately be reposed at some place as the only possible alternative to the impossible alternative of not reposing confidence at any place.

If I believed that the System were reckless, imprudent, or inefficient in the management of its household, I would check the evidence with as much care as I could muster. If the belief still seemed reasonable, I would vote to remove and replace the officers guilty of the misfeasance, or I would vote promptly to abolish the trust. These, I admit, are harsh alternatives. But I would urge that in the premise there is simply no other way out, for there is no possible ultimate reconciliation between great trust of men deemed worthy of great trust and niggling mistrust of the same men. I would want to be neither soft-hearted nor soft-headed enough to imagine that so inconsistent a relationship between the Nation's central bank and its congressional sponsor could be happy or long endure.

Consistency of relationship is fundamental. I think of it all in very homely terms, in terms related to the management of my own household. Just as the Congress established the Federal Reserve System with great care, so I chose my wife with great care. She has had the very greatest responsibility in the management of our joint affairs. She keeps a good set of books, which balance out every month, and, if a dime is missing, pursues it over the hill and dale until it is tagged and accounted for. We sit down together every so often to ask ourselves how we are doing, if we have saved any money, where the money is going, whether we can afford a new paint job on the house, and so on. We shake our heads gravely at the high cost of living and make economies where we can.

I must confess that we have not always been wholly in agreement. There have been a few times when she has bought a lipstick or a bonnet that I did not think she needed. There was a time once when I spent a little more money at the circus than she though was wholly necessary under the circumstances. Still, should I now say to her, "My Dear, you are a magnificent bookkeeper. I trust you to manage our house and to rear the children. Your advice to me has usually been excellent. But, now, I want to put an auditor on your books because I haven't got time to go over them, and I want to know whether you have accounted honestly for that $71.29 that you spent for groceries last month; and I especially want the auditor to find out why in the world you bought tomatoes when the paper says that turnips are so cheap. * * *" Could I address my wife in that way? Well, frankly, no. If I say, "You are competent and capable and I trust you, but I don't trust you, and I am going to get an auditor," at this point I have destroyed the whole basis on which the household functions. I must then assume full responsibility for the household and take over its management myself * * * or get a new manager.

So this homely illustration describes what I believe to be the long-run wise and proper relationship of the Congress to the housekeeping of its central bank. The Federal Reserve System is of the household of Congress. It must be cherished and dealt with in a spirit of candid and friendly association, or cast out, and, then, if dealt with at all, dealt with as a total stranger, quite at arm's length. The two of us should ask ourselves how our monetary policy is getting

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along. We should explore together, officials of the System and members of the Congress, the questions of our expenses. The questions could be about little things. Wouldn't taxis be cheaper? We see that we spent a lot of time selling defense bonds. Was that a profitable use of our time or were we a little out of our bailiwick? Or they could be about big things. Is our check collection system really necessary? How do we conduct a cash audit?

I think that in the process of canvassing together our problems of policy and expense, all in a spirit of candor, as would be done in a well-managed household, we shall achieve the happiest, most satisfactory relationship, and, by all odds, the greatest operating efficiency. I like the sort of thing this subcommittee has done. Maybe it is too big to be done every year. Maybe we should occasionally spend more time in going over together just how we do things and why. I think that would be helpful to all of us. Certainly, the questions asked of the System and its answers in these hearings have been in the right spirit and have illustrated the right association between people who are and, I think, must be of the same household.

If it were said to me, as a member of this subcommittee, that I could not support such a relationship because I was not an expert in bank operations or in auditing, I should not be troubled at all. I would reflect that the questions of the amateur are often more searching and revealing than the questions of the so-called expert. I would also reflect that the ability to explain clearly is often the test of whether or not a man knows what he is about. So I would be comforted with the thought that my questions would find their mark and fulfill their purpose.

May I conclude by saying how greatly I would appreciate a visit to the Federal Reserve Bank of Atlanta by any member of this subcommittee or of the Congress. I am proud of the shop, of the effective and efficient way in which it is run, of the service it performs, and of the hard-working men and women who devote themselves to it. I am proud of its board of directors. I will try to see that every question is answered clearly. The directors, I am sure, will be glad to have their auditor show just how he goes about his work.

Senator DOUGLAS. The next witness is Mr. Carrol Shanks, who is the chairman of the joint committee on inflation control of the Life Insurance Association of America and American Life Convention; who is also president of the Prudential Insurance Co. which, I must add, likens itself to the Rock of Gibraltar. Mr. Shanks was formerly a professor of law at Yale University, and formerly a member of the law firm of Root, Clark, Buckner & Ballentine.

All right, Mr. Shanks.

Mr. SHANKS. Senator Douglas, shall I proceed with my statement, sir?

Senator DOUGLAS. Well, time is short, and I wondered if you would submit your statement for the record and then briefly, if you would be willing, to talk off-the-cuff in summarizing it.

Mr. SHANKS. I can, if you wish. Of course, I would like to read my statement if I could.

Senator DOUGLAS. Our trouble is that it is now 5 minutes after 12. We are going to reconvene at 2:30. If you would prefer, we can defer your statement until 2:30, when Mr. Powell will also testify. We got so absorbed in the first witness that I am afraid we took more time than we had planned. I do not think we have quite enough time now for you to go into the statement in detail, so that if you would prefer to postponing your appearance until 2:30, that will be all right.

Mr. SHANKS. I would be glad to do that, sir, if it is agreeable.

Senator DOUGLAS. Well, suppose we convene then at 2:30 in this room.

Mr. SHANKS. All right.

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(Whereupon, at 12:05 p. m., a recess was taken, to reconvene at 2:30 p. m. of the same day.)

AFTERNOON SESSION

Representative PATMAN. The committee will please come to order. Mr. Shanks, come around, please.

STATEMENT OF CARROL M. SHANKS, PRESIDENT OF THE PRUDENTIAL INSURANCE CO. OF AMERICA, AND CHAIRMAN OF THE COMMITTEE ON INFLATION CONTROL OF THE AMERICAN LIFE CONVENTION AND THE LIFE INSURANCE ASSOCIATION OF AMERICA

Representative PATMAN. It is my understanding, Mr. Shanks, that you were presented by Senator Douglas before the session ended at noon.

Mr. SHANKS. Yes, sir; I was, Mr. Chairman.

Representative PATMAN. And you are now ready to continue.

Mr. SHANKS. Yes, sir.

Representative PATMAN. We shall be very glad to hear you in any way you desire.

Mr. SHANKS. Well, I would like to give a statement which is not too long, and then answer any questions you wish to ask.

Representative PATMAN. All right, sir. We will be glad to hear you. You may proceed.

Mr. SHANKS. I want to make it clear that I am here as a representative of the life-insurance business—and not as the president of the Prudential Insurance Co. of America. We conceive that it is our duty to speak in behalf of 86 million life-insurance policyholders on the matters being considered by your committee. These matters go to the heart of the inflation problem and we welcome an opportunity to be heard.

Life-insurance contracts are paid in dollars, and policyholders, beneficiaries—often widows and orphans—are looking to their life-insurance dollars to protect their families. The policyholders believe they are entitled to expect their Government to stabilize the buying power of those dollars so that the protection they are counting on in their insurance dollars will be there in terms of what the dollars will buy when the money is needed. The fact is, however, that our policyholders are being robbed of the protection they thought they had in their insurance, just as all persons receiving a fixed income are being robbed.

Our business is a human business. Our interest is in the families of America. The life-insurance agents are seeing these families—many thousands of them every day—and we hear what policyholders are saying about the American dollar and the way it has lost its value in the shops and stores. There is no need for them to read the statistics that are published. They know from experience what has happened over the last 10 years to the cost of living—and to their life-insurance protection on which they counted.

Even the great increase in the amount of life-insurance protection in recent years has not kept up with the decline of the purchasing power of dollars. On the surface it might appear that an increase in

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life-insurance protection from $122 billion at the end of 1941 to $253 billion at the end of 1951, a rise of 107 percent, is a great achievement in increasing family protection. But it must be remembered that in terms of prices prevailing in 1941 the real buying power of the total of life insurance in force today is $148 billion, which means a real increase of $26 billion over 1941, or 21 percent. That is as compared to 107 percent. This is not the whole story, however. The number of families in America has greatly increased. While the average amount of life insurance per family in the United States has increased from $3,400 at the end of 1941 to $5,600 at the end of 1951, the decline in the purchasing power of money has wiped out the effect of increase of insurance protection per family. So serious a decline has taken place during the past 10 years that the real purchasing power of life insurance in force per family today is $3,272, or a loss of $128 since 1951.

Officers of life-insurance companies are trustees of the funds of 86 million policyholders—more than one-half the people in the United States. As trustees for so many people, we feel our responsibility very deeply—to speak out strongly against inflation that defeats the purposes for which they took out their insurance.

This committee has wisely recognized the importance of general credit-control policies and debt-management policies in dealing with this problem. Your inquiry into these things—and the responsibilities of the Federal Reserve System and the Treasury in formulating and carrying out these policies is important to life-insurance policyholders. What Congress does in this field is of great concern to them.

There are five matters that I want to discuss:

(1) The objectives of our national economy;

(2) The respective roles of the free market and Government in pursuing these objectives;

(3) Monetary and credit policies consistent with these objectives;

(4) Public debt management policies consistent with these objectives; and

(5) The relationship between the Federal Reserve System and the Treasury.

Most of what I have to say will deal with the last three subjects; namely, credit and public debt management policies and the relationship between the Federal Reserve System and the Treasury. However, these subjects can be best dealt with only by first considering briefly the objectives of our national economy along with the roles of the free market and Government in working toward these objectives.

THE OBJECTIVES OF OUR NATIONAL ECONOMY

Our national economic objectives, as I see them, are as follows:

(1) Strengthening of our national defenses against the forces of tyranny which threaten the free world.

(2) Stability of employment of our national resources, including manpower, and stability of the general price level under conditions of general economic prosperity.

(3) A continuing advance in living standards. This advance is to be achieved in the main by increasing our national capacity to produce through the investment of savings and the further development of labor skills. Over the years our free market economy has made

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phenomenal strides toward higher and higher living standards, and we should seek a climate favorable to further economic progress.

(4) The preservation and strengthening of the freedom of individuals—both economic and political freedom. This means the preservation of democracy in both its political and economic aspects. In many respects this is our basic objective, and all too frequently we lose sight of it.

These are the major goals of our national economy, on which I am sure there is little disagreement. The crucial question is how our national economy should function to achieve these objectives.

THE RESPECTIVE ROLES OF THE FREE MARKET AND GOVERNMENT IN OUR NATIONAL ECONOMY

I think you will agree that primary reliance for the sound functioning of our national economy should be on individual initiative, competition, and the free market place. These are the things that have made this Nation great. We must avoid doing anything to destroy them. The pricing system under free markets is by far the best way to get our national resources directed to the most productive uses in response to consumer demands based on freedom of individual choice. Realistic students of political economy are coming to realize more and more the the world over that reliance upon the law of supply and demand operating freely in competitive markets, rather than on a Government-managed economy, is our best guaranty of political and economic freedom.

The role of Government in our economy should be to create an environment in which the forces of free competition can work effectively without wide and sudden swings in business activity. Business fluctuations that are moderate and gradual are, in any event, a price we must pay for a dynamic economy capable of growth in productive capacity and great improvement in living standards.

In playing its part in the maintenance of stable, prosperous conditions, the Government should influence the economy in an indirect, impersonal way so that it will bear as lightly as possible upon individual freedom. Direct controls, such as those over wages and prices, are an artificial interference with free markets. They deal merely with the symptoms of inflation without getting at the basic causes. No doubt, they are needed as an emergency measure but they should be imposed only in a great emergency similar to all-out war conditions and should be removed as soon as the emergency is ended.

What are some of the functions which the Federal Government can properly perform in the light of the foregoing? For one thing, it is desirable for the Federal Government to determine its budgetary policy so as to avoid aggravating business fluctuations. For another, the Federal Reserve System can effectively utilize general credit-control measures to influence the money supply in the interest of economic stability and a more stable unit of value. A third area in which the Government can be of aid is in the field of public-debt management, where it can also take steps to manage the national debt in a manner to contribute to stability and prosperity.

It should be reemphasized that the influence of Government in these areas can be effective in an indirect and impersonal way consistent with the preservation of individual freedom. To accomplish the de-

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sired objectives, the use of direct controls and detailed regulations by Government generally is not necessary at all.

So much in the way of background. I would now like to apply the principles I have been talking about to the main areas of this investigation, namely, credit and debt management policies.

THE USE OF MONETARY AND CREDIT POLICIES

If monetary and credit policies are to be used successfully in working toward the objectives which have been outlined, they must be employed with flexibility. This means that under conditions of inflationary pressure they should be used to check the expansion of and to reduce the money supply and the availability of credit. On the other hand, in a period of recession they should be employed to ease the supply of money and credit.

In selecting the tools to carry out a flexible monetary and credit policy, main reliance should be placed on the general credit control powers of the Federal Reserve System, namely, changes in open market operations, changes in reserve requirements, and changes in the rediscount rate. Such measures as these have the great advantage that they are general in application and impersonal and indirect in nature and thus do not interfere unnecessarily with free decisions by individuals. Moreover, they can be used promptly and effectively in checking an overexpansion of credit.

The most generally useful of the general credit control powers is open market operations—that is, the purchase and sale of Government securities by the Federal Reserve System. Purchase of Government securities by the Federal Reserve tends to inflate the money supply because it increases the reserves of the commercial banking system, which in turn opens the way to a multiple expansion of bank credit. Conversely, when the Federal Reserve sells Government securities, there is a contraction of commercial bank reserves and a multiplied contraction in the extent to which banks can lend money.

During a period in which restraint on total lending is necessary in order to avoid widespread bidding-up of commodity prices, it is therefore of great importance that the Federal Reserve should not be pumping additional reserves into the banking system. Yet, this is just what it would be doing if it undertook to support Government bond prices at par (or at any other fixed level) during an inflationary period.

The unpegging of Government securities prices in March of 1951 has in my opinion proved to be a very sound step. The Federal Reserve System's support of Government securities prices, at fixed levels above par, in the postwar period prior to March of 1951 had led to a substantial increase in the money supply. This was a potent source of inflationary pressure. Advocacy of this policy was based to a considerable extent on the grounds that to permit a decline in the prices of Government securities would necessitate higher interest rates on subsequent Treasury financing, and would thus increase the already heavy interest burden of our national debt. As has been pointed out many times, it is exceedingly short-sighted to economize with respect to the interest burden on the debt, if, at the same time, such a policy feeds the fires of inflation, thus increasing the cost of goods and services to everyone including the Federal Government.

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The pegging of Government securities prices prior to March of 1951 had the following serious disadvantages: (1) It prevented the Federal Reserve System from exercising proper general credit control over the money supply in the interest of general economic and price stability; and (2) because it did prevent the effective use of general credit controls, it led to the premature and possibly unnecessary adoption of direct price and wage controls.

The unpegging of Government securities prices by the Federal Reserve System was followed by the exercise of its powers to control the money supply through the use of general credit control measures. It reopened the interplay of market forces in the capital markets and thus obviated or reduced the need for direct measures of control or selective credit control measures. The moderate decline in Government securities prices since the unpegging operation has had an important effect toward reducing the availability of credit and thus has aided in dampening inflationary pressures.

All of these things have been accomplished without the chaos in the capital markets which many predicted would occur if Government securities prices were unpegged. On the contrary, changes in Government securities prices have been moderate, due largely to natural market adjustments. As Government bond prices declined, market demand for Governments was stimulated by the more attractive yields, and the selling of Governments was discouraged. Thus, competitive market forces gradually led to relative stability in Government bond prices even without Federal Reserve purchases except to keep the market orderly.

The abandonment of rigid support of Government securities prices does not require that henceforth the Federal Reserve System must keep out of the Government securities market. It is perfectly proper and desirable for the Federal Reserve System to be a participant in the Government securities market, both to keep the Government securities market orderly to prevent too rapid swings and also to carry on open-market operations to influence the money supply in the interest of economic stability. However, supply-and-demand forces should be permitted to exert their influence. With the national debt large and widely held, relatively small changes in Government securities prices can have significant effects with respect to the availability of credit.

PUBLIC-DEBT MANAGEMENT POLICY

May I say a few words now about the use of public-debt management policy, again keeping in mind the economic objectives which were outlined earlier.

One of the questions raised in this inquiry is what sort of public-debt management should be followed in an inflationary period. In considering this question it is my firm belief that in an inflationary period the Federal Government should avoid any deficit financing if it can. But if deficit financing simply cannot be avoided because of the requirements of national defense and because taxes cannot be further raised without destroying incentives, then any new borrowing by the Treasury should be from nonbank sources through the issuance of long-term debt attractive to individuals and savings institutions. Beyond that it would be sound policy for the Treasury to make a serious effort to fund a portion of the short-term debt held by the

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banking system and to place it in the hands of individuals and savings institutions.

I turn now to another matter with respect to public debt management which is basic in this inquiry. Several of the questions raised in the joint committeee print, Questions on General Credit Control and Debt Management, asked whether public debt securities should be insulated from restrictive credit policies and also whether the Treasury should adopt compulsory methods in the sale of Government securities. The very suggestion that there need be any compulsion in the sale of securities of the Government with the strongest credit in the world is distasteful to me. It is my firm conviction that, if public debt management is to be carried out in a manner consistent with the objectives which I have outlined, Government borrowing should at all times meet the tests of the market place. This means that Government securities should carry terms making them competitive in the capital markets at any given time. I do not believe that it would be desirable or practicable to try to insulate public debt securities in any way from the impact of restrictive credit policies. Such insulation, if possible of achievement, could be realized only through the use of direct controls in the capital markets. If we are to have real debt management in an economy which relies fundamentally on free markets, the Treasury should also subject itself to the market place.

It goes without saying that I do not believe there are any conditions under which it would be desirable for the Treasury to resort to compulsory methods in the sale of Government securities, whether it be to banks, savings institutions, corporations, or individuals. Compulsion was unnecessary in marketing the Federal debt even during World War II, and it is inimical to our basic freedoms.

Another point which I would like to make is that the level of interest rates borne by them exerts a strong influence on the demand for Government securities. It has been popular until recently to argue that the interest rate has very little effect upon the demand for Government securities. In spite of this, I am confident that a rise in the average annual yield of series E savings bonds to a rate somewhere between 3 and 3½ percent would significantly increase the amounts sold and significantly diminish the amounts of early redemptions. Likewise, a rise to competitive levels in the interest rate paid on long-term marketable Government securities would increase sales to nonbank investors in spite of the heavy demand for capital on the part of expanding defense and defense-supporting industries.

Finally, in the area of public debt management, I would like to give you my views on the recurring proposal for issuing a Government bond, the value of which would be guaranteed in terms of purchasing power. The issuance of such a bond would be not only most unsound, but would have dangerous or even disastrous consequences for the following reasons: (1) It would place other forms of fixed interest investment at a decided disadvantage, and would jeopardize their continued existence; (2) it would lead to a collapse in the value of outstanding investment media; (3) it would leave the Federal Government with an open-end commitment with respect to the Federal debt; (4) it would add another "escalator clause" to the rapidly growing list in our economy and would thus contribute to the expectation of further inflation; (5) it would attack the will of the American

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people to resist inflation; and (6) it would be a confession by the Federal Government of an inability to cope with the forces of inflation by sound and vigorous measures, and would thus contribute to the expectation of further inflation.

May I turn now, finally, to the question of the relationship between the Federal Reserve System and the Treasury which has been mentioned earlier, and which is one of the focal points of this inquiry.

RELATIONSHIP BETWEEN THE FEDERAL RESERVE SYSTEM AND THE TREASURY

In the first place, I believe that it is desirable to have generally consistent monetary, credit and public debt management policies. The desirability of this general consistency immediately raises the question of whether or not the Federal Reserve System should be brought under the control of the executive branch of the Government. I am convinced that it would be against the public interest to take such a step.

Under the Constitution Congress is given the power to regulate money. In passing the Federal Reserve Act of 1913, and later in amending it in the Banking Act of 1935, Congress acted wisely in establishing the Federal Reserve System on a basis which would give it a responsible but nonpartisan control over credit. In many respects Congress applied the principle of separation of powers in setting up the Federal Reserve System. The Federal Reserve Board was made independent of the executive branch of the Federal Government. Although members of the Board are appointed by the President, with the advice and consent of the Senate, their tenure of office and the order of expiration of their terms of office are so arranged as to minimize the immediate and direct pressure which the Administration or outside interests can bring to bear upon them. The terms of Board members are in this sense like those of some judicial offices. In order to remove considerations which may destroy their objectivity, their terms are for 14 years and they may not be reappointed after having served a full 14-year term.

Furthermore, in the original act the Secretary of the Treasury and the Comptroller of the Currency were made ex-officio members of the Board, but in the Banking Act of 1935 their positions on the Board were eliminated in order to avoid the possibility of undue Treasury influence on monetary policies. I think hardly anyone would quarrel with the proposition that the formulation of monetary and credit policy must be kept free of partisan pressures. To this end, it seems to me the public interest requires that the Federal Reserve must function as a responsible but nonpartisan agency.

There are several weighty reasons why the Federal Reserve should have the responsibility and initiative for determining monetary and credit policy within the framework that Congress has laid down for the Federal Reserve. For one thing, it is equipped to do the job by long experience and familiarity with monetary and credit problems, and it has the aid of an exceedingly well qualified economic research staff. Beyond that, and more important, the Federal Reserve is not biased in its decisions with respect to monetary and credit policy by the direct responsibility for the fiscal roblems faced by the Treasury. If control over monetary and credit policy were to reside in the executive branch of the Government, it is all too likely that the needs of the Treasury would dominate this policy, and there might well be a ten-

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dency to fall into an easy money policy to support Government spending and a perpetual inflationary bias. On the other hand, a Federal Reserve System removed from direct political pressures can take a longer and more comprehensive view of monetary and credit policies needed in the public interest.

The suggestion of bringing the Federal Reserve within the executive branch of the Government runs counter to the whole idea of separation of the central banking system from changing administrations, and it compounds the error of burdening the President with too many responsibilities in areas where a background of technical competence is essential. It would lead either to bottlenecks in arriving at decisions, or to decisions actually made by staff members having no direct responsibility to the Congress. In practice, it would probably place the Federal Reserve under the Treasury or under some other agency such as the Council of Economic Advisers.

But, if the Federal Reserve System is to retain the responsibility and initiative for determining monetary and credit policy, there still remains the problem of the proper relationship between the Federal Reserve and the Treasury. The big question is whether new legislation of some sort is required.

I am convinced that as matters now stand, no new legislation is needed. The quality of the relationship between the Federal Reserve and the Treasury depends fundamentally upon the quality of leadership in these two agencies, along with a willingness to hold a frank exchange of thinking on mutual problems at frequent intervals. It seems to me that during the past year both Federal Reserve and Treasury officials have shown a high quality of leadership and flexibility of mind. A new relationship has developed between the two agencies which has been founded on regular discussion of their mutual problems. This new spirit, which has not required the surrender of principles by either agency, has been developing with such promise for satisfactory relations that it would be my recommendation that no legislation is now needed.

If it should become clear that legislation is required, my preference would be for action along the lines of a congressional directive containing general instructions to the Federal Reserve and Treasury regarding the objectives of monetary and debt-management policies. Under such a directive, responsibility for regulating the supply, availability, and cost of credit in general should be placed in the Federal Reserve System, and Treasury actions in this field should be made consistent with the policies of the Federal Reserve.

SUMMARY

In conclusion, the points I have made may be summarized as follows:

(1) The ground covered in this inquiry goes to the heart of the problem of inflation. As trustees of the funds of 86 million policyholders who are being robbed by inflation, the officers of life insurance companies feel a responsibility to present their views.

(2) The questions raised in this investigation can be answered more intelligently if they are examined against the background of the broad economic objectives toward which our national economic system should be working. These objectives are (*a*) to strengthen our

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defense against the forces of tyranny, (*b*) to maintain stability of employment of our national resources and stability of the general price level under conditions of general economic prosperity, (*c*) to maintain a continuing advance in living standards, and (*d*) to strengthen and preserve political and economic democracy.

(3) In working toward these objectives primary reliance should be upon individual initiative, competition, and the free market place. Where Government intervention is necessary, it should be exerted in an indirect, impersonal way so that it will bear as lightly as possible on individual freedoms.

(4) Monetary and credit policies should be employed with flexibility—they should be free to check expansion of and reduce the money supply under conditions of inflation, as well as to ease the money supply in a depression. Main reliance should be on general credit controls because they are impersonal and indirect in nature and can be fully effective without bearing heavily on individual freedom.

(5) In managing the public debt and in floating its debt the Treasury should meet the tests of the market place and should offer securities carrying terms making them attractive in the capital markets at any given time. Compulsory sales of Government debt or insulation of the public debt in any way are unsound.

(6) There is a need for general consistency between Federal Reserve and Treasury policies, but it should not be accomplished by placing the Federal Reserve System under the executive branch of the Federal Government. The maintenance of a nonpartisan Federal Reserve responsible to the Congress is of vital importance for the preservation of a stable price level. New legislation is not needed for the present to insure general consistency between Federal Reserve and Treasury policies.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. I have no questions, Mr. Chairman.

Representative PATMAN. Mr. Shanks, I find myself in agreement with you unless I receive some testimony that changes my mind and up to now I have not heard anything in that direction, about compulsory selling of Government bonds. I certainly think that should be out of the picture and I do not know of anyone that has insisted upon it and it should certainly never have come to pass.

The other thing that I am in agreement with you about is what you said about the sale of bonds that have a guaranteed purchasing power, for the reasons that you stated, and I think that we could add to that some reasons.

I am convinced that that would not be a good thing, although, as I said awhile ago, I try to maintain an open mind on these things and I am willing to listen to any reasonable argument, but right now I find myself thoroughly in agreement with you on those two points.

You mentioned something about a stable dollar. You state here:

> The fact is, however, that our policyholders are being robbed of the protection they thought they had in their insurance, just as all persons receiving a fixed income are being robbed.

Now, of course, the word "robbed" is a rather strong word in the sense that we generally refer to that word, in what we generally consider the word to mean.

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But, what kind of a dollar would you have? The present dollar is often compared to the dollar in 1939. If it were within your power now to fix a stable dollar, what value would you place on that dollar?

Mr. SHANKS. If it were within my power now, Mr. Patman, to fix a stable dollar, I would not attempt to roll it back to 1939. I would try to hold it exactly where it is and then over the years, through increased production, I would hope to see generally lower prices. But, I would not attempt to push the dollar down, roll it back. I think that roll-backs are, you might say, impossible and not workable.

Representative PATMAN. Well, we found out during World War II that there was not a satisfactory way to roll back prices.

Mr. SHANKS. That is right.

Representative PATMAN. There is just no satisfactory way to do it. So, you think by increased production, increased skills, and things like that, you could stabilize it like it is now and over the years, probably a decade or two, it would work out all right?

Mr. SHANKS. If you could lower the prices over the years so they would be in line with lower production costs.

Representative PATMAN. Yes. What do you think about the policy set forth in the Employment Act of 1946?

Mr. SHANKS. I am in agreement with the policies that are set forth.

When I say that, I read this into the policy declaration, namely, that there should be stability of the dollar.

You speak of full employment and I assume that means full employment which is compatible with avoiding ever-continuing inflation, and when we speak of the public welfare——

Representative PATMAN. If I recall correctly, the original bill used the phrase "full employment" but there was a lot of opposition to it, a lot of arguments against it, and finally the words "maximum employment" were used instead, in the declaration of economic policy to which I refer.

Let me have the act, and we will just read it over:

> 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 of 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.

So the phrase "maximum employment" is used.

Mr. SHANKS. That is right.

Representative PATMAN. I notice in your statement here that you state on page 15 that these are the objectives:

> (*a*) To strengthen our defenses against the forces of tyranny;
> (*b*) To maintain stability of employment of our national resources and stability of the general price level under conditions of general economic prosperity;
> (*c*) To maintain a continuing advance in living standards; and
> (*d*) To strengthen and preserve political and economic democracy.

Although you do not say so directly there, I assume that you mean by that to maintain stability of employment of people.

Mr. SHANKS. Oh, yes, by all means.

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Representative PATMAN. Well, the phrase you used here in the sentence was "To maintain stability of employment of our national resources."

Mr. SHANKS. That is correct, Mr. Patman, but this is a summary. I spoke of it more fully in the body of my statement.

Representative PATMAN. Oh, pardon me. I am glad to get that explanation.

Mr. SHANKS. As a matter of fact, I think our most important resource is our working force.

Representative PATMAN. Certainly, and we must keep them employed or we must afford them some way of having purchasing power or our whole economy will go down. We witnessed that in the low period of our depression days.

Mr. SHANKS. That is right.

Representative PATMAN. Yes.

Mr. SHANKS. Mr. Patman, you were speaking of the Employment Act of 1946. May I say there is a very good statement—an excellent one—in the Defense Production Act of 1950, along the same line. We, of course, have that in mind, too.[1]

Representative PATMAN. Yes, sir.

Mr. SHANKS. That speaks more specifically of maintaining the price level, but I think it is just as implicit in the act of 1946.

Representative PATMAN. It should be read into that, I agree, and I think several of the witnesses mentioned that and I thoroughly agree. I had something to do in the discussions before the committee on the Employment Act of 1946 and that was written at a period when we were scared to death about a possible deflationary period right after the war.

Mr. SHANKS. That is right.

Representative PATMAN. The hearings on that bill were held, I think, in 1945, most of them before the war was over, and we were all scared.

As you know, many of the greatest economists in the country and the greatest financiers were telling us that we were sure to have a depression, that after every major war, every country always had a depression and we might just as well look forward to it. So, in writing that act, we had that in mind. In other words, we wanted to build up something in the way of inflation or expansion rather than deflation, and it was being considered from that standpoint.

Mr. SHANKS. That is right.

Representative PATMAN. And that is the reason the specific language probably was not written in there, but I certainly know they had in mind a stable dollar, of course, because without a stable dol-

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[1] Defense Production Act of 1950, sec. 401. There Congress was enacting price controls and wage controls, and Congress stated:

"SEC. 401. It is the intent of Congress to provide authority necessary to achieve the following purposes in order to promote the national defense: To prevent inflation and preserve the value of the national currency; to assure that defense appropriations are not dissipated by excessive costs and prices; to stabilize the cost of living for workers and other consumers and the costs of production for farmers and businessmen; to eliminate and prevent profiteering, hoarding, manipulation, speculation, and other disruptive practices resulting from abnormal market conditions or scarcities; to protect consumers, wage earners, investors, and persons with relatively fixed or limited incomes from undue impairment of their living standards; to prevent economic disturbances: labor disputes, interferences with the effective mobilization of national resources, and impairment of national unity and morale; to assist in maintaining a reasonable balance between purchasing power and the supply of consumer goods and services; to protect the national economy against future loss of needed purchasing power by the present dissipation of individual savings; and to prevent a future collapse of values. * * *"

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lar the whole economy is unstable, and I think you are right in considering that language in connection with it.

Mr. SHANKS. I remember in 1945 everyone was working and had lots of money to buy insurance but the insurance sales were not nearly as high as might be expected.

Why? Because although they were all working and had lots of money, they were all scared that next year they would be out of work. Then, when next year came around and they still had their jobs, then the insurance sales reached an all-time high.

Representative PATMAN. And if the Employment Act of 1946 did just a little something to create an atmosphere and climate that would cause people to buy insurance and other things that tend to make people feel more secure and thereby prevent this devastating depression that most people saw before us, then it was certainly worth while, do you believe?

Mr. SHANKS. Yes, certainly.

Representative PATMAN. And it has made a little contribution in that direction.

Mr. SHANKS. I think it might have.

Representative PATMAN. Now, the Federal Reserve was something that was created by Congress and they are not under the executive branch of the Government, there is no question about that. You mentioned how bad it would be for them to be under the executive branch.

I agree that it would be wrong for the executive to have any kind of a push-button control of the Federal Reserve or be able to compel them to do or not to do anything about lending.

That same thing I think should apply to Members of Congress. I do not think there should ever be a time when Members of Congress or committees of Congress should ever attempt to compel the Federal Reserve System to make loans or to change their policy toward commercial banks or have the commercial banks making loans which are contrary to its policy. That is out of our field. We delegated that to somebody else and we should leave it there.

But, I just wonder about this baby that Congress created back in 1913. After all, it was not written by any bureaucrat downtown and sent up here. It was conceived in the minds of Members of Congress.

Mr. SHANKS. That is right.

Representative PATMAN. With the help of the people on the outside, like insurance executives and lenders and the banking fraternity. But it was conceived right here in Congress and passed by both Houses by an overwhelming vote and signed by President Wilson and it became law, I believe, 2 days before Christmas in 1913.

Now, that was a very small congressional baby at that time but since that time, over 38 years, it has become quite a big baby, it has grown and its activities expanded. I do not know whether they have expanded as much as some of the bureaus of the Government have or not, nor do I know whether they are trying to get more power like the bureaus of the Government, but it is kind of natural for people to keep all the power they have and reach out for more and I suspect that is inherent in the Federal Reserve, just as in any Federal agency that we have.

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I do not know, but it is human nature, you know people do that.

Now, here we have an agency—how much money did the 12 banks spend? In 1951 the expenses were $95,000,000—$95,469,000 to be exact.

Now, their earnings were $394,656,000; but you realize those earnings, practically all of them, are from United States Government bonds, are they not?

Mr. SHANKS. Yes, in the main.

Representative PATMAN. So whenever you give an institution, an institution like the Federal Reserve System, the power over the United States Government's credit, the power to have money printed at the Bureau of Engraving and Printing and put it out like they do and like they should under existing laws and regulations and rules, you are giving them tremendous power.

In other words, you are giving them complete power over our monetary system and you are giving them the power to use that money to buy bonds, in other words to trade that non-interest-bearing obligation for an interest-bearing obligation which they keep, and when they keep that it goes into their earnings—in this case it is $394,000,000 which came practically all from interest on Government obligations.

So, the taxpayers are really interested in that, and you agree they should be interested, should they not?

Mr. SHANKS. They should be. Where did the $394,000,000 go to?

Representative PATMAN. The $394,000,000, well $95,000,000 of it last year went for current expenses.

Mr. SHANKS. Yes.

Representative PATMAN. And then they turned 90 percent of their net profits over to the United States Treasury.

Mr. SHANKS. Yes.

Representative PATMAN. That is the reason that all the money that is not spent, 90 percent of it through voluntary agreement—it used to be the law but it was changed—through a voluntary agreement the Government gets 90 percent, so that every dollar that goes into the Treasury that way, the less money the taxpayers have to pay, so naturally all taxpayers are interested.

Do you not think that an agency like that that has so much power, an agency of Congress, should be audited by the General Accounting Office just like all other Government agencies?

Mr. SHANKS. I think that if you start auditing an independent administrative agency, it should have an objective viewpoint as to our monetary system, that is the first thing, so as not to destroy independence——

Representative PATMAN. No, Mr. Shanks; Congress only can fix the objective. I mean only that the audit would be for what you might call normal purposes.

Now, I am not charging dishonesty on the part of any Federal agency or employee or any bank or anybody else.

However, usually it is a good policy to have audits and honest people do not fear them, of course, because they do not have anything to fear, and I am not saying that any of them would have anything to fear, and none of them is charged with anything, and I go anywhere down the line, from the highest to the lowest. But generally, as a matter of policy, it is a pretty good thing to have an institution like that audited.

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Mr. SHANKS. I would say that in this case, where the whole importance and the great importance to the country depends on an objective carrying out of the congressional policy, in the intricate day-by-day monetary policies, that audit of the Federal Reserve should be by someone other than an executive branch of the Government.

Representative PATMAN. When you really come right down to it, Mr. Shanks, what we are talking about now is the relationship of master and servant, Congress being the master and the Federal Reserve being the servant.

Mr. SHANKS. Yes.

Representative PATMAN. Also, it is the relationship of principal and agent. Congress is the principal and the Federal Reserve is the agent.

Now, why should the agent object to the principle of having the master audit them?

Mr. SHANKS. Well, of course, what you say is true, that no one is objecting to auditing as far as the question of honesty is concerned.

Representative PATMAN. That is right. That is No. 1.

Mr. SHANKS. But if it is the camel's head in the tent, to control their objective handlings of the things that Congress has given them to do, then of course——

Representative PATMAN. Well, I agree with you there, about controlling their objective, as you put it. I would be opposed to that.

Now, the General Accounting Office is not under the executive branch, as you know. It is an independent agency of the Government. So, it is not under the executive.

Now, not only as to honesty and things like that—that is not the only thing involved in auditing—the next thing to find out is whether they are branching out and getting into things into which they were never intended to get, and spending the people's money that was never intended and in violation of the spirit of the law.

You know, for instance, whenever a governmental agency expands, it gets into propaganda, and into everything else. You know that.

Mr. SHANKS. Yes.

Representative PATMAN. And they get clear out of line, you know, and not only on the verge or on the fringe, but they go overboard and get clear out of line.

Well, do you not think it would be well to have some independent agency check them now and then and see if they have gotten out of line?

Mr. SHANKS. Well, my fear would be that that would be some sort of an opening wedge to control this group which in its day-to-day operation of policy should be left independent.

Representative PATMAN. Well, how can you insist upon that being an opening wedge when all they are doing is just having an agency look over the books to make sure that the money is being honestly handled, to which I am sure there could be no objections, and to see that it is being spent according to the spirit and the letter of the law and according to our tradition?

Mr. SHANKS. Well, now, you mean this independent agency, the General Accounting Office, is to determine the letter—determine the spirit of the law?

Representative PATMAN. Well, to determine——

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Mr. SHANKS. Or determine whether it is in accordance with our tradition?

Representative PATMAN. No; they would not have any power to do anything except to point to Congress, the principal—in other words, the General Accounting Office would go in there and look them over and say, "Here is one Federal Reserve bank that is spending money in a certain way—one, two, three, or four—we believe that is a violation of the letter and spirit of the law."

And then Congress takes that.

They do not have the power to do anything about that—the General Accounting Office—they have no police power at all or no executive power at all. They have no way to harm or punish in any sense of the word, but they only point out to the principal and ask the principal, "Is this all right? Is that the way you wanted it done?"

Then the principal—the Congress—can pass on it.

Do you not think that is pretty reasonable?

Mr. SHANKS. Well, sir, I am not one that objects to outside audits. Certainly our own company is audited outside, and should be. We have outside examiners from eight State departments with us a year and a half out of every 3 years, so I am thoroughly in accord with it.

But I would certainly want to see any such law, or require in that law, that it should be double-riveted so that it is not the thing that I fear so much.

Representative PATMAN. I have an idea—in fact, I have justification for having the idea—that many of these banks are branching out in what a lot of people would call propaganda. They get out their own bulletins, they get out their own statements, they get out mimeographed releases just like the bureaucrats downtown get out, and they are spending Government money to that extent that I am telling you about; they are doing that.

Do you not think somebody should look over their shoulder to see whether or not they are keeping in line?

Mr. SHANKS. Could that not be done by law of Congress?

Representative PATMAN. Well, how could you pass a law if you do not even have the power over their expenditures? They do not even get their appropriations from Congress. They borrow on the bonds, which the Government allows them the privilege of doing, under the credit of the Nation; they keep those bonds and they draw interest and 90 percent of it they turn over into the Treasury. So Congress does not have charge of the purse strings. If it had charge of the purse strings, they could do something under the law.

Mr. SHANKS. Well, Mr. Patman, Congress could pass a law that restricted them in any way you saw fit.

Representative PATMAN. Well, I am quite sure you would be startled to find out how much money is being spent for purposes that you would agree are at least unrelated.

Mr. SHANKS. You may be right, Mr. Patman. You have looked into it.

Representative PATMAN. Unrelated. I think it would be very fine if the principal, the Congress of the United States, would let their own independent agency, the General Accounting Office, go in and examine their own agent, and I do not see where the agent can, with any good grace, oppose such examination.

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Of course, that is just one man's opinion. I do not see how they could, because we certainly want to keep them in line because they are our agency and they should want to be kept in line because they are just an agency, as they admit.

Mr. SHANKS. Yes.

Representative PATMAN. The other thing is about the appropriation from Congress. Why should not they turn this money in like other Government agencies do to the Treasury of the United States and then get their appropriations annually from Congress? Then Congress could really scrutinize their activities, not for the purpose of stopping them or directing them or giving them any guidance on monetary policies, but just to make sure that their agency is spending that money like Congress intends they should spend it.

And, you know, sometimes Congress changes its mind. This year they may be willing for certain expenses to be incurred, and next year they may not be willing for those same expenses to be incurred. Why should not Congress have that privilege over their own agency? Do you know of any reason why that should not be?

Mr. SHANKS. I am very much afraid that it would put the general over-all policies of controlling money and credit, which are so important and on which I place so much stress—it is really a semijudicial function—it would place them under partisan control by whatever party was in office at that time. It might be used for that purpose.

Representative PATMAN. Well, of course, if I had any fears of that kind, I would not think of it. But, you know, we have a Constitution and the Constitution was written by some pretty wise people, and it is the finest Constitution that the world has ever had.

It provided in this Constitution for the three branches of the Government, the legislative, executive, and judicial.

Now, the executive is an independent branch of the Government and yet it must get every dollar that it spends from an annual appropriation of the Congress of the United States, a legislative body, and that has not destroyed their independence, has it?

Mr. SHANKS. Well, that is a very broad question, I must say.

Representative PATMAN. All right, then I will give you a simpler question.

You mentioned semijudicial function awhile ago, so we will take the Supreme Court.

Mr. SHANKS. Yes.

Representative PATMAN. Every dollar that the Supreme Court or the judiciary of the country gets has to come from the Congress, they have to get the money from annual appropriations of Congress, and you have not heard of their independence being destroyed, have you?

Mr. SHANKS. No; quite to the contrary.

Representative PATMAN. Quite the contrary, that is right.

So, how could auditing do what you fear in the Federal Reserve System?

Now, what effect specifically did the accord between the Treasury and the Federal Reserve have on the Prudential's lending policy?

Mr. SHANKS. Well, sir, Prudential was a very special case—you are speaking now of Prudential?

Representative PATMAN. That is right.

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Mr. SHANKS. Prudential was a very special case. It did not have much effect upon our lending policies for this reason:

In the latter part of 1950 our commitments had grown to a point where we were concerned about them and felt we must be prepared to be in shape to meet them, no matter what happened.

We acquired a large number of Treasury bills and we had them on hand for the specific purpose of safeguarding against the commitments we had to meet in the mortgage-loan field.

When the accord came along we were in the position where we had a large amount of Treasury bills and those Treasury bills saw us through and we did not have to sell governments all during the year, I think, without exception or almost without exception.

Consequently, the fact that the governments have gone down 2 or 3 or 4 points had very little effect upon our lending policy.

Representative PATMAN. Well, now, you state that Prudential was a special case. Were the other companies special cases, too?

Mr. SHANKS. No. Some of them may have been almost in our position, but I think most of the companies were not in that exact position.

I think that the way it showed up was that for a period of a few months they went on meeting their commitments and then it began to taper off, and the losses on sale of governments had a restrictive effect upon their lending policy just as today it has a restrictive effect upon the Prudential's policy, because every time you have governments selling below par you think more carefully about making loan commitments when you have to sell governments and sell below par to meet them.

Representative PATMAN. What happens if some large borrower is in a jam and he has got to have money to carry forward a project that he is obligated to carry on and he is not only willing to pay the interest rate required by Prudential, but when a Prudential official like yourself informs him that you cannot do that because you would have to sell the bonds, at, say 3 points below par and he is willing to take that loss for you, what happens then to you if he offers to repay the loss?

Mr. SHANKS. We never have that case come up unless it is translated into the interest rate, Mr. Patman. In other words, it would be translated into an interest rate where we think it is to the advantage of our policyholders to sell the bonds and to make the loans.

As a matter of fact, we are at the present time in the position, of course, to make loans up to the extent of our current income and any increase in our assets plus any repayments we can reloan.

Representative PATMAN. What would that amount to normally per month or per year?

Mr. SHANKS. For the Prudential?

Representative PATMAN. Yes.

Mr. SHANKS. For the Prudential it amounts to $1 billion a year.

Representative PATMAN. $1 billion a year.

Mr. SHANKS. In the round figure.

Representative PATMAN. And what interest rate do you normally charge?

Mr. SHANKS. Well, at the moment we are getting—let me put it this way—in 1951 our over-all interest return was 3.28 percent.

Representative PATMAN. 3.28 percent.

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Mr. SHANKS. And you deduct the Federal income tax from that and it comes out 3.08, or 3.09, I think. We would get normally from 3½ to 4 percent as a gross rate of return.

Representative PATMAN. You mean now;

Mr. SHANKS. Yes.

Representative PATMAN. 3½ percent. Why did you increase the rates?

Mr. SHANKS. We increased the rates because we were able to get it and the market was bidding for it, gradually, after the accord.

Representative PATMAN. Did you sell some bonds below par to take the more favorable interest rate of 3½ to 4?

Mr. SHANKS. We have, some; yes.

Representative PATMAN. How low below par?

Mr. SHANKS. I do not know exactly—whatever the market was, around 97, I believe.

Representative PATMAN. The lowest, I believe, was 95²²⁄₃₂. I believe that was the lowest.

Mr. SHANKS. I do not believe we ever sold at that point. But, when the sales are now made, Mr. Patman, they are bought not by the Federal Reserve, but they are bought by universities, by trust funds, they are bought by corporations and by individuals.

In other words, it is a free market where people are buying them.

Representative PATMAN. Is the Federal Reserve supporting the market at 96?

Mr. SHANKS. I do not know. I do not think they are, I do not think they have to.

Representative PATMAN. It would take care of itself when it gets down to 96?

Mr. SHANKS. I am positive that it will.

Representative PATMAN. Would you recommend that the market be supported if it were to go below 96?

Mr. SHANKS. No, I would not recommend it. I think——

Representative PATMAN. How low would it have to go before you would recommend support?

Mr. SHANKS. It would have to go a lot more before I would recommend support but, of course, at all times the Federal Reserve should keep the market orderly.

Representative PATMAN. Well, suppose it went to 90?

Mr. SHANKS. I would not recommend support.

Representative PATMAN. Well, 80?

Mr. SHANKS. Well, now, it all depends. In the first place, going below par here has not had any dangerous or serious consequences in spite of all of the people that were crying death and destruction. The savings bonds of people are payable in cash, it has not affected their value, it was not the case of 1921.

Representative PATMAN. But, you realize——

Mr. SHANKS. Pardon me, and it is far better in a free market to take it down a considerable ways rather than turn around and start monetizing debt again by putting it into the Federal Reserve, and therefore I think the economy would be better served without any bad or particular repercussions by letting the price of government bonds go below 96, rather than by putting the debt into the Federal Reserve and monetizing it.

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Representative PATMAN. You realize there is a point below which you would support it?

Mr. SHANKS. Oh, yes; I think the Federal Reserve should if it were so bad.

Representative PATMAN. If it went to 90 you would support it?

Mr. SHANKS. I do not think so, at 90.

Representative PATMAN. At 80 you might?

Mr. SHANKS. I would take a very good look at what was happening and that is what their position should be, I think. They should take a good, hard look at the economy, see what was happening, what the repercussions were from it and when they should start something in the way of supporting the market and I would venture that the support should be only a small kind of support to keep the market in order.

Representative PATMAN. Did the open market committee buy any bonds above par?

Mr. SHANKS. Why, yes; during that period the open market committee bought great quantities above par.

Representative PATMAN. What was the reason for buying them above par?

Mr. SHANKS. Why, I understand just to peg the price so they would not go down——

Representative PATMAN. They bought them above par for that reason?

Mr. SHANKS. I am not sure, I am not expert on that, but they were on sale for a long, long while. If I am wrong, someone can correct me, but I think I am right.

Representative PATMAN. Would you like to ask some questions, Dr. Murphy?

Mr. MURPHY. Mr. Shanks, for a number of years before the accord, insurance company's holdings of United States Government securities had been continually declining?

Mr. SHANKS. Yes; that is right, they were selling them.

Mr. MURPHY. This decline continued with very little change in trend after the accord and for the last month for which figures have been published, November of 1951, the decline was still continuing.

Mr. SHANKS. The decline, as I understand it, Mr. Murphy—now, you have the figures, but as I understand the figures, the decline continued at about the same rate—when was the accord, in March?—and up to July and then it began to slow down very much, I believe.

Mr. MURPHY. In June the holdings were $17 billion. I do not have it for July. I am looking at the Federal Reserve Bulletin, the last issue, Page 178. In November, the holdings were $16,500,000,000 That is a decline of $500 million from July.

Mr. SHANKS. Yes. The figures cited by Mr. Murphy are taken from the Treasury Survey of Ownership of Federal Securities and cover 318 life-insurance companies and 609 fire and casualty insurance companies. Since the discussion relates to life companies only, it is appropriate to have a breakdown of their holdings. All data are taken from the Treasury Survey.

At the end of June 1951 the life-insurance companies held $8,227 million of marketable Government securities and $3,528 million of nonmarketable Governments. At the end of November 1951 they held $7,570 million of marketable Governments and $3,526 million of nonmarketable Governments. The decline in marketable Govern-

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ments in this period was, therefore, $657 million, and holdings of nonmarketable Government's were unchanged (the $2 million decline in nonmarketable Governments is probably accounted for by the fact that 319 companies reported to the Treasury in June and 318 in November).

Of the net reduction of $657 million in marketable Governments, $304 million were in the class "due or callable within 1 year" and represented a runoff of short maturities. Net holdings of marketable Governments in the class "due or callable in 1 to 5 years" increased $33 million; net holdings in the class "due or callable in 5 to 10 years" decreased by $130 million.

The pertinent class to consider is "not due or callable for 10 years and over," for it was in this category that Federal Reserve support purchases were concentrated in the months prior to the "accord." During the period from the end of June 1951 to the end of November 1951 life-insurance companies reduced their holdings of marketable Governments in this category by $257 million, or about $51 million per month. This compares with a net reduction of $896 million of marketable Governments in this category during the period June 30–November 30, 1950, or about $179 million per month. Thus it can be seen that the rate of reduction in life-insurance company holdings of Government bonds was much lower in the June 30–November 30, 1951, period than it had been in the same period in 1950 prior to the "accord."

I think that the life-insurance companies in the main—and I am speaking now in the main because I do not know what any particular company's position might be—but in the main are approaching the end of selling of their Governments and I think they are approaching the date, in my estimation, because in general, and again there might be exceptions, they are getting down to the point where they are reaching the minimum amount of Governments that they hold or need to hold in order to have a well-balanced portfolio.

I know the situation in Prudential. We feel there is a minimum below which, as prudent people, you cannot readily go without having readily marketable Governments in the portfolio, and I know that many companies are approaching that point.

So, I am sure the selling will dampen off as the companies get down to that point. That is, in addition, you see, to the question of selling below par, you have to make several points in order to sell them.

Mr. MURPHY. In what proportion do you think this was due to the fact that the holdings are getting down to the desirable minima and to what extent do you think it was due to changes in the money market as the result of the accord?

In other words, would this have occurred in any event due to the approach of a balance in the portfolio?

Mr. SHANKS. I think the levelling off will be longer and slower due to the fact of the lower selling price of the Governments. I think that has had an immediate effect. The companies are more careful and do not want to sell unless the loan is good and at a very good yield.

But it is also coupled with the fact if you have only $50 million to go, you will spread it out. I think it is a mixture of the two, but certainly I think the lower prices of the Government's played a big part.

Mr. MURPHY. This may be an unfairly precise way of putting a question, Mr. Shanks, but supposing there had not been an accord,

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that the old policy had continued, how much lower do you think the aggregate portfolio of United States Government securities by all insurance companies would be than it is now in the actual circumstances of the accord?

Mr. SHANKS. Well, it is too precise for me to answer, but I think there would be more companies who would have disposed of the Governments that they wanted to sell.

Mr. MURPHY. Perhaps $500 million in the aggregate?

Mr. SHANKS. I cannot say, but I am quite sure there would be more companies that would have sold out more quickly and would be right down to their minimums.

Mr. MURPHY. That is all.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. Just one question, Mr. Chairman.

Did the shortage of materials which came into the picture along in the early part of 1951, materials for housing and other community facilities, have an effect in cutting down the insurance company commitments about the same time that the accord came into the picture?

Mr. SHANKS. I do not think—when I answer, will you please bear in mind that there might have been special circumstances for certain companies which may specialize more in mortgage loans in various parts of the country, so it would be uneven and I cannot answer overall.

But, by and large, I do not think that the shortage of materials has had very much effect.

Now, we are one of the big mortgage lenders. We have always specialized in mortgage lending, I think more so than any of the large companies, at least, and it has had very little effect upon our lending.

Now regulation X, for instance, had an effect on speeding up lending because everyone was trying to get into the pipeline, to get in their commitments.

Then, when you get down to the materials—the shortage of materials—every effort has been made to keep the construction industry going so that they have not cut down starts as much as anticipated. I do not think the shortage of materials has had a large effect upon that.

Mr. ENSLEY. That is all, thank you.

Representative PATMAN. Mr. Shanks, I judge from your statement that you believe that removing the pegging, as it is often spoken of here, actually resulted in higher interest rates.

Mr. SHANKS. Yes, I do. I think it resulted in the lesser availability of credit which in turn resulted in a higher interest rate.

Representative PATMAN. Now, if I were an official of an insurance company like you are, I would want a higher rate than I had before.

Mr. SHANKS. Yes.

Representative PATMAN. And of course from the public interest standpoint you are in favor of removing the peg but at the same time, removing the peg helped raise the interest rates—which you favor, too.

Mr. SHANKS. Oh, yes. There is a selfish interest there, and I hope that you understand that interest is in behalf of our policyholders.

Representative PATMAN. Well, yes; and we can expect that in private enterprise. We all know that private enterprise is based on selfishness, up to a point.

Mr. SHANKS. That is right.

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Representative PATMAN. Up to the point where the public interest would be damaged or harmed, and then it should be stopped.

Mr. SHANKS. That is right.

Representative PATMAN. But we should always take care of ourselves and our businesses selfishly, up to that point.

Are there any other questions?

(No response.)

Representative PATMAN. Thank you very kindly, sir.

Mr. SHANKS. Thank you, sir.

Representative PATMAN. We will now hear Governor Powell. Gov. Oliver S. Powell, we are glad to have him here. He is a member of the Board of Governors of the Federal Reserve System.

STATEMENT OF OLIVER S. POWELL, CHAIRMAN, NATIONAL COMMITTEE, VOLUNTARY CREDIT RESTRAINT PROGRAM, AND MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ACCOMPANIED BY GEORGE B. VEST, GENERAL COUNSEL, BOARD OF GOVERNORS; ROBERT C. MASTERS, ASSISTANT DIRECTOR, DIVISION OF BANK EXAMINATIONS, BOARD OF GOVERNORS; CHARLES H. SCHMIDT, CHIEF, BUSINESS FINANCE AND CAPITAL MARKETS SECTION, DIVISION OF RESEARCH AND STATISTICS, BOARD OF GOVERNORS; AND HAROLD L. CHEADLE, SPECIAL ASSISTANT TO GOVERNOR POWELL, CHAIRMAN, NATIONAL COMMITTEE, VOLUNTARY CREDIT RESTRAINT PROGRAM

Representative PATMAN. You are in charge of the voluntary credit restraint program.

Mr. POWELL. Yes.

Representative PATMAN. And you were formerly first vice president of the Federal Reserve Bank of Minneapolis.

Governor Powell, do you have a prepared statement?

Mr. POWELL. Mr. Chairman, I have a statement which I would like to read and a supplement, which I believe has been furnished to the committee.

Representative PATMAN. I think so. Well, any way you would like to present it, Governor Powell, you may present it that way.

Mr. POWELL. I would like to read the formal statement and not refer to the statistical supplement unless there are questions from the committee.

Representative PATMAN. You want that put in the record?

Mr. POWELL. I would like that.

Representative PATMAN. Well, that is all right. You may proceed.

Mr. POWELL. And with your permission, Mr. Chairman, I would like to ask four of my associates to be present with me.

Representative PATMAN. Yes, of course. I will ask you to identify them for the record.

Mr. POWELL. Yes.

Here is Mr. George B. Vest, general counsel, Board of Governors.

Robert Masters, Assistant Director, Division of Bank Examiners, Board of Governors.

Charles H. Schmidt, Chief, Business Finance and Capital Markets Section, Division of Research and Statistics, Board of Governors.

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Mr. Harold L. Cheadle, an economist and my closest associate.

These gentlemen have worked very closely with me on this program and I may wish to refer some questions to them.

Mr. Chairman and members of the committee, it is a pleasure to appear before this committee to discuss the unique adventure in American finance known as the voluntary credit restraint program. A comprehensive statement as to this program appears as the answer to question No. 42 addressed to the Chairman of the Board of Governors of the Federal Reserve System and printed in the answers to the Patman committee questionnaire. This statement will, therefore, be confined to a few high lights and to more recent information now available to us as to the progress of the program. A companion memorandum of statistics and charts has been furnished to the members of the committee.

BEGINNING OF PROGRAM

The program began in a mixed spirit of patriotic enthusiasm and skepticism. The leaders in the fields of commercial banking, insurance, and investment banking who met with me to discuss the nature of the program were at the same time anxious to do their part in the fight against inflation under the terms provided in section 708 of the Defense Production Act of 1950 and fearful that they might overstep the bounds of antitrust legislation. However, the latter was considered a businessman's risk and the program was set up, approved by the Federal Reserve Board and the Attorney General after consultation with the Federal Trade Commission, and inaugurated on March 9, 1951.

ORGANIZATION

The program is administered by a national committee, appointed by the Federal Reserve Board, and 43 regional committees, appointed by the national committee. Five principal types of lending institutions are represented on the national committee—commercial banks, life-insurance companies, investment bankers, savings banks, and savings and loan associations—and each type has its own group of regional committees. The national committee directs general policy within the framework of the statement of principles and has the task of studying the Nation's credit developments to appraise the effectiveness of the program and of applying its principles to new problems. The national committee keeps the Federal Reserve Board advised of its activities.

The regional committees have the sole responsibility for answering questions as to loans and security offerings. They keep minutes and send these records to the national committee where they are filed as a public record. A regional committee, uncertain as to the right opinion on some type of case, may submit the case to the national committee.

EDUCATIONAL PHASE

The program was launched in such general terms that in the words of one critic "You could drive a truck through it anywhere." He had reference to the difficulty of interpreting such terms as "essentiality," "defense supporting" and other terms characterizing the nature of credits by which it was hoped financial institutions would

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be guided in their efforts to provide credit for the defense effort and to screen carefully all other requests. The national committee fully recognized the general language of the program and proceeded at once to help lenders in applying the program to specific problems. A series of bulletins was issued by the national committee on such topics as inventory loans, plant-expansion credits, municipal borrowings, real-estate credit, etc. Press releases and public addresses were also used to acquaint both lender and borrower with the principles and objectives of the program. Later when the regional committees had offered their opinions on a sufficient number of inquiries, digests of these opinions were made available to lenders as illustrations of the combined judgment of lenders.

APPRAISAL OF PROGRAM'S VALUE

It is my firm conviction that the voluntary credit-restraint program has achieved a large measure of success and has been an important companion and supplement of general and selective credit and fiscal controls in helping to stem the tide of inflation following the outbreak of the Korean trouble. It has given lenders in all branches of finance bench marks or guides for loan and investment policy in this emergency period. It has informed lender, borrower, and the general business public of the relation between credit and inflation. It has, doubtless, been a considerable factor in the restoration of the public's confidence in the purchasing power of the dollar which has resulted in a substantial increase in savings and a less active use of available funds.

Federal Government agencies in the lending field and in the civilian defense offices have accepted the principles of this program and have given it excellent support. Finally, I am confident that many of the projects which have been postponed for the present will furnish a welcome backlog of spending power and business activity for the inevitable let down in business which will follow the peak of the defense effort.

Statistical evidence of the effectiveness of the voluntary credit-restraint program is difficult to provide. Defense and other essential activities have been adequately financed and this has resulted in some increase in bank credit and in a tremendous volume of corporate and municipal security offerings. On the opposite side of the ledger it is impossible to measure the dollar amount of credits and security issues which have died in embryo.

We hear of many cases where a prospective borrower decides after a discussion with his banker not to apply for the loan. Other proposed loans have never come out of the directors' room of the interested corporation. At the same time, there is fragmentary information in our files from annual reports and other sources that commercial banks have denied or postponed nonessential credits in large amounts—$7 million, $10 million, $27 million—at individual banks. For a variety of reasons loans at the larger banks have risen much less in 1951 than in 1950, and in the first 2 months of 1952 they have declined about $400 million as compared with an increase of $900 million in the first 2 months of 1951. While corporate and municipal security issues has been in large volume in 1951, they have been predominantly for purposes consistent with the defense effort. Finally,

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the record of the regional committees, which aside from municipal issues only offer opinions in doubtful cases, indicates that out of some $4,300,000,000 of credit and security offerings reviewed, $456 million were declared to be not in harmony with the program. It is probable that in a majority of these cases the lender or other inquirer abided by the opinion of the committee.

FUTURE PLANS

For the remainnder of 1952 the voluntary credit-restraint program will have an added goal which is really merely an application of the principles of the program to a new problem. The Treasury Department has explained to the national Voluntary Credit Restraint Committee its financing problem for this calendar year and has requested the cooperation of the committee in its efforts to finance the deficit in the least inflationary way possible. It is, of course, highly unfortunate to have a deficit in times like these and every effort should be made to achieve a balanced budget by a reduction of expenditures or increased taxes or a combination of both. If this is not possible, however, the voluntary credit-restraint organization has pledged to the Treasury that it will do its part by continuing to urge the postponement of less essential capital flotations and other credits which otherwise could be used for the purchase of new Treasury securities. It is highly important that the Treasury finance the deficit without resorting to the inflationary process of borrowing from commercial banks. This means that a portion of the new savings and funds from existing debt repayments of individuals and corporations must be attracted into the purchase of Government securities. It will be the role of the voluntary credit-restraint program to persuade lenders on the purely voluntary basis inherent in the program to screen new financing projects more carefully than ever with this added goal in mind.

SCREENING STATE AND MUNICIPAL BORROWING

This committee may be interested in some of the special problems and techniques developed by the voluntary credit-restraint organization to meet the problems which have arisen during its short existence. One technique in which I am sure the committee will be interested is that developed for screening State and municipal borrowing proposals. At the outset it was recognized that the special characteristics of municipal borrowing practices would require a somewhat different procedure from that in private borrowing if adequate sceening were to prevail. It is customary for a State or a municipality to advertise for bids on a bond issue and usually a large number of bidders will enter sealed bids on a certain day. It would be impractical for every firm which contemplated placing a sealed bid to ask the opinion of a regional voluntary credit-restraint committee as to whether the proposed issue is in harmony with the program. Accordingly, at the request of the Voluntary Credit Restraint Committee, Mr. Charles E. Wilson, Director of Defense Mobilization, sent a letter to the governors of all States, to the mayors of the principal cities, and to other important municipal finance officers asking them voluntarily to submit proposed financing to the appropriate regional committee as-

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signed to their area for an opinion as to whether the project was in harmony with the program. This has worked satisfactorily and a very high percentage of State and municipal offerings has been so offered for screening. The national Voluntary Credit Restraint Committee was greatly pleased to receive last December, after 7 months of operations in this manner, a resolution from the executive board of the Municipal Finance Officers Association, reading in part as follows:

Whereas it is recognized that one of the sources contributing to inflationary pressure is the issuance of municipal obligations for purposes which could be regarded as nonessential or postponable in character: Be it

Resolved by the executive board of the Municipal Finance Officers Association of the United States and Canada, That we do subscribe to the principles of the Voluntary Credit Restraint Committee designed to curb borrowing by governmental units for purposes that are nonessential, postponable, or inflationary in character; and be it further

Resolved, That (1) we strongly recommend that all public-finance officers of all governmental units exert their influence at all times to curb public expenditures in order to contribute a factor toward combating the inflationary trend which has become excessive, undesirable, and not in the best interests of citizens and the national economy; (2) public-finance officers are urged to continue to cooperate with the several regional investment banking committees having the duty of screening muncipal applications for issuance of municipal debt obligations.

PROTECTION AGAINST COLLUSION

The question has been asked whether there is any danger or likelihood of collusion between lenders in the operation of the voluntary credit-restraint program. It would be simple to say that collusion is not to be expected in an operation which calls for the turning down of profitable business by lenders and underwriters. However, we have gone far beyond that assumption in safeguarding the program from such an accusation. The program itself was approved by the Federal Reserve Board and the Attorney General of the United States. Federal Reserve representatives are members of the national committee and of all but one of the regional committees, and attend all meetings to represent the public interest. The agenda for discussion by the national committee is prepared by its chairman, who is a member of the Federal Reserve Board. The alternate chairman of the national committee is the general counsel of the Federal Reserve Board. A competent official of the Federal Reserve Board reviews all opinions on individual loan applications as soon as such cases are reported to the national committee. The national committee keeps the Federal Reserve Board advised as to its current thinking on credit conditions and has, on occasion, recommended changes in the program to the Federal Reserve Board and the Attorney General.

Careful minutes of all committee meetings are kept and filed in the national office. The files of the national office are open for public inspection. Representatives of the Attorney General's office and more recently a representative of the United States Department of the Interior have inspected these files. Indeed, the effort to avoid collusion and to maintain the voluntary nature of the program among lenders has been made even at the sacrifice of some efficiency in the application of the program.

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SPECIAL CONCERN FOR SMALL BUSINESS

This committee will be interested in the methods built into the organization of the voluntary credit-restraint program to protect small business. First of all it should be recognized that of the 60,000 lenders who are in one way or another concerned with this program, the great majority deal only with small business. The success of these lenders depends on the success of the small-business enterprises of the Nation. In setting up the committee organization for the voluntary credit-restraint program, committee members were chosen from institutions of various sizes as well as with some geographical distribution. Thus, the voice of the smaller lending institutions is heard directly in the councils of the program. It is not stretching a point to add that the Federal Reserve representatives on the regional committees can be expected to think in terms of small as well as large-business institutions. The board of directors of each Federal Reserve bank has six directors elected by member banks of the district, of which two are elected by small banks, two by medium-sized, and two by large banks. Thus, the operation and policy of each Federal Reserve bank and its officers are geared to banking and business of all sizes.

HANDICAPS

Your committee should be advised that in the eyes of the voluntary credit-restraint organization there is at least one Federal program which is making the success of this program considerable more difficult.

I have reference to various parts of the Government program requiring the expenditure of Federal funds or encouraging municipalities to borrow with Federal guaranty, which the national Voluntary Credit Restraint Committee considers undesirable at this time despite the over-all merits of the programs. I refer most particularly to the various plans for supporting the mortgage market on veterans' home loans and especially to the public-housing program which is estimated to require $800 million of municipal borrowings during the current calendar year. In the latter case, it is the opinion of the national committee that this competition for funds in the capital markets in the coming months with the certain needs of the Federal Government to finance the deficit is undesirable except for essential defense housing. Furthermore, if these public-housing projects are basically desirable, they will fit into the business picture much better after the peak of defense expenditures is past and some slowing down in business and employment occurs. This is one of the few types of projects which can be administered with certainty to combat swings in the business cycle.

Representative Patman. Mr. Bolling, would you like to ask questions?

Representative Bolling. Yes, Mr. Chairman.

Governor Powell, how many different lenders are there all over the country, roughly?

Mr. Powell. We estimate 60,000.

Representative Bolling. Are all of those agencies participating in the voluntary credit restraint program?

Mr. Powell. We think that they are, and our reason for thinking so is that one after another of the major groups has asked to be included one way or another.

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For instance, early in the program the consumer bankers asked if they could have representatives on our committee organization. The mortgage bankers' association has gone over their situation to see they were properly represented; the finance companies have, through their various associations, expressed a great deal of interest in the program, and the fraternal life-insurance companies who were omitted somewhat unwittingly when we started out, asked to be brought in and we have added some of their representatives to the committee.

So, we have every evidence to think that the financing companies want to be in on it, and not only that, but they want to be recognized as being in on the program.

Representative BOLLING. It is almost impossible to know the effectiveness of your program, as I believe you bring out in your statement, because you are not absolutely sure what may be going through here or going through there that may be thought of as nonessential and deferable.

Mr. POWELL. That is correct. We can only measure the success in very general ways and by way of inference, and I would not count statistics as being overly authoritative.

Representative BOLLING. You touched on the subject of criteria which establish essentiality. What agency establishes the essentiality criteria, that is, the criteria as to the essentiality or nonessentiality and deferability and so on?

Mr. POWELL. The national committee of the voluntary credit restraint program has spelled out those words which were stated in the original statement of principles, by means of a series of bulletins.

Also, the regional committees by giving opinions on a large number of individuals cases, have expressed themselves, so that we now have a rather combined opinion of a wide group of lending officers on those questions of definitions, and whereas we started out with very general terms, we now have very few questions asked us as to the specific loans that come before the various lending agencies.

Representative BOLLING. The criteria are in effect established by officers of lending institutions who serve on that committee, or on down the line, within the limits of the general statements in the act.

Mr. POWELL. That is right. We are very careful to see that they stay within the general statement, because we have been informed by the Attorney General, and of course we would have done so anyway, but we have no right to attempt to redirect the program as against the original statement approved by the Attorney General.

Representative BOLLING. What is the major difference between this kind of credit that is controlled by the voluntary credit-restraint program and the kind of credit that is controlled by regulation X and regulation W?

Mr. POWELL. I would put it the other way around, if I may.

Regualtion W controls a large volume of relatively uniform standard transactions in the field of consumer credit.

Regulation X similarly has laid down rules for down-payment and time schedules for certain types of real estate credit, largely on new construction, but they are again standardized and very large in volume.

The voluntary credit restraint program deals with a great multitude of transactions which are tailor-made by the institutions to the needs of the borrowers. They are not uniform on the whole, and I

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am very sure it would be quite impossible to put them under a regulation.

So, in this voluntary program we depend on the business judgment, guided by our committee's statement of principles to keep the credit extention along conservative lines and particularly defense-supporting lines.

Representative BOLLING. How much consumer credit could you cover, very roughly, in the voluntary credit restraint program?

Mr. POWELL. I would say practically none, Mr. Bolling.

Representative BOLLING. What kind of credit is it, then?

Mr. POWELL. Business credit.

Representative BOLLING. Business credit.

Mr. POWELL. Of a wide variety; to help a firm to carry inventories, to buy machinery, to carry accounts receivable; and indirectly in some ways to finance consumer credit for the finance companies can borrow from the banks and the insurance companies to get the funds with which they in turn extend as consumer credit, which is regulated under regulation W.

Representative BOLLING. Governor Powell, do you have figures what the administration of the program has cost?

Mr. POWELL. I have some figures, for the out-of-pocket cost of the Reserve Board, some $18,000. I have no figures as to what it has cost the Federal Reserve banks and the branches, nor the individual lending agencies.

For example, we have some 400 men from different lending institutions who are giving their services freely without fee and without getting their traveling expenses or their postage or stationery costs, or anything like that, back. I have no idea what the over-all cost of the program is.

Representative BOLLING. What is your feeling on the basis of equity about a policy under which consumer credit is a compulsory program and business credit is a voluntary program?

Mr. POWELL. Well, sir, it is partly a matter of expediency, but I think that is the least.

It is relatively easy to set up a regulation for consumer credit, but I think that there is something in the past year or so that was inherent in the national emergency that required regulation of consumer credit.

Certainly, in a time of relatively full employment—I am not going to get into the discussion of what is full employment—everybody's credit is good and everybody who wants to borrow can do so quite freely.

It is just at that time when you do not need consumer credit piled on top of other spending power to keep full employment, and certainly at a time when you are trying to push some things out of the way so that the national defense can have priority, consumer credit should be restricted.

So I think philosophically there is a real reason under today's conditions for consumer credit to be strictly regulated. The same thing goes for real-estate credit under regulation X.

The businessman, on the other hand, in many cases is partly in defense and partly out, he is partly essential and partly nonessential in his activities and it is impractical to set up regulations to govern a situation like that, and so I think we have to depend on general restraints, allocations of materials, that sort of thing, plus an enlistment

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of the best judgment of lender and borrower alike, to see that we do not have undue credit extension in the business field.

Representative BOLLING. Now, what would the changes be in the structure that would be required from the present voluntary program if the program were made a compulsory program, with general criteria established with considerable flexibility perhaps by the Board itself, the Federal Reserve Board, using it as an operational technique but with compulsory criteria—substantially the same organizational structure that you set up voluntarily?

Mr. POWELL. I cannot envision a set-up of that sort and I might add for the committee's information that one of the so-called task force committees of the Wilson Committee of Four that operated back in the winter of 1950–51, made a rather exhaustive study of that very thing and come up with the statement that it is just impractical to set up regulations.

The only thing that could be done, I think, would be to put a ceiling on loans of institutions and say, "Within that ceiling you can make any loans that seem most urgent," but I do not recommend that.

Representative BOLLING. In other words, it is impossible to use compulsory selective technique in business credit, and it is perfectly possible to use a voluntary technique?

Mr. POWELL. It is impossible, in my judgment, to use a compulsory technique. We, I think, have demonstrated that it is reasonably possible to use a voluntary technique.

Representative BOLLING. Why is it possible? Do I gather that a compulsory program in an emergency like this, that under a compulsory program the lending institutions would not be as concerned with the program's successful operation as with the voluntary program?

Mr. POWELL. No; but I think it would be impossible to set up any regulations that would have any meaning.

Representative BOLLING. I am not suggesting rigid regulations, I am suggesting the evolution of regulations in substantially the same manner that you have evolved your criteria that you have now, starting somewhat generally and gradually building up on the basis of experience, as you have in your voluntary program, where you have an experience factor that enables you to be more specific, more selective.

It seems to me that the medium that you have developed, the technique you have developed on a voluntary program, unless there are some enormous changes in attitude, would serve equally well in a compulsory program, and this is what I am leading up to, and might have the advantage of being a little bit surer that the criteria were sound; and secondly, it would have the advantage of assuring down through the line that credit was not sliding out here and there for purposes that might be otherwise perfectly justifiable, except for the emergency.

You see, I have difficulty in understanding why, if you can do it voluntarily, you cannot also do it otherwise.

Mr. POWELL. I think there are two things that can be said about that.

One is that in a voluntary program where the combined judgment and patriotism of the lender and borrower are enlisted, you have their wholehearted support. The minute that you have your regula-

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tion, there is a tendency to do just what the wording of the regulation calls for.

Secondly, I think that the program under a compulsory set-up would require such a huge gestapo to police it that it would fall down.

Representative BOLLING. Well, the implication of that is, on the one hand, that in the voluntary set-up you can expect wholehearted cooperation and results with very little policing, and you imply that as soon as you have a compulsory situation, that they will move in a direction which will make for the necessity of a very substantial enforcement group.

Now, I cannot see what factors—that the attitude toward patriotism is going to change so drastically that a man's approach as a lender will shift from complete cooperation in the voluntary situation to complete noncooperation in the compulsory set-up, noncooperation in the operation of a substantial segment of it if compulsory, that is, unless it is voluntary it is not working.

Mr. POWELL. Unless it is voluntary it is not working, you say?

Representative BOLLING. Yes.

Mr. POWELL. I think that we could not claim that the program is working 100 percent voluntarily, but it is working to a satisfactory degree.

When this program was first set up, the fact was faced very bluntly, that probably you would have some businessmen, some lenders that either would not know about the program or would have some different judgment about the program and might not live up to what the combined group thought they should do; but that with the patriotic appeal the great majority would run along regardless of a minority that did not.

I think that inevitably when you get over from the voluntary program to the compulsory sort of thing, that that willingness to comply while your neighbor perhaps is not complying in the same way tends to break down.

Now, that is my opinion in the matter. I hope we will not get to that type of compulsory program.

Representative BOLLING. You accept the principle of self-policing if your neighbor is getting away with murder. In a compulsory program it is relatively easy to correct that.

Now, I do not want you to misunderstand my line of questions. I think you have done a very excellent job in your efforts. I have difficulty, however, in seeing the equity of the situation where consumer credit which deals with, I presume, millions of individuals, is feasible to control where, on the other hand, it is not possible to work out a compulsory program where you are in a sense dealing with 60,000 lending institutions and you can use them as in effect both the administrative set-up and the police power.

That is all, Mr. Chairman.

Representative PATMAN. Mr. Powell, do you feel like the public interest in the sense that our Government is bound to administer it, is represented on this voluntary credit restraint program efficiently?

Mr. POWELL. I do, sir, within the limits of the voluntary program; I think that it is set up with adequate safeguards.

Representative PATMAN. With adequate safeguards.

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What I have reference to is that you have on this committee the commercial banks, the insurance companies, the investment companies, the Federal Reserve Board—they are all represented on the voluntary committee?

Mr. POWELL. Yes, sir.

Representative PATMAN. Now, there is not a single person on there that is elected by the people or directly responsible to any person who is elected by the people, if I have properly stated the representation, and according to my judgment.

Mr. POWELL. Well, of course, the Federal Reserve Board representative is considered a representative of the public interest.

Representative PATMAN. Well, I said responsible, responsible to anyone. You are not responsible to the President. You do not consider that you are, because you were selected by the President, do you, Mr. Powell?

Mr. POWELL. I consider that I am responsible for the public interest.

Representative PATMAN. That is what I say, you are responsible for doing a good job according to the law and your duties as laid down to you, but you are not in any way—in other words, no one will have the right to blame the President for what you do because the President had no control over you.

Mr. POWELL. I think that is correct.

Representative PATMAN. That is correct. That is the reason I say that there is not anyone on this committee that is elected by the people or directly responsible to anyone who is elected by the people.

I bring that up only for the purpose of asking you if there should not be a little bit more of a direct connection there in a democracy such as ours where, of course, the people are the masters.

Mr. POWELL. It would change the nature of the program materially, Mr. Chairman. It could be done.

This program is set up under an act of Congress and we have tried to spell it out in terms of section 708 of the Defense Production Act.

Representative PATMAN. That is right, and I am well familiar with that, because I was one of the committee that had plenty to do with writing it. So, I am acquainted with it.

Mr. POWELL. We have worked with the Attorney General's office. To that extent—the Attorney General, I think, represents the executive branch of the Government.

Representative PATMAN. Only as far as any violation if my recollection is clear, to make sure that the agreements are not in violation of the antitrust laws. Is that not right, or something of that sort?

Mr. POWELL. That is probably the way it would be spelled out. We consider it broader than that, however, and the Attorney General's men have looked over our operations twice since we have been operating. We welcome that contact with them.

Representative PATMAN. But they were not for the purpose of seeing whether or not these actions by this committee were in the public interest necessarily, but only for the purpose of seeing whether or not they violated the antitrust laws; is that right?

Mr. POWELL. That would be a narrow interpretation, but they have been very much more helpful than that in their constructive criticism and suggestions of our program.

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Representative PATMAN. Yes. Now, I want to ask you a few questions.

The question has been brought up here as to whether or not the Federal Reserve System is a public institution or privately owned. What is your answer to that, Mr. Powell?

Mr. POWELL. I consider the Federal Reserve System as a semi-public institution.

Representative PATMAN. Well, would you say it is semi-private?

Mr. POWELL. To the extent that the member banks own stock in the Federal Reserve banks and have a voice in electing directors, six of the directors of each Federal Reserve bank, it is private; and, of course, they receive dividends on their stock.

However, they are in the position of a preferred stockholder. That is, the dividends are limited. They have rather limited powers of influencing the Federal Reserve bank operations and policies.

Representative PATMAN. And you know, Mr. Powell, that the amount of stock that they have paid in is too insignificant to be backing of even a small part of 1 percent, a sufficient backing, I will say, of a small part of 1 percent of the amount of business that is done by the Federal Reserve bank.

Mr. POWELL. The capital is very small.

Representative PATMAN. Very small, and you would not consider that significant as supporting the System, would you?

Mr. POWELL. You mean in case they took losses?

Representative PATMAN. No; of course, I am not talking about losses, but I am talking about the Federal Reserve notes issued and credit issued by the Federal Reserve banks and the business performed by the Federal Reserve banks which runs into over a trillion dollars a year; you would not figure the small amount of stock that is invested would be enough to support any substanial part of the extension of the credit to the Federal Reserve banks, would you?

Mr. POWELL. Not if they were private institutions; they would need much more capital.

Representative PATMAN. Well, the truth is, Mr. Powell, is it not, that the Federal Reserve banks operate on the Government's credit?

Mr. POWELL. Yes; they are creators of credit under franchise from the Government.

Representative PATMAN. That is right; and they are set up to operate on the credit of the Nation because every note that you issue, every Federal Reserve note is an obligation of the United States Government, is it not?

Mr. POWELL. That is right.

Representative PATMAN. It is not an obligation of the Federal Reserve bank; it is an obligation of the Federal Government.

Mr. POWELL. It is both, technically, but——

Representative PATMAN. Yes; I know; do you have one of the Federal Reserve notes in your pocket?

Mr. POWELL. I am not sure.

Representative PATMAN. Well, you ought to be carrying a pocketful, being a member of the Board. [Laughter.]

Mr. POWELL. Well, let me see if I have one.

This is a Federal Reserve note [exhibiting].

Representative PATMAN. Well, now, what does it say? Who promises to pay that note?

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Mr. POWELL. I think it just says it is lawful money of the country, "United States of America will pay the bearer on demand"——

Representative PATMAN. That is it; that is the binding statement. The United States of America will pay to the bearer on demand $10 or whatever it is.

So it is an obligation of the United States. There is nothing on it or in the law to indicate it is an obligation of the Federal Reserve banks or the member banks or anyone else except the United States Government. That is correct, is it not?

Mr. POWELL. That is right.

Representative PATMAN. All right.

Now, then, in the law as it is set up, the banks are given lots of privileges, even on taxes.

What is your status with the District of Columbia government here, tax-wise? Do you pay taxes on your fine Federal Reserve bank buildings?

Mr. POWELL. I would have to ask one of my men. I will ask Mr. Vest.

Representative PATMAN. All right. Do you pay taxes on those buildings, Mr. Vest?

Mr. VEST. No, sir.

Representative PATMAN. Why do you not pay taxes? Suppose you get over here where you can be heard, Mr. Vest, if you please.

On what theory do you not pay taxes to the District of Columbia government?

Mr. VEST. On the theory that the Federal Reserve Board is a part of the Government of the United States.

Representative PATMAN. It is a public institution?

Mr. VEST. The Board is a public institution. The members are appointed by the President with the advice and consent of the Senate.

Representative PATMAN. And, of course, the Federal Reserve System is a public institution, too, is it not, Mr. Vest?

Mr. VEST. The Federal Reserve banks are corporations created by Congress to perform public purposes, public functions.

Representative PATMAN. And use the public credit?

Mr. VEST. Yes, sir. They are not a part of the Government of the United States.

Representative PATMAN. Well, what do you consider them to be, an agency of Congress?

Mr. VEST. I would say they are instrumentalities of the United States.

Representative PATMAN. Well, do you not admit that they are an agency of Congress?

Mr. VEST. They are corporations set up to perform special functions as Congress may designate that they shall perform.

Representative PATMAN. Well, now, Mr. Vest, your testimony makes at least unclear the justification for the granting of those powers, if I understand it correctly.

Now, in the Constitution, with which you are more familiar than I am, the power to coin money and to regulate its value is in the Congress, and the only justification, as I understand it, for giving it to the Federal Reserve System is that the Congress is making the Federal Reserve System its agent to carry out that constitutional duty. Is that your understanding?

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Mr. VEST. That is right, sir.

Representative PATMAN. And then it is an agency of Congress; is it not?

Mr. VEST. The Federal Reserve System taken as a whole, I think can properly be said to be.

Representative PATMAN. Well, what part of it is not an agency of the Congress?

Now, you are the General Counsel, and when we are talking to you we are in pretty high cotton, as we say in the South, because we are talking to the big man, we are getting it right out of the horse's mouth. So we want to know from you just what part of the Federal Reserve System is not an agency of Congress.

Mr. VEST. I say the Board is an agency of Congress and I think the Federal Reserve banks are set up by Congress as corporations under the law to perform governmental public functions.

Representative PATMAN. Are they an agency of Congress?

Mr. VEST. They act as fiscal agencies of the United States, and in that sense, certainly——

Representative PATMAN. I know, but do you know of any sense in which they are not an agency of Congress? If you do, something ought to be done to clear it up, because the only justification we had for the passage of the law, I understand, was to delegate power to our agency to carry out our constitutional exclusive privilege.

Mr. VEST. I think they are agencies of the United States or instrumentalities of the United States, whichever way you want to put it.

Representative PATMAN. Well, that is still kind of on the verge, Mr. Vest; but are they not agencies of Congress?

Mr. VEST. They are agencies of the United States, and not being a part of the Government of the United States, I think they are——

Representative PATMAN. You mean they are not a part of the United States?

Mr. VEST. They are not a part of the Government of the United States in the same way that the downtown agencies here in Washington are parts of the Government.

Representative PATMAN. You mean to say that we will let a semiprivate institution print our money and distribute it?

Mr. VEST. Well, I think that Governor Powell indicated it is a quasi-public institution.

Representative PATMAN. Quasi? Why, you have disheartened me a lot to even indicate there is any question of any part of the Federal Reserve System being an agency of the Congress.

Now, I am going to ask the Board for a legal opinion on that, and of course you will have to give it to them, but I want you to be absolutely specific. It either is or it is not.

Mr. VEST. Very well, sir, we will be glad to do that.

(The opinion referred to above is as follows:)

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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, April 14, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, United States Capitol, Washington, D. C.

DEAR MR. PATMAN: I have your letter of April 2, 1952, referring to the testimony on Wednesday, March 19, before your subcommittee, at page 981 of the record, with regard to the status of the Federal Reserve System. In accordance with your request, I am pleased to enclose herewith a memorandum prepared by our counsel as to the legal status of the Board of Governors of the Federal Reserve
counsel as to the legal status of the Board of Governors of the Federal Reserve

Sincerely yours,

WM. McC. MARTIN, Jr., *Chairman.*

STATUS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND OF THE FEDERAL RESERVE BANKS

The Federal Reserve System was established by Federal statute as a means of carrying out powers of Congress with respect to money and credit. For this purpose, Congress elected to set up a regional system comprising 12 Federal Reserve banks operating under the general supervision of the Board of Governors of the Federal Reserve System.

The Board of Governors was created by Congress and is a part of the Government of the United States. Its members are appointed by the President, with the advice and consent of the Senate, and it has been held by the Attorney General to be a Government establishment (30 Op. Atty, Gen., 308 (1914)). The Board's duties are of varied character and in different fields, but among its most important duties are the rule-making functions which it performs as an agent of Congress, such as its authority with respect to Federal Reserve bank discount rates, reserve requirements of member banks, and margin requirements on securities transactions. There has been no judicial determination of the question in which of the three branches of the Government, the Board should be classified. However, the Federal Reserve Act and its legislative history show the intent of Congress that the Board shall exercise its own judgment and discretion in performing its duties, free from executive control, and the Supreme Court of the United States has upheld the authority of Congress, "in creating quasi-legislative or quasi-judicial agencies, to require them to act in discharge of their duties independently of executive control * * *." *Humphrey's Executor* v. *United States* (295 U. S. 602, 629 (1935)).

The 12 Federal Reserve banks are corporations set up by Federal law to operate for public purposes under Government supervision. Their stock is owned by the member banks of the Federal Reserve System. Six of the nine directors of each bank are elected by the stockholding member banks, and the other three directors are appointed by the Board of Governors.

The Federal Reserve banks derive their existence and powers from statutes passed by Congress, and in this practical sense may be looked upon as agencies of Congress. They operate under the supervision of the Board of Governors, a governmental establishment, and, in carrying out the functions delegated to them in the fields of money and credit, are, of course, subject to such direction and control as Congress may see fit to legislate.

The public nature of the Federal Reserve banks is indicated by the governmental character of the functions assigned to them by the law. To mention but a few of their public functions, the Reserve banks engage in open market operations under the direction of the Federal Open Market Committee, establish discount rates subject to review and determination of the Board of Governors, act as the medium for the issuance of Federal Reserve notes which constitute the bulk of the currency now in use, extend credit accommodations to their member banks, and as fiscal agents of the United States play an important part in carrying out the fiscal operations of the Government.

In view of the public nature of their functions, the courts have held the Federal Reserve banks to be agencies or instrumentalities of the Federal Government. In one case, the Reserve banks were described as "important agencies of the Federal Government in its control of banking and currency." *Federal Reserve Bank of Richmond* v. *Kalin* (77 Fed. (2d) 50, 51 (C. C. A. 4th, 1935)). In another instance, a Federal Reserve bank was referred to as "a governmental agency under the direction of the Federal Reserve Board." *Raichle* v. *Federal Reserve Bank of New York* (34 Fed. (2d) 910, 916 (C. C. A. 2d, 1929)).

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Although instrumentalities of the Government performing public functions, the Federal Reserve banks are not parts of the Federal Government in the same sense as the Board and the executive departments of the Government. The courts have said that "a corporation which is an agency of the Government is not the Government or a department or officer of it." *United States* v. *Salant* (41 Fed. Supp. 196, 197 (1938)). The Supreme Court of the United States, in discussing a related matter, stated that the Federal Reserve banks, even though instrumentalities of the Government, "are not departments of the Government." *Emergency Fleet Corporation* v. *Western Union Telegraph Company* (275 U. S. 415, 426 (1928)). The status of the Federal Reserve banks is partly similar to that of national banks. Both are created under statutes enacted by Congress and both are instrumentalities of the United States. National banks, like Federal Reserve banks, may be employed as financial agents and depositaries of the Government. National banks, however, are operated for private profit, whereas the Federal Reserve banks are operated for public purposes.

It is believed that the status of the Federal Reserve banks may be properly summarized by saying that they are corporate instrumentalities or agencies of the Federal Government, created by statute for the performance of public or governmental functions and subject to governmental supervision through the Board of Governors of the Federal Reserve System, itself a Government establishment.

A more detailed discussion of the status of the Board and of the Federal Reserve banks is contained in the answers given by Chairman Martin of the Board of Governors to questions 8 and 10 of the questionnaire submitted to him by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. Those answers were printed at pages 242 and 261, respectively, of part 1 of the recently published joint committee print of questions and answers relating to "Monetary Policy and the Management of the Public Debt."

Representative PATMAN. And you are not willing to say now specifically that all parts of the Federal Reserve System are an agency of Congress?

Mr. VEST. Mr. Chairman, I am not quite sure what is involved in the term "agency of Congress" as distinguished from "agency of the United States."

Representative PATMAN. Well, of course, there are three branches of government. Now, you do not claim to be a part of the executive branch, do you?

Mr. VEST. No, sir.

Representative PATMAN. And you are not a part of the judiciary, are you?

Mr. VEST. No, sir.

Representative PATMAN. So you must be a part of the legislative, because that is the only branch that is left.

Mr. VEST. Well, putting it that way, of course it leads to that conclusion. I think, though, that except as regards institutions which are in the Government itself, that any other institution is an agency of the entire United States, all three departments of government, perhaps.

Representative PATMAN. Well, you are getting yourself more under that shelter than anybody else I have known around here, because they all want to stay away from the executive, they do not want any part of it.

Mr. VEST. No, sir, I am not saying it is an agency of the executive department.

Representative PATMAN. Well, if it is not an agency of the executive and not an agency of the judiciary branch, it must be an agency of the legislative branch.

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Mr. VEST. I think it is an agency of the United States, or an instrumentality of the United States.

Representative PATMAN. Now, I have this here, and I want you to give me your interpretation of this:

> Federal Reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

Well, now, this says that you are not exempt from the payment of taxes on real estate. Now, you say you do not pay taxes on real estate in the District of Columbia.

Why is it you do not pay taxes when it says here you are not exempt?

Mr. VEST. Well, that section you are reading, sir, relates to Federal Reserve banks, and the question of——

Representative PATMAN. You make a distinction between the Board and the banks?

Mr. VEST. Oh, yes.

Representative PATMAN. Well, what about personal property? You pay no taxes on your personal property either, if you do not pay on real estate?

Mr. VEST. That is correct.

Representative PATMAN. What about your automobiles? Do you pay excise taxes when you purchase cars?

Mr. VEST. I believe not, but I would need to check that.

Representative PATMAN. You do not pay taxes?

Mr. VEST. I am talking about the Board now.

Representative PATMAN. That is right. Well, what about license fees for driving automobiles purchased for the Board? Do you pay that?

Mr. VEST. As far as I know, we do not.

Representative PATMAN. You do not. What kind of tag do you get? I want to inquire into that; maybe Congressmen can get in on that.

Mr. VEST. We have a Government tag.

Representative PATMAN. A Government tag. What do you pay for that tag?

Mr. VEST. That I do not know.

Representative PATMAN. Do you have anyone here in your group that knows that?

Mr. POWELL. I would doubt if anyone here would know that. They are not in the Accounting Section.

Representative PATMAN. All right.

What about the Federal Reserve banks? They pay taxes on the real estate, do they not?

Mr. VEST. Yes, sir.

Representative PATMAN. What about personal property, do they pay on that?

Mr. VEST. No; they do not.

Representative PATMAN. What about excise taxes, do they pay excise taxes?

Mr. VEST. I think not, sir.

Representative PATMAN. And they come in just like you fellows do in the Board, they just get a Government license tag?

Mr. VEST. For the cars?

Representative PATMAN. Yes.

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Mr. VEST. I think not, sir.

Representative PATMAN. You think they pay the State licenses?

Mr. VEST. I do not know what they pay for them, but I think that they use the State license tags.

Representative PATMAN. Will you find out about those two points and call Mr. Murphy and tell him, please, for the record, what they pay for automobiles in the way of license fees?

You know they do not pay excise on cars.

Mr. VEST. That is right.

Representative PATMAN. Or any other kind of excise taxes on what the Board purchases?

Mr. VEST. I think that is right, but we will supply the information.

Representative PATMAN. And the same way with the Federal Reserve banks, they do not pay excise?

Mr. VEST. Not as far as I know.

Representative PATMAN. And you do not think that they pay on the licenses—but you will let Mr. Murphy know?

Mr. VEST. I will be glad to.

Representative PATMAN. What about salaries of employees or officials? They all pay taxes, just like everybody else?

Mr. VEST. Of the Federal Reserve Board and the Federal Reserve banks?

Representative PATMAN. That is right.

Mr. VEST. Yes, sir.

Representative PATMAN. They pay the same income taxes; there is no exemptions on income taxes?

Mr. VEST. No, sir.

Representative PATMAN. And they pay excise taxes the same as everybody else?

Mr. VEST. They should.

Representative PATMAN. Except where it is connected with the Board or the bank.

Mr. VEST. Yes, sir.

Representative PATMAN. Well, if they buy an automobile in connection with the Board they pay no excise?

Mr. VEST. Not for the Board.

(The information requested with respect to excise taxes will be found on p. 981.)

Representative PATMAN. All right.

Now, the banks get 6 percent on this stock. On this 6 percent, do they pay income taxes, like other people?

Mr. VEST. The banks?

Representative PATMAN. The commercial banks I am talking about. They get 6 percent on their stock investment.

Mr. VEST. Yes, sir. Up until March of 1942 the dividends on that stock were not subject to taxation.

But in March of 1942 Congress passed a law amending the law of 1941, providing that income from all obligations of any agency of the United States would thereafter be taxable.

Since that time—or, rather, any stock issued since that time is subject to tax on dividends on the stock.

Representative PATMAN. Now, I have a memorandum here and I think it was obtained from, if not your office, someone connected with the Federal Reserve Board, which gives the information that

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there is a total amount of $237,000,000 in stock outstanding to the commercial banks and of that stock $139,000,000 was issued prior to December 3, 1940, and since that time there has been an increase of $98,000,000.

You mean to say, then, if these figures are correct, that the $98,-000,000 has a tax paid on the 6 per cent dividend each year, but there is no tax paid on the $139,000,000?

Mr. Vest. On the dividends on that stock, that is correct.

Representative Patman. That is, the $139,000,000?

Mr. Vest. That is correct.

Representative Patman. Well, is that not kind of unusual, I wonder why——

Mr. Vest. It results, I think, Mr. Chairman, from the language of the statute which was passed in 1942.

Representative Patman. Has the board ever called that to the attention of Congress or asked it be changed?

Mr. Vest. I do not recall they have.

Representative Patman. A lot of the bankers I know are hard against these tax exemptions; they are hard against them and, of course, I do not blame them, they should be against exemptions, you know, for private industry making profits and not paying taxes.

I wonder why they would accept the tax exemptions here in a case like that—it has never been called to the attention of Congress?

Mr. Vest. I do not believe so, sir.

Representative Patman. And the Board has never taken any action on it?

Mr. Vest. No action that the Board could take up—we did take it up with the Internal Revenue, to get their viewpoint.

Representative Patman. Their interpretation of it?

Mr. Vest. Yes, sir.

Representative Patman. Mr. Bolling, would you like to ask some questions?

Representative Bolling. No further questions.

Representative Patman. Dr. Murphy?

Mr. Murphy. No questions.

Representative Patman. Dr. Ensley?

Mr. Ensley. No.

Representative Patman. Thank you very much, Mr. Powell and Mr. Vest, and you will get that information for us and give it to Mr. Murphy.

Now, there is one thing I would like to mention. If we need any additional information, of course you will be glad to submit it, Mr. Powell and Mr. Vest?

Mr. Powell. Indeed, we will be.

Representative Patman. And you may give it by correspondence or telephone.

Now, there is one thing I desire to mention for the record, and that is that in his statement, Mr. Carrol M. Shanks stated on page 13:

> Furthermore, in the original act the Secretary of the Treasury and the Comptroller of the Currency were made ex officio members of the Board, but in the Banking Act of 1935 their positions on the Board were eliminated in order to avoid the possibility of undue Treasury influence on monetary policies.

I intended to ask Mr. Shanks about this, but I did not do it. So, since it does not coincide with the information I have had all along,

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I am going to ask Dr. Murphy to write Mr. Shanks a letter asking him to give his reasons for stating that was the reason the Treasury was taken off the Board. It is not my understanding at all, so I would like to know his reasons, if he is able to give them to us.

(The information is as follows:)

AMERICAN LIFE CONVENTION,
Chicago, Ill., March 26, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management, Joint Committee on the Economic Report, House of Representatives, Washington, D. C.

DEAR REPRESENTATIVE PATMAN: Dr. Murphy has asked me to give your committee some of the reasons why I think the Secretary of the Treasury was removed from the Federal Reserve Board by the Banking Act of 1935 in order to avoid the possibility of undue Treasury influence on monetary policies.

In discussing the proposed Banking Act of 1935 on the floor of the Senate just prior to the passage of the Senate bill, Senator Glass made the following statement with reference to the exclusion of the Secretary and the Comptroller from the Board of Governors of the Federal Reserve System. The following quotation comes from the Congressional Record (vol. 79, pt. 11, 74th Cong., 1st sess., July 24, 1935, pp. 11776–11777). Senator Carter Glass was the chairman of the Subcommittee on Monetary Policy, Banking and Deposit Insurance which held the hearings on the proposed bill.

"Since the establishment of the System, and now, the Secretary of the Treasury and the Comptroller of the Currency have been members of the Federal Reserve Board. Periodically, it has been urged upon the Banking and Currency Committees of the two Houses of Congress that these two officials should be eliminated, for various reasons. With respect to the Secretary of the Treasury, it was urged—and I know it to be a fact, because I was once Sercetary of the Treasury—that he evercised undue influence over the Board; that he treats it rather as a bureau of the Treasury instead of as a board independent of the Government, designed to respond primarily and altogether to the requirements of business and industry and agriculture, and not to be used to finance the Federal Government, which was assumed always to be able to finance itself.

"Moreover, it was represented that these officials, except when of their own initiative they wanted something to be acted on, rarely ever attended meetings of the Board. I think the present Secretary of the Treasury has attended only two or three meetings. I do not think I, as Secretary of the Treasury, ever attended more than one or two meetings of the Board; but, all the same, I dominated the activities of the Board, and I always directed them in the interest of the Treasury, and so did my predecessor, the present Senator from California Mr. McAdoo. That, however, was because when he functioned it was during the war, and when I functioned it was in the immediate postwar period, when the difficulties of the Treasury perhaps exceeded those of the war period. Certainly they were not less.

"In the Banking Act of 1932, which passed the Senate overwhelming there was a provision eliminating the Secretary of the Treasury, and upon a record vote it was retained in the bill by 62 to 14, after considerable discussion on the floor, which indicated that the Senate concurred in the better judgment of those who think the Secretary of the Treasury and the Comptroller of the Currency should not be on the Board.

"That provision would have been retained in the Banking Act of 1933 but for the fact that the then Secretary of the Treasury, in wretched health which eventuated in his death, was greatly concerned about the matter, and was rather importunate and insistent in desiring to be retained as a member of the Board. In the bill which we have reported, however, we leave off both the Secretary of the Treasury and the Comptroller of the Currency, with no dissent from these officials. * * *"

As is indicated by Senator Glass the matter of removing the Secretary of the Treasury or the Comptroller or both from the Board had been brought up a number of times over the years in the Congress. In fact in 1933 the matter was debated on the floor of the Senate during the consideration of S. 4412. The bill as it came to the floor of the House provided for the removal of the Secretary of the Treasury from the Federal Reserve Board. Senator Long from Louisiana took issue with this and his amendment was defeated 62 to 14 on the floor of

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the Senate. Senator Glass made a statement at this time in defense of the committee's action and I quote below the pertinent remarks. These remarks are from the Congressional Record (vol. 76, pt. 2, 72d Cong., 2d sess., January 23, 1933, p. 2264.).

"If the Senator will permit me, I will say, in response to the inquiry of the Senator from Minnesota, that I have tried twice, rather exhaustively, to explain to the Senate just exactly what the committee had in mind when it provided that the Secretary of the Treasury should not be a member of the Federal Reserve Board. It is my misfortune that the Senator from Minnesota was not present in the Senate chamber to hear what I had to say on that point.

"I stated that it was the view of nearly every recognized publicist and political economist that the Secretary of the Treasury should not be upon the Board. That has been the view of the Board itself, for the reason that the Secretary of the Treasury has an undue influence upon the activities of the Board, and constrains it to adapt its policies to the requirements of the Treasury rather than the requirements of the business of the country.

"The Federal Reserve System, as I have stated over and over again, was set up to minister to the wants of agriculture, commerce, and industry, and not to control the money market, and not to be a bureau within the Treasury. Textually, it is not a bureau within the Treasury; but my own experience as Secretary of the Treasury and my observation since convince me that the Federal Reserve System is used in an unwise way by the Treasury and under the dominance of the Secretary of the Treasury."

I would like to refer to one more statement of Senator Glass on this matter. This quotation is from the hearings before a subcommittee of the Committee on Banking and Currency, United States Senate, Seventy-fourth Congress, first session, on S. 1715, Banking Act of 1935, page 90.

"Sixty-two to a very small objecting vote passed an act that removed the Secretary of the Treasury from the Board. I have always been in favor of that, and for the reason that when I was Secretary of the Treasury—I would not say in an offensive way that I dominated the Board, but I, at least, had considerable influence with the action of the Board, and I have suspected—being like Senator Couzens, naturally of a suspicious nature—I have suspected that frequently since the Secretary of the Treasury has had too much influence upon the Board, and I do not think he ought to be there."

Senator Glass, speaking from the vantage point of having once himself been Secretary of the Treasury, was not alone in his fears of undue influence from the Treasury as long as the Secretary was a member of the Board. The hearings also contained recommendations of well-known economists and financial experts to remove the Secretary from the Board.

"* * * I would not include the Secretary of the Treasury as a member of the Board. The Secretary of the Treasury will always be in a position to exert an influence and to secure cooperation from the Federal Reserve Board.

"This is not a new thought of mine; I have been urging it for a great many years."

* * * * * * *

"I do not know of any specific instance in which the Treasury influence has been exerted to secure action of a desirable sort that would not have been taken by the Reserve Board of its own initiative.

"I do know of a number of instances in which the Treasury influence has been exerted in directions which seem to me to have been shown, by what happened, to have been regrettable."—Dr. Oliver M. W. Sprague, professor of banking and finance, Harvard University, page 226.

* * * * * * *

"Take the Secretary of the Treasury off and take the Comptroller of the Currency off the Board. That would be a step in the right direction.

"They represent the viewpoint of the administration at the moment. What we need is a Board of greater independence."—Mr. Elwyn Evans, representing the Clearing House Banks, Wilmington, Del., page 264.

* * * * * * *

"* * * the original Federal Reserve Board was intended to be a self-governing body, chosen particularly by the Reserve banks themselves, although with a representation of Government officials. It became an all-Government appointive board, with matters so arranged that the Secretary of the Treasury was practically in control of it.

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"The System has continued even under these conditions to grow more and more political as the years have passed, and there has never been a time when the Treasury Department could not, and at any time when it chose to do so did not, exercise a directive power in the management of the Reserve banks, so far at least as it was necessary to float, manipulate, and market its own securities. * * *"—Dr. H. Parker Willis, professor of banking, Columbia University, page 886.

As you know, it is sometimes difficult to tell what is the intention of the Congress with respect to one action within a large complex bill. However, I think that Senator Glass' statements as the chairman of the subcommittee considering the 1935 act, as well as the other quotations set forth above, strongly indicate that Congress was convinced, for the reasons stated, that the Secretary should not be on the Board.

Very truly yours,

CARROL M. SHANKS,
Chairman, Joint Committee on Inflation Control.

Thank you again, Mr. Powell, and your group.

(Statistical statement submitted by Mr. Powell is as follows:)

IMPACT OF VOLUNTARY CREDIT RESTRAINT PROGRAM ON DEMAND FOR AND SUPPLY OF CREDIT

(Prepared for the information of the Subcommittee on General Credit Control and Debt Management, Hon. Wright Patman, chairman, by the Business Finance and Capital Markets Section, Division of Research and Statistics, Board of Governors of the Federal Reserve System, and presented by Gov. Oliver S. Powell, chairman, national committee, Voluntary Credit Restraint Program)

INTRODUCTION

Any attempt to evaluate precisely the impact of credit restraint measures on the demand for and supply of short- and long-term funds is fraught with difficulties. This is particularly true in the case of voluntary credit restraint measures applied to business short-term borrowing from commercial banks and long-term financing through private placement or public offering of debt obligations and equity shares. For one thing, most business concerns have access to alternative sources of funds which oftentimes makes it difficult to determine clear-cut cause-and-effect relationships between specific borrowing transactions and the purposes for which funds are used. For another, the available statistical data on business sources and uses of funds are incomplete in coverage and content, are lacking in timeliness, and in aggregate form conceal many offsetting transactions and financial adjustments. Finally, and perhaps most important of all, such data as are available reflect realized, rather than potential, demands for funds—they cannot be used to answer the question as to what the volume of financing would have been in the absence of credit restraint measures. The fact that several such credit restraint measures—including regulation X and related restraints on Government-guaranteed mortgage credit, the more flexible open-market policy in effect since the Treasury-Federal Reserve accord, and the voluntary credit restraint program—have been operating together makes it even more difficult to evaluate the role played by any one of these measures.

In order to have some basis for formulating its recommendations as well as appraising the effectiveness of its actions, the National Committee of the Voluntary Credit Restraint Program has undertaken the collection and analysis of new data in certain areas and the careful study of exsting data in others. Among the new series of data which have proved extremely useful to the work of the national committee as well as to a more complete general understanding of the financial policies and practices of various borrower and lender groups are (1) changes in bank loans by major industry groups, as reported weekly by about 220 member banks of the Federal Reserve System, (2) new commitments made, outstanding commitments, and acquisitions of loans and investments, as reported monthly by 45 life insurance companies, and (3) compilations of State and local government and corporate new capital security issues, as prepared monthly by the Division of Research and Statistics of the Board of Governors of the Federal

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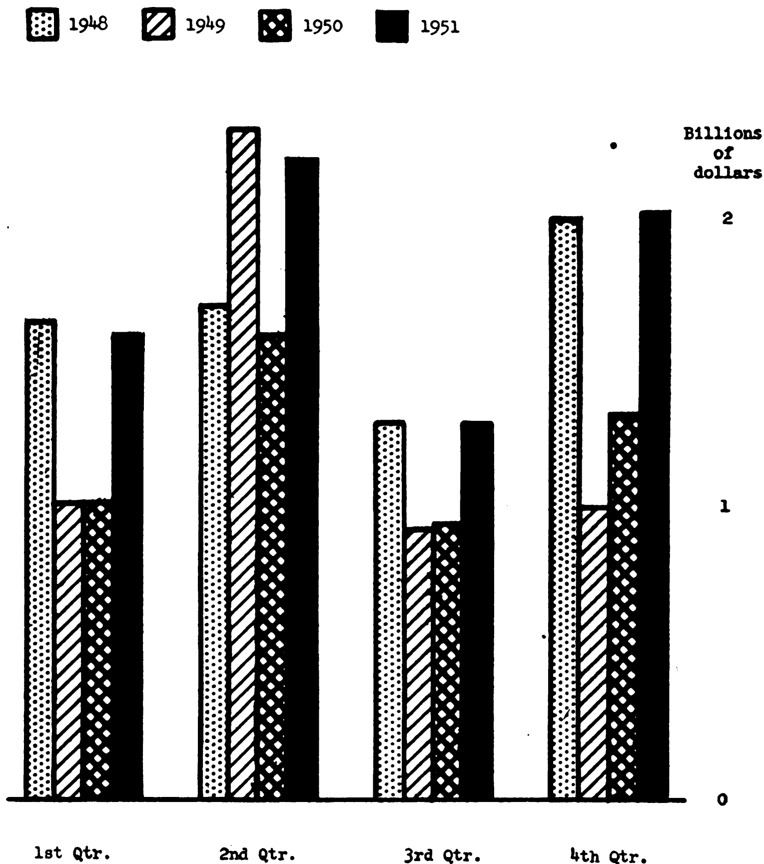
Reserve System from various public and private sources of information. In addition, such established statistical series as those of the Institute of Life Insurance on the acquisitions and holdings of life insurance company loans and investments, the Federal Reserve System and National Association of Mutual Savings Banks reports on asset holdings of mutual savings banks, and the Home Loan Bank Board data on assets of savings and loan associations have been analyzed and summarized periodically for the information of participants in the voluntary credit restraint program. From time to time the continuing analyses of these weekly, monthly, and quarterly series have been supplemented with special studies of such matters relevant to the work of the voluntary credit restraint program as the outlook for corporate sources and uses of funds, the prospective availability of life insurance company loan and investment funds, and the inventory-sales position of various manufacturing and trade groups.

An attempt to present and analyze some of the more important series of financial data utilized by the National Committee of the Voluntary Credit Restraint Program has been made in the following pages. In the interest of brevity, only the more important statistical series have been selected for presentation in chart and table form, and the accompanying write-ups have been restricted to the more salient points. Neither singly nor in combination are these charts, tables, and descriptive paragraphs intended as a comprehensive evaluation of the voluntary credit restraint program; for the latter the reader is referred to the leading article entitled "Voluntary Action To Help Curb Inflation" in the November 1951 issue of the Federal Reserve Bulletin and to the reply by the Chairman of the Board of Governors of the Federal Reserve System to the question addressed to him on this subject by your subcommittee.

CHART 1. CORPORATE SECURITY ISSUES FOR NEW CAPITAL QUARTERLY, 1948–51



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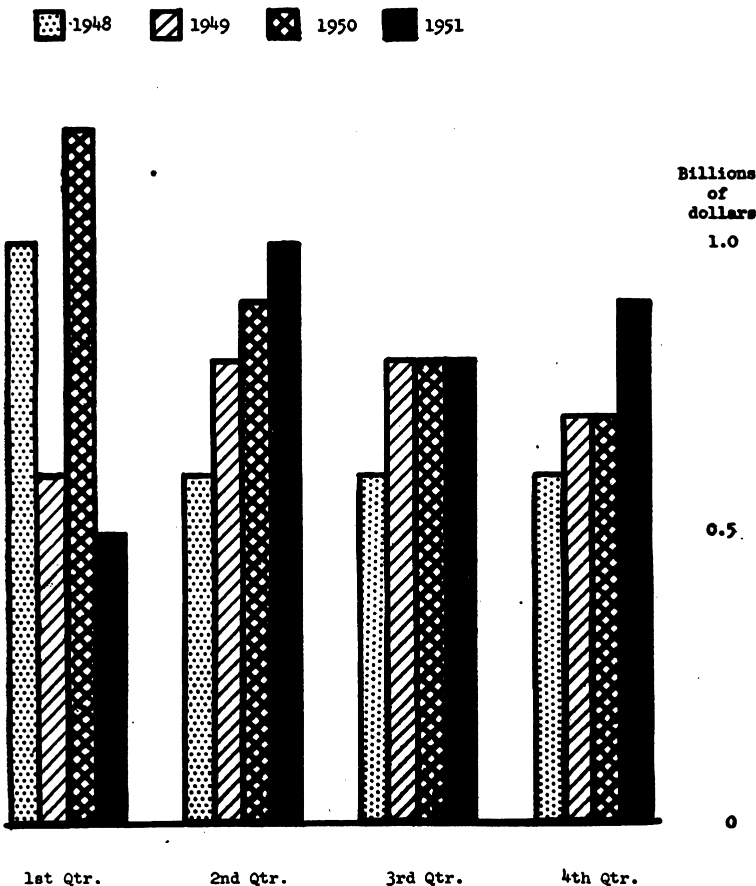
The quarter-by-quarter comparison of corporate security issues for new capital, shown in chart 1, indicates that the year 1951 was one of exceptionally heavy corporate external financing. For the year as a whole, corporate new capital security issues totaled 7.2 billion dollars, as compared with 4.9 billion in 1950 and 6.7 billion in 1948, the previous record year.

Despite the record 1951 volume of corporate security issues for new capital, a smaller proportion was accounted for by companies engaged in real estate, finance, commercial, and miscellaneous activities than in any of the preceding 3 years, as may be determined from appendix A1a. Moreover, a smaller proportion of corporate security issues during 1951 were to provide funds for the retirement of bank debt and miscellaneous purposes—and a larger proportion to finance expansion of plant and equipment—than in other postwar years (appendix A1b). Total business expenditures for new plant and equipment increased substantially in 1951, totaling $23 billion, as compared with roughly $18 billion in 1950 and $20 billion, the previous peak, in 1948. To a large extent the increase in plant and equipment expenditures during 1951 represented additions to such basic productive capacity as metals, petroleum, and chemicals, and of additions to transport, communication, and power facilities, all of which are considered essential to the defense effort.

By screening prospective security offerings to determine the proposed use of funds, participants in the voluntary credit restraint program were able to obtain the postponement of some offerings whose purposes were considered to be less essential at this time. Thus, while no over-all figures on the amount of corporate security issues that have been deferred in response to the voluntary

CHART 2. STATE AND LOCAL GOVERNMENT SECURITY ISSUES QUARTERLY, 1948–51



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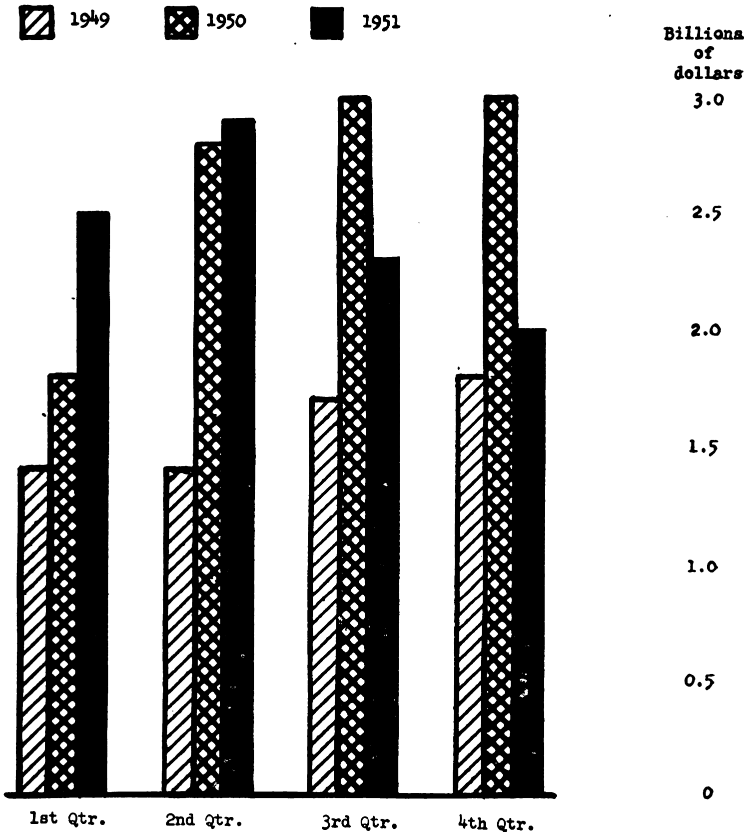
credit restraint program are available, the record on those individual cases which were submitted to the various regional committees and were disapproved suggests that both the number and dollar volume of such deferrals were substantial.

Despite a rise in the volume of State and local government construction from roughly $5.5 billion in 1950 to $6 billion in 1951, the amount of State and local government security issues declined by approximately $400 million—from a total of $3.7 billion in 1950 to $3.3 billion in 1951. All of the 1951 decline in State and local government security issues was, as is shown in chart 2, concentrated in the first quarter of the year, and reflected primarily the absence of veterans' bonus issues, which were unusually large in the same quarter of 1950.

While data on the purposes for which securities were issued has not been compiled for years prior to 1951, shifts in the relative importance of various types of construction expenditures, shown in appendix A2, suggest that the combination of material shortages and building restrictions, credit-restraint measures, and bond referenda have succeeded in diverting funds, labor, and materials into more essential projects. Thus, for example, highway construction, which accounted for 43 percent of total construction in 1949–50, declined to 37 percent in 1951, while expenditures for educational and health facilities rose in relation to the total.

CHART 3. INCREASES IN OUTSTANDING REAL ESTATE MORTGAGE CREDIT QUARTERLY, 1949–51



Outstanding real-estate mortgage credit continued to increase at a very rapid rate during the first and second quarters of 1951, as is shown in chart 3. The rapid rise in mortgage indebtedness during this period reflected the large volume of extensions on existing properties not subject to regulation X as well as

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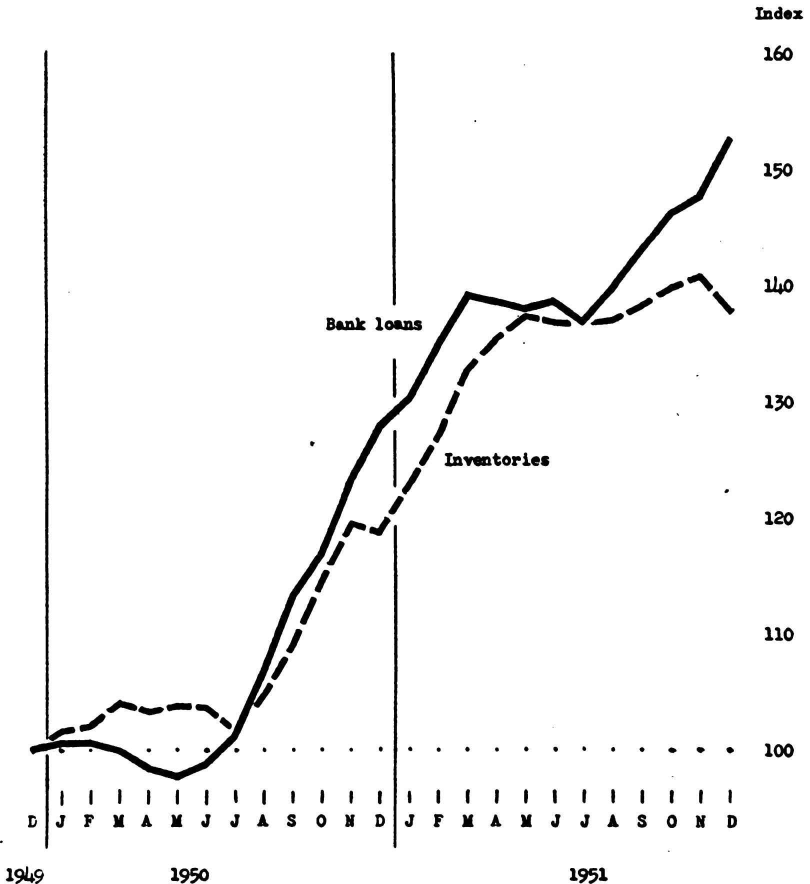
financing commitments made during the summer and autumn of 1950 prior to adoption of regulation X and associated regulations of the Federal Housing Administration and the Veterans' Administration.

During the second half of 1951, the growth in outstanding mortgage indebtedness slowed appreciably, declining from $2.9 billion in the second quarter to $2.1 billion in the fourth. Reflecting this decline in the latter part of the year, the increase in outstanding mortgage indebtedness for the year as a whole was, as may be ascertained from appendix A3, roughly $800 million less than in 1950.

In the real-estate mortgage area, the restrictive effects of selective credit regulation on borrowers, and of changed open-market policy and the voluntary credit restraint program on both borrowers and lenders, have had their principal impact on the extension of credit for the purchase of 1- to 4-family houses, as may be determined from appendix A3. During the last three quarters of 1950 outstanding mortgage credit on 1- to 4-family houses increased at a rate of $2.2 billion per quarter; during 1951 the rate of growth declined from $1.9 billion in the second quarter to $1.5 billion in the third and fourth quarters.

CHART 4. BUSINESS INVENTORIES AND BANK LOANS, MONTHLY 1950–51

[Index: December 1949=100]



During the last 6 months of 1950 commercial banks advanced a total of 5 billion dollars to business concerns—a record amount of bank credit expansion for a 6-month period, and far more than normal seasonal demands would require. Then, instead of the usual seasonal decline during the first quarter, bank loans continued to increase through March, as is shown in chart 4, resulting in an over-all expansion of about 7 billion dollars for the period July 1950–March 1951.

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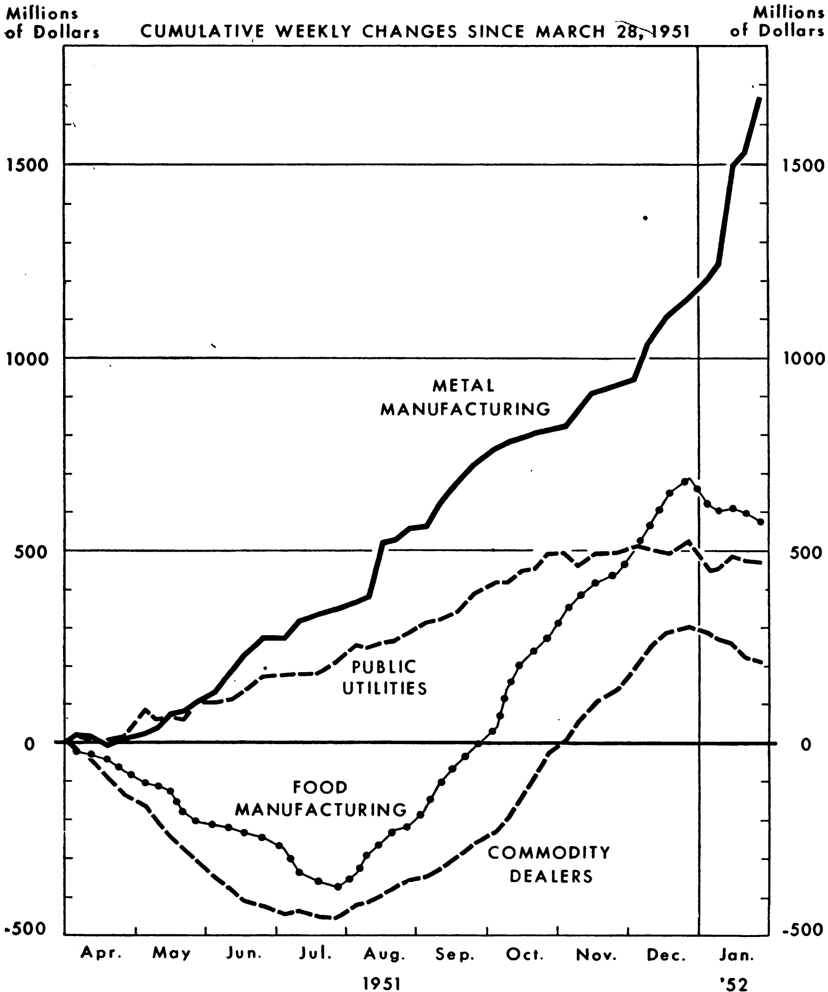
By far the greater part of this increase in commercial bank loans to business was associated with the nearly 15 billion dollar growth in business inventory holdings during this period. The extent to which bank credit was being used to finance additions to business inventories was recognized by the Voluntary Credit Restraint Committee in its Bulletin No. 1, which expressed the hope that all financing institutions would, in carrying out the terms of the program (1) "refrain from financing inventory increases above normal levels relative to sales, or reasonable requirements by other conservative yardsticks," and (2) "encourage borrowers who already have excess inventories to bring these commitments and inventory positions in line as promptly as is reasonably practical, thereby reducing the amount of credit being used in this manner."

After declining moderately from the end of March through July, commercial bank loans to business rose again in the last 5 months of 1951. Business inventory holdings likewise increased during the latter part of the year, but only slightly. The relatively much larger increase in bank loans reflected borrowing by public utility concerns and other businesses for noninventory purposes to a greater extent than in the same period of 1950.

CHART 5. CHANGES IN BANK DEBT OF SELECTED INDUSTRIES



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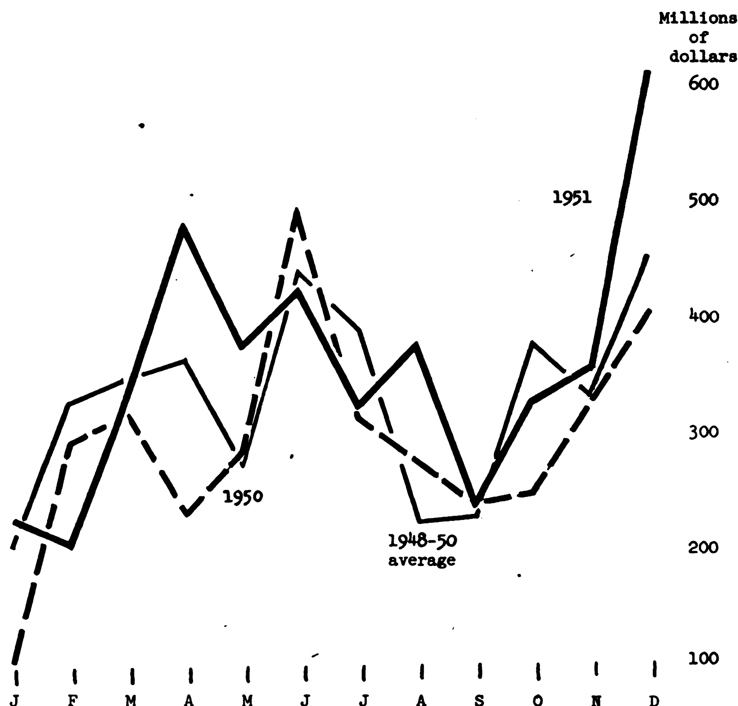
Primary objectives of the voluntary credit restraint program have been to curtail the use of credit for speculative purposes and to divert funds from nonessential to essential uses, as defined with reference to the national defense effort. Data collected from a sample of about 220 weekly reporting member banks, which account for nearly 95 percent of total commercial and industrial loans of all weekly reporting member banks and about 75 percent of those of all commercial banks, suggest that commercial banks are contributing actively to the realization of these objectives.

Defense and defense-related businesses, such as metal and metal products manufacturers and public utilities, were an important factor in business credit demand at banks in the last half of 1951. These industries, changes in whose outstanding bank debt are shown in Chart 5, together accounted for about half of the business loan expansion during this period. Borrowers in nondefense lines who customarily borrow in the fall to help move the crops, including commodity dealers and food, liquor, and tobacco manufacturers, accounted for the other half, but such loans were much smaller than a year earlier when borrowing for nondefense purposes—including both crop movements and other types of activity—was the dominant element in the increase in bank loans, while defense borrowing was still small. Thus far in 1952, loans to metal manufacturers have increased sharply while loans to other businesses have declined.

CHART 6. ACQUISITIONS OF BUSINESS LOANS AND SECURITIES BY LIFE INSURANCE COMPANIES, MONTHLY 1948–51



In recent years, life insurance companies have been a major source of long-term business funds. During the period 1948-50, for example, roughly half of all corporate bonds, note and debenture offerings were privately placed with, and a substantial proportion of those publicly offered were bought by, life insurance companies.

Life insurance company acquisitions of business loans and investments totaled 4.2 billion dollars in 1951, as compared with 3.5 billion in 1950. Comparison of loan and investment acquisitions by months during 1951 with those of 1950 and the average for 1948–50, as is shown in chart 6, reveals that their volume declined

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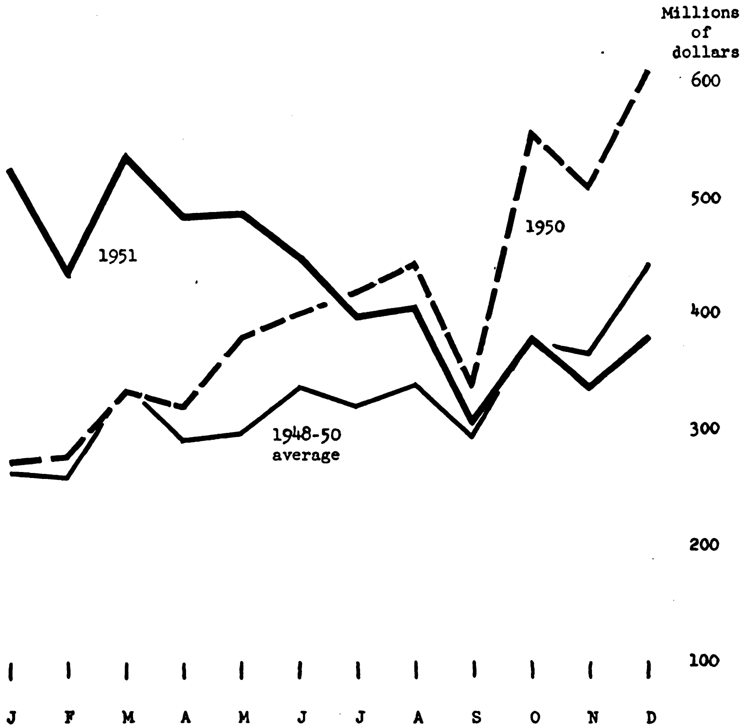
from April through September, but then rose to a record level in December. However, judging from reports of 45 life insurance companies who submit information on loan and investment commitments and acquisitions, over half of the December acquisitions represented loans and securities of business concerns engaged in defense and defense-supporting activities, as compared with one-third or less in the three preceding months.

CHART 7. ACQUISITIONS OF REAL ESTATE MORTGAGES BY LIFE INSURANCE COMPANIES, MONTHLY 1948–51



There was, as is shown in chart 7, a marked downward trend during 1951 in monthly acquisitions of real estate mortgages by life insurance companies. This was in marked contrast to the trend of acquisitions in 1950, and reflected the restrictive effects of Regulation X, the adoption of a more flexible open market policy following the Treasury-Federal Reserve accord, and the voluntary credit restraint program, as well as a reduction in new housing starts and completions during 1951.

The contrasting real estate mortgage acquisition experience of life insurance companies before and after the imposition of various materials conservation and credit restraint measures illustrates the effectiveness of concerted action to restrain inflationary pressures as well as the difficulties of ascribing specific results to any single action. When analyzed in conjunction with the chart on changes in life insurance holdings of loans and investments (chart 8) and the chart on outstanding commitments and new commitments made by life insurance companies to acquire loans and investments (charts 12 and 13), however, it appears that the voluntary credit restraint program, in conjunction with other monetary and credit restraint measures, has encouraged the progressive diversion of life insurance company investment funds to purposes deemed essential to the defense effort.

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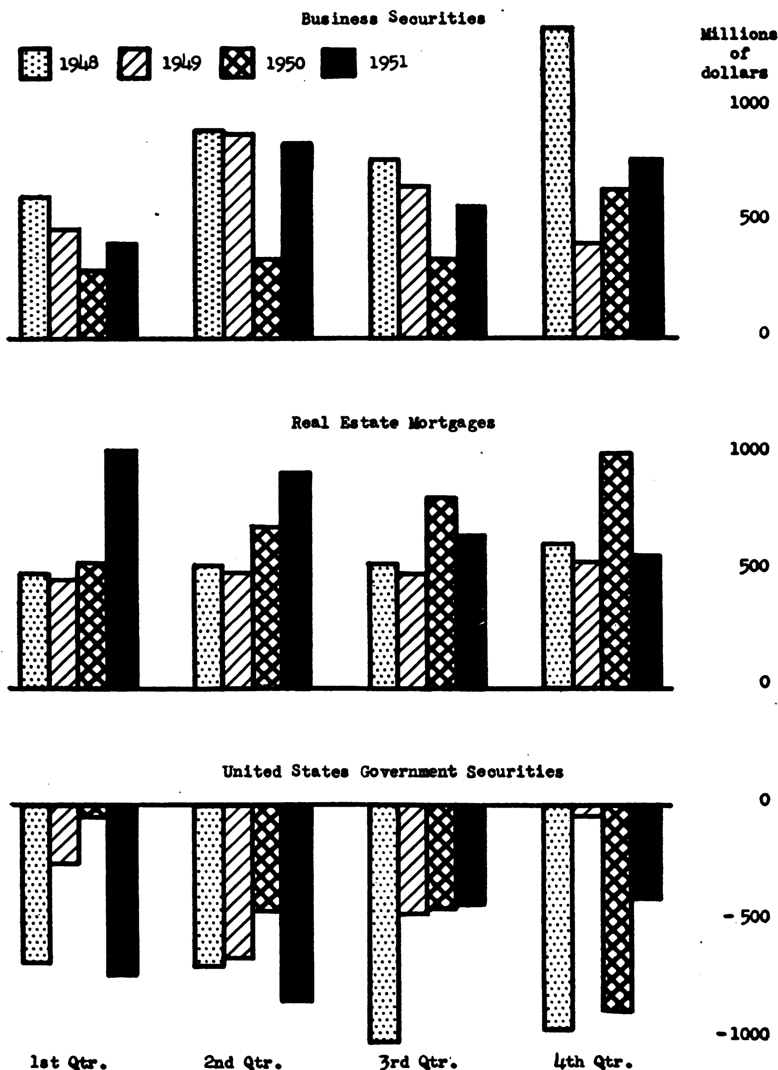
CHART 8. CHANGES IN LOAN AND INVESTMENT HOLDINGS OF LIFE INSURANCE COMPANIES, QUARTERLY 1948–51



Since acquisitions of business securities and real-estate mortgages as shown in charts 6 and 7 represent gross additions to loans and investments before deducting refundings and retirements, net changes in holdings as shown in charts 8 through 10 may give a more accurate picture of the investment activities of financial institutions.

Life insurance company holdings of business securities have increased by substantial amounts during the past 4 years, as can be seen from chart 8. For the year 1951 as a whole, such holdings increased by 2.6 billion dollars, as is shown in appendix A–8. This increase, while well above the 1950 increase of 1.7 billion dollars, compares with a figure of 3.6 billion in 1948. Moreover, the rate of growth in business security holdings has tended to taper off since the second quarter of 1951, as compared with a sustained increase throughout 1950.

Sales of United States Government securities out of life insurance portfolios were larger in the first two quarters of 1951 than in any of the preceding 3

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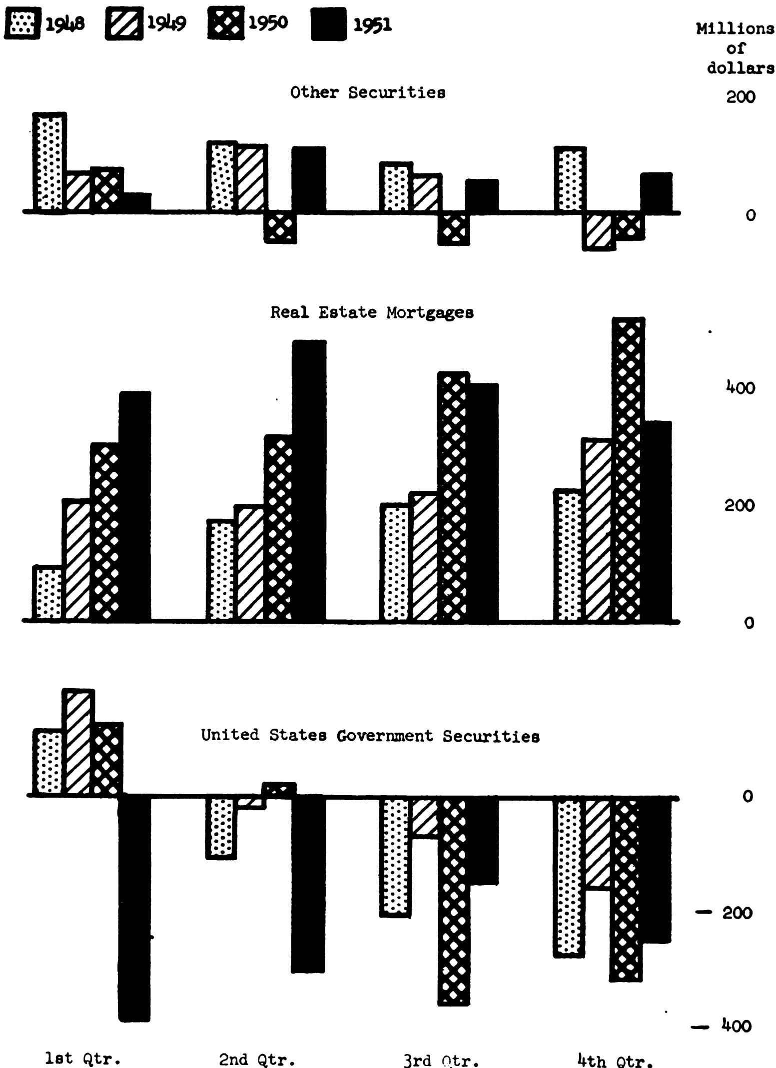
years. Since the middle of the year, however, such sales have been at a much lower level. This shift probably reflects both the change in Federal Reserve open market policy and the declining demand for real-estate mortgage credit.

CHART 9. CHANGES IN ASSET HOLDINGS OF MUTUAL SAVINGS BANKS 1948–51



Mutual savings banks also curtailed their sales of United States Government securities after mid-1951, as can be seen from chart 9. Such sales, which had amounted to 670 million dollars in the second half of 1950 and close to 700 million in the first half of 1951, totalled about 400 million in the second half of last year.

As with life insurance companies, a combination of changed open market policy and declining demand for mortgage credit probably accounted for the smaller reduction in Government security holdings during the last six months of 1951. As shown in appendix A–9, mutual savings banks' holdings of real-estate mortgages increased by a record 950 million dollars in the last half of 1950, by

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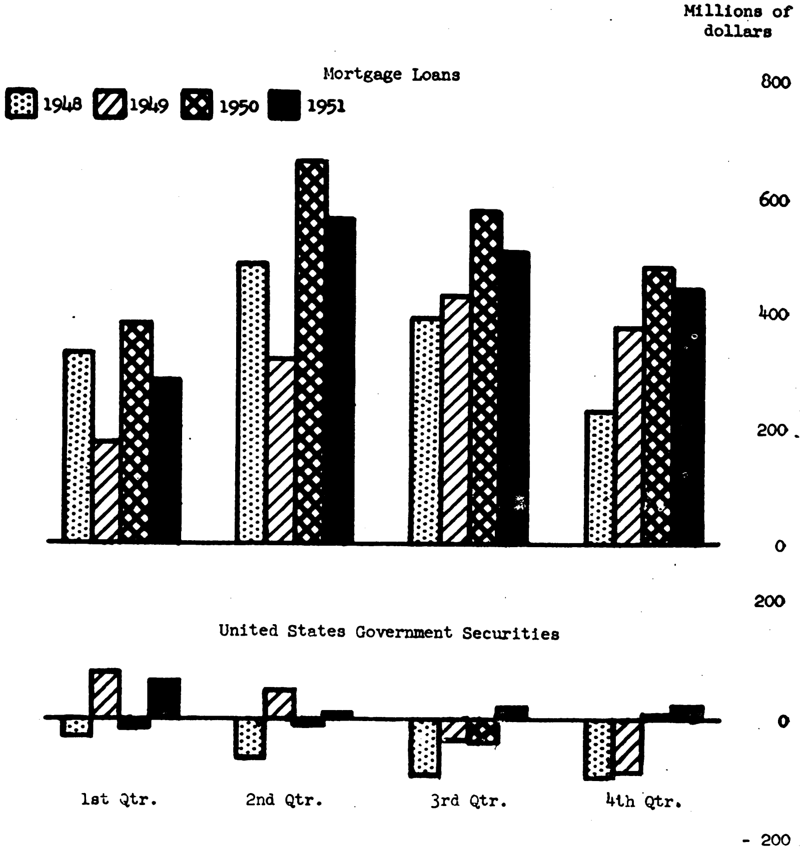
roughly 870 million in the first half of last year and less than 750 million in the second half.

CHART 10. CHANGES IN LOAN AND INVESTMENT HOLDINGS OF SAVINGS AND LOAN ASSOCIATIONS



Mortgage loans of savings and loan associations increased more slowly in each quarter of 1951 than in the same quarter of 1950, as shown in chart 10. For the year 1951 as a whole, the increase of 1.8 billion dollars in mortgage loans compared with an increase of 2.1 billion dollars in 1950. Reflecting the excess of savings and other funds flowing into these institutions over the increase in mortgage loans, savings and loan associations added to their holdings of United States Goverment securities in each quarter of 1951.

Prospective public and private credit demand during 1952 suggests that the voluntary credit restraint program may continue to make an important contribution to economic stability by screening private financing requests and discouraging less essential investment outlays and credit expansion. While a moderate decline in the volume of new capital offerings by State and local governments and a more pronounced reduction in demand for real estate mortgage credit are anticipated for 1952, corporate business demands for long-term funds from the securities markets and life insurance companies are likely to be even larger this year than last. This increase in corporate requirements for long-term funds, coupled with the new borrowing needs of the Federal Goverinment, may result in a total credit demand close to that of 1951.

In the case of business corporations, anticipated plant and equipment expenditures afford a significant measure of their prospective financing requirements.

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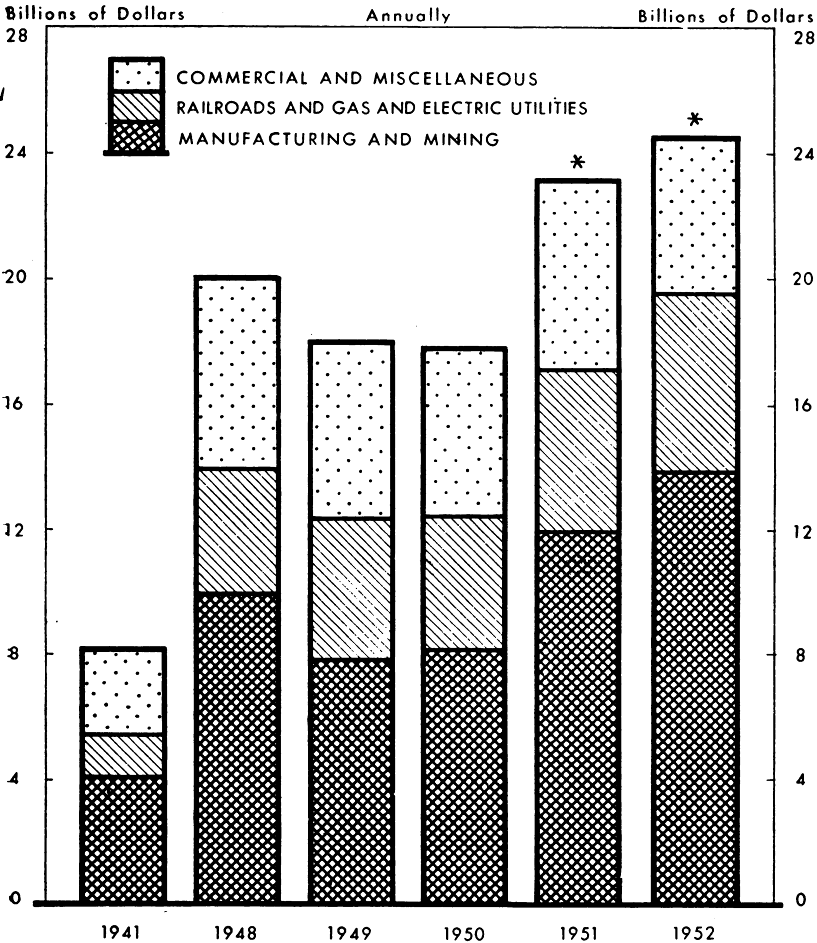
CHART 11. BUSINESS EXPENDITURES ON NEW PLANT AND EQUIPMENT



As is shown in chart 11, total capital outlays by business in 1952 are expected to exceed the 1951 peak level. According to a recent McGraw-Hill survey, manufacturing, mining, transportation, and utility industries are planning to spend 13 percent more on new plant and equipment this year than last. It is expected that this increase in plant and equipment outlays will be coupled with a substantial rise in Federal income tax payments and some decline in corporate profits.

Outstanding commitments of 45 life insurance companies, whose combined assets represent 85 percent of all life insurance company assets, to acquire loans and investments declined gradually from April through August 1951, and again from November 1951 through January 1952, as is shown in chart 12. Starting in September the coverage of the commitments data was broadened to include business mortgage loans of less than $100,000 and foreign investments; consequently, comparison of the April 1951 total of 4.5 billion dollars with the January 1952 total of 4.1 billion understates somewhat the decline in outstanding commitments over this period.

Commitments to acquire non-farm residential real-estate mortgages declined by nearly 700 million dollars from April through January, while those to acquire loans and investments of business concerns engaged in defense or defense-supporting activities rose from somewhat more than one-third to slightly less than

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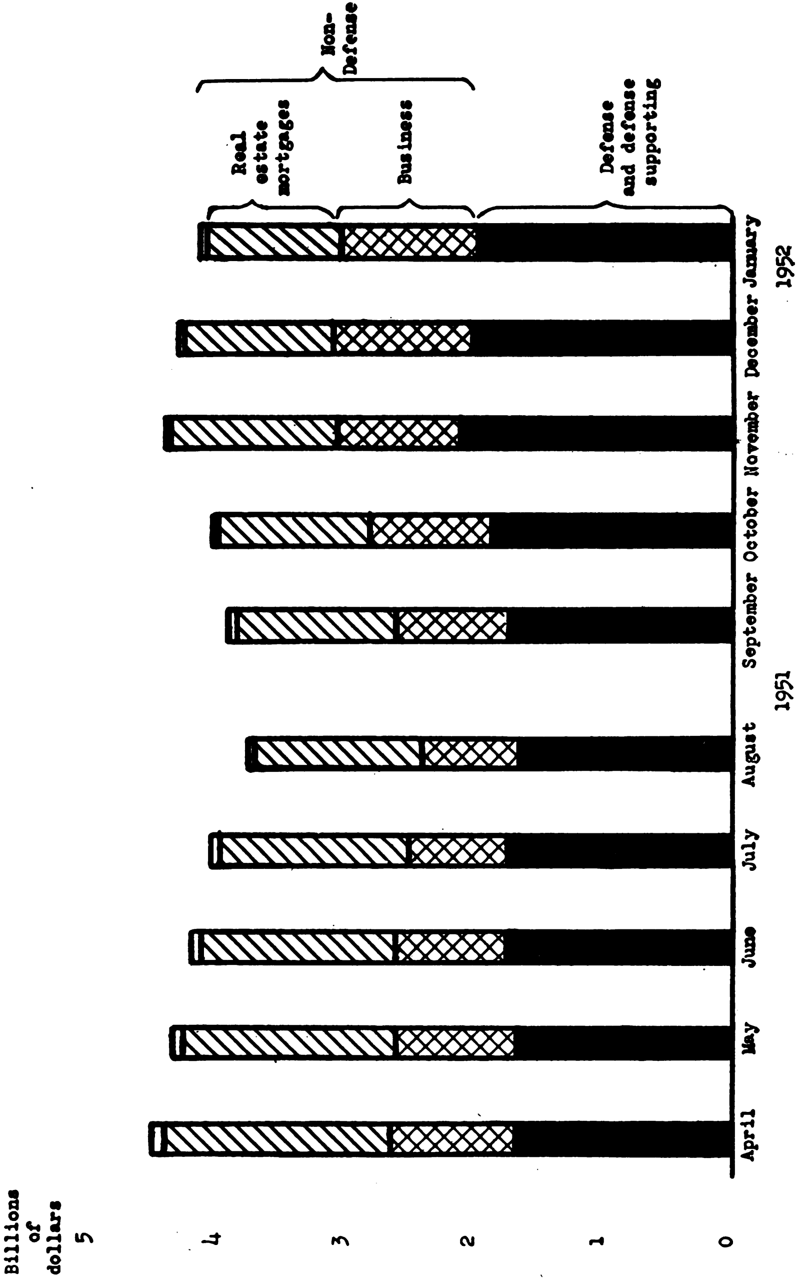
CHART 12. OUTSTANDING COMMITMENTS OF 45 LIFE INSURANCE COMPANIES TO ACQUIRE LOANS AND INVESTMENTS



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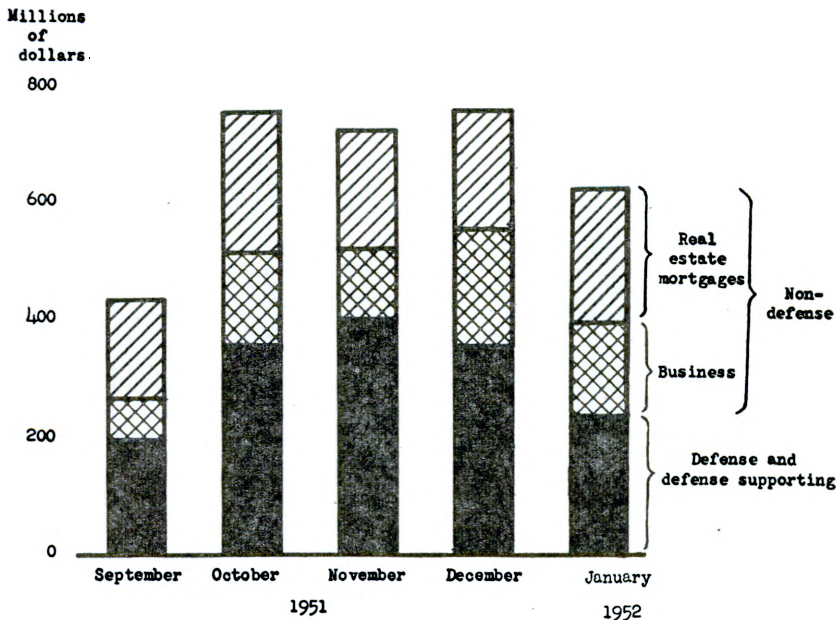
one-half of total commitments. Practically all of the April to January increase in defense and defense-supporting loan and investment commitments was accounted for by manufacturing, especially such basic industries as chemicals and rubber, machinery, iron and steel, and petroleum and coal.

CHART 13. NEW COMMITMENTS MADE BY 45 LIFE INSURANCE COMPANIES TO ACQUIRE LOANS AND INVESTMENTS



Starting in September 1951 the 45 life insurance companies which had been reporting since April on their outstanding loan and investment commitments began to compile data on new commitments made each month. The volume of such new commitments rose appreciably in October, remained at a rate of about 750 million dollars a month through December, then declined to 630 million in January, as is shown in chart 13.

During the 3-month period October to December 1951, commitments to business concerns engaged in defense and defense-supporting activities accounted for one-half of all new commitments made, while the other half was about equally divided between business concerns engaged in nondefense activities and purchases of farm and nonfarm residential properties.

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APPENDIX A-1a.—*Corporate security issues for new capital, by industry, 1948–51*

[In millions of dollars]

Year and quarter	Industry						
	All	Manufacturing	Public utilities	Railroad	Communications	Real estate and finance	Commercial and miscellaneous
1948:							
First	1,644	554	478	100	153	245	113
Second	1,706	469	604	140	273	120	100
Third	1,293	442	367	139	151	103	90
Fourth	2,009	660	687	182	312	88	79
1949:							
First	1,163	361	435	177	17	92	81
Second	2,353	559	990	111	436	195	63
Third	933	266	384	80	32	89	83
Fourth	1,109	160	572	77	33	182	84
1950:							
First	1,110	126	436	160	220	104	65
Second	1,593	319	819	91	32	233	99
Third	951	166	425	55	33	119	154
Fourth	1,337	416	502	50	29	183	157
1951:							
First	1,611	389	479	82	434	88	139
Second	2,214	1,076	740	59	30	169	140
Third	1,352	527	531	50	62	117	66
Fourth	2,028	892	719	100	100	100	117

Source: Securities and Exchange Commission.

APPENDIX A-1b.—*Corporate security issues for new capital, by purpose, 1948–51*

[In millions of dollars]

Year and quarter	Purpose					
	All	New money			Retirement of bank debt	All other
		Total	Plant and equipment	Working capital		
1948:						
First	1,644	1,511	918	592	83	51
Second	1,706	1,493	1,092	401	140	73
Third	1,293	1,057	743	314	148	89
Fourth	2,009	1,870	1,469	401	117	22
1949:						
First	1,163	969	784	185	109	85
Second	2,353	1,986	1,675	311	343	24
Third	933	789	669	120	87	57
Fourth	1,109	862	597	265	98	148
1950:						
First	1,110	941	759	182	91	78
Second	1,593	1,251	948	302	265	77
Third	951	771	571	200	64	116
Fourth	1,337	1,044	687	357	200	93
1951:						
First	1,611	1,461	1,167	293	108	43
Second	2,214	1,987	1,422	564	139	88
Third	1,352	1,260	970	290	62	31
Fourth	2,028	1,834	1,541	293	116	78

Source: Securities and Exchange Commission.

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APPENDIX A-2.—*State and local government new security issues and construction expenditures, 1948–51*

NEW SECURITY ISSUES

[In billions of dollars]

Quarter	1948	1949	1950	1951
First	1.0	0.6	1.2	0.5
Second	.6	.8	.9	1.0
Third	.6	.8	.8	.8
Fourth	.6	.7	.7	.9

EXPENDITURES FOR NEW CONSTRUCTION

[In millions of dollars]

Type	1948	1949	1950	1951
Total	3,734	4,913	5,459	5,984
Highway	1,818	2,070	2,280	2,175
Educational	618	934	1,163	1,486
Sewer and water and miscellaneous public facility	723	822	857	913
Residential	123	326	330	589
Other construction [1]	452	761	829	821

[1] Includes hospital and institutional, social and recreational, public administrative, penal and corrective, and other miscellaneous construction.

Source: Security issues, the Bond Buyer; construction, Department of Labor.

APPENDIX A-3.—*Changes in outstanding real estate mortgage credit by major components, quarterly, 1949–51*

[In billions of dollars]

Year and quarter	Total	1–4 family	Multi-family and commercial	Farm
1949:				
First	1.4	0.8	0.5	0.1
Second	1.4	.9	.4	.1
Third	1.7	1.2	.5	(1)
Fourth	1.8	1.2	.6	(1)
1950:				
First	1.8	1.3	.4	.1
Second	2.8	2.2	.4	.2
Third	3.0	2.2	.7	.1
Fourth	3.0	2.2	.7	.1
1951:				
First	2.5	1.6	.7	.2
Second	2.9	1.9	.8	.2
Third	2.3	1.5	.6	.2
Fourth	2.1	1.5	.5	.1

[1] Change less than $50 million.

Source: Quarterly figures estimated by Federal Reserve Board on a basis of Department of Commerce and Home Loan Bank Board year-end estimates.

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APPENDIX A-4.—*Business inventories and bank loans, monthly, 1950–51*

[In billions of dollars]

Year and month	Inventories [1]				Bank loans [2]
	Total	Manufacturing	Wholesale trade	Retail trade	
1949—December	50.3	28.8	7.7	13.9	17.1
1950—January	51.1	28.9	7.8	14.4	17.2
February	51.3	28.8	7.8	14.8	17.2
March	52.3	28.7	7.9	15.6	17.1
April	51.9	28.7	8.0	15.3	16.8
May	52.2	28.9	8.0	15.2	16.7
June	52.1	29.1	7.9	15.1	16.9
July	51.1	29.0	7.8	14.2	17.3
August	52.7	29.0	8.2	15.6	18.3
September	54.9	29.7	8.5	16.7	19.4
October	57.6	30.6	8.9	18.2	20.0
November	60.1	32.0	9.1	19.0	21.1
December	59.7	33.3	9.3	17.1	21.9
1951—January	61.8	34.4	9.6	17.9	22.3
February	64.0	35.0	9.8	19.1	23.1
March	66.8	36.0	10.1	20.8	23.8
April	68.1	37.1	10.2	20.8	23.7
May	69.1	38.3	10.2	20.6	23.6
June	68.8	39.1	10.0	19.7	23.7
July	68.7	39.8	10.1	18.8	23.4
August	68.9	40.2	10.0	18.7	23.9
September	69.5	40.6	10.1	18.9	24.5
October	70.3	40.9	10.1	19.3	25.0
November	70.9	41.1	10.1	19.7	25.3
December	69.4	42.0	9.9	17.5	26.1

[1] End-of-month book values, Department of Commerce.
[2] All commercial banks, Federal Reserve System.

APPENDIX A-5.—*Changes in bank debt of selected industries* [1]

[In millions of dollars]

Industry	Cumulative change, Mar. 28, 1951, through end of—									
	1951									Jan. 1952
	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
Manufacturing and mining:										
Food, liquor, and tobacco	−77	−203	−243	−371	−219	−11	279	441	690	572
Textiles, apparel, leather	24	51	115	129	75	38	−101	−194	−245	−284
Metals and metal products	8	105	275	353	560	727	812	929	1,149	1,669
Petroleum, coal, chemical, rubber	10	34	48	48	48	90	116	137	173	212
Other	9	12	61	83	112	130	136	164	201	205
Trade	67	72	62	−36	77	85	103	133	78	−77
Commodity dealers	−135	−303	−421	−456	−357	−257	−27	142	301	208
Sales finance	18	66	63	7	−39	−38	−42	−46	92	−228
Public utilities	19	103	175	213	288	393	493	496	526	473
Construction and other	3	0	52	32	11	−7	−15	−45	−9	−87

[1] Obtained from a sample of about 220 weekly reporting member banks reporting changes in their larger loans as to industry and purpose; these banks hold nearly 95 percent of total commercial and industrial loans of all weekly reporting member banks and about 75 percent of those of all commercial banks. During April and May the coverage was smaller.

NOTE.—This table is published regularly in the statistical section of the Federal Reserve Bulletin.

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APPENDIX A-6.—*Acquisitions of business loans and securities: All life insurance companies, monthly, 1948–51*

[In millions of dollars]

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Public utility:												
1948	83	122	176	178	148	152	152	119	156	198	181	268
1949	53	77	100	138	89	294	136	65	33	79	94	162
1950	39	177	87	106	143	252	157	168	73	128	86	136
1951	53	47	86	100	59	105	84	79	64	112	128	132
Railroad:												
1948	20	19	8	44	11	16	43	14	13	10	19	31
1949	5	13	10	9	6	22	11	10	6	6	19	16
1950	19	37	19	35	23	75	15	20	22	24	10	9
1951	44	13	24	23	24	19	24	18	25	30	27	41
Industrial and miscellaneous:												
1948	178	308	302	218	130	154	197	101	103	445	161	254
1949	150	162	143	273	153	197	317	79	124	142	189	219
1950	64	79	212	91	119	168	140	89	141	95	228	259
1951	128	144	223	359	293	300	215	279	147	185	199	438
Total business securities:												
1948	281	449	486	440	289	312	392	234	272	653	361	553
1949	208	252	253	420	248	513	464	154	163	227	302	397
1950	122	293	318	232	285	495	312	277	236	247	324	404
1951	225	204	333	482	376	424	323	376	236	327	354	611
Average 1948–50	204	331	352	364	274	440	389	222	227	376	329	451

Source: Institute of Life Insurance.

APPENDIX A-7.—*Acquisitions of real estate mortgages: All life insurance companies, monthly, 1948–51*

[In millions of dollars]

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Farm mortgages:												
1948	22	36	38	29	24	24	21	20	20	18	23	25
1949	25	34	42	27	28	26	20	19	22	21	20	31
1950	27	39	43	30	32	28	22	26	25	25	31	33
1951	49	48	49	39	38	29	27	24	20	24	25	35
Nonfarm mortgages:												
1948	227	203	271	256	229	272	265	271	239	284	270	327
1949	240	223	271	238	235	284	239	264	259	246	273	328
1950	244	238	339	288	345	370	394	415	313	531	475	575
1951	476	386	487	445	450	420	370	381	285	352	310	343
Total mortgages:												
1948	249	239	309	285	253	296	286	291	259	302	293	352
1949	265	257	313	265	263	310	259	283	281	267	293	359
1950	271	277	382	318	377	398	416	441	338	556	506	608
1951	525	434	536	484	488	449	397	405	305	376	335	378
Average, 1948–50	262	258	335	289	298	335	320	338	293	375	364	440

Source: Institute of Life Insurance.

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APPENDIX A-8.—*Changes in life insurance company holdings of loans and investments*

[In millions of dollars]

Year and quarter	U. S. Government securities	Real estate mortgages	Business securities	Year and quarter	U. S. Government securities	Real estate mortgages	Business securities
1948:				1950:			
First	−674	499	618	First	−45	548	303
Second	−683	532	894	Second	−456	709	350
Third	−1,016	540	769	Third	−445	829	360
Fourth	−963	620	1,348	Fourth	−887	1,117	647
Year	−3,336	2,191	3,629	Year	−1,833	3,203	1,660
1949:				1951:			
First	−274	477	475	First	−729	1,025	415
Second	−657	509	883	Second	−837	926	837
Third	−465	497	668	Third	−438	668	576
Fourth	−91	548	416	Fourth	−397	577	773
Year	−1,487	2,031	2,442	Year	−2,401	3,196	2,601

Source: Institute of Life Insurance.

APPENDIX A-9.—*Changes in loans and investment holdings of mutual savings banks, quarterly, 1948–51*

[In millions of dollars]

Year and quarter	U. S. Government securities	Real estate mortgages	Other securities	Year and quarter	U. S. Government securities	Real estate mortgages	Other securities
1948:				1950:			
First	112	93	172	First	120	297	75
Second	−110	172	120	Second	21	316	−49
Third	−209	201	86	Third	−356	427	−49
Fourth	−274	225	108	Fourth	−317	521	−40
Year	−481	691	486	Year	−532	1,561	−63
1949:				1951:			
First	181	206	67	First	−387	389	32
Second	−21	197	116	Second	−304	480	109
Third	−71	218	65	Third	−149	407	56
Fourth	−158	310	−58	Fourth	−253	341	67
Year	−69	931	190	Year	−1,093	1,617	264

Source: Federal Reserve System; National Association of Mutual Savings Banks.

APPENDIX A-10.—*Changes in loan and investment holdings of savings and loan associations, quarterly, 1948–51*

[In millions of dollars]

Year and quarter	U. S. Government securities	Real estate mortgages	Year and quarter	U. S. Government securities	Real estate mortgages
1948:			1950:		
First	−27	334	First	−15	382
Second	−65	486	Second	−10	660
Third	−95	388	Third	−40	574
Fourth	−98	230	Fourth	7	480
Year	−285	1,438	Year	−58	2,096
1949:			1951:		
First	80	175	First	65	285
Second	49	323	Second	9	561
Third	−35	430	Third	19	507
Fourth	−87	377	Fourth	23	445
Year	7	1,305	Year	116	1,798

Source: Home Loan Bank Board.

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APPENDIX A–11.—*Business expenditures on new plant and equipment*

[In billions of dollars]

Year	Total	Manufacturing and mining	Railroads and gas and electric utilities	Commercial and miscellaneous
1941	8.2	4.1	1.3	2.8
1948	20.0	9.9	4.0	6.1
1949	18.0	7.9	4.5	5.6
1950	17.8	8.2	4.3	5.4
1951	23.1	11.9	5.2	6.0
1952	24.6	13.9	5.7	5.0

Source: 1941–51, Department of Commerce, Securities and Exchange Commission; 1952, McGraw-Hill Publishing Co. and Federal Reserve.

APPENDIX A–12.—*Outstanding commitments of life insurance companies to acquire loans and investments for defense and nondefense purposes: End-of-selected months, 1951–52* [1]

	1951									1952, Jan.
	Apr.[2]	May[2]	June[2]	July[2]	Aug.[2]	Sept.	Oct.	Nov.	Dec.	
Total	4,504	4,331	4,197	4,055	3,749	3,928	4,037	4,394	4,175	4,144
Defense and defense supporting	1,687	1,677	1,760	1,757	1,642	1,706	1,867	2,112	2,019	1,983
Public utility	383	450	446	450	409	407	395	353	310	302
Railroad	300	298	309	297	286	236	204	192	170	137
Other industry	1,005	928	1,005	1,011	947	1,063	1,268	1,567	1,539	1,544
Nondefense	2,709	2,564	2,362	2,221	2,053	2,163	2,119	2,238	2,111	2,114
Industry	963	937	831	752	744	918	945	955	1,007	1,053
Other—real-estate mortgages	1,746	1,627	1,531	1,469	1,309	1,245	1,174	1,283	1,104	1,061
Farm	99	88	83	80	80	83	96	98	107	99
Nonfarm residential	1,648	1,539	1,447	1,390	1,229	1,162	1,078	1,186	997	962
VA guaranteed	650	577	531	484	402	365	316	276	270	257
FHA insured	649	619	594	566	509	490	452	437	417	409
Conventional	349	343	322	340	317	307	310	473	311	295
State, county and municipal	108	91	76	77	54	59	51	44	44	46

[1] Data for 45 companies which account for 85 percent of the assets of all United States life insurance companies; they are compiled by the Life Insurance Association of America in accordance with the program for voluntary credit restraint.
[2] Excludes business mortgage loans of less than $100,000 each and foreign investments, which were not reported until September.

NOTE.—This table is published regularly in the statistical section of the Federal Reserve Bulletin.

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APPENDIX A-13.—*New commitments made by life insurance companies to acquire loans and investments for defense and nondefense purposes,*[1] *September 1951–January 1952*

[In millions of dollars]

	1951				1952, January
	September	October	November	December	
Total	439	758	728	764	632
Defense and defense supporting	201	363	406	358	237
Public utility	44	41	12	35	36
Railroad	10	5	8	15	12
Other industry	147	317	385	308	189
Nondefense	226	384	317	402	390
Industry	71	157	130	203	166
Other—real estate mortgages	155	226	187	200	224
Farm	23	32	24	30	32
Non-farm residential	132	194	163	170	192
VA guaranteed	30	56	38	49	63
FHA insured	39	47	56	43	63
Conventional	64	92	69	77	66
State, county, and municipal	11	12	5	5	6

[1] Data for 45 companies which account for 85 percent of the assets of all United States life insurance companies; they are compiled by the Life Insurance Association of America in accordance with the Program for Voluntary Credit Restraint.

Representative PATMAN. Tomorrow we will have Mr. Beardsley Ruml and Mr. Allan Sproul and Mr. E. E. Brown before our commitee, which will meet at 10 o'clock here in this room.

Without objection, the committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 4:45 p. m., the subcommittee recessed, to reconvene at 10 a. m., Thursday, March 20, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

THURSDAY, MARCH 20, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL AND DEBT
MANAGEMENT OF THE JOINT COMMITTEE ON THE
ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:15 a. m., in the caucus room, Old House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman (chairman of the subcommittee); Senators Douglas and Flanders; and Representative Bolling.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

We have three witnesses today, and the committee has had a conference; and notwithstanding the fact that the order in which the committee would like to have the witnesses is not exactly like one or two of the witnesses would like to have their appearance, we are of the opinion that we should have them in the order of Mr. Sproul first, and then Mr. Ruml, and Mr. Brown, with the assurance that we will sit here today and get through with all three witnesses.

We hope that is not too inconvenient to Mr. Ruml and Mr. Brown, but the committee, after considering it, has decided that that is the way they would like to have the appearances of the witnesses.

Mr. Sproul, will you come around, please?

Mr. Sproul, we do not seem to have any extra copies of your statement.

Mr. SPROUL. I sent copies to Mr. Murphy for the committee, and the young lady has extra copies.

Representative PATMAN. That is fine. I beg your pardon, we do have them here, and I have one myself here underneath this.

So, Mr. Sproul, we are delighted to have you this morning, and we shall listen with interest and appreciation to your remarks.

We realize that you are the president of the largest Federal Reserve bank in the United States, and that you are vice chairman of the Federal Open Market Committee, and we realize your importance in this wonderful set-up, and we are anxious to hear your testimony.

I believe you have a prepared statement, and we are willing to leave it to you as to how it is presented.

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STATEMENT OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

Mr. Sproul. I would like to read the prepared statement, if I may, and then submit myself to questioning.

Representative Patman. That will be perfectly satisfactory, sir, and you may proceed.

Mr. Sproul. I need not read the first paragraph except to say that I have a copy of an address or talk which I made to a national group of life-insurance executives last December, which covers some of the matters with which your hearing is concerned, and I would be glad to submit that for the record.

Representative Patman. That will be accepted and carried as part of your remarks.

(The document referred to follows:)

Remarks by Allan Sproul, President, Federal Reserve Bank of New York, Before the Forty-fifth Annual Meeting of the Life Insurance Association of America, Waldorf-Astoria, New York City, December 12, 1951

CENTRAL BANKING AND THE PRIVATE ECONOMY

Not many years ago a speaker at a meeting such as this, who chose to speak on some aspects of the operations of the Federal Reserve System, would have had to begin by telling you what the Federal Reserve System is, how it is organized, and how it performs the functions which have been delegated to it by the Congress. I assume that is no longer necessary. The circumstances of the war and postwar years have brought the Federal Reserve System and the life-insurance companies in close touch with one another, even if only indirectly. You have been concerned particularly with our open-market operations in Government securities, and with the generality of our credit policies. We have been concerned with your purchases and sales of Government securities, and with your widespread activities in the field of term loans, direct purchases of capital issues, and mortgage financing.

It remains true, of course, that our primary and direct concern is with the commercial banks of the country, most of which in terms of assets and about half of which in terms of numbers are our member banks. This is so because the principal function of the Federal Reserve System is to exercise an influence upon the availability and cost of bank credit, so that inflationary pressures may be restrained and deflationary pressures may be moderated. And it is only the commercial banks of deposit which can increase or decrease the supply of bank credit, and of money in the form of bank deposits, based on reserves provided by the Federal Reserve System. This simplified picture has been scrambled somewhat, however, by the fact that we have taken it upon ourselves to maintain and preserve orderly conditions in the market for Government securities, extending this prescription, at times in the past, to the actual pegging of market prices. Right there we became pretty directly involved with the operations of life-insurance companies and other institutional investors, who were among the largest holders of and traders in Government securities.

The most critical aspect of this relationship in recent years has grown out of the fact that the market was not always able to come close to clearing the amount of long-term Government securities which you wished to sell, at prices and yields which would conform to our ideas of an orderly market, or our ideas of the lowest desirable price for the longest term issues. To make our policies effective meant purchasing, through the dealer machinery, the securities you could not sell in the market. This put reserve funds into the banking system almost as if we had made the purchases direct from the banks, and provided the basis for a possible multiple increase of bank loans and investments. And because inflationary tendencies have been present more often than not, during the postwar years, these support operations usually ran counter to our desire to restrain unnecessary expansion of bank credit.

It is true that we were able, through sales and redemptions of short-term or maturing securities, to offset a large part of the addition to bank reserves resulting from our bond-support operations, and from gold inflows and a decline

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in currency circulation as well. Nevertheless, we did provide some net addition to bank reserves during the postwar period.

The Federal Reserve System has been severely criticized for assuming the secondary obligation of preserving order in the market for Government securities. The more severe and doctrinaire critics have challenged us to show any authority from the Congress for the performance of this function. It is my own opinion that the great growth of the Federal debt over the past 10 or 15 years, its dominant position in the whole debt structure of the country, both public and private, and the importance which the instruments of Federal debt have assumed in the money and capital markets, are ample warrant for our concern and our action.

The more moderate critics, including some from your own ranks, have criticized the way in which we have attempted to carry out the task of maintaining orderly conditions in the Government security market, and more particularly the pegging of prices of the longest-term securities which we engaged in from time to time. It is not my purpose here to rake over the embers of old controversy, nor to try to justify everything we did, the way we did it, and the timing of our actions. I do want to touch on one or two aspects of this experience, however, which perhaps contain a lesson for the life-insurance companies as well as for the Federal Reserve System.

The lesson for the life-insurance companies might be that you should not try to eat your cake and have it. During the war years the life-insurance companies were among the largest purchasers of long-term Government securities. This was not wholly a patriotic demonstration of support of the war effort. The steadily increasing flow of funds into the life-insurance companies and the wartime lack of other investment outlets, as well as the safety of the Government's obligations, made most of these purchases a pleasant necessity. At the end of the war the life-insurance companies on the basis of previous standards, had an overbalanced portfolio position in Government securities. And with the appearance of a strong private demand for capital funds in the postwar years, your companies proceeded to redress the balance. They did this by committing new funds to other assets, and by large net sales of Government securities.

Taking all life-insurance companies together, this seems to have been an almost continuous process. There were wide variations among you in the amount of Government securities sold and in the method of sale, but many of you gave the impression of feeling that you had the Federal Reserve System over a barrel and could whack it at will. Taking advantage of our market support, Government bonds were treated as short-term investments bearing long-term rates of interest. They were treated as investments which could be held profitably and disposed of readily, in large amounts, when more attractive outlets for funds developed. They were even made the basis, in effect, for entering into future commitments for large-scale financing.

You may say that this is a normal aspect of your investment operations. You may say that this is an evidence of the free-enterprise system at work. Or you may say that the blame, if any, was ours for supporting the market, and giving assurances of support even though these assurances were only applicable to existing conditions and for the foreseeable future. That is all right as far as it goes, but I would introduce a note of caution. Many of you have become so big, and the operations of all of you are so charged with a public interest, as to inhibit your recourse to the market practices of investors with smaller aggregates of capital funds and with no public responsibilities. A wise degree of business statesmanship is needed to chart a course between the Scylla of increased public regulation and the Charybdis of falling behind your competitors in the race for business and profits.

It is true that you could not promise to hold forever the Government securities which you purchased during the war or after the war. No one, I believe, expected you to remain frozen into a disproportionate holding of Government securities. Looking at it from my side of the fence, however, you might have been expected not to use long-term Government securities as if they were short-term investments. You might have been expected not to try to unload long-term securities in chunks of 5, 10, 15, 20 millions, or more, on short notice whenever you wished. Such shifts in holdings, as some of you recognized, require time and marketing. Reliance on such heavy liquidation of long-term securities to meet immediate or near-term cash needs, meant that the monetary authorities felt forced to intervene to preserve order in the market, or even to peg prices in order to avoid the risks of a possible temporary panic in capital values and a temporary cessation of capital financing. And it also suggests that some of you were

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probably relying on this action of the monetary authorities to enable you to continue with safety drawing long-term rates of interest on what were being treated as short-term investments. That is trying to eat your cake and have it, too.

Some revision of ideas concerning the proportion of your assets which might be held in Government securities under present-day conditions, a better marketing approach to the liquidation of Government securities when you felt you had to sell, and a little less haste in reaching for the higher returns of corporate obligations, direct placements, and mortgage financing during periods of strain upon our economic resources, might have been becoming to your industry and good for the economy. And I say this recognizing that one of your aims was to reduce the premium cost to your policyholders. As you have so often and so well emphasized, no one has a greater stake in the prevention of inflation than the holder of a life-insurance policy. If practices which contribute to a reduction of premiums also contribute to inflation, the policyholder gains at the spigot but loses at the bung.

As for the Federal Reserve System, during the postwar years it had a harsh and thorough lesson in the difficulties of combining an effective credit policy with the maintenance of Government-security prices, and a chastening experience with the problems of "letting go" once you have resorted to pegging a market.

I do not mean by this to agree with those who argued then, and argue now with an "I told you so" inflection, that we should have addressed ourselves solely to reducing the money supply after the war, come what might in the Government-security market, or elsewhere in the economy. The financing of the war almost trebled the money supply of the country, and public holdings of liquid assets increased tremendously when incomes were high and civilian goods and services were lacking. These were the inevitable inflationary factors in war financing and in a wartime economy. The inflationary pressures thus generated were held in check but not removed by rationing, price and material controls, and other direct measures. When the war ended, and as direct controls were removed, our job was not and could not be to try to reduce drastically the war-swollen money supply. The most that could be attempted, by way of credit policy, was to prevent increases in bank credit from adding unnecessarily to the money supply and to avoid creating fears or expectations which would stimulate the increased use or velocity of the money which was already in existence.

What this country chiefly had to do in those postwar years was to grow up to the increase in the money supply generated by the war as quickly and with as little dislocation as possible. I still do not believe that we could have or should have resorted to a drastic policy of deflation. We did try to follow, with disheartening delays in application, a modest policy of restraint on unnecessary credit expansion, while facilitating a rapid strengthening of our productive capacity to meet accumulated domestic demands, and the needs of reconstruction among our friends and allies abroad. But the only final and constructive answer to the lack of balance between the supply of goods and services and the supply of money inherited from the war was an increased supply of goods and services growing out of increased production, out of increased efficiency of men and machines. That was the only way we could adjust to the increase in costs which had already taken place in our economy without the hardships and suffering and the economic losses of widespread depression and unemployment.

If the banks had been placed under severe pressure by a drastic credit policy, they would have had to follow a much more restrictive course in financing business and trade. If prices of Government securities had had a bad fall in the immediate postwar years, the supply of capital for business might have come forward hesitantly and in less than adequate amounts. It is extremely doubtful, in my opinion, that drastic action could have been taken to reduce the money supply in the years following the end of the war without seriously hampering the necessary expansion of production.

Where we fell short, in the modest program of credit restraint which we did attempt, was not in our arithmetic; it was not in our additions to and subtractions from the reserves available to the banking system, nor in holding down the money supply. Our failure, to the extent that we failed, was a failure to gain sufficient understanding and acceptance for our policies. The influence of a central bank depends a lot on tradition—on the belief that its actions will be wise and timely and effective. The Federal Reserve System has had little enough time to build up such a tradition, and you may question whether it has made the best use of the little time it has had. In any case, our policy of modest credit restraint, following the war, was tardy in application, due to differences with the Treasury, and seemed inconsistent and ineffective to many bankers and business-

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men and to the public, because of our involvement with the Government-security market. We were not able, except occasionally, to create the atmosphere of credit restraint. We did not do the job we might have done.

In 1950 and 1951, we have had to face a very different situation than that which we faced in the years following the war. By 1950 this Nation had achieved a tremendous expansion of its productive facilities and of housing and had, in fact, gone a long way toward "growing up" to the war-generated money supply. So far as the Government-security market was concerned, the longer-term debt was better fitted into investor portfolios and better held than it had been earlier. Interest rates at short term had already moved upward, so that static rates and fixed prices were no longer the only features of the market landscape to which traders and investors were accustomed. It had become practicable to try to enforce more severe general credit restraints by a coordinated program of credit policy and debt mangement.

The outbreak of the war in Korea made it imperative to put this program to the test. Strong inflationary forces had regained the ascendancy. An insistent large-scale demand for bank credit reappeared. Consumers were led to believe that a period of scarcity of goods and increases in prices lay ahead and they acted accordingly. Business plans for improvement and expansion of plant and equipment were revised upward, and inventory accumulation proceeded rapidly. The residential building boom, which had been deliberately encouraged by very liberal financing terms, was accentuated. Deficits in the Federal budget were widely predicted. There was a rapid expansion of the money supply growing out of increased private financing—not out of defense financing—and, equally important, an increase in the willingness of the public to spend. It was certainly high time for the Federal Reserve System to get wholly out of the business of pegging market prices of Government securities, and to step up its program of restraint on the availability of credit.

This was ultimately worked out with the Treasury; and accord was reached last March. A final attempt was made to remove the supply of long-term Government securities overhanging the market by means of a conversion offering, and by Federal Reserve and Treasury purchases of securities from those who still wanted cash. The Government-security market was then set free except for the maintenance of orderly day-to-day conditions, and the Federal Reserve regained, more completely than for a decade past, the initiative with respect to the availability and cost of reserve funds. And this freedom has been buttressed by a voluntary credit-restraint program which enlisted the enthusiastic and effective support of all groups of principal lenders, including your own. On this occasion we have been operating in an atmosphere favorable to credit restraint and with widespread understanding and approval of what we were trying to do.

In reaching this happy if belated resolution of some of our postwar difficulties—getting rid of our split personality—we incurred considerable displeasure in some quarters, however. A study of the Federal Reserve System by a subcommittee of the Congress, which to a certain extent reflects this displeasure, is now under way. When we look at the men making up the subcommittee, however, we can feel reassured that its work will be thorough and objective. If so, we can look forward to its hearings and its findings. It will be good for the country and for the Federal Reserve System to have an intelligent airing of some of the ideas about money and credit, and its management, which are always latent in this country and sometimes come to the surface. If we can lay the ghost of a few of these ideas, even temporarily, we shall be better able to do our jobs. Certainly you have a stake in this study which goes far beyond answering the questions which have been addressed to the executives of some of the life-insurance comanpies. As represenatives of institutions holding a tremendous amount of the savings of the people, as large-scale investors, and as citizens, you must necessarily be deeply concerned with some of the issues which are raised by this study. I should like to touch on two or three of them briefly.

First, there is the question of the independence of the Federal Reserve System. That word "independence" usually generates more heat than light. Let me make clear, therefore, what I mean by independence, and what I do not mean. I do not mean that an independent Federal Reserve System can have policies and a program which run counter to the national economic policy. That has never been the case, is not now, and never should be. An independent Federal Reserve System is one that is protected both from narrow partisan influence and from selfish private interests. It is a system with special competence in a difficult technical field, acting under a general directive of the Congress within the bounds of national economic policy as determined by the Congress.

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This is not a new question although it was brought sharply to the fore by the regrettable public dispute between the Treasury and the Federal Reserve System in late 1950 and early 1951. The question was debated and decided first at the time the Federal Reserve System was established in 1913. Whenever there have been major amendments to the Federal Reserve Act the Congress has reaffirmed its original judgment on this important point. And when the Douglas subcommittee, which preceded the Patman subcommittee, gave its intelligent attention to this problem 2 years ago, it came out strongly on the side of the angels.

The core of the problem as it has recently presented itself is the necessity for coordinating debt management and credit policy. Debt management and credit policy cannot work separately, but they can work badly or well together. Putting the case from the standpoint of the Federal Reserve System, their coordination requires recognition of the fact that there cannot be a purposeful credit policy unless the Federal Reserve System is able to pursue alternating programs of restraint, "neutrality," and ease as the business and credit situation may require, and to act promptly with each change in the general situation. It requires recognition of the fact that such programs must, as they accomplish an increase or contraction in the volume of credit and a tightening or loosening in the availability of credit, affect interest rates not only for private lenders and borrowers, but for the Government. It does not require that the management of the public debt be made unnecessarily burdensome to the Treasury, nor that the cost of servicing the debt, over time, necessarily be increased. It does require that Government borrowing hold its place in the market instead of being floated on a stream of newly created money.

Successful coordination of debt management and credit policy depends on the sensitivity of the money and capital markets, and the possibility of close and continuous contact with all areas of these markets, to make credit policy effective with relatively small changes in credit availability and interest rates. It depends on the great growth that has occurred in the Federal debt, its widespread distribution, and its importance in the portfolios of the increasingly important institutional investor, to make this sensitivity real and this contact with the money and capital marekts pervasive. In other words, it uses the facts as they exist to further the purposes of credit policy and to combine it with effective debt management; it does not try to alter the facts.

This does not require nor suggest a subordination of the Treasury to the Federal Reserve System. What is needed is to redress the balance in their coordinate spheres. The Treasury is one of the oldest branches of the Federal Government, and the Secretary of the Treasury is one of the highest executive officers of the Government and usually an intimate of the President. It has been natural for succeeding Secretaries to assume, since the relatively recent establishment of the Federal Reserve System, that their responsibility and authority is exclusive in cases where credit policy and debt management overlap. It should be possible, however, to separate the Federal Reserve System from a host of advisers to the Treasury, public and private, so that the Treasury and the System could approach these overlapping problems as equals seeking solutions and, by mutual agreement, finding solutions which best fit the needs of the economy of the country at the time.

Recognizing that there still could be differences of opinion, the situation suggests to some that the Federal Reserve System be brought within the executive branch of the Government, or that the Chairman of the Board of Governors be made a member of the Cabinet, so that as a last resort conflicts might be resolved by the President. This solution runs counter to the whole idea of separation of the central banking system from changing executive administrations, and compounds the mistake of burdening the President with too many responsibilities in fields where a tradition of technical competence is necessary. It would lead either to bottlenecks in reaching decisions, or to decisions actually made by staff members having no direct responsibility to the Congress or to the public. Its practical effect would probably be to place the Federal Reserve System under the domination of the Treasury, or to place both the System and the Treasury under the domination of something like the Council of Economic Advisers.

A more hopeful avenue to follow is the suggestion of the Douglas committee that Congress give a general mandate to the Treasury and the Federal Reserve System regarding the objectives of debt management and credit policy in the light of present-day conditions. These instructions, as the Douglas committee said, need not and in fact should not be detailed. They would not challenge the primary responsibility of the Treasury for debt management. They should specify,

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however, as part of the legislative framework of debt management, that the Treasury have regard for the structure of interest rates appropriate to the economic situation. The implication of such a directive, to me, would be that the Treasury could not, as a matter of right or of superior position, call upon the Federal Reserve System to make a market for its securities. I recognize that there would continue to be differences of opinion about these matters, and I realize that you cannot legislate cooperation between people, but the Congress, as final judge, might be able to provide a mandate which would charge debt management as well as monetary management with some responsibility for the general objectives of the Employment Act of 1946.

There may be other ways to bring about a better coordination of debt management and credit policy, without sacrificing the independence of the Federal Reserve System or the Treasury. We should be ready to consider them. But they should not sacrifice credit policy on the altar of perpetually easy money. The country cannot afford to keep money cheap at all times and in all circumstances, if the counterpart of that action is inflation, rising prices, and a progressive deterioration in the purchasing power of the dollar—including the purchasing power of the dollars which the Government itself must spend and the purchasing power of dollars invested by the public in Government securities.

Perhaps as a subsidiary of this first question, I should mention the interest displayed by the present congressional study group in the earnings and expenses of the Federal Reserve banks, and in whether money has been spent to influence public opinion on controversial questions. The facts as to the earnings and expenses of the banks are available to everyone, and are included in annual reports to the Congress. The efficiency of operations of the banks is open to the daily observation of all who have dealings with them. Their operations are under the immediate scrutiny of boards of directors performing a public service but used to the compulsions of operating a private business for profit, and they are subject to check and audit by the Board of Governors of the Federal Reserve System at Washington. There is no lack of control of the financial affairs of the Federal Reserve banks in the public interest.

Whether expenditures have been made to influence public opinion on controversial questions, depends on what these words mean. If they mean that we have tried to create some public understanding of what we are doing and why we are doing it, even if the questions involved might be termed controversial, I think the System would have to plead guilty. Central bankers in other countries have preferred traditionally to let their actions speak for themselves—some of the actions of a central bank are difficult to explain in terms which can be generally understood and which do not do violence to accuracy. In a country such as ours, however, you are likely to go out of business if you do not explain, from time to time, what you are doing in the public domain. As I see it, we have not only a right, but a duty and an obligation to let the Congress and the public know what our general policies are and why we have adopted them, even if at times we must touch on matters which some consider controversial.

To try to correct some fancied abuses in this area by putting the Federal Reserve System in with the sprawling Government departments and bureaus administered by the Civil Service and the General Accounting Office would, in my opinion, destroy something fine which has been created in the public interest. And it would be one way to undermine the independence and the regional character of the Federal Reserve System.

The second main question I want to touch on is the desirability and effectiveness of general credit controls in combating inflation and deflation. Are they still useful or are they outmoded? All that should be claimed for general credit controls, in my opinion, is that combined with other measures working in the same direction, such as fiscal policy, debt management and, in extraordinary circumstances, direct controls, they can contribute to anti-inflationary or anti-deflationary forces. This, I think, they are peculiarly fitted to do in a country with our political, social, and economic leanings and beliefs. There are those who deny this. They admit that a severe policy of credit restraint can be effective, but they say that the resultant declines in production, employment and incomes are no longer socially acceptable. A severe policy of credit restraint is also impossible, they say, in the face of a Federal debt of $250 billion and the needs and requirements of managing such a debt. A mild credit policy, on the other hand, is said to be ineffective at best and may be harmful at worst, at least in its anti-inflationary phase. Then, it is claimed, it may involve increasing the cost of servicing the public debt, disruption of the Government security market, and interference with an expanding economy, in order to get at a handful of private transactions.

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I am more hopeful than these critics as to the effectiveness of a modest credit policy and more concerned with the preservation of a control which does not do violence to our private economy. It seems to me that the same circumstances which are responsible for the problems of coordinating debt management and credit policy, contribute to the effectiveness of mild general credit policies, and that we can have an expanding economy without throwing too much of the gasoline of easy credit on the fires of active business. Because of the size of the public debt, and its relative importance in the whole structure of debt, public and private, the Federal Reserve System is now able to carry on its open market operations in a broad homogenous market, nationally integrated. The effects of its operations are more quickly felt in all part of the country and in all areas of the private sector of the market than used to be the case. The sensitivity of the market is greater than it used to be; and the leverage of credit policy has multiplied.

It must be frankly admitted that there still are difficult problems to be worked out in providing the proper sphere of effectiveness of general credit policy under present conditions, and in perfecting the mechanics of making the policy work. But I would beware of those who are trying to discredit general credit controls, and who would place main reliance on selective credit controls, or on more direct means of rationing bank credit, in adapting credit policy to our economic needs.

We all recognize that one of the central problems in our country, and in all the western democratic countries, is how far Government guidance and control of economic affairs can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we have preferred to keep such control to a practical minimum, and to have it exercised in largely impersonal ways—by means of controls which affect the general environment, not the individual. One cornerstone of such a philosophy is an independent, competent, central banking system empowered to make general credit policy work to the limit of its usefulness and effectiveness. This is one of the best defenses against Government intrusion in our individual and private affairs.

As a subsidiary of this second question concerning general credit controls, I might pay my respects to the suggestion that credit policy should now be charged with perpetual par support of Government securities. Some bankers and insurance people have succumbed to this idea, I am told, perhaps lured in that direction by earlier actions of the Federal Reserve System and statements of its representatives. I am very sorry if this is so. The idea baffles me. It is an excursion into the land of "hatchy-malatchy," which I hear about once in awhile on the radio when I don't turn it off quickly enough in the morning after catching the news. Approach it as you will, perpetual par support doesn't make sense.

Take it from the point of view of credit policy. Unless a workable way can be found to insulate the Government security market from all other markets, a project which I consider to be of dubious desirability and unlikely practicality, perpetual par support of Government securities by the Federal Reserve System would make any pretense of credit policy ridiculous. The essence of general credit control is the control of reserve funds available to the banks, and that inevitably means fluctuating interest rates and fluctuating prices of securities. The Federal Reserve System could not have a general credit policy, if at all times and under all circumstances it had to support Government securities at par.

Or take it from the point of view of debt management. If Government securities had to be supported at par, present forms of debt management would become obsolete. If all Government securities of all maturities can be liquidated at par at any time they become, in effect, demand obligations, and need only bear varying rates of interest if the Government wants to reward various kinds of holders in different ways. I doubt if the life insurance business would want to become a claimant for Government support on that basis.

Or take it from the point of view of the frequently expressed determination of the Congress to prevent unlimited direct borrowing by the Treasury from the central banking system. To fasten on the System the obligation to support Government securities at par, would mean that the Treasury could sell Government securities to the Federal Reserve banks, in almost any amount, in peace as well as in war, after only a hasty detour through the market. The only check would be the flooding of the market with the reserve funds which we would use to buy the Government securities, and the resulting willingness of the market to purchase further issues of Government securities at almost any price and yield. That is not the kind of check or restraint the Congress has had in mind.

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Or take it from the viewpoint of the public, whose common sense has always resisted the view of a shouting minority that the Government should print the money to pay its expenses. Would the public not perceive that this idea of par support of Government securities is just the same old something-for-nothing dodge, with interest? I am sure it would.

The third and final question which I would call to your attention is the question of centralization of control of credit policy. So far as the Federal Reserve System is concerned, this involves the locus of power and the structure of administration. The framers of the original Federal Reserve Act conceived a system at once national and regional. Despite the vicissitudes of the intervening 37 years, that fundamental idea has retained its vitality. It has done so, I believe, because it is in accord with our political beliefs and the Federal structure of our Government.

This concept has its defects, of course, but they are principally the defects of democracy itself, and of a system which relies on checks and balances to prevent the emergence of dictators. Plausible arguments can be assembled for abolishing the present organization of the Federal Reserve System. Action by boards or committees, such as the Board of Governors or the Federal Open Market Committee, is apt to seem cumbersome, time-consuming, and sometimes productive of group decisions which may not reflect the wisdom of the best men in the group. A distribution of powers between a board at Washington and 12 regional banks may seem to be an unnecessary obstacle to the prompt formation of national credit policies.

We would all admit, I think, that a single administrator or executive, with deputies or assistants, is the best way to manage an operating organization. It is another matter, however, to create a single policymaker in the vital field of national credit policy, no matter how competent the man you might get, once in awhile, and no matter what rank you might give him in the Government hierarchy to emphasize the importance of his duties. It would violate our national concept of the way in which Government should exercise its powers in molding or guiding our economic affairs, at least under any conditions short of total war. And I think it would do violence to the beliefs, and harm to the interests, of all of you.

Similarly, with the regional organization of the Federal Reserve System, and the partial distribution of powers as between the Board of Governors at Washington and the 12 Federal Reserve banks. In the early years of the System this organization and this division of powers did lead to difficulties in formulating and administering a coordinated national credit policy. An assertion of power by the Federal Reserve banks, and the emergence of dominant individual leadership at the banks, reduced the Board of Governors to less than its statutory and necessary position, as the central coordinating body of the System. When major amendments to the Federal Reserve Act were adopted in 1935, in order to bring about a greater degree of central and coordinated control, the Congress was careful, nevertheless, to preserve the regional character of the System.

It recognized that what was needed was not the destruction of the regional system, but to bring the Board of Governors and the presidents of the Federal Reserve banks together at a common council table having statutory sanction and responsibilities. That was achieved, so far as open-market operations are concerned, by the establishment of the Federal Open Market Committee in its present form. With it was achieved a body within the System which is at once regional and national, and which can act promptly on matters of credit policy with a minimum of internal friction. In this committee the Federal Reserve System has evolved a method of conducting policy deliberations and formulating policy actions that is uniquely in tune wtih our political and economic institutions. Government is directly represented through the Presidential appointees to the Board of Governors. Regional interests which go to make up the national whole, and the lessons of experience in the field, are represented through the rotating membership of the Federal Reserve bank presidents. National policies are established without complete centralization of authority in one man or a group of men at Washington.

This is also a question of men as well as of mechanics. The structure of and the distribution of power in the Federal Reserve System is closely related to the problem of recruiting men who will be equal to the task and responsibilities of the System. We need men at the Federal Reserve banks who are competent both in administration and in the field of credit policy, who have qualities of leadership which will make them a force in their own communities and, collec-

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tively, in the Nation. That means that the rewards and satisfactions of service must be such as will attract and hold men of talent. That is partly a question of compensation, but even more important is the opportunity for public service, with the power as well as the satisfactions which go with such service. If power and influence are wholly ripped away from the Federal Reserve banks, if the banks become branches of a central authority, the men who run the banks will become branch managers, no matter what they are called. The satisfactions and powers of public service will then be minimized, and the prestige and efficiency of the System within the districts and in the Nation will decline. We shall attract job holders when what we want and must have are men—able, competent, imaginative, progressive men. And we must give these men an opportunity to develop their powers in an atmosphere which is stimulating and satisfying, not stifling and frustrating.

In what I have had to say about some of the questions which are now under study by a congressional committee, I am not arguing that the Federal Reserve System, as it stands, is perfect in its personnel, its powers, its organization, or its functioning. It is not. I am arguing that it embodies certain basic concepts which have proved themselves over the years. I am arguing that these concepts will contribute to the further development of general credit policies which, along with other measures, will be effective in promoting high levels of production and employment in this country and in preserving the integrity of the dollar. I am arguing for effective general credit policies, as contrasted with dictatorial direct controls of individual transactions which would destroy our economic freedom. I am suggesting that an independent regionally organized central banking system can be a bulwark against the destruction of the kind of private economy which will enable this country to discharge its enormous economic responsibilities in a troubled world.

Mr. Sproul. There is no need, as I see it, to try to review here the opinions which I have already submitted to you, in writing, for your consideration. It may be useful, however, to offer some general comments growing out of a quick and partial reading of the valuable information which your committee has collected in the two volumes of replies to questionnaires published last month.

I have not had time to explore this whole reservoir of facts, figures, and analyses, but my reading has suggested three or four generalizations which I hope will not be considered "facile." I assume that we have decided, by the very fact that we have a Federal Reserve System, that we need discretion in monetary management; that we can't rely on automatic rules or formulas, on an automatic gold standard or anything else to solve our problems for us. And, except for a few commentators there seems to be wide agreement that, in exercising this discretion, general credit measures have an important role to play in helping to promote economic stability. That agreement is modified, however, sometimes to the point of nullification, by reservations as to the effectiveness of general credit measures in particular circumstances, as to the proper timing of their use, as to their impact on specific segments of the economy, and as to their compatibility with confidence in the credit of the Government and a successfully functioning market for Government securities.

For present purposes, I would like to try to cut through this mass of subtle reasoning and intricate analysis to a few simple propositions. These are what might be called informed judgments without proof. There can be no absolute proof in these matters.

My first proposition is that at times of high national production and income, when demand tends to run in excess of available supply, the further expansion of bank credit must be restrained if we are to avoid inflation. The most effective program, of course, is one in which fiscal policy, debt management, monetary and credit policy, and all other governmental programs work in the same direction and re-

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inforce each other. This should be a team job. It is largely meaningless, I think, to try to list anti-inflation measures in an ascending or descending order of value and importance. Whatever positive value you may ascribe to general credit measures, however, I feel safe in asserting that an inflationary credit policy can make it almost impossible to achieve stability by other means, particularly in a situation which does not justify comprehensive direct controls. Unrestrained expansion of bank credit, beyond what is required for increased production, leads to excessive demands on the available supply of goods and services and to inflated prices. This is so because of what it does to the money supply, because it tends to extinguish caution on the part of borrowers and lenders, because it imparts a false liquidity to business assets, and because it destroys public faith in your determination to combat inflation and preserve the integrity of the dollar.

We have been in or on the brink of this kind of situation during much of the period since the end of World War II, and particularly in the 9 months following the outbreak of fighting in Korea. Recently an increase in saving has moderated the influence of inflationary pressures, but nothing is less predictable, in the short run with which we have to deal, than the relation of saving to income. Among other things, it is highly sensitive to the public attitude toward inflation. If there had not been signs of a will to keep inflation under control in recent months by general credit measures and other means, and if there had not been a decline in fears that goods were going to become unavailable, I doubt if increased saving would have saved the day. The Federal Reserve System has felt that it had a duty and a responsibility during this period to combat inflationary tendencies by general credit measures. It is not without significance that in many other countries, with democratic capitalistic economies similar to ours, the same course has been followed.

My second proposition is that while the timing of action in the field of credit policy is a matter of judgment and opinion in the light of circumstances, which are seldom twice alike, it is a good starting point toward decision to remember that general credit restraints are usually most effective when applied before inflationary pressures have gained momentum. In the period since the end of the war in 1945 doubt and hesitation with respect to anything smacking of general credit restraint was raised to the level of a principle. What was done was usually too little and too late. Pegged prices of Government securities, which make purposeful credit policy impossible, were maintained too long. The one time prompt and agreed action was embraced with enthusiasm by all concerned was in 1949 when the temporary subsidence of inflationary pressures counseled a relaxation of restraint upon credit expansion and a concurrent decline in interest rates.

A curious form of circular reasoning seems to envelop many of those who either have little faith in or actually oppose general credit measures as one of the means of combating inflation. They will argue that such restraints are too dangerous to be used because of their collateral effects, or they will argue that they are ineffective even to the point of perverseness, but they will readily agree that a relaxation of such restraints is desirable and helpful when deflationary pressures make their appearance. Their attitude seems to be that it is always good to have credit made easy and for interest rates to go down,

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but seldom, if ever, good for credit to be made less readily available and for interest rates to go up. They seem to believe that success in curbing a rise in the volume of bank credit, under inflationary conditions, might be bought at the price of a "tenacious level of higher interest rates that would be an obstacle to future economic expansion." This belief, I would say, opposes their assertion that restricting the availability of credit has only a limited effect on extensions of credit to meet private demand. It also ignores the flexibility of general credit measures which are not committed to any level of interest rates, but only to governing the availability of credit in terms of the needs of the economy at different times and under differing circumstances. The monetary authorities are not for high rates or low rates; they are for the lowest rates compatible with a healthy stable economy. They need to be able to take action promptly, in either direction, if small doses of credit restraint or credit relaxation are to do their work well.

My third proposition is that one great merit of general credit measures is that they are not and cannot be aimed at specific segments of the economy. They leave largely to the determination of the market place and to the thousands of individual decisions which are made within the market, the impact and the areas of curtailment when restraint is in order. If there are overriding national considerations, as in time of war, which require that demand be curtailed in specific areas in some order of priority which cannot be determined in the market place, special direct controls should bear this special burden, although selective credit controls may also play an important role. In a mixed peace-war economy such as we have at present, the necessary but limited direct controls can be and are supported by measures of general credit restraint. In fact they must be so supported if they are to do their work.

My fourth proposition is that the Government's credit does not depend on price fixing or price support in the Government security market. The Government's credit depends on the productive resources of the United States and its citizens, and on the ability and sagacity and integrity with which we manage our affairs. Faith in the credit of the Government is the basis for confidence in Government securities, and this faith and this confidence do not waver with changes in prices and yields of particular pieces of paper which reflect passing changes in the demand for and the supply of funds for investment. There is no necessary incompatibility between confidence in the Government's credit, confidence in Government securities, and measures of general credit control which cause temporary changes in prices and yields of Government obligations. For my part, I believe that the great growth in the Federal debt, its wide distribution, and its importance in the portfolios of large institutional investors, has created opportunities as well as difficulties for credit policy. Through the discount rate and open market operations we are now able to have direct contact with a broad homogeneous nationally integrated market, sensitive to modest changes in the direction of credit policy. We no longer have to rely on tactics which run the risk of burning the barn to roast the pig.

I do recognize a continuing obligation, under existing conditions, to maintain orderly markets for Government securities. Orderly markets have been defined as markets without airpockets; that is,

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markets where there is a degree of continuity between demand and supply at going or moderately changed prices. Orderly markets restrain erratic movements of prices and yields which seem to have no justification in terms of general economic and credit conditions. They do not preclude broad movements that reflect changes in basic underlying forces. This conception of orderly markets is not the same as the conception of a stable market defined as one in which prices and yields fluctuate within a moderate range, over a considerable period, without exhibiting any pronounced upward or downward tendency. The latter is an invitation to a pegged market whether so intended or not. Those who deal in the market will quickly probe to find out what are the limits of your "moderate range" and the lower limit of that range will become a peg. That is not the way to maintain confidence in the credit of the Government nor in the Government security market, and it makes it impossible to have a monetary policy which will contribute its share to economic stability.

I do not want to be interpreted as denying that there is a problem of how best to combine debt management and an effective monetary policy under conditions of substantial deficit financing and frequent Treasury refundings. There is a problem which includes the necessary market stabilization at the time of Treasury offerings. We shall face it during the second half of this year, particularly if the Congress does not move to eliminate the prospective deficit in the cash budget for fiscal 1953 It is a measure of fiscal failure that with very high levels of income, and with the necessary demands of the defense program on that income not unbearably large, we are faced with a considerable cash deficit. It is a matter of regret in the field of debt management that we are faced with five refunding operations during the last 6 months of this year, rather than having a well-spaced schedule of maturities. It will require the closest coordination of debt management and credit policy to meet this situation without endangering our economic stability.

It is this general problem we should be working on, without further and sometimes doctrinaire arguments about whether and when and how general credit control measures are effective. It is this problem we have been working on since the Treasury-Federal Reserve accord of last March. The possibility of its solution, I assume, is one of the principal interests of your committee. The main hope of solution lies in the Treasury and the Federal Reserve meeting regularly as equals to define and discuss the problem, to present the considerations of debt management and credit policy which they deem important, and to devise a joint course of action. Much of the difficulty in the past, as I observed it, grew out of the tendency of the Treasury to assume that its responsibility and authority was exclusive in cases where debt management and credit policy overlapped. Since this attitude is now changed, it should be possible for reasonable men to go forward in double harness.

Because the Treasury should have every protection in this sharing of mutual responsibilities, and for the guidance of future Secretaries, I have inclined toward a new congressional mandate such as was suggested to the Congress by the Douglas subcommittee. This would act as a guide to both the Treasury and the Federal Reserve in meeting their responsibilities for debt management and credit policy; it would subordinate neither one to the other.

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It has also been proposed that there be set up a sort of national advisory council, which would try to repeat in the domestic field the success of the existing National Advisory Council on International Monetary and Financial Problems. In my testimony before the Douglas subcommittee I said that formation of a consultative body along such lines might merit your consideration. I am more doubtful now, and intervening events suggest some caveats. I certainly would not want to suggest such a body as advisory to the President, with the implication that final decisions in this field, as in so many others, would be made by the Presidential office. The practical effect of that might be to place the Federal Reserve under the domination of the Treasury, or to place both the Federal Reserve and the Treasury under the domination of some White House group. Such a national advisory council, if it recommends itself at all, should be a clearinghouse for the discussion of policy problems in related fields, and for developing staff coordination; it should not be a superauthority with either explicit or implicit executive responsibilities and duties. If establishment of such a domestic advisory council, by the Congress, is to be considered, therefore, I would bracket with it the suggestion of a new congressional mandate to the Treasury and the Federal Reserve, as insurance that the council would not try to substitute its judgment for the judgment of these two agencies.

It should be remembered, of course, that the participation of the Chairman of the Board of Governors in such a council would have to be different, in any case, from that of the executive head of a department or bureau of the Government who wields the final authority in his department or bureau. The Chairman of the Board of Governors is one member of the Board and one member of the Federal Open Market Committee. Unless you want to scrap the whole idea of a board or a committee in favor of a credit czar, the Chairman of the Board could not commit the Board nor the Committee to any course of action not sanctioned by the Board or the Committee. He could bring to the council the views of these bodies of which he is a member, and he could bring to these bodies the views of the council, but he could not decide, by himself, what Federal Reserve action should be.

This same consideration has its application to the relations between the Federal Reserve and the Presidential office. The Chairman of the Board of Governors is the natural means of liaison between the Federal Reserve and the Executive, and it is quite appropriate that he should keep open the channels of communication and information between the Federal Reserve and the Executive. But both the Executive and the Chairman must remember that the Chairman is only first among equals on the Board of Governors and in the Federal Open Market Committee; he cannot make commitments not previously sanctioned by the Board or the Committee, and he cannot give assurance of action which has not been considered and approved by the Board or the Committee.

I would have liked to end this part of my testimony by consigning past controversies to limbo and concentrating on a future of Treasury-Federal Reserve cooperation in matters of debt management and credit policy. That, I am sure, is the desire of your committee. Unfortunately, I feel that I cannot let the matter rest there if we are really to gain from past experience in meeting future problems. There has been introduced into your records an account of Treasury-Federal

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Reserve relationships since the end of World War II, and particularly during the period August 1950 to March 1951, which should not be allowed to stand as the final unquestioned record of that period. I take it upon myself to raise the question because I am perhaps the only one now active in the Federal Reserve System who has personal knowledge of most of what happened.

Senator DOUGLAS. Mr. Sproul, are you referring to the statement of the Secretary of the Treasury, as published on pages 72 and 73 of the two volumes?

Mr. SPROUL. I do not know the pages; I am referring to the answer to question 17.

Senator DOUGLAS. Yes, that is right; and the discussion of this period is on pages 72 to 73. It is on this matter that I questioned Secretary Snyder when he appeared as a witness before us. Thank you.

Mr. SPROUL. There is little or nothing to be gained by rehashing in detail all of these postwar developments; I have indicated my general view that, despite agreement on objectives, we followed a policy so cautious, so hesitant, so distrustful of general credit measures, and so little understood by the public that credit policy lost much of its effectiveness. When we come to the summer of 1950, however, our differences are said to have become more serious. It is from there on that I may be able to make some contribution to the work of your committee insofar as recommendations for the future may draw support from the record of the past.

The story really begins in the latter part of 1949 when inflationary pressures began to reassert themselves, after a lull, and the Federal Reserve thought that restraints on credit expansion which had been relaxed earlier in the year should be reimposed. A curious bit of working at cross purposes developed. The Treasury evidently thought that our arguments for credit restraint were being made known to the market and were resulting in downward pressure on prices and upward pressure on yields of Government securities. We observed, on the other hand, that the Treasury was adopting the practice of announcing forthcoming offerings of securities weeks instead of days in advance of the actual offering date, thus in effect committing us to continuous support of existing market conditions if the offerings were to be successful.

It was with about a year of such experience behind us, that we came to August 18, 1950. The outbreak of war in Korea had set off an inflationary splurge which could not be ignored. As stated in the answer of the presidents of the Federal Reserve banks—to question D 13 in the questionnaire you addressed to them—the System stood aside until the President had sent a special message to the Congress on the defense needs growing out of the Korean hostilities and until the Treasury had determined the probable magnitude of early additional financing. When the national course had been set and an anti-inflationary program announced, which placed primary reliance on fiscal and credit measures, the Federal Open Market Committee felt that in support of this program the Federal Reserve System should use all the means at its command to restrain the further expansion of bank credit, while maintaining orderly conditions in the Government security market.

The immediate action taken on Friday, August 18, was approval by the Board of Governors of an increase in the discount rate of the Federal Reserve Bank of New York from 1½ to 1¾ percent, effective

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at the opening of the next business day, Monday, August 21, and approval by the Federal Open Market Committee of a general policy of making reserves less readily available to the banks, by purchases of Government securities, thus restricting the principal source of new credit in the economy. These actions contemplated an open market policy within which we would be reluctant buyers rather than ready buyers of Government securities, a consequent rise in short-term rates, restoration of the discount rate as a policy weapon, and a reduction of the price at which we would buy the longest term restricted bonds so as to eliminate most of the premium we had been paying.

Advice of the action of the Board and of the committee was conveyed to the Treasury on Friday afternoon, August 18. The Secretary was told that the action had been taken and that a public statement concerning it was being prepared for issuance that afternoon; that his blessing had not been specifically sought in advance because it had been decided that this would be asking too much of him in the field of our primary responsibility. The immediate response was that an accomplished fact required no comment. The delayed response was advice to us, that same afternoon, that the Treasury had decided to announce its September-October 1950 refunding—a $13 billion operation—immediately, maintaining the existing rate of 1¼ percent for 1-year obligations—the actual offering was a 13-month note. The inconsistency of this decision with our action was clear to all concerned.

We could not reverse our earlier action, in the light of our reponsibilities to the Congress and to the public as we saw them. We took the only other course open to us. We purchased the larger part—$8 billion—of the securities maturing September 15 and October 1, 1950, in order to assure that there would not be an overwhelming rejection of the Treasury offering.

Senator DOUGLAS. Mr. Sproul, I do not want to interrupt, but on page 70 of the reply of the Secretary of the Treasury, referring to this peiod of time he states as follows:

> The result of the actions of the Federal Reserve System was a significant financing failure for the Federal Government.

Mr. SPROUL. Any financing failure was in terms of the fact that we had to buy most of these securities in order to make it go over.

Senator DOUGLAS. That is right; that they could not sell to the private market because of the rise of the rediscount rate.

Mr. SPROUL. That is right.

At the same time, to offset these additions to the System portfolio, and to bank reserves, we sold other securities at higher yields, yields more nearly reflecting market conditions and more nearly in line with our action on discount rates and our open-market policy. This was a deplorable situation, but it seemed to us then and it seems to me now that our action enabled us to hold the volume of Federal Reserve credit and member bank reserves at lower levels than if we had continued to peg 1-year obligations at 1¼ percent through a period of strong and rising credit demands. In that case we would have been persistent buyers of short-term securities without the possibility of offsetting sales. For the longer pull, we were taking an important step toward regaining the initiative with respect to reserve funds, rather than leaving that initiative with the market.

The next Treasury financing about which a question has been raised, involved the refunding of $2,600 million bonds maturing December 15,

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1950, and $5,300 million certificates maturing January 1, 1951. The joint refunding offering, announced November 22, 1950, was a 5-year 1¾-percent Treasury note which all had agreed should be tried in order to improve the debt structure and to space out maturities which were becoming congested because of repeated financing in the 1-year area.

Senator DOUGLAS. Mr. Sproul, on page 72 the Secretary of the Treasury, referring to this event, stated:

> The terms of the issue were approved by the President; and the Chairman of the Board of Governors assured the Treasury of the full cooperation of the System in the refunding operation.

Is it your understanding that the Chairman of the Board did make such a pledge for full cooperation?

Mr. SPROUL. I have no doubt that he did.

Senator DOUGLAS. All right.

Mr. SPROUL. The initial response to the announcement was favorable; the issue was considered to be fairly priced. As it turned out, however, the new note did not meet the needs of a substantial number of the holders of the maturing issues, who preferred either to do their own refunding into shorter-term obligations in the market, or to take cash at maturity; and the banks were less willing than usual to absorb the "rights" which these holders offered for sale, either because of their own liquidity position or because of apprehension concerning the future course of prices and yields growing out of the September-October financing experience and the evidence of Treasury-Federal Reserve conflict. In terms of the amount of the maturing issues bought by the Federal Reserve and the amount redeemed for cash, the financing was not a success by the standards of recent years.

It has been stated that the Federal Reserve, on the first day of trading—November 24, 1950—after announcement of the new issue, allowed the market to go off sharply, notwithstanding the fact that the issue had been proposed by the Federal Reserve, and the Chairman of the Board of Governors had assured the Treasury of the System's full cooperation. That doesn't mean that we put the market down; it merely means that we didn't buy so heavily and so generally as to hold up the price of every outstanding issue. Nevertheless the implication is that a failure of promised cooperation contributed to the lack of success of the financing. In my opinion, the Federal Reserve did everything it properly could to make the issue a success including the purchase of $2.7 billion of the "rights" or maturing issues—purchases only partly offset by sales of $1.3 billion of outstanding Treasury notes due in 1951—these purchases being an action directly contrary to our desire to keep additional Federal Reserve funds out of the market. It is true that quotations for outstanding issues, particularly bank eligible issues, declined in the market on the first trading day following the announcement of the financing, a not unusual development when it becomes known that a large bloc of new securities is to be placed in a particular area of the market. We resisted this tendency although, of course, we did not try to peg or even support the price of every issue in the market. Our transactions that day showed purchases of $70,900,000 of Government securities including $34 million of "rights," and offsetting sales of $24 million of

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short securities for which there was a demand. Throughout the whole period until the books on the new issue were closed on December 7 a premium was maintained on the new issue despite the fact that prices on many outstanding issues continued to move lower. There were several reasons for the relatively unsatisfactory experience with this financing, and we may have made mistakes in recommending it and in our technical handling of the market, but lack of cooperation of the Federal Reserve was not the trouble.

On the next point where controversy has been exhumed by answers to your questionnaire, I cannot testify from personal knowledge. I was not at the meeting of the President, the Secretary of the Treasury, and the Chairman of the Board of Governors in January 1951, at which the Chairman is said to have assured the President that he need not be concerned about the 2½-percent long-term rate on Government securities. So far as the Federal Open Market Committee is concerned, it was not then advocating that the price of the longest term outstanding bonds—the 2½ percent bonds of 1967–72—be allowed to decline below par, although it was most anxious to quit paying for these issues a premium which was an open invitation to holders to sell out at a profit. On the other hand, the Committee had not taken any action which would have authorized the Chairman to commit it to support future long-term financing on a 2½ percent basis.

The final point in this record on which I feel I must comment, is the statement that as a result of a series of conferences in early February 1951, including conferences with the chairman of the two banking committees of Congress, and the Chairman of the Joint Committee on the Economic Report, it was generally agreed that there should be no change in the existing situation in the Government security market; while the Secretary of the Treasury was in the hospital recuperating from an operation. This suggestion was offered but it was never accepted by the Federal Open Market Committee, and at the conferences which I attended it was made clear that it could not be accepted, desirous though we were of reaching some agreement with the Treasury.

We were disturbed, of course, by the illness of the Secretary, but we did not think that our business and the Treasury's business, which means the public's business, could be held in suspense for the indefinite period of his recuperation. The pressures were too great. We were being forced to put large amounts of reserve funds into the market each day in support of the longest term Government bonds at premium prices, a policy which we considered to be profoundly wrong. Inflationary pressures were again strong. We said, therefore, that unless there was someone at the Treasury who could work out a prompt and definitive agreement with us as to a mutually satisfactory course of action, we would have to take unilateral action. Conferences of representatives of the Treasury and the Federal Reserve were resumed, and an accord was reached which was approved by the Secretary of the Treasury and the Federal Open Market Committee early in March 1951.

There was no breach of faith with Members of the Congress or others involved in this fortunate ending of our differences, which provided the basis for the further development of a coordinated program of debt management and credit policy. I think we are back on the track, and that with free and extensive consultation between the Treasury

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and the Federal Reserve—both at the policy level and the staff level—we can stay there. That is the hopeful outcome of our difficulties, and the justification for discussing our differences so freely.

As you can see, our road has been a difficult one. It is wrong, however, to speak of it as a war between the Government and the central bank. There can be no such war, with battles won and lost. The Treasury and the Reserve System are parts of or agents of the Government. They seek to carry out the national policies of Government. I should hope and expect that as a result of our experience, and of the studies and deliberations of your committee, we shall be able to do a better job in the future than we have in the past.

We all have the same great objective, the maintenance of the integrity of the dollar and the stability of our economy. A proper and coordinated policy of debt management and credit policy can contribute greatly to these ends. No important changes in our powers nor major alterations in our structural forms are necessary to achieve our purpose. We need only the ability to assess our problems wisely, the earnest desire to work them out jointly, and the will to act resolutely.

Thank you, Mr. Chairman.

Representative PATMAN. Thank you, Mr. Sproul.

It is customary when the witness finishes his statement that he yield for questions asked by the committee members. I assume that is satisfactory with you?

Mr. SPROUL. Yes, it is.

Representative PATMAN. Senator Flanders, would you like to ask any questions?

Senator FLANDERS. Yes; I would like to ask one or two, Mr. Chairman.

Your first proposition is that in times of high national production and income, when demand tends to run in excess of available supply, the further expansion of bank credit must be restrained if we are to avoid inflation.

I would like to ask you whether there is not another condition which is, in part, the same as this, or is included in it, and which raises further questions. I am thinking of a condition of full or overfull employment resulting from the large demand, in which there seems to be a mechanism of inflation which results from the endeavor of the wage earners to keep in line with the increased cost of living, and the endeavor of business in the face of what is practically a limitless demand to keep prices in line under the rules of a free economy, with the demand.

Now, those are both exhibitions in a way of the same thing, a free market in labor and a free market in commodities and services; and under those conditions they both tend to rise. Do you feel that monetary control can keep such a situation in hand?

Mr. SPROUL. I do not think it can do it by itself. I agree with you that you can have inflation from the upward push of costs as well as from the upward pull of an excessive supply of money. But I think that if you have that situation; if you have an economy working at high levels of production and income, with full employment, and a tendency to seek increased wages on the part of labor, a tendency on the part of management to grant those increases, it is a situation in which you do not want to pour the gasoline of an excessive supply of

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credit on a fire which is already burning brightly. But I do not say that situation can be controlled by general credit measures; it can only be moderated by general credit measures.

Senator FLANDERS. Would you suggest additional measures besides that of general credit control?

Mr. SPROUL. In times of war, certainly; in times of peace and war, such as we are in now, some fiscal measures and some direct controls such as we have had to break up a price-wage spiral which gets underway. That is what we tried to do, I think.

Senator FLANDERS. So you would feel then that direct controls under war conditions and, possibly, under these conditions are necessary, in addition to credit controls?

Mr. SPROUL. I think they were in the situation in which we found ourselves with a price-wage spiral underway, yes.

Senator FLANDERS. We have now apparently a new 360° rotation of the upward spiral in prospect in the steel and other negotiations.

Mr SPROUL. I think that represents a breakdown of your measures of direct control; a too tender attitude toward labor on the part of Government, and an acquiescent attitude toward increased costs if they can be offset by increased prices, on the part of management, tends to break down your direct controls, and then I say again that general credit measures cannot wholly correct the mistakes made in other areas. It can only moderate the influence; it can only partially stop the damage which is being done.

Senator FLANDERS. This does not lie within your field of responsibility, but would you feel that legislative proposals for deferring the application of wage increases and deferring the application of price increases for a waiting period, say, of 4 months or something of that sort, beyond the point at which the justification appeared would be a useful measure for slowing up this wage-price-cost spiral?

Mr. SPROUL. I should like to think so, although I do not know how practical it would be.

Senator FLANDERS. Of course, it could be written into legislation, but how practical that is I do not know.

Mr. SPROUL. I do not know.

Senator FLANDERS. Well, that was the first point which I wished to raise a question on.

The second point relates to the situation immediately after Korea. Would you feel that monetary controls would have been sufficient either, one, to have arrested that increase or, two, to have greatly reduced that price increase?

Mr. SPROUL. I think they could not have stopped it, could not have arrested it, in terms of stopping it, if that is what you mean by arrested, but I think they could have diminished and reduced that increase.

Senator FLANDERS. Would you have suggested any measures other than monetary measures at that time?

Mr. SPROUL. Fiscal measures were also suggested and were taken, and I think, making allowance for the delay with which fiscal measures becomes available, that they were effective eventually.

Senator FLANDERS. Now, Mr. Sproul, as you will remember, perhaps, I was at one time president of the Federal Reserve bank in Boston, and as such was privileged to attend meetings of the Board and to be a spectator at the Open Market Committee meetings.

Mr. SPROUL. I would say more than a spectator.

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Senator FLANDERS. At that time and earlier, as a matter of fact, I became interested in money velocity as well as in money quantity, and I endeavored to sell to the statistical branch of the Board the notion that they should report on velocity as well as on quantity. I was told at the time that velocity was a resultant rather than determinant, and was not worth looking at, so I never got very far with that point of view.

Now, on the other hand, I met a member of the Federal Reserve Board on the train going to New York last week, and I got into a conversation with him on this general subject—and he shall be anonymous for the purposes of this discussion—but only to say that he volunteered to furnish me a chart showing turn-over of demand deposits outside of New York City. I find it quite interesting, because it indicates that the private money supply was rising rapidly at a time when wholesale prices were going down, but that the turn-over of the demand deposits was high. This leads me to ask the question as to whether the turn-over was not in some sense a determinant as well as a resultant, and whether the money supply is adequate to explain everything that happened or whether the control of it will be as effective as we have liked to think that it was?

Mr. SPROUL. I do not know who told you when you were president of the Federal Reserve Bank of Boston that you need not pay much attention to the velocity of money, because the Federal Reserve System, I think, has been paying attention to the velocity of money for a number of years.

Senator FLANDERS. Does the System report on it?

Mr. SPROUL. We have charts and tables on it published regularly.

Senator FLANDERS. I do not think I have seen them. Are they in the regular monthly reports?

Representative PATMAN. I think you will find them in the monthly reports, Senator.

Mr. SPROUL. Whether you were given the wrong information or not, I think it is clear that we have to take into account the velocity of money as well as the quantity of money. The difficulty is that it is less easy to measure the velocity of money than to measure the quantity of money. But certainly the amount of liquid assets in the hands of the consuming public, the amount of liquid funds in the hands of business organizations, and the speed with which they turn over are factors in this equation.

We cannot, and do not, purport to control wholly the velocity of money by general credit measures; but I think it is significant to observe that during the past year or two, while the consuming public was in control of a very large volume of liquid assets, and business organizations were in control of a very large volume of liquid assets, they still were heavy borrowers. There are restraints and hold-backs on the use of these liquid assets freely and without regard for the possibility of obtaining new funds easily and readily by the borrowing method. There is also the effect of general credit measures, and the evidence they give of a will to try to restrain inflation on the outlook with respect to the future of prices and the stability of the dollar which may influence, and I think does influence, the use or nonuse of these liquid assets and the velocity of money.

It is an important factor, and a not directly controllable factor, but I think general credit measures can and do have some influence upon the velocity of the use of these liquid funds.

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Senator FLANDERS. I am corrected. My attention has been called to a table in the Bulletin which gives the rate of turn-over of demand deposits in New York City and in other leading cities, so that is reported.

Mr. SPROUL. Well, there is also a little book of charts that comes out monthly that you ought to get which has it in there whenever it seems to be significant.

Senator FLANDERS. In other words, there are long periods when it is not significant?

Mr. SPROUL. There are times when there are other factors which may seem to be more significant and be displayed in charts and tables.

Senator FLANDERS. If this thing is ever significant, I suggest that its nonsignificance over certain periods is as significant as its significance over other periods, and I would like to see it included in the regularly reported charts.

Mr. SPROUL. Well, it is included in the Bulletin regularly, the figures are.

Senator FLANDERS. Yes, all right.

Now, I have said my say on that particular thing, but I take it that you are answering my question by saying also that the money supply has at least an indirect effect on velocity.

Mr. SPROUL. What we do with respect to the money supply has some indirect effect on velocity, I think, but it is not directly controlling.

Senator FLANDERS. But V/T is not a constant?

Mr. SPROUL. No.

Senator FLANDERS. All right.

Now, one other question I would like to ask, and that is this: The general impression I have gotten from the testimony of the Treasury and from the members and officials of the Federal Reserve Board has been that the arrangement or concordat or whatever you might want to call it, between the two institutions is working very well. Whenever we have sought to find out what the principles are which guide that relationship and guide the decisions, we are sort of waved off, and the best we can get is that the personal relations as between the Board, represented in its Chairman, and the Treasury officials, represented in the Secretary of the Treasury, are excellent and, as I said here yesterday, I believe, one gets the general impression that the less one examines into the excellence of that relationship the better it will work.

Now, I would like to ask you whether you feel that the proper principles for operating the joint problems of the Board and the Treasury can be put into written form? The next question to ask after that is, should the Federal Reserve Board and/or the Treasury be given a mandate of some sort?

There are two questions in one, and I would like to get the answer to both of them.

Mr. SPROUL. First, as to the working of the accord, I think it is working because I think the Treasury has abandoned the idea that in matters of debt management—in situations where debt policy and credit policy overlap—it is the final authority and makes the final decisions without regard to considerations of credit policy. In other words, I think through the discussion and trial by fire which we went through, we have come to a situation in which the Federal Reserve is no longer considered as one of a heterogeneous group of bankers, in-

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surance people, Government security dealers, and others who come to the Treasury and give it their suggestions and are told, "Thank you, gentlemen; we will let you know what we are going to do when we get ready." We are now, I think, considered as coequals with responsibilities, important responsibilities, in the field of credit, which must be considered when decisions are being made with respect to debt management.

I think that rests, in part, upon personal relations between the Chairman and the Secretary, but I like to think that it also rests, in part, upon a better appreciation of this whole problem growing out of our experience of the past year. It is not just a question of better coordination, greater consultation between policy makers. It is also a question of better staff coordination, frequent meetings between the staff of the Treasury and the Federal Open Market Committee and the Board of Governors, so that some of these questions where there may be differences of opinion may be ironed out at the staff level before policy makers, prodded by their staffs, get their heels dug in, and think they must stick to positions which have been taken.

Senator DOUGLAS. Is it possible that congressional pressure may have helped in this matter, too?

Mr. SPROUL. I think the disputes of the last year, the evidence of congressional interest and the evidence of public interest helped in this matter.

That leads me to the second part of your question. I indicated, perhaps, before you came in that I am inclined to repeat what I said at the hearings of the Douglas subcommittee, that it would be desirable to have a mandate along the lines of that suggested by the Douglas subcommittee, which would be a protection to the present Secretary in sharing his responsibilities with the Federal Reserve, and be a matter of congressional guidance to future Secretaries who may not have had this experience of going through the trials and tribulations of the past year.

Senator FLANDERS. Could that mandate be one which outlined areas of responsibility which would definitely make the two institutions coequals in some sense rather than making either one of them appear as having some authority over the other?

Mr. SPROUL. Yes, I think——

Senator FLANDERS. Should the mandate be in that form?

Mr. SPROUL. I think the mandate should be in that form. Neither one should be subordinated to the other and, therefore, I think the mandate must be general in its terms but, nevertheless, give an indication of congressional intent that when dealing with matters of debt management and credit policy they are dealing together as equals and are expected to find a joint solution of their problems.

Senator FLANDERS. Thank you; that is all, Mr. Chairman.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Mr. Sproul, in the second, next to the last paragraph on page 8, you suggest that the problem of the past is, perhaps, more difficult than it has appeared to be. In other words, it did not necessarily have to be a conflict between the Treasury, on the one hand, and the Federal Reserve Board, on the other. It would be perfectly possible for a majority of the Federal Reserve Board to be going one way and the Open Market Committee to be going another, is that not correct?

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Mr. Sproul. If you say a majority of the Federal Reserve Board, that might mean that four members of the Board could be going one way and eight members of the Federal Open Market Committee could be going the other, yes.

Representative Bolling. Or five—as many as five of the Board going one way and the rest going the other.

Mr. Sproul. Yes.

Representative Bolling. Now, only for the purpose of throwing light on the future and not going any further into the dilemma experienced in the past, is it not a dangerous possibility that that kind of situation could develop? Does not the Open Market Committee, from the statutory position, right now have the final and absolute authority within its field?

Mr. Sproul. Within the field of open-market operations the Open Market Committee does have the final and absolute authority. The Open Market Committee is a committee set up by the Congress with statutory responsibilities, and is just as responsive to the Congress as the Board of Governors of the Federal Reserve System, so that I see no danger to the public and to the congressional control of these matters in having that situation—the possibility of that situation—exist. As a matter of fact, of course, as you probably know, that sort of situation seldom, if ever, arises.

Representative Bolling. But in looking at it as we are from the point of view of, perhaps, a congressional mandate which has to take into account the organizational structure involved, is that not an important point to be considered?

Mr. Sproul. I think the congressional mandate would have to cover the Open Market Committee as well as the Board of Governors. It would have to cover the whole Federal Reserve System, I think.

Representative Bolling. So, in essence, the possible conflict is somewhat more complicated than a conflict between two groups. It is a potential conflict between three groups.

Mr. Sproul. Yes, if you consider the various parts of this Federal Reserve separately, it is a conflict between the Federal Reserve and the Treasury, or has been, but it may be considered a conflict between the Board and the Treasury or between the Open Market Committee and the Treasury or between the whole System and the Treasury. I think your mandate, if you considered one, would have to take into account the whole Federal Reserve System.

Representative Bolling. I would like to pursue a little bit further this question of the statute, the statutory situation, in which the Open Market Committee does have final authority, and the relationship between debt management and credit.

How can you conceive of a mandate which will make the two, the Treasury and the System, including both the Board and the Open Market Committee, coequal? How do you write the mandate that makes them coequal and yet leaves a power of decision somewhere?

Mr. Sproul. Well, I think the Douglas subcommittee did a very good job on that. There would still—and it must be recognized there would still—be the possibility of differences of opinion and disagreement.

Representative Bolling. The proposal of the Douglas subcommittee did not, I do not believe, view the possibility of coequality. It is, they said, the will of Congress that the primary power and responsi-

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bility for regulating the supply, availability, and cost of credit, in general, shall be vested in the duly constituted authorities of the Federal Reserve System, and that the Treasury actions relative to money, credit, and transactions in the Federal debt shall be made consistent with the policies of the Federal Reserve. There is no equality there.

Mr. SPROUL. Well, I think there should be equality, and if the Douglas subcommittee proposal does not imply or carry with it the meaning which you wish, I think it should be changed. There should be equality, and that means that there can be differences of opinion, there can be disagreements for which such a resolution would give you no final solution. But I think, with the backing and the guidance of such a resolution, that it would be unlikely that we would have differences such as we have had during the past few years.

Representative BOLLING. In effect, you are saying that if you have cooperation, as you do in the present situation, things are going to be all right, that you want to maintain a coequal situation.

I am still concerned about actual language. I do not see how, unless we take a position similar to the one taken by the Douglas subcommittee, that we are going to further define the mandate which exists now, and I do not see how you move forward, in whatever direction you choose, unless you eliminate equality. I mean, I just cannot conceive of the way in which you do not move in one direction or another.

Mr. SPROUL. I think, as I see it, what you would be trying to eliminate would be the attitude which has grown up since the beginning of the Republic that the Secretary of the Treasury already had a mandate, and has a mandate, from the Congress which makes his office superior to the Federal Reserve no matter what the problem is that is being considered, no matter whether credit policy is directly concerned, or not.

Representative BOLLING. That is a matter actually of public opinion rather than law, however, because the law is pretty clear.

Mr. SPROUL. It may be a matter of public opinion. It develops, I think, out of the fact that the secretaryship of the Treasury has been one of the highest offices in the Government since its beginning. The Federal Reserve is a relative newcomer. The Secretary of the Treasury is a member of the Cabinet, usually a close intimate of the President.

He has connections with the Congress, which we do not have, so that it has been the natural assumption that where differences of opinion arose he had the final say, his was the superior authority, and I think the Congress, if it did anything, would be trying to correct that assumption.

Representative BOLLING. How much of a correction do you think would be achieved by enhancing through various ways the prestige of the Federal Reserve Board by some of the suggestions that have been made, one of which would be to reduce the membership from seven to five, that the salaries be more reasonable, in the sense that they be much higher, that type of approach? How much influence do you think that type of an approach could have on the problem?

Mr. SPROUL. I think it would probably be better to have a board of five than of seven; I think it would be desirable to increase the salaries of the Board, but I think the prestige of the Board, in the final analysis, depends upon the ability of the men you get to serve

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on the Board, and it is only if those actions, reducing the number and increasing the salary, would get you better men, that you would improve the prestige of the Board.

Representative BOLLING. What is your opinion as to the question of the length of term? One suggestion, I think, by Governor Martin was for 6 years. The present term is 14. I imagine there are suggestions all the way through. What would be your opinion on the length of the term?

Mr. SPROUL. I would be inclined to split the difference and say about 10 years would be a good length of term.

Representative BOLLING. What would you think of the Secretary of the Treasury being a member and the Chairman of the Open Market Committee?

Mr. SPROUL. Well, there is considerable distrust of such a relationship for fear the Secretary of the Treasury would then become not only a member and the Chairman, but the dominating influence on the Open Market Committee. I am not so much afraid of that. I think if the Federal Open Market Committee could not stand up to a Secretary of the Treasury and express itself and make its opinions felt, and have them considered, that it would not be the appropriate Open Market Committee.

I do not think that such an ex officio relationship is necessary, however. If there is the will to consult, both at the policy level and at the staff level, frequently and on the basis that you are trying to work out a mutual problem jointly, then I do not think you need to have this official method of bringing the two groups together.

The purpose of putting the Secretary of the Treasury on the Open Market Committee would be to bring him into the discussions of the Open Market Committee so that he could sit around the board and hear the various views and opinions that are expressed, and present his views to the Committee. I think that can be done informally as well as by formal relationships.

But if it were your decision to recommend the formal relationship, I would not be afraid of it because of the feared dominance of the Secretary of the Treasury over the Open Market Committee.

Representative BOLLING. In essence, apparently the difficulty and the theory under discussion, which you specifically discuss, is primarily one in which there was not a will for coequal consultation, frequent consultation, both at the policy-making and the staff level.

Mr. SPROUL. There was frequent consultation at the policy level, not so frequent consultation at the staff level, and the consultation at the policy level was not on a coequal basis, ordinarily.

Representative BOLLING. Well, in effect, despite the fact that the statutes were, let us say, for purposes of simplicity, on the side of the Open Market Committee and the Federal Reserve Board, despite the fact that the law was on one side, the psychology was so effective on the other side that for a period there was dominance of the actually stronger by the actually weaker.

Mr. SPROUL. Well, we were operating in an area where you cannot be dogmatic, you cannot be sure that you are right. The other fellow's views and opinions may be more nearly right than yours, so that when these grave questions were raised as to the size of the public debt, the necessity for frequent refundings, the dangers of the international situation and the possible ineffectiveness of general credit measures,

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you do not assert yourself dogmatically and finally in the first round. You attempt to exhaust every possibility of finding an agreed mutual policy which you can follow.

It is only when you come under the compulsions of a critical situation such as we had after Korea, when you have exhausted, as you see it, all the possibilities of a mutually agreed upon policy, that you then assert yourself in accord with what may be the law, explicitly or implicitly.

Representative BOLLING. So that, in effect, the achievement of the accord was as important a thing as could possibly have happened?

Mr. SPROUL. Yes.

Representative BOLLING. Because it shifted the emphasis and brought the situation into balance.

Mr. SPROUL. I think so.

Representative BOLLING. Thank you.

Representative PATMAN. Senator Douglas?

Senator DOUGLAS. Congressman Patman, I hope you will proceed.

Representative PATMAN. You go right ahead.

Senator DOUGLAS. First, I would like to address a question of information to the chairman. Some 10 days ago we asked the Federal Reserve Board to submit a list of documents of the correspondence and memoranda in connection with this period of history which Mr. Sproul has discussed.

I would now like to ask for the record whether the Federal Reserve Board has as yet submitted these documents to the committee.

Representative PATMAN. The chairman personally has not received them. I wonder if the staff economist of our committee, Dr. Murphy, has received them?

Mr. MURPHY. No, sir. The last contact I had with the Board on it was when I talked to Mr. Ralph Young on Friday, and he said that the work of preparing them was proceeding.

Representative PATMAN. Did he indicate when they would be available to the committee?

Mr. MURPHY. No, sir.

Representative PATMAN. Well, it was agreed that they would be furnished, and we will follow through, Senator Douglas.

Senator DOUGLAS. Mr. Young is in the audience, and I wondered if he would make a statement as to whether or not he knew when it would be ready.

Representative PATMAN. Mr. Young, would you mind coming around, please? You will pardon us, Mr. Sproul, for this interruption.

Mr. SPROUL. Certainly.

Representative PATMAN. I think it is important.

Mr. Young, when may we expect the information that has been discussed here?

Mr. YOUNG. It is in preparation, sir, and I believe that as soon as it has passed the Board's review it will be ready to be sent up.

Representative PATMAN. When do you believe it will be ready?

Mr. YOUNG. Well, I believe that the Board may be discussing it this morning.

Representative PATMAN. The chairman would like to request that it be ready by at least Monday. I assume that will be all right, Senator Douglas?

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Mr. YOUNG. I believe that would be possible.

Representative PATMAN. I believe you should make a special effort to get it to us by Monday.

Mr. YOUNG. We will be glad to do that, sir.

Representative PATMAN. Thank you kindly.

Go right ahead.

Senator DOUGLAS. Mr. Sproul, as I remember it, shortly after the outbreak of the attack by the North Koreans the Federal Reserve Board issued a policy statement urging that credit be restrained in order to check the upward movement of prices. Am I correct in that memory?

Mr. SPROUL. I think you are.

Senator DOUGLAS. Yet, from July 1, 1950, to March 1, 1951, the Federal Reserve System bought a net of almost $4 billion of Government securities in the open market; is that not true?

Mr. SPROUL. Yes.

Senator DOUGLAS. And bank reserves increased almost correspondingly, not quite correspondingly, is that not true, and that bank loans increased by about 10 billion or by about 18 percent, is that not true?

Mr. SPROUL. I think so.

Senator DOUGLAS. Well, now, this extraordinary contrast between the advice which the Federal Reserve System offered and the actual policy which the Federal Reserve System followed struck me at the time as being am amazing contradiction in terms. How do you account for that?

Mr. SPROUL. Well, first, I would like to give you the figures as I have them, so that there will be no difference with respect to figures.

From July 1950 to February 1951, the System's holding of securities increased 3.9 billion dollars.

Senator DOUGLAS. I said 4 billion. I allow for a margin of 2½ percent.

Mr. SPROUL. There were additional gains in an increase through member bank borrowings and other factors. There was an offset through an outgo of 2,100 million of gold and required reserves were increased in February and January 1951 by 2 billion, leaving an increase in free reserves of $1,100 million.

Senator DOUGLAS. And you had an increase in loans of about 10 billion?

Mr. SPROUL. Of this amount 100 million was added to excess reserves, and 1 billion was used as the basis for credit expansion. The growth in total loans of commercial banks during the period amounted to a little less than $9 billion, and in the same period investments of commercial banks were reduced by about $5½ billion. The money supply increased by $5 billion, or a little less than 5 percent as compared with the rise of 17 percent in the whole commodity price index. It does not justify the conclusion that the growth in the money supply and bank credit was of no consequence, however.

Now, as to the difference between what we advised and what we did, I would say that what happened from August 1950 to March 1951 is very much besides the point in terms of the possible effectiveness of general credit policy, because we were unable to apply a general credit policy as a result of the actions taken by the Treasury in its debt management program.

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As I outlined, we had the September to October financing which we had to support in order to prevent a complete failure, overwhelming rejection of the offering which the Treasury had made, and that required us to put funds into the market.

We had the December to January financing which did not come out as we all had expected, which, in addition, required us to put funds into the market. But I say the main difficulty was the September to October public difference of opinion—more than difference of opinion—contrary actions in debt management and credit policy, which made it impossible for general credit measures to be effective during that period.

Senator DOUGLAS. That is, the terms under which the Treasury refunded the debt were such that it was not sufficient to attract private support adequately, and the Reserve felt it had to step in to support the Treasury and, therefore, bought large quantities of Government securities?

Mr. SPROUL. We bought 8 billion of the rights of that 13 billion issue, for instance.

Senator DOUGLAS. As I remember it, in January, February, and in the early part of March, you bought a huge quantity of Government securities, too?

Mr. SPROUL. That was another situation. That is when we were supporting the long-term restricted bonds at premium prices, and questions about the continuance of the 2½ percent long-term date were being actively discussed.

The evidence of continuing differences of opinion between the Treasury and the Federal Reserve were weighty, and we did have to put substantial amounts of funds into the market during those 2 months supporting at premium prices long-term Government securities.

Senator DOUGLAS. Do you have the figures as to the volume of your purchases during these 2 months?

Mr. SPROUL. I may have them here. No; I have not those 2 months separated out.

Senator DOUGLAS. Did they not run well over a billion dollars?

Mr. SPROUL. Well, I have not the figures here for those 2 months, but that figure sounds reasonable.

Senator DOUGLAS. Well, the Federal Reserve Bulletin for January 1952, page 41, the second column, shows that on the 27th of December, 1950, the Reserve holdings of Government bonds amounted to 4.6 billions—I am reading to the nearest hundred million—and on March 7, they amounted to 5.6 billion, or an increase of 1 billion; and on March 14 they rose to 5.9 billion, or a further increase of about 300 million, or an increase in the 6 weeks of 1.3 billion, indicating very large purchases during that period of strain with the Treasury.

Mr. SPROUL. There were very large purchases of the long-term restricted bonds during that period.

Senator DOUGLAS. You feel, therefore, that it was Treasury pressure and the fact that the Treasury fixed the terms of its refunding out of line with the market situation which forced you to buy Government bonds, and thus inflate the credit, the money supply?

Mr. SPROUL. I think that was the major influence, yes.

Senator DOUGLAS. Do you think the Federal Reserve should have summoned up its courage at an earlier date and taken a policy similar to that which it finally adopted in March?

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Mr. SPROUL. Well, this talk about summoning up your courage usually gives me a pain in the neck.

Senator DOUGLAS. I know.

Mr. SPROUL. We are pictured as a lot of timid "Milquetoasts" who have lacked courage through several years.

As I tried to indicate, you cannot be dogmatic, you cannot be sure you are right. There was the question of the large debt, the question of the constant refundings, the question of the domestic and the international situation. We had to exhaust all the possibilities of agreed-upon action.

But when we came to August 18, 1950, when the situation seemed to us to be so clear that there could be very little reason for doubt, we then did take action. It was not in March 1951, it was in August 1950, when we decided to go our way, despite what the Treasury had done with respect to the terms of its financing, and took the risks involved in that decision.

Senator DOUGLAS. You mean it was the failure of the Treasury to adapt its refunding policies to your policies which caused the failure—not failure, perhaps, but cool response—to the first two refunding issues?

Mr. SPROUL. I would say that was clearly so with respect to the September to October refunding.

On the December to January refunding I think we both made some mistakes in the kind of issue we thought would be desirable and possibly in our handling of the market.

Senator DOUGLAS. On this long-time situation, the purchase of long-term bonds of a billion 300 million in the space of 6 weeks in a period in which prices were skyrocketing——

Mr. SPROUL. I think we held on too long certainly to a premium price. We may have held on too long to the support of par. We held on to the premium largely, if not entirely, under Treasury insistence.

Senator DOUGLAS. Then it is the Treasury's fault in the matter?

Mr. SPROUL. What is that?

Senator DOUGLAS. It is the Treasury's fault in this matter.

Mr. SPROUL. On this matter, on the question of the long-term bonds, I think we might have asserted ourselves earlier and more strongly.

Senator DOUGLAS. Since the accord has been reached, can you say what the principle of the accord is, as you understand it?

Mr. SPROUL. The principle of the accord is that the Treasury, through the person of the Secretary and his policy-making officials, and the Board and the Open Market Committee through its policy-making officials, will consult freely and frequently in an attempt to work out a joint program, neither one being the superior authority telling the other what it is to do and why it should do it, and that that consultation and conference at the policy-making level will be and is being supported by consultation and conference at the staff level.

Senator DOUGLAS. Was this accord reached after the Federal Reserve decided that it would no longer support the Government bond market at fixed prices?

Mr. SPROUL. The accord was reached after the Federal Reserve had decided it could no longer support the longest term restricted bonds at premium prices, and part of the accord was, as it was finally worked

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out, that we would no longer support the whole market or any part of it at pegged prices.

Senator DOUGLAS. At fixed prices. In other words, that you would have a fluid market; in effect, therefore, you reached an accord on the Federal Reserve's terms.

Mr. SPROUL. As I say, I do not like the implication which one of your witnesses left that this was a battle that the Federal Reserve won, and while it may have won a battle, that the Government always wins the wars. I say there is no battle between the Government and the central bank. It was a conflict, a difference of opinion, between the Treasury and the Federal Reserve System, both of them representing the Government, and you can call it a triumph of reason, if you want to, but not the winning of a battle.

Senator DOUGLAS. Well, the Renaissance painters used to have paintings of triumphs of virtue and triumphs of Mars and triumphs of Venus, and triumphs of reason. I suppose you are painting a mural here of the triumph of reason, and I am not interested as to whether the Secretary of the Treasury appears as the vanquished in that triumph which you are painting or not. But I am interested in the principles involved, because what you are saying is that merely coequality is sufficient.

I am trying to point out that the accord was not really possible until after the primacy of the Federal Reserve System in matters of credit policy was not only asserted, but consented to by the Secretary of the Treasury. Was it not part of the accord that you would cease to support the Government bond market at fixed prices?

Mr. SPROUL. It was part of the accord that we would cease to support the Government security market at fixed or pegged prices. But I would put it the other way, that the accord was reached after it became clear that the Federal Reserve had a considerable support in the Congress and among the public for requesting and demanding equal powers and equal consideration in the determination of these questions of credit policy and debt management where they overlapped.

Senator DOUGLAS. I am glad you have stated that, because we Senators and Congressmen are modest people, as you know, and we have been reluctant to put forward our claims as vigorously as that, because we know that the administrative officials never like to have it suggested that they are at all influenced by Congress. They like to give the impression that they make their decisions completely independently of what we may be thinking on Capitol Hill. I am very glad to have this statement for the record.

Have you noticed any bad consequences which have followed since the accord has been reached, and since you no longer support the bond market at fixed prices?

Mr. SPROUL. No; I have not. I think the consequences on balance, and heavily on balance, have been good. I do not know of any bad consequences that have developed.

Senator DOUGLAS. Your holdings of securities, or at least purchases of Government bonds have declined and the price level has been steady?

Mr. SPROUL. Our purchases of Government bonds have diminished.

Senator DOUGLAS. There is one thing that is puzzling though, and, perhaps, you can clear it up. Although reserve holdings of Government bonds are less now than they were the 1st of April 1951, loans

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by member banks have risen by about $6 billion. How do you account for that?

Mr. SPROUL. Well, there are a number of factors which enter into the reserve situation. It is not only our open-market operations, it is movements of gold in and out, movement of currency.

Senator DOUGLAS. Is gold coming in?

Mr. SPROUL. Gold has been coming in.

Senator DOUGLAS. Would you trace the process by which gold comes in and builds up bank reserves?

Mr. SPROUL. In its simplest form, the gold is imported.

Senator DOUGLAS. In payment for goods?

Mr. SPROUL. Well, that is the ultimate use of the gold, to settle a balance of payments which has not been settled by the exchange of goods and services. The transactions these days are usually for official account. The gold is sold to the United States Treasury. The United States Treasury pays for the gold with a check on its balance at the Federal Reserve bank, or by transfer of dollars from its balance to the account of some foreign central bank or government on our books. That payment is then disbursed in the market and increases the reserves of the banking system.

Senator DOUGLAS. Now, just a minute. You say the Treasury deposits this in the Federal Reserve System. How does this build up the reserves of the member banks?

Mr. SPROUL. I say the Treasury pays the importer or seller of gold with a check on or transfer from its balance at the Federal Reserve bank. When the seller of the gold disburses these funds it gives the member banks an addition to their reserves at the Federal Reserve bank. There is a transfer from the Treasury balance at the Federal Reserve bank to the member bank's balance at the Federal Reserve bank, increasing the reserves of the member bank.

Senator DOUGLAS. I missed the last point. The Treasury gets the gold, deposits it with the Federal Reserve.

Mr. SPROUL. No, the Treasury gets the gold and deposits it in the Assay Office or Fort Knox or wherever, but it pays the seller of the gold from its balance at the Federal Reserve bank, reimbursing itself by issuing gold certificates to the Federal Reserve bank backed by the gold which it bought.

Senator DOUGLAS. All right.

Now, then, what happens to this check or to these checks?

Mr. SPROUL. The end result is that the amount is transferred from the Treasury's balance at the Federal Reserve bank to the member bank's balance at the Federal Reserve bank.

Senator DOUGLAS. Through the deposits of the dealers in gold?

Mr. SPROUL. Through such deposits if the transaction is a private transaction. But the simple fact is there is a transfer from the balances of the Treasury at the Federal Reserve bank to the balances of a member bank at the Federal Reserve bank, and that increases the reserves of the banking system.

Senator DOUGLAS. Therefore, it has been the inflow of gold which has built up member bank reserves during this last year, not open market purchases, and it is this that has made possible an expansion of bank reserves and of bank loans.

Mr. SPROUL. It depends on what period you take. But I say——

Senator DOUGLAS. I am choosing the last months.

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Mr. SPROUL. But there are other factors in this situation. The movement of gold, movement in currency, changes in float, changes in the Treasury balance with the Federal Reserve banks, all of those enter into the picture of the bank's reserve position, so that you just cannot take our open market operations and say that because our holdings increase bank reserves went up or because our holdings are reduced bank reserves went down. There may have been offsetting factors in all of these periods.

Senator DOUGLAS. Now, this has a bearing upon a previous period, 1946 through 1948, I believe. Those who are disbelievers in credit control pointed to this previous period during which reserve holdings of Government securities declined, and yet prices advanced, as an indication that credit-control policies were ineffective.

Now was not the decrease in reserve holdings of Government securities accompanied by a great inflow of gold so that the deflationary results of selling securities were, at least, offset by the gold inflow?

Mr. SPROUL. I do not think you have to pin it on the gold inflow. There was some offset; but in that period 1946 through 1948 we were working out the consequences of the great expansion in the money supply during the war. We had kept that expansion from expressing itself fully by various direct controls, but once those direct controls became ineffective and ultimately were removed, that great expansion of the money during the war expressed itself, and the fact that reserve bank holdings declined moderately during that period was a very slight offset to the effect of the release of this tremendous expansion of money supply which had taken place during the war, and was only suppressed by direct controls during the period of the war.

Senator DOUGLAS. But there was an inflow of gold, too, during this period?

Mr. SPROUL. Yes.

Senator DOUGLAS. I think that is all, Mr. Chairman.

Representative PATMAN. Mr. Sproul, you mentioned at the end of your statement that we all have the same end in view, and that was the maintenance of the integrity of the dollar and the stability of our economy.

I assume that you mean in that phrase "the stability of our economy" increased production and maximum employment, and things like that?

Mr. SPROUL. Yes; I do. I do not mean a static economy; I mean a stable, progressive, growing, dynamic economy.

Representative PATMAN. I believe you stated, in answer to the questionnaire, that you are in favor of the congressional policy set forth in the Employment Act of 1946.

Mr. SPROUL. In the answer of the presidents of the Federal Reserve banks, I think we expressed that opinion and, certainly, it is my own opinion that principles and policies set forth in the Employment Act of 1946 are a guide to us in our actions with respect to credit policy.

Representative PATMAN. And you recognize it as a congressional policy?

Mr. SPROUL. Yes.

Representative PATMAN. And I believe you stated that you recognize, too, that the Federal Reserve System is an agency of the Government?

Mr. SPROUL. Yes.

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Representative PATMAN. In that you recognize that it is an agency of the Congress?

Mr. SPROUL. Yes.

Representative PATMAN. Because in this case it is not the other two branches of the Government, it is the legislative branch that created it, and, therefore, the Federal Reserve System, in its entirety, is an agency of Congress.

Mr. SPROUL. I recognize that.

Representative PATMAN. Yes, sir.

Mr. SPROUL. We get our charter from the Congress and derive our being from the Congress.

Representative PATMAN. What were the results that you anticipated along with the removal of the support prices of Government bonds by the Open Market Committee?

Mr. SPROUL. At the time we removed these support prices, my anticipation, I hope I can say without too much hindsight, was just about what we had, no great disturbance in the market, certainly no calamity, no chaos, a market which pretty quickly found its own bottom, and has maintained itself there without much intervention on our part.

Representative PATMAN. Specifically, with reference to interest rates, you expected Government rates to increase?

Mr. SPROUL. Yes.

Representative PATMAN. Did you not also expect other rates to increase?

Mr. SPROUL. Yes, but that was not the primary purpose of our action. The primary purpose of our action is to restrain the availability of credit. But the reverse of that shield is some increase in interest rates if you put restrictions on the availability of credit, and in our present situation, with the Government debt so large a part of the total of public and private debt, it is almost a certainty if the rates of interest on the Government debt advance, the rates of interest on private debt will advance, and the rates of interest on commercial bank lending will advance.

Representative PATMAN. So the total cost to the people, generally, to the public, is not confined to the increase in the public debt; it will also cause an increase generally, like the life insurance housing paper, and things of that kind?

Mr. SPROUL. The total cost to the public, I would rather say there would be a shift of resources among the public. The lenders will get a little more and the borrowers will pay a little more, but you have to offset that against the absoute cost to the public of allowing inflationary pressures to express themselves unrestrained by general credit measures or any other measures.

Representative PATMAN. You do not think increasing interest rates are inflationary?

Mr. SPROUL. Not in the circumstances that we have been working with; and very seldom, in any circumstances, would I consider it inflationary, but certainly not in the circumstances we have been working with.

Representative PATMAN. An official of the Prudential Life Insurance Co. before us yesterday stated that the rate had increased for the Prudential from about 3.2 to about 4 percent. I believe he used the phrase 3½ to 4 percent, and he was selling some Government bonds

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as low as 96 in order to extend loans at 4 percent; and he said that he expected the rate to increase and, of course, he considered that of benefit to the insurance companies.

But you do not consider that type of an increase inflationary?

Mr. SPROUL. No, and I think particular insurance companies and, certainly, insurance companies in general, will sell, and have sold, fewer Government bonds at 96 in order to make other loans than they were willing and able and eager to sell at par at 22/32 before we abandoned fixed-price support.

Representative PATMAN. Do you have any definite policy now about purchasing Government securities, long-term, if they were to go below, say, 96?

Mr. SPROUL. No, we have a policy of maintaining an orderly market in Government securities.

Representative PATMAN. Suppose they were to drop to 90, what would be the action of the Open Market Committee, do you think?

Mr. SPROUL. I cannot speak for the Open Market Committee. It would have to be taken in the light of the circumstances at the time, the cause of the drop, and the possible results of permitting it to take place.

Representative PATMAN. Are your views concerning the gold standard the same now as they were in 1949?

Mr. SPROUL. I hate to say this, but they are exactly the same.

Representative PATMAN. To the best of my recollection you made a good speech on that——

Mr. SPROUL. I thought it was good.

Representative PATMAN (continuing). In 1949. I wonder if you will put that speech in the record?

Mr. SPROUL. I would be delighted to put it in the record.

(The material referred to appears at the conclusion of Mr. Sproul's testimony.)

Representative PATMAN. The Federal Reserve banks, being agencies of the Government, you consider that their first obligation then is a public trust?

Mr. SPROUL. Absolutely.

Representative PATMAN. And to the Government of the United States—to the Congress, being the master, you might say.

Mr. SPROUL. I have no hesitation or reservation about that, and I resent the implications which are made from time to time, and have been, by some of your witnesses that the Federal Reserve banks are under too great a pressure from the commercial banks, that they are subservient to the opinions and attitudes of commercial banks, in particular, and the business community in general. I say that the Federal Reserve banks recognize that they are exercising public responsibilities, and while they are glad to have the views and opinions of the banking community and the business community, and are glad to, and think it necessary to keep in touch with the banking and business communities so that they will know what the currents and influences in banking and business are, they are not dominated by the influence of private banking or private business.

Representative PATMAN. The fact that the commercial banks and others have been clamoring for an increase in interest rates for a long time did not influence the action of the Open Market Committee at all—had no influence whatsoever?

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Mr. SPROUL. No, except as we have thought they were right in their general argument that to prevent or to help restrain inflation an increase in interest rates would be effective. But so far as the private selfish interests of the banks are concerned, and their profits are concerned, it had no influence whatsoever—had no influence whatsoever.

Representative PATMAN. You believe in direct price controls; do you not?

Mr. SPROUL. Only if war or in something that is so close to war that you have to use it to break up a wage-price spiral which seems to be developing. Otherwise I think it is repugnant both to our institutions and traditions, and becomes ineffective if kept as part of the machinery too long.

Representative PATMAN. Do you believe that the Congress should extend the Defense Production Act when it expires June 30 of this year?

Mr. SPROUL. You are getting a little out of my field, but I do, personally.

Representative PATMAN. You think it should be extended?

Mr. SPROUL. Yes, I do.

Representative PATMAN. You feel, then, that this emergency justifies price controls?

Mr. SPROUL. I think that the emergency did justify it originally, and now justifies its extension, although I see signs of its breaking down in terms of wage increases which will be followed by price increases.

I am fearful of its being continued too long, but I think it should be extended now.

Representative PATMAN. How do you justify your statement that interest rates are not inflationary when the increase in the price of a commodity is inflationary?

Mr. SPROUL. Well, I think you have to consider money as money, not as a commodity. It is the thing which facilitates the exchange of all other commodities.

Representative PATMAN. Well, let us call it a service.

Mr. SPROUL. I do not think you can consider it in the same terms that you consider all other commodities. It is the measure of value, it is the medium of exchange, it is separate and apart from all other commodities. So I do not think the theories and facts which apply to all other commodities apply to money. An increase in the price of other commodities, of all other commodities together, or a large part of them, may be inflation, but an increase in the price of money, talking of interest rates and in those terms, is a different kettle of fish.

Representative PATMAN. A special case?

Mr. SPROUL. Yes.

Representative PATMAN. I just cannot see that, Mr. Sproul. Maybe I am just not schooled along that line, and I do not have the background of experience that you have had that causes me to see that, but I do not see why interest rates would not be inflationary if you increase them just the same as if you would increase the price of something.

Mr. SPROUL. Well, as I say, money—I do not think you can consider money as a commodity, and when you——

Representative PATMAN. Regardless of what it is increased to? You formerly paid 4 percent, and you are now paying 5. What is

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the difference so far as a comparison is concerned in an article that is sold for 4 cents and you increase it to 5?

Mr. SPROUL. When you make credit less readily available, and that results in an increase in interest rates you might say that that is one of the elements of cost; it is, with all the other elements of cost, exerting an upward pressure on prices. That is part of the picture; but I think the offsetting influence of restriction on credit in terms of inflation or deflation, the offsetting influence of a restriction on credit is a much more important factor than that small minor factor of an increase in costs growing out of an increase in interest rates—the increase in interest rates is much more than offset by the restrictive influence of credit restraints, so that the net effect is not inflationary.

Representative PATMAN. Do you believe, then, that the increase in rates will retard credit; in other words, you will not put out as much credit if the interest rate is increased?

Mr. SPROUL. I put it the other way. If we do not put out so much credit or put it out less readily, interest rates will increase. We do not look at interest rates first. We look at the availability of credit. It is a mistake to get this thing down to hat sizes and talk about an increase of one-eight of 1 percent not doing any good; that is an insignificant item of cost. We look first at the availability of credit, the result is an increase in interest rates, but we expect the lesser availability of credit to have an influence on expansion, credit expansion, and on inflation.

Representative PATMAN. What do you think about regulation W? Do you think it should be extended?

Mr. SPROUL. I think regulations are a headache, but I think in the present situation regulation W, like the rest of the Defense Act, should be extended, leaving it to administrative action, flexible administrative action, to relax the terms if the situation in general or in particular requires it, or to stiffen them if the situation in particular or in general requires it. In the present situation I do not think you should try by congressional action to pick the time and the place for abandoning that regulation.

Representative PATMAN. If we desire further information from you and we ask you to answer questions in a letter, it will be satisfactory, I assume, Mr. Sproul?

Mr. SPROUL. Yes, it will be.

Representative PATMAN. Thank you very kindly.

Dr. Murphy?

Mr. MURPHY. No questions.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. No questions.

Representative PATMAN. Senator Douglas?

Seantor DOUGLAS. I have one final question. I am afraid it is going to be a very embarrasing one, Mr. Sproul.

The conclusion of the accord was followed almost immediately by the resignation of Chairman McCabe of the Federal Reserve Board. Was an essential feature of the accord an understanding that Mr. McCabe would resign?

Mr. SPROUL. No.

Senator DOUGLAS. These were parallel actions.

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Mr. SPROUL. I do not remember whether they were parallel or succeeding actions.

Senator DOUGLAS. Well, they were almost simultaneous. I believe the effective date of the accord would be sometime early in April; is that not true?

Mr. SPROUL. Effective date of the accord was, I think, March 4.

Senator DOUGLAS. Yes, but I mean after a given date in April you would not feel bound to further support the market in Government bonds because the volume of Government bonds increased from 5.9 billions on March 14 to 6.5 billions on April 11; and thereafter it remained virtually stable, or there was a rise of almost 2 billions over the first of the year and a continued rise over March, indicating that your policy did not go into effect until somewhere around the 10th of April.

Mr. SPROUL. With respect to the support of the longest-term issue of Government bonds, it did not go into effect until the announcement had been made and the market conditioned to the exchange offering which was made to relieve that situation.

Senator DOUGLAS. That is about early April?

Mr. SPROUL. Yes.

Senator DOUGLAS. It was almost simultaneous that the announcement of Chairman McCabe's resignation was made public, although it had been known privately to some of us for some days—indeed weeks—before that. This was followed up almost immediately by the appointment of the Assistant Secretary of the Treasury, Mr. Martin, as Chairman of the Federal Reserve Board.

There is a very important part of the Federal Reserve-Treasury history here. Do I understand your position to be that there is no connection between the date of the accord and the charge of chairmen?

Mr. SPROUL. I expressed myself, perhaps, rashly; not that there was no connection, but it was not one of the terms of the accord that Mr. McCabe should resign.

Senator DOUGLAS. I do not think it was, perhaps, as explicit terms of the accord, but was there a parallel understanding at the same time that Mr. McCabe would resign?

Mr. SPROUL. I know of no such parallel understanding.

Senator DOUGLAS. Did you know of Mr. McCabe's impending resignation prior to the actual date of his resignation in early April?

Mr. SPROUL. Yes, I did.

Senator DOUGLAS. When did you know about it?

Mr. SPROUL. I do not remember the——

Senator DOUGLAS. Sometime in March?

Mr. SPROUL. Probably.

Senator DOUGLAS. At about the time the accord was reached?

Mr. SPROUL. I do not remember the dates.

Senator DOUGLAS. Not far from the time when the accord was reached?

Mr. SPROUL. It could not have been far because there was not much time in there.

I would like to make one gratuitous statement.

Senator DOUGLAS. You are at perfect liberty to state that.

Mr. SPROUL. Anyone who thinks that Mr. Martin was put in as Chairman of the Board as a stalking horse for the Treasury or a Trojan horse is greatly mistaken.

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Senator DOUGLAS. No, I have never made that statement, although I have expressed my fears.

Mr. SPROUL. I think your fears are misplaced.

Senator DOUGLAS. I hope very much that they are, and I would like to point out that I believe Mr. Martin is a very estimable gentleman who, in the year he has been Chairman, has done extremely well. I would also like to point out, however, that that was followed up a month later by the appointment of the First Deputy Comptroller in the Department of the Treasury to another place on the Federal Reserve Board—another excellent man, I may say, in the person of Mr. Robertson—and while I thought highly of both Mr. Robertson and Mr. Martin and did not wish to vote against them, I felt sufficiently suspicious so that I did not feel it proper to vote for them, so in both cases I passed my vote in the Banking and Currency Committee which passes on their confirmation.

I do not expect, for the record, I may say, that the Federal Reserve Board will submit documents on this matter, and I am not asking them to, as to whether there was any explicit understanding. I would say that there is a suspicious concatenation of events.

Mr. SPROUL. I think the suspicion is unfounded.

Senator DOUGLAS. You mean there is no connection whatsoever?

Mr. SPROUL. I do not say there was no connection, but I think to say that there was any understanding, parallel or otherwise, is not the fact.

Representative PATMAN. Thank you, sir.

Mr. SPROUL. Thank you, gentlemen.

Representative PATMAN. We have two other important witnesses today, and although we have been meeting at 2:30, if it is all right with the committee, we will meet at 2 o'clock.

Will that be satisfactory, Senator Douglas?

Senator DOUGLAS. Certainly.

Representative PATMAN. The committee will stand in recess until 2 p. m. here in this same room.

(Whereupon, at 12:05 p. m., a recess was taken, to reconvene at 2 p. m., of the same day.)

REMARKS OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK AT THE SEVENTY-FIFTH ANNUAL CONVENTION OF THE AMERICAN BANKERS ASSOCIATION SAN FRANCISCO, CALIF., NOVEMBER 2, 1949.

As a native Californian—and a native San Franciscan—I have tried to think of something I might discuss which would be of special interest to our generous hosts at this convention. The fact that this is 1949, and that the whole State of California has been engaged in a 2-year round of celebrations of the one-hundredth anniversary of the discovery of gold in California, and of its immediate consequences, gave me an obvious lead. Gold is something in which we are all interested. Nor is this an untimely topic on other grounds. The recent wave of currency devaluations which swept around the world, following upon the devaluation of the British pound sterling 6 weeks ago, has fanned into modest flame the always smoldering fires of the gold controversy. In addition, I was eager to review the gold question because it is a good starting point for an understanding of the place of the Federal Reserve System in the monetary and economic life of the country. When I finish with gold, I shall want to say something more specific about the System, and about your relations with it.

As central bankers, of course, charged with responsibility for our monetary and credit policies, we have the question of gold under more or less constant surveillance. Most of the time, in recent years, we have been under attack from two sides because of our attitude toward gold. Those interested primarily or initially in the price of gold, and in what they call a free gold market, have fired

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from one side. Those interested primarily and eternally in gold coin convertibility—in a full and automatic gold standard domestically and internationally—have fired from the other. More recently, we have had a brief respite from attack while these two groups fired at each other, each group arrogating to itself responsibility for the only true gospel according to St Midas. What I have to say will probably bring that brief respite to an end. The fire will again be concentrated on the monetary authorities, for whom I cannot presume to speak except as one individual engaged in the practice of central banking, but who will, no doubt, be blamed for my views.

Let me take account of each of these two groups separately; those who concentrate, at least initially, on a free gold market, and those who will have none of this heresy, but who want a fixed and immutable gold price and convertibility of currency—and therefore of bank deposits—into gold coin.

The first group, which includes the gold miners, makes its argument on several grounds, trying to combine economics and psychology with self-interest. Let me paraphrase their principal arguments as presented at hearings on bills to permit free trading in gold in the United States and its Territories. In this way I may avoid the facts as well as the appearance of building straw opponents. The arguments most frequently presented in favor of these bills were:

1. In the face of rising production costs and fixed selling prices, the gold-mining industry has been forced to curtail its operations, and to the extent that it has operated, its profits have been reduced. The higher gold prices which would presumably prevail in a free market would correct this situation. This is the "do something for the gold miners" argument at its baldest.

When this argument is embroidered a little, it is claimed that since the prices of all goods and services have increased so substantially during the past 10 or 15 years, it is necessary to open the way for an increase in the price of gold so as to be sure there will be enough gold to carry on the country's business; to bring the price of gold into adjustment with the prices of everything else.

2. A second group of arguments expresses concern over the unsettling effects of the "premium" prices which are paid for gold abroad, and claims that a free gold market in the United States, with no gold export restrictions, would cause these premium markets abroad to disappear, with beneficial effects upon world trade and international relations.

3. Third, there is an argument in equity—that gold miners should be allowed to sell their product at the best price they can obtain, as do producers of other products; and that American citizens, like the citizens of most other countries, should be free to hold or to buy and sell gold.

4. Finally, there were those who viewed and favored a free gold market as a first step in the direction of a full gold coin standard, and who held that even a free market would act as a "fever chart" of the economy and lead to reform of extravagant Government fiscal policies, remove inflationary tendencies fostered by a managed currency, and lead to sounder conditions, generally.

To take these arguments up in order, it should be pointed out right away that it is quite possible that a free market for gold in the United States would not result in a rise in the price of gold, if for no other reason than that the Secretary of the Treasury is required, by law, to maintain all forms of United States money at parity with the gold dollar which contains one thirty-fifth of an ounce of fine gold. This means that the Treasury should maintain the price of gold at $35 a fine ounce in legal gold markets in the United States. To do this, if there were a legal free market for fine gold, the Treasury should sell gold to the extent necessary to maintain the market price at $35 a fine ounce. We might, therefore, get what would be in effect gold convertibility by way of a free market, but not a rise in the price of gold. Aside from this possible outcome of the establishment of a free market for gold, what is it we are being asked to do? In effect we are being asked to do something to benefit the gold-mining industry to encourage a shift of productive resources, in this and other countries, into gold production, in order to provide gold for hoarding. This, I submit, would be a witless proceeding, in terms of the welfare of the whole economy, matched only by our bonanza provisions for the special benefit of the miners of silver.

As for the economic embroidery of this request for aid to the gold mining industry, there is no lack of monetary means of carrying on the business of the country, nor is there likely to be. It is the economics of perpetual inflation to argue that a rise in the commodity price level should be followed by an arbitrary increase in the price of gold and hence in the reserve base, thus permitting and, perhaps, promoting additional deposit expansion and a further upward movement of prices. Even on the basis of statistics, which are not always reliable

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or comparable, it is interesting to note that the increase in the price of gold in the United States, in 1934, raised the price of gold by 69 percent, whereas wholesale prices in the United States are now only 60 percent above the 1927-29 level. We have been plagued, if anything, with an oversupply of money in recent years, and the United States gold stock, at the present price, is large enough to support whatever further growth in the money supply may be needed for years ahead.

The second group of arguments has to do with the desirability of knocking out of business the premium markets in gold which have existed and still exist in various foreign countries. I share the general dislike of these markets because they are parasites on the world's monetary system and help to siphon into gold hoards the resources of people who need food and clothing and equipment—and who wouldn't need so much help from us if they didn't use scarce foreign exchange to buy gold from private hoards. But I don't think the soundness nor the stability of the United States dollar is actually brought into question by these premium markets. At our official purchase price for gold—$35 a fine ounce—the United States has been offered and has acquired more gold than the total world production (excepting the U. S. S. R. for which reliable data on gold production, as on everything else, are not available), since 1934, the year of our devaluation. During those years—1934 to 1948 inclusive—estimated world gold production, valued at United States prices, was about $13.5 billion and United States gold stocks increased $16 billion. Most of the producers and holders of gold have been quite willing to sell us gold for $35 a fine ounce despite the quotations of $45 and $55 and so on up in the premium markets. The fact is that these premium markets represent insignificant speculative adventures around the fringe of the world supply and demand for gold. They reflect mainly the urgent and often illegal demands of a small group of hoarders, together with some private demand for gold to be used in relatively backward areas, or areas where the forms of civilized government have broken down, and where the metal serves the needs of exchange—or hoarding—better than a paper note. I do not think there would be any appreciable stimulus to United States gold production, if we opened the doors of this largely clandestine trade to our domestic gold miners. But, by legalizing it, we might well create what we are trying to destroy—uncertainty about the stability of the dollar and our own intentions with respect to its gold content.

The third argument—that the miners of gold should be free to sell their product at the best price they can get—is probably the give-away. It is the argument that gold should be treated as a commodity when you think you can get a higher price for it, and as a monetary metal and an international medium of exchange when you want a floor placed under its price. I would say that you can't have it both ways. If you want the protection of an assured market at a fixed price, because gold is the monetary metal of the country, you should not ask permission to endanger the stability of the monetary standard by selling gold at fluctuating prices (the gold producers hope higher prices) in a fringe free market. Under present conditions, the only real price for gold is the price the United States Treasury is prepared to pay for it. So long as that is the case, there is no sense in a make-believe free-gold market, in which possible temporary or short-run deviations from the fixed price of the Treasury might have disturbing consequences.

Nor is the argument that citizens of the United States should have the same privileges as the citizens of other countries, when it comes to holding or trading in gold, at all convincing to me. It is true that in a number of foreign countries the holding of gold by private citizens is legal, and in some foreign countries strictly internal free trading in gold is permitted. In many cases, however, this merely represents the shifting around of a certain amount of gold which is already being hoarded in the country, since in practically all of these countries the export and import of gold on private account is either prohibited or subject to license. And, in many countries where gold is produced, some percentage, if not all, of the newly mined gold must be sold to the monetary authorities, a requirement which further limits the amounts available for trading and hoarding. These restricted and circumscribed privileges in other countries are no reflection of a loss of inalienable rights by our people. They are attempts by these foreign countries to adjust their rules with respect to gold to their own self-interest and, so far as possible, to the habits of their people, all under the sheltering umbrella of a world gold market and a world gold price maintained by the Treasury of the United States. We have deemed it wise to maintain such a fixed point of reference, in a disordered world. We have decided by

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democratic processes and by congressional action, that this policy requires, among other things, that gold should not be available for private use in this country, other than for legitimate industrial, professional, or artistic purposes. We have decided that the place for gold is in the monetary reserves of the country, as a backing for our money supply (currency and demand deposits of banks), and as a means of adjusting international balances, not in the pockets or the hoards of the people. If we want to reverse that decision, the means of reversal are at hand, but it should be a clear-cut and a clean-cut reversal, restoring convertibility. Providing a dependent free-gold market, in which gold miners and a little gold group of speculative traders or frightened gold hoarders (such as those who now take advantage of a provision in the regulations to buy and sell "gold in the natural state") could carry on their business is not the way to meet the problem.

I do not propose to get in the cross-fire of those who claim that a free gold market would be a step toward convertibility, and those who claim that a free gold market, without free coinage at a fixed price, would cause us to lose whatever modicum of a gold standard we now have and lead to monetary chaos. That is one of those doctrinal arguments in which the subject abounds. I will merely say here that I think authorization of a free gold market in this country, with no change in the present responsibility of the Secretary of the Treasury to maintain all forms of money coined or issued by the United States at parity with the "gold dollar," would probably lead indirectly to convertibility. The desirability of doing this is another matter, which I shall now try to discuss briefly and dispassionately. This is a hazardous attempt because there is no subject in the field of money and banking which so arouses the passions, and which so readily defies brief analysis.

Two groups of arguments for the reestablishment of a gold coin standard may, perhaps, be distinguished in the writings and speeches of those who propose it, one group relating primarily to the domestic economy and one to the probable effects on international trade and finance. In the first group the arguments run about as follows:

1. Replacement of our "dishonest," inconvertible currency with an "honest" money having intrinsic value would promote confidence in the currency, and encourage savings, investment, long-time commitments, and production.
2. Irredeemable paper money leads to inflation, whereas the upper limits imposed upon currency and credit expansion by a thoroughgoing gold standard serve as a restraining influence on irresponsible politicians and over-optimistic businessmen.
3. Present governmental taxing and spending policies are wrong, and dangerous. The gold standard would put a brake on public spending.
4. As a corollary of the preceding argument, since the gold standard would hinder further extension of Government control and planning, it is a necessary implement of human liberty.

The second group of arguments, relating to the international advantages of a gold coin standard, generally make no distinction between the effects of a unilateral adoption of such a standard by the United States, and the multilateral establishment of an unrestricted gold standard by many countries, and of exchange rates fixed by such a standard. The arguments run somewhat as follows:

1. The existence of premium markets in gold abroad and the lack of gold convertibility at home creates—and is representive of—lack of confidence in the gold value of the dollar. In the absence of a thoroughgoing gold coin standard we cannot convince anyone that we may not devalue the dollar.
2. Restoration of "normal" patterns of international trade is being retarded by the inconvertibility of currencies in terms of gold and, therefore, one with another. This inconvertibility has led to tariffs, quotas, exchange controls, and to general bilateralism.
3. Under a managed paper currency system there is always the temptation to solve national problems by devices which lead to international disequilibrium. This, in turn, has led to domestic devices restrictive of foreign trade. The international gold standard, by eliminating the need for restrictive commercial policy, would increase the physical volume of international trade, resulting in an improved division of labor and higher standards of living for everyone.

First, let me say that I perceive no moral problem involved in this question of gold convertibility. Money is a convenience devised by man to facilitate his

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economic life. It is a standard of value and a medium of exchange. Almost anything will serve as money so long as it is generally acceptable. Many things have served as money over the centuries, gold perhaps longest of all because of its relative scarcity and its intrinsic beauty. In this country we still retain some attachment to gold domestically, and more internationally, but to carry on our internal business we use a paper money (and bank deposit accounts) which has the supreme attribute of general acceptability. There is no widespread fear of the soundness of the dollar in this country, no widespread flight from money into things. The constant cry of wolf by a few has aroused no great public response. Savings, investment, long-term commitments, and the production and exchange of goods have gone forward at record levels.

Much of the nostalgia for gold convertibility is based, I believe on fragrant memories of a state of affairs which was a special historical case; a state of affairs which no longer exists. The great period of gold convertibility in the world was from 1819 to 1914. It drew its support from the position which Great Britain occupied during most of the nineteenth century and the early part of the twentieth century, in the field of international production, trade, and finance. The gold coin standard flourished because the organization of world trade under British leadership provided the conditions in which it could, with a few notable aberrations, work reasonably well.

The ability of the British to sustain, to provide a focal point for this system has been declining for many years, however, and the decline was hastened by two world wars which sapped the resources of the British people. The heir apparent of Great Britain, of course, was the United States, but up to now we have not been able to assume the throne and play the role. And until some way has been found to eliminate the lack of balance between our economy and that of the rest of the world, other than by gifts and grants-in-aid, we won't be able to do so. This is a problem of unraveling and correcting the influences, in international trade and finance, which have compelled world-wide suspension of gold convertibility, not vice versa. The job before us now is to attack the problems of trade and finance directly. We should not deceive ourselves by thinking that gold convertibility, in some indefinable but inexorable way, could solve these underlying problems for us.

Nor is it true, of course, that gold convertibility prevented wide swings in the purchasing power of the dollar, even when we had convertibility. Within my own experience and yours, while we still had a gold-coin standard, we had tremendous movements in commodity prices, up and down, which were the other side of changes in the purchasing power of the dollar What happened to us in 1920–21 and 1931–33 under a gold-coin standard should prevent a too easy acceptance of that standard as the answer to the problem of money with stable purchasing power.

When you boil it all down, however, and try to eliminate mythology from the discussion, the principal argument for restoring the circulation of gold coin in this country seems to be distrust of the money managers and of the fiscal policies of Government. The impelling desire is for something automatic and impersonal which will curb Government spending and throw the money managers out of the temple, as were the money changers before them. To overcome the inherent weakness of human beings confronted with the necessity of making hard decisions, the gold-coin standard is offered as an impersonal and automatic solution. Through this mechanism the public is to regain control over Government spending and bank credit expansion. It is claimed that whenever the public sensed dangerous developments, the reaction of many individuals would be to demand gold in exchange for their currency or their bank deposits. With the monetary reserve being depleted in this way, the Government would be restrained from deficit financing through drawing upon new bank credit; banks would become reluctant to expand credit to their customers because of the drain on their reserves; and the Federal Reserve system would be 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.

In effect, under a gold coin standard, therefore, the initiative for over-all monetary control would, through the device of free public withdrawal of gold from the monetary reserve, be lodged in the instinctive or speculative reactions of the people. No doubt some people would take advantage of their ability to get gold. There would be many reasons for their doing so. Conscientious resistance to large Government spending, or fear of inflation, might well be among these reasons. But speculative motives, a desire for hoards (however moti-

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vated), and such panic reactions as are generated by unsettled international conditions or temporary fright concerning the business outlook or one's individual security—all of these; and more—would be among the reasons for gold withdrawals. The gold coin mechanism does not distinguish among motives. Whenever, for any reason, there was a demand for gold, the reserve base of the monetary system would be reduced. Moreover, if only the United States 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 those countries badly need for essential supplies or for development purposes would be diverted to the selfish interests of hoarders.

Even if a particular reduction in the reserve base did occur for useful "disciplinary" reasons, 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 about one-to-five, and since some such ratio will be in effect so long as this country retains a fractional reserve banking system, a withdrawal of gold coins (once any free gold is exhausted) will tend to be multiplied many times in its contractive effect on bank credit and the money supply. In a business recession, the Reserve System might undertake to offset this effect as it does now in the case of gold exports but, if the gold withdrawals attained sufficient volume, the shrinking reserve position of the Federal Reserve banks would eventually prevent them from coming to the rescue.

It was, in part, to offset such arbitray 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. We had an embarrassing practical experience with gold coin convertibility as recently as 1933 when lines of people finally stormed the Federal Reserve banks seeking gold, and our whole banking mechanism came to a dead stop. The gold-coin standard was abandoned, an international gold bullion standard adopted, because repeated experience has shown that internal convertibility of the currency, at best, was no longer exerting a stabilizing influence on the economy and, at worst, was perverse in its effects. Discipline is necessary in these matters but it should be the discipline of competent and responsible men; not the automatic discipline of a harsh and perverse mechanism. If you are not willing to trust men with the management of money, history has proved that you will not get protection from a mechanical control. Ignorant, weak, or irresponsible men will pervert that which is already perverse.

Here, I would emphasize my view that the integrity of our money does not depend on domestic gold convertibility. It depends upon the great productive power of the American economy and the competence with which we manage our fiscal and monetary affairs. I suggest that anyone who is worried about the dollar concentrate on the correction of those tendencies in our economic and political life which have brought us a deficit of several billion dollars in our Federal budget, at a time when taxes are high and production, employment, and income are near record levels. I suggest that, going beyond the immediate situation, they address themselves to the difficult problem of the size of the budget, whether in deficit or surplus or balance. At some point the mere size of the budget, in relation to national product, can destroy incentives throughout the whole community, a dilemma which is even now forcing curtailment of Government expenditures by the Labor Government in Great Britain. These are problems gold-coin convertibility cannot solve under present economic and social conditions. Gold has a useful purpose to serve, chiefly as a medium for balancing international accounts among nations and as a guide to necessary disciplines in international trade and finance. It has no useful purpose to serve in the pockets or hoards of the people. To expose our gold reserves to the drains of speculative and hoarding demands at home and abroad strikes me as both unwise and improvident.

Perhaps before I let go of this subject, which has held me and you overlong, I should say a word about merely raising the price of gold, without doing anything about a free gold market or gold-coin convertibility of the currency. This is something which has intrigued Europeans and others who are "short of dollars," has interested some of our own people, and has become a South African war cry.

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An increase in the price the United States pays for gold would have two major results. It would provide the gold-producing countries (and domestic producers), and the countries which have sizable gold reserves or private hoards, with additional windfall dollars with which to purchase American goods. And it would provide the basis for a manifold expansion of credit in this country which might be highly inflationary.

We have been engaged in an unprecedented program of foreign aid for the past 4 years. The Congress has authorized this aid at such times and in such amounts as were deemed to be in the interest of the United States. This is much to be preferred, I suggest, to the haphazard aid which would be granted by an increase in the price of gold, which must be on the basis of a more or less accidental distribution of existing gold stocks and gold producing capacity. If we raised the price of gold, every country whoich holds gold would automatically receive an increase in the number of dollars available to it. The largest increases would go to the largest holders which are the Soviet Union, Switzerland, and the United Kingdom. Every country which produces gold would automatically receive an annual increase in its dollar supply, and its gold-mining industry would be stimulated to greater productive effort. The largest increases would go to the largest producers which are South Africa, Canada, and probably the Soviet Union. That would be an indiscriminate way to extend our aid to foreign countries, both as to direction and as to timing.

The domestic results of an increase in the price of gold would be no less haphazard. This country, as I have said, is not now suffering from a shortage of money and it has large gold reserves, which could form the basis of an additional money supply if we needed it. An increase in the dollar price of gold would increase the dollar value of our existing gold reserves in direct proportion to the change in price. There would be an immediate "profit" to the Treasury. The "profit" could be spent by congressional direction or Treasury discretion. This would provide the basis for a multiple expansion of bank credit which, unless offset by appropriate Federal Reserve action, would expose our economy to the threat of an excessive expansion of the domestic money supply. The arbitrary creation of more dollars in this way would certainly be inappropriate under inflationary conditions, and would be an ineffective method of combating a deflationary situation.

At the moment, also, we should have in mind that there has just been an almost worldwide devaluation of currencies. Using the fixed dollar as a fulcrum, individual foreign countries have taken action designed to improve their competitive position vis-à-vis the United States, and to maintain their competitive position vis-à-vis one another. An increase in the dollar price of gold, which is devaluation of the dollar by another name, would undo the possible benefits of a venture in improved currency relationships which already has its doubtful aspects.

For all of these reasons it is encouraging to know that the Secretary of the Treasury has recently reiterated that the gold policy of the United States is directed primarily toward maintaining a stable relationship between gold and the dollar, and that for all practical purposes only the Congress can change that relationship. We have maintained an international gold bullion standard by buying and selling gold freely at a fixed price of $35 a fine ounce in transactions with foreign governments and central banks for all legitimate monetary purposes. This has been one fixed point in a world of shifting gold and currency relationships. We should keep it that way as another contribution to international recovery and domestic stability.

This whole discussion of gold has been a long wind-up for what may now seem to you like a small pitch. I want to end my remarks with a few words about the Federal Reserve System and the relations of your organization and you, as bankers and citizens, with that System.

In my gold discussion I tried to emphasize what seems to me to be a fundamental proposition in the case of a country with the domestic and international strength of the United States. We can't have, or we don't want, both an automatic gold coin standard and discretionary control of the reserve base by a monetary authority. The existence of two independent and frequently incompatible types of control over the reserves of our banking system is undesirable. In the light of that finding we abandoned the gold-coin standard as a control over the domestic money supply, and placed our reliance in monetary management by the Federal Reserve System. I think it has become established American policy that a principal means of Government intervention in the economic processes of the country is the administration of broad credit powers by the

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System. In this way a pervasive influence may be brought to bear on our economy, without intrusion upon specific transactions between individuals, which is likely to be the consequence of more detailed physical controls, and which would spell the end of democratic capitalism as we have known it.

I have thought it reasonable to assume that the public in general, and bankers in particular, clearly recognized the special place of the System in our economy. The fact that the development of a national monetary and credit policy is the responsibility of the Federal Reserve System should fix its place beyond question. This is not a function which can be split up and passed around. Many of the activities of other Government agencies engaged in making or guaranteeing loans, or conducting bank examinations, or insuring bank deposits, have a bearing on the way monetary policy works, but monetary policy, as such, is one and indivisible. It is only the supervisory and service functions performed by the Federal Reserve System which are comparable to the operations of these other Government agencies. The distribution of these incidental duties among such agencies can be largely determined by administrative convenience, historical precedent, and economy of operation, so long as there are arrangements for consultation to avoid unnecessary differences in policy and practice. But overall responsibility for holding the reserves of the banking system, and influencing the creation of credit by varying the cost and availability of those reserves, 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 having to do with banking. Its duties and responsibilities are unique; they range over the whole of our economy and touch the lives of all our people.

I was somewhat dismayed, therefore, by recent reports that the American Bankers Association seemed to hold a different or opposite view. It is reported to have recommended to the Congress the maintenance of parity of compensation of the three Federal bank supervisory agencies (Board of Governors of the Federal Reserve System, Board of Directors of the Federal Deposit Insurance Corporation, and the Comptroller of the Currency), on the theory of equal pay for equal work; equal pay for sharing equally heavy responsibilities. I mean no disrespect of the Office of the Comptroller of the Currency, nor of the Federal Deposit Insurance Corporation, when I say there is and can be no such equality of responsibility. The bank supervisory duties of the Federal Reserve System are a distinctly minor part of this work. There is no desire to increase or add to those duties against the wishes of the banks or the best interests of the public. To represent the Federal Reserve System as just another bank supervisory agency, in the name of maintaining proper checks and balances in Federal bank supervision, seems to me to miss, and to misrepresent, the main reason for our being.

I mention this small but significant item first, because it cuts across the whole concept of the Federal Reserve System and, therefore, cuts across the whole range of our relationships with you. There are other points of apparent difference where we seem to be at odds, or not pulling together effectively, because of mistrust, or lack of proper consultation, or inadequate study of the broad aspects of the questions with which we are mutually concerned. I shall touch on a few of them.

Concentration of power.—The picture of a Federal Reserve System trying to arrogate power to itself, which at times you have painted, obscures the real picture. The real picture would show a Federal Reserve System trying hard to keep its powers in working order so that it can discharge its responsibilities as a monetary authority, with a measure of independence from the pressures of partisan political aims and the exigencies of managing a Federal debt which totals about $255 billion and, unfortunately, is growing. To lump the Federal Reserve System with the other bank supervisory agencies at Washington, and to play one against the other, is not an attack on the real concentration of power; it is giving aid and comfort to those who would seize upon the failure of monetary and credit controls as a pretext for fastening more direct controls upon our economy.

Organization of the Federal Reserve System.—I have been at one with many of you in my opposition to undue centralization of control of the Federal Reserve System by the Board of Governors at Washington. In testimony before congressional committees and in public statements, I have affirmed my belief that we can have in the Federal Reserve System a wise blend of national authority and regional responsibility, of Government control and private participation. I think we shall do well to retain and to improve the regional characteristics of

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the System, both in matters of decentralized operation and, more important, in matters of national credit policy. I should like to see the bankers of the country, and this organization of bankers, give some more thought to this problem, and I should like them to offer some constructive suggestions concerning it. The climate may be right for its calm consideration.

Reserve requirements.—The Federal Reserve System is charged with the responsibility of formulating and administering national credit policy. It does this chiefly through its influence upon the cost and availability of bank reserves. This is a proper exercise of Federal power, and its point of incidence is upon the commercial banks of the country because only they, among all of our financial institutions, have the ability to add to or subtract from the money supply of the Nation. I question whether there is good and sufficient reason for exempting any commercial banks from a minimum participation in this national undertaking. It only requires a moderately sharp pencil and a grammar school knowledge of arithmetic to figure out how you can save money by not being a member of the Federal Reserve System, as things now stand. But I don't think this country really likes "free riders," and nonmember banks, in that sense, are "free riders." I know the objections to compulsory membership in the Federal Reserve System, I recognize some of its dangers, and I think it is probably politically impossible. But it should not be beyond our ingenuity to devise appropriate powers of fixing reserve requirements, to be exercised within statutory limits by an appropriate body within the Federal Reserve System; reserve requirements which would be adequate for our national purpose, and which would apply to member and nonmember banks alike.

Here is another instance, I believe, where your theory of checks and balances runs the danger of being all check and no balance. And let it be clear that this is no attack on the dual banking system. State member banks have lived within the Federal Reserve System for years, and submitted to its reserve requirements, without loss of identity. We welcome this continued relationship. Nor am I frightened by the existence of a fringe of nonmembers, and the ability of State banks to move from one group to the other. A mass exodus of State member banks from the Federal Reserve System seems to me to be so unlikely as to be outside the range of practical consideration. But I do think that all commercial banks have a common obligation and a common responsibility in this matter of reserve requirements, and that they should assume the obligation and share the responsibility.

Correspondent bank relationships.—Somehow there has grown up a feeling in some places that we in the Federal Reserve System are out to undermine the network of correspondent bank relationships which you have built up over the years. Every time we suggest some change in the method of assessing reserve requirements, or make some minor improvement in our check collection system, or in our methods of providing coin and currency, or in some other detail of our operations, the question seems to be raised. I can assure you that these things are suggested or done in an effort to improve the efficiency and economy of our operations in terms of the whole banking system, the business community, and the general public. There is no hidden purpose. We recognize that there are some things which correspondent banks can do better than we can, and we are glad to have them perform these services. At the same time we would caution them against competition in providing services which really do not pay their way, and remind them that there are some things which, perhaps, the Federal Reserve System can do better than they. Surely here is an area, if our motives be reasonably pure on both sides, where there is no need for friction between us.

Selective credit controls.—We have differed on the matter of selective credit controls or, more specifically, on the matter of control of consumer installment credit. I have advocated the continuance of the control which the Federal Reserve System exercised, briefly, over consumer installment credit. I would be concerned over the dangers of any further significant extension of selective controls, whether over the credit used in commodity markets, in real estate transactions, in inventory financing, or in other forms of business lending. Requests for further powers should meet two tests—is the power really needed and will its use still leave an effectively functioning private economy? I have argued and still believe that control of consumer installment credit meets these tests. Your official position has been opposed to this view. I would ask you, however, whether you are happy about the way things are now going in this field of finance. I am not. I suggest that we might sit down together and reexamine the problem to our mutual advantage and to the advantage of the public which we both serve.

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These are some of the matters which I think deserve your constructive attention. A negative approach has been and will continue to be effective in stopping the passage of individual pieces of legislation, which you happen to dislike, but it won't check the progress of the idea of Government controls and intervention, if you have little constructive to offer in the face of difficult economic problems. Over the years you will win a lot of battles but you will lose the war.

I recognize and share your dislike for Government controls and your distrust of too much centralized power. But I recognize, as I think you must, that a certain amount of Government intervention is necessary to the preservation of our political and economic system. The central problem in our country, and in all countries but Russia and its satellites, is how far such Government guidance and control can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we have preferred to keep such guidance to a practical minimum, and to have it exercised largely through broad and impersonal controls—controls which affect the general environment. One cornerstone of such a philosophy is a competent and adequately powered monetary authority which can administer an effective monetary policy. In making monetary policy work to the limit of its capacity, we have one of the best defenses against control by Government intrusion in our personal and private affairs.

That is why I should like to see the American Bankers Association adopt an affirmative, constructive attitude toward the Federal Reserve System. If you don't like it, as it stands, put some real time and effort into the study of ways to improve it—its personnel, its powers, its organization, its functioning. In such an undertaking you will have the cooperation of all of us who are devoting our lives and our energies to what we believe to be a worth-while public service. In the struggle of ideas and ideals which now divides the world this is a minor front. But it is a fighting front. It is no place for a neutral.

AFTERNOON SESSION

Representative PATMAN. The committee will please come to order. Mr. Ruml.

We have with us this afternoon Mr. Beardsley Ruml, former chairman of the board of directors of the R. H. Macy & Co., formerly Chairman of the Board of Directors of the Federal Reserve Bank of New York, a leading figure in the National Planning Association, author of the famous Ruml plan for the forgiveness of taxes.

Mr. Ruml, we are glad to have you. Do you have a prepared statement?

Mr. RUML. Yes, I do. May I read it?

Representative PATMAN. You may proceed as you desire.

Mr. RUML. Thank you very much. Then I will answer any questions that I can.

Representative PATMAN. Thank you.

STATEMENT OF BEARDSLEY RUML

Mr. RUML. My name is Beardsley Ruml. In the past, I have had an opportunity to observe and to participate in three different capacities in events directly within the field which this subcommittee is studying: 1, as alternate to Mr. Frederic A. Delano, then Chairman of the National Resources Planning Board who served in that capacity as a member of the Fiscal and Monetary Advisory Board in late 1938 and early 1939; 2, as a member and then as Chairman of the Board of the Federal Reserve Bank of New York, from January 1937 until the end of 1946; and, 3, as proponent of the so-called pay-as-you-go income tax plan. In the latter capacity, I met with the heads of many Federal departments and agencies during the 6 months prior to July

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1942 when I first appeared before a congressional committee, the Senate Committee on Finance.

In giving the present testimony, I should like to draw on these experiences with the general warning that anyone's memory is incomplete and inaccurate, sometimes in consequential ways. However, I shall do the best I can. And may I say in parentheses that the staff of the committee has been most helpful in refreshing and correcting my memory. I also want to make clear that in recalling these experiences, I do so without the slightest intention of criticism of any department, agency, or individual, but only to draw on the past for possible lessons for the future. For that reason, I shall speak concretely of agencies and individuals only when it is necessary to give precise meaning to the discussion.

My testimony will be directed to the answer made by the Secretary of the Treasury to question 10, which was in part, "How in your opinion should policy conflicts be resolved?" The Secretary suggested in his answer paragraph 2 on page 31 of the joint committee print of this subcommittee:

> The creation of a small consultative and discussion group within the Government * * * for the purpose of discussing domestic monetary and fiscal matters with each other. This group would in a way be a kind of parallel to the National Advisory Council which works in the field of foreign financial matters.

In general, I support this recommendation, with one principal exception; namely, that in my opinion the group should meet formally as well as "informally," and that it should be created by legislative action giving it certain specified responsibilities, duties and limitations.

The balance of my remarks will be devoted to concrete past and prospective situations which I hope will support convincingly the position which I have just taken.

In late 1938, the President authorized the establishment of a Fiscal and Monetary Advisory Board. This action was welcomed with different degrees of enthusiasm by all related departments and agencies as a result of the unfortunate experiences of 1937 and the abrupt reversal of policy of March 1938.

The Fiscal and Monetary Advisory Board was ready for work in the autumn of 1938. Its members were the Secretary of the Treasury who was Chairman of the Board; the Chairman of the Board of Governors of the Federal Reserve System; the Director of the Bureau of the Budget; and the Chairman of the National Resources Planning Board. The Fiscal and Monetary Advisory Board, so constituted, was not created by legislative act nor by formal Presidential order. It was intended to be "advisory" as among its members and available to the President.

In the course of its several meetings, the Board did much to promote an exchange of views and information. But in addition, it succeeded in getting important decisions and actions, of which I shall mention two.

The first action relates to sums made available for the Works Progress Administration. By the winter of 1938 it had become apparent that from the standpoint of fiscal and monetary affairs as well as the sheer need for relief, the appropriation of funds in excess of those already authorized by Congress had become necessary. The President had expressed extreme reluctance to the WPA Administrator to go back to Congress for an additional appropriation.

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The situation was brought before the Fiscal and Monetary Advisory Board and with the advice and cooperation of the general counsel of the Treasury, a memorandum was sent to the President signed by all members of the Board. Upon receipt of this memorandum additional funds were requested of Congress and later an emergency was declared which caused Congress to make available an additional $100,000,000 over and above amounts previously appropriated for WPA. Thus, through the action of the Fiscal and Monetary Advisory Board, supporting from its own point of view the position of the WPA Administrator, the funds became available, and a rough spot or at least a hurtful delay was avoided.

A second situation was successfully met in action to recommend the postponement of the legislatively planned increase in the rate of social security taxes that was to take place in 1939. After study, the Board concluded that the economic situation would be injured rather than helped by the automatic increase in social security tax rates. Legislative action postponing this increase was taken, and, in my opinion, the unanimous attitude of the Board was decisive in obtaining this most constructive measure.

Many plans and suggestions were discussed, and some of these, possibly because of the Board but also possibly not, became recommendations for legislation in 1939.

Why did the Board die? During the spring of 1939, a memorandum was sent to the President, attached to which was another memorandum signed by one of the members of the Board expressing a minority point of view. No further meetings of the Fiscal and Monetary Advisory Board were ever called and the Board disappeared noiselessly from the governmental scene.

The whole experience is to me persuasive as to what such a board can do to make good things happen that might not otherwise happen and how these results can be obtained without the authority to issue directives. The experience also shows why it is necessary to have such a board set up by legislative action, so that its life may end, if it should, by as deliberative a judgment as that by which it was created.

The second situation which illustrates the need of a fiscal and monetary advisory committee is that shown by the history of the pay-as-you-go income tax plan during the 6 months prior to my first testimony to a congressional committee. The plan was discussed with all departments and agencies that appeared to have an interest in the matter, including the Office of Price Administration because of possible relation to the price-control problem. Only one department objected to the plan. No joint discussions with other departments and agencies as a group were held, and after six months' delay, it seemed necessary to go to Congress, which I did. The differences, insofar as they were technical, I am sure could have been resolved; and the policy differences could have been clarified. Perhaps even these differences would have not seemed serious enough to warrant the 9-month struggle with Congress and with public opinion which resulted. Of course, it is probably true that the dissenting department did not foresee the length nor the outcome of the controversy. In any case, the incident illustrates what can happen in the absence of discussion and cooperation.

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Other situations which might be put before you at equal length may be mentioned briefly. All of these situations would be improved and some would be corrected by the existence of an advisory committee on fiscal and monetary matters. Here are examples:

1. The failure to agree on the budget or budgets to be used in presenting surpluses and deficits to the public.
2. The absence of a vigorous over-all savings promotion after July 1950.
3. The $5½ billion error in a 6-month estimate of the fiscal situation in the spring of 1951.
4. The weak stockpiling program as carried on from 1946 to 1950.

I purposely do not mention the great debate which has taken so much time of this subcommittee. But I would not want to leave these illustrations without a suggestion as to future problems where an advisory committee may save time, unnecessary controversy, and make a constructive suggestion or two of its own. I shall mention two such problems.

First, some time in the near future the possibility will arise for a large roll-down of expenditures and of taxes, particularly of tax rates. The magnitude of this change will be such as to have a permanent effect on the quality and dimensions of American life from that time on. Indeed, the doing of this rather than of that will have world-wide consequences.

Some, but not all, of the decisions in connection with the coming roll-down will be primarily fiscal and monetary. All of the decisions will be affected to a greater or lesser degree by fiscal and monetary policy and action.

A consultative and advisory committee is clearly called for in this situation which lies not far ahead. Preparatory studies and consultations should begin as soon as may be.

Second, within 20 years, perhaps within 10, the locus of the national debt as among different kinds of holders will become an acute problem. An advisory committee will be helpful in preventing too much from being attempted too quickly, and at the same time in giving to the public, confidence that an over-all policy of obstruction and delay is not being pursued.

So much then for the situations, past and potential, in which a fiscal and monetary advisory committee could be helpful. How should it be set up? From my experience and observation, I make the following suggestions:

1. A fiscal and monetary advisory board should be created by legislative action.
2. Its members should be the heads of departments and agencies; and alternates should be recognized as such, not as casual substitutes for the members themselves.
3. The powers of the board should specifically exclude any powers now residing in any other department or agency. The function of the board should be to obtain informed collaboration among departments and agencies which have been created by law with powers, duties and limitations already provided, or to be provided, by law.
4. The proposed board should be "advisory" to its individual members and to related agencies. The President and the Congress through its various committees would have access to the minutes and documents of the board and would consult the board from time to time

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on their own initiative whenever the occasion arose that would cause such consultation to be desirable.

5. The legislation creating the board should specify a minimum number of regular meetings per annum at which a quorum of full members shall be present. It should require the keeping of minutes, the filing with the minutes of memoranda of any dissent, a minimum number of reports to the Congress and to the public, and the adoption of bylaws for the conduct of the board's affairs.

6. The board should have its own staff and budget, and should use, but not be dependent upon, borrowed services or space from member departments and agencies.

7. Relations with the President should be informal, with a clear understanding that the initiative for a conference can be taken by either the President or the board.

8. The President should not have the power to issue directives to the board nor to any of the members of the board where that power does not independently exist.

The board, and certainly some of its members, will find it necessary from time to time to take some unpopular decisions. Some mistakes, even, may be made. If the President has the power to issue directives, then the decisions and errors are his even though he did not act. The giving of the power to act would have made him constructively responsible.

Such constructive responsibility of the President is particularly undesirable in the case of the Federal Reserve Board. It would embarrass the President, and it would destroy the vigor and the urgent sense of responsibility of the Federal Reserve. Something of this kind has happened in the new relations since 1933 of the Federal Reserve Board and the 12 Federal Reserve banks. I feel that this changed relationship was inevitable, and I do not criticize it.

But let not the same dependence arise between the President and the Federal Reserve Board, the authority responsible for the regulation of money and credit cost and availability. Nothing but harm to public confidence in both money and Government would result. The proposed Fiscal and Monetary Advisory Board would lose its promise as a means of obtaining informed collaboration among its members and instead would devote its efforts to the procuring of directives from the President, to the use of force rather than reason in dealing with agencies with opinions of their own, and finally to attempt to shield the President from mistakes, both technical and political, in the making of which he would not have participated, but for which he would be constructively responsible.

It is not that the President should evade responsibility which is properly his. But there should not be joined in his persons the chief authority or the executive branch and final authority over money and credit. These two great powers are sufficiently distinct, and have such obvious possibilities of essential difference from time to time that all should know that the medium of exchange is not being compromised—indeed, that it cannot be compromised—by either weakness or ambition in the executive branch. The public will be reassured if the means for informed collaboration are created, but beyond informed collaboration we should not go, lest we lose that confidence in our medium of exchange upon which so much depends.

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Valuable as informed collaboration would be among the various departments and agencies dealing with fiscal, monetary, and debt matters, we must not expect too much, we should not feel that a solution has thereby been found to the problem of economic stability and progress in a free, democratic society.

Statistical analyses must be checked and supplemented by first-hand observation of how people are actually behaving, what they are thinking and doing as individuals, and what massive tendencies can be detected in the tides of group reaction.

No doubt many people have always consumed more than they really needed, and many people have always set aside something for a rainy day. But over the last decade with us in the United States, these two tendencies have enormously increased, so much so that the unpredictable has all but submerged the hard core of statistical measurement on which economic forecasting must depend.

Today as never before the ordinary individual can get along without purchasing for his day-to-day requirements. Even with many articles of food, he is relatively his own master. If he decides to change or to restrict his habitual consumption, he can do so without doing violence to his health or well-being; and the markets will shudder if hundreds of thousands do the same thing at the same time.

So also today as never before the ordinary individual has cash, or its equivalent, that he can use to buy the things he wants or the things he may some day want. When hundreds of thousands decide to stock up the same merchandise at the same time, the markets explode and the shelves are bare, at least for a little time. Thus, consumer spending is not necessarily consumption, and is only partially, very partially a matter of economics.

The consumer in the United States today is not absolutely free—sooner or later he must buy some things to satisfy his minimum requirements. However, in the aggregate, the consumer is free as never before—free to postpone, free to reduce, free to anticipate, free to switch from one unnecessity to another. He is of course not absolutely independent of his earning power, nor of the price level, nor of the compulsions of convention. But economic determination no longer contains him. He may choose in some significant measure what, when, and where he will buy; and after that, how much he will pay for quality, design and services which he can get along without if so it pleases him.

This enlarging area of choice, of expanding economic freedom, is upsetting fiscal and monetary policy, full employment policy, the business cycle, Dow-Jones averages, and the historical-statistical approach to the future generally. For when the balance is shifted from causation to freedom, as indeed it has been shifted for the American consumer, the future flows not only from the past but also from the present, an unformed present which now, and always, permits design and decision. We have heard the phrase, "What is past is prologue." The phrase must be revised to read, "What is past and in the creative present is prologue."

The old economics is very old indeed. The new economics is already old. The next phase will be a synthesis of economics, political science, and anthropology—a subject which has as yet practically no subject matter, and whose literature exists primarily in the novel.

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I shall be happy to answer as best I can questions on this testimony or on any related matters.

Representative PATMAN. Thank you, Mr. Ruml.

Mr. Bolling?

Representative BOLLING. Mr. Ruml, on page 5, toward the bottom of the page, you say:

> First, sometime in the near future the possibility will arise for a large roll-down of expenditures and of taxes, particularly of tax rates.

That is a very strong statement. What does it mean, sir?

Mr. RUML. What it means is simply that we are devoting so much of our production today to making the instruments of new production that it is inevitable that some change in the standard of living, one way or another, must occur.

The reason that I said "particularly tax rates" is to take account of the increasing national income and increasing working population. These might make it possible for rates to come down even faster than taxes themselves.

Representative BOLLING. That has the thought behind it, or the conclusion is not in any way affected by questions of relations in a world rather than within a country.

Mr. RUML. Oh, I think it definitely has relations with respect to the world. It makes an assumption, obviously, of no all-out war.

Representative BOLLING. Does it also assume the present level of defense spending?

Mr. RUML. I think the present level of defense expenditure is almost untenable without a large assumption for the building of productive plants to make the defense materials. In other words, I take it for granted that the hump is a hump and that at some point or other we will have our plants and equipment and we will have our stockpiling substantially completed. With a higher national income, a larger working population, and so we can look forward to not too many years ahead for a reversal of the present trend. And at that point there will arise very important issues that must be solved, not in controversy but in terms of some understanding of what the direction will be.

Representative BOLLING. At the top of the next page you say:

> Second, within 20 years, perhaps within 10, the locus of the national debt as among different kinds of holders will become an acute problem.

Would you expand on that?

Mr. RUML. Yes. It simply refers to the fact that I think the Secretary of the Treasury referred to, that it would be desirable to shift the debt when possible into the hands of private holders. The rate and method whereby that is done, the timing of it, and all the rest creates real problems with respect to the present holders of the debt, and, therefore, there must not be an impulsive or scattered approach to the problem of making the public the owners of the debt. It should be according to plan of some kind. Otherwise nothing but confusion could result.

Mr. BOLLING. I gather it is your feeling that this Board you propose to set up by legislative action is based not only on the experience of the past but your fear that in the future, if it were not, when it moved in the direction which displeased a minority of the Board, which had a certain relationship with the Congress, or the Congress

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had a powerful relationship with one force or another, it could be eliminated by quixotic determination?

Mr. RUML. That, together with the necessity for orderly procedures with respect to a group in which there can be a legitimate difference of opinion. A minority of one filing a dissent might prove to have been right, and it should be possible for the Congress and the public to know at what point these differences occur.

My experience has been not only in connection with this other Board, but also in other organizations, that one of the great disciplinary forces for unnecessary controversy is the requirement to file an opinion of dissent. It has a very salutary effect, not only as a matter of record, but also in eliminating certain language that sometimes is used around a conference table.

Therefore, I have a great respect for, as I say, orderly procedures in conditions and circumstances in which a legitimate difference of opinion at any particular time is entirely to be expected.

Representative BOLLING. Your statement is made positively: You recommend something. But the conclusion is implicit that the present arrangement is by no means permanently satisfactory.

Mr. RUML. Yes, that would be so. I think the present arrangement is not permanently satisfactory.

Now it would take someone with much more understanding of the powers of some of the lending agencies, of Agriculture and all the rest to know just how these agencies should be woven into a group. But I think the general principle that I have stated should be held to until there is some reason to do something differently, namely, that the new agency should not have powers of its own other than reporting. The powers of present departments and agencies should be left as they are.

Informed collaboration would be such a great gain all by itself. Then, if that does not work, we move on to something else. But that does not exist presently.

Representative BOLLING. What does not?

Mr. RUML. Informed collaboration does not presently exist.

Representative BOLLING. You feel that informed collaboration does not exist in how broad or how narrow a scope?

Mr. RUML. I think it does not exist among the agencies which have decisive powers with respect to one aspect or another of the domestic monetary and fiscal situation. I think we have confined ourselves too much to the current controversy in the last 18 months by looking at the Treasury and Federal Reserve as if that were the whole picture. It is not the whole picture, and it needs to be studied—to decide just how much you want to broaden it or how much you want to restrict it.

The Secretary, I think, mentioned five agencies—the Treasury, the Federal Reserve, the Council of Economic Advisers, the Bureau of the Budget, and the Securities and Exchange Commission. Well, if you asked me, I would not know why the Securities and Exchange Commission was included. But I would think about adding the Department of Agriculture and Home Loan group. Other people would have different ideas. Certainly the group should not be too large. Neither do I think that merely including the Treasury is sufficient to give it the scope necessary on the problem that lies ahead.

Representative BOLLING. What would be your upper limit, roughly, on the size of the group?

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Mr. RUML. You must think about it in human terms. You must think about the possibility that there will be a member and his alternate both present, and then there will be a staff of one or two people. So I should think that the top would be seven agencies, the minimum might be four or five, something like that. It is that type of group that I had in mind.

Representative BOLLING. Thank you, Mr. Ruml.

Representative PATMAN. On page 2 of your statement, Mr. Ruml, down under 1 you refer to the unfortunate experience of 1937. Would you mind elaborating on that?

Mr. RUML. I will under the condition that I made on page 1—that anybody's memory is subject to a certain amount of incompleteness and inaccuracy.

Representative PATMAN. That is right.

Mr. RUML. But it seems curious today that there was a strong feeling in the spring of 1937, in spite of the fact that there were many millions of unemployed, that we were running into an inflationary situation. This opinion was held by certain agencies of the Government and the opposite opinion was held by others.

A group in the Government that was concerned about inflation at that time was dominant until February of 1938. Then suddenly because of the most accidental circumstance the President changed his mind without consultation with the agencies that had been acting in 1937 in what we would today call a deflationary capacity.

After that incident, Mr. Chairman, all agencies who had been in controversy—and may I say that includes not only the principals but also their technicians—decided that it was too dangerous to walk around the forest all alone, that no one could tell what might happen, and for that reason, as I say in my testimony, with different degrees of enthusiasm all agreed that there should be this type of consultation so that this previous experience would not be repeated. That is what I had in mind.

I think that it would be very interesting for someone that has time to dig into history to piece together the documentation of that period. But the lesson, however, I think is clear without the precise names, dates and places where these events occurred.

Representative PATMAN. You have not mentioned one factor I think was discussed at the time. That was the payment to the veterans of World War I of what was called a bonus.

Mr. RUML. Yes, I know.

Representative PATMAN. On June 15, 1936.

Mr. RUML. Yes.

Representative PATMAN. You know a lot of people predicted that would ruin the country.

Mr. RUML. I know.

Representative PATMAN. I think there were people on the Federal Reserve at the time that felt like it was ruinous inflation.

Mr. RUML. I know.

Representative PATMAN. And for that reason I think they raised the reserve requirements of banks. I have not looked it up lately, but to the best of my recollection they doubled the reserve requirements of banks within a few months' time.

Do you not think that had a tendency to cause that deflationary period in 1937?

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Mr. RUML. I don't think you can put your finger on any one cause. I think that, as I remember the analysis we made at the time, about half the loss of national income from 1936 to 1938 was caused by the beginning of the social-security tax, which at that time had never been recognized as part of the cash consolidated budget. Consequently the revenues to the Government were running much higher than anyone had expected. Really 1937 was only 5 years after 1932.

Representative PATMAN. That is right.

Mr. RUML. And there were many lessons to be learned that we still perhaps don't know too well.

Representative PATMAN. One thing that has been noticeable in the hearings to me—we hear all kinds of suggestions, and good constructive suggestions, how to stop inflation or a trend toward inflation. But I have not heard any witness yet give a definite way out, outline a definite way of stopping a deflation. We all know that in a deflation bank loans, of course, are not made because there is no reason to make them; there is no demand for loans. You cannot make money by getting loans; therefore, they do not get loans.

What is your suggestion in the event we were to have another deflationary condition like 1932, which is not impossible? What would be one of the first remedies that you would invoke?

Mr. RUML. Well, I suppose I have to answer, do I not, Mr. Chairman, because I really have some views on the question, and it would not quite be fair to say I have not thought about that.

The difference between now and 1932, from that point of view, is in the very large sums presently being collected in taxes. In 1932 there was no possibility of a recovery through tax reduction. Today there is almost any possibility in tax reduction. And not only that, but today you can get your tax reduction as of next Saturday night if you act this week on Monday, because you will immediately change the rate of withholding. So from my point of view the most direct and the most rapid approach would be via the income side of the Government.

There are, of course, a great many other things that can be done on a somewhat longer range basis.

Representative PATMAN. That is No. 1.

Mr. RUML. That would be, perhaps, a tonic sufficiently important so that knowing you could use it might be enough to prevent your ever having to use it.

In other words, I come back again to the last part of my testimony, that public confidence in the fact that this thing cannot happen again and that you have the machinery to correct it is the thing that probably will make it unnecessary to use the machinery.

Representative PATMAN. But suppose that remedy does not work and we have a large number of unemployed like we did. What would be your next remedy?

Mr. RUML. Well, the reason I am hesitating is because I am thinking about the unemployment insurance that would be paid out net under those circumstances.

Representative PATMAN. That would be a great cushion, of course.

Mr. RUML. That is another great cushion, you see.

We have no possibility of bank failures under the insured banks. We have no possibility of the situation that arose with respect to the

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3-year home mortgage, which was a catastrophe before and forced people to find urgent ways, which no longer are necessary, to live in the house they had always lived in.

So I am really stumped to think of a situation similar to the one that existed at that time. I really am.

I frankly think that the Federal Reserve System would have to stand by and would not want to act under those circumstances in a way that would make the problem more difficult. But, as we saw in the thirties, the $7 billion excess reserve did not make people want to borrow money.

Representative PATMAN. No.

Mr. RUML. It made it possible for them to if they so wished; that was all.

Representative PATMAN. If you were to name the most serious deflationary periods during the last, we will say, 35 years, which ones would you name?

Mr. RUML. Deflationary?

Representative PATMAN. Yes. I assume you would commence with 1920.

Mr. RUML. Oh, well, I would call that a readjustment crisis, really. It was very short.

Representative PATMAN. It had devastating effects, though, Mr. Ruml.

Mr. RUML. It did. It had devastating effects, but it was buttressed by speculation of a notorious character. And, of course, I need not tell you that interest rates went to 8 percent and that sort of thing. It was a disorderly period and did have effects that were very damaging. But if you talk about a deflationary period——

Representative PATMAN. Before you leave there—500,000 people did lose their homes; 500,000 people did lose their places of business. So it was quite a deflationary period.

Mr. RUML. Well, I think we are using words in a slightly different meaning. It was certainly an economic crisis of a negative character. There is no doubt about that.

Representative PATMAN. I will accept your definition.

Mr. RUML. But a deflationary period I look at as something where wheels are rolling down and down and down.

Representative PATMAN. After you leave that period——

Mr. RUML. Then you come to 1930.

Representaitve PATMAN. And what do you think was the cause of that 1930 period?

Mr. RUML. I don't think there is any single cause, Mr. Chairman. I think the immediate cause was the fact that margin requirements were so low on so many different kinds of stocks, bonds, commodities, and what not that people were forced to sell things before they were ready to sell them, and that having gotten underway you then got into this home owners' crisis which occurred about 1931 to 1932.

Represntative PATMAN. That is right.

Mr. RUML. Then the 3-year mortgages came up. Then you got into the banking crisis because people would withdraw their money to try to do something about their mortgage, and then you got this perfectly crazy shifting of gold around from one part of the country to the other, and finally there came the end.

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Representative PATMAN. Am I correct in assuming that you believe that speculation caused the 1930 crisis?

Mr. RUML. I think that speculation on insufficient margins was a large part of it, together with the fact—and you might call this speculation—that a great many securities were created abroad for the purpose of sale in the United States, not because they were good loans. Of course, the same thing was true with the building of many apartment hotels: they were built not to house people but to sell the securities. So it was a period that ended as it did.

Representative PATMAN. Now the other periods after 1930?

Mr. RUML. Well, I would hardly call the 1937 period a deflationary period. It would have become one probably if it had lasted for another 2 or 3 years. But, as I say, certain elements in the Government became dominant as against other elements, and there was an abrupt change, and I think that the statistics will show that already in early 1939 the turning down had begun a little bit.

Representative PATMAN. Would you term that a mild recession?

Mr. RUML. The 1937?

Representative PATMAN. Yes.

Mr. RUML. No; I would term that, as I did the 1921 incident, as an economic crisis of a negative character. It had not got to the point where you could use the term "depression" or "recession" in connection with it, although it was very, very serious.

Representaitve PATMAN. When would you say was the next period of an economic crisis of a negative character, Mr. Ruml?

Mr. RUML. You were beginning, I think, to get it in 1939.

Mr. MURPHY. 1939?

Mr. RUML. I think you were beginning to get it in 1939.

Representative PATMAN. You mean 1949?

Mr. RUML. No; I do mean 1939; yes, sir; because that was the period when we were so very much concerned as to what these employment figures meant, because, with all the good things we were doing, they did not disappear.

Representative PATMAN. Do you think it is possible, Mr. Ruml, if we watch the situation closely through a coordinating group like you have mentioned, to prevent any such recession or economic crisis in the future?

Mr. RUML. I think without it you are almost sure to have them. Whether you can prevent them or not, I do not know, because, should you get a sharp roll-down of the defense expenditures, it would take some time to get a standard of living high enough to absorb our productive capacity.

We do not make cultural changes quickly. We still wear pretty much the clothes and eat the food we do, and all the rest of it.

But I should think a crisis of the character we had in 1930–33 could be prevented by coordinated means of the kind that I have been discussing, particularly if you can also get the cooperation, which you could get, of the National Advisory Committee.

Representative PATMAN. Dr. Murphy?

Mr. MURPHY. No questions.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. Mr. Ruml, just one question. I think you can help clarify the record on one point of interest to this subcommittee.

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You mentioned, as the other witnesses have, the importance of protecting the value of the dollar.

Now, I gather that a number of public programs affect the stability of the economy and the value of the dollar, such as expenditure policies, tax policies, agricultural policies, regulatory policies generally, and particularly the one we are concerned with here—monetary policy.

I gather you would create an advisory group composed of representatives of those agencies?

Now, all of them, with the exception of the monetary authority, in addition to being in this advisory group would have certain responsibilities directly to the President and the executive branch under their statutory set-up and under the Constitution.

Mr. RUML. That is right.

Mr. ENSLEY. Now, for the record, would you distinguish the role of the monetary authority—the Federal Reserve—from these other agencies that also have a part to play in the stabilizing job? Would you indicate why in the one case the Federal Reserve should be independent of the executive branch, and in the case of all of the others, at least as far as administering the statutes are concerned, they are under the President?

Mr. RUML. Well, in the first place, I would make that distinction because it presently exists. In other words, I think that this is a workable scheme if we can get informed collaboration among the agencies. They are all interested in the national welfare, even though they do have special angles to them.

But in the second place, as I said in the testimony, I think that the executive branch of the Government is better off, as the people are better off, if neither the courts nor the authority over money are the direct or indirect constructive responsibilities of the executive branch.

For example, a weak Executive could omit to recommend taxes when taxes were required if he had power over money, or an ambitious Executive could reconstruct heaven knows what without taxes—I am taking now the affirmative side—if he had the power over money.

With this enormous economic freedom that we have today, once people lose confidence in money, they can do more to destroy money than all the agencies put together, because all they have to do is to drop their savings from the present 10 percent to 2 percent to do more than the Treasury and the Federal Reserve and everybody else can correct. We have seen in other countries what flight from the currency has been—absolutely uncontrollable.

Mr. ENSLEY. You are saying the value of the dollar is more closely related to the working of the monetary mechanism than it is to the other policies of the Government?

Mr. RUML. Not quite. What I am saying is, public confidence in the fact that money will not be corrupt is of extreme importance. This confidence, therefore, should be safeguarded by the continuance of the Federal Reserve System as it is today—a direct agency of the Congress, which is the people—rather than by a Federal Reserve System which is the tool of an administration.

Mr. ENSLEY. That is all, Mr. Chairman.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. No further questions.

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Representative PATMAN. Thank you very kindly, sir.

Mr. RUML. Thank you.

Representative PATMAN. Mr. Brown.

We have with us this afternoon Mr. E. E. "Ned" Brown, chairman of the board of directors of the First National Bank of Chicago.

Mr. Brown is a member of the Federal Advisory Council; he was also a member of the United States delegation to the Bretton Woods Conference.

Mr. Brown, do you have your prepared statement?

Mr. BROWN. I have a very short and very general one which I would like to read.

Representative PATMAN. You may proceed as you desire, Mr. Brown.

STATEMENT OF EDWARD EAGLE BROWN, CHAIRMAN OF THE BOARD OF DIRECTORS OF THE FIRST NATIONAL BANK OF CHICAGO

Mr. BROWN. I have been asked to testify on the relationship between the Treasury and the Federal Reserve Board, the powers of each, the practical job of getting them to cooperate, and the question of how in the event of a disagreement between the Treasury and the Board it should be reconciled. These are large subjects to discuss in a short statement.

It is obvious that the relationship between the Treasury and the Federal Reserve Board must be a close one. Neither can efficiently perform its functions without the cooperation of the other.

I do not propose to get into a legal and theoretical discussion of the respective powers and duties of the Treasury and the Board. They are adequately covered in the answers and duties of the Treasury and the Board. They are adequately covered in the answers of the Secretary of the Treasury and the Chairman of the Board of Governors to the questionnaire sent out by your committee.

At the time of the original passage of the Federal Reserve Act, the necessity of cooperation between the Treasury and the Federal Reserve Board was realized. Both the Secretary of the Treasury and the Comptroller of the Currency were made members of the Board. At the same time, the necessity of the independence of the Board and its freedom from dictation by the Treasury and the administration were recognized as desirable. It was felt historically that control over the volume of money and over the volume of credit could not with safety be put in the hands of the national administration. The original plan of the National Monetary Commission—the Aldrich plan—placed control in the hands of a board elected by the banks of the country. President Wilson and Carter Glass opposed this, and it was provided that the members of the Federal Reserve Board should be appointed by the President and confirmed by the Senate and that they should all represent the public interest as distinguished from any banking or other private interest.

In 1913, the amount of the public debt was negligible in present-day terms and its management did not present any particular problem. Consequently, the extent to which the Board and the Treasury would have to cooperate was much less than it is at the present time.

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World War I came shortly after the passage of the Federal Reserve Act. After we entered the war, the Board had to facilitate and make certain of the success of the Treasury's borrowing operation if we were to win the war. The Board's actions during the war were necessarily largely dominated by Treasury and administration policy.

At the end of World War I, there was a short period of boom, with high advancing commodity prices followed by a collapse of such prices in 1920 and 1921 and a depression. The depression was relatively short.

The following period, lasting until the stock market collapse in the fall of 1929, saw a rapid recovery of the economy and increasing stock speculation in the United States, and monetary and economic difficulties in Europe. The Federal Reserve Board in this period, largely I think, due to the strong personality of the then Secretary of the Treasury, Mr. Mellon, let its actions be largely determined by the wishes of the administration. At the same time, Governor Strong, of the New York Federal Reserve Bank, had great influence on the thinking of both Secretary Mellon and the Board. There was no lack of cooperation between the Board and the Treasury in this period.

Then came the great depression. Rightly or wrongly, there was a general feeling that a strong Board independent of the administration could have avoided the depression. This was reflected in the Banking Act of 1935. The Secretary of the Treasury and the Comptroller were no longer to be ex-officio members of the Board. The members of the Board were given long terms and these terms were staggered. There was much talk about the Federal Reserve Board being the Supreme Court of Finance, as independent of the administration as was the Supreme Court of the United States.

To combat the depression the new administration headed by Mr. Roosevelt adopted a policy of cheap money and deficit financing. The new Chairman of the Board was in accord with this policy until the economy had recovered, and for some years there was no lack of cooperation between the Treasury and the Board. In the latter thirties there was some difference of opinion between the Board and the Treasury over the cheap money policy, but nothing serious. Then came World War II. Again, as in World War I, the Board had to go along with the Treasury policies in raising money, as it could not afford to let any loan offering fail. It pegged the prices of Government bonds at the levels fixed by the Treasury even though it might have wished a different set of rates.

After the war, the United States had a tremendous national debt and the cost of servicing it represented a sizable portion of the budget. Government bonds had become the largest asset held by the banks of the country.

The problem of managing the debt became, and remains, one of the chief problems of the Treasury. Obviously, it cannot be done without the cooperation of the Federal Reserve Board. The idea that the Board can be a supreme court of finance operating independently of the Treasury and the administration and following its own independent judgment just cannot and will not work. A failure of a refunding operation or a wild and rapidly declining market for Government bonds would mean an economic tailspin. It cannot be allowed to happen.

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This does not mean that the Board should cease to be an independent agency responsible to Congress, or that it should be placed under the dictation or domination of the Secretary of the Treasury, or the President. It should hold to the point of view that it is responsible to the people of the United States, represented by the Congress, in the field of monetary and credit management, to the end that as far as possible, by management in its sphere, that economic stability be maintained and booms and depressions be flattened out and the purchasing power of the dollar, which means the credit of the United States, be sustained. The Board should strongly urge its viewpoint on the Treasury both as to refunding operations and other Treasury actions that affect monetary and credit policies. Both agencies of Government have the same objective and with full and frank discussion and understanding of each other's position and with reasonable men on the Board and in the Treasury and a willingness on both sides to give and take, cooperation between the two agencies should be possible and continuous.

If the Board and the Treasury cannot compromise their differences on an important matter, the members of the Board should resign, and thus call to the attention of the people and the Congress their belief that Treasury action threatens economic stability. But if a refunding operation is imminent or in process the Board must first insure its success. The knowledge that they might or would resign should cause any Secretary of the Treasury, or administration, to take a long think before going against the Board's judgment. But with reasonable men on both sides, desiring the same objectives, and with some give and take on both sides, I repeat, I think a compromise could always be worked out.

I have heard many discussions and given a great deal of thought as to means which could be taken to lessen the danger of a conflict between the Board and the Treasury, or to force a decision if such a conflict should develop. It has been suggested that the Secretary of the Treasury be put back again on the Board. History, I think, demonstrates that this would mean the domination of the Board by the Treasury, and destroy the Board's independence. Carter Glass, who as Secretary of the Treasury had been a member of the Board, during the discussions of the 1935 act, favored the removal of the Secretary from the Board for this reason.

The creation of an advisory council has been proposed by Secretary Snyder. Such a council would have to have a majority of its members made up of officials appointed by and removable at the pleasure of the President. This would in effect place the Federal Reserve Board under the domination of the President and whatever national administration might be in power. This is only slightly less objectionable than placing the Board under the domination of the Secretary of the Treasury.

Realizing that for the functioning of the Government the Board and the Treasury must cooperate with each other, I have not heard suggested, nor have I been able to think of any alteration in the law which would improve the existing situation. If the national administration is backed by the Congress it must and will have its way in the event of a conflict between it and the Board. But by tendering their resignations the members of the Board can, in the event of an irreconcilable disagreement on a serious matter, bring it to the atten-

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tion of Congress and the people. But I want to repeat again that, assuming reasonable men in both the Treasury and the Board, some accommodation of their views should and could always be found.

Representative PATMAN. Thank you, Mr. Brown.

Mr. Bolling?

Representative BOLLING. I have no questions.

Representative PATMAN. You have made a very interesting suggestion, Mr. Brown. That is certainly one good way of bringing it to the attention of the country, the way that you suggested.

Do you have any other comments that you would like to make to this committee in view of the testimony you have heard presented? I know we have been honored here with your presence for the last few days, and we are proud of it, and we are glad you are so attentive and so much interested in the hearings. Would you like to make any comments that you have not made in your statement?

Mr. BROWN. Well, I would like to reiterate that I thoroughly believe in the theory that was advanced by Governor Sproul this morning, that the Treasury and the Board should be equal. I do not believe that a directive would do any good, and I think it might do harm.

I disagree with Mr. Sproul in thinking that a super-duper advisory council would be of much benefit. I think it would be weighted so heavily in favor of the administration that it would largely destroy practically the independence of the Board.

Mr. ENSLEY. Do you mean Mr. Ruml's suggestion? I believe you said Mr. Sproul.

Mr. BROWN. Sproul also made that suggestion as a possibility, I believe. Mr. Ruml I disagree with even more.

I cannot but believe that the threat of the Board resigning, the majority of the members of the Board resigning, would not solve almost any question that would come up.

If they did resign it would, of course, throw the dispute into Congress, and it would make it a matter of public discussion.

If the administration and the Secretary were convinced that the members of the Board meant what they said—that if they were overruled on an important matter that they would resign—I think that some means of compromise would always be found.

The weakness or the danger of that suggestion is that the members of the Board might be so weak and so desirous of staying on in their jobs, either because of the glamor of being called Governor and their political and social importance in Washington, or because of the desire to keep their salaries, that they would not be willing to say that they would resign and to say it in a way that would make the administration realize that they meant it.

The answer to that is that the Federal Reserve Board, if it is to work, should have appointed to it—the Senate should see that only members are confirmed who are sufficiently strong-willed.

I would like to add, furthermore, that I have seen, myself, Carter Glass dominate the Board when he was a member. I have seen Mellon do it. I have seen Ogden Mills do it. It seems to me a poor thing to put the Secretary of the Treasury on the Board, and I think the same objection applies to the Open Market Committee. The Secretary is so busy that he cannot attend all the meetings of the Board and follow the detailed reasons for a decision, and he generally sends an Assistant Secretary or somebody else as an alternate, and then when a jam comes

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along, why, the Secretary goes over and sits down with the Board; and if he is a strong Secretary, such as Carter Glass and Mellon and Ogden Mills were, and he has a relatively weak Board to deal with, they just cave in and do what he wants even though their judgment is against them.

I think Carter Glass, perhaps not in public, but I know in private in 1935, expressed his belief that the Secretary should not be a member of the Board and said, "I know because I was a member of the Board and I know—the Secretary can dominate it." It was for that reason and based on his own experience that he suggested the Secretary not be a member.

Representative PATMAN. On what you said there a moment ago about the Secretary not having the time. At that time the national debt was small when we compare it with what it is now, and there were not the problems that we have now. My recollection is that in 1935 the reason given was what you have stated as one of the reasons, that the Secretary did not attend anyway, that he was too busy and he did not feel like it was necessary to attend, it was an extra duty for him to perform that he did not have the time to give the intelligent attention it deserved, and for that reason it was all right to take him off the Board.

But I did hear also the reason as being it was unimportant to the Secretary of the Treasury, besides requiring too much time, and therefore he ought not to be on the Board.

Mr. BROWN. Well, I was not a member of the ABA committee in connection with the revision of the Banking Act of 1935, but I had a lot of discussion with its members and took part in a good many informal discussions, and I am clear that the feeling that the Secretary of the Treasury being on the Board would result in Treasury domination of the Board was an even more important factor than the fact that the Secretary himself just did not and would not attend Board meetings.

Representative PATMAN. Dr. Murphy?

Dr. MURPHY. Mr. Brown, could we have your opinion on this matter? Suppose that the Treasury-Federal Reserve accord and the monetary policy which followed had been initiated immediately following the Korean outbreak. What difference do you think it would have made with respect to the subsequent rise in prices which did take place between June and March and to the level of business activity during the period?

Mr. BROWN. Well, my opinion is that it might have slightly lessened the rise in prices, but the rise in prices was due to scare buying and an absolute lack of goods, and I do not believe that any policy of monetary restraint could have prevented a great rise in prices. I do think it might have dampened down somewhat the height of the price rise, and would have caused dampening down which occurred subsequently to occur earlier than it otherwise did.

Mr. MURPHY. In March last year, that is a year ago, the rise in prices leveled off, and since then we have had an inflationary lull. Three reasons have been given to this committee for this leveling off.

One is the stronger monetary policy which followed the Treasury-Federal Reserve accord.

The second is the imposition of price and wage controls.

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The third is that it represented a natural reaction from the period of overbuying immediately following the Korean outbreak.

Assuming that all of these explanations have some validity, if you believe they do, how would you rate their relative importance?

Mr. BROWN. Well, I think that No. 1 and overwhelmingly was the change in mass psychology—that people believed they would be able to buy goods.

Mr. MURPHY. I agree with you very much in that.

Mr. BROWN. And that price controls and the change in the monetary policy represented by the March accord had relatively little to do with the lull or decline in prices which ensued.

Mr. MURPHY. Now with respect to the monetary policy which has been followed since the Treasury-Federal Reserve accord, would you generally approve what I will call its degree of intensity, or would you prefer that it be tighter or easier? That is, do you feel that it is the policy which is best suited to the present situation?

Mr. BROWN. I think it is the policy that is best suited to the present situation, and I think that decision as to the degree of intensity to which it should be applied is a matter of day-to-day and week-to-week and month-to-month judgment.

Mr. MURPHY. And in general you are in agreement with what has been done?

Mr. BROWN. I am in agreement in general with what has been done, and I am a strong believer that the interest rates on the Government obligations, which means prices on Government obligations, should be allowed to find their own market level, and only when the changes are so rapid as to cause panic or apprehension and bring about a disorderly market should there be any active support operations, if you want to use that phrase.

Mr. MURPHY. One final question. The Douglas subcommittee in its report 2 years ago included this recommendation:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against, rather than promote, the purposes of the Employment Act, and we recommend that no action in this direction be taken.

Would you consider it constructive that this committee should include the same type of recommendation in its report?

Mr. BROWN. I would leave all reference to the Full Employment Act out, Mr. Murphy. I think however it would be very dangerous and reckless for the United States to go at the present time on a convertible gold standard.

I think there is, due to the world situation, a danger that any alarm in Europe or the Orient, any military disaster, might cause everybody to rush to convert their dollars into gold, and I think that it would be a calamity at the present time to make paper money convertible into gold.

I think it would be desirable for the committee to recommend against such convertibility at the present time, but I think the reference to the Full Employment Act is superfluous and unnecessary. I do not think that keeping the present arrangement and not making gold convertible has anything to do with full employment.

Does that answer your question?

Mr. MURPHY. That answers my question, yes.

That is all.

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Representative PATMAN. Mr. Bolling?

Representative BOLLING. It has been suggested that the number of members of the Board be reduced from seven to five, and various suggestions as to length of terms, and there seems to be general agreement it might be a good idea to raise their salaries. What is your opinion of those suggestions as to whether they are desirable and, if so, how important?

Mr. BROWN. I think a Board of five would be better than a Board of seven, having observed the Board; and if higher salaries would attract better men I would certainly favor higher salaries, and I think it would have an influence in that direction. I think the terms should be kept long enough, assuming this is Mr. Truman's final tenure in office, and that we cannot have a President in office for more than 8 years, so that all the members of the Board would not be appointed by the same President.

I think clearly that the geographical requirement which prevents more than one member from being appointed from any Federal Reserve district should be repealed, because if you can find two good men say in New York, or in Chicago, it should be possible to appoint both of them; whereas now you can have only one member from a district.

Representative BOLLING. Thank you; that is all.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. No questions.

Representative PATMAN. Thank you very much, Mr. Brown; we appreciate your testimony.

Mr. BROWN. Thank you.

Representative PATMAN. Tomorrow, Friday, March 21, we have as our witnesses Mr. Paul Appleby of Syracuse University, and Dr. James K. Pollock of the University of Michigan.

Without objection we will stand in recess until tomorrow morning at 10 o'clock here in the same room in open session.

(Whereupon, at 3:30 p. m., a recess was taken, to reconvene at 10 a. m., Friday, March 21, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

FRIDAY, MARCH 21, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:30 a. m., in the caucus room, Old House Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representative Patman and Senator Flanders.

Also present: Grover W. Ensley, staff director, and Henry Murphy, economist for the subcommittee.

Representative PATMAN. The committee will please come to order.

Mr. Appleby will be our first witness.

Mr. Paul Appleby is dean of the Maxwell School of Citizenship and Public Affairs of Syracuse University. He was formerly Under Secretary of Agriculture. He was formerly Assistant Director of the Bureau of the Budget.

Mr. Appleby, we are glad to hear you and glad to have you. We shall hear you any way you choose. We will leave that up to you.

Mr. APPLEBY. Thank you very much, Mr. Chairman.

I brought along a paper which I have turned over to your staff, a fairly brief one, from which I shall talk.

STATEMENT OF PAUL APPLEBY, DEAN OF THE MAXWELL SCHOOL OF CITIZENSHIP AND PUBLIC AFFAIRS OF SYRACUSE UNIVERSITY

Mr. APPLEBY. Mr. Chairman, it is my intention to discuss only the administrative aspects of the problems you have under consideration.

It is my belief that these hearings reflect so much policy uncertainty as they do because of a basic difficulty that is administrative. I think you will serve your own purposes best by giving more attention to the administrative aspect of the matter. The Congress is uneasy about the lodgment of responsibility for credit control and debt management, and its other fiscal responsibilities, unable clearly to identify responsibilities with respect to them, and less able than in most matters to control them. The existing administrative arrangements are extraordinary and confusing, differing very much from most of the administrative arrangements of the Government.

Before proceeding to the particularities, however, I should like to lay down several dicta as guides to such matters:

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For responsible government, a particular structure for the administrative handling of a particular kind of public business should be designed, according to these four guides:

(1) To bring into focus all of the principal factors of special interest and special competence. This means having and using economic staffs representative of the various special academic subfields most relevant to the subject and representative of the governmental functional fields most relevant. It means having association and acquaintance with the various citizen's interest and functional groups most directly concerned. It means having staff aware of and acquainted with other than economic special but relevant points of view.

The second guide is this:

To be located within an organic—formally interrelated and not merely atmospherically or spatially associated—environment strongly representative of more diversified and more general concerns on which the special matters have an important, although often indirect, bearing. This means being importantly subjected to influences other than the economic and the banking when the functions are most closely identified with economic policy and bank operations.

The third guide, I think, should be this:

To be placed under a unified control system, vested with a real and clear capacity to reconcile the special interests and points of view and, particularly, to impose upon the stubborn special preoccupations a general concern. This can only be done through an identifiable overriding agent or agency of general responsibility constituting an integral part of a hierarchal chain going steadily upward to the most responsible, most general agencies of Government—the Chief Executive and the legislative body.

The fourth guide, I think, would be to have arrangements throughout the extent of this hierarchy for particular structures designed to pose issues at levels where it is normally appropriate for issues of those kinds to be decided.

That is a pretty technical and complicated statement, and I will begin to deal with the matters more particularly.

With respect to this fourth dictum, which is most technical and undoubtedly least clear of the four, let me say that issues can be undesirably covered up when structure causes them to be resolved too far down the hierarchal line, not readily emerging to the view of more generally responsible officials. On the other hand, issues can be unnecessarily multiplied and constant, presented to officials and public in burdensome and confusing numbers, if the structure does not lead to resolution of the more routine, familiar and less controversial issues at lower levels. With this explanation I repeat dictum No. 4:

> To have arrangements throughout the extent of this hierarchy for particular structures designed to pose at issues where normally it is appropriate for issues of those kinds to be decided.

It is obvious that we are not here suffering from a structure that covers up issues. The differences in interest and functions as between the Federal Reserve and the Treasury give high frequency to congressional and public awarenesses of sharp policy differences not sufficiently readied for congressional and public consideration. Such conflicts between parts of the governmental structure are good up to a point—illuminating and helpful to the Congress—and it is for you

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to determine when these situations occur too frequently and in a way too unmanageable for the Congress. My own opinion is that administrativee reform is much needed, and this means structural reform.

With respect to dictum No. 3, the question is whether you can clearly enough identify responsibilities, and especially an over-all responsibility, to make your own responsibility manageable. Responsible government is undermined when you and the public have too much to guess "under which shell the pea of responsibility is located," to use the phrase of E. A. Ross. It doesn't much matter to Congress where within a department a responsibility is usually delegated, because the head of that department is always responsible. But when responsibility is divided between departments, or, worse, when it is divided between a head of a department and a multiheaded second agency, or, worst of all, when it is divided between one department and a multiheaded agency which is not really a part of the Government at all—then responsible government is badly undermined. This, I think, is the real occasion for your greatest concern.

It is my belief on this point that responsibilities for the matters you are considering are much too diffused. Further, I think that under present laws and structures the problems that disturb you are not capable of any good resolution. They need to be more resolved in an ultimately unifying chain of responsibility. This, I think, cannot be done without new legislation. So I repeat dictum No. 3: A structure—

> to be placed under a unified control system, vested with a real and clear capacity to reconcile the special interests and points of view and, particularly, to impose upon the stubborn special preoccupations a general concern. This can only be done through an identifiable overriding agent or agency of general responsibility constituting an integral part of a hierarchal chain going steadily upward to the most responsible, most general agencies of Government—the Chief Executive and the legislative body.

The point of dictum No. 2 is this: If we believe in democratic or representative government, we believe that the expert and the special interest alike must be subordinate to public judgment and the general interest. Because the matters you are considering are highly technical, there is a tendency for them to be too often and too exclusively determined by economists and by a banker-oriented organization. When not so determined they tend to be presented to you too much in the same specialized terms. The highest significance of the congressional judgment is that it is a general judgment, representing and similar to public judgment. Yours is the arena where John Dewey's phrase ought most often to be quoted, "that specialized knowledge which, in public matters, is not knowledge at all." You should be proud of not being experts, and should insist on dealing with these matters ultimately—although only ultimately—in your own general terms. One of the chief significances of an administrative hierarchy is that at each successive upward level responsibility, knowledge, and judgment are broadened and thus projected toward your own still more general responsibility and judgment. In the matters before you you are suffering from an incomplete administrative hierarchy below you. A believer in democracy must defer to this broader line of control, and governmental structures should be designed to make it possible.

Merely to associate some organizations with the Government does not meet the requirements of that dictum. To assign a function to a

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governmental agency not very widely exposed and broadly responsible does not well meet the requirements. To assign a public function to an agency that is not really in fact publicly responsible, not an organic part of the Government, is to go in exactly the wrong direction.

With respect to dictum No. 1, both the Federal Reserve and the Treasury meet the specifications to some extent. That is, indeed, the easiest of all my dicta to fulfill. However, there is considerable difference between the two agencies in this very respect. The Treasury staff represents a good many more varieties of economic specialization. Even more importantly, the functions of the Treasury are much more diversified. With a historic and heavy orientation to banking, this is not nearly so exclusive an orientation for the Treasury as is that of the Federal Reserve System. The Treasury is a highly diversified operation, with many popular exposures and very broad responsibilities; in such conditions it will tend more steadily to approximate good general public policy. The Federal Reserve is a much more highly specialized operation, much more narrowly exposed. It deserves to be classified as a "clientele agency," and as I told Senator Douglas in a hearing of another congressional subcommittee, the longer I observe government the less happy I am about governmental clientele agencies. I have come to favor a very loose interpretation of the theory adopted by the Hoover Commission favoring structure according to "coherent missions." The more comprehensive the function of an agency, the more they tend to relate policies to each other and to move toward general public policy.

But the Federal Reserve is to be differentiated in another and very important way, besides its limited exposure and relatively high specialization with respect to single functions: It is not really a part of the Government at all, as you gentlemen know. Its personnel are not paid by the Government or governed by most of the public laws that apply to the executive branch generally. Its regional board membership is so narrowly specified in law as to derive from special, private interest groups and to have a minimal public orientation and public responsibility. Board members at the national level have such long terms and are generally derived in such a way that they, too, have a minimum of public character, orientation, and responsibility. I say these things in no criticism of the sincerity and integrity of the persons involved, but to point to an absence of governmental responsibility, which is largely structural, and which I think is at the root of this committee's concern and confusion.

The nongovernmental structure of the Federal Reserve System derives from historical conditions under which it was set up about four decades ago. It was then quite a radical departure, and it probably could not have been achieved at all without provisions which made it rather a special province of the banks and bankers. Too, in those days few claimed to know much about credit except bankers. Those were the days when bankers uniformly and bitterly fought the suggestion of any kind of governmental guaranty of deposits, too—now widely and enthusiastically accepted. In those days credit and other fiscal matters were not regarded as having the general economic and social significance now attributed to them by everybody. I think, Mr. Chairman, that a good deal of the unhappiness of this committee arises

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from the fact that many things have changed in our society and in our outlook in 39 years, much more than the structure and functioning orientation of the Federal Reserve System have changed.

The original Federal Reserve Act embodied, as legislation sometimes unhappily and sometimes of necessity does, a simple transference to the governmental scene of thinking that is essentially private. It set up a private way of thinking, largely dominated by a sincere but parochial private interest, as an institution clothed with governmental powers but without governmental character to perform public functions of increasing importance. It is the existence of a distinctly public problem and the need to serve a distinctly public responsibility that now concerns you.

Everywhere else in the modern world, central banks have been brought into the Government, and so far as I know, incorporated within the sphere of the governmental Treasury. Whether or not that is possible here now I do not know. I should guess that it is not possible. But I think we should begin to think and move in that general direction.

Representative PATMAN. There is one thing here at the last I would like to ask you about first, in which you state:

> Everywhere else in the modern world, central banks have been brought into the Government, and so far as I know incorporated within the sphere of the governmental Treasury.

Isn't it a fact, Dr. Appleby, that they were not brought into the Government, they were created within the Government?

Mr. APPLEBY. That is more often the case.

Representative PATMAN. In fact, do you know of any case where it was not done?

Mr. APPLEBY. I was thinking in particular, in order to use language to cover the whole thing, of the Bank of England. That has been brought more wholly within the Government. It was theoretically a private organization. In practice the operation of the Bank of England was never so far outside the Government as the Federal Reserve System has been here, because the gap between Government and business and the Government and private affairs has never been so great as in Britain.

Representative PATMAN. Except England, practically all of the countries of the world have had their central banks and now have their central banks as a part of the government itself.

Mr. APPLEBY. That is right.

Representative PATMAN. On page 3 of your statement you say, in referring to the Federal Reserve:

> It is not really a part of the Government at all, as you gentlemen know.

I am not sure that I agree with you on that. Mr. Sproul, who I guess is one of the biggest men in the Federal Reserve System, testified yesterday. He said there is no doubt in his mind about it being a public institution, about an agency of Congress. I think the testimony generally has been that way. The only doubts we had about it were cast by the general counsel of the Federal Reserve Board. He seemed to try to distinguish between certain functions and other functions, some being governmental functions and some not being governmental functions. But outside of that—Mr. Martin, the Chairman of the Board, and all the other witnesses generally have admitted

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and stated that it is a public institution. Of course it is, in my way of thinking, a public institution, because primarily it uses the credit of the Nation. Isn't that correct? Isn't that their stock in trade, the credit of the Nation?

Mr. APPLEBY. That is a public function.

Representative PATMAN. It is the credit of the Nation they use. Don't you think that is giving them a lot of power? In fact, we could not justify delegating such power to any private corporation nor an agency controlled by private corporations to handle the Government's money. Federal Reserve notes, as you know, represent about 90 percent or more of the available money in the country. It is the Federal Reserve System that has exclusive power and control over the Government's money when it is printed at the Bureau of Engraving and Printing until it goes into the hands of the person who calls for it at the teller's window at the bank. They have absolute control. They have this power, which I do not think Congress could justify giving to any agency except an agency of Congress, to take those Federal Reserve notes and trade them for the Government's own obligations that bear interest, and keep those Government obligations that bear interest and receive the interest and use it as they see fit in the legitimate and proper operations of the System. We couldn't justify very well giving that power to anybody except a governmental agency, could we, Doctor?

Mr. APPLEBY. That is my belief, Mr. Chairman, and I suppose that the technical language that would apply to the Federal Reserve System is that it is quasi-governmental.

Representative PATMAN. Even the "quasi," I don't agree with. The law says that, being a governmental agency, it should be exempt from taxation, and one of the witnesses testified here the other day they do not even pay a license fee on an automobile. They have a United States Government license tag, you know. They do not pay any excise taxes. They do not have to pay excise taxes as we have to pay. I do not know whether they have canteens or not in their banks, but, if they do, just like a post exchange at a military post, they do not pay excise taxes on what they buy.

I am not carrying it that far. The point I am trying to make is that all their property is exempt from taxation except, of course, the real estate in the particular place where it is located—just the real estate alone, not the personal property of any kind. Here in Washington they get an exemption of payment of taxes on their building on the theory that it is a public institution, it is a part of the Government. They do not pay any taxes on the Federal Reserve Building down here.

It occurs to me that all those things, as small as they are, indicate clearly that they themselves consider it to be a public institution that is owned by the Government and not a quasi-governmental institution. If it were "quasi," it would still have to pay taxes, I would think.

Mr. APPLEBY. Mr. Chairman, those particular conditions are a fruit either of specific congressional enactment or interpretations of the law and, of course, Congress has the power to exempt from taxation a great many, or anybody, as it pleases. The GI's may be exempted from taxation.

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Representative PATMAN. I am not raising the question of power. I am just indicating that to show——

Mr. APPLEBY. I know your point. I am saying it doesn't follow that anybody you exempt from taxation becomes thereby a part of Government.

Representative PATMAN. No. I do not contend that either.

Another thing you state is:

Its personnel are not paid by the Government or governed by most of the public laws that apply to the executive branch generally.

In that case, we passed what is known as the Employment Act of 1946, which is the first law I know anything about that attempted to set forth a congressional policy regarding economic stability. You are acquainted with that law. The Federal Reserve System, the Board of Governors at the top, realize they are controlled by that law, that they are governed by it.

Mr. APPLEBY. There is no doubt that the Federal Reserve System can be controlled by Congress whenever Congress wants to legislate to a particular point, but so can citizens, Mr. Chairman. I wouldn't labor this point unduly. I certainly wouldn't argue that the people in the Federal Reserve System don't act in some measure with some sense of being a part of the Government, and I wouldn't argue that a great many of them would not feel that they are a part of the Government.

I am saying that in a technical sense. It goes back to structure very largely. I think the people in public administration generally would agree with me that the Federal Reserve System is certainly not a typical part of the Government and certainly is not integrated in the Government the way the bulk of the agencies of the Government are.

Mr. ENSLEY. Mr. Chairman, could I just interpose there?

I believe you are saying, Mr. Appleby, that they should be. That is your basic point.

Mr. APPLEBY. Of course.

Representative PATMAN. You state here that the personnel is not being paid by the Government. Let's see if they are paid by the Government. What is their stock in trade? It is Government credit entirely. The little capital stock that the banks have paid into the Federal Reserve System is too little to be a flyspeck in the consideration of the over-all credit policy in which they are involved. It just doesn't mean anything. The stock in trade of the Federal Reserve System, of course, is the credit of the Nation. It is its ability to issue money. It is guaranteed by the Government of the United States which, of course, is secured by the wealth of the Nation, including the property of all the people and the incomes of all the people. That is their stock in trade.

Now, then, their whole income is from that and whenever they take Federal Reserve notes and trade them for interest-bearing notes and the interest is paid to them, which is used to pay personnel, that is really the taxpayers' money that is being used to pay those people, isn't it?

Mr. APPLEBY. Of course.

Representative PATMAN. The Congress permits them to hold the Government bonds that way to get their pay. So it is just as much

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a part of the taxpayers' money as if it came out of the United States Treasury.

Mr. APPLEBY. Absolutely.

Representative PATMAN. To that extent you will agree, I believe, that they do get their pay from the Government of the United States?

Mr. APPLEBY. Of course, indirectly.

Representative PATMAN. That is the only place they get it.

Another point that is not clear to me is this. On page 4 you state that the System was set up about four decades ago and it was a radical departure, et cetera, and was made rather a special province of the banks and the bankers.

I think there is a feeling throughout the country that the banks have too much control over the Federal Reserve System. Mr. Sproul made a good statement in opposition to that feeling yesterday. I think it was timely and appropriate that he do so. Nevertheless, that feeling is over the country, that the banks have too much control and power and influence over the Federal Reserve banking system. But I believe you will recall that President Woodrow Wilson was determined that the bankers should not control the Federal Reserve System. That is your recollection, isn't it?

Mr. APPLEBY. Yes. I think President Wilson understood this problem very well.

Representative PATMAN. That is right. And Carter Glass was opposed to banker control, too. In one of his books I know he had a reference to a White House visit in which that was discussed. Mr. Wilson, the President, said it would be like the railroads selecting the Interstate Commerce Commission to fix rates over them to let the bankers control the Federal Reserve System. Therefore, he was opposed to it. An effort was made to keep the bankers out of control or influence. But there was a compromise, if it was a compromise. Arrangements were made, I know, to set up a council to let the bankers' views be presented at all times to the Board, but they couldn't compel the Board to do anything. They couldn't direct the Board. It was just advisory only. To that extent, I believe, you will agree that, President Wilson, did his very best to try to keep banker control from influencing in any way a public function.

Mr. APPLEBY. I wouldn't want to overstate the case of banker control. I do not believe that the bankers all over the country have any great consciousness of being able to control the Federal Reserve System. That may be an exaggeration of the popular interpretation of the reality here. I meant to indicate that there is, in considerable part, an unconscious and subtle orientation that goes along with the derivation of people who naturally know about banking and are engaged in this field. I am not meaning to say of course that there is anything subversive or even very conscious or very direct in the way of control.

Representative PATMAN. They just have interests in common.

Mr. APPLEBY. That is right.

Representative PATMAN. You were with the budget a long time, I believe. What do you think about a suggestion that has been made that the Federal Reserve System should be audited by the GAO?

Mr. APPLEBY. That the Federal Reserve System should what?

Representative PATMAN. Be audited by the GAO. In other words, it should come under the law which would require an accounting by the GAO, the same as other governmental agencies.

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Mr. APPLEBY. I don't believe that would be too significant. It might be mildly helpful, but it is my observation and judgment that the General Accounting processes do not get at the important problems of administration and policy, but at details.

Representative PATMAN. That is the reason I mentioned that, to bring up the ordinary report that the General Accounting Office makes on an agency. That usually discloses not only the question of auditing the books to make sure that they are balanced insofar as the monetary affairs of the agency are concerned, its expenditures and receipts, but also to make sure that it is following the law and, if it fails to follow the law, if there is a question about it, there is a criticism or a suggestion for consideration involved in the report.

Don't you think that part especially would be helpful on a matter of this kind?

Mr. APPLEBY. Mr. Chairman, I think that the significance of both the accounting and auditing are commonly exaggerated. I think they are good pedestrian and necessary functions, but I do not think they would serve the larger needs of the Congress or the larger needs of the executive branch in throwing a great deal of light on the intrinsics which are really of concern to you. I never was hostile to the General Accounting Office. I think the people in the executive branch generally use the General Accounting Office to pass the buck. They are quite happy to let somebody certify that what they do is regular. But I think that is fairly petty in terms of the things that you are really concerned about.

Certainly I think it is unobjectionable, but I do not think it is a very important or significant reform.

Representative PATMAN. Concerning appropriations from Congress, you know most agencies—and you realize that more than most of us because you were in the Budget Bureau—agencies comparable most to the Federal Reserve turn their money in to the Treasury of the United States, and then they get their appropriations from Congress.

Do you think the Federal Reserve should be exempt from that policy, or should they come within the policy?

Mr. APPLEBY. I don't see how the appropriating mechanism could be utilized very well in these terms. I would have to give more thought and attention to this problem than I have recently given to answer very helpfully, but I think some special kind of review and some special kind of mechanism could be more useful to Congress in this case than the appropriating device.

Representative PATMAN. Suppose we were to consider asking that they submit their budget to the Bureau to make sure that they come within the boundaries of governmental policies and practices and procedures, but not with the power to absolutely veto? In other words, make it a coordinating agency. In that way, it would not necessarily have to go before Congress. Then the Bureau of the Budget could make any report of any irregularities to Congress they desire.

Mr. APPLEBY. I never was one who wanted to overload the Bureau of the Budget. I think it is a very important mechanism, but I think it is only one, and that ideally there ought to be at the top of the Government perhaps two or three similar mechanisms. I am not sure what I think about this particular matter. I think the submission and reports to the Bureau so that the Bureau would be in a position to re-

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ceive information to pass on to the President and possibly to pass on to the Congress might be useful.

Where there is no function other than the function of examination, I am not sure how useful it would be, however.

Representative PATMAN. The General Accounting Office could do the same thing, I guess, if it were given that power.

Mr. APPLEBY. If it were instructed to report to the Congress in those terms.

Representative PATMAN. Dr. Murphy, would you like to ask questions?

Mr. MURPHY. Professor Appleby, could you state briefly what are your criteria of governmental, quasi-governmental, and nongovernmental agencies, and then apply these criteria separately to the Board of Governors, to the Federal Reserve banks and to the Federal Open Market Committee, indicating, in a general way, to what extent you consider each of these organizations within and without the Government, and add any remarks you want to make on the significance of that?

Mr. APPLEBY. The Board of Governors and what else?

Mr. MURPHY. The Federal Reserve banks and the Open Market Committee, which is composed of all the Governors plus the presidents of five of the banks selected in rotation.

Mr. APPLEBY. That is perhaps a $128 question. I think that centrally the problem is this: that there is nobody outside of Congress who can be identified as having final responsibility and no one who can force a bringing together of these different points of view. The capacity to enforce is more important than its exercise. The capacity to intervene and to force compromise, to force decision and to have that capacity fixed at a place where the Congress and the public can identify it is most important.

It is important to be able to say that that is the place where there is responsibility for these matters. It never is true when you have a board or a commission, as much as when you have a single head of an agency. The Hoover Commission's general direction was away from that. I think all of the students of public administration in general are moving away from that and Congress in many ways has been moving away from that.

In the first place, you have here two complicated board structures, each one governed by certain requirements for membership. In the case of the Federal Reserve Board members you have 14-year terms, which makes them much less responsive to the immediate situation and the powers and control in the Government than would be the case if they had shorter terms. You want to avoid making it possible for any one President to kick out all the members and put in a new board, perhaps, but 14 years is a long time. Fourteen years is a long time to spread that kind of capacity for change.

So you have a spongy structure here that is not characteristic of the rest of the Government. It is what I would insist upon as one that is less responsive and less clearly responsible than the bulk of the governmental activities.

As the Chairman has indicated, you have here a highly important set of functions. To have functions so important less controllable by the responsible agencies of Government seems to me not desirable.

Mr. MURPHY. That is all, Mr. Chairman.

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Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. Dean Appleby, the Federal Government has certain responsibilities, for example the Employment Act directs the Federal Government to use all of its powers to achieve maximum employment, production, and purchasing power. Our kit of tools for achieving these objectives includes such things as expenditure and tax policies, agricultural policies, housing policies and monetary and credit policies.

All of the agencies of the Government charged with carrying out these policies with the exception of the Federal Reserve System are responsible not only to the Congress but to the Chief Executive.

The witnesses who have appeared before us in the last 2 weeks emphasize the importance of continuing to have an independent central bank or monetary authority. Can you give any rationale or can you see any reason, from a political science or public administration standpoint, for this independent monetary structure?

Mr. APPLEBY. No. I understand my good friend Beardsley Ruml testified to that point. I think it is out of keeping for him to take that position because, in my view, that is simply a matter of voicing the traditional view and it is not like Beardsley Ruml to do that.

I think this just happened to be a matter he had not thought much about.

Mr. ENSLEY. How would you, from a congressional standpoint bring the Federal Reserve into the executive department?

Mr. APPLEBY. I don't know. You have the question of gradualism. I do not know just what gradual steps would be useful. I do not believe, as I said, it would be feasible to incorporate the Federal Reserve System immediately and fully into the Government in the way that the other executive agencies are incorporated. If you raise the question about how you would move in that direction, that becomes very difficult. It is in the field in which Congress is much more skillful than I am.

I would suggest that a reduction in the term, say, to 8 years, would be a mild step in that direction. I think perhaps the elimination of specifications of derivation of directors from particular interests would be a step in that direction. I think a series of steps of the general sort that the Chairman was identifying when he was talking about the intervention of the Bureau of the Budget would be necessary.

The important fact is that all these other functions are in a situation where there is a milling around and a conflict between them within an ordinary confine, and here is the Federal Reserve out here. If they can be put into a position where from day to day, from week to week, they are subjected to more influence from these other agencies that have kindred functional responsibilities, you would have a better working out of policy. You are going to get the best credit policy and the best fiscal policy out of the interaction of these agencies. On occasion you will have some interaction. I have sat in some meetings of the Cabinet or of Cabinetlike groups, when fiscal policy has been up for discussion, in matters of this sort—and I always observed how differently the spokesman for the Federal Reserve System appeared in contrast with the heads of agencies who were brought together around the Cabinet table for those discussions. You could go off on any one point of view and you didn't have to pay any particular at-

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tention. Most of the time, of course, they do not fit in even on those discussions.

Mr. ENSLEY. That is all.

Representative PATMAN. Thank you very kindly, Doctor. You have been very helpful. We appreciate the contribution you have made.

Professor Pollock is our next witness. He is chairman of the department of political science at the University of Michigan, a former president of the American Political Science Association, and a member of the Hoover Commission.

We appreciate your attendance, Professor Pollock.

Do you have a prepared statement?

Dr. POLLOCK. Yes, Mr. Chairman; I have.

STATEMENT OF DR. JAMES K. POLLOCK, PROFESSOR OF POLITICAL SCIENCE AND CHAIRMAN OF THE DEPARTMENT OF POLITICAL SCIENCE AT THE UNIVERSITY OF MICHIGAN

Representative PATMAN. You may proceed as you desire, Professor Pollock. You may either read your statement and yield to questions later, or you can put your statement in the record and make a statement summarizing it and discussing it; either way you want.

Dr. POLLOCK. I prepared this statement, Mr. Chairman.

Representative PATMAN. Probably you would like to present it like it is.

Dr. POLLOCK. I thought it would be suggestive to you in forming the basis for any questions afterward.

Representative PATMAN. Yes, sir.

Dr. POLLOCK. I am pleased that your committee has invited a political scientist, in the midst of this galaxy of economists and officials and bankers, to express an opinion on one of the important aspects of the problem before you. I think it is always wise to discuss the machinery for the formulation and execution of policy instead of spending all of our time discussing what the policy should be. If we had a better method of formulating policy, there would be fewer disagreements and conceivably better policies.

Too frequently men who are acquainted with the technical or substantive side of the problem overlook the organizational problems which are involved. I am not wanting to leave the impression that I am as sure of the answers in the field of organization as the experts appear to be in the field of monetary policy. But perhaps I can stimulate the thinking of the members of the committee in a field where too little work has been done.

I approach the problems of Government organization and administration in the fields of fiscal and monetary policy from my background of study as a member of the Hoover Commission. I have also studied the excellent volumes prepared by your staff from the information furnished by the principal agencies of the Government concerned with the fiscal and monetary policy. These volume have been very helpful and suggestive to me, as I assume they have been to you.

Recognizing the seriousness of the organizational problems confronting the Federal Government, the Hoover Commission, as you required it to do by law, submitted to the Congress in 1949 a series of

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recommendations calculated to make the Government of the United States both economical and efficient.

Following generally recognized principles of organization, we urged Congress and the President to alter the whole structure of the Federal Government so that we would have one efficient Government instead of a loose federation of separate empires.

Although considerable progress has been made in the implementation of our recommendations in the field you are now considering, one important recommendation has been completely neglected. I refer to recommendation No. 9 in our report on the Treasury, which urged the creation of a National Monetary Council. This suggestion was included in bills that have been introduced in this Congress.

Had this recommendation been adopted, we would now have had 3 years' experience with a body which was conceived as a necessary coordinating device in the vast and important fields of fiscal and monetary policy. Without this experience I must begin today where our Commission left off 3 years ago to see what the organization problems are and to decide whether our recommendation of 3 years ago is still applicable or whether some modification or extension of it is presently desirable.

It needs little argument, I think, to demonstrate the necessity for close-working arrangements in the Federal Government between all agencies concerned with fiscal and monetary policy. I am glad to have had the privilege of listening to my friend and colleague, Deane Appleby, on this point, and we are in complete agreement, I am sure, about that point.

It is as bad within our domestic economy to permit two or more voices to speak as it is in the foreign field. The public is confused enough without having spread before their eyes conflicting policies within the same government in highly technical fields. Furthermore, today we are dealing with foreign governments which are closely knit and which are not of several minds in any policy field at the same time.

Years ago we could, without too much danger, indulge in the luxury of riding off in all directions at once. But in this crisis situation and in this dangerous world we would be well advised to put our Government house in order and provide a sound and orderly procedure for settling all of our policy conflicts.

It should be clear to you that such machinery does not exist at present in the fields of fiscal and monetary policy. Although all agencies concerned demonstrate close working relations at all levels of operation, it is still possible for basic conflicts to drag along unresolved.

As the Secretary of the Treasury has put it in your volumes here:

> The outstanding disadvantage of the present arrangement is that there is no specific authority to resolve quickly any irreconcilable conflict between the policies of the President—or the Secretary of the Treasury—and the Federal Reserve, if and when such a conflict arises.

I take it, therefore, that you would like me to suggest a feasible method or methods by which policy conflicts may be promptly resolved and by means of which better coordination in these vitally important policy fields may be achieved. Other less important organizational matters will also receive my passing attention.

In Washington, coordinating mechanisms are particularly important, for our Government has developed under the principle of the sep-

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aration of powers and under statutory restrictions in the organization of the diverse parts of the executive branch.

In Great Britain, by way of contrast, with the Cabinet acting as a top coordinating device, and with the Treasury the sole organ of control in matters of organization, finance, personnel, planning, and statistics, conflicts in policy or administration can be quickly and properly resolved. Our more cumbersome system of having two or more agencies where one would be sufficient may satisfy our needs better, but I have my doubts.

In any case, I see the need for providing more definite machinery for coordination in the important fields under discussion. One can argue that interagency committees are a poor device for achieving the best kind of coordination. My fellow Commissioner, James Rowe, in a penetrating comment on interdepartmental committees, in one of our reports said this:

> The establishment of another interdepartmental committee is no answer to this problem. The permanent interdepartmental committee is probably the least satisfactory of all coordinating devices. Interdepartmental committees invariably refuse to act without the unanimous consent of all members. Committee decisions, therefore, are likely to represent the least common denominator of the committee's thinking.
>
> Even more important, however, is the fact that interdepartmental committees limit the President's freedom of action and render more difficult his task of securing over-all coordination. Although such committees are generally limited to advisory functions, nonetheless, the President, as a practical matter, is bound to accept unanimous advice from the major interested agencies represented on the committee, despite the fact that unanimity may be the product of logrolling. The only alternative would be openly to repudiate his chief policy advisers.

On the other hand, we have the precedent of a successful interagency committee in the foreign international monetary field known as the National Advisory Council. This body is quite generally recognized as having been a success in coordinating all agencies in the fields allocated to it. Our task-force report, prepared by Mr. George L. Bach, attributed the success of the NAC as a coordinating agency to the following four factors:

> First, the combination of statutory authority and Presidential responsibility has been conducive to active continuing top-level participation.
>
> Second, the responsibilities of the Council are relatively clean-cut with focus on instructions to United States representatives on the Fund and the Bank and on the formation of United States foreign lending policy.
>
> Third, NAC members have been relatively free from the pressures of the economic-interest groups that play so important a role in most domestic economic problems involving wage rates, farm incomes, industrial prices, and so forth.
>
> Fourth, the staff work has been unusually effective with major use being made of interagency working parties under the direction of the five-man interagency senior staff committee, rather than development of a large council staff as such.

Our successful experience with the National Advisory Council, it seems to me, points to the desirability of establishing a similar body in the domestic fiscal and monetary field as recommended by the Hoover Commission 3 years ago. In line with this I should like to recommend the creation of such a new National Advisory Council with jurisdiction over both the foreign and domestic fiscal and monetary policy fields and to merge with it the present NAC.

The membership of the National Monetary Council, as proposed by the Hoover Commission, and that of the present NAC is practically identical. As a matter of fact, the Hoover Commission report said that—

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Consideration should be given in this connection to joint meetings with the Council dealing with foreign credits or to the merger of the two councils.

That I am now proposing.

It would perhaps be necessary to spell out more specifically than at present that in the event of a conflict within the Council, the matter would be referred to the President for decision.

It is of course possible to raise a serious argument against the creation of statutory interdepartmental committees. In the present case, however, we already have one, namely, the NAC, and by enlarging its jurisdiction we would not be creating a new committee on top of the present one, and we would be giving it a basis of authority which is probably necessary in this case. Congress would probably want to spell out the jurisdiction of this council rather carefully.

Perhaps I should also add that in replies to your committee's questions—and here I correct my advance statement: the Secretary of the Treasury—I do not believe it has been the case with the Federal Reserve Board—the Secretary indicated general agreement with the idea of establishing a monetary council similar to that recommended by the Hoover Commission.

In any case, we should always keep in mind that regardless of the organization agreed upon, credit policy, fiscal policy, and debt policy must be considered jointly if we intend to avoid direct conflict between the two major monetary-fiscal arms of the Government.

Furthermore, a clear prescription by Congress of monetary-fiscal policy would quite certainly have the result of reducing existing uncertainties in Treasury-Federal Reserve policy-making. Of course, on the other hand, too rigid a determination by Congress of its policies in these fields might prevent desirable administration discretion. But I should think that some greater clarification of your objectives is probably desirable.

If it is thought that a new interagency coordinating committee is not enough, then the Congress should consider whether completely new machinery of a superdepartmental nature is desirable. In this connection it is well to understand that our top organization in the executive branch is not well devised for prompt and effective direction or decision by the President.

We have experimented in war years with the Economic Stabilization Board, with the Office of War Mobilization and Reconversion, and with the present Defense Mobilization Board in our desire to pull all affected agencies together in the development and execution of common policies. Recently the President appointed Mr. Harriman as a special assistant in foreign affairs to coordinate aspects of foreign activity outside the present scope of the Department of State. Conceivably, other efforts could be made.

We might create, for instance, a new integrating office like the Office of the Secretary of Defense, and subject all agencies in the economic field to its direction. Or the President could appoint another special assistant to pull together diverse policy conflicts in the economic field and at the same time carry out the recommendation of the Hoover Commission for a staff secretary for the President.

What is really needed, it seems to me, is a new mechanism for coordination below the President but above the department heads and the Board of Governors of the Federal Reserve System—in other

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words, subordinate to the President but administratively superordinate to the heads of agencies which have operating authority in the various aspects of economic policy.

Perhaps the nearest analogy to the proposed new office is the former Office of War Mobilization and Reconversion, which was a dispute-settling and policy-harmonizing office. This war agency, however, dealt more with day-to-day disputes rather than the broad and deeper policy conflicts which the proposed economic policy office would settle. Congress could establish the limits within which the office could coordinate the monetary policy of the Federal Reserve Board with the fiscal policy of the Budget, with the debt-management policy of the Treasury, and with the lending policies of our numerous lending agencies.

A sound statutory basis for the proposed new economic agency would be desirable in order to establish as clearly as possible its directive and superordinate authority over presently constituted agencies. The Council of Economic Advisers might well be attached to the new office as a staff aid.

I think I should also call your attention to the studies made by our task force and by your staff which recommend changes in the Federal Reserve Board. It would seem desirable to me to have the Chairman of the Federal Reserve Board become more of an intimate member of the President's official family. I think also it would be better if the Chairman of the Board should serve at the pleasure of the President. It also seems to me that the present composition of the Board and its method of choice might be reconsidered.

I have noticed the complaint of the members of the Federal Reserve Board against the restriction of having more than one member from a Federal Reserve district. I think one might also raise the objection that although geographical spread is desirable, the competence of the members of the Board is the highest consideration. By reducing the size of the Board to perhaps three, one might be more certain of securing outstandingly competent members without regard to geographical or other considerations.

I trust that my various suggestions may be helpful to you in your consideration of these matters of organization. I shall be glad to try to answer questions about my suggestions, if you so desire.

Representative PATMAN. I know your suggestions will be helpful to us, Professor Pollock.

Would you like to ask Professor Pollock any questions, Senator Flanders?

Senator FLANDERS. This is an interesting document, Professor Pollock. One of the most interesting things in it is the new relationships of the Council of Economic Advisers. As you know, we have a statutory relationship to the recommendations of the President derived, presumably, from the recommendations to him of the Council of Economic Advisers. Your proposal would seem to require that the Council of Economic Advisers take a subordinate position to a new body or a new functionary who is over both the Council of Economic Advisers and the Federal Reserve Board.

I am wondering whether that new coordinating outfit would not have practically the same duties that the Council of Economic Advisers have now, but with the added responsibility of some control

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over the final decisions of the Federal Reserve Board. In fact, I begin to see in this a fear of the same thing that happened through the long years of the Roosevelt administration, in which one coordinating committee or commission or individual was piled ad infinitum on top of every layer beneath. And that is the first criticism that I would make of what you have been presenting here today.

We seem to have gotten a supercouncil or superfunctionary of the economic adviser sort.

Dr. POLLOCK. If you study my testimony closely, Senator, I think you will discover that what I am principally concerned with is to provide some effective means of overcoming and settling the existing conflicts in policy within the executive branch. I suggest first the desirability of a coordinating committee, because perhaps that is about as far as you care to go. I then become a little bolder and say that if you do not care for a coordinating committee, you ought to consider the possibility of an administrative agency which would be superordinate to the operating agencies. Having then made that suggestion, obviously I fit into the proposed organization the proper agencies that belong with it.

The purpose of the Council of Economic Advisers, as I understand it, is to give the President advice in the important economic policy fields. This would now be taken over by this proposed new agency, and you therefore should not leave the President with two sets of staff advisers, the present Council of Economic Advisers and a new agency, both giving him advice. Otherwise you would not solve anything.

It is only in that framework that I propose using the Council of Economic Advisers as a staff arm to the new agency.

Now with reference to the position of the Council of Economic Advisers in relation to Congress, I think you will agree that their relationship to you has been a little bit vague. I am not sure that what you attempted to define in the Employment Act of 1946 has in fact worked out the way you anticipated. That is to say, in effect, I believe the Council of Economic Advisers—at least I so read the testimony and the replies in your volumes—have looked upon themselves much more as a staff arm to the President, and their relations to Congress are more incidental.

Senator FLANDERS. Now is not the vagueness in fact on the question of their relationship to the President rather than of their relationship to Congress? The question of their relation to the President is whether they report to him or for him, and the developments in the last year or so have indicated clearly, it would seem to me, that they report for the President, that is the determining factor; in spite of the fact that they originally report to him. They speak for him in their reports, do they not?

Dr. POLLOCK. I am not able to testify, of my own knowledge, as to that particular question. But the information I gathered from the replies in your volume leads me to think that the doubt is in their relation to Congress, and not so much in their relation to the President.

Senator FLANDERS. Well, it would seem to me, sir, that their relationship to Congress is quite clear. We get a report, and we examine it. Now the only dubious thing in their relation to Congress has been settled, and that was the question as to whether they should appear before this committee and be examined. Dr. Nourse felt that they

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should not be. The other members felt that they should, and they came.

It seems to me there is no vagueness about their relation with this committee, at least. They appear before us. That question has been settled. They make a report and that comes before us through presentation by the President. That is statutory. I see no vagueness whatsoever so far as their relation with us is concerned.

Dr. POLLOCK. Well, I was addressing myself to the question of how to provide a decision in these fields of policy conflict.

Senator FLANDERS. That is another matter.

Dr. POLLOCK. That is the matter I was addressing myself to.

Senator FLANDERS. I supposed you were. And on that question, it would seem quite evident to me that you feel that the Federal Reserve Board should be below the administrative branch?

Dr. POLLOCK. I feel that however much operating autonomy Congress leaves to the Federal Reserve Board, there should be no empire in the Government that is freewheeling and going on its own without reference to the general policy of the Government.

Senator FLANDERS. Was that to mean the general policy of the administration?

Dr. POLLOCK. No, of course the policy is frequently determined by Congress, and that is where we often get into difficulty. Congress frequently gives independent statutory authority, let us say, to the Corps of Engineers or some bureau within a department, and then occasionally this favored agency can stand up against the head of the department or even against the President.

Senator FLANDERS. The whole theory of the General Accounting Office is that. It is just that.

Dr. POLLOCK. Well, the General Accounting Office is, of course, in a different category. There you have set up an agency as an auditing agency, as it should be, to check over to see that the law has been complied with in the matter of public expenditure. That is a very common thing. That is necessary. It is not necessary in the operating part of the Government to grant powers which can't be reviewed.

Senator FLANDERS. So you feel that the Federal Reserve Board should be definitely apart and subject to the policies determined by something you call the Government, but you have not left it quite clear in my mind as to whether that means that within the Government the Administrative Branch should be the ultimate arbiter or whether the Congress should be the ultimate arbiter.

Dr. POLLOCK. I think the policies must be more clarified by Congress, but within the policies laid down by Congress, when there comes a conflict between the policies of the Federal Reserve Board, of the Treasury, of the lending agencies, that conflict should be resolved by somebody above the Federal Reserve Board, and in this case ultimately the President.

Senator FLANDERS. I do not see, then, that in this description of the relation between the Federal Reserve Board and the administration and the Congress you put the Reserve System in any different category from what any branch or bureau or administration is in, because every one of those is subject to legislation by the Congress, and every one of them, in its administrative operations within the limits set by the Congress, is subject to policy determination, administrative action, and determination by the President.

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So it would seem, to me at least, that you were suggesting that the Federal Reserve Board should become a bureau or administrative branch of some part of the administration.

Dr. POLLOCK. A definite part of the executive branch of the Federal Government, certainly.

Senator FLANDERS. I just wanted to make that clear, because you have stated your position on the heart of the legislation by which the Federal Reserve Board was set up and reorganized.

Dr. POLLOCK. I approach this, I think, with due caution and respect for the way in which the Federal Reserve law was originally passed and how it has actually worked out. I should think that it would be unwise to make such an immediate revolution as to put the Federal Reserve Board and the Federal Reserve System on exactly the same status vis-à-vis the other operating agencies of the Government.

In other words, I should like to preserve in the Federal Reserve System as much operating autonomy as our experience justifies without permitting the Federal Reserve, or for that matter anybody else, from preventing a decision when any conflict comes up in policy.

Senator FLANDERS. Now I think that point is clear in mind and clear on the record. The next point I would like to clear up is the reason for suggesting a new official or new body with the Council of Economic Advisers as its staff.

Are not the specifications for the Council of Economic Advisers just about as high as can possibly be written? And how would you expect to get any higher official or board or group of which this Council of Economic Advisers would be the staff? Where would you look for them? Who are they? How would you pick them out?

Dr. POLLOCK. I have no complaint, and you cannot discover any in my testimony, criticizing the personnel or standards of quality of the Council of Economic Advisers.

Senator FLANDERS. And yet you plan to make that subordinate?

Dr. POLLOCK. No; I have only addressed myself to the organizational problems involved, and I should say first that, as the Hoover Commission recommended, it is not sound organization to have a council act as a staff arm to the President; and therefore we proposed that there be a single economic adviser rather than a council of economic advisers. That is one way of going at the problem.

I went at it, in the second place, always assuming their competence and their necessity, that if you set up a new conflict-resolving agency as I suggested you could not leave the Council of Economic Advisers as now constituted; otherwise the President would then have two people trying to resolve the conflict. So if you consider it within that organizational framework, I find nothing inconsistent about it.

Senator FLANDERS. Well, I think that if I were President, I would be a bit confused. Here I am supposed to have the best economic advice in the world in my Council of Economic Advisers, and at the same time I am supposed to have a higher economic authority of some sort to resolve differences on matters which belong within the field of operations of the Council of Economic Advisers.

Dr. POLLOCK. Well, on the first point, on your competence to be President, you would not expect me to give a reply. On the second point, Senator again I am not raising the question of the competence of the advisers or of the necessity for the President to have such

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advice. I am merely saying that we have to get forward with some kind of mechanism to resolve conflicts which now exist and which will exist in the future. And devising then a plan to meet those conflicts, you have to have the other parts of the organization fit into it.

Senator FLANDERS. You would not feel that a more clear mandate by legislation as to the criteria for resolving these conflicts would serve the purpose?

Dr. POLLOCK. I think not, no, because then the Federal Reserve Board or the Treasury or whoever it is could stand on their legislative power and say "We won't agree," and then you would not get agreement. It is agreement on a policy, hearing all sides of the question, that seems to me to be the question for you to decide. I do not see how any government can go on indefinitely failing to resolve the conflicts that arise within it. That is not a government; it is what I have referred to as a federation of empires. And I think in this closely knit world it is very dangerous to permit such a situation to continue.

Senator FLANDERS. You would feel that the conflicts between the administration, the judiciary branch of the Government, and the legislative branch of the Government, then, are serious things which ought not to be permitted?

Dr. POLLOCK. No; now you are getting into the question of separation of powers. I am not questioning that.

Senator FLANDERS. Is not the success of our whole democratic form of government based on conflict?

Dr. POLLOCK. Yes, of course the principle of separation of powers provides that. But the Constitution never intended to perpetuate conflicts in the executive branch. There is always a means of providing for the solution of policy conflicts between the President and Congress. But within the executive branch, no. This is a different matter.

Senator FLANDERS. You are arbitrarily placing the Federal Reserve Board in the executive branch. When you do that you make your case.

Dr. POLLOCK. Well, then, maybe we should put it in as a fourth branch. Maybe we should have a fifth and a sixth branch. Wherever you set up outside of Congress agencies which are not quasi judicial but which are administrative, which decide policy which is related to the policies handled by other administrative parts of the Government, you are adding another branch. And that was not intended in the Constitution, and it did not exist in the early days of the Constitution. It has been a recent development.

Senator FLANDERS. What about the Interstate Commerce Commission?

Dr. POLLACK. You noticed I used the words "quasi judicial." Obviously when it comes to a matter of quasi-judicial importance, it is quite common and quite proper to set up agencies of that sort. You would not want the President to control such matters.

Senator FLANDERS. The judgments made by the Federal Reserve Board are supposed to be made judiciously but in some way—not being a political scientist or having studied political science, or even having gone to college, except the International Correspondence Schools, you have doubtless a distinction which carries a difference between the kind of decisions that Interstate Commerce Commission makes with regard to railroad rates, for instance and the kind of a decision which the Federal Reserve Board makes with regard to money rates.

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There must be some difference between money rates and railroad rates to maintain the distinction which you make.

Dr. POLLOCK. I think not. You have delegated to the Interstate Commerce Commission the power to fix railroad rates because you felt Congress was not capable of doing that very expertly itself.

Senator FLANDERS. That is a very good argument for delegating the same kind of power for money rates.

Dr. POLLOCK. You also have to provide some way to resolve a conflict. When they set one kind of policy and it runs into conflict with policy decisions made by another agency, either you have to resolve that within the executive branch, which would be the normal way, or you have to resolve it by referring it back to Congress.

Senators FLANDERS. You have the same sort of a situation as between the Interstate Commerce Commission and the Attorney General's office, and that has come out into the open more than once.

Dr. POLLOCK. Well, of course, you have also set up a number of agencies like the Interstate Commerce Commission in the transportation field with the result that we have no unified transportation policy.

Senator FLANDERS. Well, that is a good argument. If you pursue that argument it leads to putting all transportation under the Interstate Commerce Commission or else abolishing that Commission and putting all the branches under some other appropriate pigeonholes.

Dr. POLLOCK. That is exactly what I recommended in one of my dissenting opinions which I shared with Representative Brown in our report dealing with the regulatory agencies.

Senator FLANDERS. But it does not seem to me that it strengthens the case for the power of the Federal Reserve Board over rates as being different in kind from the power of the Interstate Commerce Commission over rates.

Dr. POLLOCK. I do not regard the Federal Reserve Board as a quasi-judicial body.

Senator FLANDERS. There you get back to words again. I am trying to bring out the difference in actions and responsibilities. By giving a different name to actions and responsibilities you do not change their nature.

Dr. POLLOCK. I do not consider that the Federal Reserve Board's power in the monetary field is anything comparable in type of function to that exercised by the Interstate Commerce Commission in setting railroad rates.

Senator FLANDERS. One deals with railroads and the other with banks.

Dr. POLLOCK. No; it is not as simple as that. I am sure you recognize it is not as simple as that, and in any case, I. C. C. or Federal Reserve, conflicts must be resolved.

Senator FLANDERS. I think I am through, sir. I believe I have developed my differences of opinions sufficiently.

Representative PATMAN. I can see one big difference between the Interstate Commerce Commission and the Federal Reserve System. The Interstate Commerce Commission fixes rates that are applicable right then, and they are governed by them right then, and it affects the entire economy and every person who uses the transportation system; whereas the Federal Reserve System fixes rates sometimes that are never used, like the rediscount rate, for instance. And it is not as effective right off as the Interstate Commerce Commission.

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Dr. POLLOCK. This obviously was a side issue that arose out of our disagreement upon the necessity for resolving conflicts. The important thing, it seems to me, is to keep in mind that—and I wonder if anybody would disagree with this point—that it is not healthy to permit important policy conflicts to go unresolved.

Representative PATMAN. Yes. I am very much impressed with your statement that we should not have four branches of Government unless we deliberately provide for them and plan for them.

Dr. POLLOCK. Yes.

Representative PATMAN. And after all, the Constitution sets up the three branches, and any agency that is set up should be under one of the three. I think you make a strong argument there. Since the Federal Reserve System is so closely related to the Government—in fact it is carrying out purely a governmental function—and it is so closely connected with the activities of the Treasury, and the Treasury is obviously influenced by the major activities of the Federal Reserve System, there should be better coordination.

And for that reason you make a good case, at least you have made a good argument, to put it under the executive branch.

I assume that you have considered, Professor Pollock, that the Federal Reserve System, after all, has had one of the greatest responsibilities, and more powers and privileges in connection with our economy, than any other one agency or group, through the power to issue what amounts to be most of the money in the country on the credit of the Nation.

Dr. POLLOCK. Of course I am not passing judgment at all on the Federal Reserve's action or policy. I do not know enough about these very technical economic and banking problems to be able to express an opinion which would be worth anything. I am merely saying that when they do come up with a policy, when they do take action which must be taken in connection with actions taken in the larger economic field, there should be provided some means, not excluding their point of view—in fact their point of view might win out—for deciding conflicts in policy.

I am not expressing, in other words, an opinion on the quality of their work, because I do not consider that I am qualified to do that.

Representative PATMAN. And I assume you think it should go through the annual appropriations in the budget just like other agencies of Congress should?

Dr. POLLOCK. I think I lean in the direction of my colleague here, Dean Appleby, on the question of gradualness. It seems to me that the first thing is to provide some means of resolving conflict. Whether you should go beyond that and specify that it should be exactly like any other department of Government, that is another question.

There I think I would move much more slowly, unless I were convinced that their present autonomy is being abused and is providing a differential treatment to which they are not entitled. And on that point, again, I have no opinion.

Representative PATMAN. Well, your statement certainly has been helpful to me, and I know helpful to the committee, and it will be a fine contribution to the record the committee expects to make.

Go ahead, Senator Flanders.

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Senator FLANDERS. I missed one point in my questioning, and that is calling attention to the fact that the Constitution puts the monetary responsibility not in the administration but in the Congress, definitely and clearly. And Congress, subject to the veto power of the President and subject to that only, is definitely charged with the responsibility of monetary control.

So that this particular function is quite definitely more nearly a nonadministrative function than are most of the other things we have been talking about.

Dr. POLLOCK. Congress can do with it anything they want to, of course.

Senator FLANDERS. They can do, and they have to do with it—they have to decide, it is their responsibility. They can delegate it, but if they delegate it to the President it is a form of delegation which has never been done, to my knowledge, in any other field of responsibility charged to the Congress by the administration.

Now the other question I wish to ask is as to whether in your study of political actions, reactions, results, and policies the world over, and history over, you have made any study of the effect of putting the central banking administration or system under the administrative branch of the Government.

Dr. POLLOCK. I have made no study of this, although I am reasonably well acquainted with the situation in England, where until recently the Bank of England occupied a reasonably autonomous position, but always working very closely with the Treasury, and I believe never getting into the position where a decision could not be made on monetary policy.

Now, of course, the Bank of England is under the Treasury; they are required to consult with the Bank of England about a matter; but the policy can still be decided by the Treasury. I should say the tendency the world over—and this is, I think, brought out very well in your written replies which are worth a great deal more than my opinion on this—I think the tendency the world over is to develop closer-knit administrative branches.

This becomes a matter, it seems to me, of sheer necessity with the complexity of modern government. You just cannot allow the whole administrative landscape to be cluttered up with all kinds of independent empires which somebody theoretically supervises but which in fact, nobody supervises.

Senator FLANDERS. It seems to me that in describing the long-time relationships between the Bank of England and the British Government, which were modified when the Labor Party came into power, you are describing what both the Secretary of the Treasury and the Chairman of the Federal Reserve Board describe as their present relationships.

Dr. POLLOCK. Well, again you have to decide. It is your judgment as to whether you think there is a conflict. It would seem to me quite clear—I did not even argue the point—that you do not now have the machinery for the settlement of that conflict.

Senator FLANDERS. Neither did the Bank of England and the British Government have that machinery.

Dr. POLLOCK. Conflicts were always resolved in Britain. It was always in the informal way which characterizes all such matters in the British Government. That is the Bank of England, although it

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was in a comparable position to the Federal Reserve Board, worked in the closest unity with the other branches of the British Government concerned with broad economic policy.

Senator FLANDERS. Yet you will note that when the Federal Reserve Bank and Board and the Treasury finally came to a unified arrangement or to an agreement it was quite evident that the agreement followed more closely the policies of the Federal Reserve Board than it did of the Treasury.

Dr. POLLOCK. I think that might well be.

Senator FLANDERS. That was.

Dr. POLLOCK. I think that might well be. The question is to get the decision. And the decision also, it seems to me, in policy, should not be just the watered-down compromise of all viewpoints. That does not seem to me to be the way in which the Executive should decide or that Congress should decide.

Senator FLANDERS. That is all, Mr. Chairman.

Representative PATMAN. At the conclusion of Professor Pollock's testimony I would like to insert in the record Recommendation No. 9 of the Hoover Commission referred to by Professor Pollock, and the comments under the recommendation.

(The recommendation and comments referred to are as follows:)

"RECOMMENDATION NO. 9

"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 National Advisory Council on International Monetary and Financial Problems under the chairmanship of the Secretary of the Treasury is already a successful council concerned with foreign lending. The new domestic council should also be under the chairmanship of the Secretary of the Treasury, with representatives appointed by the President from such agencies as the Federal Reserve Board, the Housing and Home Finance Agency, the Farm Credit Administration, the Reconstruction Finance Corporation, and others as the President may determine, having in mind the impact of their programs upon the economy of the country.

Consideration should be given, in this connection, to joint meetings with the Council dealing with foreign credits, or to the merger of the two councils.

The purpose of this Council is to develop and recommend national policies in the domestic field which would promote coordination of purpose and avoid overlapping activities and inconsistent credit policies. By the creation of such a council, the home and housing lending and credit agencies can remain associated with the Housing and Home Finance Agency, and the agricultural credit agencies with the Department of Agriculture.

This new council should be housed in the Banking and International Finance Service of the Treasury, with the Assistant Secretary in charge of the Service as secretary of the Council.

Representative PATMAN. Thank you very kindly, Professor Pollock. We appreciate your testimony very much.

We will adjourn until 10 a. m., Monday.

(Whereupon, at 11:45 a. m., the committee took an adjournment, to reconvene at 10 a. m., Monday, March 24, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

MONDAY, MARCH 24, 1952

Congress of the United States,
Subcommittee on General Credit Control
and Debt Management of the
Joint Committee on the Economic Report,
Washington, D. C.

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

Present: Representatives Patman, Bolling, and Wolcott.

Also present: Grover W. Ensley, staff director, and Henry Murphy, economist for the subcommittee.

Representative Patman. The committee will come to order.

Today we are commencing a series of four roundtable discussions. In the first three of these discussions the members of the panels have been invited purely on the basis of their personal qualifications and not in any way as representatives of the institutions with which they are affiliated. The persons invited are all highly qualified to discuss the subjects to which they will address themselves and I should like to take this occasion to thank the academic and financial communities for their fine cooperation with this inquiry and to express my regret that we will not be able to hear others, often equally qualified, who would be willing to discuss these matters with us.

Today we have a group of five persons, four of whom are officers of banks and one of an insurance company.

They have been selected on the basis of their interest in the problem of seeing that our financial institutions operate in such a way as to make the maximum contribution to price stability and high-level employment.

Tomorrow we will have a group of five persons, all professors of economics in leading institutions, and all interested in the role of monetary and debt management policy in maintaining price stability and high-level employment.

On Wednesday, we will have a group of five, three of whom are economists, and two political scientists. This mixed group of economists and political scientists has been especially selected for its competence and experience in discussing the proper machinery for the determination of monetary and debt management policy.

On Thursday, on the other hand, we will have a group of seven men selected primarily, not as individuals, but as representatives of institutions and organizations. This group will discuss the role of business, labor and agriculture in the determination of monetary and debt management policy.

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We have with us this morning Mr. Robert V. Fleming, who is president of the Riggs National Bank of Washington, formerly president of the American Bankers Association and of the Reserve City Bankers Association, and a member and vice president of the Federal Advisory Council; Mr. Wesley Lindow, vice president and economist of the Irving Trust Co., New York City, formerly a member of the Treasury staff, and consultant to the Treasury Department in the preparation of the Treasury Department's answers to the questions asked it by the subcommittee; Mr. Roy Reierson, vice president and economist, Bankers Trust Co., New York City, and consultant to the Board of Governors of the Federal Reserve System, especially on matters relating to the voluntary credit restraint program; Mr. Jesse W. Tapp, executive vice president, Bank of America, San Francisco, whose principal field of specialization is agricultural economics, formerly Associate Administrator of the Agricultural Adjustment Administration; and Mr. Donald Woodward, second vice president of the Mutual Life Insurance Co. of New York, formerly a reporter on the Wall Street Journal, financial editor of Business Week and economist for Moody's Investors Service, who has been consultant to the Treasury and to the Board of Governors of the Federal Reserve System.

Gentlemen, we are certainly glad to have you. Dr. Murphy tells me that agreements have already been reached among you as to the manner or method of procedure, which meets with our approval a hundred percent, and we shall abide by your wishes.

First, I believe, I want to ask question No. 1 under the suggested topics for discussion: What should be the role of the private financial community in the formulation of monetary policy? To what extent does this role reflect its status as a special interest group and to what extent does it reflect its status as the repository of specialized skills and information of value to the general interest?

Mr. Fleming, would you like to discuss that, please, sir?

STATEMENT OF ROBERT V. FLEMING, PRESIDENT AND CHAIRMAN OF THE BOARD, THE RIGGS NATIONAL BANK, WASHINGTON, D. C.

Mr. Fleming. Mr. Chairman, I am very happy to appear here this morning in response to your invitation, and I have been requested by the other members of the panel to lead off in a discussion of this first topic.

I have a statement here, first, and then I assume, I am to understand, that I am to be followed by Mr. Woodward on the same topic.

Representative Patman. That will be satisfactory, sir.

Mr. Fleming. It is clear to me from the scope of this topic that any discussion should include not only commercial banking but all types of private financing and credit institutions in our Nation. Taking up commercial banking first, the committee is aware there are approximately 15,000 national and State banks in the Nation and, in addition, about 5,000 branch offices of those institutions.

The American Bankers Association is the principal organization of banking institutions, its membership representing 98 percent of the banks of the country and 99 percent of the banking resources of the

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country. There is also an Association of Reserve City Bankers, comprised of individuals who are policy-making officials of banks located in central Reserve and Reserve cities throughout the country doing a correspondent bank business. The American Bankers Association membership is a membership by banks represented by delegates. On the other hand, the Association of Reserve City Bankers is an organization of individuals who must pass a membership test and its membership is limited to 450. Through meetings of this association and its committees the views of its members are made known to governmental authorities. In addition, there are State bankers associations in all of the several States, and in many States there also are county bankers associations as well. In my judgment, it would be through these organizations and their leaders that American banking would play a role, to the extent it can, in the formulation of lending and monetary policies.

Also, it must be recognized that the boards of directors of banks are made up of the principal, outstanding men in their respective communities and almost invariably are businessmen and not professional bankers. Through these directors the officers of banks are able to have the viewpoint of business and industry and be familiar with the needs of their communities, as well as having the benefit of the judgment of these directors as regards the soundness or solvency of borrowers or prospective borrowers.

I might also add that for many years the American Bankers Association has carried on a very intensive educational program through the American Institute of Banking, which is the educational arm of the association—257 chapters of the institute located in 383 cities in the United States and Hawaii having an annual enrollment of approximately 45,000. I believe the officers in charge of the administration of most of the banks of the country do everything possible to encourage their employees to take the courses in banking fundamentals and techniques, commercial law, negotiable instruments, economics, and other subjects offered by the institute, to increase their knowledge and improve their understanding of the services which banks are chartered to perform in the public interest. The American Bankers Association also established in 1935 the Graduate School of Banking at Rutgers University in which the most promising young officers of member banks throughout the Nation are enrolled each year for a 3-year intensive course in advanced banking subjects and subjects related to the banking business. There also are three other schools of banking offering advanced courses: One at Seattle for the Pacific coast, one at Madison, Wis., in the Midwest, and one at Baton Rouge, La., in the South, all under the sponsorship of the bankers' associations of the respective surrounding areas. In addition, the American Bankers Association holds a national credit conference annually, which is regularly attended by officials of government. Thus it will be seen that the educational programs which banking is carrying on are widespread and constructive in educating the official and clerical personnel of banks, to the end that they may render ever improved and enlightened service to the people of this country and its economy.

It must be realized that the officers and employees of banks are in constant touch with the public served by our banks and have the benefit of the composite understanding of the needs of the people,

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which understanding and knowledge is amplified by the judgment of their boards of directors and senior officials. Other types of financing, such as investment banking, serve a very important purpose in supplying new capital for our expanding and dynamic economy through the medium of purchase and distribution of securities, and through their association, known as the Investment Bankers Association, the composite views of this type of financial opinion can be obtained.

The insurance companies are another important factor in the financial field, both in lending long-term credit and through their purchases of securities and mortgages, while still another are the mutual savings banks, specializing in the field of mortgage lending. Both the insurance companies and the mutual savings banks have their associations through which a composite expression of their opinions and views can be voiced. As constituted today, I think the various types of lenders are most anxious to cooperate with governmental authorities in perfecting a sound monetary policy. These lending institutions, through their contacts with the public and their interest in the well-being of our country, because they cannot successfully survive unless our country is economically sound and strong, can best express themselves through these various organizations and their duly constituted committees either to committees of Congress or to the Government.

As an example, the Federal Advisory Council to the Board of Governors of the Federal Reserve System, comprised of one banker elected from each of the Federal Reserve banks, at stated periods discusses with the Board of Governors the problems that come under the jurisdiction of the Federal Reserve System. The Treasury also has committees of bankers as well as of other types of lenders who are consulted at regular intervals. Thus it will be seen that those charged with the responsibility of Government are in a position to hear first-hand from the duly constituted committees or representatives of the various organizations which I have heretofore mentioned, in regard to their views as to the needs of the Nation and the adequacy of available credit. It is my judgment that in the formulation of monetary policy the Government must take the lead after evaluating the views expressed by those in the private lending field who in their day-to-day contacts with individuals, business firms, and corporations know the financial needs of the public and have the responsibility of keeping their institutions sound while extending credit wherever necessary for productive purposes. I believe that those in Government who are charged with the responsibility of formulating monetary policy, subject to the approval of the Congress, would do well to bring in still other groups of business leaders. It would seem to me that one medium to bring about a more widespread understanding of the Government's problems would be through meetings at the regional Federal Reserve banks of bankers as well as businessmen in the respective Federal Reserve districts.

Mr. Chairman, Mr. Wolcott, and Mr. Bolling, I am thinking here when I make that last statement of an organization that was created, I think, in 1931, and which did not last too long. It did good work while it was allowed to last, and that was the banking and industrial

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committees organized through the Federal Reserve System, of bankers and businessmen back in those dark days.

Representative PATMAN. 1931?

Mr. FLEMING. 1931, I think it was, sir.

Representative PATMAN. Was there not a corporation created under the auspices or under the laws of New Jersey?

Mr. FLEMING. That I do not know, sir; I do not know about that, but this was created and organized through the Federal Reserve System.

They took the business leaders and banking leaders, and they formed committees in each Reserve district.

They had regular meetings and they reported, and they did a great deal of good work, particularly in stopping foreclosures that were going on in those days and in other ways, but it did form a composite welding of views between the two groups of businessmen and bankers.

The attempt was to try to see what the problem was, to try to pull ourselves out of that deep hole we were in, and that is what I am referring to when I mention that.

Representative PATMAN. I recall it distinctly.

Mr. FLEMING. I am thinking of something of that sort. It was allowed to die some time in 1933 or thereabouts.

I have seen examples of full and complete cooperation on the part of men who are leaders in these organizations and in their communities, such as in the establishment of the National Credit Association, organized prior to the formation of the Reconstruction Finance Corporation; the cooperation rendered by the commercial banking system during World War II and since, in assisting the Treasury in the sale of Government securities and handling the redemptions of these securities, as well as in acting as fiscal agent for the Government. Also, we should not overlook the part played by the banking system in handling the important function of ration banking during that critical period. Lastly, which I shall touch on in detail in connection with topic 2, the cooperation given in assisting in organizing and carrying out the policies of the voluntary credit restraint program under the supervision of the Federal Reserve System. So there is ample evidence that once the Government has consulted these groups, formulated policies for presentation to the Congress and they are approved, cooperation will be given by the various private lending institutions. As to the status of the private financial community as a special interest group, its primary interest is to serve and serve adequately the Nation and its people. Those in this field have become highly specialized and trained in the techniques of soundly performing the services for which they are chartered or organized, and again I repeat their interest has got to be, for their own preservation, in the soundness of the monetary policy of our Nation, otherwise they cannot succeed. As to their skills, I have tried to portray earlier in this statement the efforts made by the banking community to educate and equip its official and clerical personnel so that they can give the best possible advices, counsel, and service to our people, and it is my judgment that similar efforts are being made by other types of lenders.

Representative PATMAN. Thank you Mr. Fleming.

Mr. Woodward, would you like to comment on that?

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STATEMENT OF DONALD B. WOODWARD, SECOND VICE PRESIDENT, THE MUTUAL LIFE INSURANCE CO. OF NEW YORK

Mr. WOODWARD. Mr. Chairman, and members of the committee, I want to congratulate this committee and its staff director most warmly on the invaluable information you have collected and published. Your two volumes are a classic, and they and the hearings enrich the literature immeasurably. Everyone is in your debt. I am deeply honored to be asked to appear before a body that has so distinguished itself.

You are dealing with a subject that fundamentally influences what I believe to be the most significant development of our times. This development is the source of the unprecedentedly bountiful American standard of living, the basis for our victories over enemies in the past, the hope for successful defense against any present or future threats, and the potentiality for satisfaction for Americans in future years that will ridicule any present gloom and dwarf present optimism. I am speaking, of course, of the increasing ability of the American economy to produce goods and services, which in turn can be converted into materials to improve the welfare and dignity of man. In economic terminology we call this productivity, and measure it in terms of output per unit of the factors of production: labor, capital, the entrepreneur, and land.

To maintain present accomplishments and to realize these great potentialities of strength and welfare, we must preserve the conditions which have brought about the long and remarkable trend of rising productivity and improve if possible on any defeats.

The greatest defect, to my belief, has been marked instability in income and employment; and the possibility that sizable instability will recur is one of the greatest dangers to our future, one of the great problems of our times. The unhappy record in this regard has in large part been due to the three wars this generation has known. But imperfections in our economic organization have aggravated the instability, and changes in the nature and timing of production mean that, even though some as yet largely untested moderating devices have been established during the past two decades, the danger of marked instability hangs over us and our future.

The monetary system has powerful influence for help or for harm. The monetary system does not alone, of course, determine conditions or trends of productivity nor of instability, but it has much to do with both. Money has aggravted both boom and depression, and it can ameliorate both. I would not urge the simple quantity theory of money upon you but I certainly do believe that the role of money is far from passive.

The monetary system consists of thousands of different institutions performing many different functions. For some discussions precise definitions and measurements are needed but for the point I want to make, we may divide the system into two parts.

One part is the thousands of mutually or privately owned and privately operated banking institutions that deal with the public. Most prominent among these are the commercial banks, with credit creation, deposit, loan, and related functions of strictly monetary nature, and, in addition, major functions in savings and investment operations through savings, time, thrift, trust, and investment opera-

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tions. Beyond the commercial banks there are a variety of institutions providing financial service to the public which are greatly affected by the monetary system including savings banks, life insurance companies, savings and loan associations, credit unions, loan companies and related institutions and even individuals.

All these nongovernmental financial institutions, both banking and nonbanking, which are included in the first part of the system I am discussing, make financial service of one or more types available to the public, allocate the supply of savings and credit among claimants, compete with each other to develop better, less expensive products, and seek profit and/or better service and product for their proprietors and customers. Essentially they utilize the funds made available to them by the central monetary complex and by the saving public, and operate on the terms determined and the framework established by the central monetary complex. Their job, their complete responsibility, is to seek the greatest advantage for those they serve by operations in conformity with the ground rules.

The other part of the monetary system is the central monetary complex. This is a nonhomogeneous group of Government institutions, each established by Congress for one or more specific purposes, and each playing a role in determining the framework within which and the terms on which the private institutions serving the public operate. The Federal Reserve System is the most important part of this complex and the Treasury the next most important—I once called the Treasury the fourth bank of the United States. But significant parts in this central monetary complex are also played by the vast multipartite Government housing credit system, by the massive Government agricultural credit system, by the huge Government business credit system, and by the towering Government international monetary and financial agencies—to mention a few. Of course, Congress itself is a tremendously important constituent of the central monetary complex, through determining tax and expenditure policies, the public debt, and other public obligations, and creating or influencing the other agencies in the complex.

Each of these organizations in the central monetary complex by its policies and actions significantly influences the operation of the monetary system.

This central monetary complex in aggregate provides reserves, influences the volume of money, the availability of credit, interest rates, credit worthiness, location of funds, rates and objects of expenditure, and the quantity, location, availability, and utilization of savings.

This central monetary complex, therefore, is the critical and determining factor in the operation of the monetary system and hence the influence of that system on the economy, on productivity, and on instability. The nature and consequences of the functioning of the system are determined in this complex and not in the thousands of units in direct contact with the public.

This central monetary complex is very badly organized—if indeed it can be said to be organized at all. The policies of its constituent parts have been uncoordinated. It frequently contradicts itself from one part to another. It often works at cross-purposes within itself. Its one clear and unmistakable attribute has been confusion—and I can spell this out in detail if desired. Here is a situation that urgently wants remedying.

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The core of the problem perhaps is the definition of an appropriate monetary policy for this complex. Congress alone can supply that definition. The best general criterion would be the preamble to the Employment Act of 1946 if there were added to it a strong statement about the importance of maintaining a reasonably constant value of money. The people of this country have had much lip service to this latter objective, but determination has been sadly deficient. The robbery of the value of money which has occurred in the last dozen years should shame the conscience and disturb the sleep of every man and woman voter and nonvoter in this country, every public and private person.

Given a general guide, the constituent parts of the complex would then be able to formulate mutually consistent and coherent policies. I do not believe that imposition by authority on the constituent parts is appropriate or desirable—indeed, I am sure that any such arrangement would make the situation worse. But the problem could be solved and a great improvement achieved, if the Douglas resolution were amended to apply to all Federal agencies that issue obligations, or are involved in policy formulation of such agencies. I do not believe that any enforcement machinery is necessary or desirable, but I suggest that the Joint Committee on the Economic Report, which is serving such a very useful purpose in the whole economic sphere, might inquire into compliance from time to time.

I believe that this central monetary complex should consciously rely to the greatest possible degree upon the market place to do as much of its work as possible. Ours is a vast, complex and shifting economy and I do not believe that it can be successfully run by centralized planning. The vast mass of value judgments and personal preferences should not be decided from on high; any attempt to do so would frustrate productivity and aggravate instability.

This central monetary complex must be ingenious, resourceful, and inventive. It must work on conditions as they exist. It cannot operate successfully by rote or by formula, nor can trick gadgets do the job. Economic gadgetry has been a most vicious snare and delusion of the past two decades. Central monetary operation is an art, and not a science or a mechanism. If it is to be successful it must build on bits and pieces, orthodox and unorthodox, as are appropriate to the situation. It needs to have clear objectives and principles, but broad latitude in details.

This means that the great requirement for the central monetary complex is men and women of the very highest competence. We need to develop ways to enlist and to keep in office in the central monetary complex the very best possible men and women. They must be sought where they can be found and sought on the basis of competence. The idea of pressure group and special privilege representation is a grave error. The maltreatment of men in public office, the inadequate compensation, the abuse and vilification is a great threat to the public welfare. We have been more fortunate than we deserve in the quality of men and women in the central monetary complex, but we simply cannot afford to continue to trust to luck, nor keep on kicking that good lady in the shins. More than anything else, more than all else together, we need to make office and job holding in the central monetary complex attractive and desirable by well-trained, capable, compe-

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tent, wise men and women. Thank you. I think that completes the panel discussion on this point unless there are other comments.

Representative PATMAN. Dr. Murphy reminds me that we should have discussion at this point, if discussion is desired.

Mr. LINDOW. Mr. Chairman, I would like to comment on one of the points made by Mr. Fleming, namely, the machinery for cooperation between the financial industry and the Government.

I was in the Treasury when the various committees that he referred to were in process of being organized many years ago.

It began with the committee of commercial bankers, but it has since spread out into several fields, and I think those committees have done very valuable work. In my opinion, they should be viewed as broad advisers who can help the men in the Government who are on the firing line and, in turn, I think this is a two-way street, it is an opportunity for the agencies to make much more clear to these committees what their problems are.

It is easy for those of us on the outside to take potshots at the people who are on the firing line. As Mr. Woodward says, there have been altogether too many potshots thrown around indiscriminately. I think the consultative machinery does help a great deal to bring the outside financial people closer to the agency problems.

Mr. FLEMING. Mr. Chairman, I might say that it would be interesting to the committee to know how one committee, at least, functions, because I happen to be chairman of it. It was prior to its formalization in 1942 that Secretary Morgenthau used to call in different groups informally.

Then, 1942, when Mr. Hemingway was president of the American Bankers Association, he conferred with Secretary Morgenthau, and this committee was formalized; a group, a cross section of banking of the country, was selected. Then, of course, it has been a question of evolution, I think, and I will not take the time of the committee to review the evolution to show how it functions now.

The committee consists of about 20 bankers, representing all types, small, large, and so forth. They meet on the call of the Secretary of the Treasury.

The chairman of the committee usually confers with Dr. Haas as to the question of what statistics we should observe, we ought to know where the money is, where the securities are held, and so forth.

Well, after that is set up, the first thing the committee does is meet in the projection room of the Treasury, and there, for about 2 hours, reviews these statistics. A beautiful job is done by Dr. Haas and his staff. I say that because two gentlemen here used to serve on that group, Dr. Murphy, and also Dr. Lindow. Our committee is given complete information in a question-and-answer discussion. That orients the bankers group in the governmental picture at the start.

Then, we meet with the Secretary and his staff, and he outlines the problems that he has in front of him, and what he would like us to deliberate upon and report to him.

The next thing that happens is the committee goes into executive session. But since we received permission from Secretary Morgenthau to have the Chairman of the Board of Governors and Open Market Committee sit with us (because there are two sides to this picture, and the Open Market Committee has an important function once the securities have been sold)—since those days, the Chairman

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of the Open Market Committee or the Chairman of the Board of Governors has always appeared before our committee in executive session, and very freely and frankly discussed their viewpoints.

Now, getting that composite viewpoint, the committee then goes into executive session again and makes its report and files that report with the Secretary the following day.

Now, that is an example of how that takes place. They are pretty well oriented, and after the committee has served for some little time they become pretty nearly as familiar with these statistics of the Government and the problems of the Government as even the gentlemen who are on the technical staff of the Treasury.

Now, I mention that because I think it is a thing that can be fanned out into business groups, and this is what already has been done in the Treasury; they consult investment bankers and consult other groups. I think this has got to be, and this whole thing is, a cooperative effort of playing ball together. We have got a dangerous situation in the world, and I think every person has got to remember, first, that he is an American, and that we have all got to play this game together and abide by the rules that are finally determined on and approved by the Congress.

Representative PATMAN. Thank you, Mr. Fleming.

Mr. Reierson? Mr. Tapp, does anyone want to comment on the first question?

Mr. TAPP. Not on the first one.

Representative PATMAN. Mr. Woodward, I wish you would elaborate more fully on this central monetary complex being badly organized, if you would.

Mr. WOODWARD. Last week Mr. Powell gave one evidence of the point in his discussion when he was before this committee, of the conflict between the voluntary credit regulations and the issuance of housing securities by the public housing agencies.

During a considerable part of the time, since the end of the war, there has been a chronic conflict between the expansionary operations of the housing agencies and the attempts to curtail inflation, curtail the volume of credit, by the Federal Reserve, and there are a number of talks by the Federal Reserve authorities which I would be glad to provide—I do not have them with me, but I expect many of you remember them as well as I, about the frustrating effect on monetary policy through the housing expansion.

This is, of course, not the slightest suggestion that better housing and more housing is undesirable, Mr. Chairman, for the American people. We need more and better housing, and more and better of a lot of things, but when we try to do too much at once we find ourselves with scarce resources and hence in an inflationary situation.

Another example than the housing is in the area of agriculture, where there has been considerable expansion in the volume of loans and in the volume of money on account of agricultural price support.

Now, again, I want to be clear that I am not taking a position against agricultural price supports; that is a different question. The point is that agencies in the Government are pursuing, have been pursuing, frequently conflicting objectives, for perfectly understandable reasons. There is nothing wicked or malicious about it, but there has been conflict on the matter of monetary policy.

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Mr. TAPP. I feel I would have to disagree somewhat with one of my associates on this matter of price support.

Representative PATMAN. We will be glad to have your viewpoint.

Mr. TAPP. I think if you look into the situation you will find that price supports have not been a very important factor in the level of agricultural prices during the war or postwar period, except in a few cases where it was necessary, where it was considered necessary, to place the supports at a relatively high level in order to encourage production, such as soybeans, flax, and a few other items; but, generally speaking, the prices of agricultural products which are, of course, subject to support, have been, during the real inflationary spurts, higher than the support prices for other reasons.

Mr. WOODWARD. I think that probably is a fair statement, but the agricultural operation has nevertheless increased the volume of money over what it would otherwise have been, whether it would be, in your opinion, small or large.

Mr. MURPHY. I just wanted to congratulate Mr. Woodward on doubling the potential field of participants in monetary policy by his consistent reference to men and women. I highly approve of his two-way approach which endeavors, on the one hand, to reduce the confusion and, on the other hand, to make it more enjoyable.

[Laughter.]

Representative PATMAN. Mr. Bolling, would you like to ask some questions?

Representative BOLLING. I would like you to go a little further into the problem of how we possibly can coordinate more effectively the complex without at the same time going any further than you suggest in your statement.

Now, for example, take the question of housing, the housing policy that is followed is essentially a policy of Congress with a social objective, and very clearly it can come in conflict with the Congress policy on monetary objectives which have, at the same time their own social implications.

The obvious social implication is that inflation hits a certain group of people.

What is the technique that you would have in mind for any practical manner of implementing most effectively the policy of the Congress in, let us say, the social objectives and, at the same time, holding down the bad effects that it might have on the monetary objectives, with their social implications?

Mr. WOODWARD. The chief proposal, sir, that has been discussed, has been the creation of a domestic equivalent of the National Advisory Council on International Monetary and Financial Problems, and that proposal, as you know, was made by the Hoover Commission and, I believe, was discussed here in previous hearings.

I am loathe to go that far for the very reasons that I suspect you have apprehension, if I detect the implications in your questioning. This might serve to put more of a strait-jacket than would seem to me desirable, at least as a first try, on the agencies to pursue their quite differing objectives that Congress intended. I should rather see a try made by a congressional directive in the form of an expanded Douglas resolution, asking them all, directing them all, to follow in those of their operations which are relevant, Federal Reserve monetary policy. They would thus make their interpretation, and would them-

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selves decide how best to reconcile any conflicting objectives, and the Joint Committee on the Economic Report could and should discuss compliance.

Now, in the case of the housing agencies, if I may make one more point, as I say, I am exceedingly sympathetic to the desirability for housing, but we do not really improve housing by carrying on inflation and limiting the ability of a great many people to buy houses. This may alter the allocation of resources, but does not improve housing.

The housing agencies might still pursue their objectives essentially as Congress has set them forth, but with some limitation in their drafts on materials during inflationary periods. The chief agencies have considerable latitude in the establishment of interest rates; they both have considerable latitude in their appraisal policies and, I think, they would be found to have latitude in other matters of terms. They could tighten up a bit as a restraint on inflation, without necessarily going to an extreme of curtailment.

Representative BOLLING. You do not feel that that has been done to any great degree whatsoever in the last 2 years?

Mr. WOODWARD. Virtually none. The Federal Housing Administration at one point did increase its rates from 4 to 4¼ percent. The veterans' rate has not been changed from the peg of 4 percent. It is interesting that that is the pegged rate that has not been broken, whereas the pegged rate on the Treasury's securities was broken. I think they have done very little during the last 2 years.

Representative BOLLING. What specifically do you think they should have done, aside from the interest?

Mr. WOODWARD. I think they should have followed tougher appraisal policies, as well as interest.

Representative BOLLING. That is all on that point.

Representative PATMAN. Mr. Lindow.

Mr. LINDOW. I would like to say a word about the proposal to set up a council within the Government to discuss monetary and fiscal problems. I think such a council is needed. It was recommended by the Douglas report a couple of years ago; it was recommended by the Hoover Commission; and now it is recommended by Secretary Snyder, who says that he suggests the creation of a—

> small consultative and discussion group within the Government, to consist of the Secretary of the Treasury, the Chairman of the Board of Governors, the Director of the Budget, the Chairman of the Council of Economic Advisers to the President, and the Chairman of the Securities and Exchange Commission. I would have this group meet informally but regularly and frequently for the purpose of discussing domestic monetary and fiscal matters with each other.

I am reading from Secretary Snyder's recommendation. He continues:

> Heads of the lending agencies would be called in for these meetings from time to time when the discussions involved their programs.

Now, as I understand this idea, it visualizes a discussion of the whole range of budget and monetary policies, including spending from whatever source that may be encouraged through Government action, whether it is by loans or insurance or direct Government spending.

I think that such a council would be helpful. Some persons have expressed the view that it would weaken the independence of the

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Federal Reserve to be included. I do not quite see that, and I am myself in favor of Federal Reserve independence.

It seems to me that, if the Federal Reserve independence were in some way under attack, the attack would proceed whether there was any such council or not; and, if the Federal Reserve is as able and strong as it should be, then I do not see that sitting down in a council is going to jeopardize its independence one single bit.

I do not see that when equals sit down at a table to discuss common problems the position of any one of them is jeopardized.

Now, perhaps I should note at this point that many variations of the council idea are possible, and questions may be raised as to whether it should confer with the President, whether it should report to the Congress, or whether it should be purely an informal discusion group. I should think that such questions could be ironed out perfectly well without interfering with the independence of the Federal Reserve in any way.

So I would like to reiterate I think that this subcommittee ought to back the idea of the council, as it did in the Douglas report 2 or 3 years ago.

Representative BOLLING. Mr. Chairman, would it be perhaps appropriate for us to get a round-up on this from the other members of the panel?

Representative PATMAN. Yes. I did not believe they wanted to comment. You see, they have other questions.

Representative BOLLING. I realize that, but I think this is a very important question, and I wonder if we could elicit comments on this particular question.

Representative PATMAN. About this particular point about the over-all coordinating group?

Representative BOLLING. Advisory council.

Representative PATMAN. It is very interesting. Would any of you other gentlemen like to comment on it?

Well, we will pass on to the next question.

Mr. Wolcott.

Representative WOLCOTT. I should like to, if I might, ask Mr. Woodward if he thinks the creation of this council, as suggested by the Secretary of the Treasury, would alleviate the condition which, as he brings out, exists at the present time in respect to the marked instability in income and employment. Just by way of background, I might state that most of us were members of the so-called Douglas committee of 2 years ago. My memory was that we suggested an advisory council merely as an ancillary to the problem, but we did not offer it as a panacea for the major problem. We recognize that debt management was our major problem. Of the council, which has been suggested by the Secretary of the Treasury, all of them would be members of the executive establishment excepting the Chairman of the Board of Governors of the Federal Reserve System.

I wondered if we could remove any of the influence which debt management has on the Federal Reserve policies by the creation of such an advisory council principally within the executive establishment?

Mr. WOODWARD. Well, sir, my apprehension is that, in the establishment of such a council, the Federal Reserve System would be put under more pressure from the executive department.

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I have served on a great many committees—I think sometimes far too many—and the inevitable tendency is to seek agreement and, when there is an issue of much moment, to push very hard for agreement, and any member of any committee under such circumstances is consequently pressed quite far.

I should rather, at least as a trial, see them all operating under a policy directive by Congress, from Congress, and coming back to Congress, the Joint Committee on the Economic Report, to discuss any problems that arose.

I would myself rather leave open until after that experiment the question of whether some more formal machinery would need to be established of the kind you are discussing.

Representative WOLCOTT. Thank you.

I recall that I dissented in two particulars in that report. In my dissent I said that I joined—

> in recommending the creation of a national monetary and credit council but disagree with the recommendation that it should be headed by the Chairman of the Council of Economic Advisers. In his opinion, this would concentrate too much power in the Executive over the volume and cost of credit. He recommended, instead, that the chairman of the credit council be a person of neutral interests removed as much as possible from the direct influence of either the Executive or the Federal Reserve Board. He also agrees that periodic reports should be made to Congress by the council.

Representative PATMAN. Are you through?

Representative WOLCOTT. Yes.

Representative PATMAN. Question No. 2: How successful has the voluntary credit restraint program been? What should be its role over a longer-term period? Has the treatment accorded State and local governments been more rigorous than that accorded private business firms?

Mr. Fleming, would you like to comment on that?

Mr. FLEMING. Mr. Chairman, Mr. Wolcott, and Mr. Bolling, I feel that first I should mention that, as a forerunner to this program, the American Bankers Association in December 1947 organized and put into operation early in 1948 a voluntary credit-restraint program when the country was undergoing inflationary pressures and it seemed desirable to dampen down extensions of credit, particularly for speculative purposes and nonessential in character. This program received the approval of the President of the United States, the Secretary of the Treasury, and leaders of both Houses of Congress. However, it only pertained to banks and was undertaken by the then president of the American Bankers Association, Mr. Joseph M. Dodge, president, Detroit Bank, Detroit, Mich., who, you will recall, served as financial adviser to both General Marshall and General MacArthur. Thirteen pilot meetings were held in strategically located cities throughout the United States, where the necessity for holding down credit extensions for speculative or nonessential purposes was explained to the bankers present at very fully attended meetings.

Subsequently these meetings fanned out into similar meetings held at the State and county level and had a very helpful effect during that period. Therefore, there was some background of experience when consideration was given to the present voluntary credit restraint program provided for under section 708 of the Defense Production Act

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of 1950, the President having delegated his powers to the Board of Governors of the Federal Reserve System for execution. After consultation with various types of lenders, it was felt this program could be more effective than the program undertaken in 1948 by the American Bankers Association because it would encompass a larger field of lending. The voluntary credit restraint program presently in operation was organized after consultation with and approval by the Board of Governors of the Federal Reserve System and the Attorney General of the United States, and after consultation also with the Federal Trade Commission. It became effective in March 1951, and representatives of commercial banks, investment banking, insurance companies, mutual savings banks, and building and loan associations were appointed to the national as well as the regional committees organized throughout the Nation. The Honorable Oliver S. Powell, member of the Board of Governors of the Federal Reserve System, was placed in charge of the program, and in my opinion the program has been very effective in holding down inflationary pressures and confining lending to loans for the defense effort or essential to the civilian economy.

These regional committees, comprised in each region of representatives of the five groups I have mentioned, screen such applications for loans or security offerings where the lending institution or the investment bankers committee had reason to believe that it was not essential to the defense effort and the civilian economy but were speculative or inflationary. In my opinion the program has been very helpful in dampening down nonessential credit extensions. It is difficult to evalute dollarwise, however, the amount of credit which might have been applied for and granted had this program not been in effect, because, through the dramatization of the program in the press and otherwise, would-be borrowers have been retarded from approaching lending institutions, for their knowledge of the program indicated to them that applications not conforming to the provisions of the program would be declined. There has also been a byproduct, making all types of lenders conscious of their responsibility to do their part in holding down extensions of credit for speculative or nonessential purposes.

As to what should be the program's role over a longer-term period, my answer is that as long as we are in a defense economy, with the vast expenditures that must be made for armament and with the need to maintain full civilian employment to keep our economy on a high level, the program should be continued, as it is one of the most helpful instruments for holding down inflationary pressures. It has the advantage of flexibility without the rigidity of special controls. I think even at some future time, when our expenditures need not be so enormous as at present, it would be well to have it borne in mind that the program could be reactivated if in these changing times it should appear necessary to make use of the program to combat a return of inflationary pressures in our economy. Its educational value has been extremely good, and the program has had very hearty cooperation from the Honorable Charles E. Wilson, Director of Defense Mobilization, who, through a committee of the Business Advisory Council of the Department of Commerce, brought to the attention of industry the necessity of doing their part in the program. This was construc-

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tive, as the borrower should understand the program as well as the lender. This, together with the dramatization by bankers and other organizations through the press and other media, has, in my opinion, made both the lender and the borrower aware of the necessity, in these difficult times, to be guided by the sound principles of the program.

As to the question, "Has the treatment accorded State and local governments been more rigorous than that accorded private business firms?", in my opinion, while this type of borrowing is somewhat different than that of the private borrower, I do not know of any cases where State or local governments have been denied permission to sell their securities except in instances where the funds to be obtained were to be used for purposes not essential to the defense effort or the civilian economy. I do know of cases where bonus issues of State or municipal governments were disapproved by the investment bankers committee of the Voluntary Credit Restraint Committee, but these were cases where, following disapproval, investment bankers did not bid on the securities. These issues were not for productive purposes and would only have added to inflationary pressures by pouring more money into the hands of the public. It is also my understanding that toward the close of 1951 the Municipal Finance Officers Association of the country passed a resolution approving the principles of the voluntary credit restraint program and gave assurances to the national Voluntary Credit Restraint Committee that they would cooperate with respect to the flotation of any securities nonessential, postponable, or inflationary in character.

I brought with me, because I know something about the Fifth Federal Reserve District committee—I know their work very thoroughly—I brought with me some of their annual reports, which I thought I might pass on to the committee to see what is being done.

I also have a few other examples here. That is the annual report of the fifth district committee and their little organ called Lending, Ltd.

I might also add——

Representative WOLCOTT. That is significant.

Mr. FLEMING. Yes; the name chosen purposely—Lending, Ltd.—every bank is asked to fill out a weekly form, and I also will pass out some of those forms to the committee.

Representative PATMAN. It is a very impressive report.

Mr. FLEMING. Well, you will find also in the back a questionnaire to test what was going on.

Representative PATMAN. I wonder how you would feel about voluntary restraint of credit which is now limited through regulation W?

Mr. FLEMING. Mr. Chairman, that is a different—I think that is a different type of situation. Regulation W regulates certain articles, such as automobiles, televisions, things of that sort. This part of the program does not bear on regulation W, because it encompasses every type and description of applications for credit that can be made in the whole complex economy that we have.

Representative PATMAN. But last year I noticed the installment credit on automobiles actually reduced after the credit terms were liberalized. Is that not rather significant to the people involved? Are they themselves trying to——

Mr. FLEMING. I think, generally speaking, Mr. Chairman, most of what I would call the sound lenders on articles covered by regulation

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W more or less continued to apply that. Regulation W was done away with—the lapse, as you will recall—I think they have more or less followed those principles of regulation W that we had in the law.

Representative PATMAN. I'm not talking about—it was just liberalized, as I understand it.

Mr. FLEMING. I do not quite understand that.

Representative PATMAN. On Regulation W, I say the terms on automobile paper were liberalized, not done away with.

Mr. FLEMING. Yes. Well, the act lapsed, you will recall.

Representative PATMAN. Yes, I do.

Mr. FLEMING. I am referring to the period after the act lapsed. I think, generally speaking, that the sound lenders—of course, there are always some that would extend out—but I think the more sound lenders were not too overliberal, I mean, in their extension of terms.

Mr. MURPHY. You are speaking now of the period of 1949 before Korea, is that right?

Mr. FLEMING. Yes, I am speaking of the period before Korea; I am speaking of the period between the time that the regulation, regulation W, lapsed by——

Mr. MURPHY. And when it was reinstated after Korea.

Mr. FLEMING. I was just thinking of the period in between that.

Representative PATMAN. I am not talking about that period now. I am talking about the year 1951 after the terms were liberalized by the Defense Production Act last year.

Mr. FLEMING. That was by the act of Congress.

Representative PATMAN. The amount of paper actually decreased in volume from then to the end of the year, automobile paper—that is my understanding.

Mr. FLEMING. I think that is correct.

Representative PATMAN. And if that is true, is that not a strong indication that the people who are involved in this are extremely anxious not to grant terms that are not justified in business?

Mr. FLEMING. Of course all the automobile manufacturers are pretty anxious not to have a mortality of dealers. They want to hold their good dealers, and I do not think they force too many cars on them.

Representative PATMAN. I know, but you are talking about the chartered dealers, we will say. I am talking about all dealers, second hand dealers and all; and the uneconomic concern, the fellow who, in other words, is too unsound, he would not stay in business long, would he, Mr. Fleming?

Mr. FLEMING. No. I think also, Mr. Chairman, that the question of the law of supply and demand had a lot to do with that tapering off.

You will bear in mind that shortages of World War II were very fresh in the minds of the people, and everybody that could buy an automobile or some gadget bought them at that particular time and, I think, a kind of saturation point was reached.

Representative PATMAN. We have a number of questions here, and I will not insist on discussing that too much, but do you not think we should give real consideration to a voluntary restraint program there, the same as the other, with respect to regulation W?

Mr. FLEMING. I think it could be tried, but I doubt if it would be quite as effective as the present regulation.

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I might go further than that and say this: If we were not in a defense period I would be in favor of the abolition of regulation W. I think it is only an instrument that should be used in a period where we are either in a war economy or a defense effort, such as we are in now.

Representative PATMAN. However, to one group we say it is all right to have voluntary restraints, and to another group we say we have got to regiment them.

Mr. FLEMING. I recognize that; but I don't see how it is humanly possible to issue regulations without damaging the economy very greatly, where every kind and description of credit is applied for, as contrasted against specific articles. Every type of thing that keeps the economy ticking is applied for in connection with the other loans that would be encompassed in the voluntary credit restraint program.

Representative PATMAN. Just a few major ones there.

Mr. FLEMING. No, sir. Every type of credit in the world comes up under that. If a fellow wants to enlarge a chicken farm, and another has his mortgage down on an apartment house he owns, and he wants to increase the mortgage on that and buy another building, well, that is usually declined because that is inflationary; it just pours more money out.

Representative PATMAN. Well, variety is on the side of voluntary credit restraint, too. You have not got as many different types of loans as you could receive on it.

Mr. FLEMING. I think the principal difference, as I stated before, is that regulation W attacks the specific article for sale, the voluntary credit restraint program encompasses every type, as I have described, of credit that is applied for.

Representative PATMAN. I see.

Without objection, we will insert, sir, the report of the Fifth District Commercial Banking Voluntary Credit Restraint Committee at this point.

Mr. FLEMING. You might also have the form that you get the report on.

(The documents referred to follow:)

LENDING, LTD., FIFTH DISTRICT COMMERCIAL BANKING VOLUNTARY CREDIT RESTRAINT COMMITTEE

BALANCING FACTORS IN 1951

Inflationary:	Deflationary:
Defense expenditures	Federal taxes
Nondefense spending	Central bank action
National income	Voluntary credit restraint
Near-full employment	Regulations U, W, and X
Bank credit	Consumer savings
Currency circulation	Increased production
Materials-scarcities	Peace moves

YEAR-END REPORT

The Fifth District Voluntary Credit Restraint Committee was organized on April 25, 1951, as part of the national program for action against the rapidly rising and dangerous credit spiral which war in Korea brought from mid-1950 onward.

The committee has now been functioning for the better part of a year. At the outset, it would like to offer sincere congratulations to the great majority of the banks in this district for their support and patriotic motivation in the voluntary

credit restraint program. Manifestly, it is important that all banks work together in a project of this nature, since failure to do so would create competitive advantages and disadvantages which would inevitably destroy an unselfish, cooperative movement. The committee would also like to review, for the benefit of the many interested lenders throughout the district, the facts concerning its original organization and functioning during the period April 1951 to year end. And it would also like to give cooperating banks a frank preview of its thinking regarding credit problems and possible developments in 1952.

Nineteen fifty-one—with its semiwar and defense planning environment superimposed upon a major civilian boom—brought into action a wide variety of both direct and indirect controls. Here we are concerned with the part played by one of these indirect controls, the voluntary credit restraint program. Voluntary credit restraint both nationally and districtwise was conceived as an experiment in restraining loan expansion and as a supplement to other anti-inflation measures. In such a setting, it is obviously impossible to weigh accurately the influence of the voluntary program, though the evidence clearly indicates that it has exerted an important influence on inflationary lending through cooperation of bankers.

While the idea is not novel (voluntary credit control was an American Bankers Association project in 1948), the organization and method of operation have been unique in American lending practice. To your committee, the program has as its base the twin appeals of self-interest and patriotism, that is, preservation of the individual and the Nation from the danger of being consumed by serious credit inflation. It has been described, and we believe accurately, as typically American, since it relies on voluntary cooperative effort. While no one would claim perfection for the plan, either in intent or operation, it does seem to go to the heart of the inflation problem, namely, the expansion of money supply which, in the American banking system, is typically through expanded deposits, created as a result of loans or investment expansion.

Furthermore, its basic appeals have been directed to the relatively free segments of the economy—the financial. Here the intent has been to suggest a pattern for actions of many types of lenders to which they would apply the acid test of productivity, particularly productivity of loans for defense and essential civilian purposes (as contrasted with inventory and other speculatively tinged advances) in an economy whose resources may not be capable of meeting the voracious credit needs of heavy and continued civilian demand plus the extraordinary military requirements projected.

In this setting, the principles of voluntary credit restraint have been offered as a guide, and the committee an interpreter of the border-line cases. Fortunately, we believe, the soundness of its basic premises and techniques, plus the attitude of avid cooperation by many lenders, large and small, has been frequently demonstrated during the months in which it has operated. Numerous committee meetings have been held—typically through the medium of the weekly "telephonic round-table." Data have been disseminated through biweekly publication of Lending, Ltd., on cases involving queries and judgments (both favorable and unfavorable), and hypothetical situations for the guidance of interested credit men.

Your committee endeavored, during this early period of organization and operation, to aid in contributing, in the basic sector of credit granting, to the reduction of inflationary pressures. Fortunately, in the second half of 1951 the "inflationary heat" diminished considerably.

Looking back, voluntary credit restraint is glad to have had a part in inducing this unexpected, though perhaps temporary, return to stability. During the last quarter of 1951, average prices were as nearly stable as they have ever been in modern American business history. Indeed, the variations for the full year 1951, a year which was almost unanimously forecasted to be one of heavier and more dangerous inflation, have been less than 5 percent from high to low, and thus constitute a modern record for price stability.

Many analysts have paid tribute to the voluntary program's contribution in this respect, while recognizing that other forces were also operating in the same direction, namely, central bank action (such as requiring higher reserves and "pulling the peg" on Governments), direct controls on prices and wages (which have functioned "lightly"), and the sharp shift in consumer spending habits from a rush-to-buy to a distinctly Scotch attitude that doubled the savings rate during the year.

In any event, the program may well have created some new credit attitudes and shifts in policy that, in future, will prove exceedingly valuable in this highly

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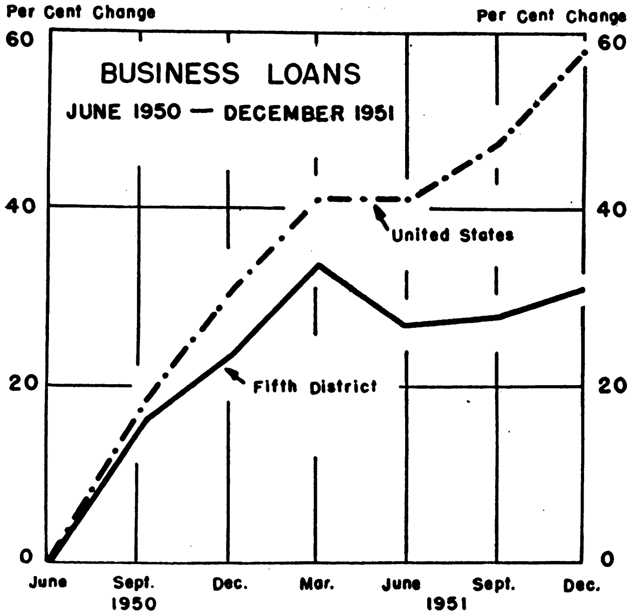

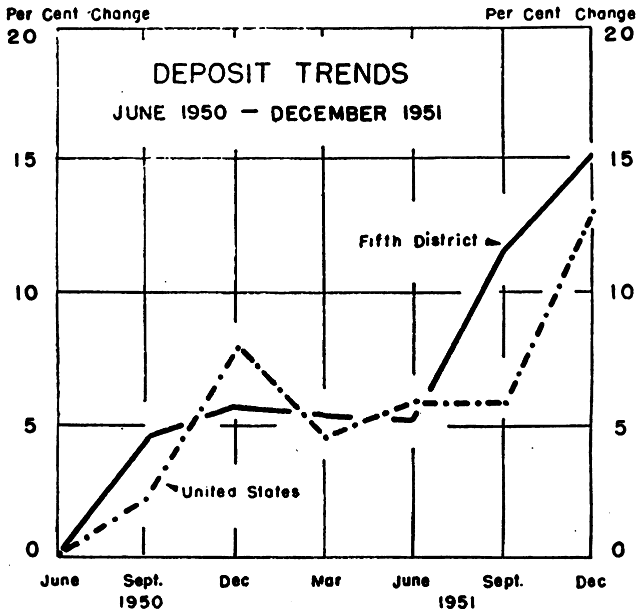

abnormal era. As Governor Powell, of the Board of Governors of the Federal Reserve System, recently described it, the voluntary credit restraint program has offered private lenders an opportunity and an interesting and practical challenge by (1) fostering a spirit of caution and restraint in general lending policies—especially in credit fields not suited to selective credit controls; (2) channeling the supply of credit into the defense program and essential civilian activities; and (3) giving bank loan officers new benchmarks for use in prudent appraisal of loan applications by relating them to desired stabilization, on the one hand, and undesirable speculation and inflation, on the other.

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RÉSUMÉ OF 1951

In 1951, fifth district business activity continued at or near record levels. Bank debits, a useful indicator of over-all spending, for the full year increased from $54.9 billion in 1950 to $63.6 billion, or 16 percent. Interestingly, this district's figures compared with a 12-percent national increase. Industry, with the exception of textiles, which were a depressing factor, especially in the Carolinas, was quite active. Manufacturing employment reached its peak during the fall months, and was within 4 percent of its all-time high of wartime 1943. Department stores in the district sold, in dollar volume, approximately 4-percent more than they did in 1950—the previous record year.

From spring on, consumers unexpectedly reversed their buying habits, forgot the sprees of mid-1950, and early 1951, adopted a more rational buying attitude, reduced their debts, and accumulated still higher liquid assets.

Fifth district member banks during the year saw their demand deposits rise from $4.7 billion to $5.1 billion, an increase of 8.5 percent. Time deposits, which barely held their own in 1950, increased by 4.5 percent, and the rate of net redemptions of savings bonds diminished.

Inventories, which had been relatively high in the early part of the year, were gradually worked down to lower levels, with the result that the year-end position appeared to be more reasonable, although textile inventories continued to be an exception and still a subject of some concern. The keynote to inventory policy during the last half of 1951 was definitely one of caution, with purchases on a short-term (30 to 90 days) basis.

Materials shortages during 1951 could hardly be described as serious, despite much talk on the subject. Shortages of certain materials, notably construction, existed but did not seriously restrict residential construction during the year. Here the major factors were undoubtedly the shortage of funds, the influence of regulation X, and the credit-control program of the monetary authorities—as well as voluntary credit restraint.

The net effect of these curbing influences is shown in the business-loans chart, which indicates clearly that credit expansion in the fifth district was at a slower rate than that occurring in the Nation as a whole.

Apart from unusual activity in aircraft and shipbuilding, Baltimore and Newport News, and the Savannah River, S. C., atomic-energy development, no sharp change took place during 1951 in the level of defense activity, and hence in defense-supporting loans in this district. From May through mid-December these loans, as reported by classifying banks, totaled only $7 million; and a similar situation existed in the case of V-loans, with only 46 applications, totaling about $16 million, received up to December.

Farm income in the fifth district rose approximately 17 percent during 1951. Since farm costs apparently increased a lesser percentage, it is estimated that net farm income increased about 20 percent.

WHAT ABOUT 1952?

As far as price inflation is concerned, 1952 begins on a more optimistic note than did 1951. A year ago, the BLS wholesale price index was moving up sharply from week to week—actually, it increased 11.4 percent in the first 6 months after the Korean outbreak and another 5 percent from January through March 1951, a total of 17 percent in 9 months. Fortunately, the sharp rise continued only through the first quarter of last year, and a moderate price decline occurred during both the second and third quarters. Throughout the fourth quarter prices remained remarkably constant, on a high plateau but some 4-percent under their spring peak. The causes for such an unexpected reversal will probably remain a subject for debate, but the more reasonable ones have already been stated. What is important now is their future course.

The business situation, both in the district and nationally, is admittedly a mixed one. For some months, however, it has been in a relatively neat balance, despite the growing defense program, advancing Government expenditures, dislocations in materials, and shortages in skilled manpower. This neat balance, however, is certainly a delicate one—and it could tilt either way.

Your committee, as it looks out on the uncharted year 1952, feels that the pause in the uptrend from early summer of 1951 to year-end was primarily due to three factors: (1) The heavy case of "inventory indigestion"—which the past 6 months have considerably reduced; (2) the failure of the defense program to maintain previously announced schedules of rapid expansion; and (3) the decline in consumer buying previously described.

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Each of these situations appears susceptible to relatively rapid change—time has a way of "eating up" inventories of all types and, interestingly, requiring consumers to buy whether they are frightened or merely normal. It becomes increasingly clear that the defense program has emerged from its "birth pains" and early blueprint stages and is now well through the tool-up stage so that the end products will begin to roll much more rapidly within the current year.

Specific elements in the developing business outlook for the district in 1952 are as follows:

(1) Industrial construction contracts, though trending downward for the past 6 months from a record level, are likely during 1952 to assure a substantial volume of work—due to expanding defense outlays.

(2) Employment in the district, which has been on a near-full basis, is likely to become tighter rather than easier in the coming year, since any cut-backs in the private economy are likely to be offset by the expanding military construction program.

(3) Agriculture, the district's major industry dollarwise and jobwise, has just closed a very successful year; and 1952 is expected to show little change. Emphasis is to be placed on the plans for crop expansion by 3 to 5 percent and a possible increase of another 5 percent in farm expenses, with the result that net farm income will probably vary little from last year's figure. At its existing level, it is a powerful contributor to high-level business in the district.

(4) Retail trade, which has been in an uptrend in recent months, should continue on a high level through 1952, with dollar sales keyed to advancing consumer income and up possibly another 5 percent.

(5) Materials shortages, which have been a headache here and there, are neither widespread nor critical in the fifth district; and the lag in defense production schedules seems to indicate that cut-backs for this reason will occasion no real problems in the district during the forthcoming year.

While admitting that the 'economic visibility is low," your committee is impressed with certain definite influences on the national economy—for these filter into the district economy. They include the almost inevitable coming increases in wages, employment demands, and projected advances in Government expenditures to still higher levels. In the committee's opinion, all lenders should note that, despite the various and sundry restrictions of the past year and the sizable decline in civilian consumer spending, money supply has continued to expand, even during the lull of the past summer, and currently stands at a record-high level of more than $190 billion. Bank loans, though held well in check in the fifth district, have continued to expand in the over-all, and business loans nationally also stand at a record total.

Under these conditions, it appears difficult, if not impossible, to argue that inflation is not a continuing threat and that it is only an academic problem. Granted that the galloping inflation of a year ago seems to have been nipped in the bud—either through the combined efforts of direct and indirect controls of one type or another or the self-control evidenced by the majority of the consuming public—or both—the fact seems to be that another upsurge could well occur during the second half of 1952. This reasoning is frankly predicated on two assumptions: (1) the near balance, on a cash basis, in the Federal budget for the first half of this calendar year (due to much heavier tax take and an off-schedule defense program); and (2) the definite return of deficit financing on a relatively large scale during the second half of the calendar year.

According to the committee's reasoning, therefore, it clearly behooves us as bankers to continue to screen loans carefully and in conformity with the principles of the voluntary program. We should probably do well to continue to consider ourselves as part of the "fire department"—if loan volume, out of which money supply is largely derived, can be prevented from increasing sharply, and if consumer self-control with respect to spending habits were by some sort of magic to continue, there will be no "big fire" on which to pour the water of restriction. In such a situation, you and the committee would undoubtedly be grateful for the lack of need for restraint. A realistic analysis of previous business history, however, seems to indicate that periods of stability are both rare and short-lived, and are almost inevitably succeeded by further up-surges, given the delicate balance of the present and unbalancing factors that are, unfortunately, in prospect.

In its first letter, dated April 27, 1951, to the banks of this district, it was stated: "Your committee firmly believes that this is an unparalleled opportunity for banking, on a purely voluntary basis, to serve the national interests in a

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critical period and, at the same time, to protect the private banking system." These sentiments appear to be just as valid today as they were in April of last year.

TABULATION OF ACTIVITIES

Up to December 31, 1951, your Voluntary Credit Restraint Committee has handled 143 cases, involving nearly $9 million. The statistical recap is, of course, merely an indication of the interest expressed, and the requests represent loan applications about which doubt existed. Together with Lending, Ltd. cases, these requests provide interesting evidence of genuine solicitude. The accompanying table gives a breakdown of requests by type and amount:

Recapitulation of requests through Dec. 31

Favorable	54	[1] $5,011,300
Unfavorable	53	[1] 2,354,250
Beyond scope of program	21	930,875
Conditionally approved	9	483,000
Total	137	
Hypothetical cases	6	
Total	143	8,779,425

[1] No specific amounts contained in 5 requests; consequently, dollar figure not increased.

The year-end figures show total loans and discounts of fifth district member banks at $2,041,000,000. The comparable figure for the April 9 call date was $2,026,000,000. Total loan expansion, therefore, was $15,000,000 for the period. Since cooperating banks reported that a total of $28,000,00 in loans had been declined in substantially the same period, the figures offer further tangible evidence supportive of the program.

During December, the committee formulated and mailed to all banks in its area a questionnaire designed to provide information as to how effective its functioning had been, and inviting suggestions as to improvement of its program for voluntary action. More than 300 banks responded to the VCR questionnaire and the results were as follows:

FIFTH DISTRICT QUESTIONNAIRE

1. Do you feel that the voluntary credit restraint program is functioning effectively in your area?
   - 88 percent of replying banks felt that the program was functioning effectively in its area;
   - 3 percent felt it was only partially effective;
   - 2 percent said it was not at all effective;
   - 6 percent did not answer the question.
2. If not, what are the obstacles and what suggestions have you for overcoming them?

Only 2 percent listed obstacles, which included fear of losing customers, the fact that all banks are not complying, Government spending, and lack of public information about the program. Suggestions included: public information campaigns and enforced participation of all banks.

3. What is your estimate (or actual record, if maintained) as to the number— and amount $—— of loans declined by your bank in cooperating with the voluntary credit restraint program?
   - 55 percent of the banks responding noted a total of 3,500 loans, aggregating more than $28 million, had been declined.
   - 4 percent said no loans had been declined;
   - 10 percent failed to answer the question;
   - 31 percent stated that no records were kept and gave no estimates of loans declined.
4. Are the case study examples in Lending, Ltd. of helpful assistance?
   - 88 percent described Lending, Ltd., as helpful;
   - 1 percent said it was not helpful;
   - 11 percent failed to answer the question.
5. Have you any suggestions or ideas for inclusion in Lending, Ltd.?
   - 65 percent had no suggestions for inclusion in Lending, Ltd.;
   - 6 percent wanted more case studies;

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1 percent offered such suggestions as data on VCR activity in other districts and elimination of nonessential spending by Government;
28 percent failed to answer the question.

6. What can the committee do to be of more effective assistance?
   42 percent said they knew of nothing the committee could do to increase its effectiveness and several added they thought a good job was being done;
   6 percent suggested more public education on VCR principles;
   4 percent made varied suggestions, such as "require banks to sign an agreement to comply with the program," "stop Government spending," and "stop Government Agency lending";
   48 percent did not reply to the question.

Reporting Form Used by the Fifth District Commercial Banking Voluntary Credit Restraint Committee

F.R. 416a

Budget Bureau No. 55-R183

PRINCIPAL CHANGES IN COMMERCIAL AND INDUSTRIAL LOANS

Week ending Wednesday, ______________, 195__ Page No ____

Instructions

Loans to be listed are commercial and industrial loans made to or repaid by borrowers with active lines of more than the minimum requested by the Federal Reserve Bank. These are the large non-agricultural loans included in item 1-a of the weekly condition report, form F.R. 416, and included in item 1 of schedule A of the call report. Renewals may be included or omitted if the purpose of the loan is unchanged; **if the purpose does change, please enter as two items, a repayment and a new loan.**

Business of the borrower should be taken from the table below. If more convenient, item numbers may be used instead of full descriptions, for example, 1-a to indicate a manufacturer of food, liquor, or tobacco.

1. Manufacturing and mining
   a. Food, liquor, and tobacco
   b. Textiles, apparel, and leather
   c. Metals and metal products (including machinery and transportation equipment)
   d. Petroleum, coal, chemicals, and rubber
   e. Other manufacturing and mining
2. Trade
   a. Wholesale
   b. Retail
3. Commodity dealers
4. Sales finance companies
5. Public utilities (including transportation)
6. Construction
7. All other types of business

Purpose of the loan should be taken from the table below. Please allocate mixed-purpose loans where possible. Item numbers may be used instead of full descriptions.

1. For financing defense contracts (including loans to prime and sub-contractors for defense contract inventory, working capital, plant, and equipment)
2. For financing defense-supporting activities (including loans required (1) for production or expansion of productive capacity of essential basic materials (steel, copper, coal, petroleum, etc.), or (2) by railroads, gas and electric utilities, other transportation, communications, and public utilities)
   a. Plant and equipment
   b. All other
3. For financing non-defense activities
   a. Inventory and working capital
   b. Plant and equipment
   c. Retirement of non-bank debt and preferred stock
   d. All other

Please total new loans and repayments listed and show net increase (+) or net decrease (—)

Net change in listed loans $__________,000

Net change in total commercial, industrial, and agricultural loans (item 1-a in weekly condition report, form F.R. 416) $__________,000

If these changes are in opposite directions or if they differ by more than approximately 25% of the smaller figure, a brief comment on the cause of the difference will be appreciated.

PLEASE MAIL THIS REPORT BY THURSDAY TO
Research Department
Federal Reserve Bank of Richmond
Richmond 13, Virginia

Bank Stamp

Business of borrower	Purpose of loan	Amount of loan (thousands)	
		New loan	Repayment
Total of this page			

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MEMBERS OF COMMITTEE

Members of the Fifth District Voluntary Credit Restraint Committee for commercial banking are as follows:

ARCHIE K. DAVIS (chairman), *Senior Vice President*, Wachovia Bank & Trust Co., Winston-Salem, N. C.
HULBERT T. BISSELLE, *Senior Vice President*, Riggs National Bank, Washington, D. C.
THOMAS C. BOUSHALL, *President*, The Bank of Virginia, Richmond, Va.
J. PHILLIPS COLEMAN. *Vice President*, First and Merchants National Bank, Richmond, Va.
JOHN S. ALFRIEND, *President*, National Bank of Commerce, Norfolk, Va.
EUGENE L. MILES, *President*, Baltimore National Bank, Baltimore, Md.
ERNEST PATTON, *Chairman of the Board*, Peoples National Bank, Greenville, S. C.
N. L. ARMISTEAD (secretary), *Vice President*, Federal Reserve Bank of Richmond, Richmond, Va.

Representative BOLLING. Mr. Fleming, in the present voluntary credit restraint program, the criteria within the very general statement of the Congress are, in effect, established by the lenders who serve on the various city committees, regional and national, is that roughly true?

Mr. FLEMING. Well, the program is based upon the background of experience of what happened in the first 6 months or 7 months of 1948, and the general principles are, of course, that any loan that aids the defense effort or is necessary to sustain the civilian economy should be granted, but loans are to acquire inventory, an excessive amount of inventory, or for speculative purposes, which would simply add to the money supply and not be productive, are usually declined.

Now, just how many of those loans, dollarwise, there are that have never been applied for through the grave realization of the consequences by the public—because it never has been dramatized—they have never been applied for; nobody can tell you that.

Representative BOLLING. The point I am getting at, without in any way arguing the merits or demerits of any bonus issue, is that the actions that have been taken on the bonuses—I think there have been a couple—have been an interesting demonstration of the thing that concerns me very much.

The bonus, to become authorized, has gone through the democratic process of the given state, either by action of the representatives, a referendum or some other way, and the bonus in that particular state has been authorized, without arguing whether it is good or bad, that is what has happened. The effect of a turn-down under the voluntary credit-restraint program has been to put in the hands of people who may not be concerned with the social objectives, the power to veto a legislative act achieved through democratic process.

Now, that is an illustration of the thing that I think could be very serious.

For example, the criteria of the lenders might be that it was unnecessary to take the steps required to float an issue for school bonds for the construction of schools, for the construction of hospitals, and the question that concerns me very deeply in this is, Is a voluntary group of lenders the proper agency to establish criteria which have, in effect, an impact in the area of social welfare? I wonder if it is not possible—and certainly preferable, in my judgment—for the criteria in a general way to be established, perhaps, by the Congress?

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Mr. FLEMING. Well, the provisions are not too tight. It is simply the principle of whether they are for the defense effort or for the civilian economy.

Representative BOLLING. Well, it is very easy to——

Mr. FLEMING. Not speculative.

Now, a bonus issue, regardless of the social issue, does not create anything. It simply puts more money in the hands of certain people. It may be desirable from a State situation, but not necessarily desirable on a Nation-wide basis.

Representative BOLLING. Everything that you say however, could be very easily argued in relation, I suspect, to the establishment or replacement of schools or hospitals, of a number of other things. It would be a matter of value judgment.

Mr. FLEMING. If there has been any case where it has been necessary like schools or hospitals, and things like that, I do not know of any such case, sir; there may have been, but I do not know. The only cases that I know of are bonus issues which did not produce anything other than to put more money in the hands of a certain group.

Now, no matter how worthy it would have been for that group to have had it, it would add to the inflationary pressure.

Representative BOLLING. As would a school, for example; as would the construction of a school.

Mr. FLEMING. I think that is a little different. I think we need all the schools we can get, sir. I think the more we can be educated, the better we are going to be.

Representative BOLLING. I certainly agree with you, but the question that still concerns me is if it is wise to leave in the hands of the people, most of whom, I am sure, would agree with you on schools and other things, a decision which is essentially a decision which should be made by the people either represented in Congress or in the State legislatures by a broad democratic process rather than in a relatively narrow field.

Mr. FLEMING. Well, the conflict comes between a program looking at the picture from a Nation-wide situation of money supply as against the particular desire of a given municipality or State. But I do not know, again, sir, of any issue that has come to my attention—I am not an investment banker so I do not know all the cases. The only ones that I know of were bonus issues of States where the credit restraint committee of the investment bankers felt it was inflationary, and did not meet the purposes of the program, did not produce anything, just put more pressure on the money supply and, in turn, the price structure and, therefore, they did not look with favor on it, and the result was that the investment bankers did not bid.

Mr. REIERSON. Mr. Chairman, may I make a comment with reference to the point made by Representative Bolling that the lending criteria are established by the lenders who serve on the various committees. I should like to point out that the statement of principles under which the voluntary credit restraint program operates was approved by the Board of Governors of the Federal Reserve System. Lending criteria established under the program must agree with this statement of principles. Furthermore, the voluntary credit restraint program operates under the authority expressly granted by the Congress in the Defense Production Act of 1950.

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The lending standards set forth in the statement of principles are couched, necessarily, in general terms. The application of these general standards to various types of financing is achieved by means of bulletins and other communications issued by the national committee. Flexibility must be maintained in order to adapt lending criteria to changing economic conditions or to take action in various areas when indicated. Thus, the first bulletin issued by the national committee dealt with the financing of inventories. It was put out at a time when inventory accumulation was proceeding at a rapid rate. The second bulletin dealt with the financing of business capital expenditures. Subsequent bulletins have covered State and local financing, real-estate financing not covered by regulation X, and financing in American markets by foreign borrowers. It would not be feasible to rely upon action by the Congress to establish lending criteria in view of the need for adapting the program to the needs of a changing economic and financial situation.

Most of the proposed State and local issues turned down under the program fall into one of three major classes.

The first class consists of bonus issues. On an economic basis there is little justification for bonus issues under conditions of inflationary pressures. The Director of Defense Mobilization, early in May 1951, addressed a letter to State and local governments in which he urged the postponement of financing, if possible. Bonus issues were specifically mentioned as examples of postponable issues.

The second type of State and local financing turned down under the program consists of issues for the acquisition of privately owned utilities by Government bodies, which involves borrowing to replace equity capital. Financing of this type is specifically covered in one of the bulletins issued by the national committee. Incidentally, these are the types of loans that lenders are turning down in the private field.

I have done a little checking with lending officers as to the types of loans they have been turning down in the business field. On practically every list I have seen loans for the purchase of going concerns, or for the purchase of an interest in a going concern, represent types of loans which the lenders have been loath to make under the conditions of the recent past. Thus, it appears that State and local borrowers have been subjected to substantially the same type of screening of proposed financing that prevails in the case of private financing for the purchase or sale of existing properties.

The third class of State and local issues turned down under the program consists of issues for public improvements, such as parks or recreational facilities, which could be postponed without interfering with necessary public services. I do not recall a single instance in which the financing of necessary facilities, such as hospitals or schools, has been turned down under the program.

Representative Bolling. Of course, the point I am getting at is that this is a very clear demonstration that if monetary policy is carried to a certain degree it serves as a veto on the legislative enactments of cities, counties, States, and, conceivably, the Congress itself; and I am concerned about that more in terms of its future possibility than I am in terms of the present situation. But it seems to me that we are very clearly establishing, if we follow this policy through to its logical conclusion, an absolute veto by monetary authority on legislative enactment which, I think, is an extremely curious situation.

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Representative PATMAN. Really it is not monetary authority, Mr. Bolling; it is just this voluntary group of people who are interested in some instances—they are going against their own interest, of course—but people who are not part of a real legally constituted monetary authority.

Representative BOLLING. I certainly agree with you, Mr. Chairman. The only point was that I was extending it to a higher level, the relationship, the potential relationship, of the Federal Reserve Board to the Congress.

Representative PATMAN. That is right. Without reference to the type of loan that was made by a State, I think it is a very serious matter for a group to attempt to tell a State, "Now, you did wrong, and we are going to try to keep you from getting the money." I think it is all right to say, "In the future, you should not do this," or try to persuade them not to do it, but where the action has been taken and the legislature and the voters of the respective States have approved it, I think it is a very serious question; I am not taking a stand on it. But it occurs to me it is worthy of a lot of consideration on the part of the group.

Now, what about new businesses? Are new businesses permitted under this voluntary restraint committee?

Mr. FLEMING. Well, if it is for productive purposes, yes.

Representative PATMAN. Well, suppose it is distribution, not productive purposes?

Mr. FLEMING. If it is essential to the civilian economy. We plan to try to do two things: We are trying to build our defense efforts as quickly as we can, and also trying to keep our civilian economy at a high level, and if it was aiding in the civilian economy, I think it would be approved.

Representative PATMAN. Suppose it is a local grocery store or a filing station?

Mr. FLEMING. I do not know of any loan around this area of that type that has been declined, sir.

Representative PATMAN. In other words, if it is needed in the community; but who determines the need in the community? You know, in some parts of Europe, the competitors have to determine it.

Mr. FLEMING. I know every loan that is applied for does not go before the voluntary restraint credit committee of the area. It is in the judgment of the bank that is approached. Here is a case like what you mention here. Here, I have got an absolute case, if I can locate it——

Representative PATMAN. We have a case here which was disapproved, where a pharmacist wanted to buy a drug store, and that was disapproved as unnecessary.

Mr. FLEMING. Well, of course, I could not pass judgment on individual cases.

Mr. MURPHY. The basis of the disapproval was that there was an existing drug store.

Mr. FLEMING. There was not any need of another one.

Mr. MURPHY. It would not have added another one; he was acquiring existing facilities.

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Mr. FLEMING. Well, the theory was there that it was putting money into the hands of the person that sold it.

Mr. MURPHY. That is right.

Mr. FLEMING. And he could use it for other purposes, and put more pressure on the price structure.

Representative PATMAN. Suppose a person needed to sell out, though, such as if there was an estate involved or bad health, or something like that, and he needed the money?

Mr. FLEMING. I do not believe that under circumstances such as those surrounding it, that the bankers would decline that.

Mr. TAPP. Mr. Chairman, I might say that in our district, at least, they do approve loans of that character where it involves settlements of estates, factors like that.

Representative PATMAN. I felt that would be like that.

Mr. FLEMING. Mr. Chairman, here is an illustration showing that small banks are participating, as well as large banks. This is the First National Bank of Ceredo, W. Va. This is addressed to the credit restraint committee of the Fifth Federal Reserve District, and is as follows:

GENTLEMEN: We have an application in the amount of $12,000, the purpose of which is to erect new poultry broiler building and equipment for same for the purpose of increasing production in an existing plant in this immediate area. The new buildings and equipment when completed would increase the annual output of broilers to 80,000 from the present capacity of 36,000. All of these broilers are sold locally and insofar as we can see the business has no connection with the defense effort. It is expected that the loan would be retired over a 3-year period from the profits accruing from the increased production.

We have handled this account for several years and so far it has been satisfactory although the income has been nominal. We have told the applicant that we are of the impression that this type of loan would not be approved by your committee; however, we would like your committee to pass on same advising at your earliest date.

Bear in mind that an officer, a representative of the Federal Reserve bank, sits as a member and is secretary of each committee. These records are all public, and in this case, Mr. Armistead, who is vice president of the Federal Reserve Bank of Richmond, is the secretary, and this is his reply after the committee's determination:

It was a pleasure for the committee at its meeting this morning to consider the proposed loan described in your letter of February 6.

The operator's plan to increase broiler production is large in a relative sense and would be considered contrary to the principles of voluntary credit restraint were it not for:

1. The purpose would enable an increase in the food supply;
2. An increase in such production would tend to restrain the price rise in this field;
3. The proposed expenditure would quickly enable this increase in production.

For these reasons the committee feels that the loan would be in harmony with the program.

I only offer that as an illustration.

Representative PATMAN. That is a production loan which is good.

Mr. FLEMING. That is a production loan. Now, this bank had some doubt——

Representative WOLCOTT. Mr. Chairman, may I suggest to Mr. Fleming that his answer to question 3 in this little pamphlet might throw some light on this question.

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Mr. FLEMING. That is a tabulation of the activities of the questionnaire—oh, yes, it does answer it.

Mr. Wolcott calls my attention to the questionnaire that the fifth district committee sent out, and specifically question 3:

What is your estimate (or actual record, if maintained) as to the number and amount of loans declined by your bank in cooperating with the voluntary credit restraint program?

The answer is:

55 percent of the banks responding noted a total of 3,500 loans, aggregating more than $28 million, had been declined.

Four percent said no loans had been declined; 10 percent failed to answer the question; 31 percent stated that no records were kept and gave no estimates of loans declined.

Mr. REIERSON. Mr. Chairman, may I make one further comment?

Representative PATMAN. Yes, sir.

Mr. REIERSON. May I make an observation with reference to the point raised by Mr. Bolling as to whether the voluntary credit restraint program might, in effect, veto the legislative enactment of the Congress by preventing financing. The statement of principles specifically provides that "This program would not seek to restrict loans guaranteed or insured, or authorized as to purpose by a Government agency, on the theory that they should be restricted, in accordance with national policy, at the source of guaranty or authorization." This provision has, in fact, given rise to some criticism of the program by lenders. A number of lenders have raised some question as to the propriety of trying to restrict private credit under the program at the same time that public housing bonds were exempt from being screened under the program.

Representative BOLLING. I wonder if it has been pointed out to them that proportionately the public has been reduced more than private.

Mr. REIERSON. That I would not know, sir.

Representative PATMAN. Shall we go on to the third question?

What is the responsibility of banking institutions for the economic development of their communities? Should banks, as a long-term proposition, be more venturesome in undertaking lending risks? Has a lack of venturesomeness on the part of banks contributed to the growth of Government lending agencies? How does this apply to the special problems and inflationary hazards of the present defense period?

Mr. Tapp, would you like to discuss that?

STATEMENT OF JESSE W. TAPP, EXECUTIVE VICE PRESIDENT, BANK OF AMERICA

Mr. TAPP. Yes, Mr. Chairman. First, I want to express my pleasure at being here. I will not repeat the question as it has been read.

The "dynamic economy" which we all seek in this country is one which, among other things, affords opportunity for the steady and constructive employment of our productive resources in ways which contribute to community and national well-being. Banks can and do play a vital role in making it possible for the communities which they serve to utilize their productive resources most advantageously. The banks of a community serve as depositories of much of the liquid

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funds of their customers and as such are in a position to extend credit to those credit worthy customers who are in a position to use such credit in the expansion of the production or distribution of goods and services.

For example, the local farm implement dealer suddenly finds that his customers are in need of a newly developed but expensive piece of equipment such as the mechanical cotton picker. His needs of credit for "flooring" such equipment for his customers in advance of the harvest season is greatly increased. But a wise use of credit will benefit both the dealer and his farmer customers. Likewise the cotton grower who finds it desirable to shift from hand picking to machine picking may need credit for one, two, or even three seasons in order to invest $10,000 in a modern mechanical cotton picking unit. The progress which has been made in the rapid mechanization of many branches of our agriculture over the past several years has been aided greatly by the wise use of bank credits of this general type.

Another example is the small radio parts or electrical supply manufacturer with a proven record of special skills who finds it possible or even necessary to shift to extensive subcontracting for the fabrication of some important defense item to which the skills of his management and employees are adapted. But such a shift will call for a new financial program and a new schedule of credits from his bank. In such circumstances most bankers will see that the customer's credit needs are met even though it may involve some risk, some reliance upon an assignment of amounts due under the contract, a temporary equipment lien or perhaps the paper work of a "V" loan.

Similar examples could be cited with respect to all types of small business engaged in production, manufacturing, processing, wholesaling and retailing at the local or small community level as well as in larger centers of activity. Credit wisely used for such transitional needs in connection with the continuous progress of our flexible, and ever changing economy certainly speeds up the productivity of our economy and adds to its dynamic character.

Banks generally tend to have the same attitude toward their borrow customers that other businesses have toward their customers. They want to take care of their legitimate credit requirements as they arise. In their efforts to do this bankers have made changes in their lending procedures and practices over the past two decades. Business loans of banks now quite generally include a great variety in types of loans in addition to the customary unsecured seasonal line of credit. Some of these lending techniques have been originated by banks and others have been adapted from the specialized lending experience of other credit agencies. Loans supported by the pledge of accounts receivable or by inventories held under field warehousing arrangements have been used extensively in recent years and have been particularly helpful to business in the medium and small size groups and especially to rapidly growing business units. Of special value to small business units has been the increased use of term loans which are amortized over a period of years. A great deal of plant and equipment modernization and extension by small businesses was financed by such term loans extended by banks after World War II. In these and a variety of other ways banks are continuously trying to set up loans for their customers which will meet the requirements of

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safety in lending and at the same time add to the productive potential of their customers and their communities. In addition we should not fail to mention that the character loan is still an important factor in loans which are available to individuals and small enterprises and the management factor must be given proper consideration in connection with all types of loans, large and small.

In our own area the great growth of recent years has presented a challenge and an opportunity to provide credit for small business which we have tried to meet in a variety of ways including a very extensive use of term loans to small business set-up on a regular amortization basis and a small business advisory service which undertakes to provide small business units with the best available information and training guides designed to indicate some of the problems to be overcome in the development of a successful small business.

As a long-term proposition the responsibility of banks for the economic development of their communities will not require that they be more venturesome in undertaking lending risks in terms of the Webster definition of "venturesome" which mean "inclined to venture, daring, risky, involving hazard, dangerous." It will depend rather upon a constructive and creative approach to customer credit problems, upon continued progress in the development and adaptation of appropriate lending procedures which enable banks to meet legitimate customer needs within a sound lending policy.

In the broad field of installment credit lending the problem of "lending risks" has been met in part by the establishment of rate patterns which on the basis of long experience provide for the calculated risks involved in handling a volume of credits of this character. Banks serving large areas of diversified risks may find greater opportunities for developing or adapting lending services to meet what might be regarded as more venturesome loans than could be undertaken without such diversification and broad coverage.

Bank credit cannot properly be substituted in any significant degree for "venture" or "risk capital" as such. Much of the credit extended by governmental lending agencies has been in the category of risk capital. This was true of much of the RFC lending in the 1930's. It was characteristic of the loans made by the Federal Farm Mortgage Corporation and of most of the loans being currently made by the Farmers Home Administration. Most of the capital loans made by such agencies involved a degree of risk or terms and conditions which commercial banks are not expected to undertake.

Undoubtedly there have been occasions when Government lending may have been substituted for private bank credit because of overcautiousness on the part of banks, particularly during the depression years. But this is not a characteristic of the present situation and has not been generally true for the war and postwar period.

Some governmentally sponsored agencies are in direct competition with commercial banks and are handling credits which banks could handle were it not for the subsidy feature contained in the interest rates charged by the quasi-governmental agencies.

In still another category is the Commodity Credit Corporation which makes nonrecourse price supporting loans which are not appropriate for banks to make except as they may act as agents for the Commodity Credit Corporation.

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The making of low interest rate home loans with a maturity of 20 years and more has been facilitated through the insurance or guarantee features of the FHA and VA. Certainly commercial banks should not be subject to criticism for failure to provide such loan terms and conditions without Government intervention, particularly in view of the scale of such home financing requirements in recent years.

The present defense period confronts bankers with a special challenge to see that their lending activities make a constructive contribution to the community and the economy as a whole. This they are attempting to meet by focusing attention on the provision of credit for the defense production and defense supporting industries. It should be emphasied that these are not narrow categories. They include very large segments of our economy, the whole range of raw material production and distribution activities, food processing, transportation, etc., etc. In fact, in the absence of full-scale war it is generally recognized that a vigorous civilian economy will contribute directly to the success of the strictly defense segment of the economy and indirectly to the maintenance of a highly productive economy which is best able to stand whatever shocks an outbreak of full-scale war might present.

This means that bank credit must be used with restraint in relation to any activities which produce avoidable speculative pressures, but it may at the same time be used with vigor where necessary to get production of an essential character.

At the present time also banks can and are, through their contacts with individual and corporate customers, exerting a constructive influence toward the build-up of "savings" in various forms which, in turn, is helpful in reducing inflationary pressures on the economy as a whole.

Representative PATMAN. Mr. Lindow, would you like to comment on this subject?

STATEMENT OF WESLEY LINDOW, VICE PRESIDENT, IRVING TRUST CO.

Mr. LINDOW. It is a real pleasure to appear before this subcommittee to participate in a panel discussion. You have made a fine contribution in publishing the two volumes based on the answers to your questionnaires on monetary policy and the management of the public debt. Now as to the present question, the banks constitute a reservoir for savings on the one hand and a credit pool on the other hand. Each bank tends to view itself as a service agency for its customers, either in the sense of taking care of their money for them or in the sense of making loans to them. The customers, therefore, fall into two distinct groups, that is, depositors and borrowers, although many customers are found in both groups.

The typical bank management views itself as being under obligation to its depositor customers to protect their funds and handle them wisely, and to its borrowing customers to take care of their future needs on the basis of two hypotheses: (1) that the financial status of the customer meets agreed conditions, and, (2), that the credit control operations of the monetary authorities do not make it impossible for the bank to carry through.

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A borrowing customer develops a relationship to a bank such that both parties understand where they stand, the customer knowing that the bank will lend him a certain amount under certain conditions and the bank knowing that it must reserve some of its lending capacity for the customer. Sometimes this is formalized into a definite line of credit; sometimes there is a tactic understanding between the parties; sometimes one party may be anxious to increase loan volume while the other party is reluctant—or vice versa—depending on conditions, but the important point is that the banker wants to take care of his borrowing customers in essentially the same way as any other business wants to take care of its customers. There is always competition to acquire new customers by taking them away from the other fellow, and customers are sometimes lost to the other fellow by misunderstandings or other difficulties.

Moreover, each bank is always trying to get more deposit customers and more deposits from existing customers and if it succeeds it will thereby have more loan funds to take care of its borrowing customers. Competition is going on continually for both kinds of customers.

Each bank has an orbit of influence, sometimes limited to one community, sometimes extending over the whole country and, in fact, even into foreign countries. It may thus contribute to economic development over a vast area wherever it has customers. It will try to do the best it can to help these customers in every way. Competition keeps it on its toes. If it doesn't take good care of its customers it will lose them and if it does take good care of them it may get a larger share of their business and develop still new customers. In answer to the first question, therefore, I would say that banking institutions feel a very great responsibility for meeting the needs of their customers and that this in turn is the means by which economic development is facilitated—whether it be in a local community, in a national industry, or in foreign trade.

But should banks as a long-term proposition be more venturesome in undertaking risks? The answer here is probably "Yes and no". The "Yes" part is that banking should be fluid and develop new techniques, as has been done heretofore, to best meet the needs of the economy. The "No" part would be that banking should not try to go so far as to provide venture capital or anything resembling it—at least in the present type of banking traditions and institutional organization.

Banking has changed a good bit over the years. The original concept of commercial lending was the self-liquidating loan, which, as for example in the case of inventories, would be quickly paid off as the goods were sold. Today banks go way beyond this concept in financing their customers. One notable development has been the wide-spread use of term loans. Something like one-third of all business loans today are term loans which mean that they have maturity dates running beyond 1 year. A study of the Federal Reserve System made in 1946 showed that term loans had maturity dates spread out over periods as long as 10 years, and sometimes even more.

Bankers feel a very deep obligation to meet the needs of their customers. Most of them try to be open-minded and to move with the times. If a new type of loan arrangement is desired, they try to meet it. Sometimes they can do this best locally or sometimes they can

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work out a cooperative arrangement in conjunction with other institutions, i. e., either other banks or insurance companies to find a package arrangement for the customer.

On the other hand, banks should not be too venturesome. They should not provide risk capital or loan substitutes for risk capital. They must exercise prudence in protecting depositors against excessive risk. This means that some people may sometimes feel that banking institutions are not venturesome enough. Obviously the line between a proper banking risk and one that is not proper is very thin and wavering and subject to the differing judgments of different people. Competition between institutions is an important factor in this connection. One bank may go further than another. This is as it should be and is in tradition of our American competitive system. The more venturesome bank may blaze a path which others may follow later on, but, as far as I can tell at the present time, the commercial banks are not subject to much criticism for neglecting any large segment of potential customers. Charges of this kind that are made from time to time usually relate to so-called small business and investigation frequently shows that the demands which are not being met are not suitable for bank loans but call for risk capital.

Now we come to the question of whether a lack of venturesomeness by banks has contributed to the growth of Government lending? The answer here is that many Government agencies, notably the RFC, make loans which the commercial banks do not and should not make. I am not prepared to say how far Government institutions should go in making such loans, or indeed if they should make them at all except in depression or war periods. But I am convinced that private institutions entrusted with depositors' funds must use sensible, realistic, and hard-headed standards in determining the eligibility of loans. Assuming that the Federal Reserve does not tighten the reserve position of member banks too drastically, competition between commercial banks will see to it that most appropriate loan demands are met.

In the present situation the operations of Government lending agencies ought to be severely curtailed. The program designed to expand economic activity in a depression should be cut back severely or eliminated entirely in a boom. Everything ought to be put on ice that is possible so that in the event of depressed economic conditions later on projects can be undertaken which might be suitable to help lift economic activity. I think that one one of the greatest problems the Government faces is to find ways of turning on and off its programs in an appropriate way to help meet the problems of the business cycle.

Representative PATMAN. Are there any questions or is there any discussion on that point?

Representative WOLCOTT. Mr. Lindow, would that not apply as well to Government-created credit as well as private-created credit, credit over which the Federal Reserve in its indirect controls, has some juisdiction?

Mr. LINDOW. I am not sure that I understand you. You are not thinking of the public debt, you are thinking of credit assistance to private borrowers?

Representative WOLCOTT. Manipulation of bank reserves, rediscount rates, and things of that kind.

Mr. LINDOW. Oh, yes. We should use all the tools in the kit in a situation like this. I mean fiscal, as well as monetary measures which may be suitable.

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Representative WOLCOTT. I have thought that we set out to create inflation in the thirties to lick the depression, and that we continued it throughout the Second World War to help finance the war, and we are considering now getting off it, and I would like to know if we should not give some consideration to reversing the processes of making money available.

Mr. LINDOW. I think Government insurance and credit assistance is a very serious problem. There may be institutional lags that explain these things, but it seems to me that we do not move fast enough to get the programs going when depressed conditions come in, and we do not know how to turn the Government machinery off after we do not need it any more.

I come back again to this idea again that greater coordination of Government programs is needed, and that is one of the reasons why I favor the idea of a national council to work on such problems.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. The basic decision that we have made, apparently, in terms of meeting this particular variety of semipeace, semiwar defense economy has been to expand our production in such fashion that we would maintain a high level of civilian consumption and, at the same time, produce the hardware and, more important, perhaps, as the program is designed to produce the enormously expanded productive capacity which could be turned on to produce the hardware in the event that the situation became more difficult.

Do you believe that that basic decision is reconcilable with the point that you have just made in feeling that the Government intervention, if you want to put it that way, in the field of credit availability could be turned off? For example, would you throw into that category an indirect technique such as the certificates of necessity for accelerated tax amortization program?

Mr. LINDOW. Well, my position is this: We should try to get as much production as possible because production determines the standard of living and production is itself a potent anti-inflationary weapon. At the same time, we should try to hold the level of demand for goods down to the point where it can be met without putting upward pressure on prices. We need to use all available tools to restrain demand. We will make less mistakes and do a more effective job if we turn each valve a little bit at a time than if we try to get dramatic results by concentrating on one valve. In other words, I see no reason to focus attention exclusively on monetary policy in examining the inflationary situation in the last couple of years, and I think that monetary stringency might have curtailed production which would have made things worse rather than better. Later on, in connection with another question, I intend to make the point that we should not criticize our national economic tools too much for what happened after the Korean war began because I do not think that the available tools—monetary, fiscal, direct controls, or otherwise—are suitable to cope with violent changes of public psychology. I do not think you could have really stopped the great demand for goods which developed after the Korean war started simply by turning some valve somewhere a little bit in Washington or in the Federal Reserve banks. It was not that kind of a problem.

In solving inflationary problems, I think we will have to rely on all measures we can to try to whittle demand down to meet the highest

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level of production we can induce, and to work in every way possible to increase the level of production as much as may be feasible.

Mr. FLEMING. Mr. Chairman, do you not think that the subject we are discussing here is that we are a little impatient in trying to turn the spigot on and off too fast? It is not possible, in my opinion, in a democracy.

Representative PATMAN. In other words, we cannot have that thermostat control in our economy.

Mr. FLEMING. I do not think we have in that way. If you take the atmosphere, as I recall it, prior to the surprise attack in Korea, at that time Congress, and I think quite wisely, increased the guarantees of veterans' loans up to $7,500. That was to stimulate them to acquire more housing. This was prior to Korea, and you will recall that Senator O'Mahoney had given a great deal of study and work on a bill to create capital banks to be set up through the Federal Reserve System, and the banks were to be allowed to buy stock in that, and ultimately the directors were to be elected by the owners of these banks, but to be under the direction of the Federal Reserve System.

Now, that all indicated an atmosphere that the Congress certainly—and Congress is certainly a great listening post so far as the economy of this country is concerned—felt that possibly we might need some few more props.

Then, all of a sudden, Korea hit us, and again the people with their minds attuned to the shortages of World War II, said, "Well, we are going to be in an out-and-out war," and they rushed in to buy, and with the liquid assets the people had from their buying of savings bonds and other savings, I do not think you could have stopped it that fast within 30 or 60 days, to save your life.

It is one of the ills, maybe, of a democracy, but I do not think we want to give up our freedom for a temporary ill.

Representative PATMAN. We have two more questions: Number 4, to discuss the various inflationary factors in recent years in relation to the role of bank credit. How has the price level been affected by changes in the money supply? What has been the role of bank loans in the postwar inflation and, particularly, in the inflationary movement after the Korean attack?

Mr. Reierson, would you like to discuss that one, sir?

Mr. REIERSON. Thank you, Mr. Chairman.

STATEMENT OF ROY L. REIERSON, VICE PRESIDENT, BANKERS TRUST CO., NEW YORK CITY

Mr. REIERSON. Since the end of Warld War II, we have experienced two waves of inflation—one from 1946 through 1948, the other after the outbreak of war in Korea. Our most serious economic problem has been how to cope with inflation. In the field of credit policy, this has given rise to two knotty questions: (1) How has the price level been affected by changes in the money supply? (2) What has been the role of bank loans in this inflationary environment?

I am submitting to your subcommittee, Mr. Chairman, a document in which these questions are considered in some detail. For my oral statement, I shall limit myself to a brief summary. The charts to which I shall refer in my oral statement are shown in the formal document before you and will, I presume, be included in the record.

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With regard to money supply and price inflation, I should like to make the following observations:

(1) The relationship between commodity prices and the volume of money is not simple, nor is it consistently reliable (chart 1). Prices may decline, as in the 1920's, while the money supply rises, and vice versa; or prices may rise sharply with a relatively stable money supply, as in the years after World War II. But by and large, the past two decades have demonstrated that a large increase in the money supply has been followed by a very substantial rise in prices, although over the long run prices have risen far less than the amount of money outstanding.

(2) The main cause of the huge increase in the money supply was the financing of Treasury deficits through the commercial banking system in the prewar and war years. The end of World War II confronted the economy not only with a huge backlog of demand for housing, automobiles, machinery, equipment, and the like (chart 2), but also, as a consequence of deficit financing, with a tremendously increased supply of accumulated liquid assets. Consumer buying power was further increased by the constant rise in civilian employment in the postwar boom and the rapid increase in wage rates (chart 3, upper section). The result, naturally and inevitably, was higher prices (chart 3, lower section). Although the money supply in the years 1946–48 was quite stable, the rate of turn-over rose significantly (chart 6); thus, the price inflation in these years reflected largely the more intensive use of the money supply created by the deficit financing practices of earlier years.

(3) The 1950–51 inflation (chart 9) was touched off by the outbreak of war in Korea, which immediately brought greatly increased worldwide demands for commodities, the expectation of an international rearmament boom, the prospects of a war economy with its controls and its scarcities, and the fear of world war III. The money supply increased relatively modestly; although bank loans rose sharply, bank holdings of Government securities declined. A much more important factor in the price boom was the increase in the rate of turn-over of this large volume of money. Thus, here again the large money supply created through the deficit financing of earlier years contributed to the inflation.

(4) The moral of our two postwar inflations is that large Treasury deficits, and the increase in the money supply which their financing customarily entails, constitute the greatest single threat to the value of the dollar. This danger is insidious because of the delays that sometimes occur between increases in the money supply and the consequent effects upon prices. In the 1930's, these delays were due to the large volume of unemployment and idle capacity; during the war, they were due to controls and wartime psychology. But if we wish to avoid inflation, we must avoid fiscal excesses.

I shall now turn to the rôle of bank loans in these two periods. In both the postwar inflation of 1946–48 and the post-Korean boom of 1950–51, bank loans expanded rapidly. Did this expansion contribute significantly to the price increases? It is noteworthy that the percentage of bank loans to gross national product (shown on chart 10) was lower in 1951 than in the depressed and semidepressed 1930's. There are a number of considerations which indicate that our inflationary ills are not due to the profligate use of bank loans:

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(1) In contrast to Treasury deficit financing, which increases the money supply without adding to the supply of goods available to consumers, bank lending is generally closely associated with production and business activity. Business, in the modern economy, is done largely through the use of credit, and if production is to expand, credit must be available to finance the increase in inventories and the higher volume of trade. Admittedly, credit extended even for such purposes facilitates spending and therefore may generate some immediate upward pressure upon prices. But this is an inevitable part of the productive technique: before output can be raised and sold, business must first gather and pay for the materials, the labor, and the equipment. And to do this, it needs credit.

(2) A further distinction is that whereas an expansion of the money supply through Treasury deficit financing tends to be frozen into the credit system, additions to the money supply that result from bank loans, especially bank loans to business, tend to keep pace with the increase in the volume of goods and tend to contract if production declines. Businessmen borrow only if they can put the money to work, and repay the debt when they no longer need the funds.

(3) In the immediate postwar years, 1946 through 1948, bank lending was necessary to facilitate the resumption of civilian production (chart 4). Even though many businesses and individuals had accumulated large holdings of liquid assets in the war years, these were not always well distributed in the light of postwar requirements. Bank lending on real estate was of large proportions in the early stages of the building boom but tapered off when other lenders entered the field in volume. Bank loans to business helped fill the inventory pipelines and bring goods back on the shelves, even though bank loans provided only a small part of the funds used by business in the postwar years (chart 5). Probably no major boom in our history developed so little speculation as the 1946-48 period.

(4) In the post-Korean boom, there apparently was more speculative activity than in the earlier period. However, most of the price-raising forces were outside the field of bank lending: The variety of these forces is indicated on chart 7; they include the boom in world commodity markets, the increase in business spending on plant and equipment, peak levels of residential building, the consumer buying spree and, very importantly, the boosting of prices and wages in anticipation of price controls and wage stabilization which Government spokesmen so generously heralded in advance. Bank loans had little or no bearing upon these developments. Only one major type of demand was importantly financed by bank loans (shown on chart 8); this was the accumulation of business inventories. However, inventory accumulation was not excessive as measured against current sales and anticipated needs in the fall and winter of 1950–51. And when, with the help of bank loans, a substantial increase took place in inventories and output, this contributed greatly to the easing of inflationary pressures in the spring of 1951.

What are some of the conclusions of these observations? An inflationary environment poses real problems of credit policy. Credit must remain available to support the increases in production which are necessary in order to cope with inflationary pressures. At the same time, credit policy must discourage spending and the liquidation of Government securities, and encourage savings and the retention of

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investments. Credit policy has by no means a simple task, but the experience of the past 12 months demonstrates that the combined efforts of the monentary authorities and the financial community can contribute to the achievement of this goal.

Furthermore, the experience of the past year has made it clear that if we are to use credit policy effectively as part of an anti-inflation program, the cornerstone of that policy is general credit restraint, although selective credit controls can make a contribution in some sectors of the economy.

However, if general credit policy is to be used effectively, it is essential that the Treasury run a surplus under conditions when latent inflationary fires may be rekindled by untoward developments at home or abroad. The effects of Treasury deficit financing on the money supply and prices over a period of years have already been observed; a Treasury deficit in an inflationary environment makes the effective use of general credit policies most difficult.

In the field of debt management, policy must be flexible; it must be adapted to changes in the economic and credit situation. One of its major objectives, especially with a high level of employment and active use of industrial capacity, should be to do as little financing as possible through the banking system. This requires a willingness to tailor Treasury securities to meet the needs of nonbank investors and to compete with other investment media in the securities markets.

The ultimate solution to the problem of inflation, however, goes beyond the limits of credit control and debt management policies. A formidable inflationary bias has been built into our entire political and institutional structure. If we are really earnest in our determination to meet the problem of chronic inflation, we must develop a better and more widespread understanding of the long-range implications of some of our present policies and practices. We must develop a sound fiscal policy which will yield adequate Treasury surpluses under conditions of full employment. We must be willing to tighten Government guaranty and lending policies in periods of full employment and inflationary pressures, and to accept a somewhat lower volume of business activity in some areas of the economy as a price of easing a boom; we certainly cannot expect a restrictive general credit policy to achieve much success if at the same time Government agencies continue to make credit available to important sectors of the economy on liberal terms.

Most importantly, we must examine the long-run implications for costs and prices of repeated rounds of wage boosts at rates far in excess of the relatively slow and gradual improvement in industrial productivity. We must face the consequences of the tendency to link, through escalator clauses and price supports, wages, costs, and prices in a complex structure which leads almost inevitably to progressive inflation. In sum, we must reconcile the objective of full employment with the no less essential objective of stability in prices, lest in our natural eagerness to maintain employment and business activity at peak levels, we bring about the continuous erosion of the dollar.

In closing, let me say that I sincerely appreciate the opportunity of taking part in this round-table discussion. The questions posed by this committee in its questionnaires were excellently designed to point up the issues encountered in the difficult task of determining debt management and credit policies under inflationary conditions, and the

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answers will be an invaluable source book of material in this field for many years to come. The full and free exchange of ideas at these hearings is helping to illuminate some areas not wholly covered in the questionnaire and to discuss problems raised by some of the answers received. It is a privilege to be here.

Representative PATMAN. Thank you very much. Without objection, we will place your entire statement in the record along with your remarks, Mr. Reierson.

Mr. REIERSON. Thank you, sir.

(The document referred to is as follows:)

COMMERCIAL BANKS AND THE POSTWAR INFLATION [1]

Statement prepared for submission to the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report on March 24, 1952, by Roy L. Reierson, vice preseident, Bankers Trust Co., New York

For 10 years and more, we have been struggling with the problem of inflation. The decade brought us virtually full employment, a broad rise in production and incomes, and sustained high levels of business activity. But it also brought a serious decline in the purchasing power of the dollar, took a large slice out of the accumulated savings of the people, and led to a persistent spiral of wages, costs, and prices.

The activities of this subcommittee, and of its predecessor, evidence the significance of credit policy and debt management as anti-inflation tools. In the area of credit policy, the role of bank credit quite properly is in the forefront of attention. This reflects not only the importance of the commercial banks as lenders to business, agriculture, and individuals, but more particularly one respect in which their operations differ from those of other financial institutions. This peculiarity is that a net increase in loans or investments of the commercial banking system results in larger bank deposits, and this generally means a growth in the money supply. And an increase in the money supply is frequently regarded as the main if not the sole contributor to price inflation.

THE PRICE LEVEL AND THE MONEY SUPPLY

That there is a broad relationship between changes in the money supply and commodity prices is evident from chart 1. (The money supply is here defined as the total of demand deposits adjusted and currency outside the banks.) The price declines after World War I and in the great depression were accompanied by a reduction in the volume of money outstanding. The recovery from the depression and the higher price levels of the 1940's coincided in a general way with a huge growth in the money supply.

However, it is apparent from chart 1 that changes in the money supply are associated not only with the general movement of the price level but also, and perhaps even more closely, with industrial production. This is to be expected. As our economy expands, and business sales, payrolls, and other measures of activity increase, a larger money supply is required. Thus industrial production, commodity prices and the money supply all tend to fluctuate broadly with the major swings in underlying economic conditions.

Furthermore, chart 1 shows that the relationship between the price level and the money supply is far from exact. Prices and the money supply sometimes move in opposite directions. In the 1920's, for instance, the volume of money increased substantially, measured by contemporary standards, as the result of the expansion in bank lending, while commodity prices drifted downward. In the depression, price recovery began while the money supply was still shrinking. In the second half of the 1930's, the gold inflow and the Treasury's large deficit financing brought a rapid increase in the money supply without significantly influencing the price level; wholesale prices in 1940 were somewhat lower than in 1935, although the money supply had expanded by more than 50 percent. The opposite situation occurred from 1946 onward, when commodity prices soared while the money supply moved only slightly higher.

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[1] Arthur Brickner, of the economics and business research department, Bankers Trust Co., New York, has assisted materially in the preparation of this document.

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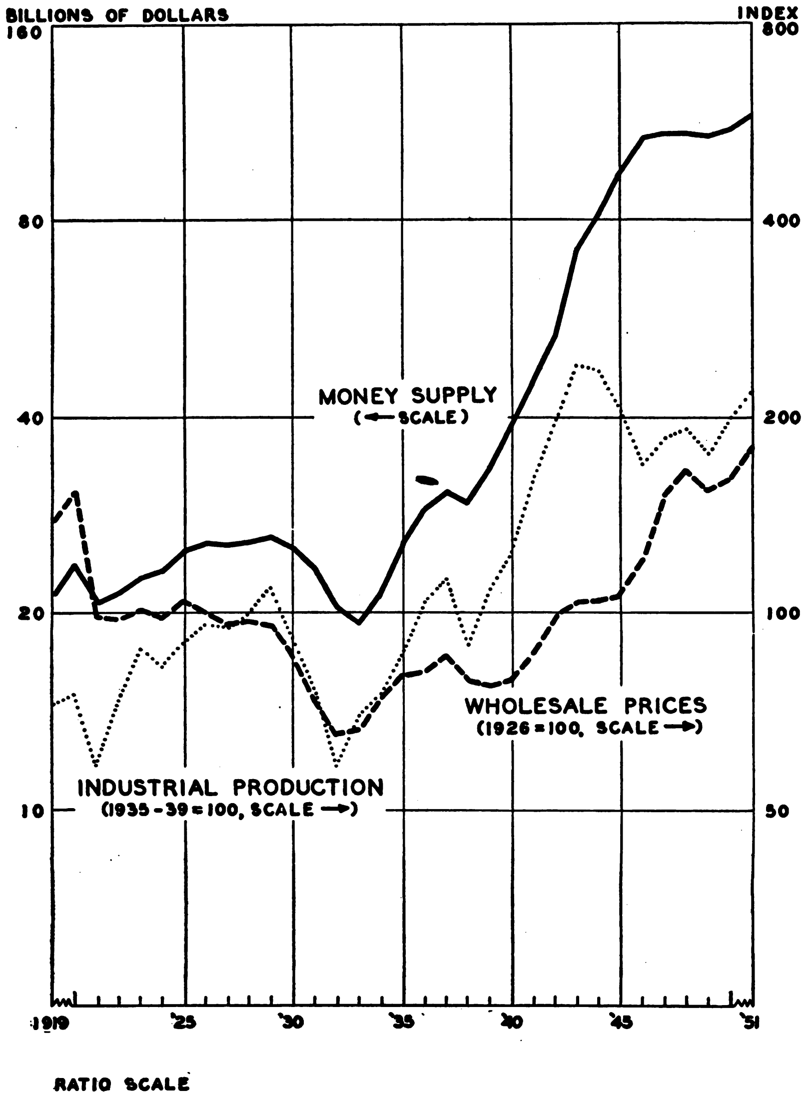
CHART I

PRICES, PRODUCTION AND THE MONEY SUPPLY, 1919-51



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There are a number of reasons for these developments. In the depressed 1930's, the persistence of idle manpower and idle industrial capacity greatly moderated the impact of higher spending on prices. In World War II, the pressures on the price level were held in check by economic controls and by the remarkably high degree of public cooperation and patriotic discipline, which was reflected in a high volume of savings and the absence of widespread black markets. Furthermore, the virtually complete absence of many important goods, such as automobiles and household appliances, helped to hold price bidding down and facilitated savings. Reflecting these factors, the rate of utilization (or turn-over) of the money supply—shown for the postwar period in subsequent charts—declined rather consistently for a number of years until the end of World War II. Consequently, the impact of the increased money supply upon the price level as the result of Treasury deficit financing in the 1930's and during the war was deferred for several years.

Since the end of World War II, on the other hand, the American economy has experienced two very real and pronounced periods of price inflation. The first was the boom which began in 1946 and continued into 1948, when it was succeeded by a relatively mild business and price readjustment. The second was sparked by the outbreak of war in Korea in mid-1950 and came to an end in the spring of 1951.

In both periods there were large demands for bank credit; bank loans expanded sizably, although the total money supply increased only moderately. Both periods were characterized by considerable controversy concerning the responsibility of bank lending for the progress of inflation. Consequently, these two periods provide a topical and worth-while case study of the role of bank credit in an inflationary economy.

THE 1946–48 INFLATION

The reconversion of industry from war to peace in 1945–46 proceeded in unexpectedly smooth fashion and without the substantial unemployment that had been feared by some observers when the war was drawing to its close. In 1946, as civilian goods began to reappear and price controls were terminated, the economy entered a boom of hitherto unprecedented proportions.

Ingredients of the boom

The major factors underlying this first postwar boom are still fresh in memory. With the release of manpower, plant and materials for civilian production, businessmen immediately began to replenish their depleted inventories. The demands of business for new equipment, and of the public for new housing, automobiles, and most other types of consumer goods began to make themselves felt. These enhanced demands reflected not only the pent-up requirements of the war years but also the generally low levels of prewar production; they were further magnified by large needs for foreign rehabilitation. The effects of these demands are illustrated on chart 2, which shows the output of machinery and equipment, new dwellings started, automobile production, and exports of foodstuffs.

Not only did businessmen and individuals have large unsatisfied demands at the end of the war, but, as shown on chart 3, they also had considerably greater means to satisfy them. Largely as the result of the Treasury deficit financing of the war, which substantially increased personal and business holdings of cash and Government securities, the public entered the postwar era with nearly $230 billion in liquid purchasing power. Consumer buying power was further increased by the constant rise in civilian employment in the postwar boom and by the rapid increase in wage rates; nonagricultural employment substantially exceeded the wartime peaks, while average hourly earnings in manufacturing increased by more than 30 percent between 1945 and 1948. These developments are also illustrated on chart 3.

In this environment of enormous demands for goods of all kinds, fortified by current and accumulated purchasing power, it was probably inevitable that the lifting of price controls and the return to a peacetime economy should have been accompanied by strong upward pressures upon prices. This is indicated by the data shown on the lower half of chart 3. The exports of foodstuffs were especially significant in this respect; at the end of the war, we embarked upon a large program of providing food to devasted areas abroad, and this contributed importantly to the particularly sharp rise in food prices in the postwar years. But the prices of virtually all goods and services shared in this upward trend.

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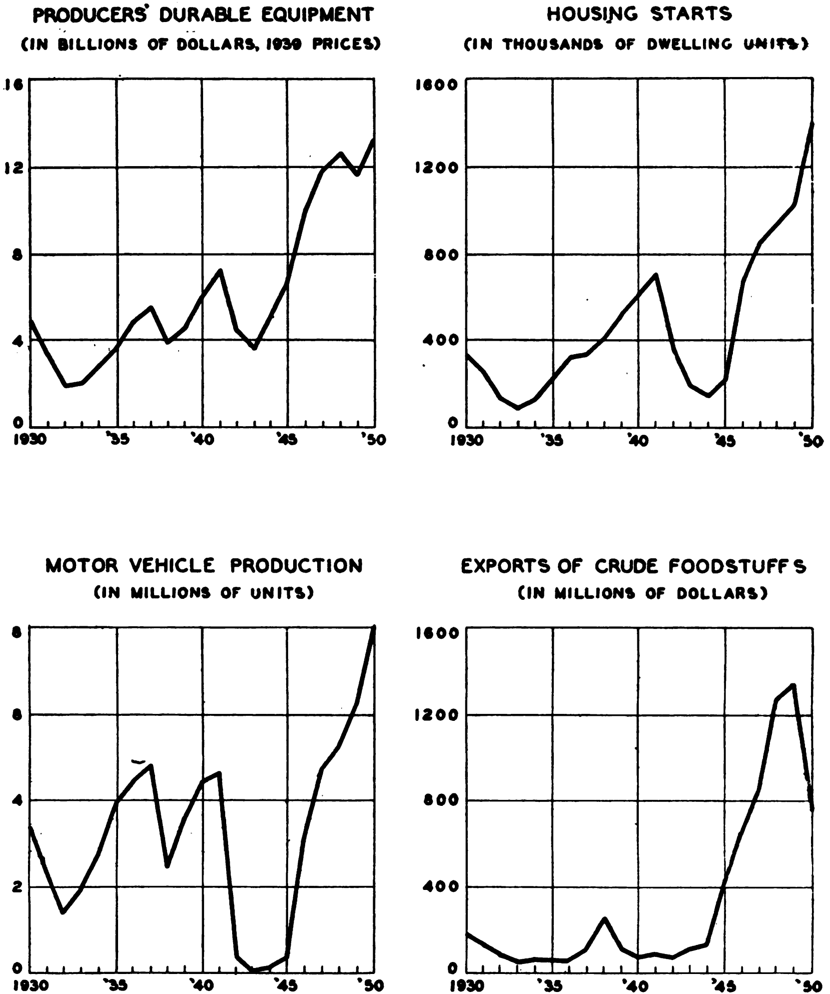
CHART 2



The need for bank credit

That this situation would lead to a large demand for bank credit was a foregone conclusion. Despite the great rise in the liquidity of business corporations generally, many manufacturers, distributors, builders and other businessmen lacked the necessary funds to resume and expand their normal preacetime activities. At the same time, virtually all economic factors combined to bring about a substantial increase in the working capital requirements of business enterprise. Government financing of war contracts, which had played an important part in the financing of business in the war years, came to an end. More funds were needed to meet the larger payrolls of an increased labor force working at rising wage rates. Most importantly, the refilling of inventory pipelines and depleted shelves was essential to the resumption and maintenance of economic activity. With output substantially above prewar levels, business needed greater stockpiles of materials, and supplies were further tied up by the production bottlenecks and strikes of the early postwar years. Under these circumstances, business obviously found it necessary to make growing use of commercial bank credit.

Among consumers, too, the distribution of liquid assets at the war's end was not necessarily commensurate with their postwar buying needs. While many indi-

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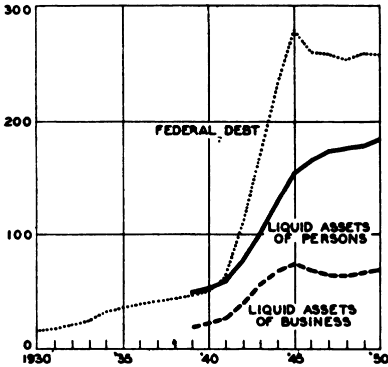
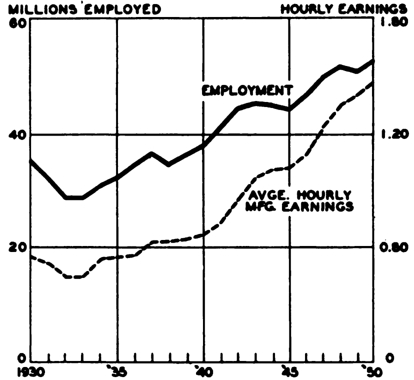
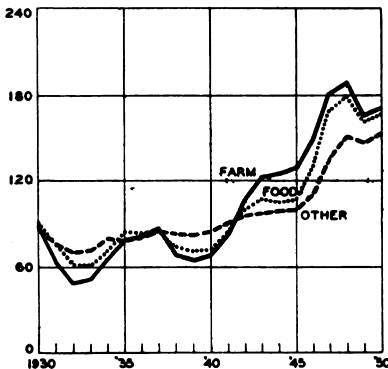
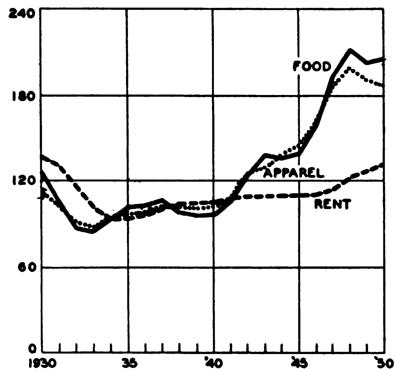
CHART 3









viduals had no need to make great inroads upon their savings, many others found their demands for housing, home furnishings, automobiles, and the like in the postwar world to be considerably larger than could be financed out of their holdings of cash and savings bonds. The liquid assets, however, provided the necessary down payments and thus facilitated the use of credit by many borrowers.

The increase in bank loans

The result of all this was a sharp increase in business borrowings, home mortgages, and consumer credit in the postwar boom, and bank loans expanded rapidly. In the 3 years starting with 1946, total commercial bank loans increased by more than $16 billion, as shown on chart 4. The largest increase, $10.8 billion, took place in commercial, industrial, and agricultural loans, commonly known as business loans. However, the banks were very prominent also in the field of mortgage lending and consumer credit. A significant part of these lending activities reflected the direct response of the banks to goals of public policy.

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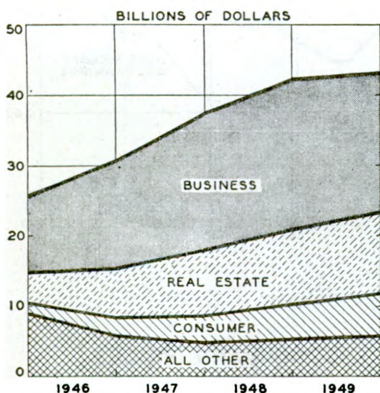
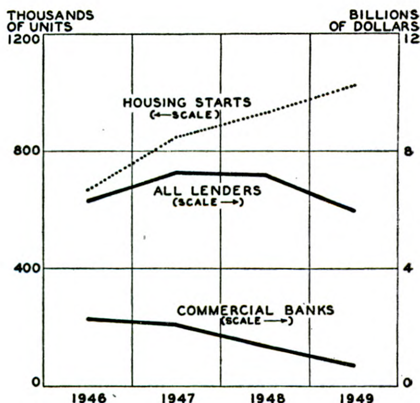
In the early postwar years, for instance, the problem of meeting the critical housing shortages created during the war years received a high priority as a matter of Gevernment policy. In order to increase the ready availability of low-cost real-estate credit, the Congress expanded loan-guaranty operations under the FHA and established a new loan-guaranty program for veterans. The commercial banks, in the early postwar period, responded more promptly than other lending institutions to these programs. It is doubtful whether the rapid growth in housing starts, shown on chart 4, could have been achieved without the

CHART 4

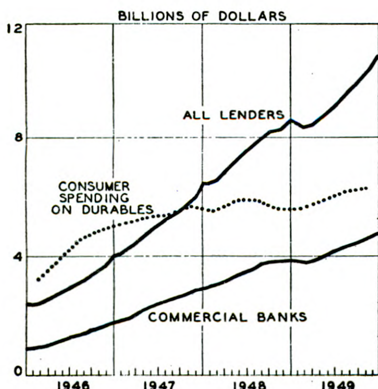
TOTAL COMMERCIAL BANK LOANS



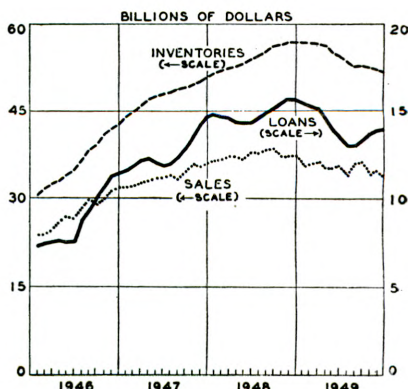
NET RISE IN MORTGAGE LOANS



CONSUMER INSTALMENT LOANS



LOANS TO BUSINESS



aggressive mortgage lending undertaken by the commercial banks. The commercial banks acquired about 35 percent of the net increase in nonfarm mortgage debt (residential and commercial) in 1946. As other lenders became more active, the commercial banks absorbed a smaller part of the new financing and their proportion declined to 20 percent in 1948.

On balance, it appears that Government action caused real-estate credit to be made available on too liberal terms in the postwar years and thus contributed to an increase in building costs. Perhaps this liberalization in lending terms could better have been delayed until the volume of new building had declined. How-

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ever, the Congress was impressed with the postwar housing shortage and established a public policy which led to a rapid increase in housing and, of course, in real-estate mortgage debt.

The commercial banks also rapidly expanded their consumer loans in the postwar years, as illustrated on chart 4. In the 3 years 1946 through 1948, consumer installment credit expanded by more than $6 billion, of which nearly one-half was supplied by the commercial banks. Such loans, it will be recalled, were subject to control under regulation W until the Congress permitted this regulation to lapse late in 1947. The Congress did not authorize the reimposition of this regulation until about a year later, when the immediate postwar inflation had already drawn to a close.

That type of bank loan which is of greatest significance for this discussion is business loans. The behavior of loans to business by the weekly reporting member banks is shown on chart 4. While bank loans to business reflect a great variety of demands for funds, their behavior over the years appears closely related to the inventory policies of business enterprise. In part, this expresses the fact that inventory requirements represent the most important source of business demand for bank financing; it also suggests that both the inventory policies and the borrowing policies of business reflect underlying economic conditions, especially the behavior of production and sales.

The important question here is whether the availability of bank credit to business permitted too rapid a growth of business inventories or other outlays and thus contributed to the upward pressure upon prices, especially prices of raw materials. The evidence indicates that the bulk of the inventory accumulation in the 1946–48 boom was supported by an increase in sales, as shown on chart 4; business was required to keep larger stocks on hand in order to meet the high levels of postwar demand. It was not until 1948 that inventories showed signs of top-heaviness, but by then the big increase in business loans for this period was about over.

Indeed, one of the most remarkable features of this boom was the paucity of any major speculative excesses. While some misplaced optimism is probably the unavoidable companion of every rapid expansion of business activity, the amount of bank credit which went into inventory hoarding or speculative ventures in this period was, by all odds, very small. In contrast to the boom-bust period of 1920–21, the years 1946 through 1948 were characterized by persistent uncertainty regarding the business outlook and a good deal of concern over the imminence of a postwar recession; businessmen in general moved with considerable caution, sought to keep liquid, and tended to avoid undue commitments. The great bulk of credit extended to business in this period, therefore, was not in excess of what was required by the rate of production and sales. The moderate character of the 1949 business adjustment is impressive evidence that the expansion of bank credit in the preceding boom had been neither unhealthy nor excessive.

In appraising the contribution of bank loans to business outlays for increased working capital and plant and equipment in the postwar years, it is well to keep in mind that bank credit was a relatively minor source of financing in the aggregate. Chart 5 shows estimates of the sources and uses of corporate funds for the whole period 1946–51. The striking fact is that in this period, which comprised two spectacular booms, only 6 percent of the funds expended by business corporations were provided by the increase in bank loans. In the 1946–48 portion of this period, the proportion was less than 8½ percent. Even if funds available from the issuance of bonds, stocks, and mortgages are included, the amount thus subject to some measure of control through credit policy was not more than about one-quarter of the total. Over 55 percent of the funds were provided out of internal sources—out of reinvested profits and out of noncash expenses such as allowances for depletion and depreciation. Obviously, these averages cover wide differences among individual corporations, and one should refrain from drawing overly broad and sweeping generalizations. But the figures give strong support to the conclusion that business enterprise as a whole did not embark on any speculative spending spree through the use of bank credit.

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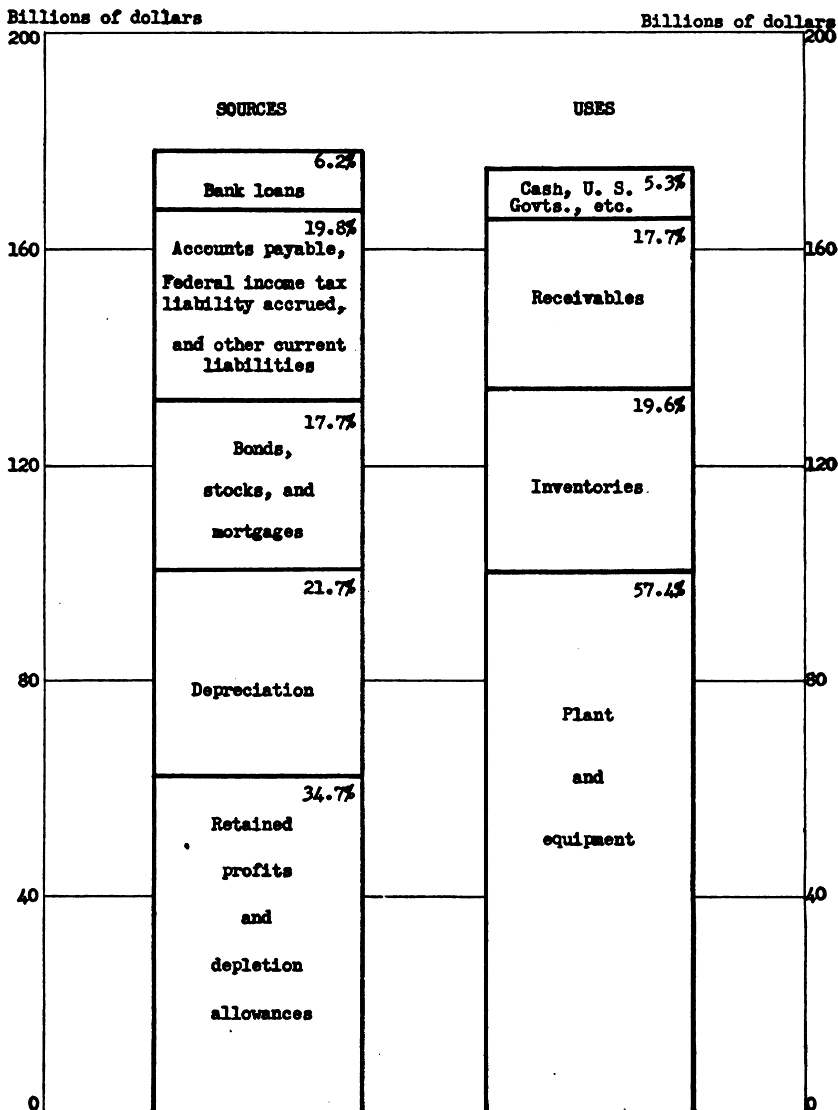
CHART 5

SOURCES AND USES OF CORPORATE FUNDS, 1946-51



Prices, production, and the money supply

Chart 6 shows in somewhat greater detail for the immediate postwar years the data on prices and production presented for a longer period in chart 1. Data on the estimated turn-over of demand deposits outside New York are shown as a rough measure of the rate of utilization of the money supply.

Most of the price inflation in this period took place in 1946 and 1947. A considerable part of the initial price rise reflected simply the adjustment of price levels to the higher costs of production and distribution, an adjustment which

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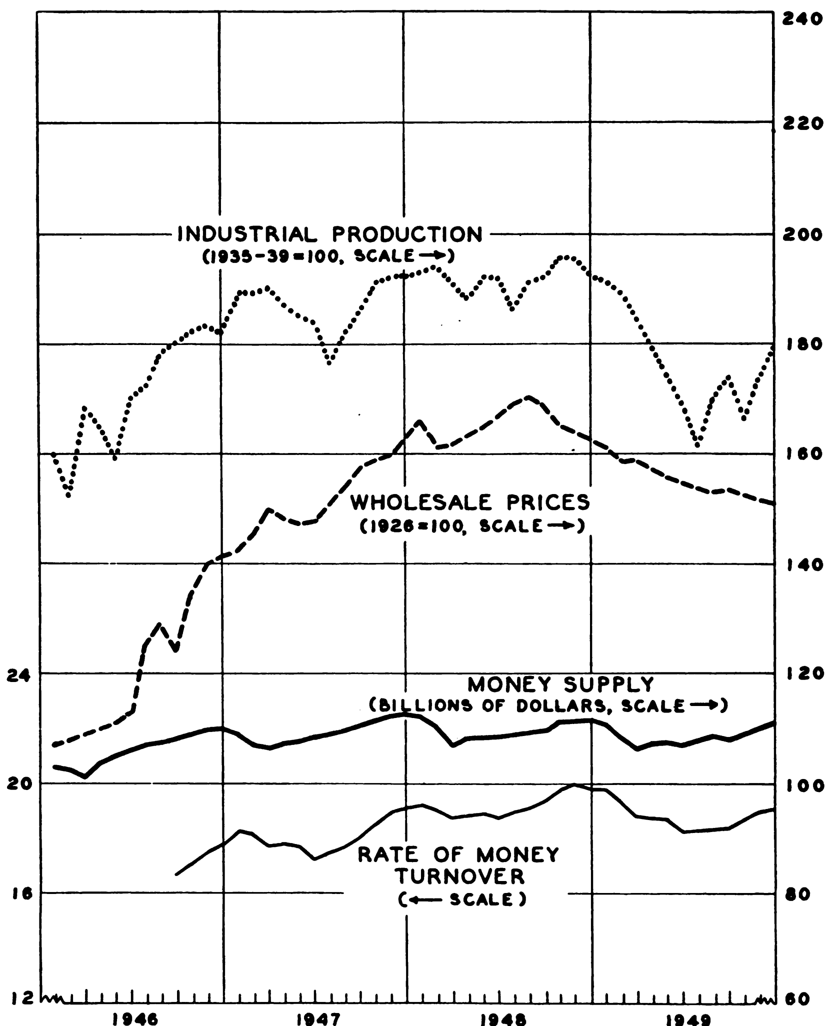
became possible after the removal of wartime price controls. However, the prices of farm and food products, which even in the war years had been less tightly restrained than the prices of manufactured goods, also continued to move briskly upward.

CHART 6



In contrast to these developments in prices, chart 6 demonstrates that the money supply increased only moderately during the 1946–48 boom. The increase in bank loans was about offset by sizable declines in bank holdings of Government securities. However, the rate of turn-over of bank deposits showed a significant increase from 1946 through 1948. This again suggests it was the more rapid use of the greatly increased money supply resulting from the Treasury's wartime

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borrowings, rather than an important contemporary rise in the money supply, which facilitated the price inflation of 1946–48.

The expansion of bank loans in 1946–48 was not wholly unrelated to the steep price rise of those years. The immediate effect of bank lending was to facilitate spending, and this undoubtedly added to the already strong upward pressures upon the price level. However, it must be recalled that bank loans are essential to business activity and that the major part of the increase in bank loans was for the financing of higher employment and pay rolls, greater production, larger inventories, increased residential building and the many other requirements of an expanding economy. The use of bank credit in 1946–48 helped to facilitate the flow of money and resources into these channels; and this, in turn, helped to whittle down the pent-up demands and to bring the initial postwar inflation to a halt. A more restrictive bank lending policy in this period would probably have had some restraining effect upon production and business activity. Whether, in the face of the huge deferred demands and large liquid assets, it would have been really effective in coping with inflation is, at the very least, a debatable question.

THE POST-KOREAN INFLATION

The initial postwar boom came to an end in 1948; it was followed by a moderate decline in economic activity and a relatively modest price correction. The index of wholesale prices declined about 11 percent from its August 1948 peak to the low point in December 1949. Farm product and food prices declined more and other commodities less than the average.

This adjustment was short-lived. Residential building and automobile production continued to display great vigor, and in the early months of 1950 business activity was once more moving upward. Thus the outbreak of war in Korea in mid-1950 found the economy operating at peak peacetime levels of production, with commodity prices already in a rising trend.

Impact of the Korean war

The post-Korean inflationary boom differed from the initial postwar boom in many fundamental respects. Although once again huge demands were making themselves felt, they represented not the release of pent-up requirements but the anticipation of future needs. Concern over a possible serious economic downturn vanished, and was replaced by the expectation of a huge defense program, a rearmament boom,, and a war or semiwar economy replete with rising costs and prices, Government controls, and widespread shortages. This state of public and business psychology was actively encouraged by continuing Government announcements of impending scarcities, allocations, and price and wage controls.

The rise in commodity prices which had begun early in 1950 was greatly accentuated after the outbreak of hostilities, and the post-Korean boom was characterized by one of the most rapid increases in commodity prices in our recent history. Our post-Korean experience dramatically illustrated the latent inflationary potential in our economy.

This boom lasted approximately 9 months and led to a considerable rise in prices. In March 1951 the index of wholesale prices reached a peak 17 percent above the level of June 1950. It is important to observe, however, that this boom reflected much more than simply a scramble for goods. Chart 7 shows that all major economic indicators registered a sizable upturn, including business inventories and production. Thus, while demands surged upward, their rise was accompanied by a sharp increase in output and in available goods. This was a powerful factor in causing the inflationary wave to subside early in 1951, and to be replaced by a more cautious and conservative appraisal of the outlook.

Bank loans and price inflation

The post-Korean boom was mirrored in a rapid increase in bank loans; business enterprise as a whole was less liquid than at the start of the postwar period, and its borrowing requirements were consequently higher. The behavior of bank loans and some related economic factors in this period is shown on chart 8. The $7½ billion rise in bank loans in the second half of 1950 was the largest on record for any 6-month period. The biggest and most dramatic growth was obviously in business loans which rose by $5 billion, due in part to the fact that the sharp upward thrust of production and prices occurred at the very time when normal seasonal factors, such as crop movements, were increasing the borrowing requirements of trade and agriculture. Increases in consumer and real-estate loans were of much less importance, relatively, than in the boom of 1946–48.

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CHART 7

SELECTED ECONOMIC FACTORS IN THE POST-KOREAN BOOM

Per cent Increase	Item
57.1	Prices of Import Commodities
37.6	Manufacturers' New Orders
23.5	Business Inventories
22.8	Prices of Farm Products
21.5	Bank Loans
17.0	Wholesale Prices
16.3	Plant and Equipment Outlays
15.7	Wage and Salary Incomes
11.6	Industrial Production
10.7	Consumer Spending
10.6	Turnover of Money Supply
9.9	Federal Spending
8.4	Consumers' Price Index
2.9	Money Supply

June 1950 — March 1951

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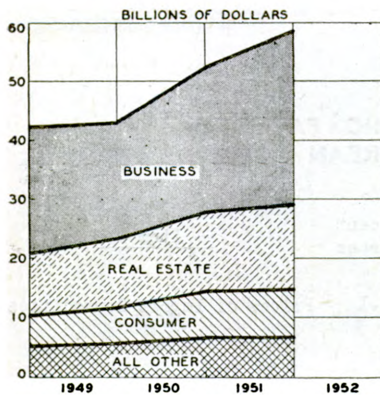
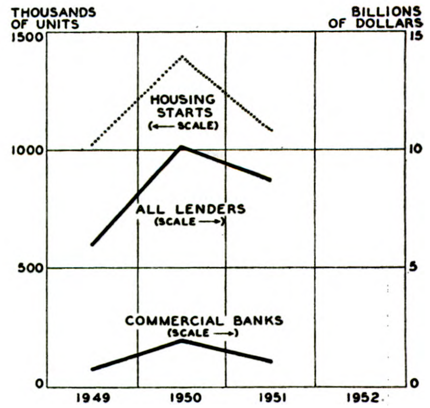
CHART 8

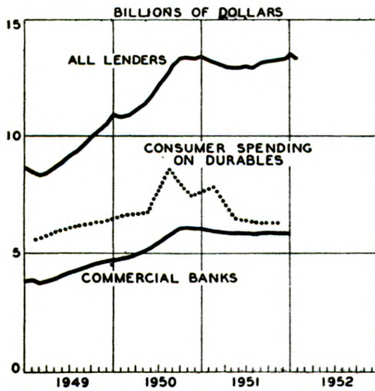
TOTAL COMMERCIAL BANK LOANS



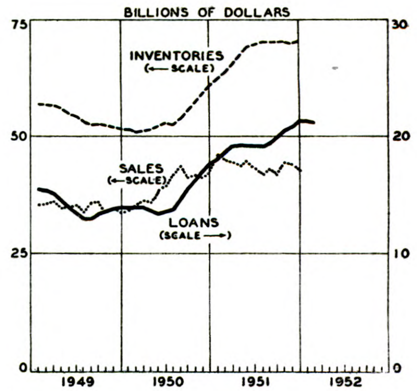
NET RISE IN MORTGAGE LOANS



CONSUMER INSTALMENT LOANS



LOANS TO BUSINESS



One of the controversial questions of this period is the relationship between the sharp rise in prices and the sizable expansion of bank loans. Did bank lending bear a significant measure of responsibility for the rapid increase in the price level? To appraise this question, it is necessary to review some of the factors that operated to raise demands and prices in the post-Korean boom.

The sweeping rise in commodity prices reflected the combined impact of a great many forces which boosted the demand for goods faster than could be matched by an increase in supplies in the short run. An intangible and immeasurable but very real factor was in the field of public psychology. All appraisals of the outlook tended to make buyers more anxious for goods, and sellers reluctant to part with them. There was a widespread rush to raise selling prices before the imposition of price controls, and labor unions pressed for large wage advances in anticipation of the expected wage freeze. For the first time in a great many years, our economy experienced an attack of speculative fever. Underlying the movements in prices were a number of major economic forces:

(*1*) *World commodity prices.*—One of the most important and most immediate price-raising forces was the great boom in world commodity markets sparked by the outbreak of war in Korea. The certain prospect of world-wide rearmament

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and the real fear that world war III might be imminent caused some international raw materials to be bid up to fantastic heights, as shown by the following tabulation of some major import commodity prices:

Commodity	Price		Date of peak	Percent rise to peak
	June 26, 1950	Peak		
Burlap.....Yard..	$0.164	$0.350	Jan. 24, 1951	113.4
Cocoa beans.....Pound..	.318	.444	Sept. 14, 1950	39.6
Hides.....do....	.258	.435	Jan. 18, 1951	68.6
Rubber.....do....	.305	.875	Nov. 9, 1950	186.9
Shellac.....do....	.350	.565	Jan. 5, 1951	61.4
Tin.....do....	.775	1.830	Jan. 25, 1951	136.1
Wool tops.....do....	2.020	4.350	Jan. 19, 1951	115.3

These price rises were largely beyond the control of domestic economic policy. They reflected a world-wide scramble for raw materials, in which American as well as foreign business participated. In view of the prevailing military uncertainties, price considerations naturally became of secondary importance. This was true especially in the case of Government stockpiling activities, which were resumed at a rapid pace upon the outbreak of hostilities. All these developments brought about an immediate and sizable increase in business financing requirements and in production costs.

(2) *Plant and equipment outlays.*—Another important price-raising development was the spurt in business spending for plant and equipment. These outlays are generally a key factor in the industrial economy; a high level of capital spending is a powerful element in maintaining and increasing economic activity. In the months after the outbreak of war in Korea, business stepped up its plant and equipment outlays from an annual rate of $16.7 billion in the second quarter of 1950 to a rate of $22.1 billion in the fourth quarter.

This large increase was prompted by a variety of considerations. The growing rearmament program indicated a need for more production, and the enlargement of our industrial capacity became one of the announced objectives of economic policy for the defense emergency. Furthermore, in the case of many nondefense projects, the rising trend of material and labor costs suggested the advisability of undertaking many projects which had hitherto been postponed. Official announcements of impending shortages of equipment and limitations on plant construction further spurred expansion.

The bulk of business spending in recent years was internally financed; bank loans were a minor factor. In general, while these expenditures added considerably to the immediate strain upon manpower and materials and were undoubtedly an important price-raising factor, they also served to raise the country's productive capacity and thus ultimately to increase the supply of goods.

(3) *Residential building.*—A further factor tending to raise demands and prices was the housing boom. The number of new dwelling units started had reached a new peak during the first half of 1950, about 50 percent above the previous high mark set in 1948. This record volume of building activity further added to the demands for labor and materials throughout the remainder of the year. New starts remained high even after controls were imposed; here again, the fears of a renewed housing shortage in the wake of a defense or war economy was a strong stimulant.

Credit is obviously far more important in this field than in many others, and the housing boom was greatly aided by the loan and guaranty policies of the VA and FHA, which remained fairly liberal even after the tightening of lending terms in mid-1950 and the issuance of regulation X in October of that year. By far the largest portion of mortgage credit was supplied by lenders other than commercial banks, as shown on chart 8. The chief lenders were life-insurance companies, mutual-savings banks, and savings and loan associations.

(4) *Consumer spending.*—Yet another factor in this boom was the accelerated demand for goods on the part of consumers, who indulged in a buying spree which at times assumed panic proportions. The buying wave began shortly after the outbreak of the Korean war; it fed on the fear of inflation and the return of wartime shortages. It subsided in the early autumn of 1950, flared up anew

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with the entry of Chinese forces in the Korean war late that year, and came to an end with the improved news from Korea in the spring of 1951.

Consumer credit undoubtedly played a part in financing this spending spree, although regulation W was imposed fairly early, in September 1950, and was tightened in October. However, the great bulk of accelerated consumer spending in the boom was out of current income; in the buying spree of the third quarter of 1950, for instance, consumers spent 97.8 percent of their disposable income, compared with 90.1 percent in the corresponding months of 1951.

(5) *Business inventories.*—Inflationary pressures in the post-Korean months were increased by the rapid accumulation of business inventories which began in the autumn of 1950 and continued through the first half of 1951. Higher business sales and rising industrial activity made a sizable inventory increase essential if pipelines were to remain filled and production bottlenecks were to be avoided. Furthermore, some of the increase in inventories reflected simply the sharp rise in the costs of labor and raw materials. Also, in the second half of 1950, large amounts of cotton passed from the Commodity Credit Corporation into regular trade channels.

In addition, there was undoubtedly considerable inventory accumulation in excess of current requirements. One factor that contributed to this development has already been observed—the natural desire of businessmen to protect themselves against being cut off from their sources of raw material if the war should spread. Another factor was the prospect that the Government would shortly curtail the production of goods for the civilian market; many business managements thought it only prudent to keep factories and manpower busy on civilian production, even if this meant the accumulation of inventories, until such time as materials and productive facilities would be needed for defense work.

The sharp spurts in consumer buying also had their impact. Retailers increased their orders probably even more than was justified by the increase in retail sales, and this increase in orders was felt all along the production line. When the military situation in Korea became stabilized and consumer buying slumped early in 1951, many businesses were just beginning to receive deliveries on the large orders placed a few months earlier.

As in the previous periods, the sharp increase in business inventories was accompanied by a rapid expansion of bank loans to business, as shown in chart 8; inventory accumulation was undoubtedly financed to a significant degree through the use of bank credit. In evaluating the role of bank lending in the post-Korean months, it is appropriate to bear in mind the tremendous unknowns and uncertainties that prevailed during the months following the outbreak of hostilities in mid-1950. Most of the post-Korean increase in inventories and output reflected prudent business judgment in the light of the conditions then prevailing, including the predictions and forecasts from official sources. Speculative inventory hoarding was probably not wholly absent, but it appears that such activities were neither widespread nor sustained and were not important in the aggregate. At the time, it appeared to be in the best interests not only of business but of the national economy to build up inventories as rapidly as possible.

Bank loans and production

The growth of bank loans reflected, for the most part, the response to the increased financing requirements of business. In addition to inventory financing, it will be recalled that the demand for bank loans in the second half of 1950 was accentuated by the seasonal rise in loans which is normally associated with the marketing of the crops during the autumn. The rapid rise in bank loans continued in the first quarter of 1951, when a leveling off or a slight seasonal decline might have been anticipated. A factor operating to sustain loan volume in this period was the acceleration in corporation tax payments under legislation that first became effective in the first half of 1951. Throughout, the financing requirements of business were increased by the need for other forms of working capital, including larger amounts of receivables. Although these needs were especially great in the first 6 months after the outbreak of war in Korea, they persisted in 1951 as higher costs and prices were gradually reflected in business operations.

From the point of view of the individual banker and businessman, the increased demand for bank loans during this period clearly and unmistakably reflected the direct and immediate effects of larger orders, rising production, and other business decisions that appeared sound in the light of the situation then prevailing in the world. This accordingly suggests that the bulk of the rise in bank loans was in the service of economic expansion. From the broader point of view of economic analysis, however, it can be argued that the rise in bank

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loans increased demands for some commodities in short supply and thus contributed to the ensuing increases in prices.

Probably all that can be said is that there are elements of truth in both points of view. It is apparent from the preceding review of price-raising factors that the inflationary impetus in the post-Korean months came from a great variety of sources: The specter of world war III, the certainty of an international rearmament boom, the almost universal rush for goods, soaring world commodity markets, and the natural impetus toward higher prices arising out of expanding or peak level production in many sectors of the economy. Consequently, a sharp rise in costs and prices appears to have been largely unavoidable with the outbreak of the Korean war. At the same time, it is probably true that at least in the short run inflationary pressures were increased somewhat by the liberal use of credit, including bank loans, in the post-Korean months.

However—and this appears to be a point of some significance—if the increase in production and business inventories in some sectors of the economy proved to be excessive in the light of hindsight, the abundance of goods thereby created helped to stabilize prices in the early part of 1951 and to correct some of the price inflation of the boom months. Thus, in the past 12 months of rising defense expenditures, during which the economic impact of accelerating defense production came to assume real proportions, we have experienced declines in many wholesale prices and only a modest increase in the Consumers' Price Index.

In an effort to reduce the inflationary impact of credit expansion, furthermore, the commercial banks and other members of the financial community a little over a year ago joined forces in the voluntary credit restraint program. It is designed to repress unessential and less essential lending and financing, while facilitating the extension of credit for the defense program and the essential needs of the civilian economy. The program curbs not only speculative activities, but also legitimate business demands for credit which are not established as essential. There are impressive indications that this program has been of substantial influence in restraining borrowings by business and others; the increase in bank loans in 1951 represents in largest part the financing of defense and defense-supporting activities and the marketing of crops.

Credit policy and the money supply

The post-Korean period has again demonstrated the complexities and uncertainties surrounding the relationship between the money supply and the level of commodity prices, illustrated on chart 9. In the 9 months of the boom the level of commodity prices increased far more rapidly than did the money supply. While commodity prices rose by some 17 percent, the total money supply advanced from $110.2 billion to $113.4 billion, or less than 3 percent. The growth in the money supply from June 1950 to March 1951 was moderated by the normal seasonal decline associated with the concentration of tax payments in the first quarter of each year. However, if the change in the money supply is measured from March 1950 to March 1951, in order to eliminate seasonal variation, the increase is still of relatively modest proportions, about 5 percent, compared with a 20½ percent increase in wholesale commodity prices. More significant than the moderate increase in the money supply was the substantial increase in the rate of money turn-over shown on chart 9; the post-Korean boom was sustained from the money side mainly by the greater utilization of the already existing volume of bank deposits.

Although the modest increase in the money supply was not a significant price-raising factor in this boom period, a more vigorous policy of credit tightening soon after the outbreak of war in Korea would nevertheless have helped to curb inflation. It will be recalled that until the spring of 1951 the financing of business plant expansion and residential building was facilitated by the open-market policies of the Federal Reserve; institutional investors were heavy sellers of Treasury bonds, on balance to the Reserve banks, and invested the proceeds in mortgages and other private securities. Furthermore, the support of long-term Governments at pegged price levels provided significant encouragement to institutional investors to expand their private financing commitments.

Consequently, the more energetic use of general credit policy would have discouraged some investing and spending by those who were financing themselves in part through the liquidation of Government securities. It would have reduced the purchases of Government securities on the part of the Federal Reserve banks and the accompanying increase in bank reserves. This would have made bank credit somewhat less readily available. Finally—and this might conceivably have been the most important of all—a determined credit policy, if

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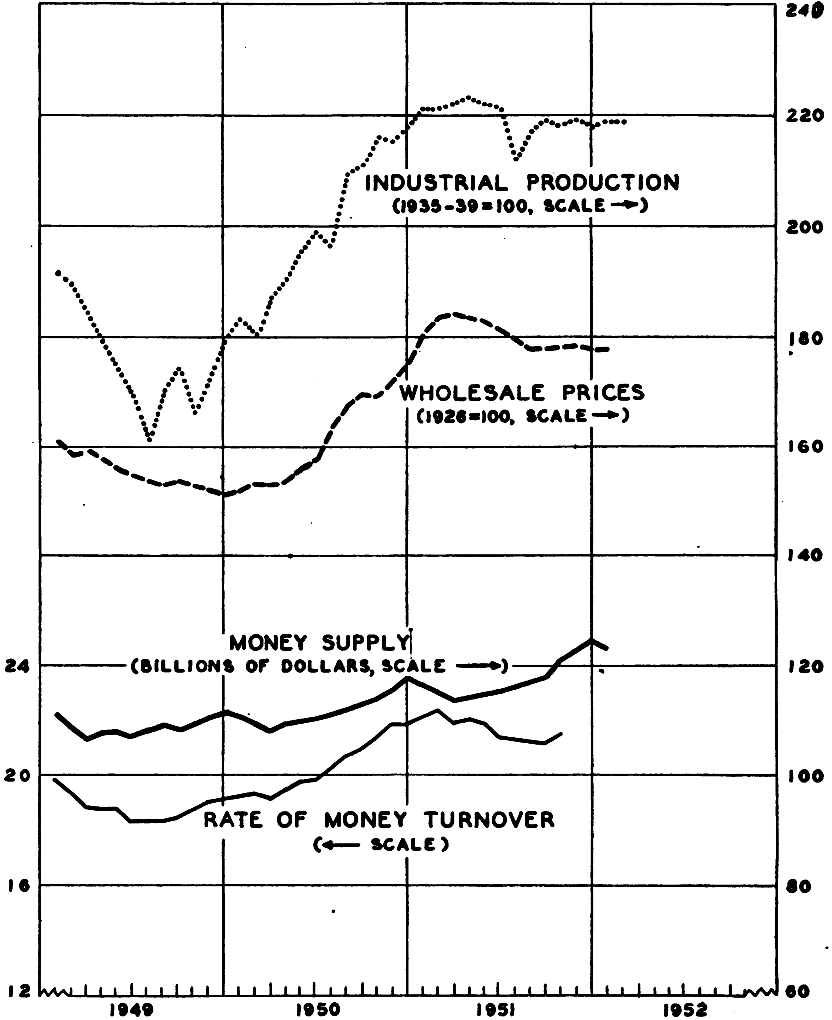
CHART 9

PRICES, PRODUCTION AND THE MONEY SUPPLY, 1949-52



coupled with appropriate Government actions in other fields (including a real curtailment of nondefense spending), would have provided the public with concrete evidence that the Government was seriously bent upon fighting inflation. Such evidence, which was almost wholly absent in the first few months of the post-Korean boom, would have helped to create a more skeptical view concerning the inevitability of rising costs and prices, and might have restrained some of the rush for goods.

It must be recognized, however, that there were various barriers to the full use of anti-inflationary policies in the early post-Korean months. The main goal

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set for the economy at that time was quickly to reach the highest possible output of civilian as well as of defense goods. Also, the rearmament plans and the threat of spreading war raised the prospect of large Treasury borrowings to meet the emergency. All this precluded the resort to a drastic credit policy.

Furthermore, while a more restrictive credit policy would have helped to moderate the intensity of the boom, it would be unrealistic to overemphasize its effectiveness under the circumstances which then existed. Probably no measure of economic policy short of an immediate and comprehensive freeze of prices and wages and meticulous controls over inventories, construction, and perhaps even over consumer spending, could have forestalled the buying waves and consequent sharp price rises in the months after the outbreak of the Korean war. For such drastic action we lacked the necessary statutory authority and the administrative machinery; several months were to elapse before public and congressional opinion was ready to accept reasonably strong economic measures.

When credit policy finally became significantly restrictive, its effectiveness was implemented to a considerable degree by many other simultaneous developments, such as an improvement in the military and foreign situation, the attainment of new peaks in civilian output, and the demonstrated adequacy of virtually all civilian supplies. These developments had important repercussions upon business and consumer psychology; they were reflected, in the monetary field, by a downturn in the rate of turn over of the money supply early in 1951. Consequently, even though the money supply increased more from March to December 1951 than it did during the comparable months of 1950, the trend of commodity prices, as already mentioned, was moderately downward in 1951, in contrast with the sharp rise in the previous year.

SUMMARY REVIEW OF FINDINGS

The preceding review has indicated that the inflationary developments since the end of world War II have been based not upon a great concurrent expansion of the money supply but upon a large money supply inherited from the past. In spite of the substantial increase in bank loans since the end of that war, there has been only a modest growth in the money supply. The inflation in 1946–48 reflected the huge backlog of demands for housing, industrial equipment, construction, and consumer goods of all kinds, sparked by the greatly increased money supply and liquid asset holdings arising out of the deficit financing of the war and prewar years. The post-Korean inflation reflected a normal and largely unavoidable public reaction to this new war and the prospects of another war economy; here again, the large money supply was a contributing factor in facilitating the increase in buying and spending.

In both of these inflations, the increase in the velocity, or turn-over of the money supply was a much more important inflationary factor than the growth in the money supply. An increase in the rate of turn-over permitted a relatively stable money supply to facilitate a big rise in spending. Our experience indicates that this danger is especially serious when the money supply is large and when therefore a relatively small rise in turn-over may have substantial inflationary repercussions.

Prior to the end of World War II, the money supply increased much faster than the dollar volume of economic activity. This conclusion is graphically portrayed on chart 10, which compares the money supply and bank loans with the gross national product since 1929. The main reason for the large money supply in the postwar years was the financing of Treasury deficits through the commercial banking system which began in the 1930's and assumed huge proportions in World War II. The ensuing years illustrate the consequences of these financing practices. We have learned that the inflationary impact of deficit financing through the commercial banking system may be postponed for some time, either by the existence of idle resources (as in the semidepressed latter 1930's) or by wage, price, and other controls (as in World War II), but the underlying pressures, resulting from the excessive money supply, persist, and ultimately they lead to a higher level of commodity prices.

Bank loans, however, increased much less rapidly over the past two decades than the gross national product, as chart 10 also illustrates. They did not recover significantly from depression levels until the end of World War II brought the resumption of civilian production and the termination of wartime financing of business by the Government. But even in the hectic booms of 1946–48 and 1950–51, the volume of bank loans remained much smaller, in comparison with

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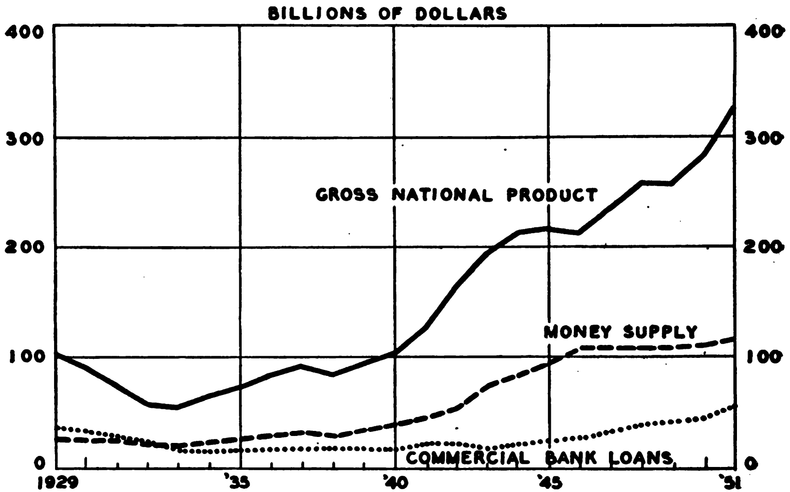
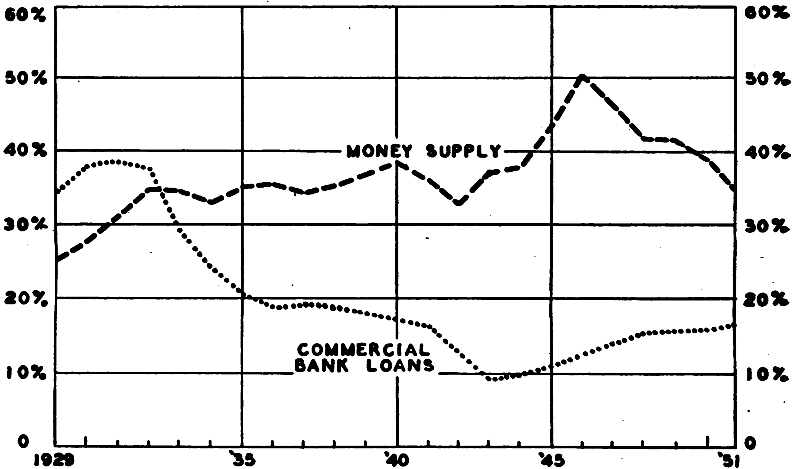
CHART 10

GROSS NATIONAL PRODUCT, BANK LOANS AND THE MONEY SUPPLY



BANK LOANS AND MONEY SUPPLY AS PER CENT OF GROSS NATIONAL PRODUCT



the greatly increased size of our economy, than in 1929. Indeed, bank loans in 1951 were a smaller percentage of gross national output than in any year of the depressed and semidepressed 1930's. Our inflationary ills are not due to the profligate use of bank loans.

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IMPLICATIONS FOR CREDIT CONTROL AND DEBT MANAGEMENT

There is a fundamental distinction in our economy between increases in the money supply arising out of Treasury deficit financing through the commercial banking system, and those arising from the expansion of bank loans. Government spending does not generally lead to a larger volume of goods available to the public; consequently, the rise in the money supply is not as a rule offset by a rise in output. Thus, latent inflationary pressures are created. Furthermore, once the money supply has been expanded in this fashion, it is extremely difficult to undo the process, of the $48 billion increase in commercial bank holdings of Government securities that took place between 1932 and the end of 1945, two-thirds are still with the banks.

Bank credit extended to commerce, industry, agriculture, and most other private borrowers, on the other hand, has significantly different functions and demonstrates a quite different behavior. An expansion of bank loans, especially of bank loans to commerce, industry, and agriculture, is a necessary concomitant of rising production and business activity. Business, in the modern economy, is done largely through the use of credit, and if output is to expand, credit must be availalable to finance the increase in inventories and the higher volume of trade. True, credit extended even for such purposes facilitates spending, and may, therefore, subject prices to some upward pressure. But this is an inevitable part of the productive machinery: before output can be raised, business must first gather the raw materials, the manpower, and the equipment. And to do this, it needs credit. Furthermore, additions to the money supply arising from this source tend to hold pace, by and large, with an increase in the volume of goods and tend to be reversed quite naturally and before too long when the economy no longer needs such credit.

These observations suggest the following general conclusions for policy:

(1) Large Treasury deficits, and the increase in the money supply which their financing customarily entails, constitute the greatest single threat to the value of the dollar. This danger is insidious because of the delays that sometimes occur between increases in the money supply and the consequent effects upon prices. If we wish to avoid substantial upward movements in prices, we must avoid fiscal excesses and we must minimize the financing of Treasury deficits through the banking system.

(2) Least of all can we afford the luxury of Treasury deficits under conditions of full employment, when latent inflationary pressures may be rekindled by untoward developments in the domestic or foreign field. Treasury surpluses are necessary under such conditions for a variety of reasons including the very pertinent one that Treasury surpluses facilitate the effective use of restrictive general credit policies. Conditions of active inflation and large Treasury deficits would impose almost insuperable obstacles to the effective use of general measures of credit control.

(3) Under conditions of high economic activity and fairly complete utilization of industrial resources such as prevail at present, the dangers of large Government deficit financing through the commercial banking system are acute and immediate. Consequently, there is a pressing need for a flexible policy of debt management under which every possible effort will be made to encourage investment in Government securities of funds outside the banking system, thereby reducing the amount of the Treasury requirements to be financed by the banks.

(4) The development of general credit policy must be guided by prudence, discretion, and detailed, up-to-date knowledge concerning the operations of the economy. Even in an inflationary environment, credit must remain available to support the production and distribution of goods, which is an important part of any successful program to cope with inflationary pressures. The task is to apply a restrictive credit policy which will discourage spending and the liquidation of Government securities, and which will encourage the accumulation of savings and the retention of investments, but which, at the same time, is not so drastic as to make credit unavailable to commerce, industry, agriculture, and others who are properly entitled to it. The experience of 1951 demonstrates that the combined efforts of the monetary authorities and the financial community can contribute to the achievement of this goal.

(5) The ultimate solution to the problem of inflation, however, goes beyond the limits of credit control and debt-management policies. Important as these policies are, they cannot by themselves cure the chronic inflationary afflictions of our economy. A formidable inflationary bias has been built into our entire political and institutional structure. If we are really earnest in our determina-

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tion to meet the problem of chronic inflation, we must develop a better and more widespread understanding of the long-range implications of some of our present policies and practices. We must develop a sound fiscal policy which will yield adequate Treasury surpluses under conditions of full employment. We must be willing to adapt our debt-management policies to the credit and economic situation. We must be willing to tighten Government guaranty and lending policies in periods of full employment and inflationary pressures, and to accept a somewhat lower volume of business activity in some areas of the economy as a price of easing a boom; we certainly cannot expect a restrictive general credit policy to achieve much success if at the same time Government agencies continue to make credit available to important sectors of the economy on liberal terms.

Most importantly, we must examine the long-run implications for costs and prices of repeated rounds of wage boosts at rates far in excess of the relatively slow and gradual improvement in industrial productivity. We must face the consequences of the tendency to link, through escalator clauses and price supports, wages, costs, and prices in a complex structure which leads almost inevitably to progressive inflation. In sum, we must reconcile the objective of full employment with the no-less essential objective of stability in prices, lest in our natural eagerness to maintain employment and business activity at peak levels we bring about the continuous erosion of the dollar.

Representative PATMAN. Any comments? Any questions or suggestions?

Mr. Lindow, I believe it has been suggested that you be called upon for comments on this.

Mr. LINDOW. A careful study of the inflation problem has convinced me that inflationary price increases of the last few years stemmed from a complex group of causes. I would like to mention briefly 10 inflationary factors which stood out in the 5-year period between the end of World War II and the beginning of the Korean war. I do this not to assign blame but because we must consider causes to get at solutions. There was no single cause and there is no single solution.

The 10 factors of major inflationary importance in the 5 years before Korea were as follows:

1. The various "rounds" of increases in wage rates which took place with the blessing of the Government. I am for a high purchasing power economy, but it is a fact that costs are intimately connected with prices. Wage increases in excess of productivity gains are inflationary.

2. Agricultural support programs. When farm prices stay high even with large surpluses—as in the case of potatoes, Mr. Tapp—I think that they motivate labor to seek higher wages in compensation.

3. The housing program of the Government with mortgage guaranties and subsidies, and public works generally. In my opinion, we were too slow in developing some of these programs in the great depression and we were too slow to turn them down in the face of inflationary pressures in the postwar period.

4. Foreign-aid programs involving buying in this country. This was a particularly important inflationary factor in 1947 when heavy food buying for foreign aid came at a time when we had a very bad corn crop and low wheat supplies.

5. Government payments to veterans. Veterans' payments rose to as much as $7 billion a year and constituted almost one-fifth of the whole Federal budget in some years before Korea. We should be generous with veterans but it is well to remember that veterans themselves are likely to be badly hurt by inflationary price rises.

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6. Postwar "catching up" by consumers. After several years of shortages, consumers were able to buy freely inasmuch as their incomes were rising steadily and they had $200 billion of liquid assets accumulated, largely from the war.

7. The record expansion programs of business. Business, too, was trying to catch up and get its facilities in shape for postwar markets and was encouraged to set its sights high by the huge demand coming from consumers. Was the rate of business expansion unreasonable? The answer is clearly "no" because increased production itself proved to be a potent anti-inflationary factor.

8. State and local government spending in excess of taxes—although this was more than balanced by a Federal cash surplus of $14 billion in the four fiscal years ending June 30, 1950. Of course, I realize that State and local governments desperately needed to undertake many of the capital projects which had been held up during the war, particularly where they were needed by the huge growth in population in the war years.

9. Wartime growth in public debt leaving individuals and businesses with more liquid assets than ever before. This is the result of not taxing ourselves heavily enough at the time. I believe that it was not simply the portion of the debt which went into bank hands which was important, but the fact that all of the debt represented liquid assets, or certificates of purchasing power, regardless of who held it. There is something to be said for the idea that the volume of total debt outstanding is at least as important in economic significance as the volume of monetized debt, that is money, outstanding.

10. Willingness of banks, insurance companies, and other lenders to expand loans substantially. Total private debt increased $68 billion from December 1945 to December 1949, of which the commercial banks absorbed 29 percent; the life insurance companies were second with 26 percent; and savings and loan associations accounted for about 10 percent.

The 10 items listed above stand out in importance for the pre-Korean period. I have not tried to determine the order of their importance, and I am sure that other items could be added to the list. My purpose was not to line up the defendants and assess the degree of responsibility for the crime, but rather to show the wide variety of basic causes for inflationary pressures, and also to make clear that practically every citizen and business had a hand in bringing on inflationary tendencies, either because of what they did themselves, or because of the pressure they put on the Government to do something. And now I come to an eleventh point, a new and vital factor which was added after the Korean war began.

11. A "fear psychology" regarding potential shortages. There was general apprehension that world war III was on the horizon and the memories of World War II shortages were still very clear.

Businessmen, consumers, and our stockpiling agencies in Washington all rushed to stock up for world war III before "shortages appear" and also because of a conviction that prices would go up with war. I remember a cartoon showing a woman buying an enormous

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quantity of groceries and explaining that she wanted to buy before the hoarders got there.

As the fear of all-out war receded so did the scramble for goods, and in fact we have recently had a very comfortable period of living off the shelves on the part of both consumers and businessmen, which I assume is evidence of a widespread feeling that all-out war is not now on the horizon. Panic buying these days, or the lack of it, is a good barometer of the fears of war.

It is true, of course, that some of the fears of shortages were well taken. Some very tight situations in raw materials developed and it was raw materials, particularly international raw materials, which showed the wildest price increases after Korea. A sensitive index of 16 industrial raw materials rose almost 60 percent within 7 months from the Korean attack, hitting its high on January 24, 1951. Then it began to recede so that by January 1952, one-half of the rise had been lost. A broad index of wholesale prices first rose about 15 percent in the same 7-month period and then lost about one-fifth in the next year. Bank loans were not closely correlated with these price changes. Total loans of commercial banks rose 18 percent in the first 7 months after Korea and then rose another 9 percent while the price indexes were declining over the next 12 months. Also, the Federal Government operated at a cash surplus in this period so we cannot blame deficit financing for the price changes.

The behavior of personal saving tells us a great deal about the change in the inflationary pace in the last couple of years. The personal saving ratio declined sharply in the quarter following the start of the Korean conflict as a buying wave developed—that is, spending went up as a proportion of income-after-taxes, and saving went down—the wholesale price index turned upward sharply at the same time. In the next quarter (October-December 1950), savings was more normal but the momentum of the price rise continued, probably mainly because of the further large increases in prices of international raw materials. In the first quarter of 1951 the saving ratio again dropped off sharply due to a new buying wave, and the wholesale price index rose substantially further. In the second, third, and fourth quarters of 1951 the personal-saving ratio turned sharply around and increased to a very high level; the wholesale price index stopped rising and then settled back a few points. Meanwhile, the prices of international raw materials declined very substantially, probably reflecting a world-wide feeling that all-out war had been successfully avoided.

The lesson of the experience following the outbreak of the Korean struggle seems to me to be that (1) fear psychology played an enormous role; and (2) our tools of national economic policy cannot be expected to cope very effectively with such quick changes in sentiment.

Much of the increased spending was financed by current income, use of liquid assets, and by various internal funds. Viewed this way, it seems obvious that our monetary authorities could not easily have stopped the increased spending by simply tightening up the monetary valves. Some tightening was clearly desirable along with other measures of national economic policy which could contribute to restraining spending, but it was also very necessary that the monetary picture be left sufficiently free to cope with the legitimate increased demands

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for credit which inevitably accompany an increase in production of the magnitude which occurred after the Korean conflict began.

Mr. TAPP. Mr. Chairman, could I offer one comment?

Representative PATMAN. Certainly, Mr. Tapp.

Mr. TAPP. I would not want to pose as a defender of price supports under all terms and conditions and, particularly, as a defender of the potato price supports. I would like to call Dr. Lindow's attention to the fact that the potato price supports caused difficulty when prices were low, and at the present time, with no potato price support program, potato prices are high, and are causing difficulty in the consumer price index because we have too few potatoes. I think it is generally true that in the discussion of the farm price support program we tend to greatly overemphasize the effect of price support programs on the agricultural price level over the years. Our greatest difficulty has been in meats where there have been no price support programs since 1943.

Mr. LINDOW. I do not want to pose as an expert on price support—I do not know too much about it—but in the whole complex of factors in the period I think that it was an important item.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. I am not sure that I understood the implication of your statement, but if I did, it will come out in this question: Do I gather from what you said that you feel that—let us take housing, for example—that if we had followed a coordinated and wise policy we would have done a great deal more to stimulate housing in the thirties than was done, in part, to avoid a situation where we were forced to do a tremendous amount in an inflationary period, which further stimulated the inflation. When I speak of that period I am speaking of the period that you discuss, the postwar period.

Mr. LINDOW. That is right; it is my thesis that we moved too little and too late in both directions, and we have an amazing propensity to turn programs on, and they never turn them off when conditions change.

Representative BOLLING. In other words, the effect has been that because of the political situation in the thirties we went too slowly, and again because of the political situation in the postwar period, and in order to achieve the social objective of more housing, we created a tremendously strong inflationary impact just in that one field.

Mr. LINDOW. I think that is right; yes, sir.

Representative BOLLING. And that could apply, of course, to a great many other programs other than housing; you mentioned public works and things of that sort.

Mr. LINDOW. It does—this is something like your discussion earlier when you mentioned the merits of State and local spending—I do not challenge the merits of some of these things. I do not think that is the question. The question is what is our aggregate capacity to meet requirements? We do not do ourselves any favor if we say, "Now, this is good and this is good," and we add them all up, and they add up to more than we can provide.

Representative BOLLING. In other words, we get back to the point that timing is a supremely important factor.

Mr. LINDOW. The timing of when you do it, I think is very important.

Representative BOLLING. On this question of the thesis which has been propounded, I am not sure that I can restate it accurately, that

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the Federal increased its holdings of Governments by 3.9 billion in that period from July of 1950 to March of 1951; that in the same period commercial bank loans went up, I think, 9 billion; that in the same period wholesale prices went up how much?

Mr. ENSLEY. Seventeen percent.

Representative BOLLING. Seventeen percent. That, in effect, is a process of cause and effect from one step to the second step to the third step; is that a fair statement?

Mr. LINDOW. I have read some of the hearings, and it seems so to me.

Representative BOLLING. I would like you to comment specifically on that statement, although you have commented on it in your statement.

Mr. LINDOW. I would like to make two comments: If the relationship is that good then why did bank loans go up in the next 12 months while prices were going down, including these international prices which lost one-half of their rise between January 1951 and January 1952? You get a price rise of 60 percent in this one sensitive index in 7 months, and then you get a decline which wipes out one-half of that rise; you get a rise of 15 percent in a broader index and then a decline of one-fifth of this rise; but bank loans rise 18 percent and then they rise another 9 percent in the second period. I do not think the bank loan relationship is there as a casual factor and I feel that it is an oversimplification of the inflation problem to simply blame bank loans.

I would like to emphasize that it is total spending which causes prices to go up. It is not simply the volume of spending that is financed by bank loans.

The gross national product is running over $300 billion of which bank loans finance only a small portion. When you step up demands in some segment of the gross national product faster than production rises, and you can do that very easily by drawing on existing liquid assets, by turning over money faster, as Mr. Reierson pointed out, then you have inflationary symptoms.

I think you also have to take into account the volume of financing which goes through the savings institutions. The act of saving and putting money into a building and loan association is a deflationary act, but the act of lending that money by that institution has inflationary repercussions. It puts spending power in the hands of corporations and mortgagors.

My second comment refers to the increase in the Federal Reserve portfolio of Government securities. The total increase from the end of June 1950 to the time of the accord in March 1951 was about $4 billion. This was caused by several factors and only a small part of the total increase actually served to permit banks to increase deposits. The major factors accounting for the $4 billion increase in the Federal Reserve portfolio in this period may be summarized as follows:

To offset gold outflow	$2,300,000,000
To meet increase in percentage reserve requirements made effective in January 1951	2,000,000,000
To carry increase in commercial bank deposits during the period	900,000,000
Total	5,200,000,000
Less: Reserves provided by other factors (net)	−1,300,000,000
Equals increase in Federal Reserve portfolio	3,900,000,000

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The gold outflow reduced bank reserves by over $2 billion during this period and had to be offset by Federal Reserve purchases of Federal securities. The increase in percentage reserve requirements made effective in January 1951 resulted in a transfer of about $2 billion of Government securities from member banks to Federal Reserve banks. This was the inevitable result of increasing reserve requirements at the time because member banks customarily carry only a small volume of excess reserves and an increase in the percentage reserve ratios required can be met only by selling Government securities which in this case were picked up by the Federal Reserve banks.

Some reserves were provided by various factors other than the purchase of securities during this period to a total amount of $1.3 billion. These included such items as a reduction in Treasury deposits in the Federal Reserve and a similar reduction in "other" deposits in the Federal Reserve, as well as an increase in Federal Reserve discounts and an increase in float. The significant thing is that reserves required because of increased deposits amounted to less than $1 billion. This is the portion of the increase in the Federal Reserve portfolio which is significant for the present discussion. This portion alone, in effect, made it possible for the commercial banks to expand their deposits by roughly $6 billion.

Representative BOLLING. Do you have anything to say, Mr. Reierson?

Mr. REIERSON. I certainly share the opinion expressed by Mr. Lindow. It happens that I took a look at the magnitudes involved in the period from June 30, 1950, to March 31, 1951.

During that period, Federal Reserve holdings of Governments increased by about $4.6 billion, and increases in other items of Reserve bank credit—more particularly float and rediscounts—probably totaled about $900 million, or a total increase in Federal Reserve credit of about $5.4 billion. Of that amount, $2.4 billion was absorbed by the gold outflow to which Mr. Lindow has referred; $2 billion was taken up by the increase in reserve requirements and, as he suggested, the amount that was left available to support an increase in bank deposits was of the magnitude of $900 million.

I think I have no further comments. I think the whole argument which I presented in my summary statement and in the longer document points out that the price behavior during this period was a reflection of a great many forces, the most important of which was the change in psychology.

Of one thing I am reasonably sure, I certainly share Mr. Lindow's opinion that a somewhat more restrictive credit policy in that period would have been useful and desirable.

I have no way of telling how significantly the course of commodity prices would have been affected by any particular course of credit policy. I think that is one of the questions that will never be answered in this complex economy.

I want to point out that the increase in inventories has been of significant effect in the last 12 months in changing an inflationary situation. I guess the commercial banks have to assume part of the responsibility that was implicit in the developments in the latter part of 1950, and I think they should get, perhaps, some of the credit for what has happened since then.

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Representative BOLLING. That brings me to my next question: How important do you consider the accord between the Federal Reserve and Treasury in the economic events subsequent to that accord?

Mr. REIERSON. Well, I likewise have read part of the transcript of these hearings, Mr. Bolling, and I shall certainly make no attempt to appraise the accord in quantitative terms or even to assign it in order in the list of 7 or 17 items, as the case may be.

Personally, I believe that the accord was a very useful and important development. I believe, as I think my statement indicates, that coping with inflation is a very difficult task. I believe furthermore that credit policy is of real significance in an anti-inflation program.

It has many advantages, and I am of the further belief that if we are going to use credit policy, we have to have some flexibility in applying general credit policy. That flexibility was achieved by the accord. I think it was an important development.

Representative PATMAN. I should like to ask a question about what effect did the unpegging of the bonds have. I will ask you first, then, Mr. Reierson.

Mr. REIERSON. I think one effect was that it did reduce the creation of bank reserves arising out of the continued liquidation of Governments, particularly on the part of the non-bank investors. I think it was a significant factor in that general situation.

I think, furthermore, that it has had some restrictive effect in the field of lending.

Representative PATMAN. What percent, if you were to evaluate it by percentage, could you indicate?

Mr. REIERSON. I would not attempt to do that, Mr. Chairman.

Representative PATMAN. You would not attempt to do that?

Mr. REIERSON. I would not attempt to do that.

Representative PATMAN. What do you say about that, Mr. Lindow, what effect did the unpegging of the bonds have?

Mr. LINDOW. Well, I find it very hard to determine the exact importance of it. I have asked a great many lending people, and I get conflicting opinions on it. I think, though, that the accord was a good thing. It resolved a serious problem, and, I think, it was handled very well. It all came out much better than I expected it would.

I think that the full accord went considerably beyond the dropping of bond prices as a matter of economic significance. For convenience we may say that the accord was a package of three parts. It was not simply reducing the price of bonds below par; the offering of a 2¾ percent nonmarketable issue to mop up a substantial amount of the floating supply of long marketable securities was another very important part of the accord. In my own opinion, the biggest mistake of war financing was in putting out too many of those long marketables, although there were times in the period after the Victory Loan when it seemed there were nowhere near enough of them; and everybody was worried about the relative scarcity of long bonds. But the exchange into 2¾ percent nonmarketables was very important last year in taking bonds off the market.

I also think that there was a third important factor, namely persuasion. I think that the Federal Reserve reached understandings with some of the major lending groups that helped a great deal in

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holding down the volume of credit financed through the selling of Government securities; and the voluntary credit restraint program was developed to get wide cooperation.

So I do not think we will ever know whether it was simply dropping the price of bonds below par which had the primary force in abating the inflation. I am somewhat skeptical that this factor by itself was as effective as many other people would say; but as part of a package in the accord it was a helpful development.

Representative PATMAN. What would you say about that, Mr. Fleming? What effect did the unpegging of the bonds have?

Mr. FLEMING. I generally agree with Mr. Lindow on that. I think a very important step was to get as many as possible of the long-time two and a halves converted into two and three-quarters. As a matter of fact, in my opinion we never needed to sell as many two and a halves as were sold in the Victory Loan campaign. What actually happened there was that we thought we needed more money, and we sold in the Victory Loan campaign—we never needed that money, and we paid 2½ percent on a lot of it, and retired that debt out of seven-eights percent certificates, but I doubt very much if it had not been for some of the discussions and, you might say, divergent viewpoints, that you would ever have been able to have gotten in as many of the two and a halves converted to two and three-quarters, if it had not been for what happened.

Representative PATMAN. Mr. Fleming, I wonder if it would be all right if you gentlemen could come back at 2:30? Would it be all right if we recessed until 2:30, and then for you to come back here in this room at that time? That will be very fine.

Without objection, the committee will stand in recess until 2:30.

(Whereupon, at 12:50 p. m., a recess was taken until 2:30 p. m., the same afternoon.)

AFTERNOON SESSION

Representative PATMAN. The committee will please come to order. I believe that you were making an explanation, Mr. Fleming, when I interrupted you. I hope that I did not disrupt your train of thought.

Mr. FLEMING. I think I had just stated that I am generally in accord with the views expressed by Dr. Lindow, and I felt that without the accord we would not have been successful in converting the large amount of outstanding 2½'s and 2¾'s.

I think that was the point at which we left off. I think you asked me what were the benefits. I think that you have to recognize that we were in an inflationary period, very highly inflationary, due to the Korean situation, and due also to the fact that we had had the biggest housing boom in the history of any country in the world, which generated, of course, the mortgage paper which I touched on before, which was done to stimulate housing prior to the Korean outbreak. That mortgage pressure, the pressure to buy and sell those mortgages in order that the homes might be financed, brought about a situation that the holders, which were non-bank holders, mainly, of these long time 2½'s just had pressure on them from every direction and they sold their 2½'s in order to use this money because of the premium income from the insurance companies and deposit structures from savings—the biggest purchasers of mortgages—were not sufficient to meet the pressure that was on them. They were not only selling at a premium

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but it seems to me that it was done in a war economy to assure people that prices were going to be stable, and we had to have a peg. We did not want to repeat the example of World War I where on each issue that came out the interest rate increased resulting in a very unhappy situation.

When you get into a peacetime economy as we are, and with this tremendous housing boom, it seems to me that something had to be done to prevent this monetization of the debt. I think that this accord by giving flexibility to the market has been a rather helpful factor. I think the accord could have been reached very much sooner if it had not been for the dramatization of it, of the different viewpoints.

I think in my answer to question No. 4, in response to the 10 questions which were prepared by Dr. Murphy with your approval, I think that I am right when I say that the situation now seems to be only history. I think that is about where it stands. I think I mentioned before that the committee on Government borrowing conferred with the Treasury. Three Secretaries of the Treasury—Secretaries Morgenthau, Vinson, and Snyder—have welcomed, have wanted us to consult and advise with the chairman of the open market committee. That pertains to new financing and also to refundings. Generally, on balance I think that the accord in an inflationary period was something that had to be reached, and I think you had to drop the price somewhat to prevent the continued sale to the Federal Reserve System of these long-time 2½'s.

Representative PATMAN. Mr. Woodward, would you like to comment on that, about the effect of unpegging these bonds?

Mr. WOODWARD. Yes, sir. The unpegging represented a reintroduction, a re-use of the techniques of general monetary control as contrasted with a condition in which funds were available without limitation to anybody who had Government securities, forcing us to rely upon selective credit and direct controls to try to prevent inflation.

The accord means to me the reinstitution of general monetary control, and I think it was an exceedingly helpful thing. It served to start the market processes of rationing scarce resources among various claimants, to erect deterrents on credit to the marginal cases, which is what one would expect it to do. It was a healthy thing.

Representative PATMAN. Mr. Tapp, would you like to comment on that?

Mr. TAPP. Not particularly, except to concur in what has been said, especially with what Mr. Fleming said. I think it is unfortunate it was not done sooner and perhaps without so much dramatization.

Representative PATMAN. Thank you, sir. The next question, gentlemen: To what extent do time deposits represent a stable form of savings? Demand deposits? Is it desirable to encourage the holdings of savings in these forms? Under what conditions? It has been suggested that Mr. Lindow be called upon to give the first answer to that.

Mr. LINDOW. Mr. Chairman, I read this series of questions and wondered just what you had in mind in asking them. I think that there are some fairly fundamental matters involved here. At least I assume that the way the questions were phrased that the intention was that we go beyond simply stating the ordinary distinction between time deposits and demand deposits.

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This raises some complicated concepts. I would like to try to get into them to some extent. I hope that you will interrupt me at any point because this may not be just what you had in mind in phrasing the questions.

It is frequently taken for granted that savings going into time deposits should be assumed to be "good" savings and savings going into demand deposits should be considered more in the nature of "hot" funds than savings.

During the war the Treasury tried very hard to get new savings invested to the fullest possible extent in Government securities. Savings taking the form of demand deposits were not considered very durable, very permanent. Every effort was made to hold this kind of savings down by emphasizing the sale of Government securities. This was logical on the theory that $1 in savings bonds was more likely to be retained than $1 in increased demand deposits.

The various kinds of savings in liquid asset form could be characterized by degree of "goodness" in the following order: (1) Savings bonds; (2) marketable Government securities; (3) time deposits; (4) demand deposits; (5) currency. I would be willing to argue the merit of this reasoning as a general proposition and I suppose most economists would agree. But I think it is a good deal more complicated than this in the long run.

Demand deposits may hold permanent savings to a very considerable extent. In this connection it should be noted that both individuals and businesses tend to carry a certain amount of working cash in demand deposits and the volume of this working cash rises steadily as economic activity rises.

More working cash is needed as payrolls rise, sales rise, and population and income increase. There is thus a continuous amount of new saving being dedicated to increased working cash as may be needed. On the other hand some time deposits have a high turnover rate inasmuch as many individuals try to economize in service charges levied against demand deposits frequently on the basis of the number of checks written.

While they cannot write checks against time deposits, they can and they do make frequent deposits and withdrawals and thereby utilize time deposits as a vehicle for current cash in much the same way that demand deposits are used.

Representative PATMAN. The same way as practiced in postal savings?

Mr. LINDOW. That is right. Now I should like to turn to the unique ability of the commercial banking system to create credit and what this means in terms of the flow of savings in the economy. Commercial banks create credit by extending loans to their customers. No one bank of course feels that it is creating credit when it makes a new loan, because it will have to count on the borrowing customer withdrawing most of the loan. This however means that funds will be shifted to someone else as the borrower spends them, presumably they will be shifted to depositors in other banks.

If the full amount of the loan is withdrawn from the original bank by the borrower, that bank will have the same total assets and the same total liabilities as before the loan was made. But it will have exchanged some other assets for the note signed by the borrowing customer.

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Other commercial banks will have increased their deposits however as the borrowers spent the funds and the recipients in turn deposited them in their banks. The total assets of the banking system as a whole will have gone up by the addition of the new asset represented by the new note and the deposits of the whole banking system will have gone up likewise.

In this way the banking system as a whole (not to be confused with one bank) creates credit, and both sides of the balance sheet of all banks go up simultaneously, of course.

You may wonder why I have gone into this process when we are talking about savings held in the form of bank deposits. The reason is that the creation of bank deposits, as I have described them here, results in an automatic kind of saving since some one must get the new deposits which have been created throughout the entire banking system. Economists have described the processes that go on here as involuntary saving, that is, if demand deposits go up $5 billion because commercial bank loans go up $5 billion, the public as a whole can not avoid accumulating, that is, saving, that $5 billion in the form of deposits.

This may be considered to be "hot" money. Credit has been manufactured for somebody to spend, possibly unwilling savers have thereby been given new deposits which they in turn may not want to hang on to. Ultimately, as the funds move around from one person to another, they will get into the hands of real savers at which point the involuntary saving will have been replaced by voluntary saving. That is, the increased credit will have been digested perhaps by increased production and possibly by increased prices as well.

But I wonder whether saving in demand deposits is really as passive as this indicates, at least in a growing economy. Suppose year by year people wanted more cash savings as the economy grew. Would this not be a motivating factor in the expansion of bank loans? The sequence of events would be as follows—it would be just the opposite of the one I have just described: First, corporations or mortgagors could not sell securities to individuals or savings institutions to absorb these particular new savings that wanted to go into cash form. Second, they would have to borrow from commercial banks as an alternative source of funds.

Third, the banks would be a passive element in providing a simultaneous increase in deposits to meet the demand on the part of savers and an increase in loans to meet the related need of borrowers. Through all of this the corporations might prefer to get the money from nonbank sources, either in bonds or in equity securities. The public could comply if they wanted to. They always have accumulated deposits on hand and they are continually making new savings from income.

But the public wants the increased demand deposits. What causes the public to want to save in the form of demand deposits? I have already mentioned the growth of the economy as a factor and this is a point that Professor Harris cited the other day when he said we needed continuous growth in the money supply and he was worried about it for some future period. I think there is a second major factor in motivating saving in the form of demand deposits; namely, the total volume of liquid assets. Based on studies that were made in the Treas-

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ury during the war I would say that people like to divide their liquid assets up in various forms. It is like the principle of diversification.

One major form of course is demand deposits. If liquid assets rise $100 billion in any period, the past statistics show a clear tendency for a substantial fraction of this to take the form of demand deposits. Probably what happens is that the growth of liquid assets gives the people more dollars to hold in various ways and they quite naturally are willing to hold more demand deposits under such circumstances.

Cut the liquid wealth back again and they would want to reduce their demand deposits. Increase the liquid wealth still more and they would want to increase demand deposits still more. This leads to still another point. For the longer run, is it not likely that savers, then—that is the holders of these cash funds—determine the level of demand deposits outstanding? If deposits are excessive in relation to needs of the economy—that is the whole economy—will not depositors shift some funds net to earning assets such as corporate securities, mortgages, or Government securities?

This in turn would reduce the reliance of corporate borrowers, mortgagors and the Government on commercial bank funds.

Commercial banks in the final analysis are the residual lenders of funds. What I am saying here is simply that somebody has to hold all the debt (private and public), and if you persuade the people to hold more of the debt that is outstanding then the banks are going to hold less of it. You are going to have less monetized debt. It is in the power of the holders of deposits to change around the way they hold their cash funds. This has an important bearing on the volume of monetized debt.

Where does this lead us? It seems to me that it can be argued that commercial banks as a whole create credit both at the demand of borrowers as customarily explained, and at the demand of savers, that is, businesses and individuals which voluntarily save through accumulations of demand deposits.

The question at any time then would be whether the creation of credit was running ahead of the demands of savers for new deposits. If so, involuntary savings would have to take place. These would have the inflationary implications going with "hot" money. It is this increase of hot deposits which may cause instability from bank credit at times rather than the total increase in deposits taking place. If you need a certain volume of increase in deposits because people want that additional amount of cash and force themselves to save in that form, for whatever the reasons are, then that amount of bank credit creation is necessary simply to keep the economic processes going.

Increases in credit beyond that point are the part that I would worry about rather than the total amount of bank credit. So long as people want to dedicate increased savings to the ready cash form of savings our institutional arrangements provide that such needs will be met. The only way to change this is to induce people to make more funds available directly through the purchase of corporate securities and mortgages or indirectly through their savings institutions. But if individuals do not wish to make such investment and prefer ready cash saving instead, the commercial banks will have to make the loans as a substitute process.

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In conclusion, then, I would say that demand deposits typically represent the accumulated savings of businesses and individuals which remain in the form of cash for whatever reasons the holders have in mind. Such factors as rising business activity, higher prices, views regarding the economic outlook, possible interest earnings on other investments, service charges on demand deposits, and similar factors, all have a bearing. Moreover, the total volume of liquid assets outstanding probably is of considerable importance in determining the allocation of liquid assets among various categories.

In the final analysis the volume of commercial bank loans and deposits is the product of a number of forces pulling in different directions. The public wants to save in certain forms and wants a certain money supply. Business wants to raise money for expansion. The commercial banks want to provide credit to their customers in order to help conduct their business on a profitable basis. The Government, under present conditions, wants to restrain bank credit because of its inflationary implications. All of these forces are pulling and tugging and the public is a very important element in determining the volume of commercial bank deposits.

Representative PATMAN. Thank you, sir.

Mr. MURPHY. I would like to congratulate you on a fine job of mind reading.

Mr. LINDOW. Thank you. I hoped I had interpreted the question properly.

Representative PATMAN. Would any other member of the panel like to comment or discuss this particular question?

Mr. WOODWARD. I think this is an exceedingly interesting analysis. I would like to suggest a possible footnote, which may be included in Dr. Lindow's thinking. As I understood his discussion, he mentioned the influence of interest rates in the distribution of liquid assets between demand deposits and other forms only once. It seems to me that it might be mentioned more than once. We have a considerable amount of evidence that the differentials in interest rates will move funds from one form of savings to another.

Savings banks have discovered this is a very powerful factor. When New York had one rate and New Jersey had another, there would be a sizable movement of funds even on a small differential.

It has seemed to me that the level of the interest rate does have a considerable influence upon the proportion or amount of funds that people will hold in cash, demand deposits or currency; if they are rewarded sufficiently they will economize on their nonearnings assets. If they are not rewarded very much they will not economize, but will hold more non-earning assets. This seems to be significant to a main point of my opening statement; economic instability. The more of these unanchored demand deposits that are created, the more the potentiality may build up for instability over a period of time.

I think it was implicit if not explicit in Mr. Reierson's statement this morning that the large amount of cash deposits created in war financing, when they were loosened by the supply of goods and by popular confidence after the war, contributed a great deal to the large upswing in prices we had at that time. If they had been more firmly anchored I suspect that we would not have had such an amount of inflation after the war.

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Indeed, I think it is a reasonable hypothesis that a slightly higher interest rate during the war would have resulted in more savings going into Government securities and the creation of fewer deposits to bring about inflation. In short, my suggestion is that the interest rate has more of an influence on the determination of distribution of assets and the creation of demand deposits and instability than the literal wording of the statement may have suggested.

Mr. Lindow. I do not think we know exactly how much influence the interest rate has in this particular respect. It surely has some influence; if you get paid for holding your liquid assets in one form and do not get paid in another form, I would think it has an important influence. But I think that there are other things in the picture too; I think that the total volume of debt outstanding and the total volume of liquid assets outstanding are enormously important factors. I doubt very much that a moderately higher rate paid on Government securities during the war would have made an appreciable difference in the statistics on the ownership of the debt at the time.

Surveys made at that time indicate—I am talking now about public opinion type of surveys—that most of the buyers of E bonds did not even know what the interest rate was on the bonds, let alone being motivated by the rate. Also, opinions were expressed in several of these surveys that the prudent thing for a person to do was to buy bonds up to a certain amount, maybe 10 or 15 percent of his wage, and then the smart thing to do with the rest of the money was to divide it up, put some in a savings bank, some in a commercial bank, and maybe some under the mattress. People were asked why they felt this way. The reasons they gave were good, logical reasons.

They were almost all associated with fear of one kind or another. There was a great fear of postwar difficulties, of unemployment, of freezing of bonds. You may not remember the talk that occasionally cropped up that E bonds were going to be frozen; that the Treasury was not going to be able to meet all the demand redemptions after the war.

Representative Patman. And compulsory savings were discussed.

Mr. Lindow. That is right. I think the natural thing for human beings to do when they find collectively that their liquid wealth is being pushed up very rapidly by the creation of debt, that they will divide up the assets in various liquid forms including demand deposits. I am not going to deny the implications of Mr. Woodward's point. There is certainly something to it. Interest rates are important in shifting savings around from one institution to another; but I do not think we should assume for one minute that moderately higher rates on E bonds during the war would have prevented the growth of demand deposits.

Representative Patman. Mr. Reierson?

Mr. Reierson. Mr. Chairman, I wonder if I might have the privilege of appending a footnote to a footnote. Apropos of Mr. Woodward's comment and Mr. Lindow's rejoinder, I wonder if the facts do not indicate that in the postwar years the interest rate on savings bonds was an important consideration to some holders? Certainly I think that the meager sales and large redemptions of the large-denomination bonds in the past year or thereabouts would indicate that some holders at least are significantly affected by the yields.

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Mr. Lindow. I hope I am not being pushed into the position of denying that interest rates have any validity because if so I am going to get out of it right away. Surely there are holders of savings bonds who are very much influenced by the rate. Surely many of them bought savings bonds during the war and later on did not keep them because the rate did not go up and alternative investments had a higher rate. But the great mass of individuals during the war were not rate-conscious, and were interested in increasing cash assets as well as buying E bonds.

I would like to add a footnote to end this series of footnotes, and that is that the opportunities for investments in other forms became much more plentiful at the end of the war. It is not solely a matter of rate which determines the way people divide up their money. It depends on a lot of things, including whether they feel that they have the right percentage distribution of their total holdings in the form of different kinds of assets. Take the life-insurance companies. At the end of the war 45 percent of their assets consisted of Government securities, a highly abnormal amount. The prewar percentage had been below 20 percent. I think that the general feeling in 1945 was that the high percentage was all right because "we are probably going to get into some kind of recession when the war ends anyway" and they would be mighty glad to have all those Government bonds when new investments were scarce.

Instead of getting into a recession, we got into a boom. The opportunities for higher-yielding investments in the form of mortgages and corporate securities were plentiful. The percentage in Government securities was reduced from 45 percent to the present level, I think of around 16 percent. I do not think that all of that reduction can be attributed to the fact that interest rates were higher on corporate securities and mortgages than on Government bonds. I think that a large part of the shift from Governments to other assets occurred simply because it was abnormal to have such a large ratio for Government bonds. At some point you try to get back to a more normal ratio. I do not claim to know what normal is. I expect we are probably getting back near to it now. At that point the desire to shift out of Governments into other securities is diminished very sharply. What I have said about insurance companies applies also to other investors and I think it must have applied to some of these holders of large-denomination bonds that Mr. Reierson is talking about. For a long period, during the depression and the war, the only real opportunities for investment were Governments. When other opportunities come along the logical thing to do is to take them.

Mr. Fleming. Mr. Chairman, referring to Mr. Reierson's statement about the redemptions of the larger holders, I think of some other factors. I think first of all that they acquired these bonds with a patriotic motive, everybody doing their bit to help the war effort. When the war effort was over and our tax rate started to rise, there was no income on those bonds, and even if there were income, the net return to those who had the means to buy the larger savings bonds would be so small that they naturally turned to some other types of investment so as to be able to keep something for themselves. The patriotic motive was out. We did not have a Pearl Harbor to shock us into the necessity of that patriotic impulse.

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Representative PATMAN. Mr. Tapp, would you like to comment on this question?

Mr. TAPP. I might comment on one other aspect of this question as it is written here and that is with respect to the stability of time deposits. I think some of our ideas about instability of time deposits were acquired from the experience during the depression period when we had a very substantial decrease in the volume of time deposits, first due to change in classification by the depositors shifting from time over to demand and later by the problem of bank foreclosures.

So that we did have a very sharp decrease in time deposits between 1929 and 1933. But if you will examine the experience of mutual savings banks during that period you will find that their time deposits showed very little decline. I would think that under the present system of deposit guaranties that the behavior of time deposits in commercial banks might, during a period of readjustment, tend to behave more like those of the mutual savings banks during the period 1929–39.

Representative PATMAN. Mr. Woodward?

Mr. WOODWARD. Just to be sure that there is no misunderstanding on the record, I want to say that as I understand it, the life-insurance company shift from Governments to non-Governments was tremendously affected by the interest rate. I do not know just how much importance Mr. Lindow means to give to it, but I would like to say that it is very important.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. We had tremendous emphasis throughout these hearings for good and sufficient reasons on the way in which the activities of the Federal Reserve Board can create reserves which can then affect the availability of credit in commercial banks. I am interested in our getting into the relationship between the lending of commercial banks and the noncommercial bank lenders. I have not been able to get any very accurate figures on volume for any specific period, but I gather that the noncommercial bank lending is larger than that of commercial banks. What is the impact on that field of credit of the activities of the Federal Reserve Board as they affect the commercial banks? How much is transmitted through, in some process? What comments could be made on possible improvements in our management of that whole area? That is a big question?

Representative PATMAN. Who would like to answer that? Anyone of the panel?

Representative BOLLING. Perhaps I can make it more pointed. My impression has been that quite a number of people in the commercial banks have indicated that if their reserves are too seriously restricted by activities of the Federal Reserve, perhaps new reserve requirements and so on, that then they are actually put in an unfair position competitively in relation to the noncommercial bank lenders. So that it might be that Mr. Woodward would be the one to start this off.

Mr. WOODWARD. I will try. I am not quite clear, sir, as to what the question is. Let me make a couple of comments and see if I am being responsive.

So far as the noncommercial lenders are concerned, they have funds only of two kinds which they can invest. One is that strictly of savings, which arises from deposits and premium payments, and that sort of thing, and including the interest earned and amortization on their

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investments. In all these activities there is no process of credit creation involved. They simply take the funds and reinvest them. The other source of funds which they may have is in the conversion of existing assets, the sale of one asset to get funds and reinvesting those funds.

To the extent that the latter procedure represents sales of Governments, commercial bank reserves may be created. Reserves obviously will be created if the Federal Reserve purchases the Governments.

This conversion of assets, more specifically conversion of Governments, is the one place where credit creation is involved anywhere in the nonbank lending process.

One other point: If the commercial banks buy assets which the nonbank lenders are selling, there will be an increase in the quantity of money, by the process Mr. Lindow described, though there will not be an increase in the volume of reserves. Is that responsive to your question?

Representative BOLLING. It certainly is. That is exactly the thing that I am after. The further point that I am interested in is the reverse perhaps of the process that you have described. What is the impact on the nonbank lenders of the activities, of various activities of the Federal Reserve Board. For example, when they increase reserve requirements, unpeg the market, and so on, what are the impacts on the nonbank lenders? I am aware of some, but I wonder about others that I am not aware of.

Mr. WOODWARD. When they unpegged the market, as I have said in answer to the chairman's question a while ago, they did reconstitute a restrictive process on the volume of credit. The market was made more difficult for the sale of securities, so the nonbank lenders were restrained from the conversion of assets by the sale of securities and reinvestment, though, of course not prohibited.

General credit control and higher interest rates may be restrictive on the volume of money. If carried very far, but not far enough to cause a significant change in the level of incomes, higher rates will I think increase the volume of savings that appear among the nonbanking institutions. As Mr. Lindow stated a while ago, there probably is some kind of a rough relation between the quantity of money and the volume of savings and the volume of liquid assets which we cannot specify with much clarity; and I suggested that the relationship probably can be altered by interest rates.

But over-all we are discussing the operation of a complex—not in the sense that I was using the word in my opening statement—a complex monetary savings system in which general credit restraint will tend to slow activity, and general credit liberalization will tend to increase activity, though we cannot state just how much of what will cause just how much of what.

Representative BOLLING. Then it will be your opinion that the tools that are available now in various ways, but primarily through the operation of the Federal Reserve Board and the Open Market Committee, are adequate under present conditions to restrain credit enough?

Mr. WOODWARD. I think so, sir. I am always hesitant because the history of the Federal Reserve System, and indeed of central banking in other countries so far as I know it, has been the practice of an art. I think when the Federal Reserve System began, for example,

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there was very little comprehension of what we now call open market operations and regard as almost the primary instrument of the policy. I do not personally remember it but I believe that open market operations were not within the purview when the act was founded.

This was an invention, a discovery as time went on, that something could be utilized that had not been utilized before. In that sense it was an unorthodox thing.

Representative PATMAN. May I interrupt there? Mr. Martin, Chairman of the Board, testified on that point. I believe he stated that the original reason for the first open market operation was to secure earning assets for the 12 Federal Reserve banks. Am I correct in that, Dr. Murphy?

Mr. MURPHY. He said it in his written answer. I am sure of that. I believe he said it in his testimony.

Representative PATMAN. I am quite sure that he did. That is the way I remember it.

Mr. FLEMING. When the Federal Reserve System was created there was no thought that Government securities would be used to the extent of operations as developed in World War I and II, and subsequently. The whole thing was founded upon discounting commercial paper and making last currency and forming a money pool which could be shifted from one section of the country to another in times of crop moving or wherever there was money shortage.

That ties into the power that the Federal Reserve Board required a Federal Reserve bank to lend to another Federal Reserve bank and state the amount of interest to be charged. It was based upon commercial paper which vanished to a certain extent and was substituted for Government securities.

Then the open market operations got into full swing.

Representative PATMAN. I am not sure about this but I have a feeling and what I say is not intended as criticism, but I have a feeling that they were trying to avoid direct appropriations from Congress, and that one way of doing it was to take the money that Congress made available to them and trade that money for interest-bearing obligations, and then take the interest and use it for their purposes, rather than for Congress to make an appropriation. Do you not think that entered into it?

Mr. FLEMING. I think that undoubtedly entered into it at the very start. But that was a very minor operation at the time. Subsequently of course, the operations have become of great importance in the economy of the Nation.

Representative PATMAN. Yes. Now the Federal Reserve banks have almost as much in bonds as the national debt was up until say 20 years ago.

Mr. FLEMING. Yes, sir, about $22 billion.

Representative PATMAN. If somebody had suggested then that the Federal Reserve banks buy the national debt, I suspect we would have had an argument on our hands. Excuse me for interrupting.

Mr. WOODWARD. To complete what I was saying to Mr. Bolling, I think the Federal Reserve and these agencies in the central monetary complex have a very large variety of powers and instruments, not all of which they have been using very much. Indeed some of them hardly at all. I am not sure that they do not need more powers

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but I think that we could suspend that question until ingenuity is applied to see if the job can be done with their present ones which are very large and not entirely used.

Representative BOLLING. I have one more very general question. Two decisions were made, two policy decisions were made, as to the manner in which we would go into this partial mobilization, whatever the proper term for it is—that is, the manner in which we would meet the new situation created by the Korean attack. One of those decisions was that our primary purpose would be to create production capacity for military hardware, that it would not create a tremendous amount of hardware.

We were setting up production lines. Two, there were two choices as to how that would be done. One by Government construction of plants and facilities as was done in World War II to an appreciable degree, and two, almost entirely by private industry, private enterprise. I think that is a fair statement of the two policy decisions. Within the framework of those two policy decisions, could those programs have been carried out if there had not been a very substantial expansion of credit in the commercial banks?

Mr. FLEMING. My answer to that is that there could not have been. You cannot have the defense production that we are getting now or will get unless there are credits for it. Up to the present time the various defense departments mainly relied upon the private sources for credit rather than to centralize and make the advances themselves. To illustrate, in the beginning of World War II, I would not want to venture to say how many millions of dollars of credits were arranged by industry with the banking system.

I think the largest was the General Motors which was $1 billion. It was never availed of. The reason was that the Government itself, through the Army and the Navy, made the advances themselves because they thought they could get it in production more speedily than by going through the regular credit structure—the private credit structure. You just cannot do two things as we are doing today, one, build this vast defense establishment, and also generate sufficient productive capacity to meet the civilian needs which are good to hold inflationary pressures down without credits being established for it, and particularly on the plateau that we are on now.

Representative BOLLING. That ties in pretty decisively with the other things that have been said in this panel, that monetary policy, while important, could not have been described as the decisive factor in restraining inflation. I am not saying was not, but could not have been the decisive policy in restraining inflation in the immediate post-Korean period.

Mr. FLEMING. I think Mr. Reierson's chart that he gave, possibly chart 6 or 5, showed the level of bank loans to gross national products. Maybe it was 10. I have forgotten the number. But while it rose, it did not rise commensurately with the gross national product but it did have a bearing in creating the gross national product.

Representative PATMAN. Mr. Wolcott.

Representative WOLCOTT. The Joint Committee on the Economic Report, was set up to try to prevent the dips and booms in our economy, all of which were most interesting when I went to school, but it seems to me that during these hearings we have not gotten any definite recom-

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mendations as to just what this committee might recommend to prevent further inflation. Is the panel prepared to give us their ideas as to what we could recommend to the Congress, or what could be done within the Treasury, Federal Reserve, to prevent further inflation?

Representative PATMAN. That is an excellent question. You recall that I asked one witness the other day, reminded him that he had given us good methods to stop inflation, but he had not suggested anything to stop deflation.

Representative WOLCOTT. There are a lot of things that bother me. I understand if the Federal Reserve were given additional power to raise reserve requirements, the banks would be compelled to offset that by selling some of their Governments, and the Federal Reserve would have to buy the Governments. That just does not make sense. If we are going to attack inflation, it does not make sense.

I do not understand the process by which we stop inflation on the one hand and encourage it on the other.

Mr. FLEMING. One phase that does not require legislation is that the Treasury could find ways and means by which they could finance deficits, as there will be by the end of this year, from nonbanking sources. That is one problem. That is a factor tied into revitalization and reexamination of the whole savings program to try to attract the money. That is where the money is, in the smaller income groups.

Representative WOLCOTT. Could you not do that by selling your Governments in the open market other than to the Federal Reserve System?

Mr. FLEMING. I think first of all, as you know, as you sit on the Banking and Currency Committee, a bank in a Reserve city such as we have here—there are 63 in the country—they have 20 percent of every deposit locked up to begin with in the Federal Reserve.

In addition to that, they have the till cash that they use to do business—in my institution that amounts to about $5,000,000. Then, in our case, in the neighborhood of about 15 to 20 million dollars of money must be carried with correspondent banks in order to pay them for the services they are performing for our clients, and to speed up the transactions that go through industry.

That takes quite a sizable chunk out of your funds. You have to have a secondary reserve. If you raise these reserve requirements further, and at this particular time, you have a situation which, even if the power was granted at this moment, they could not use it because we do not know at this moment whether the Treasury is going to sell the securities for deficit financing to the public and not rely on the banks.

Representative WOLCOTT. Is that the reason why the members of the Federal Reserve Board cannot agree on the reserve requirements that they will ask of the Congress?

Mr. FLEMING. There have been continuing studies on that, various types of reserves that might be imposed. One of the best ones was the uniform reserve plan which, of course, provided for reduction in reserves in order to put it into effect. Right now there is about $600,000,000 of excess reserves in the country, member banks in the country. I do not look for loans to go down sufficiently to make room for any deficit financing if they have to turn to the banking system. I do not think at the present moment, with the forty-two-billion-odd dol-

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lars that the Treasury has to refinance, with the situation in the offing of anywhere from $6 to $11 billion of deficit financing in the second half of this calendar year, that there is very likely to be an increase in the rediscount rate which has a direct bearing on the cost of the public debt, which is estimated at $6,200 million in the new budget.

Representative WOLCOTT. Senator Douglas said that inflation is a matter of Government policy for everyone.

Mr. FLEMING. If the Treasury cannot tap nonbanking sources for any deficits that occur—and loans do not go down sufficiently, and I do not think they will—then the Open Market Committee would have to take a sizeable, as I see it, a sizeable part of the first Treasury offering which would put automatically the reserves in the banks of the country where it would allow them to buy on the next offering.

In other words, it is a priming of the pump operation because it does not do any good for banks to sell securities to the Federal and then buy new issues. That is a rather cumbersome procedure and not liable to occur. Any power that is given to them in the immediate, foreseeable future I do not believe could be used.

Mr. LINDOW. Could I add something?

Representative WOLCOTT. I should hope that the entire panel would get in and help us out in this dilemma. I think Congress and the people generally are asking us to make some recommendations as to what might be done to avoid further inflation. I have some rather hairbrained ideas that I do not seem to be able to get anywhere with. I am trying to see if I cannot substantiate some of them.

Mr. LINDOW. I think the Federal Reserve has been criticized too much, sometimes very unfairly. I think considering the problems that they had to face in the last 10 years that they really did a very good job of meeting those problems. The idea that you can use monetary policy to cope with every economic problem does not seem to me to be right, and it is unfair to the Federal Reserve. This committee, if you want a suggestion, I think could put down a list of the inflationary factors of the postwar period, and probably a better list and a more complete list than I attempted to do in my earlier remarks today.

Representative WOLCOTT. You did very well. You could add to that list what we did legislatively in the 1930's to bring about inflation. I think probably you would have had a very complete list of the causes of inflation.

Mr. LINDOW. Could you not go down such a list, line by line, and say which of these policies involve the Government? It goes way beyond the Federal Reserve and the Treasury. For example, the business of having constant increases in wage rates that go beyond productivity—the Government encourages that. Also the housing program moves along faster at times than our real resources will permit, and the Government encourages that too. Then the veterans' program may be running too fast. I think there are a lot of items that go way beyond the monetary-debt management area. Then there is the deficit problem which is coming along this year.

A $7 billion deficit, or whatever it is going to be later this year, may not have to be. I do not believe that we should just take this for granted and say that we are stuck with $7 billion, and the Treasury ought to finance it outside the banks.

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Of course, we should try to do this, if we are going to have the $7 billion deficit, but is the deficit really necessary?

Representative WOLCOTT. Possibly what you are saying is that the reason why last year we had the Treasury surplus, we had our biggest depreciation in the value of money, the most inflation.

Mr. LINDOW. Absolutely. I would like to see somebody analyze the causes, instead of looking for a way in which we can turn one valve and solve all the problems. I personally think we should turn all the economic adjustment valves that we can; I think there are a lot of them. Some gain can be had here and some there. But the excessive use of any one of the national economic tools that we have is likely to cause unemployment and not the high level of production that you want.

I think Mr. Bolling had something in his line of questioning, that what we are after is more production in order to sustain us if international trouble comes. We can stop inflation, but we must do it in the right way. There are more things than inflation in this picture to worry about.

Representative WOLCOTT. Government spending seems to have terrific influence on inflation. We all recognize that. As I recall it—I hope our memories are not so short that we forget—a month before Korea we were faced with a recession or depression, or some cut-back. Since then we have had an inflation to the point where if we continue this same fiscal policy that we have been living with for the last 18 months, for another 3 years, with the influence deficit financing has, and the anticipation of deficits for the next two 18-month periods, we can only expect further depreciation. The danger of another 12 percent depreciation alarms me, rather shocks me into the realization that somebody around here, including ourselves, perhaps, is not doing too good a job.

Representative BOLLING. Is it generally accepted that the month before Korea we were in whatever you want to call it, a recession?

Mr. FLEMING. I think we were.

Mr. LINDOW. I do not think we were. I think we had come out of a recession, a mild one, in 1949. We had a big increase in production from the middle of 1949 to June 1950. I do not think we were really in a recession, Mr. Fleming, although some people thought that this was a little bubble and we would have more trouble later on.

Mr. FLEMING. I did not mean to say that we were in a depression. But the atmosphere was certainly one that indicated that business activity was tapering off and we might need some props.

Representative WOLCOTT. I recall in 1949 and 1950, in the President's economic message or the budget message, there was an indication—in 1949—that he wanted the same controls that he had in the Second World War to prevent a depression. It was joked around here perhaps too much. Then again in 1950 he asked for the same controls to prevent a depression, thinking that under a managed economy undoubtedly that he could do the job that we were set up here to do. We did not give him the authority.

Perhaps we should have given him the authority so that he could have prevented the depression or recession, or whatever it might be. But surely with the tools which he had, he has not been able to do the job which people had a right to expect of him. If Government is going to take the responsibility of managing our economy, of course

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Government has to take the responsibility for inflation and depression. I, frankly, have been sitting here now on this and the Banking and Currency Committee since 1933, and I do not remember when I was ever as alarmed as I am at the present time with respect to Government. What can we do about it;

Representative BOLLING. Mr. Woodward?

Mr. WOODWARD. If you want an answer from all of us, I would be glad to give you my answer.

Representative WOLCOTT. I submit to the chairman that it would be helpful, at least helpful to me.

Representative BOLLING. I think it would be very helpful.

Mr. WOODWARD. I would like to go back to the main point that I tried insufficiently, perhaps, to make this morning. It does not seem to me that Congress can undertake the mechanical job, Mr. Wolcott; for example, it cannot undertake to set discount rates and reserve requirements and things of that sort. Congress must move rather slowly. It is a deliberative body. Whereas actions in the economic area, to implement policy making, require action with greater speed than Congress can do it. Therefore, it seems to me that in moving against either inflation or deflation—and I agree with you that our acceptance of inflation has been very shameful and that all of us have been here while it has been happening—Congress must provide the policy and delegate the authority to the agencies to carry on.

Monetary policy, I agree, is not everything, but let us not dismiss monetary policy until we have used it. I submit that we have used it very little in the fight against inflation, because we shackled monetary policy about 1940 or 1941—if not earlier—and we only just barely began to unshackle it last year.

I would reiterate my suggestion, therefore, that the Employment Act be amended to include an objective to give attention to the value of money as well as the other objectives with which I thoroughly agree, and that the variety of executive ageneies dealing with the loaning, insurance, guaranty, and expenditure of funds, be put under a congressional directive to follow monetary policy as determined under the conditions by the Federal Reserve Board which would be acting against inflation or against deflation, as the case might be.

I would not for a moment exclude consideration of other activities in the wage-price area and in other areas. But monetary policy can do much more than it has done.

Finally, I have appeared before the Joint Committee on the Economic Report at its round table before and I have in front of me the statement that I gave to the committee on January 30, this year, with a number of specific suggestions. I should like to reiterate them. At that time I suggested that we spread the military expansion program out over the maximum time that the experts believed prudent, and I suggested that this is not solely a military decision, but that this is a political decision of the highest order.

Secondly, that we curtail the expansibility and contractability of the monetary system. You are concerned with that and the suggestions that I have just made go to that point.

Third, that we decentralize decision making so that little mistakes will have little importance and even big mistakes do not shake the world.

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Fourth, let markets make decisions instead of men to the utmost possible extent.

Fifth, encourage savings that stay put.

Sixth, restrain public expenditure to the utmost possible degree.

Seventh, seek to bring about conditions most conducive to regularization of business investment at a high level.

Eighth, open much wider the channels of trade among countries.

Ninth, give added encouragement to scientific and technological development.

These are all broad directive kinds of things.

Representative WOLCOTT. It is very helpful. The suggestion has been made on several occasions that we lay down an inflationary policy in the Employment Act of 1946, in that it is the policy of the Government to practically guarantee full employment, high income, and as high as possible productivity. That was propably a good policy, but I wonder in the administration of our various laws, if the authorities are not taking that too liberally.

Mr. WOODWARD. That is the reason that I feel it highly important that a clause on the value of money be added to the other considerations in that act. If that defect—to me it is a major defect—if that defect were remedied it seems to me that the preamble, more accurately the declaration of policy, would be a good policy.

Representative WOLCOTT. Picking up just one more thought, the factor of monetization of debt and the influence which deficit financing has on the value of the money, that was not apparent previous to the mid-1930's because the volume of our money was pretty well regulated by commercial paper, was it not?

Mr. FLEMING. Yes, sir.

Representative WOLCOTT. We substituted Government debt for commercial paper. It seems to me we have wedded the debt so closely to the value of our money, that fluctuations in the debt are reflected almost in the same proportion to fluctuations of the value of our currency because the fluctuations in debt have always been up and the fluctuations in the value of the currency have always been down.

Is there some suggestion which you could make to us that we could make in the form of a recommendation to Congress to correct that situation, to divorce debt, or some part of debt, from the value of our money, and remove somewhat the influence which deficit financing has upon the value of our money? To make myself a little clearer, I will propound a direct question. Would it be possible to put a ceiling on the amount of bank debt above which that debt would not be monetized?

If we do not want to restore the gold reserve to 40 percent behind the issuance of Federal Reserve notes instead of the present 25—it was 40 and then reduced to bring about inflation—could we perhaps by legislation provide that not more than a certain amount of the available gold could be used as the basis for the monetization of bank loan debt? Are we getting into too crazy a field?

Mr. LINDOW. Somebody has to hold this debt.

Mr. FLEMING. That is right. You are in a very difficult area there.

Representative WOLCOTT. That is why I said in the first place, because of the situation, must we accept inflation as a matter of permanent Government policy?

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Mr. LINDOW. I would say "no," but I do not see that you can do anything in the way of legislative limits on bank-held debt. As a matter of fact, I am not convinced that the monetization of debt is the only important part of the story anyway.

Representative WOLCOTT. I agree.

Mr. LINDOW. I think we probably have not paid enough attention to the economic consideration of debt as a whole. While I do not claim to have any answers, I feel that more attention ought to be given to the significance of the creation of debt.

As long as we have a public debt that results from spending in excess of tax revenues, I would hate to see anything that limited bank holdings because I think it would make an almost impossible situation for the Treasury. They certainly do not want to sell the debt to banks. They stood on their heads to sell as little as possible to banks during the war.

People are inclined to think that they could have done better, and I am sure that they could have. Nothing is ever perfect. But, as one of those who was involved in it at the time, I think it was a pretty fair job. I just do not see what the Tresury would do if you put a limit on bank holdings. What would they do? Not pay Government bills?

Representative WOLCOTT. Yet the balancing of the budget does not seem to be the answer.

Mr. FLEMING. Mr. Wolcott, in defense of the banking system let me say that the bankers of the country are not anxious to have any more Government debt. They are going to work their heads off to help the Treasury in getting this debt into nonbanking hands, noncommercial bank hands. I agree with Mr. Lindow that there has to be some escape there if the Congress appropriates X dollars to be spent and you cannot get it from taxation and you cannot get it from nonbank sources.

Representative WOLCOTT. I quite agree with you that banks are not at fault. It seems to me that banks have been mainly fiscal agencies for the distribution of inflation under Government policy. I think under our present policy probably that is the only way we are going to be able to finance our war effort.

I wonder if there is not some other alternative.

Mr. REIERSON. In an earlier day, in a less sophisticated world, there was another way. Clipping the coinage or issuing paper money.

Mr. FLEMING. That was inflation.

Mr. REIERSON. We are now more sophisticated. We have graduated from those simple and more direct ways of dealing with these matters. If I may make a few random observations on the very important question that you pose: I start with the assumption that we shall never be able to achieve complete stability of prices; that as long as business activity fluctuates—and I think it will continue to fluctuate, the Employment Act of 1946 to the contrary notwithstanding—prices will tend to fluctuate with the levels of production. I take it that the thing we are all concerned about is not the fluctuation in prices which is associated with some relatively modest changes in the rate of industrial production.

I have the feeling that as of today the inflationary potential in this economy has been reduced rather substantially, first, because we have

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taken care of a large part of the deferred demands which existed at the end of the last war, and, secondly, because the size of the economy and the price level under which it operates, have together resulted in our growing up to the money supply and, to some extent, to the amount of debt we have outstanding.

Looking ahead, it seems to me that there are really three avenues through which significant and serious further depreciation in the currency can develop. The first of these, I think, is typified by what happened after Korea.

I would suggest that to cope with a psychological situation of that kind is well-nigh impossible as a practical matter. Had we wanted to prevent the price increases that occurred after Korea, we would have been forced to impose overnight very substantial price controls, wage controls, controls over inventories, construction, and perhaps consumer rationing. Obviously we did not have the machinery. We were not ready to do it.

How salutary the experience of Korea will be if by chance we are confronted with another situation of this kind. But if, after a few years, we take off controls and abolish the machinery, and if we then have another deterioration in the international situation similar to that of mid-1950, I think we shall again face problems that are about as incapable of solution.

Excluding these very serious inflationary outbursts of a psychological origin, I think there are two inflationary risks we run over the long range.

The most important of these, I think, is unquestionably fiscal excesses. I see no alternative to facing the need for developing a sound fiscal policy. I think that any other course is simply temporizing. If we do not have, in our democracy, the good sense to recognize the long-range implications of fiscal excesses, then I am afraid that further deterioration of the dollar is almost unavoidable. I hope that this will not happen. It need not happen. But from my rather limited knowledge of what has happened in years past in other countries, it seems to me that the lesson of fiscal excesses is a lesson that shall never be forgotten.

Beyond this, I think, the second inflationary factor that is operating in this situation is the one to which Mr. Woodward referred, and that is the full-employment philosophy. It seems to me that in the postwar years we have had a series of experiences which raise a grave question that should be considered very seriously by the Congress; namely, can we have full employment without inflation in a political democracy with the potent pressure groups that exist?

I think that we here face the very real danger of using our ammunition at the wrong time, that we shall do everything possible to prolong every upward move instead of being willing to accept a certain amount of slack in the economy. To the extent that these efforts are successful, we reduce or limit the readjustments in the price structure that might otherwise occur. We put floors under prices so that each cyclical increase in prices starts out from a successfully higher floor, or from a floor that would not be as low as otherwise would be the case.

So the whole gamut of governmental policy has to be appraised in terms of this basic question: Are we paying too high a price for the last ounce of employment? I think the question was raised by Sena-

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tor Douglas very appropriately one day last week as to what levels of unemployment might be proper in an economy of this kind. I think he has put his finger on a very crucial factor which has important ramifications throughout all governmental policy.

That is why I come back to the point of view I expressed somewhat earlier, that this problem is so complex I doubt there is any very easy solution. We need to use all the instruments we have. I think we have to put first things first and recognize on the one hand the tremendous importance of fiscal policies, and, on the other hand, the implications of political programs for full employment.

Representative WOLCOTT. I want to thank you, Mr. Reierson, Mr. Woodward, Mr. Lindow, Mr. Fleming, and Mr. Tapp for a very interesting day. I think they have been most helpful to us. I think it is an imposition, Mr. Chairman, to keep them here any longer.

Representative BOLLING. Mr. Murphy, do you have any questions?

Mr. MURPHY. Despite the lateness of the hour, I would like, if I could, to take a poll of the panel on one point. The Douglas committee in its report 2 years ago included this recommendation:

> We believe that to restore the free domestic convertibility of money into gold coin or gold bullion at this time would militate against rather that promote the purposes of the Employment Act and we recommend that no action in this direction be taken.

Would you like to comment on that, Mr. Fleming?

Representative WOLCOTT. Will you pardon me, Dr. Murphy? May I call attention to the fact that there is written in there "at this time."

Mr. FLEMING. Yes. As I understood what you read there, it was a question——

Representative WOLCOTT. In other words we did not want to recommend against the discussion of the desirability of converting back to the gold standard sometime in the future.

Mr. MURPHY. My present question is whether or not we should reiterate that in our report without foreclosing the possibility that we might wish to return to domestic convertibility at some future time.

Mr. FLEMING. In the posture of the whole world today I do not think it would serve any useful purpose to make money convertible into gold coin.

Mr. LINDOW. I would repeat the wording in the Douglas report.

Mr. FLEMING. You agree with this?

Mr. LINDOW. Yes.

Mr. WOODWARD. I would not repeat that wording, if you looked at me, Mr. Chairman. I think one of the most interesting things that has happened in recent years has been the meeting lately in London of the Finance Ministers of the British Commonwealth of Nations, and the statement by the Finance Ministers of the British Commonwealth that they want to move as rapidly as possible toward the convertibility of the currencies into gold.

I think that with that declaration from that important group of nations, raising the possibility that bad money made be made into better money throughout the world and thus improve the vehicles of trade, that it would be a mistake on our part to take an adamant stand of any kind. This is a historic move. We ought to be in a position to join in anything that can be done.

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Mr. MURPHY. Mr. Woodward, I would like to raise a very important question at that point, and that is, as I understand it, the proposal with respect to the British Commonwealth is not to restore a domestic convertibility of gold in their respective countries, but to return to the very type of gold standard which the United States is now on, that is, to make its currency convertible into gold and other currencies for all external transactions.

So it would seem to me that a declaration of this kind would facilitate rather than impede what the British Commonwealths are attempting to do. If the United States should restore the domestic convertibility of gold, would it not create a shortage of gold which would greatly interfere with British Commonwealths in their endeavor?

Mr. WOODWARD. I did not understand there was that firm a limitation on the London declaration. What I am suggesting is that since they want to move in the direction of a greater utilization of gold, let us be receptive and encouraging in any way that can be done instead of taking a position of any order now.

Mr. FLEMING. Do you not think, Mr. Woodward, it would be a rather dangerous experiment to make currency now to anyone convertible into gold? Maybe my mind is a little bit too fresh as to what happened in 1933 where the gold was just sucked out of the whole Federal Reserve System until they could not make a loan below their reserves, each individual thinking that he could get the gold and protect himself, rather than recognizing that he was in a collective community where he could not stand individually and alone.

There is no question but that people think that the feel of gold in their hands gives some confidence in the dollar. Whether that outweighs the fact that those frightened people will again want to suck our gold out and bury it around I do not know. I had a unique experience. My office was the only one in our bank that had curtains on where you could not see what was going on. I became the teller that received all the gold that people came in, after they dragged it out of other banks and the Treasury, they would all come in—gold is very heavy—they would come in weighed down on one side and they all had the same story, that they had a little gold in their family, and, in my opinion, they just did not have this $5,000 or $10,000 in gold in safe-deposit boxes.

If you feel that the temper of the people is such that you need that confidence, to let them feel or bite the coin, that is one thing. But if you believe, as I do, that a lot of people would suck the gold out as they do right now in France, I do not think it would serve any useful purpose at the present time.

Representative BOLLING. Do any of you gentlemen have any comments?

Mr. TAPP. I think that with that "at the present time" in there I would have to agree. It might be well for us to state more positively our determination to return to something in the nature of a gold standard when stability in world affairs permits. I would like to see some positive indication that we do have that objective in mind and that we are prepared to cooperate with other like-minded nations to that end.

Representative BOLLING. Mr. Reierson?

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Mr. REIERSON. I concur in the wording of the Douglas report.

Representative BOLLING. Are there any further questions or comments of the Government panel?

(No response.)

Representative BOLLING. The committee is grateful to you for your presence here and for the enormous contributions that you have made.

The committee is now in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 4 p. m., the subcommittee was recessed, to reconvene at 10 a. m., Tuesday, March 25, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

TUESDAY, MARCH 25, 1952

Congress of the United States,
Subcommittee on General Credit Control
and Debt Management of the
Joint Committee on the Economic Report,
Washington, D. C.

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

Present: Representative Patman (chairman of the subcommittee); Senator Flanders, and Representative Bolling.

Also present: Grover W. Ensley, staff director, and Henry Murphy, economist for the subcommittee.

Representative Patman. The committee will please come to order. Senator Flanders will be here, and Senator Douglas is getting in this morning from Chicago, and will be here later; Representative Bolling is here, and Representative Wolcott will be here directly.

We have with us this morning, Mr. Howard S. Ellis, professor of economics, University of California; formerly president of the American Economic Association, formerly Assistant Director of Research and Statistics of the Board of Governors of the Federal Reserve System; editor of Survey of Contemporary Economics, a review of contemporary economic theory officially sponsored by the American Economic Association.

Mr. Milton Friedman, professor of economics, University of Chicago; formerly member of the research staff, National Bureau of Economic Research; formerly member of the staff of the Division of Tax Research, Treasury Department.

Mr. Paul Samuelson, professor of economics, Massachusetts Institute of Technology; consultant to the tax advisory staff of the Treasury Department.

Mr. C. R. Whittlesey, professor of economics, Wharton School of Commerce and Finance at the University of Pennsylvania, and economist for the Penn Mutual Life Insurance Co.

And Mr. Raymond Mikesell, professor of economics, University of Virginia, and formerly a member of the staff of the Office of International Finance, Treasury Department, now consultant on international finance to the Department of State.

Professors Ellis, Friedman, Samuelson and Whittlesey were participants in the Conference of Monetary Economists at Princeton,

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N. J., in October 1951. The statement resulting from this conference is reprinted as chapter 14 of our compendium, Monetary Policy and the Management of the Public Debt.

We are delighted to have you gentlemen this morning, and we are looking forward to hearing your testimony.

The suggested topics for discussion this morning are—I will just read all the topics at one time, and then we will call on the speakers, and they can cover the points that they would like to cover—first, how much reliance should be placed on (*a*) direct controls, (*b*) selective credit controls, (*c*) general monetary (that is, "tight money") policies in combating inflation? Under present circumstances? Under other circumstances?

Two. Is a tight money policy compatible with maximum production and employment?

Three. How desirable is a stable Government bond market? Now? Under conditions closer to total war? In a peacetime inflation?

Four. What kinds of securities should the Treasury issue? Now? Under other circumstances?

Five. What is the proper relationship between monetary and fiscal policy?

It has been suggested that we first call on Mr. Ellis for his comments. Mr. Ellis.

STATEMENT OF HOWARD S. ELLIS, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA

Mr. ELLIS. Mr. Chairman, I should like to direct my remarks to a few fundamental propositions that are sufficiently well known, but which may bear repetition in the present context.

The first of these pertains to the relative importance of direct controls, selective credit controls, and general credit controls.

Direct controls are chiefly useful in coping with a few specific shortages in an emergency. In this particular role they are significant chiefly for influencing the direction of spending, and only slightly in controlling the total amount of spending.

If they are small in number they deflect spending to other lines. If they become more numerous they approach the controlled or socialist economy, and if all-inclusive, they may suppress inflation, but do nothing toward removing or limiting the underlying inflationary pressures.

Much the same thing may be said concerning selective controls. They also have a slight influence in limiting inflation, but if they become more numerous they become less selective, and their distinct characteristic, in contrast to general-credit control, disappears.

If there are only a few of them they have the same kind of effect, in general, as a law against murder between 4 and 6 p. m. This would probably reduce the amount of murders somewhat, but probably not by one-twelfth because people would rearrange their murder schedules and carry on these activities at other times of the day.

The only really effective ways to reduce and control total spending are taxation and the control of the supply of money.

It is impossible to tell what is an appropriate mix as between taxation and controlling the money supply in an abstract and general way

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in advance. Usually this question does not have to be settled because in an inflationary situation the amount of taxation is a datum given by Congress, and the role then of the monetary authority is a predetermined one in taking care of the balance of inflationary pressure by debt management and appropriate operations of a general monetary sort.

I think it important to emphasize, although it ought to be by now sufficiently evident, that budget policy alone cannot prevent inflation.

I would like to read two sentences from the testimony of Mr. Blough before this committee about 2 weeks ago. In his concluding paragraph he said:

> In closing, I would like to repeat that monetary policy and debt management are by no means all there is to the problem of economic stabilization or its solution. The inflationary problem is one of holding down total spending, not simply that relatively small part which is financed by increases in debt, public and private.

But it is not just the increase of debt with which monetary management is concerned, but the entire current scene and the entire debt. Even with a balanced budget, inflation can proceed from three main channels: Through monetizing of the debt amounting to $260 billion, through spending faster than formerly out of people's cash balances, and through inflows of short-term credit and gold.

The heart of monetary policy is open-market operations—purchases and sales of Government securities, with their accompanying fall and rise in the rate of interest and rise and fall of capital values. Other instruments of monetary control are relatively peripheral.

I would like to remark upon the fact that many skeptics with respect to the use of the general monetary controls adopt a somewhat ambivalent or contradictory position in saying, on the one hand, that these controls are so powerful as to be dangerous, and at other times in another context say that they are so weak as to be impotent.

Mr. Keyserling's testimony before this committee on Wednesday, March 12, contains this statement:

> And if a monetary policy were exercised for the purpose of putting brakes upon the rate of activity of the economy as a whole it could hardly be pushed far enough to do this under current conditions, without reducing substantially the over-all level of production and employment.

But in the same testimony he also referred to monetary controls as "no more than one mild tool amongst many in the quest for economic stability."

Now, these two attitudes are obviously contradictory and, I think, neither proposition is correct.

The monetary weapons can be as strong as you want them to be, and need not be stronger. To say that they are dangerous or to imply that they almost always must have catastrophic or cataclysmic effects, I think, has been belied by the result of the flexible interest-rate policy of the past year, which was put into effect without any disastrous consequences.

On the other hand, they are not weak or impotent. There are important aspects of the smooth developments of 1951 which, I believe, followed from the use of the flexible interest rate policy introduced by the Federal Reserve last March.

Finally, a few remarks with respect to the efficacy of the general monetary-control mechanism. It has been customary to cast some doubt on the efficacy of the interest-rate policy by emphasizing the

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fact that savings are not very responsive to the rate of interest—with which, I think, most anyone would need to agree.

On the side of limiting the demand for capital, there are some notable segments of the capital market which are not particularly sensitive to interest, and others which are. But this argument really misses the crucial thing with respect to open-market operations and its effect on the rate of interest, and that is the effect upon lenders and the availability of capital.

Finally, I would like to conclude with a statement, which I believe is coming to command more and more acceptance, that it is cheaper to pay taxes for an interest-rate policy than to undergo the social distortions, the social costs, of inflation.

Thank you very much.

Representative PATMAN. Mr. Friedman.

STATEMENT OF MILTON FRIEDMAN, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. FRIEDMAN (reading):

> No complaint has been so common as the increased prices of every commodity, but very few know, or can be made to understand, how large a portion of the inconvenience which they suffer, is to be ascribed, wholly, to the improper use which the bank directors have made of the extraordinary powers with which the legislature has entrusted them. The evil is not less real because its source is concealed from ordinary optics.

This apt description of our present situation was written nearly 142 years ago by David Ricardo about English monetary policy during the Napoleonic wars. Whenever, as then, now, and on many other occasions, the exigencies of war have led countries to resort to money creation to finance governmental expenditures or to ease the burden of government debt, two different explanations have been offered for the attendant price rise; one, that it was a necessary consequence of the increased stock of money, the other, that it reflected special circumstances of the particular occasion and that the rise in the stock of money was either an irrelevant accident or an unimportant result rather than a cause of the price rise. In light of the record, there can be little doubt that the first explanation is, if not the whole truth, a major part of the truth. There is scarcely a case on record in which a substantial rise in the stock of money over a short period has not been accompanied by a substantial rise in prices, or in which a substantial rise in prices has occurred without a substantial rise in the stock of money. And a similar proposition is valid for declines in prices. There is scarcely a case on record in which a substantial decline in the stock of money over a short period has not been accompanied by a substantial decline in prices, or in which a substantial decline in prices has occurred without a substantial decline in the stock of money.

I do not mean to claim that there is a precise correspondence between changes in the stock of money and changes in prices. This is patently untrue. Changes in output require corresponding changes in the stock of money for price stability, so what is important is the stock of money per unit of output, not the total stock of money. In addition, for a variety of reasons, changes are constantly occurring in the command over real resources people in general deem it desirable to hold in the form of money, and these may lead to changes in prices without

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changes in the stock of money, or to changes in the stock of money without corresponding changes in prices. There is ample evidence, however, that such changes in attitudes toward holding money are seldom large, at least over short periods of time, if they are not reinforced by changes in the stock of money in the wrong direction. Equally important, they can be offset by compensating changes in the stock of money and so prevented from influencing prices. And this is as true in time of war or of great economic change as in more normal times.

I recently made a detailed study of monetary changes during the three major wars in which our country has been engaged in the last century: the Civil War, and the two World Wars. In all three wars, the change in prices from the outbreak of the war to the succeeding price peak is very nearly of the same magnitude as the change in the stock of money per unit of output, and the year-to-year deviations from this relation are relatively small.

I am led to emphasize these trite observations about the critical role of the quantity of money because, as in previous similar episodes, there is a tendency to lose sight of their importance in the current controversy over monetary policy. Monetary policy is not an untried expedient; there is ample historical evidence that it is a potent and essential weapon for preserving price stability and that its misuse is the basic source of inflation.

The primary task of our monetary authorities is to promote economic stability by controlling the stock of money. They have had ample powers to do so. They could and should have prevented both the postwar and the post-Korean inflation by exercising these powers. They failed to do so, not because they lacked the power, but because they lacked the will. The Federal Reserve System chose, or was induced, to adapt its policies to the minor objective of avoiding incidental effects on the prices of Government bonds rather than to the major objective of preventing inflation.

At the present time and under existing conditions, monetary policy should be directed exclusively toward the maintenance of a stable level of prices, and should take the form primarily of open-market operations in Government securities, conducted at the discretion of the Open Market Committee of the Federal Reserve System. These should be conducted solely to promote price stability and no consideration at all should be paid to their effect on the rate of interest on Government securities.

There is some evidence that the Federal Reserve has been following such a policy since the accord with the Treasury of a year ago. However, the Federal Reserve's task was eased during the past year by a number of fortuitous circumstances that are not likely to recur, and the true test will be whether they have the courage to continue this policy under less favorable circumstances, when it may require allowing the rate of interest on Government securities to rise more sharply than it has to date.

The rate of interest that will have to be paid on Government securities depends in part, of course, on whether the Government has to borrow to meet a deficit and how much it has to borrow. The present outlook is for a cash deficit not exceeding \$5 to \$10 billion during the next fiscal year. This is less than one-third of the aggregate savings that are likely to be made if prices are stable. It should not require

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a particularly high interest rate to divert to Government use this fraction of the real resources that will in any event not be devoted to current consumption. But the validity of this empirical judgment has no effect on the desirable policy. If it should take a high interest rate to divert the required amount of real resources to Government use, this simply means that there is more pressure for inflation to be counteracted. If this interest rate is higher than appears desirable, the proper—and only—alternative is to get more of the resources the Government needs through taxation.

It may appear that there is a third alternative, namely, to issue money by having the Federal Reserve support Government securities; but this is a delusion. The issuance of money is itself a form of taxation—taxation through inflation. It is a tax on all who hold cash balances or fixed dollar obligations of the Government. It is not only an inequitable tax that would hardly be voted for explicitly by the Congress; under our present fractional reserve-banking system, it is a tax from which the Government gets only part of the proceeds, the rest going to the commercial-banking system.

Given a firm determination by the Federal Reserve System to control the stock of money so as to prevent inflation, the particular securities used by the Government to borrow additional funds or to refinance maturing obligations is a matter of secondary, but nonetheless considerable, importance. It is at this point and with respect to this question that the desire to keep down interest payments is an appropriate and important objective. The relation between the form of the securities and the total interest burden is, however, more complex than may at first appear.

For example, short-term securities are a better substitute for cash than long-term securities. If the Treasury were to sell short-term securities rather than long, the Federal Reserve might also have to sell securities to prevent the cash released by the availability of a good substitute from raising prices. In consequence, a larger total amount of short-terms than of long-terms would have to be sold to have the same effect.

Put differently, the Government's fundamental objective is to borrow a given amount of real resources, not a given amount of money. It may have to borrow more money in the form of short-terms than of long-terms to borrow the same net amount of real resources.

Except as it affects the total cost of borrowing a given amount of real resources, it is of little or no importance whether the securities are marketable or nonmarketable, or whether they are sold to individuals or to commercial banks—provided always that the Federal Reserve conducts its operations with price stability as the overriding objective.

Our earlier sacrifice of monetary policy on the altar of Government-security prices led to the adoption of a number of undesirable measures in the monetary field in a vain attempt to control inflation without controlling the stock of money. These should be eliminated. I refer in particular to specific credit controls and to the voluntary credit-restraint program. Neither has any direct effect on the quantity of money; both are essentially devices for discriminating against particular classes of borrowers, in order to permit the Government to borrow at a lower rate of interest. They both use largely irrelevant criteria of discrimination, and so are inequitable and foster an inefficient allocation of resources. The interest rate, despite admitted defi-

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ciencies, will do a far better job. In addition, the voluntary credit-restraint program is fundamentally antithetical to our basic economy and social philosophy. Insofar as it has any effect, it does so through the exercise of arbitrary power without either the economic check of competition or the political check of responsibility to the electorate.

Similarly, undue concentration on possible incidental effects of monetary policy has led to numerous proposals for insulating the Government-security market. These proposals are in general undesirable. They would reduce the efficiency of our private-credit system by altering, in essentially arbitrary ways, relative yields on various classes of private loans and securities. They are, in effect, proposals for taxing the returns from particular classes of loans or securities, with only part of the yield being garnered by the Government in the form of lower interest payments. I doubt that there would be much support for them if they were explicitly proposed as taxes.

Before closing, I should like to make a few remarks on the longer-run problem of monetary policy. My advocacy of discretionary open-market operations as the best monetary instrument available for the current emergency does not imply its endorsement as a permanent instrument of stabilization.

Despite the prevailing belief to the contrary, I am convinced that the Federal Reserve System has failed to promote the objectives for which it was established, and that this conclusion is abundantly supported by the historical evidence. The System facilitated inflation in two world wars, permitted or promoted unnecessary inflation immediately after both wars, had much to do with making the great depression of the 1930's as deep as it was, and even failed in the one function that its founders were most convinced it would perform: namely, the prevention of a banking panic. I do not believe that the failure of the System reflects ignorance or incompetence, or malice on the part of the group of men who have guided its destinies. On the contrary, they seem to me an unusually well-informed, able, and public-spirited group. I therefore believe that the solution, if there be one, lies in a fundamental reform of our monetary institutions. As a matter of long-run reform, I would like to see the Federal Reserve System in its present form abolished and replaced by a 100-percent reserve-deposit banking system in which there was no monetary authority possessing discretionary powers over the quantity of money.

While this is as good a time as any to begin this long-run institutional reform, it cannot be accomplished overnight. We must, willy-nilly, meet the present emergency with present institutions. Fortunately, the very nature of the emergency and the associated danger of inflation enormously simplify the technical—as opposed to political—problem of discretionary monetary policy by making prediction relatively easy.

Representative PATMAN. Thank you, sir.

Mr. Samuelson.

STATEMENT OF PAUL SAMUELSON, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Chairman, I shall divide my opening remarks into two parts. The first will be rather trite, and the second part I will try to make provocative.

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I should say in the beginning that I think the trite part is probably the more important.

Let me ask myself the question of how much reliance should be placed on (1) direct controls, (2) selective credit controls, or (3) general monetary, quantitative monetary, policies if we want to prevent inflation?

I think I can only answer such a question against the background of my best appraisal of the quantitative potency of each of these three measures.

Thus, suppose I believe this to be a fact: That an increased quantitative tightness of money would do all of the following things: (1) It would raise interest rates only a little, but (2) it would thereby greatly decrease family spending and consumption and increase family savings; and (3) it would considerably cut down on nonessential private investment spending without greatly impairing essential private investment; and, finally, suppose that it would do all these things without much unsettling of confidence in Government credit or in the capital value of existing institutions?

Under these circumstances, obviously, I and any other sensible man would favor very heavy reliance on general over-all quantitative monetary, tight-money policy, to combat inflation.

On the other hand, suppose that my studies of all the factual statistical data available, and my interpretation of all of the theoretical arguments, pro and con, such as we will hear today, lead to this conclusion: (1) Tight money actions would have to be extremely drastic in order to lead to any considerable increase in interest rates; (2) such increases in interest rates would have very little effect upon private consumer spending; (3) such increases in interest rates would have very little effect upon private investment spending because the schedule of private investment spending is an extremely inelastic one; and (4) the increase in interest rates would have a harmful effect upon the composition of investments between essential defense-capital formation and private unessential-capital formation.

Under these circumstances, I should obviously not put great reliance upon quantitative over-all tight-money credit policies in comparison with other measures.

I say this even though, as a matter of philosophical value judgment, I do not like direct controls for their own sake, and would prefer the more impersonal over-all indirect controls.

Now, where does the truth stand between these two straw men at the extremes? I suggest that we do not know the answer, that nobody knows the answer and is entitled to speak with confidence; but that, as far as I can tell, it stands somewhere, tritely, in between these two extreme viewpoints.

Therefore, until we have settled the quantitative question of just how important these different effects are, I think we are not entitled to give a hard and fast "yes" and "no" answer to this first question, but must proceed on a more pragmatic basis. That is the trite part of what I have to say.

Now, let me turn to the more provocative part, and I will do it by labeling what I shall call four fallacies. I might call them four sophomore fallacies, but I think I had better drop that adjective for our present discussion.

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The views that I am about to criticize, I find amply represented in these two valuable green documents, or compendia, both on the part of Government agencies and on the part of the private voluntary answers to your questionnaires.

The first view that I would like to put, and I will overstate this in order to be provocative, is the almost completely fallacious view that the purpose of credit policy is not to affect the cost or availability of credit so much as rather to affect "the quantity of money in existence."

Holders of this viewpoint—and I will not name any—speak glibly of monetization and demonetization of the public debt as if that mystical process had a potency outside of its effects upon the terms and availabilities at which borrowers can borrow money to spend on consumption or investment goods, and the lenders can get upon their asset structure.

In fact, I will go further and say that the quantity of money is a fabricated concept. We all know what dimes are and what nickels are and what dollars are, and we know what demand deposits are, and we know what time deposits are, and we know what short-term Government bonds are, and we know what a long chain of various money substitutes are. And sometime in the 1920's it became fashionable to decide that you could chop off the chain at a given place, and could add together what you call M, the amount of money, and M′, what you arbitrarily call the amount of adjusted demand deposits, and then suddenly this particular time series, out of all the time series, in the Federal Reserve chart book is given an especial potency in explaining events—especially in explaining them retroactively.

Now, I shall argue instead that the real problem of monetary policy open to the central-bank authorities is the problem of its effects upon the cost and availability of credit to spenders.

Now, I will be a little specific, but I do not mean to be specific in any unkind way.

In reading over the quarrels between the Federal Reserve authorities and the Treasury in the early postwar years, I find the repeated assertion by the Federal Reserve authorities in some of the correspondence given in your replies that they did not desire higher long- or short-term interest rates—and they certainly did not desire a higher interest charge for its own sake; that is perfectly clear there—but they claimed they simply desired "demonetization of the public debt" or "a cessation of the further monetization of the public debt."

I think I can make sense out of those last remarks; but in the absence of changes in reserve requirements or special reserve requirements, I can only make sense out of them in terms of effects upon the interest-rate structure, or, what is very close to that, the availability of credit.

It is not just the terms on which I can borrow but whether I can get the money from the bank or not. There is no other effect of demonetization or monetization of the debt that is open to the central-bank authorities so long as they do not print money or have the right to call it in and expropriate it, if they just stick to open-market operations and rediscount operations of the conventional type.

I might put the point in the following technical way: All that a central bank can do is to bid up or bid down the price of assets; it can thereby bribe the banks and public into changing the composition of assets, but it cannot primarily affect the total of such assets. (There

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is one minor exception to this, but this will not be of any comfort to those who believe in the reality of "monetization of the public debt" without regard to interest-rate changes. The open-market operations of the central bank may cause interest-rate changes and, therefore, capitalization changes in the value of certain assets, so that the total is not, strictly speaking, a constant.)

Now, in my opinion, then, the Federal Reserve authorities should, if it were proper to do so in 1945, 1946, and 1947, have said that it was their purpose to tighten up on interest rates, and certainly to tighten up on the availability of money. There was no other purpose. The monetization of the public debt was not something over and above and beyond this. That is the first fallacy.

The second fallacy is a slightly more subtle one—perhaps this is a junior rather than sophomore fallacy—it goes as follows: It is a misleading simplification to speak of controlling inflationary conditions by means of controlling bank reserves rather than by means of change in the cost and availability of credit. It is misleading unless you admit that you are going to accomplish this by (1) affecting the interest rates at which various people can borrow or lend or (2) affecting the availability of credit to them. To see this, take the position of an individual bank on Main Street. Most of its assets are in the form that it can go to the telephone at any moment and exchange those assets for cash without regard to any Federal Reserve operation. It is too small to affect the price of any of the bonds that it holds; and, therefore, as an economic theorist, I would insist that you go through this chain of reasoning. You must show how each individual bank will be compelled or tempted by your central-bank policies to refuse credit to would-be borrowers.

I think the only way to do that is by changing the terms that the man at the other end of the telephone or the newspaper financial page gives with respect to bonds when our Main Street banker calls him up.

The reserves of an individual bank are as changeable as you could wish in the course of 1 day's business; and, again, to be realistic, you must go through this same procedure.

Now, you may think that I am beating a dead horse here; but, actually, I have met many people who were as hot as could be for tight-money policies yet who, when you asked them about interest rates, would say, "Oh, no; we do not want to have higher interest rates."

"Do you want to refuse credit arbitrarily or by rationing?" you may ask.

They say "Oh, no; we do not want to do that. What we want to do is to control bank reserves and do something about the amount of M and not these other things." Now, there is no other way of performing that miracle—certainly not by conventional central-bank activity.

Now, let me, as my third point, go into a more subtle form that the doctrine now takes, among us academic economists and also among the Federal Reserve System spokesmen. The argument goes something like the following: An increased interest rate is not likely to cause very much of a reduction in private investment. (I might add that everybody seems to be agreed—perhaps, there is suspiciously unanimous agreement—that the interest rate has almost no effect upon savings. That happens to be my view, and I have looked over all the statistics I could find on the subject and all the theories I could find on the subject, and there is no reason why the amount of savings should be

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affected strongly in one direction or another by changing the interest rates.)

But, let us turn to the problem of private investment spending. Suppose that private investment spending is, for the sake of the argument, regarded as being purely inelastic with regard to interest rates, so that if I am a merchant or a builder, and I have to pay 4 percent interest, and you raise the rate to 6 percent, so keen is my desire to get on with these activities that I will borrow just about the same amount.

Nevertheless, it is argued that tighter money policies on the part of the Federal Reserve authorities are likely to have considerable deflationary impact upon the economic system because there is a great direct effect upon lenders; that lenders have an elastic supply even though borrowers do not.

Now, there is a germ of truth in this. There is the germ of truth that insurance companies and banks are very responsive to slight changes in interest rates.

However, if you examine the problem you find that this elasticity works against monetary policy. The more elastic the supply in a perfectly competitive market of large financial lenders, the more is contractionary policy thwarted. You have to do more to get the same effect.

Let me illustrate that by an extreme case. Suppose that the supply was so elastic on the part of all commercial banks, insurance companies, and other institutions that you could not get any change of the interest rate. You see that the peg of the Federal Reserve System would then be replaced by the peg of the private free market and, therefore, there would be no leverage for you to tighten on borrowers. So, we have to go to a different aspect of this argument, which is a more subtle one, and is an ancient one, but has been resurrected in recent years—and I think properly so—namely, that the market for borrowing funds is an imperfectly competitive one.

The loan market is not a question of perfect competition, like the wheat market, where any man can come in and buy or sell wheat without affecting the terms. On the contrary, getting a loan is a negotiated process.

You go into a banker's office; he looks you over, looks your books over, and decides what he will charge you, and he has an administered price, just like any other merchant on Main Street.

Now, we have made strides in an analysis of imperfect competition in economic theory, and I think this is a case where we have to apply some of those tools.

According to this argument, if you change the terms of Government bonds—and that is all you can do to an individual bank by open-market operations, for you have no other control, over him—what he will do is not post a sign outside his doors saying "I am going to raise my interest charges." But, on the contrary, for a while at least, he might hold the same interest charges, but he is going to be more choosey in that margin of to whom he makes the loan. In other words, he rations out credit.

I do not know what you may think of this philosophically. (By the way, there is nothing more reprehensible about this action than that of any other merchant on Main Street who is following sound commercial practices.) But this is not the type of thing that an adherent

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of quantitative credit control ought to point to with great pride if the basis of his sponsorship of quantitative credit control is that it avoid arbitrary rations and fiats and is impersonal.

But, let us waive that and examine it just as a factual proposition. I think in the short run there is a lot to this; there is a very variable margin on the part of the banker as to whom he gives credit and to whom he does not.

Moreover, there are many dimensions to the loan contract. There is a question of how much money you have to keep on deposit in the bank, and that is a very important cost to you. There is a question of what down payment you have to make, what valuation on your house will he accept, and so forth.

All of these dimensions of the imperfectly competitive market would have no scope in a perfectly competitive market; nonetheless I think this is an imperfectly competitive market, and these are all very important, and so there is room for leverage for contractionary monetary policy from the lender's side.

I think this contractionary effect is greatly exaggerated because once you put the focus on the imperfect competition aspects of the problem, you must appraise them, and appraise them over a period of time.

Now, it is unthinkable that over a period of time, of a few months, let us say, or of over a year, or more than a year, that a banker should act so irrationally that when credit is scarce he will hold his rates perfectly inflexible, and arbitrarily make trouble for himself by refusing solid citizens in the community, and some who think they are solid citizens, credit, and thereby bring upon himself all the troubles that come from rationing.

On the contrary, it seems to me that after the shortest run, what he will do will be what any normal prudent commercially minded man would do: namely, if a thing is in short supply, he will gradually raise the interest charges on it, and let the higher price help him do the rationing.

The imperfect competition aspect of banking is absolutely crucial for the recently fashionable doctrine that the central bank gains its leverage not through its effects upon the cost of credit but by its effects upon the availability of credit. I would gladly trade 100 pages of the written and oral testimony before this committee for even a few paragraphs of careful analysis on this point. This is not the place to undertake such a detailed analysis but a few thoughts may be thrown out.

The loan market is an imperfectly competitive one only in small part because of what might be called monopolistic impurities. To be sure in many regional localities the individual banker is large enough to affect significantly the interest rate to be charged to borrowers. However, the more crucial factor is tied up with the imperfections of competition inevitably associated with uncertainty. No one can read the future and therefore each lender must necessarily have a different opinion as to the credit worthiness of different borrowers. This lack of perfect knowledge and differentiation of opinion in the market place inevitably means that the infinite elasticities assumed by the theorist of perfect competition are unrealistic. Hence the interest charged for borrowing must always be an administrated price and a

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negotiated one. There must always be a large element of personal discretion on the part of the banker. It is quite possible therefore that, in the period immediately after open market contractionary operations by the Federal Reserve System or after an increase in legal reserve requirements, the individual banker will react to the credit stringency not by raising his posted interest rates but by rationing out the smaller supply of credit more stringently. Why do I say that after a few months time this rationing aspect will become less important? Do I mean that after a few months time the competitive character of the loan market will change and that the banker will cease to be an administrator of interest rates and a rationer of credit? No, I definitely do not; rationing and discretionary decisions will always characterize the loan market in the short run and in the long run.

What I mean is the following: the extra tightness of rationing that the central banker can induce by his ordinary operations will disappear after a few months and be replaced by a firming of interest charges and a return to normal stringency of rationing. Put yourself in the shoes of a banker. Imagine that Government bonds will now yield you 3 percent instead of 2½ percent and that the rate at which you can borrow from the Federal Reserve System has gone up by ½ of 1 percent. If you are now deciding whether to make a new loan to a man who has walked into your office, the only effect upon your decision that the central bank can have is by affecting this interest cost to you of making a loan to your customer. There are good reasons why in the short run in an imperfectly competitive market you will not change your charges but simply increase the frequency with which you arbitrarily say "No" to people. If previously you might have considered making a loan to a man at 5 percent at the same time that you could only count on making 2½ percent on your money invested in Government bonds, you may now say, "with money costing me 3 percent, I shall refuse to make this 5 percent loan." But after some months have gone by, you will say to yourself, "with money costing me 3 percent, am I willing to make this new loan at 5 plus one-half percent?" And it will be essentially up to the borrower and to the elasticity of his demand schedule for loans to determine whether the extra one-half percent charged to him will discourage him from borrowing. In other words after the lapse of a short amount of time the same or even narrower differentials between different kinds of interest charges are likely to reassert themselves from the ordinary motivation of bankers and from the ordinary operations of supply and demand. If my analysis of imperfect competition is at all correct, we must realize that there is "implicit theorizing" in the overly simple notion that the central bank can operate directly on bank reserves without bringing the interest rate mechanism into play. Under the conditions that I have postulated the central bank will only be able to contract bank reserves by depressing Government bond prices enough to raise interest rates charged to borrowers enough to cause them to cut down on their borrowing enough to create the postulated stringency. For emphasis I have indulged in over-simplification in this analysis of imperfect competition, but I direct the attention of economists to this most crucial of all questions.

So, I am brought back again to the following moral of the story that in anything but the shortest run, I am afraid we must again go back to the crucial question about which we know very little, and

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about which, I am afraid, nobody knows very much. What is the degree of elasticity or inelasticity of response of private investment spending to upward changes in the rate of interest?

I think that all monetary policy must pass through the eye of this needle of interest rates. I say this with due deference to the imperfect competition aspect of the problem, which is quite important in the first 3 months after you do something, I am sure. It seems to me the true debate between the hot adherents of this policy of tight money and the opponents of this policy, and people who, as I regard myself, are in the middle on this, would be on the question: What is the likely quantitative degree of elasticity?

Now, Professor Ellis started to break this down into the different categories of borrowers and, I think, that is absolutely the most fruitful way to handle the problem, to go through the different kinds of borrowers and just see what the likely pressure of interest costs will be at each point, and I hope I will learn more about this subject today.

Thank you, Mr. Chairman.

Representative PATMAN. Mr. Whittlesey.

STATEMENT OF C. R. WHITTLESEY, PROFESSOR OF FINANCE AND ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. WHITTLESEY. I wish to begin, Mr. Chairman, by addressing my remarks for a moment to the question of the appropriate policy and I start by saying that I agree heartily with statements presented by the Federal Reserve authorities themselves, particularly at times when emotions were somewhat less aroused than they have been in the last few years.

I quote first from the Federal Reserve Annual Report for 1948 which was submitted by the Chairman in the middle of 1949. On page 4 the annual report says:

> In earlier periods * * * Federal Reserve policy could be * * * directed * * * toward * * * reserves * * *. With a large Government debt which is likely to be a dominant part of the debt structure for many years, the Federal Reserve has to cope with the dual problem of maintaining an orderly Government security market and exercising control over the volume of bank reserves.

Going back a couple of years to the Annual Report of 1946, which is dated June 17, 1947, we have an pages 6 and 7, the following:

> While it would continue to be necessary for the System to support Government securities and maintain an orderly market, the relationship between rates for various types of market issues might be permitted to become more responsive to demand and a greater degree of flexibility would be restored to control of credit through the money market.
>
> An attempt to restrict credit through sale by the System of securities in the open market or even by limiting the System's purchases might cause sharp declines in prices of Government securities which could not be tolerated and which might fail to accomplish the desired purpose.

On page 7:

> If, in the changed postwar situation, the Reserve System is to be able to perform the function for which it was established, namely, to adjust the supply of bank credit and money to the needs of the economy, and, especially, to prevent undue credit expansion in periods of inflation, additional powers will be required * * *. The problems * * * will continue for many years. Action along these lines will be needed to rehabilitate the traditional instruments of Federal Reserve policy—open market operations, discount rates, and re-

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serve requirements—and to assure a reasonable degree of financial stability in the future.

Some of these statements were presented, as I said, as late as 1949.

The essential features of Federal Reserve policies may be summarized. There is, first, the necessity of coordination with policies followed by the Treasury, and that is not to say that either should dominate.

Secondly, there is the dual character of these policies, namely, security markets and the volume of credit.

Finally, the methods in conformity with the statements made, relate to both quantitative and selective instruments as conditions seem to indicate, plus fiscal policies to the extent that is possible. This includes avoiding deficit financing under inflationary conditions.

Now, I want to turn to the troublesome problem of the effectiveness of policies introduced in the last year and a half or 2 years, to which reference has frequently been made.

I have asked that all the members of the subcommittee and the panel be given copies of the most recent Federal Reserve chart book, and I shall refer to various of these charts by number. I am sure that it will facilitate the explanation if you follow as I direct your attention to them. I must acknowledge at the start the complexity of this problem and the existence of a great variety of influences. I hope that you will not feel me unduly guilty of oversimplification; such oversimplification as exists is necessary in order to save time.

First of all, a rather minor point, but one which has attracted a great deal of attention. Please turn to chart 1, where you will see a chart showing life insurance company assets. These are the assets of selected savings institutions; the largest, of course, are the life insurance companies.

The curve for United States Government securities shows a steady decline since the end of 1946.

You will notice that up to the time of the accord, which was early in March of 1951, the decline had been continuous; some months it was fairly steep, but by inspection one would say that it went down just as rapidly, perhaps a little more rapidly, after the accord than it had done before.

My point is that the statement so frequently made to the effect that the accord brought about a marked reduction in sales of life insurance holdings of Government bonds is contradicted by this chart.

I might make one further refinement, which is slightly technical. The figure toward the end includes nearly a billion dollars of bills, but did not at the start of the period. That means that they sold nearly a billion dollars more of bonds than this figure indicates, so that the decline would be still greater if we allowed for the fact that they sold bonds and then put some of the cash back into short holdings which are a substitute not for bonds but for cash. Thus the sales of bonds are understated by this chart.

Secondly, and again an important but, perhaps, relatively minor point, the action failed to halt visibly new bond flotations and new security registrations.

I have here a chart which I will pass around—I regret that I do not have copies for everybody. This chart is from the Statistical Bulletin of the SEC for January 1952. It discloses very clearly a sharp increase in bond offerings in March 1951 (chart 2).

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CHART 1

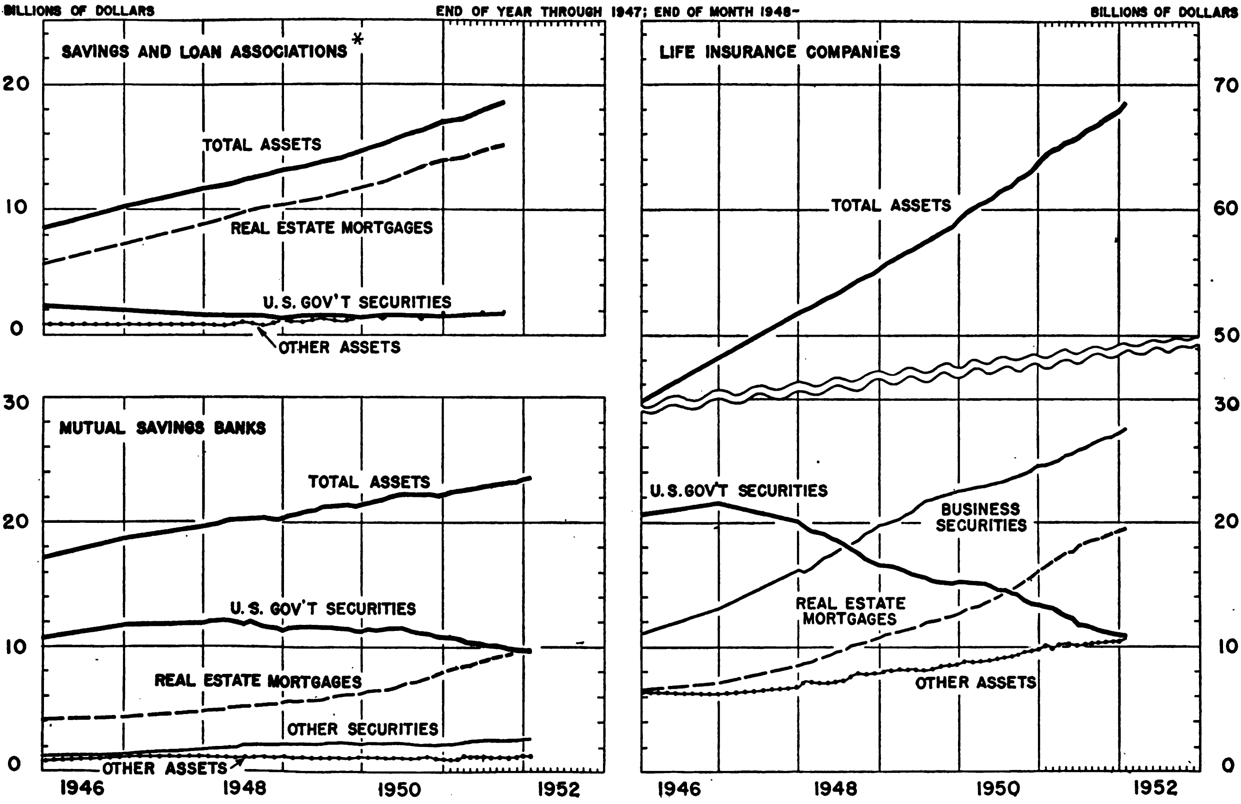

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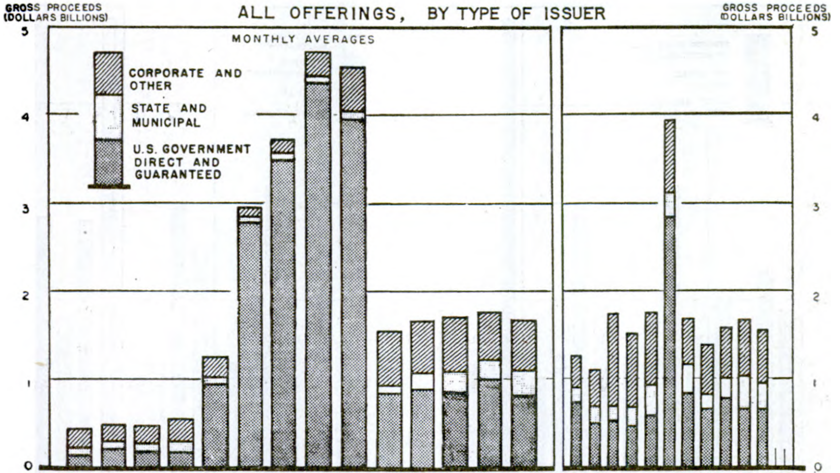
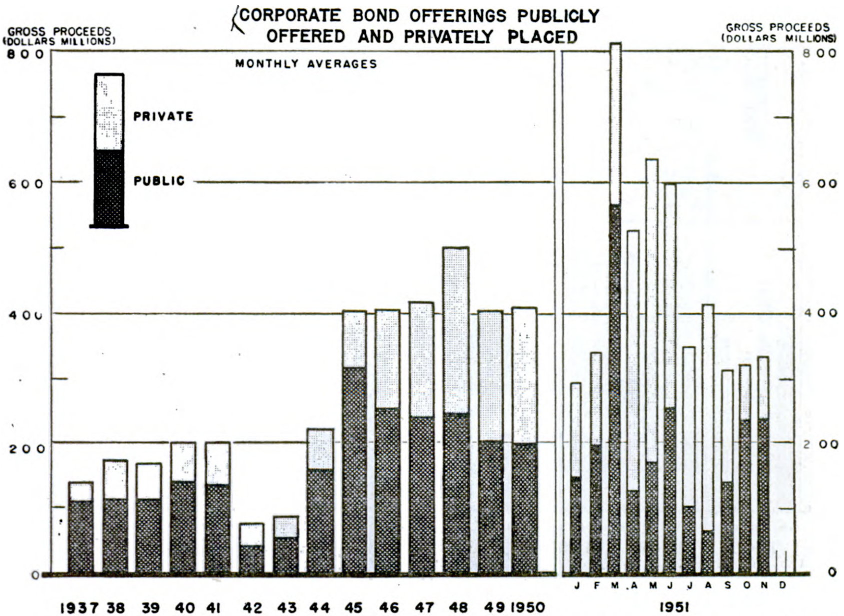
CHART 2

NEW SECURITIES OFFERED FOR CASH IN THE UNITED STATES





Source: Statistical Bulletin, Securities and Exchange Commission, January 1952.

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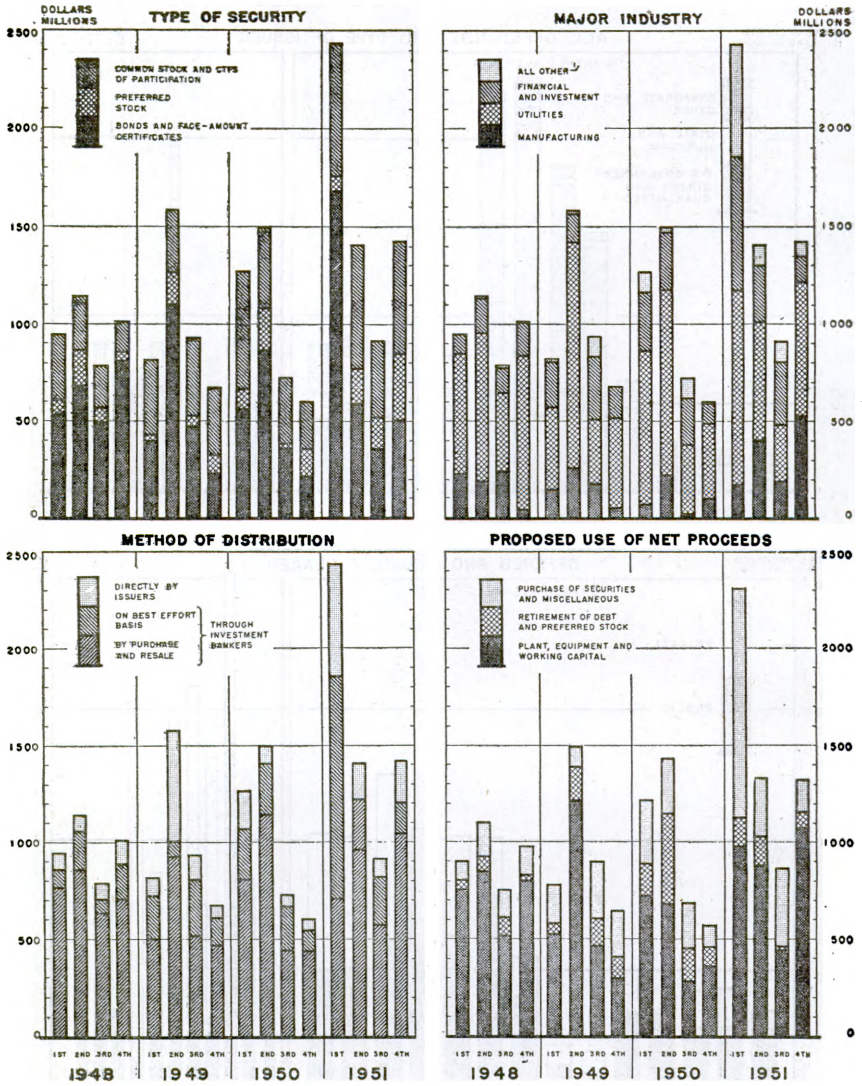
CHART 3

SECURITIES EFFECTIVELY REGISTERED UNDER THE SECURITIES ACT FOR CASH SALE FOR ACCOUNT OF ISSUERS



Source: Statistical Bulletin, Securities and Exchange Commission, February 1952.

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CHART 4

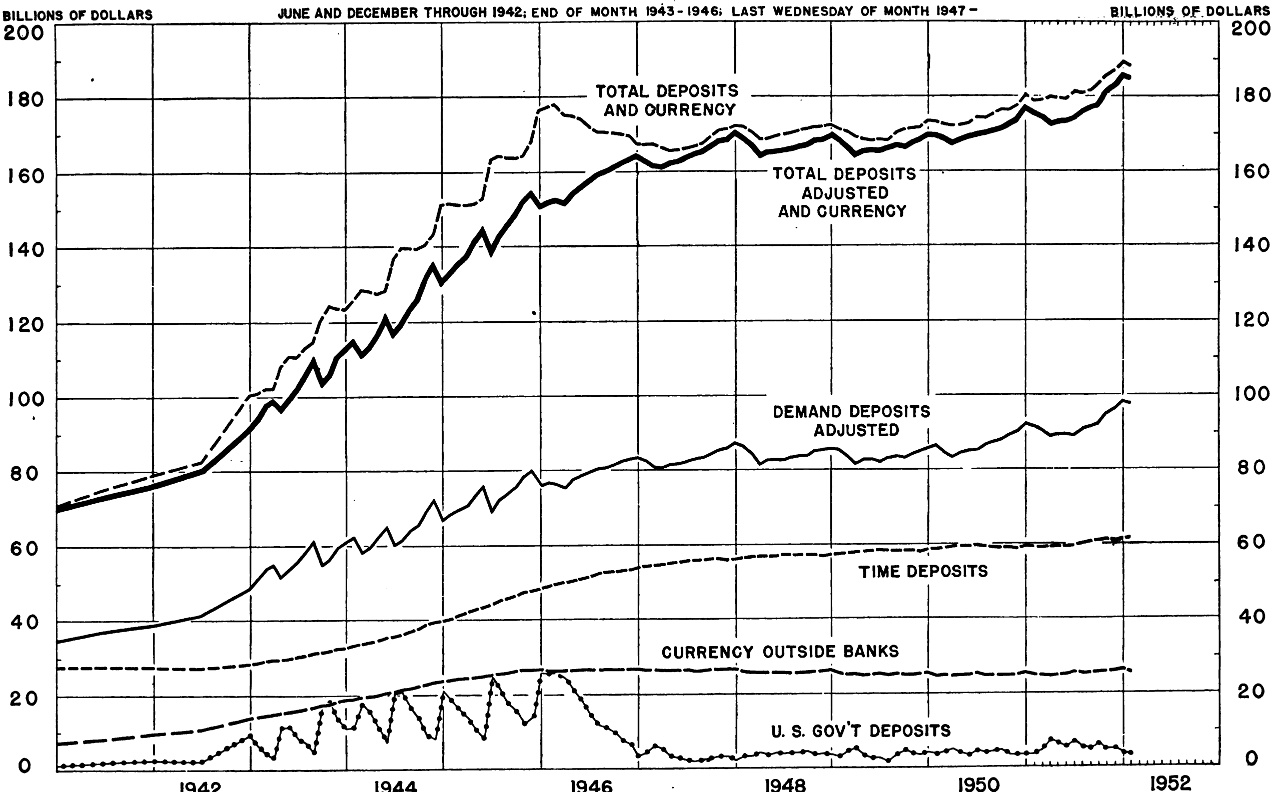

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CHART 5

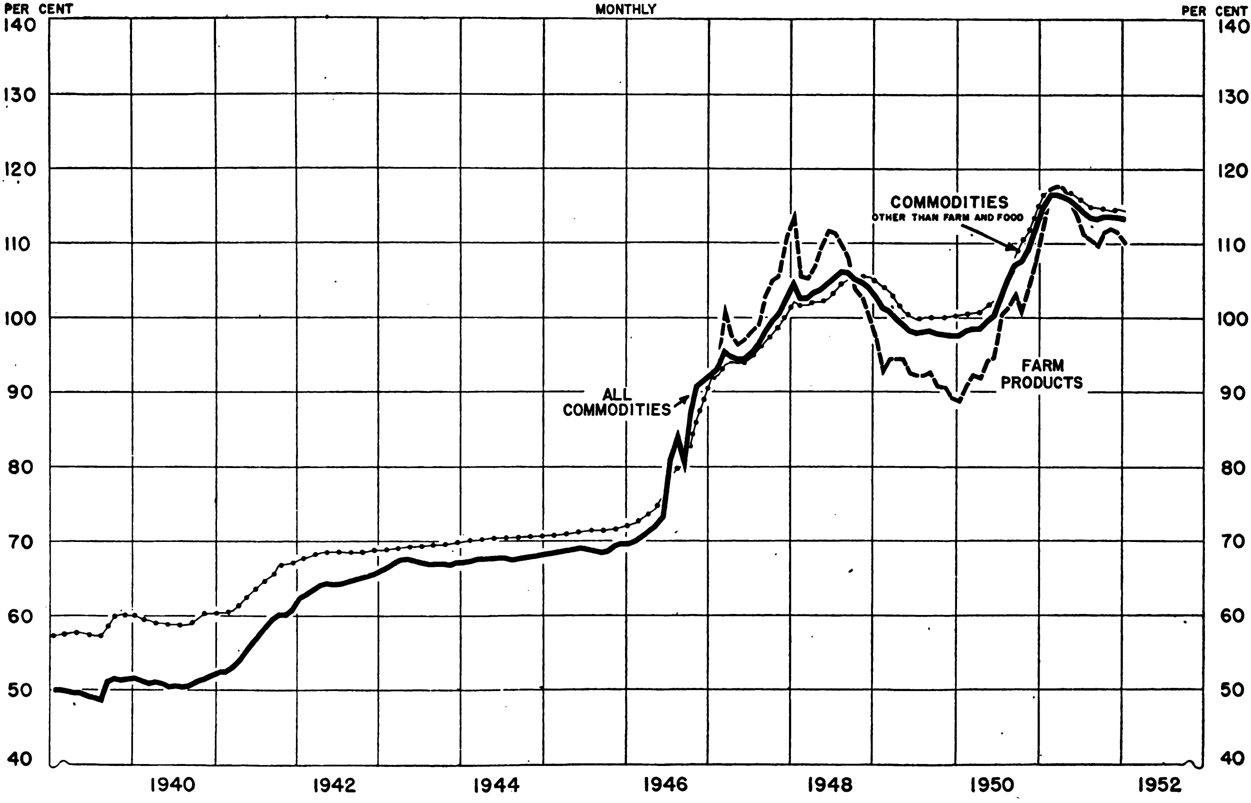

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CHART 6

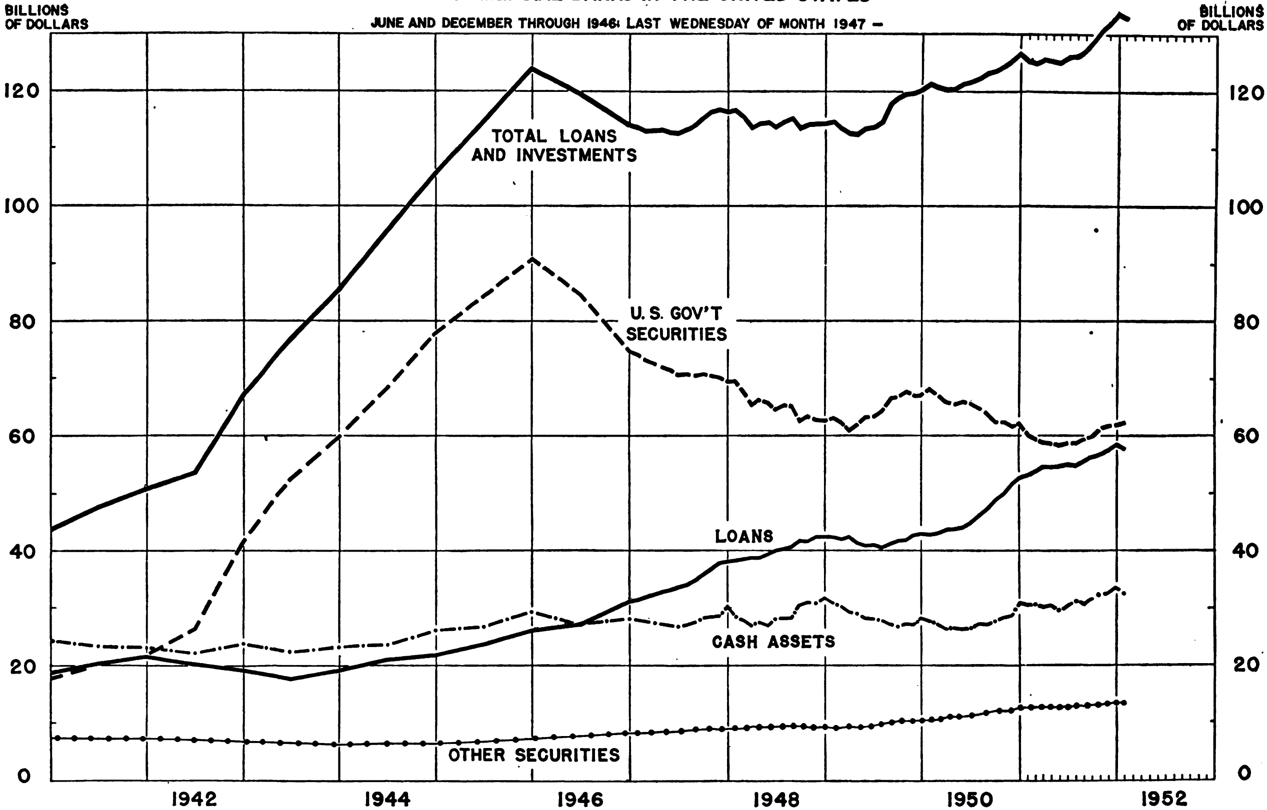

CHART 7

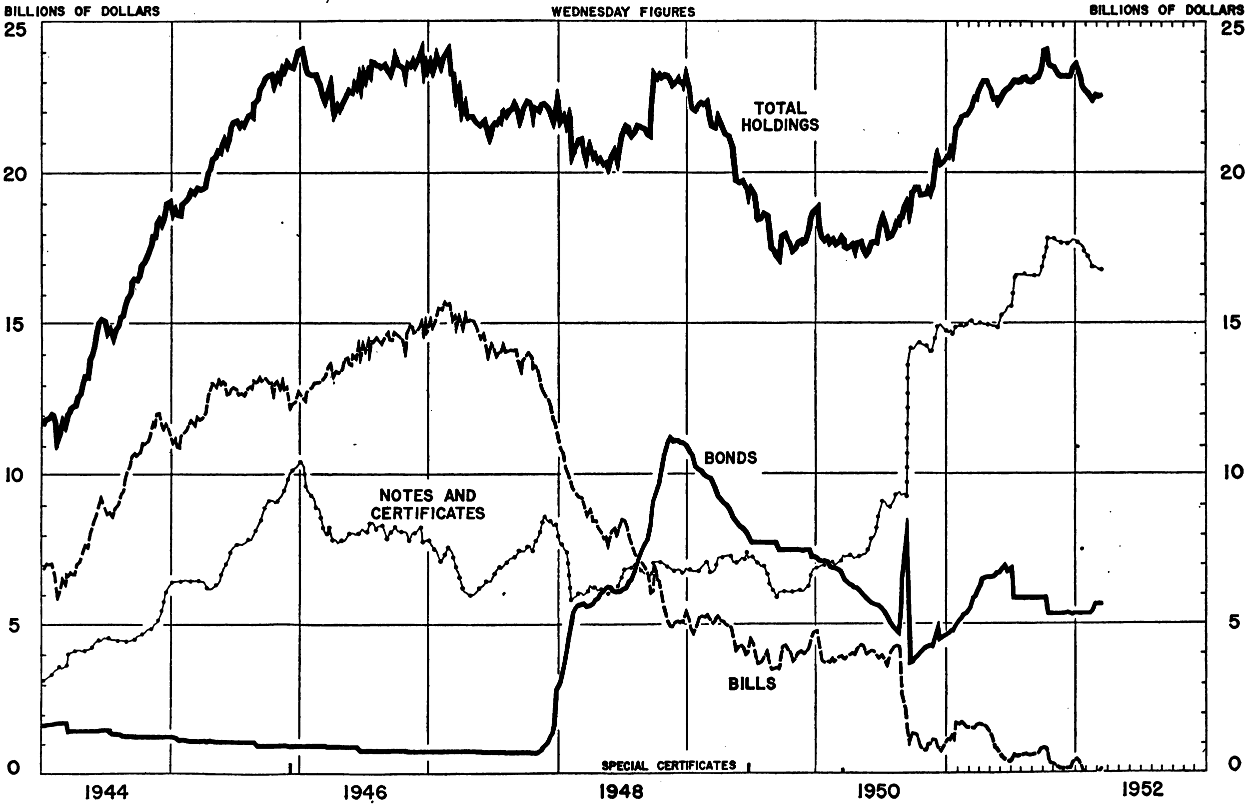

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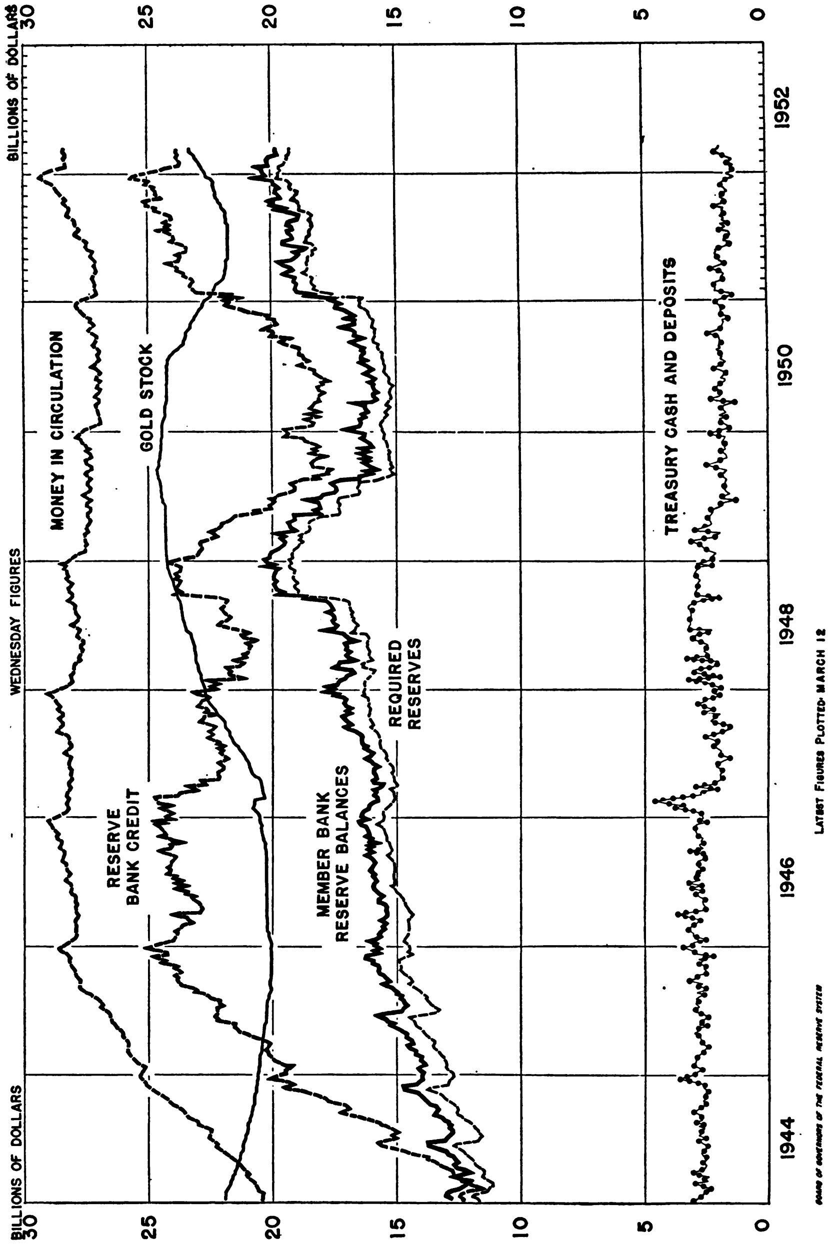
CHART 8



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Now, March was the first month of the accord since the accord occurred in the first days of March, so that is really a post-accord figure. It was extremely high.

There is a seasonal element in these figures, and I want to warn you against taking them at face value. This chart overstates the point I am making, but it makes it, nevertheless, and it is significant. Far from the accord having checked new bond offerings, it appears to have stimulated them.

More significant still is the chart from the February issue which shows registrations. These registrations anticipate offerings since they take place somewhat in advance (chart 3).

These are quarterly figures. The first quarter of 1951 reflects the sharp rise in the volume of offerings during March, to which I have just called attention. But the most surprising point brought out by this chart is that as late as the fourth quarter of 1951 registrations were far in advance of what they had been in any previous fourth quarter shown here. Moreover, where previous fourth quarters show a decline, this particular fourth quarter shows a sharp upward movement, suggesting that the movement I am speaking about is continuing up to the present time.

I might make a slight digression in view of the testimony that has just been made to say that one important factor that we tend to overlook is the importance of expectations.

We are taught in economic theory that rising prices will tend to discourage buying. We are told also that a rising interest rate will tend to discourage borrowing. But these statements are valid only if we leave out considerations such as expectations. If, as we have witnessed frequently, there is an expectation that a price rise will continue, then that price rise not only does not stop buying and selling but may stimulate it. I submit that precisely the same consideration has operated with respect to borrowing in the period under discussion here.

My third point returns to the Federal Reserve chart book. Briefly, it is the failure of recent policy to bring about a restriction of the quantity of money.

Please refer to chart 4. With all the qualifications Dr. Samuelson has pointed out with respect to the definition of money, nevertheless this is the figure which has attracted principal attention.

You will notice that the rise in 1951 in total deposits adjusted and currency was greater than it was in the second half of 1950. In other words, the most recent half-year shows a more rapid expansion in the volume of money, following the period of the accord, than the corresponding period before the accord.

This chart is also important as demonstrating, it seems to me, a failure of the quantity of money to correspond with the presumed effect on prices. Referring to chart 5, but keeping in mind chart 4, please note that wholesale prices spurted rapidly, as we all well know, in the second half of 1950, but went down in the second half of 1951. Yet, as you will note, the quantity of money was rising in the later period, and while rising also in the previous period, was rising less rapidly.

Please do not infer that I am saying that the quantity of money is unimportant. I feel that the quantity of money is extraordinarily

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important, but that for short periods of time, such as we are discussing and such as have been before us in the last couple of years, it is changes in the rate of its use that are of primary significance.

For a slightly more basic point, which I offer with some hesitation but which I feel is extremely important, please refer to chart 7. The point I want to make here is that long-term bonds were of secondary importance as an "engine of inflation," to use the expression that has been so much before us.

It seems to me that undue attention has been focused upon the sale of bonds to the Federal Reserve as a factor in the expansion of reserves in the period before and after the accord.

As you will notice, the figure that shows the most rapid rise during 1950 was not bonds. During most of 1950, they were going down. We can ignore that sharp peak under "Bonds," and we can also ignore the very sudden rise in the figure for notes and certificates just above.

Look, however, to the movement exclusive of those sudden jerks, and you will see that before the sudden rise at the time of the August refunding operation, it was notes and certificates, not bonds, that were being sold to the Federal Reserve. If the Federal Reserve was an engine of inflation it was not primarily because of bonds where the 2½-percent rate was involved.

Also in the final months of the year, holdings of notes and certificates seem to be rising as rapidly as, perhaps more rapidly than, the holdings of bonds.

I want to urge, therefore, that in directing so much attention to the Government bond market we have not been entirely accurate.

My final and most important observation with respect to the effectiveness of these policies relates to gold movements as a factor influencing both the sales of securities to the Federal Reserve and the volume of member bank reserves.

I agree with Dr. Samuelson on the oversimplification of statements frequently encountered with respect to reserves as a factor controlling inflation. I would add also that there has been oversimplification in identifying changes in member bank reserves with Federal Reserve purchases of Governments, particularly of Government bonds.

Notice the chart on chart 4. We see here the rise that I mentioned a moment ago in deposits in the second half of 1950, and a somewhat smaller rise the previous year.

Compare this with the principal assets of commercial banks shown on chart 6. You will notice that the expansion of deposits reflects, as we all know, the expansion of assets held by commercial banks. During the most recent half year both loans and United States Government securities were going up; it is that combined rise, even though loans were rising less rapidly than they had risen the year before, that gave us this very sharp rise in deposits in 1951 that is shown on chart 4.

In the previous year when the rise in deposits was not as great as we were led to believe at the time, loans were going up very rapidly but the increase resulting from loans was largely offset, as may be seen on chart 6, by a decline in the holdings of United States Government securities.

Thus, the growth in deposits, shown on chart 4, reflects the net combined movement of both loans and Governments.

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One must relate the growth in deposits shown on chart 4 to reserves. You will notice, turning to chart 7, that that growth fails to accord with the growth shown in Federal Reserve holdings of United States Government securities. It is to be observed that we got the rapid increase in deposits in the second half of 1951 at a time when Reserve bank holdings of Government securities were going down, or at least were rising very little.

In the corresponding period of 1950 there was a smaller increase in deposits and currency than in the later period, even though Reserve bank holdings of Governments were rising very rapidly. The point is that deposits have not moved with purchases by the Federal Reserve of Government securities alone. There is evidently another factor. The answer to what that other factor is is on chart 8. Here, as a much overlooked factor yet one of major significance, we have the figure for gold stock. Gold holdings are an important factor contributing to changes in the volume of member bank reserves.

In the earlier period when we were struck by the failure of deposits to expand more rapidly, reserves were being held down by an outflow of gold. Conversely, the expansion of deposits that occurred in the later period was made possible through an increase of reserves resulting from an inflow of gold.

The evidence is clear that the movement of gold contributed to changes in reserves and primarily affected the purchase of Governments by the Federal Reserve in 1950. The "engine of inflation" was not merely generating reserves, it was also, wisely or unwisely, replacing gold which was flowing out of the country.

Likewise, the decline in purchases of Governments by the Federal Reserve in 1951, shown on chart 7, did not mean a corresponding limitation of reserves, because reserves were being piled up by an inflow of gold.

By way of conclusion, the evidence indicates that in order to be able to combat inflation in an emergency, we must have considerably more than general credit controls. It suggests that the quantity of money was not the determining factor in the movement of prices in 1950 and 1951.

It indicates that monetary behavior—that is to say, the activation of existing quantities of money—was of critical importance in these periods.

I suggest that these observations indicate the importance of measures which are directed toward the behavior of money rather than toward the quantity of money, even though the latter is of major importance at times. These measures include regulations W and X. Public policy should also be concerned with avoiding the aggravation of popular fears.

It seems to me that one of the fundamental errors of policy in the period following the outbreak of war in Korea, was that we aggravated—by statements in business and official circles—the fears that were the immediate cause of the inflationary movement.

Representative Bolling. Mr. Chairman, before you proceed, I would like to suggest that the charts be placed in the record, the charts as described by Mr. Whittlesey.

Representative Patman. Without objection, it will be done.

Representative Patman. Mr. Mikesell?

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STATEMENT OF RAYMOND F. MIKESELL, PROFESSOR OF ECONOMICS, UNIVERSITY OF VIRGINIA

Mr. MIKESELL. Mr. Chairman and members of the committee, while I have been teaching money and banking for many years, my principal field of interest and experience has been in international economic relations; and with the permission of the committee, therefore, I should like to begin my statement with a few remarks regarding the international aspects of monetary stability.

The promotion of monetary stability has been one of the ways by which this country has sought to strengthen the economies of the free world. I think our foreign-aid programs have made an important contribution to the restoration of monetary stability in other countries, but the international aspect of this problem which I would like to emphasize is that for most countries internal stability depends to a considerable degree upon world economic stability.

Of course, each country has a responsibility for taking appropriate internal measures to avoid inflation or deflation leading to unemployment. But in the postwar period many countries in Western Europe and elsewhere whose economies and markets have been greatly damaged by war have had serious structural maladjustments which could not be solved by internal monetary measures alone.

The end of the war found most Western European countries with a large volume of liquid assets and depleted stocks of commodities, on the one hand, and a need for large investment expenditures to restore industrial and agricultural production, on the other.

The solution of this problem required, as you know, large amounts of the United States aid and a variety of internal governmental measures, including direct allocation and price controls, as well as selective and general monetary controls.

While some countries employed certain of these measures to a greater degree than others, by the middle of 1950 most Western European countries had not only restored industrial production to far better than prewar levels but had also achieved a fair degree of internal stability.

Now, the events since the outbreak of war in Korea have revealed a high degree of interdependence in the movements of prices throughout the world. There have been international inflationary forces at work which have affected all countries.

Nearly every nation has experienced a significant rise in prices and some have had increases in wholesale prices of up to 50 percent.

This movement was initiated by the rise in raw-material prices brought about by heavy buying for defense production and for stockpiling and for the accumulation of private inventories. In addition, there was the increased defense spending here and abroad and an expansion of consumer buying, some of it scare buying. These developments were accompanied by an expansion of business investment, financed in part by bank credit, and in part by accumulated funds.

I have no doubt that a more effective use of monetary controls on the part of individual countries could have dampened the inflationary impact of these forces.

I do not believe, however, that inflation could have been entirely avoided by monetary measures alone without interference with production in most countries.

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In fact, in the face of the sharp rise in international raw material prices, an increase in the general price level in most countries was probably inevitable. Some increase was probably necessary, also, in order to achieve the expansion of production or the shift in resources which was required by the defense effort.

Also, I think it is extremely difficult for many countries, especially those heavily dependent upon foreign trade, to maintain internal stability and balance of payments equilibrium in the face of sharp increases in world prices. This is true, perhaps, to an even greater degree when nations are subject to deflationary pressures from the outside; that is, it is very difficult for them to maintain balance-of-payments equilibrium, and internal stability in the face of external deflationary pressures.

Now, the international character of price and income movements suggests that the United States, which is, perhaps, better equipped than most countries by reason of our economic strength and our relative economic independence, to maintain price and income stability, can exert a very great influence on the stability of the rest of the world. I believe, that as the leader of the free world in its struggle for security and economic progress, we have an international responsibility for maintaining a healthy domestic economy which, perhaps, goes beyond even the responsibility of our Government for the economic welfare of our own citizens.

The most significant contribution that we can make to international stability is to avoid inflation and deflation at home. There are some aspects of the problem of international stability which cannot be dealt with by purely national measures.

I believe, therefore, we also have a national interest in cooperating with other countries in mitigating the international impact of short-run fluctuations in United States economic activity, and of interna-ional developments which affect all nations, such as price developments in the field of raw material prices.

Mild fluctuations are, perhaps, inevitable in a free society such as ours, but even mild fluctuations can bring about rather substantial changes in our trade balance, which have been shown to have had a tremendous impact upon the economies of other countries and their ability to maintain stable conditions.

While any extended discussion of this topic is probably beyond the scope of this committee's work, what I have in mind are the kinds of measures discussed in a recent United Nations' report entitled "Measures for International Economic Stability." This report was prepared by a group of economists under the chairmanship of Prof. James W. Angell, who, as most of you know, is head of the Department of Economics at Columbia University.

Now, I should like to turn to one or two aspects of internal monetary policy in the brief time that I have remaining.

I have noticed that the answers to the committee's questionnaire range all the way from almost sole reliance on tight money policies to major reliance, under some circumstances, at least, on direct controls and selective credit controls.

Now, it seems to me that in dealing with this problem we ought, in considerable measure, to try to fit our remedies to the cause or causes of the disease.

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For example, a sharp rise in raw materials brought about by speculative and scare buying in a period of national emergency might best be dealt with by selective price and credit controls.

Under certain conditions it would make little sense to apply over-all deflationary pressures which might reduce national output or prevent it from expanding in order to check, say, a rise in the price of copper brought on by speculative activity. Yet a sharp rise in the prices of basic raw materials not justified by fundamental supply and demand conditions ought to be checked, since sooner or later they will pull a lot of other prices up with them.

Now, let us assume that prices are rising in response to a considerable volume of business borrowing from banks, and, for a moment, let us assume that the Federal budget is balanced.

Under these conditions reduced availability of bank credit would certainly seem to be called for.

The tightening up of credit, of course, brings up the question of how to prevent the monetization of governmental debt through the sale of Government securities by the banks. I do not know how much of a rise in interest rates would be necessary in order to prevent a further expansion of bank credit in the face of an active demand for bank loans.

I get the impression from reading the replies of the Federal Reserve bank presidents to the questionnaire, and of others who know more about this problem than I do, that it is not so much the absolute level of yields on Government securities which deters banks from selling them in order to expand their loans, but rather it is the uncertainty which small increases may create, and the reluctance of banks to sell securities below par for fear of incurring an accounting loss.

However, Mr. Samuelson pointed out that he believed this was only a short-run situation, and interest rates would be likely to rise, perhaps considerably. A substantial rise in interest rates might be necessary in order to prevent banks from selling bonds in order to expand their loans to business.

If, however, it is necessary to raise interest rates on Government's by 2 or 3 percent in order to prevent their monetization by the banks, I think I would favor as an alternative some kind of special reserve plan in order to insulate the bank-held debt, at least, as a temporary measure.

I say, I would hesitate to take action to raise interest rates by 2 or 3 percent in order to prevent the monetization of Government debt as a means of taking care of a temporary situation, because over the long run, I think that the maintenance of high levels of employment in this country will require relatively low rates of interest, perhaps not much above the rates existing at the present time.

Well, why not raise them as high as you want and then lower them again next year if that is necessary? I think that the loss of capital values and the disruption of the market for governmental securities might have unfortunate long-term repercussions not only upon Government credit but upon the willingness of investors to buy corporate securities. In other words, I do not think we can afford a 6-percent economy. I am speaking here, of course, of a rather substantial increase in the rates, and not changes in the rate of interest of up to 1 percent; and I am also speaking here of the problem of dealing with a

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rather temporary inflationary situation. For those reasons, rather than have a very large rise in the rate of interest over a short period of time and all the disruption it might create, I would prefer as a means of preventing the monetization of bank-held Government debt some kind of plan for insulating governmental debt in the hands of the banks.

Now, the problem becomes much more complicated if inflation is fed by continual deficit financing by the Government, say, as a result of defense spending.

Under these circumstances, I think that the most that general monetary controls are likely to be able to do without interfering greatly with production is to prevent a further expansion of bank credit to nongovernmental borrowers.

If the Government deficit, plus private investment, is greater than current saving, some reduction in private investment is necessary if inflation is to be prevented.

I would not deny that it was possible to curb inflation even in the face of a large Government deficit by forcing drastic curtailment of private investment through a reduction in the money supply, and raising interest rates to 6 or 8 percent.

But how far can you go with such a policy without affecting essential production? Suppose you want to reduce investment in housing. Will the rise in interest rates, no matter how high it need be, cut off investment in luxury hotels or in housing near new defense plants?

Do you reduce investment in automobile plants or in public-power facilities in new defense areas? Surely we cannot sacrifice essential production in order to offset a budgetary deficit by general monetary controls alone. I think the answer under the circumstances that I have indicated—that is, inflation with a large deficit spending—must lie in selective credit controls and materials allocations which, along with a judicious exercise of monetary controls, will achieve the results we are seeking.

If the Government were to engage in large deficit financing, we could very well have substantial inflationary pressures even with a decrease in bank loans. This, of course, occurred during certain periods of World War II.

Now, as between letting inflation run its course and keeping the lid on prices and wages with direct controls, I think we have very little choice if we intend to maintain our economic strength.

An inflation of substantial proportions would certainly weaken this Nation psychologically and materially. It must be recognized, however, that while direct controls will prevent the existing inflationary pressures from snowballing, they will build up latent inflation which may plague us later on.

As to the relationship between fiscal and monetary policy, I am convinced that they must work together to be effective. In many circumstances the monetary authorities may be helpless in controlling either inflation or deflation without the cooperation of fiscal policy; that is, if there is some concern with the volume of production. But fiscal policy is, to a large degree, governed by congressional action in passing revenue and appropriation measures.

Therefore, I should hope that some way might be found to provide a measure of flexibility in the administration of our fiscal policy while,

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at the same time, preserving the fundamental responsibilities of the Congress.

This might be accomplished by flexible tax provisions or by the appropriation of funds for certain types of public works, the spending of which could be speeded up or retarded with movements of our economic indicators.

I should like to conclude by saying that, except in periods of emergency, I believe that a reasonable degree of economic stability can be achieved through a coordinated monetary and fiscal policy with, perhaps, a limited use of selective credit controls at certain times.

In my opinion, direct controls could be limited to selective controls over a relatively few commodities after the next year or so, but if we have large deficit financing we had better try to keep the lid on everything we can.

Representative PATMAN. Thank you, sir.

We will now have questions and discussion.

Senator Flanders, would you like to ask any questions? Would you like to comment on what has been said?

Senator FLANDERS. Unfortunately, I was not able to be here, Mr. Chairman, when Mr. Ellis was speaking. I did hear at least part of Mr. Samuelson's discussion, and the succeeding ones.

I tried to get, Mr. Samuelson, from your testimony what it was that you felt to be the objective of general monetary control. As nearly as I could make out, you had your mind centered on the cost and availability of credit; is that right?

Mr. SAMUELSON. Exactly.

Senator FLANDERS. Do you consider that to be an ultimate objective or a means of attaining something else?

Mr. SAMUELSON. I think of that as the inescapable mechanism through which credit policy must act.

Now, I should say that you can express the same thing in other words, but those other words must be translatable into this particular mechanism. It stands or falls upon this.

Senator FLANDERS. What is the ultimate product of the mechanism; what are we doing all this for?

Mr. SAMUELSON. The purpose, as I would envisage credit policy, would be in times when there is a tendency toward excessive spending in all directions to use this mechanism to reduce spending by putting upward pressure on the cost and the unavailability of funds, and conversely in times when unemployment is growing, when prices are sagging, when we wish to expand total spending, we would use that same mechanism in reverse. Its potency, by the way, would not be equal in both directions probably.

Senator FLANDERS. Now, if I understand you, we get to what can be classed as an ultimate objective when you begin to bring in the question of employment and unemployment; that is, can we conceive of there being any objectives, final objectives, which do not ultimately express themselves in human terms?

Mr. SAMUELSON. Absolutely not. Unemployment, high levels of employment and production, useful production, and our defense problems, I would say, and the behavior of prices over a period of time, money prices——

Senator FLANDERS. Those would be our human objectives?

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Mr. SAMUELSON. Those would be our human objectives.

Senator FLANDERS. What you are saying is that the cost and availability of credit is an essential mechanism for effecting these human objectives?

Mr. SAMUELSON. Yes, and it is the only mechanism by which overall quantative credit policy can operate; that was my point.

Senator FLANDERS. Yes. Well, I just wanted to make sure that you did have an ultimate human objective in mind, because nothing else finally makes sense.

Mr. SAMUELSON. I am glad to have that in the record, Senator.

Senator FLANDERS. All right.

Now, Mr. Whittlesey, in your testimony you spoke of the quantity of money. I judge that you are somewhat dubious as to the all-sufficing explanation of all economic incidents and accidents in terms of the quantity of money.

Mr. WHITTLESEY. That is correct, sir.

Senator FLANDERS. You did refer at one point, and you used the word "behavior." Now, that by itself is not particularly informing. Is, for instance, velocity a part of behavior?

Mr. WHITTLESEY. It is. If I may refer again to my charts, I should like to have you notice page 8. I suggest that the rise that we saw in wholesale prices in 1950–51, the two sharp upward thrusts in wholesale prices indicated on page 75 of the chart book, correspond much better with what is suggested by the turn-over of demand deposits on page 8 than they do with changes in the total quantity of money.

One further item which is interesting, and which I have found useful in my work with the insurance company: On page 72 you will notice that the rise in department store sales shows those same two sharp peaks that we detect in the turn-over of demand deposits on page 8.

These are graphic representations of what I mean by behavior. You can summarize them in terms of velocity, but you cannot, it seems to me, identify them in terms of the quantity of money. I might add that one can correlate changes in savings inversely with the movement of department store sales. That is a rather crude device but it illustrates my thought on behavior, and the necessity of policies directed toward this factor, though not, of course, to the exclusion of the quantitative factor. I feel that in periods of emergency the Federal Reserve would be greatly handicapped if it were deprived of the selective instruments of credit control.

Senator FLANDERS. Yes; that is interesting because in the Banking and Currency Committee, of which I was a member at the time, the question of selective controls, with the wholesale price lists in mind, was very much under discussion at that moment, but we wandered off into other lines of interest, and finally, of legislation.

Now, how much credence do you place in the old-fashioned formula $MV/T=P$?

Mr. WHITTLESEY. It is a truism and indisputable. The doubt arises when you make assertions with respect to the initiation of changes in any particular factor.

Senator FLANDERS. It is a truism obviously, and you would say it is not particularly valuable as a guide in some way?

Mr. WHITTLESEY. I think it has very great usefulness under certain circumstances for purpose of explanation. You can integrate

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the turn-over of deposits and consumer behavior velocity, if you will, but calling it velocity does not explain why the change which was observed took place.

Senator FLANDERS. No; it does not explain why.

Mr. WHITTLESEY. It just shows how you classify it in the formula.

Senator FLANDERS. It just shows what goes on.

Mr. WHITTLESEY. That is right.

Senator FLANDERS. And you have to do some research for the reason why.

Mr. WHITTLESEY. There has often been a tendency to revert to the rigid form of the quantity theory and stress M as the only factor that is important.

Senator FLANDERS. What we have just been saying indicates that the question of behavior, a part of which, at least, is shown in velocity——

Mr. WHITTLESEY. Yes.

Senator FLANDERS (continuing). Is fundamental.

Mr. WHITTLESEY. I do not disagree with the view at all that M is important. And, particularly, over longer periods; but that one can stop with M it seems to me to be contradicted by the evidence to which I have called your attention.

Senator FLANDERS. I asked to have a chart made in which everything is in except T. Mr. Chairman, if there are any useful suggestions, I would like to have T added to the chart—that is, what the volume of transactions are, which, I suppose, might be found in—well—is industrial production a fair measure of that or is there a good measure of that?

Mr. WHITTLESEY. I do not know a good measure; industrial production does not include agricultural production, and it doesn't include other items.

Senator FLANDERS. There is not any measure of T that you know of currently being carried on. Has a measure of T been attempted?

Mr. WHITTLESEY. It has been attempted but not with any great success.

Senator FLANDERS. One way to do it—if, as you say, you have indicated that $MV/T=P$ is a truism—all you have got to do is to solve the equation for T and you have it, have you not?

Mr. WHITTLESEY. Provided you know what P and V are, but you do not know that.

Representative PATMAN. Would you like to insert that in the record?

Senator FLANDERS. I would like to have this chart and some explanatory material that was prepared for me inserted at this point.

Representative PATMAN. It will be inserted at this point.

(The chart and material referred to above are as follows:)

On several occasions during this inquiry questions have been raised as to the closeness of the relationship of money and credit to business activity by comparing changes in the privately held money supply with changes in price indexes.

While no one will deny that the money supply has an important bearing on prices, it would be surprising, indeed, if, particularly in the short run, there were precise relationships between changes in the money supply on the one hand, and price indexes on the other. In the first instance the quickness of response to changes in demand and supply situation varies considerably among different kinds of prices. Some react very quickly, others more slowly. Secondly, there are other factors than changes in the money supply which affect prices. If an

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upward shift in demand occurs when there are large amounts of unemployed resources a considerable increase in output may occur accompanied or not by an increase in the money supply without a corresponding increase in prices. When the economy is fully employed an increase in demand may result almost entirely in increased prices in the short run and need not necessarily be accompanied by an increase in the money supply.

These divergencies in the short run between movements in the money supply and prices are, in part, explained by the fact that the money supply itself has two dimensions; that is, there is, first, an amount, and, secondly, there is its use. Money, once created, may be spent quickly, slowly, or held idle for long periods of time either in demand deposits, time deposits, or currency.

There are a variety of factors which lead to long-run shifts in the turn-over of bank deposits. In the short run, however, changes are apt to reflect the community's expectations as to the future trend of prices. In some periods expectations as to the availability of goods may not only be a powerful additional influence on whether to buy now but may be the most important consideration. During the last war, for example, a wide variety of consumer goods and services were not available and people built up large idle cash balances. In the early postwar period the pent-up demand for goods and services of all kinds was sufficient cause for an increase in deposit use. Similarly in the first 7 months following Korea there was not only the matter of price expectations but a real question as to the future availability of many kinds of consumer goods.

In periods of inflation, it is the purpose of monetary action to see to it that bank reserves are less easily available. It usually follows that consumers and businesses can only get additional credit, if at all, on more costly terms. While consumers and businesses may offset to some extent inability to obtain credit by increasing the turn-over of existing cash balances, this can be only a partial offset. Since the institutions and individuals that borrow and are thus able to compete for goods and services are not, by and large, those with large cash balances, the creation of money through extensions of credit of this kind is bound to have an upward influence on the turn-over of deposits and on prices. Borrowers do not ordinarily borrow for other reasons then to spend.

For these reasons selective credit instruments such as regulations X and W which aim at dampening demand where it is most volatile are very useful as supplements to general credit instruments which by their nature have a more pervasive influence.

The significance of this analysis of the two-dimensional aspects of the money supply is shown in part by the chart on which there are plotted some related indexes of economic activity for the period January 1950 to the latest month for which data are available.

It will be noted that the indexes except for the money supply reached their peaks in December 1950 or early in 1951 and, after rather sharp declines, have been relatively stable in recent months. Moreover, as the chart shows, the increases in the indexes for wholesale prices and for turn-over of demand deposits outside New York City show comparable percentage changes from Korea to their respective peaks and for the declines therefrom.

Demand deposit turn-over index

June 1950	108.6
December 1950	123.7
Change ... percent	+14
January 1951	118.0
January 1952	110.0
Change ... percent	−6.8

Wholesale prices index

June 1950	100.2
February 1951	116.5
Change ... percent	+16
February 1951	116.5
February 1952	111.4
Change ... percent	−4

The index of the privately held money supply, on the other hand, has shown an almost continuous rise since Korea with the bulk of the increase coming in the late months of 1950 and the second half of 1951. Thus in the second half of 1950

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while the other indexes were advancing very rapidly the money supply index increased by something less than 4 percent. In 1951 this index increased by 5 percent or $8.8 billion, whereas, as the chart shows, the other indexes were first declining, then stabilizing at lower levels.

An explanation for this lack of a close correlation between movements in the money supply and wholesale prices over this period is provided by movements in the index measuring changes in the rapidity of use of a large segment of the money supply, i. e., turn-over of bank demand deposits. In the period closely following the Korean outbreak consumers and businesses alike evidently activated their holdings of existing demand deposits to a considerable extent. In addition, both businesses and consumers increased their credit demands by record amounts. Increments to the money supply from these sources, as noted above, have an upward influence on money activity since people ordinarily borrow in order to spend. The demand for goods and services as a result was considerably enhanced and lacking comparable expansion in supply, wholesale prices rose sharply. The increase in the money supply, on the other hand, was more moderate.

In the period since early 1951, the opposite phenomenon has occurred. Despite large increase in the money supply the index of wholesale prices has shown a decline and then relative stability. The simultaneous decline in turn-over of bank deposits over this same period reflects the less active use of the increased money supply and increased savings. Extensions of bank credit to the private sector which in the earlier period were greater than the increase in the money supply, were a much smaller factor during this period.

On an annual basis, the turn-over of bank demand deposits has shown an upward trend since the end of 1945 except for a moderate decline in 1949. The turn-over rate of 22.5 times per year reached in April 1951 represents the highest level since 1937. Despite these increases, however, the turn-over rate remains substantially below levels prevailing during the middle twenties which at a range of from 32–34 were then generally considered to be normal. The 1952 rate is, of course, only little more than half the rate of 40 times per year recorded for the year 1929.

Mr. FRIEDMAN. May I interrupt to insert a minority "no" on the final point. It seems to me that the quantity equation is more useful in a slightly different truism which puts on the right-hand side, not total transactions, but total real income, so that the velocity, instead of being the velocity of money in effecting transactions is the velocity of money in effecting income payments. You have then on the right-hand side prices times real income, and we have very good measures of real income——

Senator FLANDERS. Just a minute.

Mr. FRIEDMAN. Another way of writing the formula is M times another V, say, small v, is equal to prices——

Senator FLANDERS. M times small v——

Mr. FRIEDMAN. Equals P times——

Senator FLANDERS (continuing). Equals prices times income.

Mr. FRIEDMAN. Times real income in goods. That leaves out of the transactions all transactions in the stock market or intermediate transactions between wholesalers and retailers. It concentrates upon the purchase of final goods and services or the payment of final income.

Senator FLANDERS. Mr. Chairman, I am interested in this new formula, but I can assure you that I will not understand it until tomorrow.

Representative PATMAN. Well, without objection, each member of the panel, may extend his remarks in connection with the remarks he has made or in connection with anything that has been brought up in this discussion, including any remarks that he would like to put in.

Representative BOLLING. If the Senator does not object, it seems to me there have been implications that there is some question as to

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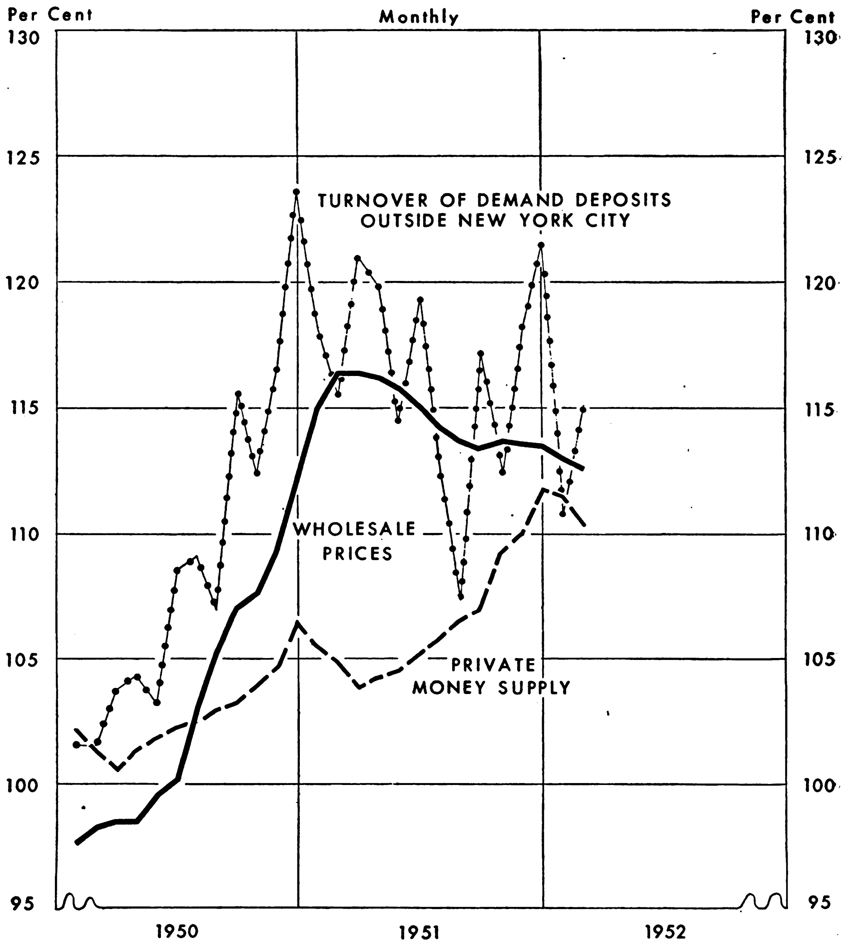

what "M" was. I understand there is some controversy on that question as to what is money.

Mr. SAMUELSON. Mr. Chairman, I was about to mention that the current edition of the Encyclopedia Britannica mentions this formula MV equals PT, and it says of the four, three are completely unobservable, and must be constructed, and on the basis of my provocative testimony this morning, the fourth has been brought into suspicion.

Mr. FRIEDMAN. I believe that the quantity equation can be defended not only as a truism, but as one of the few empirically correct generalizations that we have uncovered in economics from the evidence of centuries.

It is, of course, true that velocity varies over short periods of time. The fact of the matter, however, is that these variations, especially of income velocity, are in general relatively small. So far as I know there is no single equation that has been developed in economics that has nearly as much predictive power as this simple truism. Further,

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this conclusion is in no wise contradicted by the evidence that Mr. Whittlesey pointed to about the rapid rise in the stock of money in the last half of 1951. That was one of the occasions on which the point that Mr. Samuelson brought up about the definition of money was particularly important.

When the Federal Reserve dropped the peg on Government bonds, Government bonds ceased to be as close a substitute for money proper as they had been before. They were no longer immediately convertible into money at a known price. This increased the demand on the part of people for money proper, for money as we usually define it. I therefore think that the rise in the stock of money in the last part of 1951 without a corresponding rise in prices is to a considerable extent a reflection of the changed meaning of Government bonds.

Representative BOLLING. I still want to know what money is.

Senator FLANDERS. I was going to say that I suggest, Mr. Chairman, that your suggestion be observed by the participants this morning, and that this particular subject might be treated by each of them in the record in accordance with their own points of view.

Representative BOLLING. I am particularly concerned about this question of what is money at this point, and I gather there is substantial disagreement on what money is. What is money?

Senator FLANDERS. It does seem reasonable to suppose that Government bonds were money until they were unpegged.

Representative BOLLING. Does Mr. Samuelson have anything to say on that? What do you consider money to be?

Mr. SAMUELSON. I myself would not make too much of the point that the definition of money is a shifting one, because I have not had the good success that Mr. Friedman has had in the predictive power of this truism.

I make predictions all the time, and I use every method suggested to me, and you may be sure that I do not neglect the quantity theory.

Now, my batting average has not been very good on it. In fact, it is a hunting license which tells me to catch rabbits by putting salt on their tails. There are lots of little factors I have to catch hold of there.

Now, it is true that retrospectively I can go over the data, as Mr. Friedman has just done, and find that a slight change in the definition of money for the last 6 months or a temporary neglect of a change in velocity or taking out the long-term trend in velocity will make my retroactive predictions better. Velocity appears to be variable in the short run and variable in the long run. I have not had much luck with that truism. It is a much used and abused formalism; and, much as I would like to crow as to the part my profession plays, I submit our predictive record has not been too good.

In the first year after Korea many economists, in my opinion, did harm to the cause of tighter money by blaming the subsequent rise in prices pretty much completely on the Federal Reserve. They cited what I can only regard as some pretty superficial empirical coincidences, between the percentage price change and percentage change in one or another of the definitions of money. In economics empirical correlations more impressive than this by far are a dime a dozen, and one of the disadvantages of a flimsy argument is that it weakens the good cause that you are favoring. Thus, as Mr. Whittlesey has

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pointed out with detailed references to the Federal Reserve chart book, the pattern of events in the second year after Korea is explained very badly by using the quantity theory of money in anything but its empty truistic sense. Only with considerable retroactive juggling can you get it to predict the course of prices in the last calendar year. Just as I did not believe in the case for tight money because of the previous flimsy argument so the backfiring of this argument does not shake my faith. It is strange however that Mother Nature should have played so cruel a trick on the simpler versions of the quantity theory. It is not usually so wrong a formula.

Senator FLANDERS. Just to complicate this thing a little bit further, Mr. Chairman, if an amateur can complicate it, if it is suggested that pegged bonds are money, it might be suggested that different kinds of money have different velocities, and that, perhaps, the velocity of pegged bond money was not as high as nickels and dimes. That is just a little complication which I am glad to throw into an otherwise simple problem.

Now, the only other thing that I am interested in pursuing, Mr. Chairman, is to get from these gentleman, each of them, some expression as to what is the ultimate objective of monetary and fiscal policy; perhaps I had better say monetary policy, because the objective of fiscal policy is to spend money and raise it, and you get to the question as to whether what we are spending money for is worth while, and whether we ought to raise it or not; but let us talk about monetary policy.

I judge from what Mr. Samuelson said that the employment and production are fundamental or final objectives. You would agree with that?

Mr. SAMUELSON. Yes; but I also included price behavior over time.

Senator FLANDERS. Yes, that is right, price behavior.

Now, when you put in price behavior along with employment and production do you feel that they are objectives which can be attained at the same time ordinarily or does the attainment of one tend to make the attainment of the other difficult?

Mr. SAMUELSON. I believe there are certain dilemmas of policy which we do face when we are interested both in stable average prices, the cost of living on wholesale prices and, at the same time, in maximum employment and production.

I do think, however, that this particular dilemma is not peculiar to monetary policy. It is also a dilemma of fiscal policy and a dilemma, indeed, of private investment supported booms.

Now, if you try to get the last little drop of extra production out of your system so that people are upgraded to the greatest degree imaginable, and people are taken off the farms from low output jobs, and coaxed to the cities by job opportunities, so that the 5- and 10-cent store at Harvard Square in Cambridge, Mass., where I live has, as it had during the war, a sign "Married women wanted; hours can be arranged at your convenience," now, if you want to get that kind of high employment, it is pretty clear you would have to have so much monetary steam in the boiler that there are grave doubts that a betting man must have as to the future of the stability of the cost of living and of wages, so there are dilemmas.

Senator FLANDERS. Supposing you put residual unemployment at some figure—2 million, 3 million, somewhere; I do not know whether

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it ought to be higher or lower—would you then feel that the two objectives interfered with each other, sir, too much?

Mr. SAMUELSON. At the present time, with our present institutional structure in the labor market, collective bargaining, and even in industries where there is not collective-bargaining-administered wage agreements, I do not know what level of unemployment—what percentage level of unemployment—would have to be to result in money wage increases each year not greater than the increase in physical productivity averages for the system, and, therefore, I do not know the answer to your question.

Senator FLANDERS. Do you have in mind in saying that that the price-wage-cost spiral was a mechanism of its own under our present institutions which, perhaps, leads to an increase in the amount of money?

Mr. SAMUELSON. I would accept your statement up to the last.

Senator FLANDERS. Up to the last?

Mr. SAMUELSON. The last few words, although I do not disagree necessarily with the last few words, but to tell you what is in my mind I have precisely in mind the wage-cost-price spiral of which so much has been heard recently.

Now, there have been certain fashions of thought in this area where it was thought right after the war that the causation was pretty unilaterally from wage increases brought about by collective bargaining or by other mechanisms to prices.

More recently, the point of view has gained in prominence that the causation is probably unilateral the other way; that the wage increases really only follow upon the excess of demand.

I am afraid that on this point I do not feel that I know the answer. I really feel that an eclectic answer, with causation running in both directions, is extremely important here, and, having looked at all the elements, I am not a convert to either of these theories. This leaves me in doubt as to the answer to your question as to what degree price stability is incompatible with high employment.

Senator FLANDERS. Now, I would like to ask one other question. Suppose that price stability is threatened by the spiral of which we have been speaking, can the increase in prices, which is one of our objectives, be prevented in the face of that spiral by monetary manipulation; and if so, can it be prevented without seriously affecting employment?

Mr. SAMUELSON. Let me be optimistic about the potency of monetary policy for the purpose of answering this question; and so let us assume that by raising interest rates and the nonavailability of credit to borrowers, even a little, you are able to get a very sizable reduction in investment and/or consumption spending by the community.

At the same time you have a unilateral wage push—this is, I understand, the question that has been presented to me. I should think that under these circumstances in most of American industry it would be likely that there still would be some increase in prices, but there would not be the money volume of spending to take off the full-employment production of goods. Therefore, inventories would start to pile up; therefore, orders would be cut back; therefore, production would be cut back; and, therefore, then, I suggest what would happen would be some increase in prices accompanied by some increase in unemploy-

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ment; and then the open question which I do not know the answer to comes up: Would the existence of a small amount of unemployment or even a large amount of unemployment cause an attrition of the money wage rate structure so as to bring prices back gain to that base period?

Now, we have not had very many experiments in the last 20 years on this sort of thing.

Senator FLANDERS. You cannot use a controlled laboratory experiment on that.

Mr. SAMUELSON. No. So I do not know what the answer to that question would be. I do not wish such an experiment for the System, but if and when such an experiment is performed, I shall be there as an interested observer to see what the results would be.

Senator FLANDERS. I would like to ask, Mr. Chairman, these other gentlemen, in turn, without asking the questions over again, for any comments they might have.

Mr. MIKESELL. Senator, in answer to your first question with regard to the objective of economic policy and monetary policy, I would say it is to maintain a high level of production and employment, which would provide what we consider to be full employment, with this residual that you spoke of, with minimum changes in price relations which affect the distribution of real income.

Now, again, I think that I would agree with Mr. Samuelson's statement that there may be contradictions in this if you have, on the one hand, a strong upward pressure for higher wages, which tends to outrun increases in productivity.

I think that when we have a period of emergency, of course, where it is necessary to achieve increases in defense production very rapidly, that you have an additional problem of mobilizing resources for some purposes very quickly, and that again you may run into difficulties. You may have to permit some increases in prices in order to achieve your goals very quickly, without sacrificing the achievement of those goals.

Senator FLANDERS. Thank you.

Mr. Whittlesey?

Mr. WHITTLESEY. I directed my first remarks more or less to this question of objectives. I would summarize my views again by quoting from what the Federal Reserve Board of Governors had to say on the subject. On page 213 of the Board's answer to this committee's questionnaire quotes from the 1945 Federal Reserve Report as follows:

> 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. Traditionally, this over-all policy has been followed by easing credit conditions when deflationary factors prevailed and, conversely, by restrictive measures when inflationary forces threatened.

In that same annual report, on page 4, appears a reference to—

> * * * the Reserve Board's assurance to the Treasury that the rate of ⅞ percent on 1-year certificates will be maintained, if necessary, through open market operations.

The report then went on to say:

> This assurance is necessary from the standpoint of the Government's financing operations, and was given because the Board does not favor a higher level of interest rates than the Government is now paying.

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Now, I feel sure that the precise level should be adjusted, but the essence of policy, economic policy in general, is the problem of choices. It is never black and white. There are multiple objectives. In this case, as I have mentioned repeatedly, there is more than a single objective, and the apparent conflict is not so much inconsistency as that they are pursuing ends which are all desirable, and among which compromise is necessary.

I would like to add also that the phrase "restrictive measures" used here should be interpreted to include, as it did earlier, the judicious use of selective instruments and perhaps of other methods yet to be discovered.

Senator FLANDERS. Now, following the line of thought you have just been giving us of the different objectives and the fact that we may have to compromise between them, is it your point of view that we can usefully give some sort of a mandate to the Federal Reserve that will clarify their objectives and the means of reaching them, or do you feel that the present situation in which the Chairman of the Reserve Board and the Secretary of the Treasury get along very well together, is the best way to handle this position of the conflict of interest and complications of responsibilities?

Mr. WHITTLESEY. That is admittedly a most difficult question, and I do not have a glib answer to it.

I do feel that the question of the independence of the Federal Reserve or the independence of the Treasury is largely a matter of semantics. There is no such thing. Each one is prisoner of the other. They cannot act independently because the necessary functions they carry on involve the purposes and objectives and measures of the other. Each one, as I say, is the prisoner of the other.

The real problem is not that of independence but of coordination. I think that we shall not have another conflict comparable to the one we have just come through. It seems to me that the question of maintaining par was probably more of an issue than any we are likely to see again. I may be wrong, but that is certainly not a precedent.

I may say, without intended disrespect, that in my opinion the greatest threat to the independence of the Federal Reserve, in the sense of its ability to carry out its responsibilities, comes first from pressure groups, if they can bring sufficient force to prevent the use of credit control instruments, as they have attempted to do with respect to regulation W and as they did with respect to raising the interest rate in 1920, when the Federal Reserve was under vigorous attack; and, secondly, its independence is threatened if Congress refuses to give it the necessary powers for meeting emergencies as they arise.

Senator FLANDERS. That, however, may be exactly the same thing as the direct impact of pressures on the Federal Reserve; that is, the same pressures on Congress' legislating for the Federal Reserve.

Mr. WHITTLESEY. That is right; I would not separate the two.

Senator FLANDERS. It is the same thing; you do not escape it in any case.

Mr. WHITTLESEY. That is right, and the pressure is probably going to operate as it did last summer namely, through Congress.

In 1949 or 1950 I came down to testify before one of your groups, saying that for standby purposes the Federal Reserve ought to have the brake provided by regulation W, just as a car ought to be equipped with brakes before it hits a downgrade. That power was not granted

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to the Federal Reserve. At the time of the outbreak of war in Korea, they lacked the power to restrict consumer credit. If they had had that power they would have been in better position to take prompt steps to combat inflation. Instead, they emphasized the inflationary dangers, thereby contributing to the panic, in order, I think, to bring pressure upon Congress to grant them the authority they should have had all along. Therefore, it seems to me that the real problem of independence is the problem of giving the Federal Reserve the authority, and strengthening their determination, to carry out the policies indicated so well in earlier reports and statements by Federal Reserve officials.

Senator FLANDERS. Thank you, Mr. Whittlesey.

Mr. Ellis?

Mr. ELLIS. Thank you, Senator. I will attempt to offer an observation or so upon your question relative to the point as to whether it would be advisable to address a mandate to the Federal Reserve Board with respect to its responsibilities.

Mr. Samuelson, I think, has stated three ultimate objectives in terms of a reasonably high level of employment, stability of prices, and national defense. These three often conflict to a certain degree. But it ought to be made clear, I believe, that it is the responsibility of the Federal Reserve Board to maintain a reasonable degree of monetary stability so far as that is within the power of monetary authority.

I believe that such a clear mandate might have contributed something to the prevention of the postwar price rise before Korea which, in my estimation, served no useful purpose and which, in general, rested back upon a gradual process of monetizing the debt.

The objectives of full employment and stable prices do, through a certain range, represent a dilemma; that is, as Mr. Samuelson said, you may be able to extract some more employment and production by letting prices rise. But it is also worthy of note that this dilemma may disappear through the very fact that a rise in the price level may actually interfere with production, reduce employment, reduce the effectiveness of the economy.

During the postwar period the frequency of strikes and the intensity of labor troubles was, I think, in part attributable to the inflation itself. Whether real wages rose or fell, whether the impulse came from the side of the unions or from the monetary side, in either event this process was one that was socially wasteful and, I think, might substantially have been reduced by firm monetary policy.

Senator FLANDERS. Thank you, Mr. Ellis.

Mr. Friedman?

Mr. FRIEDMAN. It seems to me that the objective of economic policy in general is to have as high a level of output as we can, as high a real income.

We use many different instruments and many different agencies to promote this ultimate objective. In doing so, it is appropriate to think of subsidiary objectives being assigned to particular instruments or agencies. In my view, the objective assigned to monetary policy ought to be to promte a stable value of the dollar, that is, to promote price stability. Further, this is an appropriate objective of monetary policy because it will contribute to the ultimate objective of a high level of output for the economy as a whole.

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Rather than regarding the objectives of high output and of price stability as inconsistent, I think that fundamentally price stability will promote a high level of output by avoiding a good many of the interruptions to output that we have had in the past, by giving people stable expectations, and so on.

As to the special problem of the wage-price spiral that you raised and that was commented upon, in principle, it would clearly be possible for highly organized groups, whether of wage earners or producers of farm products or employers——

Senator FLANDERS. May I just suggest that in a market which is, in a manner of speaking, without limit, the endeavor of the producer to get high prices and the endeavor of the wage earner to get high wages bears a very close similarity.

Mr. FRIEDMAN. Absolutely.

Senator FLANDERS. So that we do not say that one is on the side of the angels and the other is somewhere else. It is the same problem in two different fields.

Mr. FRIEDMAN. Absolutely. While in principle a problem can arise even with a stable supply of money as a result of a cost or a price push on the part of organized groups, in fact, I do not think such a problem has arisen to any important extent. I think the so-called wage-price spiral has been enormously exaggerated, that what we have had has been inflationary pressure pulling both wages and prices up. If we had had a reasonable level of price stability I think we would not have had much trouble from the so-called wage-price spiral.

But suppose a wage or price push by highly organized groups should develop, then I would say the appropriate answer is not monetary policy. Monetary policy ought still to be conducted with an eye to keeping the price level stable. The appropriate answer is then to try to eliminate the monopolistic conditions on the side of either business or labor that permit small groups to determine, without reference to market pressures, their prices or wages.

Senator FLANDERS. May I go back just a moment to your apparently implicit confidence in monetary policy? Do you feel that monetary policy, applied intelligently and vigorously and strongly, could have held down the post-Korean price rise?

Mr. FRIEDMAN. Yes; I think there is no question but that it could have prevented it.

Senator FLANDERS. Could it have done it in any other way? Could it have done it without resulting in decreased production and employment?

Mr. FRIEDMAN. Yes, I think so. Prior to Korea production and employment were on the upgrade and were rising.

Senator FLANDERS. They were.

Mr. FRIEDMAN. I think that they would have continued to rise without the stimulus of something like a 10 percent rise in prices. I think immediately after the beginning of the Korean episode there would undoubtedly have been pressure for price increases because of anticipatory fears that prices were going to rise; but if the Federal Reserve had at that time taken vigorous action to sell Government bonds and tighten up on the money supply, this action and its results would have eliminated these destabilizing expectations, and I think you would have had reasonable price stability.

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Senator FLANDERS. Would you have worked through restriction of the credit, specific restrictions of credit for the building of inventories, restrictive selective application of credit against installment buying, and so on?

Mr. FRIEDMAN. No; I would have worked solely through general monetary measures of selling bonds and keeping down the supply of money. I think that selective credit controls are bad, like other direct controls; that they discriminate against certain classes of borrowers for reasons that are not really relevant; and that it would be much better to do without them and to rely exclusively on general monetary controls.

Senator FLANDERS. You would not have feared then that general credit restriction would have borne down heavily on normal production as well as on abnormal inventories and abnormal purchases?

Mr. FRIEDMAN. Well, I find it hard to make the distinction very sharply. The inventories that are accumulated because prices are rising are, in a sense, abnormal, but if when prices are reasonably stable, businessmen or consumers prefer to accumulate inventories rather than to consume the product currently, such action seems to me a proper use of their resources on their part.

As a matter of prediction, I think that this monetary policy would, in fact, have curtailed mostly what it is tempting to call abnormal inventory accumulations.

I want to make one final comment on the issue that has been raised about the pressures on the Federal Reserve System, if I may. With our present institutional structure, it seems to me that the best way to avoid pressure on the Federal Reserve System would be to have a clear, announced mandate from Congress about the immediate and proximate objective that the Federal Reserve System should pursue.

Senator FLANDERS. Will you write such a mandate and put it into the record?

Mr. FRIEDMAN. I will. I was going to say——

Senator FLANDERS. You can do it anonymously if you wish.

Mr. FRIEDMAN. I have no objection to signing it, no desire to cloak it in anonymity.

The mandate ought to be to preserve price stability, but I wanted to go on and say that in light of the failure of the Federal Reserve System in the past to be immune from pressure, I think that a more fundamental reform is required, namely, a reform in our general monetary and banking structure so as to reduce the possibility of bringing pressure.

Senator FLANDERS. Well, I do not wish to take any more time questioning, but do you feel that you have sufficiently described that fundamental reform in your presentation? I was not here.

Mr. FRIEDMAN. No, I just adverted to it. I indicated the general nature of it.

Senator FLANDERS. Mr. Chairman, would it be proper to ask him to write a memorandum at that point as to his point of view, and incorporate it in the record?

Representative PATMAN. Certainly, sir, and each member of the panel may have permission to extend his remarks.

You all have that permission to extend your remarks, as we say on the floor, and you may include any materials that you wish to include.

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I wonder if it would be possible to suggest to the other members of the panel to consider any sort of monetary policy that Congress should consider? Would you be interested in that, Doctor?

Mr. SAMUELSON. Let me get my breath thinking of this. Some of the other members of the panel may have more ready positions.

Representative PATMAN. Have you any comment?

Mr. MIKESELL. I have no pat answer for you at the moment.

Representative PATMAN. I will not press you on that. If you think you have something to present, we will be glad to receive it.

Mr. WHITTLESEY. That is not an answer you can give quickly, although it is in general statements probably available in a good many things we have written and said.

I agree with Mr. Friedman of the desire to maintain stability of the dollar. I do not share his conviction that this one device would accomplish it.

I have been associated earlier as one of the members of this committee at one time in an interest in the 100-percent reserve plan, and I think there is a great deal to be said for it intellectually; I do not regard it as practical politics, and I have no particular zeal for it.

Representative PATMAN. Mr. Bolling, would you like to ask a question?

Representative BOLLING. Mr. Friedman, you indicated that you felt that general monetary policy could have handled the situation, and that you did not feel that either selective credit controls or the other direct controls or direct controls were desirable. Did that include a disbelief in allocations and priorities of materials?

Mr. FRIEDMAN. The problem of allocations and priorities needs to be separated into two parts.

First, I do not believe in allocations and priorities as a means of preventing inflation. Second, there are some markets which are imperfect in the sense that there is not a free market in the product or that there are advance contracts for large amounts of it. In such markets, prices may not rise rapidly enough when the Government imposes its demand on top of the demand of the private concerns to enable the Government to get the amount it requires.

Under those circumstances there is a case for priorities. I think the case is not for allocations, but for priorities, as a means of breaking into the order books of the concerns in question so as to enable the Government to get its share of the output of that industry, to get what it needs for the defense effort for sure.

I believe that prices are flexible; any such need for priorities would rapidly disappear, as the prices in particular areas adjust themselves to the demands. Our objective ought to be a stable general level of prices, not to keep each individual price fixed. On the contrary, it seems to me that we want as much flexibility as we can get in the prices of particular items so as to promote the most efficient use of resources.

Representative BOLLING. You feel, in effect, I gather, that given the two decisions that were made on the policy level that, No. 1, our manner of meeting the threat implicit in the Korean incident, that is the threat beyond the involvement of the Korean war, was to be one of building production lines for hardware as well as some hardware. No. 2, that rather than do that through Government construction of plants and facilities, it would be done entirely by private enterprise with

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certain incentives, such as assistance by way of subsidies here and there, and certificates of accelerated amortization, and so on.

Do you feel that, given the situation that we had in 1950, general credit control, monetary policy, plus priorities, could have resulted in the necessary defense production, at the same time as we maintained a high level of civilian consumption?

Mr. FRIEDMAN. I think it would have facilitated it, because during this period we had essentially a private inflation, not a governmental inflation. The Government budget was essentially in balance. The competing demands of private groups, unchecked by any limitation on the supply of credit or money, made the task of achieving the requisite Government output more difficult rather than less difficult.

Representative BOLLING. What would have been the motivation for people to go into the production of defense materials or plants if it were more profitable for them to go into the production of consumption goods?

Mr. FRIEDMAN. But the imposition of general monetary controls would have made it less profitable than it was for them to go into the production of private consumer goods, because the monetary controls would have damped down the demand of civilian groups. The monetary controls would not have affected Government demand, which is why it seems to me that they would have increased the ability of the Government to get the share of the output needed for the defense effort.

Mr. ELLIS. I wonder if I might be allowed to underscore strongly what Mr. Friedman has just said? Selective credit controls, I believe, have an important allocative function, also the direct allocations, but this set of selective credit and direct controls would work very much better if we had not had in the months between Korea and last March a 22-percent expansion of banking credit, which made everything profitable and, therefore, tended to divert production away from the channels which have been emphasized in the selective credit controls.

Representative BOLLING. Do I gather from what you said that you feel, as Mr. Friedman, that the whole thing could have been handled without monetary controls, without selective——

Mr. ELLIS. No, I did not mean to imply that. I meant to say that the selective controls were useful in an allocative function. I meant to say, however, they would have worked still better if you had had a restraint on general monetary expansion and, perhaps, even an absence of expansion.

Representative BOLLING. We have heard a great deal, I think, in the last 2 weeks as to the impersonality of monetary policy and general credit controls, and so on. It seems to me the keystone of the argument of many of the people who insist that that is the only proper way, in which those things can be managed. I will not attempt to elaborate the argument because I am sure you all know it.

I am a little curious as to how impersonal credit actually is. The impression that I have been getting increasingly is that it is quite personal, the actual operation of who gets credit and when.

Mr. ELLIS. May I say a word on that? The credit rationing that goes on in a commercial banking system continuously is in a way personal because each banker exercises this rationing function.

He presumably, however, is exercising that rationing on the basis of some business and commercial principles. This kind of rationing can

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be contrasted with rationing at the center. The British Labor Government, when it nationalized the Bank of England, indicated that it would henceforth consider it to be within its prerogative, and that prerogative was exercised by the board of trade, to direct commercial bankers as to the character of their loans.

Now that is, obviously, a different kind of rationing, and that is what one would really mean by personal; at least it is authoritarian. I think the two contrast in ideals substantially.

Representative BOLLING. I certainly agree with that, but we arrive at the point with the so-called absolutely impersonal being not absolutely impersonal.

Mr. FRIEDMAN. Nothing is absolutely impersonal. It is a question of degree. By comparison with almost any alternative one can conceive of, I think it is fair to say that what is called credit rationing by individual banks is highly impersonal.

One has to get perspective on this. To the individual person who is refused a loan, it will appear highly personal. Looked at from a broader point of view, with due regard to the large number of independent banks in our system and to the alternatives outside of the banking system, it seems to me that the process is highly impersonal.

I would like it to be even more impersonal. Indeed, one of the advantages that would come from the 100-percent reserve system I described earlier would be the possibility of having a much greater degree of competition, and hence of impersonality, in the provision of loans if this activity were separated from the provision of the money supply in the country.

Mr. WHITTLESEY. May I comment on that question?

Representative BOLLING. Certainly.

Mr. WHITTLESEY. All laws are impersonal in one sense, and personal in another.

The laws against murder that were referred to earlier are directed against the person who wants to murder and not against the general public and ourselves. So with traffic limitations; they are directed against the person who wants to speed.

Now, it is true that selective-credit controls are personal in one sense: they are directed against people who want to expand consumer credit. But by the same token a higher discount rate is directed against the bank that may want to expand its credit when some other banks do not.

Selective-credit controls come somewhere between the general-credit controls and direct controls. I would suggest that the degree of impersonality associated with selective controls is considerable, and leaves them desirable in many ways and in many situations. A judicious use of these measures may be a surer way of forestalling resort to a still more objectionable method, namely, direct controls, than attempted adherence to some more extreme position.

Mr. SAMUELSON. Mr. Congressman, I think the case for monetary policy can only be helped by a certain amount of realism concerning its importance in terms of other alternative activities. I do not believe that a sudden political event, like Korea, would have been followed in a perfectly free-enterprise system by anything but a great upward surge in many prices if that price system is behaving the way a free-price system ought to be behaving.

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Now, it is true that the very different relative price configuration which would be appropriate after the event could be achieved by quite a number of prices rising a great deal and by quite a number of prices falling a great deal, and the over-all average remaining the same. And I think that I can imagine a degree of tightness of monetary policy instantly acted upon which might leave the price index in this chart, the average index, the same.

I think it would represent almost a revolutionary change in individual markets, and I think our present system is such that you would not get the downward flexibility in many of these prices with the result that you would not succeed in maintaining production in very many of these channels.

Now, it might be argued that you do not want to; that what you want, since the situation is a new one, is to give a system a good shock and gets lot of nonessential lines into a temporary conversion depression, and realize more defense conversion in this way. But I do not, for a moment, believe in this easy picture of the central bankers making rather mild changes in bond rates and thereby averting the post-Korean inventory bulge.

For example, I do not believe that with bonds never below 90, you could have kept from having a bulge in the wholesale price index in this chart book. I do not see why you would want necessarily to achieve that, but I think it would be doing a disservice to the cause of monetary policy to hold out any such hopes. Now, I may be wrong, and if I am wrong, I am wrong on a very difficult question of fact.

I think this is not contradicted by Professor Friedman's testimony because, if I understand his point of view, he would be prepared, if necessary, to see those bonds at 60 to do this, or 50, or 40, or if 40 would not do it, 38 might.

Now, that is all very well, provided everybody understands exactly the frame of reference in terms of which we are talking, and if I misrepresented it, my good friend Milton Friedman, I hope, will correct me.

Am I correct in my interpretation of the sense in which you meant——

Mr. FRIEDMAN. Yes and no.

If it took a fall in the price of bonds to 50, why, of course, I would be prepared to see it go to 50, but what would that mean? It would take a fall in the price of bonds to 50 only if the inflationary pressures to be counteracted were enormous.

In that case, any other method of counteracting inflation would also have to be very extreme.

The "no" part is that I think that you have driven a good point too far; that the impact of a thing like Korea on the price structure is much less drastic, and required must less drastic action than you indicated.

I might note that the outbreak of World War I was followed by a substantial decline in prices of major raw materials; that this also occurred on the outbreak of World War II as an immediate reaction.

The major reason why the Korean outbreak had an opposite effect was because people were so close to the experience of World War II and interpreted war and price rises as synonymous.

If this expectation could have been eliminated by relatively mild measures, as I think it could have been, this would have stopped the

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part of the price rise that arose primarily and exclusively from these anticipatory purchases of goods. The fact that the price rise, even with our expansionary credit policy, was only of the order of 10 to 15 percent during that period is evidence that only relatively mild measures were required and that you overstate the magnitude of the shock that would have been required to maintain a reasonable degree of stability in the price level, and I emphasize this "reasonable degree."

I am not arguing that the index ought not to change by one-tenth of a point from 1 day to another, but that the price movements ought to be kept within a few percent either way.

Mr. SAMUELSON. May I return to the problem of direct allocations and priorities? It seems to me that you could envisage fighting a major war without any of these. In fact, this has been proposed—I think it has been proposed—by a number of persons. Prof. A. P. Lerner made such a proposal, I think, and I think another proposal was made in England, and I am sure there are others who are ready to make such proposals.

The schemes go as follows, and it seems to me it follows from the logic of a pricing mechanism. If a decision is made by the body politic that 60 percent of the Nation's resources are to be devoted to the purpose of war and 40 percent to be left to civilians, that you should make a major taxing decision reflecting that difference.

You should also engage in tight monetary policy if certain effects upon capital formation and the future capital stock are desired.

Then, in the new wartime situation an extremely different relative price configuration will usually be called for because there will be an entirely different evaluation on the things to make guns, and on the things to make butter, and the thought is that you should let the free price mechanism bid so as to make adjustment.

In Professor Lerner's scheme, people always laugh when you go on to spell his logic out, but he is not ashamed himself to follow the logic to the conclusion. He goes so far, as I understand it, to believe that within the Government itself, different departments and different theaters of war, should do their allocation in the same way.

I believe it is no exaggeration to envisage the Pacific theater of General MacArthur given a certain amount of abstract purchasing power, and the European front of General Eisenhower given a certain amount of abstract purchasing power to be determined by democratic decision and grand strategy, and each of those persons to do his bidding in a free market mechanism.

The more elaborate versions of this scheme are even to have MacArthur allocate to his lieutenants general according to an arrived at strategy of importance, a certain amount of abstract purchasing power which they then allocate in this particular way.

If I just continue with these details it begins to sound like a caricature, but it is not. This is the logic of a pricing mechanism. If you are willing to let the relative prices find themselves in free markets, if you are willing to tolerate the very great changes in individual relative well-being that will result, the man who happens to have butter-making implements, ending up one way, and the man who happens to have gun-making implements ending up another way—very great differences of this sort—I think that you could imagine fighting a war in this way.

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I suspect that probably if we did this we would lose the war; but that need not be so, because I can give you strong arguments of efficiency, and certain inefficiencies which would be avoided by doing this.

Now, we come up into a mixed situation, and it seems to me that the shorter the situation the more drastic the changeover that is necessary; the more you must, much as you dislike to do so, rely upon allocations and priorities.

Now, the hateful thing and the harmful thing is that if you freeze an ancient system of relative prices, a system of allocations and quotas and priorities, gradually you are building up more and more poisonous inefficiencies in that system, and in a long cold war you could actually lose that war because of inefficiency; nonetheless I would think that the strain on fiscal policy of having to tax—you gentlemen in Congress having to increase taxes—and the strain on monetary policy would be very great without specific controls.

Consider for example direct controls over housing. They seem to me to be fairly impersonal and my primary objection to them is not on this basis, but rather in connection with long-range inefficiencies. Nevertheless by means of regulations on housing credit, you may much more efficiently channel the construction industry into defense areas and into essential plant construction. Moreover, by making specific credit controls in this area, and at the same time having gilt edged Government bonds at 93, you might get the same deflationary impact on the system as could be achieved without regulation X and regulation W with Government bonds at 80. Thus judicious specific controls may greatly lighten the load on quantitative credit policy and make its use feasible. I regard quantitative credit control not as being competitive with fiscal policy and specific controls but as being supplementary and reenforcing.

I use a figure like 80 in Government bonds with a certain amount of trepidation and trembling. Even a little bit as a reductio ad absurdum. If you think of relatively mild changes in credit policy, then you must be realistic as to what the load is in mild changes in credit policy that can be taken, and how much of this load may be helped by these other devices.

Mr. Friedman. May I answer that?

First, let me refuse to be drawn into the question of the appropriate housekeeping of an army. I think that is really a separate question. While it is an interesting intellectual exercise, it is not particularly relevant to the problem before this group, which is monetary policy.

Second, let me note that the problem that was faced at the time of Korea was not a major change-over. The ultimate level that is now planned for war expenditures will take something like 20 percent of our national income. The amount of increase required at that time was in the order of a few percentage points of our national income.

I think it is perfectly clear that this could have been accomplished by a free price mechanism without the widespread drastic price adjustments that have been suggested.

But more important, Professor Samuelson argues as if a fall in the price of bonds to 80, which he regards as drastic, could be pre-

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vented and offset by a mild selective credit control. The two kinds of measures ought to be treated on the same level. If it takes drastic general credit control measures, why then, it will take really drastic selective control measures.

One final point: The question is not only one of desirability, it is also one of possibility; and I submit that I do not know of any case—maybe somebody else does—in which inflation has been prevented in the face of a substantial rise in the stock of money by any of these direct controls or allocations.

Whether they are desirable or not, they are completely ineffective instruments for preventing inflation.

Representative BOLLING. I would like to make a comment at that point. It seems to me pretty clear that the situation in 1950 and 1951 looks very different from this point, that is, today, than it did at the time. In 1950, after Korea, nobody had any idea what was in prospect. A great concern was what was in prospect, was it a limited war in Korea? Was it world war III? Again, I believe the inflationary impact pretty much followed these two periods when the Chinese Communists intervened in Korea, and again nobody knew what the situation was. It seems to me that has some bearing.

I think that is all, Mr. Chairman, for me.

Representative PATMAN. I would like to bring up one point about interest rates. I believe Mr. Ellis mentioned interest rates, first.

Without passing on the merits of any wage increase, it appears to me that any increase in wages may be inflationary. I am not saying that they all should be denied, without reference to the merits, but, as I have suggested, some increases may be inflationary.

Similarly, the more interest that business must pay for the capital it uses the more it adds to the cost of doing business. To that extent I have had the impression all along over the years that increases in interest rates were also inflationary.

I recall when we used to have such a difficult time in the House of Representatives maintaining any sort of a price control policy. It was pointed out then that just a little increase here and there snowballed until at the end it was very high, very large. Now I cannot understand why the other day some of the members of the panel suggested that rising interest rates are not inflationary. I know that in my section of the country today utilities going into the market for additional funds are expecting to pay more interest because they say that interest rates have increased, and by paying more interest they are calling upon the different cities and towns to give them rate increases; and I refer particularly to electric light and telephone and water and utilities like that.

So it occurs to me that there is a direct case where interest rates can be inflationary just the same as wage increases can be inflationary.

Mr. Ellis, what do you think about that?

Mr. ELLIS. I think that interest rates are a cost of production, and any cost of production enters into price. The aggregate of all costs in the economy is the national income of the economy, and the importance of interest rates in raising prices could be appraised by their share of the national income.

Now, wages take something like—depending on whether we have good times or bad—between 60 and 80 percent of the national income;

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60 to 80 percent of costs are wage costs; the balance are property incomes or ownership costs, profits, rents, and interest.

Interest itself is probably the smallest of these property incomes, and may account for maybe 5, 6, 7 percent of the national income, so its influence as a cost of production is pretty small.

On the other hand, the interest rates that we have been talking about are important not from the side of cost, but from the angle of aggregate demand. There the interest rate is at the bottom of an inverted pyramid, controlling in greater or lesser degree the total amount of aggregate monetary demand for goods in general. The rate of interest bears on the rate of creation of money through new loans, and there it has a multiple effect, equal to several times its own magnitude.

Interest is a cost of production, a part of price, but it is only a small part of our total aggregate of prices or production; but it has a strong leverage effect when it comes to the volume of total purchasing power.

Representative PATMAN. Do you agree with that, Professor Friedman?

Mr. FRIEDMAN. I agree very largely, but I would like to add a few comments. One is that I agree that wage and interest costs are perfectly symmetrical, and I would not make any distinction between them as costs.

Second, I do not agree that any wage increase is inflationary. What is inflationary is an increase in the general level of prices, and an increase in the general level of wages is not inflationary if it arises out of increased productivity for the economy.

But let us eliminate productivity. With the general level of prices and wages stable, we still want all sorts of changes in relative prices and wages. A rise in the wages of workers producing munitions when the Government is expanding munitions production is not inflationary if it is balanced, as it should be, by declines elsewhere thanks to a diminution in demand elsewhere.

Third, the purpose of monetary policy is not to raise interest rates. The purpose of monetary policy is to maintain price stability, and on some occasions this will call for actions that tend to raise interest rates and on other occasions for actions that tend to lower interest rates. When the Government is borrowing large funds the interest rate will tend to rise for the same reason that the wage of a worker in a munitions plant rises, because the Government demand is particularly for providing capital resources, for providing resources not used for current consumption, and this is what the interest rate pays for. If this use is not to be inflationary in general, it must be balanced by declines elsewhere in other prices and costs.

Representative PATMAN. Mr. Whittlesey, would you like to comment on that?

Mr. WHITTLESEY. I find it difficult to think in terms of simple price relationships between the demand and the supply of credit.

We have come to believe that more bonds will be floated at a lower interest rate than at a higher interest rate. I suspect that a large part of such additional floatation is a result of a tendency of borrowers to refinance at a lower rate. If a corporation has bonds outstanding at 4 or 5 percent, and the market rate goes down to 3, it is going to refinance at the lower rate. There may be more refunding at such a

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time; one may get the impression that the lower rates have brought about a great increase in borrowing when it is really nothing more than a refinancing of existing credit.

Another problem is this: I heartily agree that we want to restrict expansion of the money supply in an inflationary period, and that one way of doing that is to borrow more heavily, if we must borrow, outside the banking system. Now, what bothers me is or the inference that it would be easier to borrow outside the banking system if the price of Government bonds goes down.

Observing the behavior of lending institutions, I would be inclined to conclude that they may tend to become more reluctant to acquire Government bonds or to hold what they have when the interest rate goes down than when it remains at a higher rate. If the interest rate were to go down, substantially as has been suggested here, I doubt that the life insurance companies would be at all interested in moving in increasingly in proportion as the rate went down. There is plenty of evidence on that point. Banks were dumping securities in 1947 and 1948 because of the apparent weakness in the bond market and a feeling that the rate might go still lower.

The Federal Reserve was buying bonds in May 1951, even though the reserves of member banks which were selling those securities were rising. The banks on balance did not sell bonds to get reserves; they sold when their reserves were already going up. This suggests that they sold for speculative reasons of one sort or another. Similarly insurance companies, savings banks, and others sold either to build up cash holdings or acquire short Governments.

The relation of the support policy to Treasury financing seems to me to have been passed over too lightly and too simple assumptions made with respect to it. I might make one further observation. It may seem curious that insurance companies sold Government bonds more actively when the bonds were below par than when they were above. What happened was that the spread between those Government bonds and other securities widened; in other words, the rate on Governments rose, but the rate on business loans rose even more. In such a situation they will sell because they can recoup their losses by the higher return realized on these other types of investment. The desire to borrow from insurance companies and other lending institutions may be stimulated by the rise in rates. A friend of mine told me about the financing officer of a large corporation who was coming in to see him in the next few minutes to ask for insurance money, meaning by insurance money, money which the corporation would have available in case rates should rise or some event should occur which might cause a further rise. In other words, it was his fear, rather than the current rate, that governed his desire to borrow; and that fear was induced by the very decline in bond prices which we are talking about.

I do not challenge the idea from a long-run standpoint. I believe that the principles of price apply here, too, but I think that we push them too far if we assume that an inflationary situation could be handled as precisely and as simply as is sometimes suggested.

Another consideration which has not received the attention it deserves is the effect of an increase in corporation taxes on the net cost of borrowing. The principle involved can be indicated by an illus-

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tration; as a starting point it is to be noted that interest payments are a deductible expense. With corporation taxes at 38 percent, therefore, the net cost to the corporation of every dollar paid in interest is only 62 cents since the other 38 cents represent a reduction in tax liability. If the corporation tax is raised to 52 percent the cost to the borrowing corporation for each dollar paid in taxes becomes 48 cents.

Let us suppose that the rate charged borrowers goes up—as a result, for example, of a tightening of credit by the Federal Reserve—from 3 to 3½ percent. But let us also assume that this action occurs along with a rise of the corporation tax rate from 38 to 52 percent. At the former interest rate of 3 percent the net rate to borrowing corporations would be 1.82 percent (that is 62 percent of 3 percent). At the new rate of 3½ percent the net rate to borrowing corporations would be 1.68 percent (that is 48 percent of 3½ percent). Thus the net cost to the borrower would be appreciably less at the new and higher interest rate than it was at the old rate. The rise in the corporation tax rate would have more than offset the action of the Federal Reserve in tightening credit, as far as the net cost to the borrower was concerned.

The illustration offered above would be much more extreme if the effect of excess-profits taxes were included. I have been told by friends in business that in some instances more than 100 percent of the cost of borrowing may be borne by the Treasury in this way. This would presumably be because of high normal and excess-profits taxes, plus the fact that borrowing may serve to increase the base used in calculating excess-profits taxes.

The failure of the rise of interest rates in 1951 to bring about a reduction in borrowing by corporations, to which I have called attention, may be explained, in part at least, by the fact that there was a substantial rise in normal and excess-profits taxes during the period. The point also bears on the question of whether, under some circumstances, an increase in particular types of taxes may tend to be inflationary. It is one of the complicating factors that can too easily be overlooked in discussing the effect of interest rates on borrowing.

Representative PATMAN. Do you believe that an increase in interest rates is inflationary?

Mr. MIKESELL. I certainly agree with Mr. Ellis that increasing interest rates can be deflationary by dampening the demand for credit, the demand for investment. An increase in investment as it affects the demand for goods and services will be inflationary—I do not know whether it takes a small change in interest rates as Mr. Friedman seems to indicate, or whether it takes a much larger one, as Mr. Samuelson seems to indicate—the thing that does concern me somewhat, however, is that when you raise interest rates, when you try to apply general monetary pressures and higher interest rates as your sole instrument for dampening inflationary pressures, do you get the kind of pattern of investment and production that you want?

Now, I agree that it would be possible through monetary means to have defense mobilization, with a stable level of prices, and with some prices rising and some prices falling.

I am not at all sure whether it would give you the pattern of production that you want. It is true enough, of course, that the Government could bid up prices of commodities that it wanted and see that it got the production that it wanted by bidding up prices, and if you had

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sufficient monetary pressures you might be able to force other prices down if you carried it far enough.

I am inclined to believe that you might have to carry it quite far in a period of rapid mobilization; but there are other parts of the economy that are not concerned directly with the impact of this Government spending. I am not sure to what extent you would dampen your less essential or luxury-type investment as against the more essential.

I am not sure whether you would reduce investment in luxury hotels or in new housing near defense plants. You may do just the opposite.

A high interest rate, in other words, may not deter investment in speculative inventories and in luxury hotels and night clubs, but it might deter the kind of investment that you want, and for that reason I feel that general monetary policies alone are not enough, that they need to be supplemented by selective-credit controls.

Representative PATMAN. Professor, would you like to say something about it?

Mr. SAMUELSON. Mr. Congressman, at this point I hew to the party line, and I agree with Professor Ellis that paradoxical as it may seem, an increase in interest rates is in its direction deflationary. I have been somewhat skeptical as to its quantitative potency, but as to its general direction I am pretty clear as to what it is.

Now, it is paradoxical in the same way that an increase in sales taxes, which I do not necessarily advocate, could be considered as a deflationary device. You may say that an extra tax is surely going to raise the price level, and I would not be inclined to disagree with you on that, but I think you would be more likely to get a new plateau of prices which you could then hold the line on in a way that you could not do without the sales tax.

Similarly, subsidies, which is the same as a sales tax in reverse, would seem superficially for the moment to depress prices. And I would think for the moment it very well might, but it might do so by making it more certain that prices would rise very rapidly.

To summarize, I would say that to the extent that the interest rates rise, in the short run, they do tend to increase costs and prices. But the subsequent effects of higher interest rates are in the direction of reducing the spending demand for commodities thereby decreasing the total dollar volume of sales and thereby puting downward pressure on profits and other cost elements. So I am in favor of the view that the higher the interest rate the more deflationary the pressure, other things being equal.

I have expressed some skepticism concerning the quantitative potency of credit policy. I would like to call the shots fairly, just as they fall. I would like to comment upon a very important phenomenon that Mr. Whittlesey has mentioned. When the rate of interest is high, you might think that would encourage people to hold bonds because of the better yield.

While the price of a bond is moving, is falling—not when it is low, but when it is falling—we have a very familiar phenomenon in economics of the reverse behavior taking place. As an investor, you think it will fall still lower. You do not say the bond price is low; paradoxically, you say it is high because it is going to be still lower later. Hence, the opposite happens: You wish to hold less rather than more bonds.

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I recall in December 1947, a former student of mine who worked for one of the big insurance companies called on me when Government bonds were falling from 103 to 101, and he said, "We have sold several million; we liked bonds at 103, and we do not like them at 101." That is a familiar dynamic effect.

But here is my point: I do not think it should necessarily lead to skepticism of monetary policy, because he went on to say in the next breath "As a matter of fact, we gave a term loan a few months ago to Mr. W. of the ——— Co., at 2¼ percent—a 5-year term loan. We are now awfully sorry we did it. We wished we had charged them more, and if he came back to us today we would quote stiffer terms." It shows that even though they were holding more cash in short terms because of this speculative consideration (known to technical economists as a Taussigian penumbra effect of type $\frac{dP}{dt}$ rather than P) they were at the same time tightening upon their terms.

Now, a simple-minded approach by way of monetization of the debt would term this transient phenomenon as inflationary. However, I regard it as a step in the right direction, namely, as deflationary, because it created in the transient period what you might call a penchant to hoard money that offset the perverse increase in M.

In fact, I am skeptical of many of the transient effects that occupy too prominent a role in current discussions. For example, the "locked-in effects"—of investor's being unwilling to sell bonds once their prices fell to below par and showed a paper loss—we heard so much about. But now we hear so much less because recently they have been put to the test. Since a year ago Government bond prices have gone below par and I understand from experts in the market and from Mr. Whittlesey that the looked for locked-in effect has been rather weak. It is quite obvious that any person will be chagrined if he made a mistake, but also over a period of time he will rectify that mistake if he has something better to do with his money, and I understand from various specialists in the bond market that that is very definitely what has happened.

I should like now to revert to the question as to what mandate I might give the Federal Reserve authorities. I do not believe much in general mandates and I shall not try to spell out the answer. But I do feel is necessary to warn against certain misapprehensions. First, I think it is technically bad economics to subscribe to the mystical view that it is the task of fiscal policy to stabilize production and employment whereas it is the task of monetary policy to stabilize the price level. In their general over-all direction monetary policy and fiscal policy tend to have similar effects. If the effect of a contrationary fiscal policy were to create unemployment rather than falling prices, then a contractionary monetary policy could be expected to have exactly the same qualitative effects. Similarly on the expansionary side. Therefore the Federal Reserve authorities do not as a matter of brute fact have any greater leverage to affect prices than they have to affect money spending generally. Second, and this follows as a corollary from the first technical fact of economic analysis, it would be nonsensical to parcel out our ultimate, and partially conflicting, objectives among different agencies: that is, you cannot give the central bank the problem of stabilizing the price level while giving the Treasury and executive branch the problem of stabilizing

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employment and production. The instructions that you give the central bank concerning price goals must contain in them all of the reservations about conflicts with other goals that are contained in the instructions you give to yourself as Congressman or to the executive branch generally. Finally as a third point, any mandate given to the central bank in terms of a general goal will be quite without interest unless you include in that mandate hints as to the mechanism by which the goal is to be achieved. To tell the Federal Reserve that they should at all times favor stable prices is fairly meaningless. Your prescription will gain in meaning if you add some such stipulation as the following: "So long as the average level of wholesale prices rises more than such and such number of percentage points for such and such number of months, you as central bankers must engage in open-market sales of a magnitude of not less than such and such and you must raise the rediscount rate by a magnitude of not less than such and such." Now I do not wish to be misunderstood. I would be against giving any such automatic mandate to the Federal Reserve authorities. But anyone who does believe in such mandates should bring them out into the open for critical analysis and not simply fall back on the vague generality that the Federal Reserve should be against sin and price instability.

I may summarize as follows:

1. The purpose of central bank restrictive monetary policy is to cut down on investment and consumption spending by some billions of dollars per year. This it can do only by affecting (*a*) the interest cost of credit to borrowers and spenders generally. Or (*b*), in the short run, the central bank can hope by its contractionary policy to affect the availability of credit by increasing the degree of imperfection of competition with which lenders ration out their loans. But actually, as a matter of realistic fact, after a short time has passed, the old degree of imperfection of competition with which lenders ration out loans will probably reassert itself. Hence, in the intermediate- and longer-run, the central bank can depress the flow of current spending primarily by the single device of raising the interest cost to spenders enough to discourage their spending by the desired amount. As a matter of philosophy, those of us who regard it as an advantage of quantitative monetary policy that it acts impersonally and as an efficient capital allocating mechanism should not much regret that the mechanism (*b*) is only of transient importance, since reliance upon it would, in any case, weaken the claims for general versus specific credit controls.

2. To achieve the desired stringency of credit to spenders, the central bank can (*a*) offer to sell Government bonds at lower and lower prices, thereby bidding up their interest yields and bribing lenders to hold their assets in this form rather than in the form of loans to business and consumer spenders; or (*b*) it can increase the legal reserve requirements of member banks, thereby requiring them to try to sell their Government bonds until security prices have been bid down and their interest yields bid up to a level at which lenders will prefer to withhold some of the funds they have been previously lending; or (*c*), if the commercial banks have been borrowing from the Federal Reserve banks, the latter can increase the rediscount rate charged for such credit accommodation, thereby raising the cost to the

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lender of getting the dollars that he lends to his spending customers. Note that in every one of these cases, the true and exact chain of causation by which spending is contracted is not via any such meaningless sequence: (1) cut down on bank reserves, (2) apply a 5– or 6–1 leverage factor to determine the resulting contraction in bank deposit money, (3) apply a "quantity equation" to show how the cut in total M results in a cut in prices or dollar spending. On the contrary, in every one of these cases, you must show how the lenders are induced to withhold credit to business and consumer spenders at the old easy terms and how they are induced to raise their interest charges so high as to reduce the volume of borrowing from them. The only leverage open to a central bank is to affect the yields of various assets and people's expectations of the future course of security prices and yields; its open-market operations have no effect upon the commercial banks different in kind from its effects on insurance companies and all other institutions and persons generally.

3. This down-to-earth realistic way of describing the mechanism of monetary policy is important because it brings to the forefront the crucial quantitative questions involved. It makes you ask the vital question: How much of a reduction in aggregate spending will be associated with each half-percent increase in the structure of interest costs? How will inventory buying be affected? How will long-term construction be affected in the case of firms which must float new issues and firms which rely heavily on retained earnings and depreciation allowances? How will family spending on nondurables and durables be affected by changes in interest costs? What will be the effects on housing starts and mortgage borrowing? In short, it focuses attention on the crucial question of the quantitative degree of elasticity of investment and consumption spending to tightening of interest rates—a question about which we all realize our ignorance.

4. It is my judgment that we should help to fight any sustained period of inflationary pressure by some tightening of credit. This is not a substitute for fiscal policy, or for certain specific controls and allocations, but a reinforcement. The realistic mechanism here described enables us to bring into focus the main problems that the central bank will face during any such sustained period inflationary pressure. Thus, as the months and even years go by with business booming and prices rising, the central bank will find it more and more difficult to sell Government bonds net to the market. But it would be the reverse of the truth to think that this implies an inability of the central bank to tighten up on interest terms. On the contrary, under the postulated sustained conditions of inflation, the market place itself will be terribly anxious to sell its old low-yielding Government bonds, and interest yields will tighten themselves. The central bank will face the question of how much support it will give to the bond market to keep things "orderly" and possibly to keep bond prices from falling to too low a level.

In brief, during a sustained period of rising prices the free market's equilibrium rate of interest, if not "interferred" with by the central bank, is probably much higher than postwar levels, and yet (because velocity of M is a variable) not high enough to offset the inflationary pressures of a buoyant boom and defense program. Those who worry about declines in capital values of old bonds will have plenty to worry about, especially if we vigorously try to apply credit contraction. Of

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course, if the future should not provide so inflationary a picture, then none of the above need hold.

Representative PATMAN. Gentlemen of the panel, for the committee I want to express appreciation for your attendance here. You certainly have helped us, and we appreciate it very much.

As stated heretofore, if you desire to elaborate more fully on what you have said or what any other person has said in this discussion, you may do so in the final record.

We had expected to have an afternoon session and ask you gentlemen to be with us again, but the committee wants to have an executive session this afternoon, so we are going to forego the opportunity of asking you gentlemen to come back and be with us. We did hold you here about an hour longer than we would have otherwise, for which we thank you very much again.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD BY MILTON FRIEDMAN, UNIVERSITY OF CHICAGO

1. NOTE ON THE QUANTITY EQUATION

The quantity equation is frequently written:

Stock of money X transactions velocity=total payments for all purposes, and total payments are regarded as the product of an index of prices times an index of physical volume of transactions, so that the equation is written: "MV=PT." This form has serious defects primarily because total payments are so heterogeneous, including, for example, payments for the purchase of securities or property, as well as payments for physical commodities and services. In consequence, it is difficult to give any clear meaning to either P, the average price level at which such transactions occur, or to T, the volume of transactions.

An alternative formulation of the quantity equation is to write: "Stock of money X income velocity=Total money income." Total money income can then be regarded as the product of an index of prices times an index of real income, so that the equation can be written: "Mv=pR," where R is an index of real income, and p is the price index of the goods and services entering into real income, and v is income velocity. This form has the great advantage that the payments considered are much more homogeneous, and hence that both the price level and the index of real income are more meaningful. This is reflected in the statistical fact that whereas there are no good, widely accepted, current measures of T, or P, or even of PT, there are good, widely accepted measures of pR, namely, the national income series currently constructed by the United States Department of Commerce, and of p and R separately.

Income velocity as so defined (v) is a reasonably stable magnitude. The exact number computed for v depends on the particular definition used for the stock of money and for money income. If we regard the stock of money as currency in public circulation plus adjusted demand deposits plus time deposits, and money income as given by the Department of Commerce concept of national income, the value of v is currently around 1½. Income velocity has been declining over the last century, from a value apparently around 4½ to 5 in the Civil War to its present value. However, the decline appears to have been rather gradual, and income velocity is relatively stable over short periods.

2. PROPOSED MANDATE BY THE CONGRESS TO THE FEDERAL RESERVE SYSTEM

I would favor a mandate along something like the following lines:

The powers of the Federal Reserve System to buy and sell securities on the open market, to make loans, and to determine the terms on which they will rediscount eligible paper shall be used for promoting reasonable stability in the general level of prices, as measured by a comprehensive index such as the existing Bureau of Labor Statistics wholesale price index number.

One problem this statement does not meet is that which would arise if the prices of a large number of the commodities in the index were at the ceiling imposed by price control. In this case, the price index would become misleading and it would be desirable to rely instead on an index computed from prices not subject to control.

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3. PROPOSED LONG-RUN REFORM IN OUR MONETARY AND FISCAL FRAMEWORK [1]

The monetary and fiscal framework that follows is designed to promote economic stability and, at the same time, to be entirely automatic and to involve no discretionary action by governmental authorities. It covers the fiscal, as well as the monetary, framework because of the intimate connection between the two. It is intended to describe the normal peacetime structure, and some modifications, particularly the issuance of interest-bearing Government obligations, would be appropriate for wartime. The particular proposal is not original; it is an appropriate selection and combination of elements from existing proposals.

The proposal involves four main elements: the first relates to the monetary system; the second, to Government expenditures on goods and services; the third, to Government transfer payments; and the fourth, to the tax structure. Throughout, it pertains entirely to the Federal Government and all references to "government" should be so interpreted.

1. A reform of the monetary and banking system to eliminate both the private creation or destruction of money and discretionary control of the quantity of money by central bank authority. The private creation of money can perhaps best be eliminated by adopting the 100-percent reserve proposal. The adoption of 100-percent reserves would also reduce the discretionary powers of the reserve system by eliminating rediscounting and existing powers over reserve requirements. To complete the elimination of the major weapons of discretionary authority, the existing powers to engage in open market operations and the existing direct controls over stock market, consumer, and real estate credit should be abolished.

Under the 100-percent-reserve proposal, existing commercial banks would, in effect, be separated into two parts. One part would provide depositary facilities. This part would essentially be a "warehouse" of funds, since it would be required to hold reserves, in the form either of currency or of deposits in a central governmental depositary, equal to 100 percent of its deposits. Its income would come from service charges to depositors, unless, as a matter of public policy, it were thought desirable to subsidize this activity, in which case interest could be paid on deposits in the central governmental depositary. The transition to 100-percent reserves could be accomplished without financial disturbance by open-market purchases of governmental obligations by the Federal Reserve System coordinated with the raising of reserve requirements. These purchases would not be inflationary, since the funds provided would be needed for additional reserves.

The other part of the existing commercial banks would take over its lending and investing functions. It would be an "investment trust," and would operate entirely with its own capital, or with funds obtained by the issuance of securities. The separation of this lending funtcion of the banking system from its depositary function would make unnecessary existing detailed legal control over the types of loans that may be made or investments that may be acquired. This part of the present commercial bank would need to be subject only to the regulations now governing other lenders.

These modifications would leave as the chief monetary functions of the banking system the provision of depositary facilities, the facilitation of check clearance, and the like; and as the chief function of the monetary authorities, the creation of money to meet Government deficits or the retirement of money when the Government has a surplus.[2]

2. A policy of determining the volume of Government expenditures on goods and services—defined to exclude transfer expenditures of all kinds—entirely on the basis of the community's desire, need, and willingness to pay for public services. Changes in the level of expenditure should be made solely in response to alterations in the relative value attached by the community to public services and private consumption. No attempt should be made to vary expendi-

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[1] This statement is largely a summary of a proposal described and analyzed at greater length in my article entitled "A Monetary and Fiscal Framework for Economic Stability," published in American Economic Review, XXXVIII (June 1948), pp. 245–64, and reprinted in Readings in Monetary Theory (Blakiston Co., 1951), pp. 369–93.

[2] The adoption of 100 percent reserves is essential if the proposed framework is to be entirely automatic. It should be noted, however, that the same results could, in principle, be achieved in a fractional reserve system through discretionary authority. In order to accomplish this, the monetary authorities would have to adopt the rule that the quantity of money should be increased only when the Government has a deficit, and then by the amount of the deficit, and should be decreased only when the Government has a surplus, and then by the amount of the surplus.

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tures, either directly or inversely, in response to cyclical fluctuations in business activity. Since the community's basic objectives would presumably change only slowly—except in time of war or immediate threat of war—this policy would, with the same exception, lead to a relatively stable volume of expenditures on goods and services.

3. A predetermined program of transfer expenditures, consisting of a statement of the conditions and terms under which relief and assistance and other transfer payments will be granted. Such a program is exemplified by the present system of social security under which rules exist for the payment of old-age and unemployment insurance. The program should be changed only in response to alterations in the kind and level of transfer payments the community feels it should and can afford to make. The program should not be changed in response to cyclical fluctuations in business activity. Absolute outlays, however, will vary automatically over the cycle. They will tend to be high when unemployment is high and low when unemployment is low.

4. A progressive tax system which places primary reliance on the personal income tax. Every effort should be made to collect as much of the tax bill as possible at source and to minimize the delay between the accrual of the tax liability and the actual collection of the tax. Rates, exemptions, etc., should be set in light of the expected yield at a level of income corresponding to reasonably full employment at a predetermined price level. The budget principle might be either that the hypothetical yield should balance Government expenditure, including transfer payments (at the same hypothetical level of income) or that it should lead to a deficit sufficient to provide some specified secular increase in the quantity of money. The tax structure should not be varied in response to cyclical fluctuations in business activity, though actual receipts will, of course, vary automatically. Changes in the tax structure should reflect changes in the level of public services or transfer payments the community chooses to have. A decision to undertake additional public expenditures should be accompanied by a revenue measure increasing taxes. Calculations of both the cost of additional public services or transfer payments and the yield of additional taxes should be made at the hypothetical level of income suggested above rather than at the actual level of income. The Government would thus keep two budgets: the stable budget, in which all figures refer to the hypothetical income, and the actual budget. The principle of balancing outlays and receipts at a hypothetical income level would be substituted for the principle of balancing actual outlays and receipts.

Under the proposal, Government expenditures would be financed entirely by either tax revenues or the creation of money, that is, the issue of non-interest-bearing securities. Government would not issue interest-bearing securities to the public; the Federal Reserve System would not operate in the open market. This restriction of the sources of Government funds seems reasonable for peacetime. However, in time of war or immediate threat of war, involving a substantial expansion of governmental expenditures expected to be temporary, it would probably be desirable to finance part of these expenditures by borrowing from the public through the issuance of interest-bearing securities. Provision should therefore be made for this exception under the stated conditions.

Under the proposal, deficits or surpluses in the Government budget would be reflected dollar for dollar in changes in the quantity of money; and, conversely, the quantity of money would change only as a consequence of deficits or surpluses. A deficit means an increase in the quantity of money; a surplus, a decrease.

Deficits or surpluses themselves become automatic consequences of changes in the level of business activity. When national money income is high, tax receipts will be large and transfer payments small; so a surplus will tend to be created, and the higher the level of income, the larger the surplus. This extraction of funds from the current income stream makes aggregate demand lower than it otherwise would be and reduces the volume of money, thereby tending to offset the factors making for a further increase in income. When national money income is low, tax receipts will be small and transfer payments large, so a deficit will tend to be created, and the lower level of income, the larger the deficit. This addition of funds to the current income stream makes aggregate demand higher than it otherwise would be and increases the quantity of money, thereby tending to offset the factors making for a further decline in income.

The proposal therefore automatically produces monetary and fiscal effects promoting stability in aggregate income, output, and prices.

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EXTENSION OF TESTIMONY OF R. F. MIKESELL

I should like to discuss briefly a question which has been brought up in a previous meeting of this committee, namely: Would a return to a system of internal gold convertibility in the United States assist or encourage the return to convertibility on the part of other countries?

First of all I would like to refer to my previous statement to the effect that anything which promotes the stability of the United States dollar will provide a more favorable climate for internal stability and balance of payments equilibrium in other countries. Now I believe that a return to internal gold convertibility in the United States, would make it more difficult for our monetary authorities to promote price and income stability in this country. Monetary action is concerned to a considerable degree with the control of banking reserves. Sudden flights to and from gold on the part of our own citizens in response to speculative and psychological influences would make difficult a proper control of banking reserves. Should we experience a very heavy gold drain, our monetary authorities would have to be guided by the objective of maintaining gold convertibility rather than by the much more important objectives of maintaining stable prices and incomes at high levels of production and employment.

While I believe that we should encourage and assist other countries in restoring the convertibility of their own currencies into dollars, other countries would find it very difficult to do so under a system which permitted internal redeemability into gold. Most countries need to mobilize their gold reserves in order to provide a cushion against fluctuations in their balance of payments without having to resort to exchange and trade controls. Few countries have sufficient gold reserves to be able to withstand large internal gold drains as well as those occasioned by periodic fluctuations in their balance of payments. In short, I believe that a return to internal gold redeemable in the United States would not contribute to the achievement of the kind of international monetary system which we are seeking.

Representative PATMAN. We will recess until tomorrow morning at 10 o'clock.

(Thereupon, at 1:05 p. m., the committee adjourned, to reconvene at 10 a. m., Wednesday, March 26, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

WEDNESDAY, MARCH 26, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

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

Present: Representative Patman, Senator Flanders, Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director, and Henry Murphy, economist for the subcommittee.

Representative PATMAN. The committee will please come to order.

We have with us this morning five witnesses we are very anxious to hear from. I will first tell the committee something about them. Also for the purposes of the record, the members of the subcommittee will all be here this morning. They seem to be late getting in, but they have their own personal problems. Senator Flanders will be here, Mr. Bolling will be here, Mr. Wolcott will be here, and Senator Douglas has two other meetings and will be a little late, but he is coming.

We have with us this morning G. L. Bach, professor of economics and dean of the Graduate School of Industrial Administration, Carnegie Institute of Technology, Pittsburgh, Pa., formerly a member of the staff of the Board of Governors of the Federal Reserve System, formerly a member of the staff of the Hoover Commission and author of the staff report on the Federal Reserve System, formerly a consultant to the Treasury Department.

E. A. Goldenweiser, member of the Institute for Advanced Study, Princeton, N. J.; formerly president of the American Economic Association, and for many years Director of Research and Statistics and Economic Adviser to the Board of Governors of the Federal Reserve System, consultant to the CED on monetary policy.

Harold Stein, staff director of the Committee on Public Administration Cases, now the interuniversity case program (the purpose of these organizations being to prepare materials for the university teaching of public administration by the "case method"), consultant to the Public Administration Clearing House, and formerly consultant to the Hoover Commission and the Bureau of the Budget, in Government service from 1934 through 1947.

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Jacob Viner, professor of economics, Princeton University, formerly president of the American Economic Association, formerly consultant and Special Assistant to the Secretary of the Treasury, consultant to the Department of State.

Lucius Wilmerding, who is now engaged in completing various studies having to do with the system of controlling public expenditures in the Federal Government. These studies are complementary to his book The Spending Power published by the Yale University Press in 1943. He was formerly a member of the Treasury staff serving successively as assistant to the Administrative Assistant to the Secretary, and as assistant to the Commissioner of Accounts. He has also been a member of the Institute for Advanced Study at Princeton. He recently wrote, under his own name, three columns for Walter Lippmann on Treasury-Federal Reserve relationships.

Professors Bach, Goldenweiser, and Viner were participants in the Conference of Monetary Economists at Princeton, N. J., in October 1951. The statement resulting from this conference is reprinted as chapter 14 of our compendium, Monetary Policy and the Management of the Public Debt.

We have as topics for discussion this morning, first, What should be the role of the private financial community in the formulation of monetary policy? What are the implications in this respect of the private ownership of the stock of the Federal Reserve banks?

2. Is the division of authority over monetary policy between the Board of Governors and the open-market committee desirable? If not, how should it be resolved?

3. Should the monetary authority be vested in one man or a board? What is its proper relationship to the Treasury, the President, the Congress?

4. What should be the role of the monetary authority in the determination of debt-management policy?

It has been suggested that we call on Mr. G. L. Bach for comments first on these topics.

Mr. Bach?

STATEMENT OF G. L. BACH, PROFESSOR OF ECONOMICS, CARNEGIE INSTITUTE OF TECHNOLOGY

Mr. Bach. Mr. Chairman, in order to conserve time, I will limit my remarks to one particular aspect of the problem assigned, namely, the question of Federal Reserve independence and Federal Reserve participation in governmental economic-policy formation.

Much of the testimony presented to this committee has centered around the recent Federal Reserve-Treasury "accord" and the immediate problems of effective control over inflation. Some of it has implicity compared the abilities and wisdom of the individuals in the two agencies. This is proper. But there may also be some advantage in stepping back to take a longer look at the whole role of the Federal Reserve in the Government economic policy making. This approach seems to me to throw a somewhat different light on some of the proposals currently under consideration. To reach fundamental judgments, I think we need to look beyond both the current economic situation and the individuals now in office.

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MONETARY POLICY INTERRELATIONS WITH ENTIRE EXECUTIVE BRANCH

Today's far-reaching governmental intervention in economic activity was unforeseen in 1913. The Federal Reserve Board and banks established then had relatively simple duties—adhere to the gold standard, meet seasonal fluctuations in the country's need for currency, restrict bank lending to short-term, self-liquidating paper. It was easy to envisage the Federal Reserve as largely separate from the Government, though closely related to it.

Today, by contrast, monetary policy has become an integral part of the Government's entire economic policy, aimed at the objectives laid out in the Employment Act of 1946. Whether the Federal Reserve is called independent or considered to be part of the executive branch of the Government, there is no escape from the great impact of monetary policy on the level of income, employment, and prices; nor can monetary policy be neatly shut off from the Government's debt-management policies, its lending policies, its agricultural policies, its veterans' policies, its defense policies.

I see no way this committee can realistically avoid this fact: The fundamental issue before you is not merely the relationship of the Federal Reserve to the Treasury and debt-management policy but, instead, its relationship to the entire range of the economic policies of the Government, reaching into nearly all the executive departments. If we want a Federal Reserve truly "independent" to put up interest rates in inflation, against the Government as well as against private borrowers, we must recognize that not only direct governmental borrowing is involved but also the cost and availability of money for veterans' loans,, subsidized housing, rural electrification, and many other such Government-sponsored projects.

RESPONSIBILITY TO THE ELECTORATE

Congress and the public by and large hold the President responsible for the execution of the legislation providing for these governmental programs and for the promotion of economic stability. Since this is so, it is hard for me to see how the conclusion can be escaped that the Federal Reserve must be intimately related to the executive branch of the Government, not only on debt-management policy but on a much broader scale. I doubt that the public, if money becomes tight and prices are turned downward, hold the Federal Reserve responsible. I suspect they think of the President and the Congress as responsible. And responsibility to the electorate is the cornerstone of our democratic system of government.

THE NEED FOR INCREASED FEDERAL RESERVE INFLUENCE RATHER THAN MORE INDEPENDENCE

In my judgment, therefore, the problem is not a simple one of being for or against the "independence" of the Federal Reserve. Rather, it is to how to obtain the most reasoned, deliberative, and responsible formulation of monetary policy as one part of the Government's whole economic program, as formulated by Congress and carried out by the executive branch.

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Viewed in this light, the main case for a separate central banking agency is simply that it may contribute a special viewpoint in Government monetary-fiscal policy formation that is specifically oriented toward maintenance of high level economic activity and financial stability—and that this viewpoint will not be adequately represented by the other agencies of the Government. There are human beings in the Federal Reserve, just as in the Treasury, the White House, the Veterans' Administration, and the Congress. I see little reason to suppose that the occupants of the Federal Reserve building will be uniquely wise as individuals, and I believe that this assumption would be a dangerous cornerstone on which to rest our entire governmental structure.

On the other hand, we do need some organization in the governmental structure that places primary emphasis on maintenance of economic and monetary stability, even though its individuals, man for man, may be no wiser than those in other agencies. To contribute this point of view is the main job of the central banking agency. If, for example, Federal Reserve Board members can press steadily for inflation control when the Treasury is impressed with refunding problems and the Congress wants low-cost mortgage money for veterans, the Federal Reserve's role in governmental policy making may be a most useful one. The Nation may not want the inflation-control arguments to dominate. I, as one private citizen, would not be happy to see a governmental arrangement under which my elected representatives in Congress and the White House were dominated very far by an "independent" central bank. But I am also very unhappy if I feel there is no agency in the Government continuously emphasizing the need for measures to maintain economic and monetary stability.

HOW CAN FEDERAL RESERVE INFLUENCE BE STRENGTHENED?

I am convinced that the Federal Reserve can play such a role effectively only if it works primarily as a part of the governmental process rather than by interposing objection and obstruction from outside. The Federal Reserve has not carried out a strong anti-inflation policy over the last decade of inflation, until the exceptional events of the "accord" of 1951. Monetary policy was subservient to, or at least in accord with, the Treasury's low interest debt management policy. Unlike most observers, I do not attribute this to the fact that the Federal Reserve's independence was not sufficient. On the contrary, I believe it may be attributed more to the very emphasis placed on the formal independence of the Federal Reserve from the executive branch of the Government.

The Federal Reserve and the Treasury will get together on opertional policies. Federal Reserve Board members are, and properly feel themselves to be, a part of the United States Government. A monetary policy and a debt-management policy at loggerheads more than temporarily would be intolerable. Spectacular outbreaks such as occurred about a year ago will surely be the exception. Most issues will be settled quietly in day-to-day negotiations.

In this day-to-day process I believe the Treasury has ordinarily been the stronger party, basically because it has been the major operating financial agency of the Government and because it is an integral part of the President's administrative family. It appears to me that

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Federal Reserve "independence" has, anomolously, done more to shut the Federal Reserve off from exercising real influence on the operating policies of the administartion than to protect the Board's freedom.

I believe we need a mechanism that will increase the Federal Reserve's influence in making and carrying out the economic policies of the Government. But I believe this will come about more through making the Chairman of the Federal Reserve Board a more effective participant in the going organization of the executive branch than by making him more "independent" and hence more isolated. Ours is a government by negotiation and compromise. The participant who is shut out from the process is unlikely to exercise great influence on the results. Unless we are willing for the Federal Reserve to come into closer working relations as part of the President's family of top financial advisers, I think it is unlikely that the Federal Reserve will be very effective over the years in doing its main job.

Today the Federal Reserve is riding high. But the events of a year ago were very special ones, and friends of monetary policy should not forget that seldom in the long history of central banks have they effectively stood out against the executive branches of their governments. As Mr. Wiggins aptly stated before this committee a few days ago, central banks may win battles against governments, but the governments win the wars.

SUMMARY—THE ORGANIZATIONAL PROBLEM

I have taken time for this broad look at the problem of Federal Reserve independence, rather than devoting my time to specific suggestions, because I believe much of the testimony to date may have had too little perspective—both over the history of central banks and over the broader relationships of central banking to the executive branch today. May I summarize briefly my analysis:

(1) Monetary policy is inseparably intertwined with many other major economic policies of the Government, as enacted by Congress and executed by the executive branch. Thus it is unrealistic to believe monetary policy can be separated from other Government policies merely by making the Federal Reserve formally "independent."

(2) A central banking agency can contribute a needed viewpoint in Government policy-making, by and large because it will resist many inflationary tendencies in the governmental process. We need to plan how to implement this viewpoint.

(3) The Federal Reserve can exert more influence by becoming part of the policy making and executing process than by insulating itself further from the process. Only in rare instances can the central bank expect to win out, from "outside," against the rest of executive branch and the pressures of congressional expansionary programs.

SOME IMPLICATIONS FOR CURRENT CHANGES

In my judgment, there are several steps that might improve the way in which our monetary and debt-management policies are determined, in the light of the above analysis.

I am sympathetic to the proposal for a small, informal top-level monetary-fiscal advisory council to the president, along the lines outlined by this subcommittee's predecessor under Senator Douglas

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and more recently by Secretary Snyder. I favor this step as a device for strengthening the voice of the Federal Reserve, not for subordinating it to the Treasury and the President, as several witnesses have suggested might be the case.

Conversely, I doubt the realism of the proposal that the Treasury be directed simply to make its debt management conform to the policies set by the Federal Reserve—unless Congress wishes to transfer outright the responsibility for debt management to the Federal Reserve.

If the Treasury's present responsibilities are to continue, what is needed, in my judgment, are roughly equal voices for the Federal Reserve and the Treasury in working out the best available solution to problems as they arise. More generally, the Chairman of the Federal Reserve Board, sitting in top governmental economic councils of the executive branch as an equal with others of the President's top advisers, seems to me the most promising solution to the problem of most effective utilization of potential central bank contributions. This arrangement need not, and should not, imply Presidential or Treasury dictation of Federal Reserve policy. But if the Federal Reserve is to have an effective voice in governmental policy formation and execution, in my judgment it must participate in the give and take of the Government's operations, reserving its right to appeal to the Congress and the public for support on major issues of disagreement with administration policies for a small number of matters of major importance.

This approach to Federal Reserve policy making implies a major role for the Federal Reserve Board Chairman, and emphasizes the need to elevate this post to first rank governmental importance and influence. It questions the need for a large Federal Reserve Board, and for the present elaborate division of responsibilities and administrative arrangements within the Federal Reserve System. It leaves no doubt as to the basic governmental nature of the Federal Reserve and its monetary policy operations. I hope these questions can be explored in the panel discussion which follows:

Representative PATMAN. Thank you, sir.

Mr. Wilmerding, would you like to comment on these topics?

STATEMENT OF LUCIUS WILMERDING, JR.

Mr. WILMERDING. Yes, sir.

Mr. Chairman and members of the committee, let me say to begin with, that I have no proposals to make for improving the machinery of controlling the management of money and the public debt. I think that the existing machinery is, in the main, adequate to its purpose; and, while I have no doubt that improvements in detail might be made, I suggest that these might be left to the time when the banking laws are next subjected to a general revision.

I should like to confine my remarks, therefore, to questions having to do with the present status of the Federal Reserve Board—particularly with its relation to the President. The committee has inquired whether that Board is or is not a part of the executive branch of the United States Government, and if not, what its status is. It has also asked whether the President has, under the Constitution, any power to resolve policy conflicts between the Treasury,

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or other agencies of the executive branch, and the Federal Reserve System.

The question of the status of the Federal Reserve Board is a difficult one to answer. It depends at bottom upon the view which one takes—or rather which the Supreme Court might take—of the power of Congress, under the Constitution, to create agencies for the administration of its laws which are responsible directly to itself and not to the President.

The idea that Congress has such a power has frequently been entertained. Back in Jackson's administration, Henry Clay and many others contended that the Treasury Department was not an executive department but an administrative department—an agent of Congress. They argued that, since the Constitution had given Congress the power to collect taxes—not simply to provide for their collection—Congress could collect them through an agent of its own. In like manner, one might now contend that, since the Constitution has given Congress the power of regulating the value of money, Congress may carry that power into execution itself, either directly or through an agent responsible only to it. For my own part I should consider such a proposition absurd. Congress can ordain a rule; the Constitution has pointed out what branch of Government is to put into practical operation the rules which Congress has ordained and it has made that branch independent of Congress. When Congress created the Federal Reserve Board and assigned it its duties, it did all that it could do toward carrying into execution its power of regulating the value of money. It is neither called upon nor empowered to carry into effect the provisions of its own laws.

There is another line of reasoning, however, which might take the Federal Reserve Board out of the executive branch and make it an agent of Congress. One might say that the functions of the Federal Reserve Board are not executive but something else. By calling them quasi legislative or quasi judicial, one might bring the Board under the doctrine announced by the Supreme Court in the Humphrey case. It will be remembered that in that case Justice Sutherland asserted that a member of the Federal Trade Commission "occupies no place in the executive department." But whether the Court would, in fact, recognize an analogy between the Federal Reserve Board and the Federal Trade Commission, I shall not venture to predict.

These considerations lead me to suggest that, in the absence of a Supreme Court decision authoritatively declaring the status of the Federal Reserve Board, it is impossible to return a clear answer to the question of this committee about the board's status.

Fortunately, from a practical standpoint it is not important that a clear answer be given. Let it be conceded for purposes of argument that the Federal Reserve Board, unlike the Federal Trade Commission, is a part of the executive branch. Would such a status alter in any practical way the relationship which has been established by statute between the Board and the President of the United States? In particular, would it give to the President, under the Constitution, a power to interfere with, set aside, correct, or revise, the decision of the Board in any matter which has been committed by Congress to the Board's exclusive jurisdiction?

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This question, I submit, can be answered with a categorical negative. A long line of opinions by the Attorneys General, acquiesced in by the Presidents, corroborated by the action of Congress, and the proposition that, when the execution of a law has been committed by Congress to the exclusive jurisdiction of a subordinate department or officer of the Executive, the interference of the President with such execution, either in the form of direction beforehand or revision and reversal afterward, so far from being permitted by the Constitution, would be a usurpation on the part of the President which the subordinate department or officer would not be bound to respect. In such cases the duty of the President to take care that the laws be faithfully executed extends no further than to see that the officers to whom Congress has given an exclusive jurisdiction perform their duties honestly and capably. If they do not, he must, under the Constitution, remove them and appoint others in their stead, but, in the words of one of the Presidents, "he cannot override their decisions and ought not to interfere in their deliberations."

In the light of these considerations it is evident that the question of the status of the Federal Reserve Board is purely academic. Congress has committed certain business to the exclusive jurisdiction of that Board, and this business it must perform under the responsibility of its trust and not by direction of the President. The case is the same whether the Board be considered in or out of the executive branch.

To argue otherwise—to claim for the President a jurisdiction not intended to be conferred upon him by law, a jurisdiction, indeed, from which Congress clearly sought to exclude him—is to argue unreasonably and against the weight of authority. It is to assert that there must exist, and therefore does exist, some lurking, undefined power in the President, which entitles him to control the acts of all officers of the Government whose rank is inferior to his own. It is to draw the words "under the direction of the President" out of the general duty of the President to take care that the laws be faithfully executed, and then to read those words as if they were expressly inserted in every law as a qualification of every statutory duty imposed upon every officer of Government. Such line of reasoning is inconsistent with the principle that every officer of Government, even the President, is subordinate to the laws and with the related principle, declared by the Supreme Court in *Kendall* v. *United States* that the duties and responsibilities of every officer of Government "grow out of and are subject to the control of the law, and not to the direction of the President."

I conclude, therefore, that the status of the Federal Reserve Board—the place which it should occupy in an organization chart—has nothing whatever to do with the question of its independence from Presidential control. That independence is granted by law; nothing but the law can abridge or enlarge it.

Representative PATMAN. Thank you, sir.

Mr. Viner?

STATEMENT OF JACOB VINER, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Mr. VINER. The program of this panel is limited to questions as to the proper location of authority with respect to the formulation and execution of monetary and debt management policy. Answers to

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these questions would reasonably differ according to different assumptions as to what the national objectives of management are and as to where, as among different instruments of control over, say, the level of economic activity or the national price level, this national policy wishes major emphasis to be put. I will try nevertheless to refrain from discussion as to what the control policy should be. But in order that I shall not be speaking in an intellectual vacuum, and in order that I shall be less liable to be misunderstood, I think it advisable that I state, briefly, and with the dogmatism that brevity imposes upon me, my three basic assumptions with respect to the function and role of monetary management, which I accept as binding upon myself.

First, monetary management, except at times of great and rapid changes of program, such as rapid mobilization for war, can, if skillfully and firmly administered, by itself effectively prevent inflation from being generated by nongovernmental sources, such as the activities of business, or of the commercial banking system, or changes in the state of our international balance of payments.

Second, monetary management can within substantial limits counteract or offset the effects, if such there be, of inflationary governmental fiscal operations.

Third, the choice at any one time as to where authority over monetary control policy should be located is bound to be influenced, consciously or unconsciously, by judgment as to the relative wisdom, competence, courage, and flexibility of action, of the Congress, the Executive, and the Board of Governors, respectively, as of the time being.

Having, to this extent, made my general philosophy with respect to monetary management clear, I will proceed to answer, as best I can within the time limit set, the four specific questions suggested to us as topics for discussion.

First, and I will subdivide this, (*a*) What should be the role of the private financial community in the formulation of monetary policy?

I would answer, the private financial community should have the fullest of freedom and it should accept it as its duty to make recommendations for future policy and action and to offer criticisms as to the past record of Congress, of the Executive, and of the Board of Governors. It should have this freedom in common with all other citizens. It should have no further role with respect to the formulation of monetary policy. It has special interests which will not necessarily march in full harmony with the national interests. It has valuable information and experience, and individual members of it have valuable insights and judgments to contribute. But these can be drawn upon by Congress, the Executive, or the Board of Governors as becomes expedient, without conferring upon it any special status or authority, as compared to any other citizens, or any other organized or unorganized private business interests, in the formulation of official monetary policy.

(*b*) What are the implications in this respect of the private ownership of the stock of the Federal Reserve banks?

It would seem to follow from my answer to the first part of this question, that there should not be private ownership of the stock of the Federal Reserve banks, and if the System were to be established anew, I would make the Federal Reserve banks in form as well as in fact completely governmentally owned and directed institutions. I

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do not believe, however, that under existing conditions the fact of private ownership of the stock of the Federal Reserve banks has any significance with respect to the mode of operation of the banks, or of the Board of Governors, or that it has any significant influence on the formulation or the execution of monetary policy. It is an obsolete relic of earlier and mistaken views as to the nature and functions of central banking, but it is thoroughly harmless today, and does not urgently call for any action by Congress.

2. Is the division of authority over monetary policy between the Board of Governors and the Open Market Committee desirable? If not, how should it be resolved?

I believe that all authority over open-market operations should be in the same hands as over reserve requirements, discount rates, and other instruments of central bank control over the supply of money. I am not aware, however, that the partial division of authority involved in the inclusion of a minority of governors of the Federal Reserve banks in the Open Market Committee has, since the Banking Act of 1935, ever been the cause of a deviation of open-market policy from that desired by a majority of the Board. If such has ever been the case, I would strongly recommend the transfer to the Board of sole authority over the amount, the direction, and within limits the timing of open-market operations, but would leave to the New York Bank, subject to Board veto, considerable discretion with respect to the selection of the securities and the precise timing of the operations.

I am not impressed by the regional argument which the presidents of the banks so strongly stress. Central banking in general, and the conduct of open-market operations in particular, are national, not regional, in nature. The regional emphasis on central banking is an obsolete relic of the past, and of primitive thinking with respect to the functions of central banking. No country, not even Canada, which is much more a collection of distinct economic regions than is the United States, has thought it expedient to follow our initial example of introducing regionalism into central banking.

The actual conduct of open-market operations is an operation requiring detailed knowledge of conditions in the money market and great skill, and the Board, as such, needs to draw upon the accumulated experience of the New York Bank and to leave much of the details of operation to its qualified staff. The major decisions as to policy, however, should be made by the Board and, in case of any difference of views, only by the Board.

1. (*a*) The third question I will break up into two parts: Should the monetary authority be vested in one man or a board?

My preference is mildly for a board, but I am not an expert on such matters, and attach no importance to my own opinion.

(*b*) What is its proper relationship—that is, the monetary authority—to the Treasury, the President, Congress?

The Treasury and the Board should be in constant and close touch on a consultative basis, but should have no authority over each other. The President should continue to have the power to appoint, subject to senatorial approval, the members of the Board, and, for cause, to terminate their appointment. It should also be within his authority to inform them and Congress whenever in his opinion the Board is not carrying out properly its mandate from Congress. The Board, however, should have a specific and unambiguous mandate from Con-

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gress with respect to monetary controls, something it does not have now, so that it shall not be a floating body, with legal responsibilities to no other agency. This mandate should provide the Board with ruling principles with respect to the use of monetary controls to check inflation or deflation, and should specifically free the Board, after some specified period, from any responsibility, except in times of war or great emergency, to feed inflation in order to support the Government bond market.

4. What should be the role of the monetary authority in the determination of debt-management policy?

The range of discretion in debt-management policy would be limited if the Treasury could not count on more-or-less coerced Federal Reserve support of whatever cheap-money policy the Treasury should desire. The two agencies should consult each other on all matters of common interest, but the Treasury should have unlimited authority over Treasury issues, redemptions, and conversions.

Representative PATMAN. Thank you, sir.

Mr. Stein?

STATEMENT OF HAROLD STEIN, STAFF DIRECTOR, COMMITTEE ON PUBLIC ADMINISTRATION CASES

Mr. STEIN. Mr. Chairman and members of the committee, perhaps I should preface my remarks by saying that I have not been in collusion with Professor Bach; nevertheless we seemed to arrive at about the same place.

With your permission I shall limit this brief opening statement to what I consider the central practical problem of policy formation in the field of debt management and general credit control—the relations and responsibilities of the Treasury, the Open Market Committee, and the Federal Reserve Board.

Accordingly, I shall not discuss such questions as the present unfortunate statutory limitations on Federal Reserve control of reserve requirements; they are related to the application, not the formation of policy. I shall not discuss the role of the private financial community for two reasons: (1) This role seems to me to be essentially the important but inevitable client-agency relationship—and unaffected by member banks' mandatory stock ownership; (2) the Reserve Banks seem to me today not to be participants in central policy making, except in a quite secondary capacity like the regional offices of any Government agency. The curious role of the Federal Reserve Bank presidents as individuals I shall refer to later.

Finally, I shall not discuss the large constitutional questions involved in the respective functions of the President and the Congress. These are relevant and important; but if the practical issues can be worked out, they should cause no difficulty. There is nothing in the Constitution that need preclude a sensible solution of the central problem.

All the economic operations of the Government constitute a continuum. Within that general continuum, debt management and credit control are a joint enterprise, as the president of the Federal Reserve Bank of New York has stated. Because they do constitute a joint enterprise, it would be easy to have one agency set policy while delegating operations to another—as is shown by Treasury-Federal Re-

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serve relations in the Treasury's own open-market operations for the trust funds. When policy responsibility is shared, as it is now, there are bound to be strains whatever the cut-off point.

The interagency strain can be avoided in two ways: all policy responsibility can be lodged in one agency, or Congress can prohibit the exercise of discretion. I do not believe that the transfer of the Treasury's responsibilities to the Federal Reserve is either feasible or desirable; transfer in the other direction I shall discuss later. Prohibition of the exercise of discretion, as by making credit control the sole or absolutely paramount criterion of debt management, seems to me probably not feasible and certainly unwise. The Chairman of the Federal Reserve Board gives explicit recognition to the need for wide discretion on certain occasions, and the need for frequent discretionary actions of limited magnitude by both Treasury and Federal Reserve is apparent.

The particular issue that has led to the current investigation by the joint committee is the use of these governmental powers in restraining inflation—more particularly whether or not there should be general reliance on the money market itself to push down prices of Government securities, during boom periods, with a corresponding rise in yields. This effect is secured by minimizing Government intervention in the open market and by adjusting the terms of new Treasury offerings.

Both Treasury and Federal Reserve seem to agree fairly well in principle to this approach. However, as I read the record, I find the Treasury instinctively disposed toward low-interest rates and an extremely stable pattern of interest rates on new offerings; in consequence, the Treasury has been consistently hesitant about permitting the free movement of interest rates in the market—even a free movement modified by continuous or frequent stabilizing operations.

This attitude is not surprising. The words "caution" and "prudence" come easily enough to the lips of Secretary Snyder; and I speak with full respect for him. Actually, any Secretary of the Treasury is bound to be affected—and would be irresponsible if he were not—by the cost of servicing the Government's debt and by the crucial importance of floating new issues successfully every year and several times a year. It is this latter responsibility that weighs so heavily; annual offerings of the Treasury total some $50, or $60, or $70 billion. The thought that they will not be taken up is a nightmare; and the need for major adjustments in terms on every new offering would create a serious if not an impossible burden.

These are not light considerations. They are recognized by the Federal Reserve. The president of the Federal Reserve Bank of New York has said rather pointedly:

> We can't treat the Government security market as we might a $50 million issue of the XYZ corporation.

Constant large-scale refinancing requires a high measure of cooperation, and precludes repeated resort to Mr. McCabe's shock-treatment technique. No statutory formula can insure this kind of result. We must seek more delicate adjustments.

Some of the principles suggested to this committee for solving this problem seem to me not helpful.

For example, the proposition about the Federal Reserve System; "as a creature of Congress, it is responsible to the Congress." This is a

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ritualistic formula that makes commissions happy, and that is often solemnly blessed by Congress and the courts. Actually, a commission is no more a "creature" of Congress than the Treasury or, say, the Department of Agriculture. All were created by statutory enactment.

More important, commissions in general, and particularly those with some prestige, are far less responsible to Congress than the executive departments. The fact that decisions are taken by vote insulates the commission—makes it independent, as we say; more precisely it makes the commission irresponsible in the technical sense; it acts, under its statute (like all Government agencies) but as its individual members vote, and they are remarkably well protected from congressional influence. No individual member can commit the agency even to a congressional committee. The Secretary of the Treasury by comparison with the Federal Reserve Board is a servant of Congress, and of its committees.

Another piece of folklore asserts "the historical independence of central banks." This would hardly be determinative in any event, but it is peculiarly irrelevant to the use of powers which central banks traditionally either did not exercise at all or exercised for entirely different purposes. The central bankers of the nineteenth century would have shuddered at the thought that they were responsible for carrying out the objectives of the Employment Act of 1946.

I omit any discussion of the Federal Reserve as a "supreme court of finance." That bit of rhetoric should be of interest only to students of congressional debates.

Finally, and this is critically important, let us consider the proposition that any commission, including the Federal Reserve, derives its strength from its independence. That may be more or less true of a commission deciding adversary proceedings or making general rules for a peculiarly isolated area of national interest. But it is untrue of a commission operating in an area in which other agencies have major responsibilities.

For many years, Treasury preoccupations have generally tended to be too dominant in our general credit control and debt-management policies. The cure for this is to find ways of reducing the independence of the Federal Reserve and thereby increasing its influence.

One feasible and very obvious move in this direction would be the transfer of the policy powers of Federal Reserve to the Treasury. That would be in line with the sound general principles of the Hoover Commission about centralizing responsibility and authority—even though they carefully forgot about those principles in this particular connection. It is quite possible that this is the right move. If the Treasury had full responsibility for general credit control, it would be much more likely to overcome its present excess prudence. Furthermore, if Federal Reserve were an agent, not a partner, in debt management, it could afford to be bolder, more independent—in the best sense—and a more effective spokesman for the use of these powers for credit-control purposes. And certainly the whole problem would come up for more frequent consideration by Congress.

Somewhat hesitantly, I do not make this recommendation. I have three reasons: First, at heart, I suppose, I am in part a sort of Treasury man—I am cautious; I do not believe in disturbing working arrangements unless they are working noticeably badly and at the mo-

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ment affairs are moving satisfactorily; second, I have some fear that the credit-control possibilities in this complex problem might be lost on occasion in the recesses of those long quiet corridors on Fifteenth Street and Pennsylvania Avenue; they could easily be found under Presidential or congressional stimulation, but time would be lost; third, the Federal Reserve Board does serve a valuable political function. Its decisions are accepted by banks and other investors more easily than the Treasury's are, and perhaps even should be. Transfer to Treasury might diminish the acceptability of sound decisions.

Hesitantly, therefore, I propose that we continue with the present allocation of powers, while striving to increase the Federal Reserve's influence.

Offhand, one would expect or hope that the Council of Economic Advisers might be of help, but I fear not. If the President had an economic adviser, he might well be enormously useful. But a council by its very nature can't negotiate, and because of its all-too-public statutory responsibilities this Council cannot serve as an effective intermediary.

A related solution has been put forward, not too vigorously by the Treasury, more vigorously by others: The creation of a monetary policy council. This seems to me unwise. Statutory interdepartmental committees almost always end by causing trouble or becoming a mere nuisance. Such a committee is particularly unsuitable when, as here, the vast bulk of the responsibility is shared by only two agencies. Finally, Treasury and Federal Reserve have built up a magnificent network of interrelationships, which would be hurt, not helped by a new body.

The most recent development in the Treasury-Federal Reserve relationship gives us the best lead. Mr. Martin is obviously respected and trusted by both the President and the Secretary of the Treasury. As long as he remains as Chairman, and retains their confidence, Federal Reserve will have great influence in the high councils. This is as it should be. The lesson is simple: The Chairman of the Federal Reserve Board should serve as Chairman at the pleasure of the President. This is the rule in most Federal commissions and it is peculiarly applicable here.

I would also shorten the present unrealistically long terms of the members of the Board. This change would also bring the Board and the President into closer relations.

Finally, I would abolish the Open Market Committee. There is no reason why the Board cannot and should not have full responsibility for the open-market part of the over-all credit control job. Open-market policy is not a strange and different problem, unlike discount policy or reserve-requirement policy. I do not at all propose that consultation with the Reserve bank presidents be abandoned, but I do propose that responsibility be placed directly and fully on a group of officers appointed by the President, by and with the advice and consent of the Senate.

Two minor points deserve mention: (1) Open-market policy cannot be made in the void; it must be formed in consultation with the Treasury, and is in fact so formed. The Board may well find it desirable to leave the detailed policy questions to an executive committee which will work with the Treasury, but this question should be settled by the Board itself, not by Congress. (2) The particular need for

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consultation with the president of the Federal Reserve Bank of New York is apparent; but this, too, should be left to the Board's discretion.

Above and beyond these formal recommended changes (with the possibility of a larger change as an alternative, as I have suggested), I urge that the Congress welcome and support consultation between the Board, the Treasury, and the President. Among the ritualistic incantations in this field, I suggest that we include, "In union there is strength."

Let me close with hasty and therefore dogmatic comments on the particular topics suggested for discussion.

I think the present quite indirect relationship of the private financial community to public monetary policy satisfactory. I consider the stock ownership by member banks irrelevant and immaterial to this relationship.

I oppose the present division of powers between Board and Open Market Committee and recommend that these powers be vested in the Board.

My preferred recommendations is that monetary authority continue as at present divided between Board and Treasury (subject to the changes in the Board indicated above), and with full and overt recognition that this is a partnership job. I believe that debt-management and open-market operations should be jointly determined by the partners in the enterprise. I believe that the President and the Congress should continue to give broad policy direction as they do now.

Representative PATMAN. Thank you, sir.

Dr. E. A. Goldenweiser?

STATEMENT OF E. A. GOLDENWEISER, MEMBER, INSTITUTE FOR ADVANCED STUDY, PRINCETON UNIVERSITY

Mr. GOLDENWEISER. Mr. Chairman and members of the committee, I have not prepared a statement. I have some notes, and I shall take the liberty of speaking about the four points that you raise more specifically rather than about general philosophies which have been effectively presented by some.

I want to make just one general remark to begin with, and that is that in human institutions the thing that matters is how they actually function, and that any institution that is established and has a history extending over a fairly long period of time develops interpretations of the original charter creating it, in response to economic conditions and changes, and any modification that is suggested must bear the burden of proof that it is necessary not only because of political science or economic theory but also because of its bearing on actual operations and results.

It is important for me to have this principle before us as I discuss the four particular propositions that have been put to this panel.

I believe in what practically everyone has said, that the private financial community has no occasion, authority, or opportunity to exert any more influence on the Federal Reserve than any other part of the public. The only extent to which it may be more influential is that it is likely to be more informed about the matters under discussion.

The technical fact that the banks are legally owned by member banks has been referred to by several of the speakers, and it seems

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to me very properly it has been indicated that that is a piece of atavistic remnant of the philosophy of the Federal Reserve Act when it was enacted and that it has lost any important significance.

It is essentially a compulsory contribution to the capital of the Federal Reserve banks.

If in the course of time a thorough revision of our whole banking legislation were undertaken, I would think that this appendix might be removed, and it could be done simply by having the Federal Reserve banks repay to the member banks the capital which is no longer necessary and which constitutes a very small part of the resources of the System.

If that were done, it would be done both because of logic and because of the appearance of political implications that are often attached to this. Practical importance it does not have.

Secondly, about the division of powers between the Board and the Open Market Committee, I think that logically it is very clear that a division of power is not good organization. It is perfectly obvious that authority over open-market operations in a different body from that which determines reserve requirements and discount rates makes no particular sense because the two agencies, the two bodies, theoretically could work at cross purposes; but, referring to my original principle, there is not any occasion to modify that because it is operating very smoothly without any interference with the rights of the Board.

I think it is a correct statement that there has never been a decision of the Open Market Committee that was contrary to he wishes of he Board, and on very few occasions has it been contrary to the wishes of the Chairman of the Board.

I think that it is a body that operates effectively, and it has a certain merit on the human side. It contributes to the strength of the grass roots of the System. It makes the presidents of the banks feel more a part of the family and more involved in the policy of the System. It makes those presidents, in the first place, study monetary problems more carefully in the broader view than would be the case if their activities were confined to the district, and it contributes to the espirit de corps of the System.

I think, in my thinking about the Federal Reserve, the grass roots, the connection between the Federal Reserve and the districts, the directors that are elected, the advisory council that is appointed, the participation of the presidents in the councils of the Federal Reserve, are a large part of its strength. It also results in a mass of information about regional conditions and reactions regularly reaching the Board.

The Federal Reserve System, in order to perform its functions properly, has to have the support of the people, and I think that a very large part of its support is based on the fact that the various communities have a feeling of family relationship to the System, and while I agree with Professor Viner that regionalism, as such, in monetary decisions has no place in the modern world, connection with the currents of opinion and thought, and with the affections, if one might use that phrase in a financial connection, toward their Federal Reserve banks are a very important part of the machinery through which the Federal Reserve can resist criticism to which it is bound to be subjected because a part of the functions of the central banking organization is to do unpopular things. If those unpopular things are explained to

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the various groups in the United States by people who are their own people, and who have had a hand in the formation of the policy, the System is much more likely to weather the storms to which it is bound to be subjected.

I also think that a transfer of all the powers to the Open Market Committee would not be a good thing, both because it would then make the Board an entirely futile organization. To have a Board of Governors consisting of men appointed by the President and approved by the Senate, and a large organization with important functions on paper, to be deprived of all of the policy-making functions, which would be the case if reserve requirements, say, and discount rates and other similar matters were transferred to the Open Market Committee, would reduce the Board to the status of a gold settlement supervisory agent. It would cease to be a responsible organization, and I think that would be highly undesirable. As I said before, in practice it might work, but it would be theoretically wrong and practically unnecessary.

There is one important practical objection to a transfer of more power to the committee. Having been in the System for many years, I have felt on many occasions that it is very important to have a body continuously in session that makes the policy decisions.

To have a body consisting, in part, of people scattered all over the United States, even though you can have telephone connections and executive committees, nevertheless, is not quite the same thing as having people who have one job to do, who are there all the time, who meet and discuss problems continuously and, therefore, are most likely to reach satisfactory conclusions; so I would be inclined at this stage of my thinking to leave the Open Market Committee just as it is.

About the composition of the Board, I have done a lot of thinking at different times; I have written some passages advocating a one-man board, because I think that the Board's functions are not judicial and not altogether coordinating. There are a great many of its functions that are operating functions, and operating functions are better performed by an organization headed by one person who has the full responsibility, and that results in better selection of the men, and a better appeal of the job, and in various other advantages.

When I was thinking about this subject I was very much under the influence of a desire to make the Chairman of the Board as important a person as possible, in order to facilitate his meeting with the Secretary of the Treasury on equal terms; for these reasons I had even suggested that he be made a member of the Cabinet.

I have taken my own advice and given this matter further consideration, and have reached the conclusion that the Cabinet part of it would be a definite mistake because I think it would knit the Chairman of the Board too closely into a political administration.

As to the number of members of the Board, so long as we have a Board, I do not think it makes a great deal of practical difference whether you have seven or five. If you had three it would be a somewhat different organization.

I think that at this time with the sort of situation we are in, with the problems that we have to confront, it would be better to make no changes in the composition of the Board pending such time as our entire banking legislation is reviewed, brought up to date, and freed

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from obsolescence and the remnants of past thinking, and organized in a more effective way.

I think some day that has to be done; I think that the work that this committee has done in its questionnaires and in its hearings is going to be enormously valuable in shaping at least part of that legislation. One always says this is not the time, but at this particular time I think it really is not the time because I think that we have so much more vitally important things to do than to stir up the enormous volume of controversy that any kind of fundamental revision would bring about, so that it is vastly better not to undertake any such task until we have reached a little more quiet time in the affairs of the Nation.

As to the question about the place of the monetary authority in the determination of debt-management policy, that has been essentially answered by several of the previous speakers in a way that, as I recall it, and as I listened, seemed to be entirely satisfactory to me.

I think that it is clear that the responsibility of the Treasury for the management of the debt is complete. The Secretary of the Treasury is the one who has the authority to issue securities, to price securities, to call them when they are callable, and to determine the rate of interest and the terms. I do not think that there is any use in talking about the fact that that is the law, and there is not any disposition on anybody's part that I have seen to suggest any modification of that law. Having determined the terms of his issues, however, the Secretary should not expect the Federal Reserve to make a market for them. He should adjust to the market rather than expect the Federal Reserve to adjust the market to his issues.

The Federal Reserve has a responsibility to keep in touch with the Treasury, as the Treasury has to keep in touch with the Federal Reserve. This responsibility, I think, has always been discharged; whether those conferences have always been illuminating, and whether they have always led to mutual understanding and agreement is a question, but there has always been a great deal of consultation, and there is bound to be, at the present time these consultations seem to work very satisfactorily.

I think as far as the Federal Reserve is concerned it has no direct responsibility placed upon it by the Congress for the price of Government securities or the yields on Government securities in the market. Technically, legalistically speaking, the Federal Reserve has no authority to buy Government securities for purposes of supporting them in the market. It has only authority to purchase securities if it thinks that the consequences of not purchasing them would interfere with the fundamental functoin of the system of maintaining stability, that is, if there was a chance of financial chaos if it did not support the issues.

I think that the duty of the Federal Reserve to contribute to continued stability is not written in so many words ntio the law, but it has been written into the understanding of the law to a point where it is hardly ever questioned, and the Federal Reserve's responsibility is just that, to do in the open market, a well as through its relationships with member banks, those things that will constitute a climate, an economic climate, that will contribute to continuous employment and prosperity. Now that has been understood so well that it does not need to be written.

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I think that, personally, I am not in favor of any mandate being written into the law because I think the general mandate in the Employment Act and in phrases in the Federal Reserve Act, together with the public understanding and the legislative and congressional history of the Federal Reserve, has now made its mandate reasonably clear.

If you write it into the law, you are in danger of putting into statutory law a current economic fallacy or a current academic illusion, and I think that it is much better to have the contents of the general principles of that sort develop out of practical interpretations, just as the interpretations of the constitution have made it an instrument that is workable 150 years after it was written, in ways that were not contemplated by its framers.

I want to say one word—maybe I am talking too long—but I would like to say one word of my understanding——

Representative PATMAN. May I say this, Dr. Goldenweiser, that you may proceed as long as you desire so far as the chairman is concerned. I have had the pleasure and privilege of listening to you before congressional committees for 24 years, and I always benefiit when I hear your opinions expressed; and I hope that we will have that privilege for many more years to come, that is, to draw on your wonderful storehouse of knowledge; so you may proceed for as long as you desire.

Mr. GOLDENWEISER. Thank you, Mr. Chairman, I am not going to abuse that privilege, but I would like to say a few words about my concept of the independence of the Federal Reserve System.

There has been reference to it by all the speakers, and some of the things that have been said, I feel, are mistaken, and some of them, I think, are highly theoretical.

I think that the problem presents itself primarily in this form: Here is a question of regulating the supply availability and cost of money—an awfully academic sounding term—but it means something terribly important to every person in the United States. It has an effect on the availability of money, which is something everybody confronts and is confronted with, and also on the price level, although that relationship is not always clearly understood.

I do not think there would be any difference of opinion about the fact that it is a matter of vital importance; the extent of the importance, the extent of the influence, is debatable, and there is always a great deal of controversy. When a group of economists met in Princeton, and issued a statement which you printed in your report, you will notice that there are dissenting opinions, and that the dissenting opinions are on both sides; that there are two economists who failed to sign because they thought the statement went too far in the direction of hard money, and two failed to sign because they thought the statement was too namby-pamby in making a number of propitiatory gestures, and I think that this shows that in the profession there are differences of opinion. I listened to some here yesterday; there are also differences among officials, as you have always known and have heard here.

When a subject is as controversial as that, and is as important as that, it seems to me that the best opportunity, as a practical matter, of avoiding or reducing the number of mistakes, making it less likely that disastrous mistakes will be made, is to have the matter in the hands

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of an organization that has no other duties, and that has no institutional bias. By institutional bias I mean other duties and traditions that are likely to lead to a biased approach to this problem.

Now, the only agency that has that kind of a position of full-time work on this issue, of no institutional bias, is the Federal Reserve which you set up for that purpose. The Treasury Department is bound to have an institutional bias; it is bound, in view of its responsibilities, to be interested both in always being able to make a success of its issues and in keeping the servicing of the debt at as low a rate as possible.

It is clearly, being the largest borrower in the world, not an agency that ought to have much to say about the rate of interest, because the rate of interest is the price they have to pay when they borrow.

I think that subordination of central banking functions to treasuries has always led to difficulties, and I think that it is inherent in the whole institutional history of treasuries. No criticism of the Treasury is involved. They have their responsibilities.

This new condition of having a very large debt and of having to take into consideration a great many things other than those that the private organizations do when they issue bonds, are relatively new to the Treasury, and they have been making considerable progress in understanding their significance recently, but there is not the objective attitude that is desirable.

I think that a close subordination of the Federal Reserve to the Chief Executive would be a mistake, because he has other things to do in overwhelming amount, because he is not likely to be trained to make the decisions in this field, based on all the relevant considerations, and because institutionally he has a political bias which, without suggesting any abuse, does open the door for using influence on the Federal Reserve in the direction of party politics.

I think that as a pure matter of political science it would be a highly undesirable thing to have the control of our money under the influence, too directly, of the head of a political party, who is also the head of the Government.

And so, I think that independence of the Federal Reserve in the sense that it must be devoting its entire time and effort to one thing, without institutional bias, with as high-grade personnel as you can get appointed, holds out the best promise of correct decisions in this very vital matter.

It is not a matter of political science. It is a matter of practical expediency, and I think that it is of great importance.

The limitations on the independence are too long a subject to discuss. There is no doubt that there are limits to the autonomy of any organization. It is a part of the Government. It has to function as a part of the Government, but it should not be interfered with in its decisions on general credit policies.

I think that I might just say that on the question of the council that has been suggested, I have no serious objection to it, provided it has no powers but is merely advisory.

I have thought of it as a desirable thing primarily because there are promotional lending agencies in the Government—the Housing Administration, Rural Electrification—who get enthusiastic about their particular function, and who ought to have a regular channel through which they are informed of the broader credit policy needs,

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so that we will not be generating inflation in part of the Government while the monetary authorities are laboring to prevent inflation.

I think for that purpose a consultation, which is provided by law—because otherwise it is apt to peter out, as Mr. Ruml indicated—is a desirable thing, but it should have no real authority, because the minute a thing, an organization, like that has authority that interferes with the operations of the agencies involved and results in a deterioration of the service which these agencies can give the public.

I think that is all I want to say, unless I had a word on the resolution that Senator Douglas had introduced at the time of his report. That resolution, in effect, instructs the Treasury to conform to the money market in issuing its securities, and to accept the Federal Reserve's action in connection with that market, with the substance of the resolution I am in hearty sympathy, but I should not welcome the passage of the resolution because, in the first place, its introduction and its passage are a long ways from each other, and you can never be sure in what form it will emerge if it were once introduced. It might come out as the opposite of what it says.

In the second place, I think that it is a bad precedent. If we are going to favor that resolution because it happened to suit us, we will not be in a very strong position to oppose congressional interference on that level if Congress should happen to want to reduce the discount rate or reduce reserve requirements.

I think that the Federal Reserve Act is in the nature of a constitution, and I think it should not be amended by resolution. I think that if the Congress wishes to make changes in the Federal Reserve Act that should go through the regular legislative channels with the Banking and Currency Committees of the two Houses of Congress, and that it should be very thoroughly considered.

The much easier method of getting a thing through Congress by way of resolution seems to me an undesirable entry of Congress into a field that ought to be left to the constituted agency, with Congress prescribing the general rules and being always available for investigation in order to find out the facts, for determining what changes in the law should be made. There should be no resolutions about current policies, because I think that is not a good way to proceed. That is all, Mr. Chairman.

Representative PATMAN. Thank you, Dr. Goldenweiser.

Senator Flanders, would you like to interrogate the panel about any questions that have come up?

Senator FLANDERS. I have some questions, Mr. Chairman.

Representative PATMAN. You may proceed, sir.

Senator FLANDERS. I am interested in the point of view, Mr. Bach, that you expressed. If I understand you, sir, you are in favor of tying the Federal Reserve Board in operations rather more tightly into the administration.

Would you do, for example, the same thing for the Interstate Commerce Commission?

Mr. BACH. No, I think not, sir. It seems to me there are important differences between the two cases. I know of no way in which the Interstate Commerce Commission is so intimately intertwined with the other major economic operations of the Government as is true in the case of the Federal Reserve.

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Secondly, it seems to me that the Interstate Commerce Commission is, so to speak, a bona fide commission; it has a semijudicial, quasi-judicial, job to do, in considerable part.

It seems to me this is by no means equally true of the Federal Reserve; that, by and large, it has very little in the way of handling adversary controversies. It is primarily a fundamental policy-making and executing body in, I think, many respects very much the same way that the Treasury is.

As several of the gentlemen here have suggested, I also question whether the Board structure of the Federal Reserve Board, the whole tradition of the Commission, so to speak, is an awfully important one. I do not think it does a lot of harm, but I do not see, for example, why it is so important to have a Federal Reserve Board completely set apart from the whole procedure of government to handle monetary policies; whereas you let the Treasury, which is very much a part of the operating part of the Government, make pretty much equal decisions on debt management, which are very closely tied in with the money market.

Senator FLANDERS. Would you carry your thought of tying the Federal Reserve Board and its policies more tightly into the administration to the point of expecting that with each change in the administration there would be a change in the Federal Reserve Board?

Mr. BACH. My personal view would be this: That it is extremely important that the President not be saddled with a Chairman of the Federal Reserve Board who is out of sympathy with his basic policies.

It seems to me that is a very unrealistic situation to expect to work very well. I would feel, therefore, that it is very important that the Chairman be removable as Chairman, not as a member of the Board but as Chairman, at the will of the President.

I think, secondly, that the present terms of the Federal Reserve Board are unrealistically long.

Senator FLANDERS. What would you suggest?

Mr. BACH. It seems to me that depending on the size of the Board, perhaps 6 or, at most, 9 years or something of that sort is plenty long. It seems quite important to me that we achieve two objectives: One, that we make the Federal Reserve more a part of the going process of the executive branch of the Government, because I am convinced that unless you do that they are, by and large, shut out of a lot of those decisions; but, secondly, you do not want to go so far that the Federal Reserve gets overturned every time there is a whim in the executive branch.

So, it seems to me, perhaps a somewhat smaller Board, with shorter terms of perhaps 6 years for a five-man Board or even a three-man Board, with the Chairman as Chairman serving at the discretion of the President, would go a good way in the direction of these goals—both protect the Board's continuity, its freedom from the current push and pull of politics which has been referred to, and, at the same time, give a greater real responsibility and a greater real possibility for participation and influence of the Federal Reserve Board.

Senator FLANDERS. Would you not, however, be substituting in many cases a conflict between the Board and the President for a conflict between the Board and the Treasury?

Mr. BACH. I do not see why. Could you rephrase your question?

Senator FLANDERS. Well, I do not know how to rephrase it, but the

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operations of the Board are technical. The objectives of the Board can be stated in terms that everyone would agree to, namely the stability of production, employment, and as far as possible the purchasing power of money, but when it comes to the means which the Board is concerned with in seeking to obtain those things, it would seem to me they would be just as often in conflict with a nontechnical person like the President as they are with the, at times, and I think superficial, positions in opposition taken by the Treasury. I do not see that you have solved anything by making that change.

Mr. BACH. I would like to suggest, at least, that the occupational bias of the Treasury is apt to be greater than the occupational bias of the President.

Senator FLANDERS. But the President might be more susceptible to political bias than the Treasury is as a department.

Mr. BACH. That, I think, is possibly true, although in my limited experience I am not sure that it is extremely important in terms of this differential.

I would like to repeat, however, from my own observation that we are on the horns of a dilemma. We would like to have the Federal Reserve have more influence. If, however, we move to the alternative of making it more and more independent we remove it further and further from the going process of the day-to-day decisions which do pretty much amount to the monetary policy of the United States. If I thought that by firming up the formal independence of the System one could give it more real influence in the operations of the policy-making and executing sphere I would be for that.

My whole argument rests on the belief that the only way to give the Federal Reserve more influence, the only way to keep it from being isolated and pushed out of the picture more and more, is by making it more a part of the top advisory group to the President—but, at the same time, not in any sense either formally or informally putting it in a position where it must go along with the President in the sense that the Secretary of the Treasury must go along. It seems to me we must allow for the Federal Reserve to go to Congress, to go to the public, when it does feel strongly on a very major issue. But I suspect that if it does this too often, all it does is pretty much shut itself out of the regular processes of policy making.

Senator FLANDERS. I was about to raise that question about the difference in relationship between the Board and the Treasury. You do seem to assume that the Board should have the power to go to the Congress and should have the power to go to the public whereas the Secretary of the Treasury, would be most unwise to go to the public or to go to the Congress on anything which he had not taken up with the President, or to which the President was opposed to, so that you do still have in your mind a degree of independence for the Federal Reserve Board which would not apply to the Treasury.

Mr. BACH. I definitely do; yes.

Senator FLANDERS. Yes. I wanted to straighten that out in my own mind.

Mr. STEIN. May I supplement that, Senator? May I supplement what Professor Bach has said very briefly?

Senator FLANDERS. Yes.

Mr. STEIN. It seems to me that one of the difficulties we have had over the past years has seemed to me that the President has received

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almost all his education in this field from the Secretary of the Treasury.

What, I think, Professor Bach and I are trying to do is to put the President in a position where he will get some direct education from the Federal Reserve Board.

Senator FLANDERS. Well, that sounds to me like a pious project.

Mr. STEIN. I think it not only pious, but I think at the present moment it is practical. I think it is going on today, and we want to encourage that.

Senator FLANDERS. When I said that I was not referring to any particular President or any particular Secretary of the Treasury or any particular Chairman of the Federal Reserve Board. I was just speaking generally.

Mr. GOLDENWEISER. The trouble is that the President of the United States has not very much time for education.

Senators FLANDERS. No.

Mr. GOLDENWEISER. And I think that the bad consequences of knitting the Chairman into the administration more closely than he is now are likely to overbalance the good effects, in my judgment.

Senator FLANDERS. What would be the evil effects?

Mr. GOLDENWEISER. The evil effects would be that he would be more caucus-bound than he is now. I mean if he is always there, and if everyone is of a different opinion from him, that will have a very considerable weight with him, whereas he ought to be able to decide on this particular highly controversial subject—he ought to be able to have a degree of detachment, which closer participation in general political councils of the Nation might make more difficult.

Senator FLANDERS. You do not think that "seen too oft, familiar with his face, he would first endure, then pity, then embrace" the Chairman of the Federal Reserve Board?

Mr. GOLDENWEISER. Well, the progression might be in the opposite direction.

Senator FLANDERS. Mr. Viner, you seem in your document to place a great deal of confidence in the effectiveness of the monetary management over, I judge both production, employment and price. I notice this, first, that you say that monetary management, except at times of great and rapid changes of program, such as rapid mobilization for war can, if skillfully and firmly administered, by itself effectively prevent inflation from being generated by nongovernmental sources; and I think elsewhere you expressed some confidence in its control—yes, on the first page—over the levels of economic activities as well.

The question that I have put to others who have appeared here is this: Do you feel that monetary policy intelligently and firmly applied during the period immediately following our entrance into the Korean war would have prevented the inflation which followed?

Mr. VINER. First, I want to make a qualification. I am not withdrawing anything I said, but I see now that I worded it very skillfully to protect myself, and I want to disclose that.

Senator FLANDERS. You want to avail yourself of the protection.

Mr. VINER. Yes. I believe that monetary controls can do a good deal, but not nearly as much as needs to be done, if what you are fighting is a deflation, and I just want you to note that my claims as

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to its power are with respect to stopping inflation, not with respect to reversing deflation.

Senator FLANDERS. Your process then would be to avoid deflation primarily by avoiding inflation?

Mr. VINER. Well, that would be one thing; and beyond that, if it should come, if action to stop it should have been delayed, and if it should come, then I would look to fiscal policy as the effective instrument for dealing with deflation, and by that I include both expenditure policies and revenue policies.

Senator FLANDERS. Yes.

Mr. VINER. But I would like to say something more to support my position, which I stated dogmatically, and I know that in your documentation many persons who should speak with great authority have expressed great skepticism. I would admit that empirically there is very little that you can prove through experience in the application of monetary control firmly and intelligently administered, because there has been very little firm and intelligent administration of monetary policy, either here or elsewhere. I should also add that there has been no legal or congressional inducement to firm or intelligent administration because, while I know that what I am saying cannot be true, I know of no evidence to the contrary that there is no legislation instructing any branch of the executive or instructing the Federal Reserve, which mentions the question of price level, which speaks of inflation, which speaks of deflation, or which clearly or unambiguously states that one of the primary objectives of the Federal Reserve is, to use the phrase that you used, to maintain the purchasing power of the American dollar.

Now, that phrase is in your mind; it may have been even in your mind when you voted for congressional measures, but it has never been introduced in a clear-cut way into any statute, and, therefore, the Federal Reserve, on this important issue, is floating in a complete legal vacuum. While discussion here is in the light of the events of the past 2 years, and those persons who plead for more independence for the Federal Reserve are thinking in terms of the Federal Reserve as the righteous agent and the upholder of virtue, and the Treasury as the evil influence, I do not regard that as a correct historical picture.

I want independence for the Federal Reserve, provided the Federal Reserve receives and acknowledges receipt of a genuine mandate to place great emphasis on the stability of the purchasing power of the dollar.

Senator FLANDERS. You are, then, favorable to a mandate?

Mr. VINER. I am favorable to a mandate. I am not only favorable; I also suspect, probably speaking again beyond my knowledge, that there is no other agency of the Government that is so free, has such complete discretion. The Federal Reserve is so free that it can do as it pleases. What it has used its freedom for is not so much to do wrong things, as to refrain from action in the use of instruments always uncomfortable to use, or to use them too feebly or too belatedly.

Representative PATMAN. Since you have stated, in reply to Senator Flanders, that you would prefer a specific mandate, I wonder if we would be imposing upon you too much to ask if you would submit a draft of a mandate that you would like to see considered?

Mr. VINER. Well, Mr. Congressman, I would have one general answer to that. I could frame such a one fairly readily, and I would

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consider it—I would frame it and feel confident that it was worthy of consideration——

Representative PATMAN. That is all.

Mr. VINER (continuing). By a group involving all the available skills and talents and wisdom, but the challenge to frame the statute—I know enough about how statutes are framed to know that it takes weeks and months of toil, and at the end something comes out that nobody was wise enough to forecast at the beginning.

Representative PATMAN. Just give us a rough draft, if you please.

Mr. VINER. You mean extemporaneously and offhand?

Representative PATMAN. Any way you prefer.

Mr. VINER. Well, one sentence I would certainly have somewhere in the statute book, and that is that "it shall be a major responsibility of the Federal Reserve so to conduct its operations that avoidable rises and falls of the general price level shall not occur." That would give it a status in dealing with the Treasury. The Federal Reserve at times—I do not know whether it is in this documentation—the Federal Reserve at times has stressed the difficulty of its task. One way of demonstrating the difficulty has been to list all the things it has to consider, and this range of considerations has included about everything that matters in the operation of the American economy.

Well, too many objectives mean no objectives. Nowhere in the statutes can anybody put his finger on a provision and say "By this there has been placed a great responsibility on the Federal Reserve to see to it not only that it counteracts other forces that are producing inflation or deflation, but that it does not support them." If you examine the Federal Reserve's own statement of its record, you will find that a copious part of the record reveals action on its part in an inflationary direction when inflation was already well underway, or a movement in a deflationary direction when deflation was already prevailing.

Now, the variety of objectives always provides an excuse, so that I am not criticizing the Federal Reserve, I am not criticizing the Treasury; I am criticizing Congress. Congress has either never had a mind on this subject or has never clearly expressed it. I say it is an obligation on a matter that is of as major importance as this, for Congress to find out what sort of a monetary and banking system it wants.

It has never yet made up its mind with respect to the question of the importance of the purchasing power of the American dollar and how it moves from time to time.

Senator FLANDERS. Now, Mr. Chairman, we have had one sentence of a mandate which I trust that our reporter has taken down.

Mr. VINER. I hope he will send it to me; I would like to see what I said.

Senator FLANDERS. I do hope, with you, that Mr. Viner will give a little further thought to the entire contents of such a mandate, and we will consider it, and if we legislate on it, why, you will not recognize it when it is finished.

Mr. VINER. That, I suspect, is true; but Mr. Senator, I would say even that one sentence, if I remember it rightly, will be an important change.

Senator FLANDERS. Yes.

Mr. VINER. There has been the question here, the administrative question, of how can you give more status to the head of an agency.

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Here I speak, not from any general principles or theory—this is outside my field—but from what I have observed.

I have seen subordinates in an important agency of the Government speak with great authority and stand up against their own immediate chief on the ground that they had a statutory authorization or mandate. I want to bring into the picture the fact that what status a Government official has does not depend merely on his own personality; it does not even depend wholly on the scale and weight of his organization or on the degree of his intimacy with the President only. It depends greatly on these things, but also it depends on what Congress has given him a mandate to do. In particular, if he can bring his counsel along and say, "My counsel tells me that this act of Congress does not permit me to do that," that man stands like the Rock of Gibraltar against any superior, including the President of the United States.

Senator FLANDERS. Well, thank you. I think we have that on the record, and we shall take it into account when, as, and if it arrives.

Mr. Stein, you and Mr. Bach are apparently more or less of the same mind with regard to the independent status of the Federal Reserve Board, of the nature of its independence and on the nature of its influence, and both of you feel apparently that if it gives up its independence it gains in influence. Is that a correct statement of your point of view?

Mr. STEIN. I think, subject to the inevitable distortions of brevity, that is a correct statement.

Senator FLANDERS. What do you think about this mandate question?

Mr. STEIN. Well, I do not really share Professor Viner's faith in the value of a mandate. These are very difficult things to draw. If they are drawn tightly they are bound to cause great trouble later on, and I suspect that Professor Viner would agree with that.

Mr. VINER. Yes; I would.

Mr. STEIN. If they are drawn loosely, they may help.

I think maybe something could be added to our present mass of statutory enactments that affect the operations of these two great agencies, that would point up the great importance of using the powers for general credit-control purposes.

I am in complete agreement with Professor Viner that the open-market operations, particularly, and the related operations with reserve requirements and discount rates can hold down inflationary tendencies. I do not know how far they can hold them down. I cannot put it in quantitative terms, but I do think they have at least a moderating effect and should be used.

I also agree with him that they do not do us much good when you start getting into a deflation. I see no reason why Congress, if it happens to agree with that position, should not say so, but I do think we should bear in mind the fact that we cannot pick out one objective as being of sole importance.

We can avoid inflation also by not rearming, but I think that is a very bad way to avoid inflation, and so I think this has to be done cautiously.

It may be of some help, and if it can be drawn cautiously, I would say, all right, let us see if we cannot do it.

Senator FLANDERS. Mr. Stein, in your statement you say:

> Another piece of folklore asserts the historical independence of central banks.

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You say that that would hardly be determinative in any event, but it is peculiarly relevant to the use of powers which central banks traditionally either did not exercise at all or exercised for entirely different purposes. You say that the central bankers of the nineteenth century would have shuddered at the thought that they were responsible for carrying out the objectives of the Employment Act of 1946.

Are you in that statement placing yourself sympathetically in the position of the central banking power of the nineteenth century or do you feel that the central banks have now responsibilities which are new?

Mr. STEIN. Well, I feel very strongly that the central banks do have new responsibilities, very important new responsibilities which should be carried out.

I feel, however, that because these responsibilities are new and very different, the kind of organizational arrangement that was appropriate for a central bank in the nineteenth century may or may not be appropriate today. That is my main point; that we should look at the problem as it faces us now and not say that because central banks were organized in a certain way in the nineteenth century they should necessarily be so today.

Senator FLANDERS. You would feel that Government, in general, has taken on new responsibilities so far as the maintenance of production and employment was concerned, that were certainly not considered a main responsibility, except as there came a crisis from time to time throughout the nineteenth century. I suppose a central bank at that time focused its attention almost entirely on the gold supply, did it not?

Mr. STEIN. Well, I am hardly the person to give a very informed answer on that. I do recognize the new responsibilities of Government; I do believe in them, and I do think that because of the tremendous difference in the nature of the economy in the nineteenth century, the central banks could then operate as independent agencies in the fullest sense, not even directly connected with the Government. I think that no longer possible.

The Bank of England was, as I remember, essentially a private institution in days gone by.

Mr. VINER. May I inject a historical note here? There is an American phase of that for which foreign experience is practically worthless, and that is that in the United States executive policy and congressional policy can go in opposite directions. That complicates the problem. It means that there is no neat solution available here. Executive and legislative policy are uniform in most other countries because the executive is immediately responsible to the legislature. One of the issues to discuss where the question is as to the location of powers, in the American Government is, if there is an executive policy which goes counter to a congressional policy, where then does the Federal Reserve Board, or the Treasury—we know where the Treasury stands—but where then should the Federal Reserve Board stand? If you do not face that question you are not really meeting one of the facts, one of the major facts of American political life.

Mr. STEIN. I think what Professor Viner says is true, but it is even more difficult than the way he puts it, because one of the great problems is to find out what congressional policy is.

Senator FLANDERS. I would like to ask some questions of Dr. Goldenweiser.

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You addressed yourself to the question. What should be the role of the private financial community in the formulation of monetary policy, and in that connection I was interested in the implications of the stock ownership feature of the Federal Reserve System and the independence of its supply of funds. At least ownership has some significance, it seems to me, in the independence of the Federal Reserve System of the Federal budget.

Do you think that is a fortunate or unfortunate feature?

Mr. GOLDENWEISER. I think its independence of the budget is vital, vitally important to the Federal Reserve because the sort of functions it performs it could not perform effectively if it had to have appropriations.

I think that if it had to have appropriations its organization would be subject to a great deal more political pressures than it has been.

You have here an organization that over the years has built up the best economic staff in the world. You have the kind of service that arises from the possibility of cutting red tape, of complete freedom from pressure for political appointments, and it would be highly undesirable and destructive of the public interest to interfere with the functioning of the Federal Reserve in that way.

Now, the ownership of the stock, as everyone here seems to agree, has become a very minor matter. It is not a source of funds. I do not remember what the capital is now, but it is in the minor hundreds of millions, whereas the resources of the Federal Reserve are in the tens of billions, so that you can see that the ratio is negligible.

I think that it is of no particular consequence in that respect, and I think that if one were revising the banking system, that stock ought to be abolished, because I think it stands for a wrong principle, but, as I said at some length, I think it has lost all practical importance, and I think this is——

Senator FLANDERS. You do not believe in changing things simply because they are illogical as long as they are working all right?

Mr. GOLDENWEISER. That is right. I think that the most effective things in the world are illogical, and that logic can be one of the most destructive things in the world.

Senator FLANDERS. I think that is so, and I trust that the reporter is taking that down also, Mr. Chairman. I would like to inquire briefly of the other members of the panel as to what they feel about this matter. I will start over here, and I would like to inquire about how they feel in this matter of the independence of the budget which the Federal Reserve System has.

Mr. Wilmerding, what do you think about that?

Mr. WILMERDING. Well, I agree with Dr. Goldenweiser. I think everything seems to be going along all right now, and that to bring the Board under the system of appropriations might unduly hamper it.

Senator FLANDERS. All right, thank you. Mr. Stein?

Mr. STEIN. Senator, I would also be inclined to leave it alone. I think the thing to be borne in mind is that the effect of bringing the finances of the Federal Reserve, the operating finances, within the general budgetary and appropriations system would not, I suspect, make any significant difference in its relations to the President, but it would make a tremendous difference in its relations to the Congress. If the Congress wants to exercise a steady and continuing and

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very important annual influence on the operation of the Federal Reserve, then bring it inside the appropriations process. If you think that the independence from the Congress is, in a sense, desirable, leave it alone, but I think that is the cruical question, and not the relations to the White House.

Senator FLANDERS. Mr. Bach?

Mr. BACH. I think Mr. Stein's analysis is exactly accurate, and I would personally favor leaving the situation alone, not because I think Congress should not have a very direct control over the Federal Reserve but because it seems to me that if you want the central bank to play this one role of being a little outside but not too much outside the whole process, you cannot have it worrying each year about exactly how it is going to justify everything that it does to Congress.

Senator FLANDERS. Dr. Goldenweiser?

Mr. GOLDENWEISER. I thought I had said——

Senator FLANDERS. Oh, yes, you have.

Mr. GOLDENWEISER. I would like to add though something that may be rude, but it ought to be in the record, and that is that Congress is an inflationary body. It is bound to be an inflationary body because the groups in the population that are in favor of inflation are vastly better organized than many millions who suffer from inflation and are not organized, and I think that it is very wise for Congress to have a few hurdles between itself and direct influence on current credit policies.

Senator FLANDERS. Well, Mr. Goldenweiser is playing the part of a Dutch uncle.

Mr. Viner?

Mr. VINER. Why, I do not see what would be gained by making the operations of the Federal Reserve subject to annual appropriations except what would be gained from an annual review of the operations of the Federal Reserve by the Congress.

I like the latter idea, but I do not think that that is the best procedure for procuring this and I would add, as a second sentence to my proposed mandate, that responsibility should be specifically placed on the Federal Reserve to report each year to the Congress the form, the extent, and the degree in which it acted in conformity with this particular mandate, and its reasons for not acting. That would be the only enforcement machinery; I mean, there would be no penalties and no formula.

With respect to the Federal Reserve, I am afraid of inaction rather than—much more than—I am of wrong action, and I would say that on the major issue, the point that Dr. Goldenweiser makes, that he would sort of have the Federal Reserve act as a substitute for the nonexistent conscience of Congress in these matters——

Senator FLANDERS. Did he say that?

Mr. VINER. Well, the words are mine, but the idea is his. I would suggest that what I am asking is that Congress do consult its conscience on this major issue, and come to a determination which, I would hope, would be a determination of virtue, and then give a continuing assignment to the Federal Reserve to carry out this moral mandate, and to report to it each year how it did carry it out.

Senator FLANDERS. All right. Thank you.

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I would just like to raise one other question: With regard to the source of the supply of funds by which the Board in its operations is run, of course so long as the operation of pegging the bond market was the official policy, the Board had at its disposal the most watertight, unbreakable, perfect system of money making that the world has ever seen. It was required to buy when low and it was required to sell when high. Now, if you can beat that, I do not know just how to do it.

Can any of you gentlemen foresee any conditions under which the proper operation of the Federal Reserve System over its whole area of operations, rediscounts, and so forth, as well as open-market operations, might result in losses?

Mr. VINER. Mr. Senator, it is quite possible under some kinds of central bank operation. In fact, central bank operation never made the Bank of England rich and, in fact, it was always on the edge throughout its history. One particular type of central bank operation is to borrow from the market and to pay interest in order to mop up funds; that is one kind of operation which the Bank of England conducted at certain times, involving a clear outlay on its part, with no income.

Moreover, we are in a historical situation now in which the Federal Reserve has accumulated, as the result of the war methods of finance and of postwar inflation, a great stock of Governments. A situation would be quite conceivable in which the Federal Reserve would not have a large enough volume of Governments freely to operate through selling operations, and it might have to use other methods to check inflation which would not be self-financing. The Federal Reserve has been concerned about its own income at certain times in the past. It has denied at times that it was conducting its control operation with a view to revenue, even though appearances might seem that way. Under the present-day conditions, it is hard to see how the Federal Reserve could give serious consideration to the revenue consequences of its operations. Of course, it is swollen with revenue today.

Senator FLANDERS. Would you suggest that we put into that mandate a prohibition against operations for the sake of revenue?

Mr. VINER. No, because I have trust in the Federal Reserve—I would not have trusted the Bank of England in the nineteenth century on that score.

One of the major faults of the Bank of England—it was a fault, again, of Parliament, which did not give it enough assets—but one of the major faults of the Bank of England was that it had to consider its own solvency.

I would see to it that the Federal Reserve never has to worry about its own solvency. Arrange this in whatever way you like, and beyond that I would trust it on this score without any question whatsoever.

Senator FLANDERS. Dr. Goldenweiser, do you want to answer that question of the continuity of the funds from the point of view of the operation of the Federal Reserve bank?

Mr. GOLDENWEISER. I should be glad to make some comments on it. There have been times in the past where the question of meeting its expenses has been a question in the Federal Reserve. Of course, it has never permitted that to interfere with what it considered to be the proper policy, but it has been concerned about the necessity of

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maintaining an adequate income to meet its expenses. That was at the time when gold was moving into this country very rapidly and liquidating all bank indebtedness, and the portfolio of securities was small, and there were years in which the Federal Reserve had to dip into its surplus, and that is one of the reasons that it had always felt that it ought to have a substantial surplus. But I think that at this stage that has become, as Viner, indicated, historical. I mean, with $20 billion or $23 billion of Government securities it is not likely to come up again. The Federal Reserve banks, and even more emphatically, the Federal Reserve Board, have always had as their first principle that they do not operate for profit and do not refrain from doing things that are disadvantageous financially.

Now, I think it was in the autumn of 1950, it sold a great many securities because of credit circumstances that have been explained to you, at the time when these securities had a very substantial decline, and I think it can be trusted to do that. I think that it is one of the items on which you can let the next generation worry, because I think it is taken care of for the present generation.

Senator FLANDERS. Well, those are all the questions I have in mind, Mr. Chairman.

Representative PATMAN. Will it be imposing on you gentlemen too much to ask you to be back at 2:30? We will take a recess until 2:30.

(Whereupon, at 12:15 p. m., the committee recessed, to reconvene at 2:30 p. m.)

AFTERNOON SESSION

Representative PATMAN. The committee will please come to order.

Mr. Bolling, would you like to ask the members of the panel some questions?

Representative BOLLING. Yes, Mr. Chairman.

Representative PATMAN. You may proceed.

Representative BOLLING. It seems to me that throughout almost all of the discussions that we have had and the accumulation of materials on this subject there has been implicit in the discussion a feeling that monetary policy was somehow sacrosanct. I admit that when I began attending these hearings I approached them a little bit in the same way that I am sure a Greek might the ancient mysteries, but I have not come to the conclusion, but there has arisen in my mind a very substantial question as to whether the underlying thought that appears in the testimony of most witnesses and in the materials is correct.

Are there any grounds of principle on which one can justify an approach to monetary policy as something different from more important than, for example, defense policy or foreign policy?

I would like to add at that point, before I ask the panel to answer that question, that I can see very easily that for reasons of expediency it might be well to have a monetary policy in, rather, say its privileged position but I would like to get some comment on that on the basis of the principle rather than the expediency. I would be willing to start at any point.

Mr. STEIN. I will be glad to say a word. I do not think there is anything essentially different in principle. It do not think, for ex-

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ample, that monetary policy is more or less important than the size of the Federal budget, for instance. And they are not unrelated.

I think there are certain reasons of expediency, probably of a historical nature, for handling it in this way, but it seems to me an essential governmental operation, like a lot of other governmental operations.

Representative BOLLING. It is not more or less important than, say, a policy field like foreign policy?

Mr. STEIN. I am inclined to think that at times it is less important.

I think I might add one word, if I may.

The separation of monetary policy, really, is in large part, certainly, a historical hang-over from a day when the National Government's relationship to these large questions of employment and stability, and so on, was either not understood or not accepted. And at that time the private banks had need for central banks for their own purposes, and they were created.

Now the two have come closer together with the extension of governmental activities, and we retain some of the forms. And there may be expedient reasons for retaining them.

I see no essential difference in principle.

Representative BOLLING. I would like to get comments from any member of the panel who would be interested in commenting.

Mr. BACH. I would agree in general with what Mr. Stein has said.

It seems to me that the main reason for treating monetary policy as something separate from, say, defense policy or the State Department's policy is its rather peculiar status as by and large a nonoperating part of Government.

We need some way to make an agency that is not a big agency—is not a big force in the operations of the Government like the Treasury is—important in the Government.

I think that for a strong separate central bank—for a by and large independent central bank, whatever that means exactly—you have got to find some way to give status, to give importance, influence, prestige to this central banking agency, or you just will not have it as an operating part of the Government.

The central bank is too little. It does not do enough things. So it seems to me there is nothing peculiarly different in principle, but it still is a case where we will not get very big influence out of the central bank unless we take some special measures to see to it that that central bank does have this special, somewhat preferred position.

Representative BOLLING. When you say it does not do enough things, you mean it does not do things dramatic or widely understood enough for it to have popular support on a broad basis?

Mr. BACH. I mean that in considerable part. I also mean just sheer size in the sense of the operating part of the Government. It may be irrational, but I think it is quite true that things that are big do tend to get attention paid to them, whereas things that are little tend to get sloughed aside.

Mr. GOLDENWEISER. I think that there is more to it than that. I think that we live in a money economy. That word derives, naturally, from the fact that practically all that is done economically is done through the medium of money. Money is pervasive. It affects everybody.

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It is also relatively simple. It is at the tap. You take the employment policy. It involves a great many organizations doing all kinds of things.

You take foreign policy and that is again a very large field that involves Army, Navy, diplomatic corps, finance and point 4, and all kinds of things.

Here is a general tap, a general spigot that provides the liquid on which the whole economic life floats, and it is peculiar in just that respect that it is the other side of every economic transaction.

And I shall not say more important, but more pervasive than the others, and operated through fewer channels, and requires to be handled in a somewhat different organizational way.

Representative BOLLING. Do you care to make a comment?

Mr. VINER. I think that in terms of modern American history it would be very hard to find any evidence that monetary policy has been sacrosanct.

I think the great issue is that monetary policy has been grossly neglected, and that there has been nowhere located a real responsibility.

Congress has neglected it. The Federal Reserve has neglected it. The Treasury has other interests which it regards as more important.

The question of priority, I think, does not really enter.

There ought to be national decisions as to what is wanted, and then there ought to be a good deal of discretion as to what instruments are used to obtain that purpose.

At one time it ought to be the monetary instrument. And at another time it ought to be fiscal policy. At another time it ought to be one that involves ad hoc legislation. But it is not a question of monetary policy being sacrosanct.

The real issue is, should monetary policy continue to be grossly neglected and have no agency expressly charged with preserving its significance in the American economy?

Representative PATMAN. This morning I do not think you answered the question that Senator Flanders asked you, if monetary policy could have prevented the inflationary period immediately after the Korean conflict commenced.

Mr. VINER. It is my belief that in the testimony and in the materials you have received it has been stated a number of times that monetary policy is so powerful and dangerous an instrument that you do not dare use it. The reverse has also been said, that monetary measures are ineffective, sometimes by the same persons. I will let those individuals reconcile the two positions.

I agree that the monetary instrument is a very powerful instrument as a means of checking inflation. I agree that it can give rise to side effects which are very damaging. Therefore, it ought to be used with skill and caution and sobriety

And I would add, experimentally, and especially in the sense of quick reversibility.

I believe, therefore, that used rigorously enough and vigorously enough, it could have stopped any appreciable inflation as the result of the outbreak of the Korean war.

I am not saying that there should have been total reliance on it. I am not even saying there would have not been adverse effects.

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Representative BOLLING. Would not the great principle that was so heavily emphasized by the Hoover Commission, that authority and responsibility should be placed in sufficient degree in one set of hands or one agency, so that there would be the power to execute and at the same time, from the political point of view, another kind of "power to execute." If the person with the authority did not live up to his responsibilities, and the responsibility was fixed clearly, the electorate, the democratic processes would take care of him.

Other than on grounds of expediency, why would not more prestige be given to the problem of monetary policy to put it in the hands of the person who, at least, as one individual is the most powerful person in the United States, the President?

If somebody would start it, I would be happy. Would you, Mr. Bach, like to start on that one, or have I asked a rhetorical question?

Mr. BACH. It seems to me that in one sense you never put these responsibilities quite in the hands of the President. You always have the President, but he has agencies of various sorts that handle these special parts of problems for him.

I am not clear whether your question implies there should be no central bank. You just hand it to the President and somehow he takes care of it. Or are you implying that the central bank should become part of the Treasury, for example? Is that the point of the question?

Representative BOLLING. What my question means and implies is this: With the exception of those rare cases, the famous one involving helium, where the Congress deprived him of certain Executive authority and put it in the hands of the subordinate, since the President has the responsibility for executing the policy and the laws laid down by the Congress, why should he not have the direct authority and responsibility in this extremely important area?

Mr. BACH. I am willing to start an answer, although I think these other gentlemen have had more experience than I.

It seems to me that the first thing to say is that you have a historical accident in some sense, not in the sense that it is bad, but that is just the way it came to be.

Mr. Stein has remarked already on the way central banking grew up, first, essentially as a service group to bankers.

My personal judgment is that there is a lot of folklore in this field that does not amount to very much. There is still a lot of feeling that there is something peculiarly bankerish about running a central bank.

My own judgment is that the field of monetary policy, essentially is one in which commercial bankers have no special competence any more than any other intelligent people would have.

So I think the first reason is that history has been this way, and it would be very disruptive to change it. Maybe that is all you mean by expediency.

The second reason, though, is that I think Congress has thought of money as sacrosanct. They just, because of the kinds of considerations that Mr. Goldenweiser has cited, have been unwilling to say that this is nothing more than the Defense Establishment, or the State Department, or what-not.

It is my personal judgment that money is no more important than what the State Department does, and no more important than what

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the Defense Department does. And very often, probably, somewhat less important than what those particular ones may do.

It seems to me if one takes this position that the real case for keeping the central bank outside, and not under the direct control of the President is the kind of thing I was suggesting this morning. Congress really wants to impose on itself, as well as on the President, a kind of barrier, if you like, to too quick response to the electorate, to the way the wind blows today and tomorrow, and so it set up a rather special arrangement for the central bank. And this special arrangement makes a certain amount of sense to me, although it seems to me that it is an overadjustment to the problem. By making the Federal Reserve as independent as it has made it, by and large, Congress has made it less effective than it could otherwise have been.

Representative BOLLING. Does anybody else want to comment?

Mr. STEIN. I could add a word on that.

I referred to this in my opening statement. It is a very close question.

Here in an informal discussion before we opened up the session this afternoon I was told that the people in the Bank of England feel that they have more influence now that they are officially completely part of the governmental operation.

I suggested this morning that it might be that if these powers were transferred to the Treasury it would be the normal way of having them under the control of the President, the simplest way, perhaps, that we might find that the credit control carried more weight in the minds of the people in the Treasury than it does now.

It is a very tricky thing. It is very hard to guess just exactly what will happen when you make organizational shifts of this character.

My own feeling is that I would rather ride with it in approximately its present form, and yet quite seriously, as I have suggested and as Professor Bach has suggested, try to bring it closer to the President, so that it would be expected as I think to have more influence.

In think the history of the last years has shown, by and large, it has not made its position sufficiently powerfully felt.

I think that is because of its independence.

I, therefore, disagree respectfully with Dr. Goldenweiser. I think that he interprets the independence as a sign of strength, and I interpret history as showing that it was weakness.

Mr. WILMERDING. In my view, there is no constitutional reason why the Federal Reserve Board should not be under the direction of the President or be a subordinate part of the Treasury Department.

The Constitution, I think, gives Congress the power to do whatever it wants, more or less, with it.

I think the whole matter is one of expediency.

The argument has always been, as I understand it, for leaving matters of this kind up to the determination of an independent Board, that there is a great danger that party politics and political partisans might be introduced into its management. So I think it is only a question of Congress deciding whether that danger is real or not.

Most people from the year 1 or rather from the year 1789, seemed to think that it was real—people like Hamilton and Gallatin—experienced men. And even today I think plenty of people would

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say that party politics ought to be kept out of the Federal Reserve Board.

Congress seems to have thought so too, for it has set the Board up in such a way as to give its members the power to make the decisions on their own responsibility. Of course, the Board is not wholly independent of the executive branch. The President has the power of appointing the members. I think his principal duty is to see to it that he appoints good men to the Federal Reserve Board. And I would say that almost as important is his duty to remove those that show themselves to be incompetent.

Representative BOLLING. I think it is important to point out, however, at this point, since you raise the question of party politics, there are a number of ways in which both the party in power and out of power can play politics.

I suspect that it would be possible in theory under certain circumstances, with a particular type of President and a particular type of majority in Congress, for the country to be wrung out completely by a firm application of monetary policy by a "nominally" independent Board "nominally" not being influenced in any way by the Congress when , in actual fact, the Congress was using the Board as an instrument to accomplish its ends but avoiding the blame.

I think that is a theoretical case to be sure. But there is a certain possibility is there not?

Mr. GOLDENWEISER. I think that is possible, but I think that this matter is not merely a matter of expediency.

I think that back of the expediency there is historical precedent. There is the fact that governments use money and abuse it.

Originally, in the olden days, by clipping the gold coins, later by issuing paper money.

There has developed the belief that this particular element in the modern economy which has become the principal single factor in the economic life needs to be separated from current political pressures.

There has been world-wide recognition of that. And country after country has set up a central bank and has attempted to meet this problem that you are discussing right now as to what its relationship to the Government should be and what its independence from the Government should be.

In some places the head of the bank is appointed by the government, where the directors are not. And in other places the directors are appointed by the Government, but the head of the bank is not. And in some places there are various combinations of those plans.

I think that Mr. Wilmerding's original statement is that there is no great difference in this respect between the Federal Reserve and other agencies in the sense that they have duties put upon them by Congress, and they have got to perform them, and that the President has no more right to interfere with their performance than he would have a right to tell the Bureau of Entomology to leave a certain kind of bug alone, because the happens to be interested in it. I mean, it is a technical job.

You established an organization to administer it. And the President, who has over-all authority, has no authority over the day-to-day operations, or the general policies.

It has been a good principle for the President and the Federal Reserve not to be in too close contact, because the President, as I said

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this morning, and as you all know is, naturally, the head of his party, and he is, inevitably, influenced by political considerations.

You probably all remember what Senator Glass tells in his book An Adventure in Constructive Finance. He says that President Wilson was asked why he cold shouldered the Board and did not see anything of it. And he said that he felt that the minute he began seeing much of the Board members, he would be accused of bringing pressure on it, and he thought it was very much better organization not to do so.

I do not know whether you call this an historical precedent or call it expediency, but it does seem to work much better everywhere in the world when there is a break.

That does not mean that the Federal Reserve could pursue a deflationary policy, for example, at a time that the administration policy was one of fighting a depression. I think the rules of reason have to apply to it I mean to say, that the Federal Reserve is not independent of the Government, which is a phrase that I have heard used, but it is a careless use of language, it is an absurdity. The Board cannot be independent of the Government. It is a part of the Government. But it is a part that has a very special duty. And as I said before—and I do not want to elaborate now—the chances of it serving the people best as if the matter is left in the hands of an organization that has no institutional bias. And that is what you have set up here.

You have not made it bipartisan, but you have deliberately made it nonpartisan, which means that every member of the Federal Reserve Board is supposed to take an oath to serve the interests of the people and to perform his functions as a representative of the people at large.

I think you have an organization that works satisfactorily. And you have on the Hill control over the legislation and access to all of the information that you want.

The administration, on the other hand, has an opportunity to select the members, and if it wishes to keep in touch with what they are doing, it has plenty channels for that.

It seems to me that matters of principle as such, in a highly technical and philosophical sense, are not things on which governmental institutions and human institutions are run. What you have got to run them on is what, on the whole, is apt to serve the people best.

And it is my conviction that an institution that is free from interference, within the framework of being a part of the Government and subject to the laws, and open to examination and review, has the best opportunity to do what it thinks is best in discharging its responsibilities.

Representative BOLLING. It seems to me that that ties in very interestingly with some of the things that Mr. Viner has said earlier and that have been implicit in the line of questioning that Senator Douglas has taken from time to time.

Here we have had this institution which grew up historically with the independence that you described and which at least, some people will say has failed at every crucial point to accomplish the objective for which its independence was first established.

Mr. VINER. Except 1951 and 1952.

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Mr. GOLDENWEISER. I would like to answer what you asked, but I will let Mr. Viner speak first.

Mr. VINER. I think an important addition should be made to the reasons that have been stated as to why the Federal Reserve System should be treated differently from other governmental agencies, which was your question. I think it a very crucial question.

Why should anybody argue that what is good for the Treasury and what is good for all of these agencies, for defense, for foreign policy, should not be good for monetary policy?

I would say that the major reason, without at this moment contesting any of the other reasons that have here been given, the major one is that monetary policy was taken care of, until 1932, by the gold standard—badly taken care of, but taken care of. We abandoned the gold standard, but we have not adopted or substituted any new congressional policy with respect to the purchasing power of the American dollar.

The Federal Reserve operates in such a way that it does not require an annual appropriation and, therefore, Congress has not got an annual obligation of taking a look at it. Congress always practices economy with respect to the powers it confers on or permits the Executive to exercise, and by giving instructions, it limits executive power in effect.

But here is a case where in an area of great importance, generally acknowledged to be of great importance in principle, Congress has not legislated, so that if the President were to exercise his normal powers such as they are, for instance, with respect to other agencies, he would be tied by no congressional strings. He would be a free agent, as far as any meaningful statute was concerned, in imposing policy directies on the Federal Reserve.

Congress has not been willing, nor have any other persons been willing, to see a complete transfer of policy-making without congressional guidance to the President in any major field of economic activity.

That does not settle the answer as to what the ideal organization would be.

I would suggest that if it were feasible to give the Federal Reserve System the same sort of congressional mandate that the Treasury has in its taxation activities or that even the State Department has in the conduct of foreign policy, or that Agriculture has with respect to most of its operations, there would be very little reason why Federal Reserve could not be a branch like any other branch of the executive part of the Government, to be directed and guided and supervised by the President as he wished, subject, however, to an adequate code that had been enacted by Congress.

Actually, we have had an evasion of congressional policy-making in this field, and everywhere an unwillingness to see it fully located anywhere else.

Representative BOLLING. I think I remember that you said this morning that you felt that it might be well to postpone the handling of it.

Mr. VINER. The need for postponement was acknowledged in my statement this morning.

When we decide issues as to administrative organization and location of powers, we do so always in terms of going situations, and that

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includes the question of personalities always. It includes special situations. I think that our debt still requires nursing. We had a prolonged period of suppressed inflation and we have not yet overcome all of its effects.

And therefore, in my statement, I carefully stated that the specific mandate from Congress should not become fully effective until after a time. What I had in mind was that not until we had gotten the debt into good hands, at proper rates of interest, so that it was reasonably firmly held, could monetary policy be exercised with a free hand, and with only moderate concern for its impact on the Government-bond market.

If that stage could be reached, I would know how to answer your question.

If I thought that the Federal Reserve were operating within as narrow a range of discretion as the Treasury in general has to operate in, or as the State Department, or as the other important agencies of Government, then I could not see why, in terms of good housekeeping, all of these agencies, having parallel and overlapping functions, should not be subject to the general direction of the President in very much the same degree.

Representative BOLLING. Did you want to comment further?

Mr. GOLDENWEISER. I did not quite like to let it pass without any reply that the Federal Reserve System failed on all crucial occasions.

I think that I have gone over the record of the Federal Reserve and lived with the record of the Federal Reserve for a considerable part of its existence. I have criticized it. I have disagreed with it on the inside when I was there, and out the outside since I have left, on many occasions. So I do not think I can be considered as a spokesman for the Federal Reserve.

But I think that statements that it has always failed are, with all due respect to my colleague, irresponsible statements.

The Federal Reserve has, probably, not accomplished as much as it might have accomplished if it had had greater wisdom and, particularly, if it had the hindsight that we can now have, but it is a complicated and difficult subject.

The Federal Reserve has, in general, at all times moved in the right direction. It may at times, and has at times moved too late and too little. And it has at other times, but much less frequently, moved too fast and too far. But it has always moved, in general, in the right direction. And there is noway of telling how much worse things would have been if it had not been there.

I feel convinced, to take a very recent situation, since the finish of the Second World War, the Federal Reserve has been too timid in its treatment of open-market operations. That is my conviction.

And it seems now to be accepted Federal Reserve doctrine, although it was not awhile back.

They all say that we could have done more, even though the debt situation was what Mr. Viner has just suggested, but at that time they used the very best judgment, and taking into consideration all of the circumstances, thought that is what they should do.

They have done during that period quite a great deal to restrict credit expansion, but they have not done quite enough to satisfy us at this time, and some of us at that time.

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It is no more fair to say that the Federal Reserve always fails than it is to say that the democracy has failed, because there have been a lot of evils that have developed under democracy.

It is a world in which things are not perfectly done. And they have done as good a job in it, all things considered, as could have been expected.

I think an improvement in their actions will arise partly from better understanding of the economic forces which, in general, have developed in recent years, and to which they have very considerably contributed by their own investigations.

It will arise when there is better public understanding of their functions, among the people throughout the country, and in the Congress, and in the administration.

They are going to make mistakes, just as you are going to make mistakes, but the best that you can do is to try to make as few as possible and as unimportant ones, and when you make them, correct them as soon as possible. And it seems to me that the set-up that is most likely to give you those results is the set-up where the Federal Reserve has the degree of independence that we have outlined here on several occasions.

While I am speaking, I would like to say another word about the mandate that Dr. Viner is so enthusiastic about. I do not think anything of it at all. And I think that he is entirely incorrect in saying that all other agencies have mandates.

A great many institutions in the Government have only very general mandates.

I think that the mandate that the Federal Reserve has, both in the law and in the way the law has now been construed in connection with the Employment Act and in connection with general public understanding, is very clear, that they have a function to maintain economic stability, to the extent that it can be done by monetary means. That is very generally accepted. It is vague. That is its merit, because if you make it specific, if you make it rigid you are going to handicap it and you are going to be tied down tomorrow by the views that you hold today, which is bad.

And if you make it loose, as it has been, as it will be before people can agree on the formula or on a statement, then it becomes completely unimportant. And the argument about what to do is not going to be greatly changed.

I think there are very nice preambles to central bank organizations in a great many countries. And I still would like to see a government of a central bank that thinks about those preambles in the administration of the bank. They do not accomplish anything, because the general purposes are clear, and particular wording that sounds beautiful at some time in the history of the organization, sounds very foolish, maybe 5 years later.

Mr. Murphy told me at lunch that he wrote the preamble or an objective or a mandate for the Central Bank of Iceland in which he outlined four main considerations for that particular community. And he said when those considerations are in conflict, use your own judgment.

I would have no objection if we enumerated a lot of valuable objectives and then said, "When in conflict use your own judgment," which,

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in the final analysis, means just use your own judgment all the time. There is no escape from judgment, and you do much better to emphasize and expend your energies in getting the kind of people who will use good judgment than in trying to devise a formula that will make judgment unnecessary.

Mr. BACH. I would like to say a word in support of Professor Viner's position, although, perhaps, it does not need any support.

I am, perhaps, not as enthusiastic as he is as to the great amount that can be accomplished through the use of some such mandate. But I would like to make two points here.

The first is, as he suggested this morning, there is not in the basic controlling legislation any reference to the avoidance of price inflation. I, personally, consider this to be a serious weakness in the Employment Act of 1946. It seems to me that if the Federal Reserve says, "We are governed by this act," they ought to be governed by something that tells them to try to avoid price inflation, which is one of the main things we want them to do.

The second point I would like to make is this: It seems to me that the strongest case for the mandate, or certainly one of the strong points for it, is the prestige point that I was trying to make this morning.

If we want the Chairman of the Federal Reserve Board to be able to stand up more effectively, let us say, against the Secretary of the Treasury, or against any of these other people that we want to think of in terms of an adversary, we need to give him a better position on which to stand. A mandate, in common with some of the other suggestions made this morning, is one very important way in which you can give the Chairman of the Federal Reserve Board a firmer position from which to take a stand in these inevitable differences of opinion in the Government.

So I would support the mandate idea, perhaps not as a separate mandate, but at least as part of the Employment Act with particular reference to the Federal Reserve, as a very good thing to have, still leaving myself some place between Mr. Goldenweiser and Mr. Viner.

Mr. STEIN. Could I add one word to that? I think, perhaps, the parting of company with Dr. Goldenweiser is on the nature of my partial dissatisfaction with the Federal Reserve.

I do not complain about the Federal Reserve because it has made mistakes. The Treasury has, also, made mistakes and, maybe, on the average they make as many.

What I am bothered about, as I read the record of the recent years, is the fact that when, occasionally, they do the right thing, they did not, somehow, carry their point, except after months and months and months.

Take the issue of the preferential buying rate and the buying of Government bills. You will find that they caught on. They woke up to the undesirable aspects of those practices that had been adopted for the war period long before the Treasury, but they did not push it across.

They have to work together. So you cannot say, well, they should disregard the Treasury. That very soon creates an impossible situation. It is because of the fact that their influence seems to me to be inadequate that I propose what I think is a halfway step toward what you are asking about, which is, by making the Chairman of the Board more responsive to the President, particularly, by removing the term

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of office as chairman, so that there will be more chance that they will carry more weight.

I think the Board is as independent as Congress can make any board. They did not carry enough weight.

Representative BOLLING. I have one more question, Mr. Chairman.

The other day it was brought out that in the operation of the voluntary credit restraint program—and this is not perfect illustration of what I have in mind, because it brings into play two interests, one a local interest and the other a national interest—but it was brought out that in a couple of States, I think the State bonuses which, of course, have to go through the democratic process of being legislated or passed on by the people of the State, that the mandatory power was sufficient to reverse, in effect, the action of that particular State, because the lenders agreed among themselves, in accordance with policy laid down by the national committee, that they would not make the bonuses possible, since they depended upon bonds.

That is not a perfect illustration of the thing that concerns me, but it seems to me that it illustrates to a degree the dilemma that has developed for us by this special treatment of the Federal Reserve as a somewhat insulated institution which we desire to do for us our job. We are in effect saying that we are incapable of doing our job as a Congress, because we recognize our capacity to tend to political expediency, perhaps. We are in effect, saying, I believe, by the insulated set-up that we give the Federal Reserve.

At the same time we are violating the democratic process pretty clearly when we give to one authority, which is a part of over-all policy, social policy, the right to veto the actions of an entity in a democracy.

What is the answer to that kind of a dilemma? I do not see how you can get yourself in a position of giving one element a policy veto power over-all policy, which, in theory, is what you now have.

Mr. VINER. The Federal Reserve picked that up, because it did not have the strength, the support of Congress to carry out by more suitable instruments what was its primary function under these circumstances, namely, to keep the supply of money under control.

I believe that these committes are a dangerous innovation. They may be operating very well at this time, but in general I think they ought to be watched very closely by Congress.

They involve transfer to an organized local monopoly of the selection of who can borrow and who cannot. They deal directly with individuals. They execute a national policy in immediate contact with the individuals selected, without any adequately formulated rules or principles. This is all wrong. But you have given the Federal Reserve no better tools.

The emergency was an emergency. And it was a real emergency.

And once more, if Congress had in any genuine way, at the time since 1933 or 1934 given adequate consideration to the purchasing power of the dollar, in one way or another, it would in its wisdom have found ways of setting up administrative powers and procedures which would not have involved even in an emergency resort to these makeshife devices which, I believe, go against the American and democratic tradition.

Representative BOLLING. Does anybody else care to comment on that?

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Mr. STEIN. It seems to me that the proposal made, I believe by Senator Douglas, to have the debt-management policy of the Treasury guided exclusively by the monetary policy of the Federal Reserve would be a step precisely in that direction. And I think a most undesirable one at the present time where we live with a curious situation where somehow the two agencies must live together, and we do not say that one takes total precedence at all times over the other.

Representative BOLLING. That is all I have, Mr. Chairman.

Representative PATMAN. I would like to ask Dr. Goldenweiser about two or three things.

I always read with great interest and appreciation what you say, Dr. Goldenweiser. I have read your two books that were put out by the Committee for Economic Development.

I well know that you were connected with the Federal Reserve Banking System a long time.

When did you first associate yourself with the System, Dr. Goldenweiser?

Mr. GOLDENWEISER. I came to work for the System in March 1919.

Representative PATMAN. About 5½ years after the System was organized?

Mr. GOLDENWEISER. That is right.

Representative PATMAN. Has the System grown as much as you think it should, or about right, or too much?

Mr. GOLDENWEISER. What do you mean, Mr. Chairman?

Representative PATMAN. I mean in size, the expansion of the 12 banks, and their branches, and the businesses they perform, and the size, including the personnel and the duties, and so forth—have they expanded about right or have they expanded too much or too little?

Mr. GOLDENWEISER. That is a rather difficult question to answer. If I am to answer it offhand as I feel at the moment, I would say there is no criticism of it that I would make on that score. I think it probably is about right.

Representative PATMAN. About right?

Mr. GOLDENWEISER. Yes.

Representative PATMAN. In one of your books I read an interesting chapter about financing a huge national debt. If I remember it correctly, you suggested, first, that the Congress should pay as much as possible of any unusual or abnormal expenses by taxation. That was No. 1.

No. 2, if it should become necessary that additional money be raised, that security should be sold to nonbank investors.

And No. 3, if additional money should be needed that could not be provided by taxes or sales of securities to nonbank investors, that the securities should be sold to the Federal Reserve banks.

Did I recite correctly what you have written in one of those books in connection with that matter?

(The excerpt referred to is quoted at the conclusion of this day's roundtable proceedings.)

Mr. GOLDENWEISER. I did say something substantially like that. Is that the end of your question?

Representative PATMAN. Yes, sir.

Mr. GOLDENWEISER. If that is the end of the question, I would like to answer it a little more than "Yes" or "No."

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I did say that. And it is one of those cases where logic carries you too far.

What I meant to say, and I think, perhaps, did not make clear enough, is that if you are not going to raise the money by taxation or by selling bonds to savers, there is no other way to finance the balance except by creating money. And if you are going to create money, you might as well create it directly as indirectly, because it is easier to discontinue. And it does not leave as much of a problem about marketable bonds as we have had after World War II.

But the emphasis is on the fact that the creation of money should not be resorted to at all if it is possible to avoid it.

And the thing that I overlooked in that particular passage is that "other things are never equal." The point is that, if there is that easy way of getting additional money, perhaps not as much effort will be made to meet the expenditures by taxation, nor as much effort put forth to get the money from savers. And, therefore, as a precedent and as an actual operation I am afraid that this way out would turn out to be a mistake.

I think it would have been just as well not to have said it at all, although the logic of it is perfectly correct, provided all of the other factors are as I have stated them now. But they are not likely to be as stated now. And I modify my statement to this extent. It is true and logical that if you are creating money, you might as well create it straight out.

The point is that, if you can create it straight out, you are apt to create more, and that would be an evil.

Representative PATMAN. The evil would be, I assume from your answer, the danger that the Congress might not try as hard to get funds through taxation and/or from nonbank investors. They would say, "Well, we can just get it by creating the money through the Federal Reserve Banking System. Why pay such heavy taxes?"

Mr. GOLDENWEISER. That is part of the answer. And the other part is that the Treasury would not be under as great pressure to sell savings bonds.

I think that enormous effort to get is from savers is important.

Logically, there is not any trouble with what I say, but it is susceptible of a change of emphasis.

There is a danger that if the Treasury can get its money very easily and very cheaply by just simply a stroke of the pen, in effect, it is not as likely to make the effort that is necessary to reach the saver.

Representative PATMAN. I agree.

Mr. GOLDENWEISER. That is the only reason that the suggestion is not a good one.

Representative PATMAN. It would be better, because you would save interest on it that way.

Mr. GOLDENWEISER. Yes; for that marginal amount which every effort should be made to reduce to zero, and to the extent that it exceeds zero it should be just as small as possible.

Representative PATMAN. What would be the limit of the ability of the Federal Reserve System to go in that direction? How much could it actually create in money within the limits of the present laws?

Mr. GOLDENWEISER. Well, I do not have the figures of the exact amount of excess reserves that the Federal Reserve has now. So

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whether it is 40 billion or 50 billion or 100 billion, I cannot say offhand without referring to statistics. But it is a very large figure, large enough, so that that particular question is not likely to come up. I mean, they must have 10 or 12 billions of excess reserves. And on the basis of 10 or 12 billions of excess reserves they could create 40 or 50 billions of member-bank reserves. And the member banks, on the basis of the 50, could create 300 billion. So the amounts involved are fantastic. That limit is not in sight.

Representative PATMAN. Yes, I remember one time when you were here with Mr. Eccles, I asked some questions along that line. It was then estimated at about $300 billion, long before World War II.

Mr. GOLDENWEISER. And since that time the reserve requirements of the Federal Reserve have been reduced from 35 and 40 to 25 percent, and the gold reserves have increased.

I say I would not want to underwrite the figures I just mentioned. They are subject to statistical verification, but it is enough—it is beyond anything that is likely to be wanted.

Representative PATMAN. In other words, if all of the people in the Nation today were to decide—of course, they will not—that they wanted their money, all of their savings, postal savings and time deposits and demand deposits and everything else, the Federal Reserve notes could be issued to pay every one of them?

Mr. GOLDENWEISER. I think that is, essentially true, but if the demand is for notes rather than for deposits the limits are much narrower because this eliminates multiple expansion by commercial banks. Of course, the Federal Reserve can suspend reserve requirements if it finds that an emergency exists. So for all practical purposes you can say there is no limit.

Representative PATMAN. If I recall your statement that I have just called your attention to, you said that if the banks were to suffer because of the lack of earning assets, because of their lack of earning assets—I am talking about the commercial banks now—by reason of bypassing them, and selling bonds directly to the Federal Reserve System, that they should increase their earnings through service charges, because the people who get the services from the banks should pay for them, anyway.

Mr. GOLDENWEISER. I think I did say that. And I think that that is perfectly sound.

I think the fact is that if the banks' operating business would increase enormously because of the creation of more money, and they would get no return for it, then the remedy should be through service charges.

Representative PATMAN. Your answer involving the amount that could possibly be issued in Federal Reserve notes, running up to this fantastic amount, does not include the deposits of the commercial banks in the Federal Reserve Banks? You do not consider that a resource, do you?

Mr. GOLDENWEISER. The deposits are a liability. It is a liability that is usually created by the Federal Reserve through the purchase of securities or through the extension of loans to the member banks. The limiting factor on the Federal Reserve is only its gold reserves.

Representative PATMAN. Gold reserves?

Mr. GOLDENWEISER. And the capital contribution, which is a minor item.

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Representative PATMAN. The reason I ask you that question is that occasionally you will hear it said or see it in the press that the Federal Reserve banks are operating on the deposits of the commercial banks. Of course, that is certainly not true.

Mr. GOLDENWEISER. That is correct, it is not true.

Representative PATMAN. Do you think the Employment Act of 1946 sets forth a reasonable and fair policy for governmental agencies, including the Federal Reserve System?

Mr. GOLDENWEISER. I have not any positive opinion on that. I would be inclined to include into that act, offhand without having it before me and without having studied it for this purpose, some reference to the maintenance of stable values. It was formulated during the period of the depression when no one thought about price advances. And I think that some reference to that, more explicit than there is in it now, would be desirable.

Representative PATMAN. Did you interest yourself in the passage of the Federal Reserve Act when it was before Congress?

Mr. GOLDENWEISER. No, sir. That was before 1913. At that time I was not giving much attention to that line of business. I was working for the Department of Agriculture, studying farm income and farm tenancy and things of that sort.

Representative PATMAN. Do you remember any of the discussions when that act was passed about the social rank of the members of the Federal Reserve Board?

Mr. GOLDENWEISER. Some of the repercussions reached me, but it is not personal experience at all.

Representative PATMAN. Would you mind reciting some of the contentions that were made at the time?

Mr. GOLDENWEISER. I would have to go so much by memory and second- and third-hand that I am not sure that it is worth your time.

Representative PATMAN. All right, sir.

Dr. Murphy, would you like to ask any questions?

Mr. MURPHY. No, thank you.

Representative PATMAN. Mr. Ensley?

Mr. ENSLEY. I have just one observation in connection with the mandate that Professor Viner mentioned.

In drafting declaratory language or mandate language in legislation it is important not to appear to be guaranteeing something.

You recall that early versions of the Employment Act bills called for measures assuring full employment, with the clear implication that such measures would end all business slumps. I would assume that in the mandate you would write for the Federal Reserve, Professor Viner, you would not state expressly or by implication that the full and effective use of monetary policy would automatically result in stable price levels. Rather would you not express the hope that use of monetary policy would assist in the achievement of maximum stability of prices?

Mr. VINER. The easy answer to anybody who suggests a mandate is to say that you must not put the Federal Reserve in a straitjacket and make it work under a formula.

I am not advocating a formula. I am not saying that it shall be the responsibility of the Federal Reserve System to see to it that the price level, as reflected by some specified index, does not change beyond certain points.

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Again, I am being pushed into framing now the text of a mandate, whereas I say that the proper way to frame it, if there is the will to frame it, is through careful thought by a group embracing all of the skills and judgments possible.

I do not object, however, to throwing out my present ideas.

The responsibility I would place on the Federal Reserve System is the responsibility to give major weight, by which I do not mean predominant weight, but weight as one of the few major considerations in guiding such of its operations as affect the national supply of money, to the trend of prices in the United States, and to operate with a view to promoting stability of the price level.

The text of the mandate they have now has just been handed to me, and I want to read what that mandate is, for the special benefit of those who think that the Federal Reserve has a sufficient mandate now.

In the delaration of policy in the Employment Act, the last words are, "to promote maximum employment, production, and purchasing power."

I do not know even at this stage what Congress meant by promoting "maximum purchasing power."

In standard professional usage, it can have one or the other of two meanings. One is to have as much money in circulation as possible, in other words, have as great inflation as you can. The other one is to have as high a purchasing power as possible per unit of money, which means a maximum of deflation. Other standard meanings I do not know for this phrase. It is at best ambiguous. It shows either deliberate intention to be ambiguous or confusion and an unhappy selection of terms.

Anybody who is satisfied with that as a guidance from Congress, with respect to one of the major responsibilities and obligations we have, must realize that we have done very badly, whichever way the mandate is interpreted.

I repeat that the central issue of monetary policy is the historical fact that since, at least 1939, the purchasing power of the United States dollar has been going down, and that it is now down to less than one-half of what it was in 1939. This had become, apparently, a chronic or progressive trend, and nothing serious was done about it until 1951 and 1952.

The mandate I propose would include a statement of responsibility. Others would know better than I, but I could cite cases where statements of responsibility have operated as discipline. I repeat what I said this morning, that I have seen subordinates stand up against their immediate chief in Washington on the ground that a statute did not permit them to do what their chief was instructing them to do, and stand up successfully. I have, also, seen a court throw out an assessment of a State tax commission where the act under which the State commission was assessing property required that it take a series of stated things into account, and the commission was unable to provide evidence that it had given consideration to one of the factors required by the statute to be taken into account. I cite that as evidence, but this is a point on which lawyers and public administration experts can alone speak with authority.

My second suggestion at this stage would be not only that there be a mandate, but also each year careful and painstaking reporting on how it had been fulfilled the year before, and where there had been

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failure, why the failure, to be made to Congress each year, with explicit reference to what had actually happened to the trend of prices.

On the record of the Federal Reserve, one single test—it is not enough, it is not fair, if you take it by itself—but neverthless it is significant—as to what the Federal Reserve System has done to the supply of money is the amount of credit created by the Federal Reserve each year. And in most of the periods of inflation, the Federal Reserve was increasing the amount of money in the United States.

On that sort of test, on the historical record, the Federal Reserve failed. I am not saying that they did not have adequate excuse for it, in most cases, and its actual record does not matter to me, for present purposes. But what I do say, is that if they at that time had had a mandate to do what they could to preserve the value of the American dollar, and each year had to explain solemnly what they did do, and why they did no more than they did, they might have operated differently than they did. Moreover, their ability to resist pressure from the Treasury, to operate in a destabilizing or an inflationary direction might have been greater.

The word "enthusiast" was used. I am afraid that Dr. Goldenweiser exaggerates my capacity for enthusiasm. I think many, many things in addition to monetary controls are necessary to save the world. Moreover, I do not really clamor for complete salvation. I accept the prospect of a world which continues to exhibit flaws and specks.

All that I am arguing is that while we are talking about monetary policy, the purchasing power of the dollar is a major issue, that has not been dealt with adequately by Congress, and ought to be dealt with.

I do not see what harm my proposal could do. All that I have committed myself to is that there is a reasonably good chance that it would bring some good results. If anybody wants to label that as enthusiasm, that is all right with me.

Mr. ENSLEY. You would not advocate it as a guaranty?

Mr. VINER. No.

Mr. ENSLEY. And there might be other objectives than price stability that would be overriding in a particular case?

Mr. VINER. If we did not see any other way of protecting the national security of the United States than by engaging in violent inflation, what would I do? I would inflate violently with the aid of the most expert inflationary craftsmanship that I could get. What would I do, if I did not know how to cure persistent mass unemployment without destroying a large part of the purchasing power of the dollar? I would destroy the dollar, rather than let Americans starve.

Mr. ENSLEY. Thank you. That is all.

Mr. GOLDENWEISER. May I add a word? I want to say about the mandate that I do not have any emotions about it. If enthusiasm was the wrong word, I withdraw it.

The only emotion I had and still have and which Mr. Viner has now largely talked away, is a sentence on the record which might be read as a wholesale condemnation of everything the Federal Reserve has ever done. I did not like to let that pass. That is the sentence which I labeled as irresponsible and I will stand by that definition.

Mr. VINER. Was it a sentence of mine?

Mr. GOLDENWEISER. Yes.

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Mr. VINER. I do not know whether the record is available. I do not know of any such sentence.

Representative BOLLING. It may be that rhetorically I placed the wrong emphasis in commenting on a critical view sometimes urged in connection with the historical record.

Mr. VINER. I want to appeal to the record. I sprang to the defense of the Federal Reserve at the time by saying that as of 1951 and 1952, I have no criticism to offer of its general pattern of operation.

Representative PATMAN. You referred to the purchase of bonds in 1951 and 1952.

Mr. VINER. The Federal Reserve applied then a general pattern of controls that I regarded as an extraordinary display of courage. My own forecast was that they were going to lose their battle, and that they were going individually to suffer heavy penalties. I regarded them at that time as really heroes stepping into the breach. The only critical point that I wish to make on their record as a whole is that their virtue was belated.

Mr. GOLDENWEISER. It is just that having studied it very intimately and lived through much of it, I do feel that they have had a good deal of courage and a good deal of wisdom a good deal of the time. I did not like to have the record stand in my presence that there were failures throughout, even though 1951–52 be excepted, without explaining how I felt about it.

Representative PATMAN. That seems to be satisfactorily adjusted now.

Does any other member of the panel desire to make a statement before we close?

If not, we certainly thank you gentlemen. It was very nice of you to give us all of the time you have and the fine suggestions and fine statements which we appreciate. We, certainly, will consider every word that you have said. Thank you very much.

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 3:45 p. m. the subcommittee recessed to reconvene Thursday, March 27, 1952, at 10 a. m.)

EXCERPT FROM MONETARY MANAGEMENT BY E. A. GOLDENWEISER, A RESEARCH STUDY OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT, MCGRAW-HILL BOOK CO., INC., 1949, PP. 94–96.

FINANCING FUTURE DEFICITS

Since it seems probable that the country may once more enter upon a period of Treasury deficits, it may be desirable to indicate briefly what past experience suggests as the best way to finance necessary future deficits with a minimum of interference with economic stability.

If a deficit arises from Government outlays in alleviating economic distress and combating a depression, it is generally agreed that the deficit should be met by new money, that is, by the sale of Government obligations to banks. To avoid the difficulties that arise from the issuance of a large volume of marketable long-term bonds, the securities issued should consist of short-term paper of the kind that appeals to banks.

If the deficit arises from the necessity of waging war or from large-scale preparations for war, financing should proceed on the following plan:

1. Make the deficit as small as possible by raising as much as possible by taxation.
2. Offer nonmarketable bonds to the public. If necessary, make their purchase compulsory, making the bonds redeemable only after the emergency has passed. (This is one method of compulsory saving.)

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3. Raise the rest of the needed money by the sale of securities at a nominal rate of interest to the Federal Reserve banks. To prevent the inflationary effects of this method of providing money, impose high reserve requirements on bank deposits created after a given date. If Treasury surpluses appeared a ter the emergency was over, the debt held by the Federal Reserve could be reduced or paid off entirely. If the cost of handling the new deposits without adequate additions to earning assets made the operation of banks unprofitable, they should deal with this problem through service charges to their customers. This method would place the cost of using the banks' service on those who availed themselves of bank facilities and in proportion to their use of these facilities. It is probable, however, that bank earnings would not suffer unduly under the plan.

By adopting these methods of financing a military deficit, the inflationary impact would be greatly reduced. It would not be eliminated altogether, since the deposits created by the Government's borrowing from the Federal Reserve would add to the amount of money available to bid for goods. But the element of multiple expansion of bank credit would no longer aggravate the situation. Complete elimination of inflationary pressure from large-scale Government expenditures could be achieved only if these expenditures were financed entirely by taxation.

Borrowing from nonbank investors would not be inflationary insofar as it involved funds that otherwise would find their ways into the spending stream. Insofar, however, as it tapped funds that had been and were likely to remain idle, it would increase monetary activity. Borrowing of nonreserve dollars from the Federal Reserve would be a way to finance the balance of Treasury requirements not covered by taxation and borrowing of existing funds through the direct creation of money by a Government agency. This would involve no radical innovation. Under conventional practice, money is also created at the behest of the Government, but this is done through the sale of securities to banks operating under private ownership and management. As has been demonstrated in recent years, large-scale holdings of marketable public debt by private investors create serious problems for monetary authorities. The proposed method would not only save interest charges and avoid distortion of bank assets, but would also avoid the erection of further obstacles on the road of the Federal Reserve in the pursuit of monetary policies with the sole objective of contributing to economic stability.

War and preparation for war is economic waste; it can be paid for only by increased production or by reduced consumption. Taxation and inflation both reduce consumption, but the reduction by taxation is far more equitable and its effects terminate when the drain is met. Reduction of consumption by inflation is inequitable in its impact and has effects that reach far into the future.

Sound monetary management of war finance, therefore, includes high taxation, large savings—compulsory, if need be—and, if these sources are insufficient, the creation of nonreserve money. The painful impact of such a program on the people is one cost of war, which carries with it many greater costs in life, in treasure, and in freedom. This is the monetary cost of war and the monetary reason for the maintenance of peace.

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

THURSDAY, MARCH 27, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT
CONTROL AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

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

Present: Represent Patman (chairman of the subcommittee), Senator Douglas, Representatives Bolling and Wolcott.

Also present: Grover W. Ensley, staff director, and Henry Murphy, economist for the subcommittee.

Representative PATMAN. The committee will please come to order.

Again we are honored with the presence of a very distinguished panel of outstanding Americans this morning. We will call upon them alphabetically.

First, I will read the topics for discussion:

1. What are the special interests of business, labor, and agriculture in monetary policy? How should each be represented in its formulation (except as they are represented in ordinary course in the formulation of Government policy generally)?

2. Should individual members of the Board of Governors or individual directors of the Federal Reserve banks represent special interest groups? If so, should the interest groups participate in their selection?

3. What monetary and debt-management policy is most in the interest of business? Of labor? Of agriculture? Now? Under other conditions?

Participants this morning will be the following:

John A. Baker, legislative secretary, National Farmers Union.

Allan B. Kline, a farmer and president of the American Farm Bureau Federation. Mr. Kline is a class C director of the Federal Reserve Bank of Chicago, and he is a member of the board of trustees and of the agricultural committee of the National Planning Association.

Murray Lincoln, president, Farm Bureau Insurance Companies; president, Cooperative League of U. S. A., and of the Cooperative for American Remittances to Europe (CARE); trustee of the National Planning Association.

Donald E. Montgomery, director of Washington office, International Union, UAW–CIO. Former Director of Registration Division, Securities and Exchange Commission, and Consumers' Counsel in

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Department of Agriculture. Formerly with Wisconsin Department of Markets and with Wisconsin attorney general, administering State unfair competition and antitrust statutes.

Herschel D. Newsom, a farmer and master of the National Grange. Connected with Grange activities for 30 years; formerly master of the Indiana State Grange. Member of the National Advisory Board on Mobilization Policy; also of the Mutual Security Agency Public Advisory Board; and of the Research and Marketing Administration Advisory Committee of the Department of Agriculture.

Boris Shishkin, economist for the American Federation of Labor since 1933; secretary of the federation's housing committee and of its committee on social security. Formerly president, and at present Chairman of the Board of the National Bureau of Economic Research. Member advisory panel of the Joint Committee on Atomic Energy.

Jerry Voorhis, for the last 5 years secretary to the Cooperative League of U. S. A., a national organization of regional wholesale cooperatives and mutual insurance companies with approximately 2 million members. Represented Twelfth California District in House of Representatives from 1937 to 1947. Author of book, Out of Debt, Out of Danger, devoted to monetary problems. Has written numerous articles and pamphlets on the subject of money and credit.

In the discussions for this week the National Association of Manufacturers and the Chamber of Commerce of the United States of America were invited to be represented at this discussion, but they prefer to file statements instead. The statements will be included in the record.

(The statements referred to are as follows:)

NATIONAL ASSOCIATION OF MANUFACTURERS,
New York N. Y., March 11, 1952.

Hon. WRIGHT PATMAN,
House of Representatives, Washington, D. C.

DEAR MR. PATMAN: I must apologize for not having acknowledged earlier your invitation to participate in the Subcommittee on General Credit Control and Debt Management. Unfortunately we find that we will not be able to have a representative at the public-panel discussion on March 27.

We will be following the hearings with a great deal of interest. If the hearings should result in the introduction of a bill in Congress, we would like to testify at the time such a bill is considered.

With appreciation for your invitation, I am,

Yours very truly,

WM. J. GREDE, *President.*

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D. C., March 7, 1952.

Hon. WRIGHT PATMAN,
United States House of Representatives,
Washington, D. C.

DEAR MR. PATMAN: Attached is a memorandum on the general subject of credit control and debt management which we should be glad to have you include in the hearings to be published.

We appreciate your invitation of February 11 to participate in in a round table, arrangements to be made through Mr. Murphy, but in view of the extensive materials we have already sent to the joint committee in the last few weeks, we would be content to let the additional manuscript, herein enclosed, constitute our contribution.

Dr. Emerson P. Schmidt, director of our economic research department, answered the economists' questions, and recently the economic research depart-

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ment prepared a memorandum on the President's Economic Report in which a good deal of attention was devoted to the subject of your particular inquiry.

Nevertheless, we appreciate your kind invitation.

Cordially yours,

CLARENCE R. MILES,
Manager, Legislative Department.

Attachment.

STATEMENT OF THE CHAMBER OF COMMERCE OF THE UNITED STATES PRESENTED TO SUBCOMMITTEE ON GENERAL CREDIT CONTROL, AND DEBT MANAGEMENT OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT, MARCH 1952

MONETARY POLICY AND DEBT MANAGEMENT

In response to the request of the chairman of this subcommittee the Chamber of Commerce of the United States is happy to present the following statement:

Much of the significance of the specific issue of the relationship between the Treasury and the Federal Reserve System on monetary policy and debt management depends on the answer to another question: How important is money and monetary policy? It must be recognized that there is considerable lack of agreement about many aspects of this question. This is all to the good. It is through this discussion and debate that issues become clarified and resolved.

This process, of discussion and debate, however, sometimes conveys the impression to the casual observer that there is very little agreement on any phases of the problem. This is not true. On many important and fundamental matters of money and monetary policy there is general agreement among responsible authorities. It may be useful to restate some of these areas of general agreement in order to see the more controversial aspects of money and monetary policy in better focus.

Money is the communications system of the free economy. When incomes are paid in money, the individual has generalized purchasing power. In return for his contribution to productive activity, he can use his money to buy as he prefers. This pattern of consumer preferences expressed in the stores and the market generally tells businesses what to produce and how much to produce. If consumers dislike a product, sales are slow, losses follow, and production is curtailed. If they like a product, sales and profits rise, and production is encouraged.

One assumption is fundamental to our way of life. Wealth and economic activity exist to serve people. Money is the means by which people communicate their desires and needs to business and industry, thereby telling businessmen what and how much to produce. In this way, through the "ballots" of consumers' dollars, production and the allocation of productive resources are channeled and guided along lines designed to assure maximum consumer satisfaction. Money is thus an essential aspect of political and economic democracy.

If money is to be a useful "communications" system for a free economy, people must have confidence that its value will remain reasonably stable. Historical experience and common sense make this quite clear. When consumers begin to have fears about the value of their money, their main concern is to spend, not well and wisely, but quickly. No longer is what they buy necessarily what they most want or need. Price inflation becomes both a result of this and a further cause. Economic activity eventually deteriorates to primitive barter. While we usually illustrate this with examples of China, or Germany, or Russia, it is well not to forget that "not worth a continental" comes from our own history. Or, as in the early 1930's, there may be a disorderly scramble back into cash. Deflation, unemployment, and demoralized markets are then the result.

We believe this whole point is particularly well stated in a study suggested by Congressman Wright Patman and Senator Ralph E. Flanders, and prepared by the staff of the Congressional Joint Committee on the Economic Report:

"One of the most important elements making for economic strength is maintenance of confidence in the value of the dollars. Inflation, that is, a steady depreciation in the value of the dollar, is the main enemy within the gates. If allowed to run its course, it in every instance brings unrest and has in some instances paved the way for communism. China and Czarist Russia are but recent examples. Military measures on the fighting front are bound to fail if not matched by vigorous anti-inflationary measures on the home front." [1]

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[1] General credit control, debt management, and economic mobilization, materials prepared for the Joint Committee on the Economic Report by the committee staff (82d Cong., 1st sess., 1951), p. 1.

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Thus there is general agreement among responsible authorities regarding the importance of money to economic activity and the necessity for maintaining relative stability in the value of our monetary unit.

Those responsible for monetary policy must, therefore, be able to employ such monetary measures as changes in interest rates, changes in bank reserves, and changes in rediscount rates if they are to implement the objectives of sound monetary policy. Proper monetary policies are of considerable importance in mitigating cyclical fluctuations in prices, production, and employment—provided those responsible for such policies are prompt, courageous, and skillful in applying them.

What we have to say subsequently about the set-up of the Federal Reserve System is based to a substantial degree on our profound concern that the banking system make its maximum contribution toward maintaining economic stability.

With this in mind, we now turn to the specific issue in question—the relationship between the Federal Reserve System and the Treasury.

What is an "independent" Federal Reserve?

It is essential at the outset to keep one thing in mind. The Federal Reserve is not a constitutional creation; it is a creation of Congress. It is the major instrumentality through which Congress has chosen to exercise its monetary responsibility. The Federal Reserve was established presumably in recognition of two things. First, responsibility for the country's money supply is an important one. Second, Congress as such, for a variety of obvious reasons, some of which became clear through experience, is not itself in a position to assume this responsibility directly. Moreover, experience has taught us that when Congress intervenes directly in these matters the results have not always been very reassuring. It, therefore, has delegated this function to a special-purpose organization, retaining, of course, ultimate policy authority and responsibility.

Consequently, the Federal Reserve cannot and never has been independent of Congress because it is an instrumentality of Congress, performing a function which the Constitution explicitly and implicitly has declared to be ultimately a congressional responsibility. If a Federal Reserve independent of Congress were deemed desirable, it would be a fundamental departure from the present basis of Federal Reserve authority.

What this independence apparently does mean is this: The Constitution gave to Congress, and not the Executive, power to regulate the money supply. Consequently, the Federal Reserve, as an instrumentality of Congress, is not subject to Executive authority. This would be a fundamental departure from the original scheme of things.

Changing Federal Reserve objectives

This does not dispose of the matter. An organization once created develops a momentum of its own. The objectives and functions of the Federal Reserve have tended to evolve with experience, tradition, and subsequent statutory directives. Therein lies a part of the present problem.

While all of this makes precise discussion and documentation virtually impossible, it is nevertheless desirable to say something about the major changes in thinking or shifts in emphasis about what the objectives or guideposts of monetary policy ought to be.

1. Early the objective of Federal Reserve policy was conceived to be to provide a more elastic currency or money supply. The preamble to the Federal Reserve Act itself, which presumably comes close to the initial definition of objectives, states that it is: "An act to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

Moreover, the nature of the discussions at the various hearings and studies preceding the adoption of the Federal Reserve Act reinforce the view that the role of the new central banking institution was to provide for a more flexible and orderly monetary and banking system. This is suggested by some of the more frequently cited problems for which, it was hoped, the new Federal Reserve System would provide an answer.

(1) Reserves were unduly centralized in the financial centers, and in times of stress when banks tried to call home reserves they produced monetary crises because there was no ultimate source of liquidity. On a smaller scale, the same money tightness occurred when seasonal demands for credit were high.

(2) Currency in circulation was highly inelastic, depending as it did largely on a fixed or even shrinking supply of eligible Government securities.

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(3) There was little cohesiveness and coordination to the banking system.

(4) The check collection system was slow and awkward.

(5) Monetary panics, with their scramble for liquidity, were difficult to avoid or mitigate.

In its annual report concerning its first year of operation, the Federal Reserve Board reflected this view that its function was to provide a more flexible and elastic monetary environment. For example, it expressed satisfaction that the crop movements and seasonal demands for money had been accommodated without strain. It affirmed the principle that the Federal Reserve banks "should conserve their resources and hold themselves in readiness to meet any unexpected developments in the situation."[2]

2. This somewhat circumscribed and limited concept of the Federal Reserve's functions gradually evolved into the view that monetary policy should be concerned with promoting economic stability generally. This broadening of the scope of monetary policy objectives began to be clearly apparent in the decade following World War I and in the early years of the depression. It was given implied statutory recognition with the 1933 amendments to the Federal Reserve Act, which, among other matters, describes the objectives of open-market policy as follows:

"The time, character, and volume of all purchases and sales of paper described in section 14 of this act as eligible for open-market operation *shall be governed with a view to accommodating commerce and business* and with regard to their bearing upon the general credit situation of the country."[3]

It is not without significance that the accommodation of commerce and industry precedes mention of the general credit situation in this 1933 amendment to the Federal Reserve Act outlining the desire of Congress with respect to the objectives of Federal Reserve open-market policy.

This was confirmed in the 1935 amendment to the Federal Reserve Act (Banking Act of 1935) when the Board of Governors of the Federal Reserve System was granted authority to change reserve requirements (varying them between the levels then existing and twice those levels) in order to prevent injurious credit expansion or contraction.

In the 1945 Annual Report of the Board of Governors of the Federal Reserve System the shift of emphasis toward maintaining economic stability received its most explicit formulation.

"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."[4]

3. Although the System had coordinated open-market operations from 1922 to avoid disturbing the market, the next shift in emphasis came in 1937. Early in that year the Federal Reserve conducted open-market operations (purchases) for the first time in order to maintain orderly markets for Government bonds and not primarily to provide more bank reserves or to make the discount rate effective (the Federal Reserve had just raised reserve requirements to mop up some excess reserves).

Again in the fall of 1939 open-market purchases were conducted not to relieve a tight reserve position (excess reserves were generally large), but to stabilize a weak bond market. With the outbreak of the war and the prospect of substantial Treasury financing, a major objective of monetary policy became a stable bond market maintaining rates on Government securities at about the then existing levels.

This policy prevailed into the postwar years. Even though inflationary forces were dominant in the economy, the vast increase in Government debt, with the attendant constant refinancing problem, made monetary measures designed to check inflation appear open to serious question.

Any major disturbance in the market for Government securities, it was felt, could have had damaging repercussions throughout our entire economy.

The Federal Reserve was faced, on the one hand, with its responsibility for attempting to maintain economic stability within the prerogatives given it by Congress, and, on the other, of maintaining the market for Government securities. This problem continued unresolved until the "accord" of March 1951.

To what extent the "accord" can be considered another shift of emphasis—this time back to more consideration for the effect of monetary policy on the

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[2] Second Annual Report, Federal Reserve Board, 1915, p. 2.
[3] Federal Reserve Act, sec. 12A, par. 3 (c). [Italics added.]
[4] 1945 Annual Report, Board of Governors of the Federal Reserve System, p. 1.

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general business situation—largely remains to be seen, but the intent of that action was to restore the freedom of the System to take such action as was required to restrict inflationary developments.

In a sense, the shift in emphasis from monetary and credit considerations in the narrow sense to regard for the economic situation generally (the "highest possible degree of sustained production and employment") is quite a reasonable and understandable development. It reflects in part the generally greater emphasis accorded to such objectives. Moreover, there must be some guides as to how "elastic" the currency and credit situation should be and the general economic situation seems to be a very logical and important one. And it is in accord with an explicit expression of congressional policy as contained in the Employment Act of 1946 which states:

"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 an instrumentality of Congress, the Federal Reserve is presumably bound by this declaration of policy. Moreover, since monetary policy is an important means of achieving and maintaining a maximum level of business activity and employment, the Federal Reserve cannot evade or ignore this congressional declaration of policy.

On the other hand, we should not be unmindful of the definitive directives to the Federal Reserve that its operations "shall be governed with a view to accommodating commerce and business," and that reserve requirements may be changed "in order to prevent injurious credit expansion or contraction" (Banking Act of 1935). These specific directives are obviously "essential considerations of national policy" which should guide the Federal Reserve in furthering the general objectives of the Employment Act of 1946.

Suppose, however, that the Federal Reserve and the Executive disagree about what appropriate policies ought to be. The administration in office, with considerable logic, will consider its election a mandate from the people to carry out its policies. Furthermore, in a boom, subject and sensitive to immediate political pressures, the bias (traditional of all executive branches) will tend to be toward those policies whose net impact is inflationary, even though one of the Executive's official objectives may be to avoid inflation. The Federal Reserve, on the other hand, is less sensitive to these pressures.

There is the problem. The Federal Reserve will be endeavoring to perform its delegated responsibilities. The administration will be endeavoring to fulfill its election mandate. They do not agree on what the policy ought to be. The administration may understandably think the will of the people is being thwarted by a group of appointed men on whose policies the electorate has no opportunity to pass. It cannot be denied that here are some real issues. The problem, in fact, may be rendered more acute because, on occasion, the Federal Reserve may seem to be out of step with the intent of some congressional thinking.

What an "independent" Federal Reserve ought to mean

We should recognize that occasional difference of views between the administration and the Federal Reserve (or even Congress and the Federal Reserve) is not evidence that something has gone wrong with our machinery. Streamlined consistency is not the primary objective. Occasional "incompatibility" is quite in line with the American tradition of checks and balances in Government. That Congress and the Executive are both to be responsive to the will of the people is a fundamental assumption of the American system of government.

It is also fundamental to this system that there be varying degrees of exposure to popular pressures of the moment, e. g., the Senate with its 6-year terms. Through the long experience of history, we have learned that hastily considered monetary schemes, which might get momentary congressional support, do not necessarily serve the national interests well. Consequently, we delegate monetary responsibilities to an organization which has some degree of remoteness or insulation from the current political pressures to which individual Members of Congress are more immediately exposed.

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Congress deliberately built this remoteness into the Federal Reserve structure in various ways. For one thing the top policy authority is a Board of seven men in order that (among other reasons) immediate pressures of the moment which might be too strong for one man could be diffused among seven. Moreover, these men serve 14-year staggered terms. In this way personal insecurity, because of adverse political pressures, can be minimized.

The regional nature of the System constitutes another significant safeguard. The existence of the 12 Federal Reserve banks does more than decentralize System operations. It also gives the Federal Reserve the advice and counsel of men close to the banking and business communities and it brings into the banking structure outstanding men from every section of the country. It constitutes a dispersion of authority and power which assures not only some stability amidst shifting political winds but also some measure of protection against the evils of bureaucracy as well. Our tradition has been against a single strong central bank. Decentralization in banking has been the accepted concept in this country since 1836, when the second bank of the United States was denied an extension of its charter.

By and large, experience seems to suggest that the Federal Reserve has served the national interest least well in periods when it has endeavored to follow blindly political pressures. There is no evidence to suggest that this remoteness thwarts basically desirable policies, or that the Federal Reserve has demonstrated insensitivity to proper administration concerns, e.g., that the public credit be supported, etc.

This is not to say that the Federal Reserve and Treasury ought not to collaborate closely. The Treasury has a heavy responsibility for management of the public debt, and the Federal Reserve needs to be cognizant of Treasury problems. Nor do we see evidence of any insensitivity to these matters. On the other hand, debt-management decisions have fundamental significance for monetary and banking policies. If these decisions are made to minimize the difficulties and costs of borrowing for the Treasury, the Federal Reserve cannot exercise its primary responsibility, for which it was created by Congress—the provision of a flexible and elastic monetary environment.

The "needs of debt management" have probably been magnified out of all proportion to their actual importance in economic policy. It is hard not to conclude that a firmer policy of the Federal Reserve in the postwar years could have mitigated to a large extent the inflation that has occurred, without demoralizing the market for Government securities.

Therefore, within the legal framework laid down by Congress, "independence" of the Federal Reserve must mean independence of judgment in carrying out its responsibilities.

The important issue is that the status of the Federal Reserve be such that where necessary there can be a second point of view.

The Federal Reserve System has ample legal power to carry out its directives. The problem has become acute in those cases where the Federal Reserve did not seem possessed of sufficient courage to exercise this independence of judgment.

CONCLUSIONS

We arrive at these conclusions on the question of Federal Reserve-Treasury relations.

1. Since the Federal Reserve is a creature of Congress, it obviously is not "independent" of Congress. Within the limits of the mandates of Congress the exercise of independent judgment by the Federal Reserve System is essential if there is to be any practicable and responsible exercise of monetary authority. We know of no compelling argument for altering this principle, and strongly urge its reaffirmation.

2. Obviously, courage and ability of the members of the Federal Reserve Board and the presidents of the Federal Reserve banks become of utmost importance in this connection. Additional legal power cannot make good deficiencies of monetary policy imposed on the country by men of insufficient experience and competence. With men possessing these qualities of competence, ability, and courage, present powers and directives should be quite adequate for the task.

3. Furthermore, since the exercise of sound independent judgment by the Federal Reserve System is essential to good monetary management, it is extremely important to have men of high ability, courage, and integrity on the Board of Governors of the Federal Reserve System and as presidents of the Federal Reserve banks.

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The reply of the Chairman of the Board of Governors of the Federal Reserve System to this subcommittee's questionnaire points out that—

"The functions of the Board require a familiarity with Government finance, money markets, banking operations, and the many and varied aspects of the Nation's credit problems. Since the Board's problems thus fall chiefly within the financial field, it is essential that the members have a clear understanding of financial matters, including banking, and it is most desirable that at least some of the members of the Board be well versed in finance and banking, both by training and experience." [5]

The point should be emphasized that these men should be chosen on the basis of their ability and understanding as individuals and not as representatives of any specific group or sector of the economy.

The reference in section 10 of the Federal Reserve Act of 1913, as amended, to the selection of Board members with due regard to the representation of the financial, agricultural, industrial and commercial and geographical divisions of the country has not, generally speaking, caused Board members to look upon themselves as representatives of particular groups or interests or prevented them from acting in the national interest.

One matter needs immediate congressional action—the present relatively low salaries for Board members. Although the Federal Reserve has had the benefit of able men who have served even in the face of these personal sacrifices, this tends to limit the selections to able men of independent means or to those with limited ability and experience still attracted to the post. We do not believe public policy is well served by tending to limit appointments to those from these two groups.

4. Congress deliberately recognized the appropriateness of some degree of Federal Reserve remoteness from momentary political pressures. The considerations making this seem desirable when the Federal Reserve was created seem just as compelling today. We believe this principle is just as fundamental as the first and ought also to be reaffirmed.

The Executive and the Congress are in varying degrees more immediately responsive to political pressures. This is in accord with our structure of government. It is also in accord with this structure that some responsibilities must be carried out which require more remoteness and insulation from these pressures. We believe monetary policy is one of them.

Addendum

PERTINENT STATEMENTS OF POLICY ADOPTED BY THE MEMBERSHIP OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Domestic banking and monetary policy

The chamber reiterates its support of the essential principles of the Federal Reserve System and of the dual plan of Federal and State chartered banking.

Federal Reserve System.—The Federal Reserve System was conceived as a vital part of the mechanism of commerce, industry, and agriculture and not as an agency for implementation of a highly developed scheme of economic planning. It is essential that its management be independent of domination by the Treasury Department.

Inherent strength of the Federal Reserve structure was demonstrated in two world wars and a major depression. The experience of the years has proved the wisdom of the chamber in supporting the System during the period of its inception and development and in opposing hasty innovations. There should be continued opposition to any change which does not add to the strength and usefulness of the System.

Dual system of banking.—The dual system of banking provides checks and balances consistent with effective supervision in a private enterprise economy of a business with definite public responsibilities. Extension of credit powers of the Federal Reserve over nonmember banks would be an entering wedge toward destruction of this dual system.

American banking as an essential segment of free enterprise requires the widest play of the initiative, resourcefulness, and intelligence of the management of individual banks and freedom from excessive regimentation.

Monetary panaceas.—In the light of problems created by war financing, which resulted in increased deposits, large bank holdings of Government securities and

[5] Monetary Policy and the Management of the Public Debt, pt. 1, Joint Committee on the Economic Report, 1952, p. 300.

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abnormal liquid assets in the hands of individuals and corporations, special vigilance is needed for the safeguarding of the banking system against monetary panaceas offered as cures for inflation or deflation.

Tested devices for restraint of credit under existing permanent authority of the Federal Reserve System give greater promise of effectiveness than enlarged powers.

Voluntary methods.—Maximum reliance upon voluntary methods and minimum use of regulatory devices are desirable in dealing with inflationary influences or in providing a stimulus against deflation. Voluntary restraints upon the use of credit under the leadership of banking groups have played a conspicuous part in moderating inflation, while encouraging constructive employment of credit for needed production.

Bond-price support.—Monetary devices intended to act as a check upon inflation have been weakened by policies giving new impetus to inflation. Rigid support of the market for Government securities tends to impair the ability of the Federal Reserve authorities to maintain normal credit controls. There should be relaxation and eventual abandonment of the bond-price support policy.

Cheap money.—Debt-management policies should be directed toward greater freedom of interest rates than permitted under excessively easy money policies of recent years. Flexibility in market movements of interest rates is desirable to permit voluntary adjustments of the volume of credit.

Savings bonds.—Vigorous efforts should be continued to induce individuals to purchase and hold Government obligations, particularly of the savings-bond type, in order to tap on a voluntary basis the current income of the Nation available for savings and to effect a wider distribution of the Government debt.

The Chamber of Commerce of the United States is a national federation of 3,151 trade associations and local chambers of commerce, which, in turn, represent 1,450,000 individual businessmen. Because the chamber in membership and direct interests embraces every important activity in our economy; and, through its membership—small businesses as well as large—it presents the opinion of a cross section of our entire economy. Thus, it is that policies of the chamber do not represent the views of some special group or particular interest, but are drawn from the diverse interests of the country as a whole and are voted by its membership. This voting, incidentally, is so regulated that no geographic concentration of interests or economic concentration of power can override the broader interests of the entire membership.

Since the chamber of commerce is a democratic organization, and since its membership encompasses the widest range of interests, the members retain every right to express themselves as individuals.

Representative PATMAN. First, taking the panel members alphabetically, I will call on Mr. John A. Baker, legislative secretary of the National Farmers Union. Mr. Baker.

STATEMENT OF JOHN A. BAKER, LEGISLATIVE SECRETARY, NATIONAL FARMERS UNION

Mr. BAKER. Mr. Chairman, the National Farmers Union is concerned in the banking and monetary policy of the Nation from two standpoints: There is at the present time a growing severe scarcity of credit at reasonable rates of interest on terms adopted to family farm agriculture

The other concern that we have is that the banking and monetary policies should contribute to and encourage a continually expanding economy, without the up and down spurts of wild inflation and of disastrous deflation and depression.

This is not a new concern in our Nation. In the early days the argument waxed over the issue of whether the monetary and banking policies of the country would be determined by the National Bank of Philadelphia. Andrew Jackson and the people who had faith in an expanding America in the early days tried, finally successfully, to take the monetary and banking policies of the country away from the privately controlled bank and return it to the Government of the people.

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At a later time the argument was between those who advocated the gold standard as being the proper policy and that everyone must bow to the demand of gold, or whether we should again follow a policy which would contribute to the growth of the country and the welfare of the people. That also was finally won by the people against vested interests after many years of debate.

The same argument is still with us. It was not so many years ago—about 20—that a great President, Franklin Delano Roosevelt, discovered it was time, if we were to save the Nation, to move the capital back to Washington from Wall Street, so we could preserve and strengthen the free-enterprise system in this country and get the Nation back on its feet and moving toward prosperity.

Now there is the same argument between generally the same two points of view here again with us this morning, Mr. Chairman. I am sure there will be able advocates on both sides of the money and banking question, of the bankers and vested interests versus the people.

One way of stating the basic issue, as I see it. One side is the concept held by those that follow a more or less simplified or naive interpretation of economics, who believe solely in economy-wide, what they call "indirect," controls; a concept that most members of Congress have already discarded. That is what you might call the broad-ax approach.

This is the point of view that holds that by tampering with the rate of interest you can prevent inflation or deflation. That by having an economy-wide, Nation-wide reduction in the amount of credit available you can prevent inflation and promote the common good. Now, actually, what that does is to substitute what you might call dictatorial socialism by an independent board of some kind for a more delicately attuned mechanism. What we need to do is to encourage production and inflation-preventing production investment while at the same time discouraging investment and borrowing for luxury items and nonessential goods.

In the field of farm credit, I am told that in most States the Farmers Home Administration has already run out of loan funds this year. Just to give you an example along that line. In the State of Arkansas there are a growing number of acres of land that are growing up in weeds and persimmon sprouts because there is no credit available to make the adjustment to conform to the pattern that the experiment station recommends and that the farmers will have to make to stay in the farming business.

What has happened is this: A lot of these veterans and other farmers cannot find the credit to develop adequate farms and they are simply walking off and trying to find other jobs. Even at that, it would be not so bad if the land they are leaving would be taken over by someone else and put into some productive use. But the adjoining farmer does not have the credit available to him to put the land into productive use. (In the Arkansas case it is the establishment of year-round pasture and moving into a dairy enterprise or beef cattle.)

By the broad ax simplified approach that will be urged here by some, I imagine, you do two things: One is to raise the rate of interest to everybody in the country. At the same time you reduce the amount of credit available to everybody in the country. There is no selectivity at all in the process, so that the fellow who is building a race track gets just as good a chance to get credit as the farmer who

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is trying to increase his production of food to meet the Nation's production goals.

With the more selective credit control approach, credit can be made available to add to our steel capacity, to increase farm production, to do desirable things, while discouraging the extension of credit to those that in no way are absolutely necessary and essential in a time like this.

Now as to who should make the policies and what mechanisms should be used in making them, it seems to me that Andy Jackson and Mr. Biddle solved that problem over 100 years ago. It is a question whether you turn it over to an irresponsible crowd of vested interests that, at best, operates without any regard to democratic processes or whether you turn it over to the democratic governmental processes by which laws are made in this country.

The proper procedure, it seems to me, is to have most of the laws affecting this, or the regulations affecting it, to be adopted by the Congress according to the time-honored democratic procedures, and that the actual day-to-day administration should be turned over to responsible agencies of the executive branch, under the close supervision of the proper congressional committees, Mr. Chairman, including the Joint Committee on the Economic Report. Whether then the particular administrative agencies that are doing that work would have advisory committees of laymen or not is not too important. If the congressional committees and regular administrative people found that they were unable, within that framework, to correctly consider all points of view in the making of that policy, then probably an advisory committee to the executive agency would be desirable.

I don't know whether I answered all the questions, Mr. Chairman.

Representative PATMAN. Thank you, Mr. Baker. If you desire to elaborate on what you said when you get the transcript of the testimony from the reporter you may do so.

Mr. BAKER. Thank you, sir.

Representative PATMAN. We are certainly glad to have Mr. Allan B. Kline, president of the American Farm Bureau Federation. Mr. Kline is a class C director of the Federal Reserve Bank of Chicago and he is a member of the board of trustees and of the agricultural committee of the National Planning Association.

Mr. Kline.

STATEMENT OF ALLAN B. KLINE, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. KLINE. Mr. Chairman and members of the committee, we have very great confidence in the things which can be done in the monetary and fiscal policy, but we are not unaware of the fact that it cannot do everything; that monetary policy cannot possibly be substituted for the defects in budgetary policy. If we, for instance, spend in the next fiscal year $87 billion and collect $77 billion, then the purchasing ability of the Government for the $10 billion comes primarily from cheapening money, flooding the country with new money. Of course, the major access of the Government to this new money is through the Government technique of cheapening income and savings. This primarily is a matter of bookkeeping transactions in the commercial banks. The primary method is for the Government to print bonds

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and sell them to commercial banks. The banks set up an account showing the bonds as assets and a checking account as a liability. The Government spends the money to pay its bills, the people get the checks, put them in the bank, and get money for them if they want it. This new money cheapens all income and all savings such as bonds, deposits in banks, and insurance policies.

It can be understood, at least reasonably well, that a great deal of Government propaganda avoids creating this sort of understanding, and it seems to me to be one of the things that the American people must understand in order to act intelligently rather than on the basis of emotions or prejudice or on the basis of the delusion that they are getting something for nothing.

Further, it seems to me to be apparent that there is in the United States an extraordinary productive capacity that is founded basically on the proposition on which the country began, that has been basic in its political philosophy ever since. It is the proposition that men have certain inalienable rights. This economy, this political set-up has operated continuously now for a long time as a Government of free men. Economically, the most fundamental proposition is the encouragement of the individual, the development of his ability to produce, and the right of the individual to freedom of choice in regard to what to do with the product of his labor. This is an incentive and reward system.

There have been a great many people who have put forward the proposition that here were great resources in America and America just could not help but be where she is. There is something more fundamental than that. So far as I am concerned, it would have been impossible for these results to have been achieved without this extraordinary incentive for the individuals and without the matter of freedom of choice on the part of individuals.

We have had in this country now a continuing inflationary tendency for a long time. The dollar is approximately a 50-cent dollar compared to so recent a time as pre-World War II. This results primarily from the fact that we paid a very high proportion of the cost of the Second World War with new money. Any currency can very much more easily be cut in two as to value the second time than the first.

We now face a situation where we are invited to further this basic disparagement of the value of the dollar by an unbalanced budget. In the present situation there can be no doubt but that the payment of these bills with new money is a real threat to the freedom of choice of the individual in this country. When money and dollar assets in savings become unable to do things, when private capital is stripped of its value and therefore unable to accomplish new investment, new capital, new production, then the easy answer is that public capital must be substituted. This denies the validity of the American way. This is a basic proposition.

Now, coming more particularly to monetary policy, there is no better example in history of the effect of monetary policy than the post-Korean inflation in the United States, We had at the time of the outbreak of the Korean situation, as far as the budgetary policy is concerned, a deflationary situation by a considerable margin. That is, the cash budget showed a surplus. What was the inflation made of? I will say to you categorically that the fundamental propositions were these: First, by action of the Government itself, actions of the

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Congress, actions of the Executive based on actions of the Congress, we convinced the people of the United States that the goods were going to be scarce, that money was going to get cheaper.

Taking up first the proposition that goods were going to get scarce, we discussed setting up machinery for distributing goods on another basis than freedom of choice, where, instead of being able to use the fruits of their labor as they thought best, the individuals got coupons that entitled them to buy.

Senator DOUGLAS. Mr. Kline, let me interject. In the first place, rationing was not proposed, and, in the second place, we did not know what the Korean war was going to bring forth. It might have been a scrimmage, it might have been a very serious engagement, it might develop into general war.

Now I have been very critical of the administration's credit policy, as you know, and many features of the administration's policy, but it seems to me on this point the circumstances were omnious and we, in a sense, had to be prepared.

Mr. KLINE. This is not intended as a matter of criticizing any action. I will be prepared to do that at another time, but for the moment I am trying to lay out the basis of monetary policy and its consequence of inflation.

First, as far as the matter of inflation is concerned, we did start collecting staff, we did have the talk emanate from people in positions of authority to the effect that by next spring we should have to ration, or by next month we should have to ration. Why mention rationing if goods were not to be scarce? Why would you have a proposal for stand-by authority unless prices were going to get higher? The people, remembering the Second World War, and not being as dumb as some people think they are, acted accordingly. They went out and bought things. They spent their income first.

Last March, as compared to a year earlier, showed installment credit up 25 percent. Businessmen figured this out, too. They had inventories almost $13 billion above the year before. These are the evidences of people believing things were going to get scarce, that money was going to get cheap.

Having spent what money they had, the first thing the people did was to go to the banks and borrow some more. Our policy was one of furnishing unlimited reserves to the commercial banks at prices which were profitable, so when the individual came in to borrow some money over and above what he had, or the businessman came in to borrow money over what was available, there was plenty of room to take care of him.

The figures on the deposits in the banks and, of course, the other end of deposits is loans, are very clear on this point. From Korea to the 1st of January demand deposits rose $7 billion. This was the fundamental basis of the post-Korean inflation and this is proof that we can in our present situation, with the debt which we have, inflate out through the roof if we create in the minds of the people a fear of the future of the dollar. Further, we could do it even though we did balance our budget.

Now the fundamental point which I wish to make is that the American system is based fundamentally on freedom of choice. It is based fundamentally on Government for the individual citizen, on recognition of the proposition that the individual should take advantage of

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opportunity, develop his abilities, and deliver the goods. He has been encouraged to believe that if he does deliver the goods he can confidently expect that he will profit by it.

The philosophy that is currently supplanting this proposition in all the more advanced nations of the world is political determination at the national level. It is stated in a lot of terms that, in themselves, are excellent but which, applied to the organization of the economy, destroys an initiative and reward system. "Equality of sacrifice" is a delightful term. It is not equality of sacrifice but equality of opportunity that is basically dynamic.

"Fair shares" sounds good but it is not productive. We are interested in raising the whole economy, in raising the whole production based on individual progress.

With this statement, Mr. Chairman, I am perfectly willing to rest the case at this moment. What I have said is that to us monetary and fiscal policy cannot do this whole job, in fact, nothing could do it under unbalanced budgetary policy. The control of expenditures is absolutely fundamental. However, monetary policy can and must do a job. It would have to be done by a semi-independent group responsible to the Congress, and by that I mean the Federal Reserve Board. Otherwise there would be no means of insulating action in this field from political pressure in the administrative branch of the Federal Government.

The temptation to manage money supply with political objectives, in my opinion, would be too much for any party that I know of in this country; monetary policy can and must be directed toward the objective of keeping the supply of money and credit consistent with the needs of the country, and, fundamentally, consistent with the basic proposition of the American way, which is incentive and reward and freedom of choice for the individual.

Representative PATMAN. Thank you, Mr. Kline.

We are also glad to have with us this morning Mr. Murray Lincoln. Mr. Lincoln is president of the Farm Bureau Insurance Companies of Columbus, Ohio; he is president of the Cooperative League of the U. S. A., and of the Cooperative for American Remittances to Europe—CARE. He is also a trustee of the National Planning Association.

Mr. Lincoln, we will be delighted to hear from you.

STATEMENT OF MURRAY D. LINCOLN, PRESIDENT, FARM BUREAU INSURANCE COMPANIES, COLUMBUS, OHIO

Mr. LINCOLN. Mr. Chairman and members of the committee, today I should like to testify in my capacity as president of the Farm Bureau Insurance Companies. In these companies, we are working with more than one and half million people who are using insurance services to obtain security against accidents and illness and death. Our companies grew up as a part of a people's cooperative movement. That is why we take the broadest possible view of our policyholders' needs and interests. We see them not just as payers of insurance premiums, but as consumers of most of the goods and services our economy produces, and as citizens with a responsibility for their Government and its policies.

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Insurance is the means by which people seek security against the hazards to life, health, and property. But it is only a small part of their security needs. In the long run what happens to our economy is more important to that security than how much insurance they buy.

May I just interject here, Mr. Chairman. I would like to confirm what you said, Mr. Baker, about the needs for additional money by these farm and home agencies. Only yesterday both the heads of the Ohio and Pennsylvania administrations called up, and we have done all we could as an insurance company to take up some of those mortgages, but there is a tremendous need and I don't think anybody can challenge the principle of guided credit in what they have done.

As I see it, our policyholders, as people, have three broad needs which are affected by monetary and debt management policy.

1. The first need is for stable prices. Our policyholders as consumers no less than as savers, need a dollar which will buy more, not less, in the future. We have seen the 1939 dollar drop to 52 cents in value within our own recent experience. Those of us who can remember back to the turn of the century can recall when a dollar would buy three times as much as it does now. In 1820, the dollar bought four times what it does in 1952.

This is a serious matter for an insurance company. It affects all those millions of Americans who put their savings into life insurance. Constant price inflation has affected our companies as insurers of automobiles and as fire underwriters. It plays hob with claims and with calculations of cost.

But this is of small moment compared to what inflation has done to Americans as consumers and savers. The insurance industry cannot divorce itself from the interests of the economy as a whole, or of people as people.

A stable price level ought to be the first objective of monetary policy. To achieve it, the Federal Reserve should limit the creation of money to the increased volume of goods and services turned out each year by agriculture and industry. Instead, the Federal Reserve officials have disclaimed concern with maintaining a stable price level. Consequently, the money supply has soared and the purchasing power of the dollar has continued to drop.

Since 1939 our national production has risen by about 80 percent, but the money supply during the same period has tripled. With "more dollars chasing goods" prices have almost doubled. The results have been inequitable gains by borrowers at the expense of lenders, an undermining in the incentive to save, loss of confidence in insurance and Government bonds, and a wasteful diversion of economic resources into speculative and less productive activities. I would recommend that Congress make price stability the principal objective of monetary policy, and that the performance of the Federal Reserve be judged according to its success in meeting this guide to action.

2. The second great need of our policyholders is for security of income. That means the elimination of depressions and unemployment. A man whose income is cut off cannot provide his family with the security of insurance. An unstable economy is one where the general insecurity becomes the personal insecurity of every man in it. As Edward Hallett Carr has said so well in his book, Conditions of Peace:

> Our most urgent economic problem is no longer to expand production, but to secure a more equitable distribution of consumption and a more regular and

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orderly utilization of our productive capacity. Inequality and unemployment—unemployment both of manpower and of material resources—are the crying scandals of our age.

The main thing the Federal Reserve can do in relieving unemployment is to fit monetary policy into a broader program of fiscal policy and public works. It should also try to prevent bankers from making things worse by squeezing their borrowers. In the past, however, our monetary authorities have too often been timid and unimaginative in dealing with a recession. At worst, they have supported deflation, as in 1920, when their "stabilization" policies were disastrous to the farmers. One leading authority also maintains that their policies during the period 1931–32 "transformed a bad depression into a catastrophe."

I share Mr. Allan Sproul's concern when he says, "I have been and am greatly disturbed by what seems to me to be the fact that banking does not speak with a voice that is in touch with the great underlying social movements of our time, with a voice that reaches the public and enlists its support." The experience in 1920–21 shows that credit deflation, used to correct inflationary mistakes in wage and price policies of labor, agriculture, and business, produces nothing but increased unemployment. Let us hope this error is never again repeated.

3. Finally, there is need for a rising standard of living for all people. We have achieved an astounding measure of abundance in this country, and in my opinion we have only just begun. Within a generation the United States will have the manpower and the productive capacity to double present output. If we make use of our own creative forces, each American can enjoy a standard of living 50 percent above what we have now. But the increased production must be distributed. Monetary policy can and must, through more enlightened financial leadership, provide the credit required for increased consumption.

Insurance functions best in a prosperous and a growing economy. That is why we at the Farm Bureau Insurance Co.'s are not primarily interested in interest rates and credit as they affect our own portfolios, but as they affect the general welfare.

It is one of the stated principles of the Farm Bureau Insurance Co.'s that people have within their own hands the tools to fashion their own destiny. In terms of this basic philosophy, we have recently organized a development company to build low-cost homes for the families who cannot afford a conventional high-cost house. We have also established mortgage and finance companies to meet the needs of people for loans at reasonable rates of interest. The credit policies of the Federal Reserve will determine in large part how far we can go with these services.

The dynamic productive forces of our economy should be given full sway, particularly during this period of international stress. As a Nation, the principle of an expanding economy has helped us to meet our international-security commitments more effectively. Since 1947, the 60-billion-dollar increase in annual output, measured in 1951 prices, has been greater than the total cost of the defense program during 1951.

But the military build-up means that many nonessential forms of investment and consumption must be deferred. Our companies have participated in the voluntary-credit-restraint program, which limits the use of funds for nondefense purposes. Our policies have also con-

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formed to regulation X, relating to construction credit, and to regulation W, relating to installment-purchase credit. We favor these flexible forms of credit control in preference to direct controls. However, even these credit restraints may precipitate a recession if they are retained after the inflationary factors have disappeared. The Reserve officials should be sensitive to any need for revision of their policies, and should act promptly to forestall deflation.

Role of special-interest groups in monetary policy

It is my opinion that the members of the Board of Governors and Directors of the Federal Reserve banks should not represent special-interest groups. The function of regulating the supply, availability, and cost of money is a broad public responsibility, and it must be exercised in the interests of the general welfare.

At the present time, bankers and big business exercise too much influence on the Federal Reserve System through the Reserve banks. The Open Market Committee, which handles open-market operations relating to the purchase and sale of Government bonds, should be abolished and its functions taken over the the Board of Governors.

The method of selection of class B directors of the Federal Reserve banks might advantageously be changed. These directors should be chosen, not for their representation of special producers' interests, but for their capacity to represent the general interests of the people. The welfare of people as consumers, for example, should be at the forefront of banking policy.

In selecting the Board of Governors, I would recommend that at least two of the seven members be outstanding public-minded citizens rather than individuals identified primarily with business or financial interests.

Role of Government in monetary policy

I further suggest that the Secretary of the Treasury and the Chairman of the Council of Economic Advisers be made members of the Board. These changes would permit the Board to work more closely with Government agencies and would help to resolve the conflicting responsibilities which give rise to differing viewpoints.

If it has done nothing else, the credit controversy of the past few years has demonstrated this fact. The responsibilities of the Treasury are so vitally affected by monetary policy that the Secretary must have a direct voice in its formation. The delicate job of managing the public debt can be made impossible by ill-timed credit operations. Fluctuations in Government security prices resulting from Federal Reserve open-market operations can be a severe blow to investment planning by companies such as ours which have invested heavily in these bonds. And it will, of course, make the Treasury's large refunding operations most difficult. Understandably, the Treasury wants to keep interest costs on the debt down and maintain public confidence in Government bonds by holding their prices steady.

There are other reasons why testimony before this committee advocating increased independence of the Federal Reserve is mistaken. Government spending and taxation have great influence on monetary matters. Fiscal policy is one of the most powerful instruments for stabilizing economic conditions, and it must be closely coordinated with credit policy. Each is a separate cog in the machine. By making

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the Secretary of the Treasury a member of the Board he would have to realize his monetary responsibilities. At the same time, it would prevent Treasury concern with debt management from dominating credit policy.

When Congress passed the Employment Act in 1946 it gave the Federal Government, among other powers, responsibility for promoting employment, production, and purchasing power, and the right to use all practicable means to these ends. The Chairman of the Council of Economic Advisers, as chief economic adviser to the President, will be better able to perform this function if he sits on the Board as representative of the President. The Federal Reserve System is one of the principal means of achieving the purposes of the Employment Act; in fact, it would be practically impossible to attain them without extensive use of monetary policy.

At the same time, there are a large number of Federal institutions granting and guaranteeing loans which are outside the scope of Federal Reserve, such as the RFC, the FHA, and various agricultural agencies. Through their extensive operations they can directly affect credit policy. The Chairman of the Council, through his membership on the Board, can help to integrate the various policies into an over-all monetary credit and fiscal program.

Finally, I would suggest a complete revision of the banking and monetary laws of this country. This has not been done since 1864. There are numerous parts of our financial legislation which need revision and clarification. Such work, however, would be a long-range undertaking, and would require a comprehensive study of our monetary system.

The immediate problem is to clarify the appropriate roles of the Federal Reserve and the Treasury in monetary management. I am confident, Mr. Chairman, that the work of your subcommittee will be a major contribution in this regard. I am equally confident that it will help to develop credit policies which will stabilize prices and lay the foundation for a prosperous and growing economy.

Senator DOUGLAS. Mr. Lincoln, it is always a great pleasure to have you testify before any congressional committee. We regard you as one of the truly great citizens of this country.

I would like to ask some questions, if I might, about the first part of your paper and the latter part.

On page 1 you say that the primary objective should be the stability of the price level, and then on page 2 you criticize the Federal Reserve for inflating the money supply since 1939, and apparently also since Korea, and imply that this is the fault of the Federal Reserve. Later in your paper you suggest added powers for the Secretary of the Treasury and a joint council of economic advisers, you would have them put on the Board and increase the influence of the executive branch in the conduct of the Federal Reserve Board.

Now I think we have taken enough testimony before this committee and I think that the documents for which we have asked, if they are ever published show that the record is very clear that while the Federal Reserve Board has been weak in buying Government bonds in the open market and thus permitting banks to make more loans and we have had increasing prices, and so on, while the Federal Government has been weak, the force which has been pushing them all the time has been the Treasury. The testimony is abundantly clear

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on that point. As I say, if the documents are ever published, I think they will bear this out.

I wonder if there isn't a contradiction between the first part of your testimony and the latter part? That what you are apparently proposing is that the real sinner, the real forces making for inflation should be put in the driver's seat.

Mr. LINCOLN. Senator, I have respect for your opinion. When I asked our assistants the type of question you would probably ask in order to be better prepared to answer, they said you would raise just this question.

Now, as far as I see it—and maybe a layman has a right to inject himself into this great controversy that is going on down there—while there may be some validity in what you say, if we can push the two forces together we might get a compromise, at least, on what is good for everybody, rather than have the controversy that is going on.

Senator DOUGLAS. I am reminded of the fact that under the agreement that was reached before I came in I probably should not ask you any questions until after you had finished, but I will just make this comment, and that is that, that type of cooperation reminds me of the cooperation between the tiger and the young lady.

You know the two went out to ride and when they finished the ride they finished it with the lady inside and a smile on the face of the tiger.

Mr. LINCOLN. I think that opens some discussion, Senator, but at least I think this might offer an opportunity of both forces pulling together.

Senator DOUGLAS. I think it would result in the Federal Reserve System winding up in the alimentary canal of the tiger, the Treasury Department.

Mr. LINCOLN. We do not share that opinion, particularly if Congress gives the Federal Reserve a clear mandate to stabilize prices, as we suggest. You may be right, however.

Senator DOUGLAS. Well, excuse me.

The chairman had to go to another meeting. He presented his apologies and he asked me to go on.

The next witness is Mr. Donald E. Montgomery, who is director of the Washington office of the International Union, United Automobile Workers-CIO.

Mr. Montgomery has had a great deal of experience in economic matters. He served as consumers' counsel in the Department of Agriculture, in the Wisconsin Department of Markets, and with the Wisconsin attorney general administering State unfair competition and antitrust statues.

Mr. Montgomery, we will be very glad to hear you.

STATEMENT OF DONALD E. MONTGOMERY, DIRECTOR OF WASHINGTON OFFICE, INTERNATIONAL UNION, UAW-CIO

Mr. MONTGOMERY. Mr. Chairman, I am going to confine my comment to just two items of the large subject matter which your committee has been considering.

In order to cover the two items in this brief time I am going to read the statement I have prepared.

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One of the questions is how to restrain the expansion of bank credit in times of inflation without impairing the ability of the Government to refund maturing securities and to sell new issues as the need arises. The other is how to make the Federal Reserve Board a part of our Government, rather than a Government apart.

Neither the Treasury nor the Federal Reserve Board has given the committee an answer to the first question. The so-called accord, as it is described to this committee in the written replies by the Treasury and Federal Reserve Board, provides no answer. Nor does the practice that has been followed since the accord. Judging by the open-market activities of the Federal Reserve since March 4, 1951, the accord must have involved an agreement by that agency to support the market for the Government securities when refunding is taking place and then to let go of it and allow it to take its course more or less.

Apparently something like these window-dressing operations which are condemned when they are practiced in Wall Street.

This is no answer. It does not provide the stability of the market which the Treasury needs and investors in Government securities expect. It does not prevent inflation of bank credit. Under the accord we have had neither market stability nor control of inflation. While commercial loans of weekly reporting banks were rising by more than $2½ billion in the last 5 months of 1951, security offerings of the Treasury were experiencing very poor public acceptance.

The testimony of one of your earlier witnesses tabulated the refunding operations from June 15, 1951, to March 1, 1952, showing offerings of publicly held securities in the amount of $27 billion, on which there was an 18 percent public rejection of the total of those 10 issues, a very high percentage of rejection.

Presently, there is a lull in the demand for bank credit. But what will the Federal Reserve do, under the accord, to restrain credit when strong inflationary forces build up again? How will the Treasury float $10 billion of new securities and some $50 billion of refunding issues if the Federal Reserve is undermining the market by selling Government securities to restrain inflation?

There are answers to this difficulty, but we cannot find anything in the record, either as written or as put into practice, which provides those answers.

One answer was given by the Federal Reserve itself only 5 years ago. It proposed that Congress empower it to require the banks to quarantine part of their Government securities by putting them in special reserves, reserves which could not be used, therefore, to extend the credit base. If the Federal Reserve Board of 1952 would get itself into agreement with the Federal Reserve Board of 1947 we might be on the way to a solution of the problem which this committee has been considering.

No doubt the banks might object to this limitation on the use of their bonds. But why not, in time of inflation, isolate some part of bank-held bonds so that they cannot be converted into reserves for the expansion of loans? The bonds didn't cost the banks anything. They represent simply the toll which the banks levied for creating the greatly increased volume of fountain-pen money needed to finance a high level of economic activity in the war and postwar years. The banks cannot now claim the unqualified right to dispose of these bonds in ways that endanger national stability.

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Another answer would be to empower the Federal Reserve to impose direct controls on bank loans, such as it asked for and received and put to work with respect to consumer credit. Direct controls can be applied selectively, which is desirable when strong inflationary pressures develop, permitting full steam ahead on defense production but putting the brakes on speculative inventory accumulation. Nearly 60 percent of the increase in commercial loans during the last half of last year was used to finance inventory and working capital of a nondefense character.

The Federal Reserve Board does not now recommend such practical and feasible means of restraining credit inflation and at the same time permitting support of the market for Government securities. Instead, it stands pat for manipulating the interest rate through open-market operations—a control device which cannot be applied strongly enough to hold inflation in check for fear of wrecking the Government securities market and perhaps bringing on a sharp drop in production and employment. If the interest rate was ever an adequate means of stabilizing the economy, and experience has not proved it so, it certainly is not suited to the postwar financial facts of life.

But the Federal Reserve Board stubbornly insists on driving its 1925 model car through 1950 traffic and blames all the other drivers for tying things up. Before we come to the next dangerous intersection, it is to be hoped that this committee will have recommended action by which we may have effective restraint of credit inflation and at the same time a Government securities market sound enough to meet the heavy demands that will be put upon it.

This brings me to our second point. To protect its arbitrary position, the Federal Reserve Board demands the right to remain independent of the executive branch and not subject to policy direction by the President. This is a proposition which your committee should examine exhaustively, for it challenges the power of the executive branch to develop a fully coordinated program for stabilizing the economy in time of crisis and for maintaining full employment in normal periods.

The only policy directive cited to you by the Board as giving it responsibility with respect to stabilizing the economy is the Employment Act of 1946. But that act contemplates no independent action by any part of the Government. On the contrary it calls for coordination of all the relevant powers of government under the direction and responsibility of the President. How can the Federal Reserve Board pretend to draw authority from that act while proclaiming its independence of the executive?

The Board seeks to defend its independent status by comparing itself to such independent agencies as the Interstate Commerce Commission and Federal Trade Commission. The analogy falls apart at both seams. These are quasi judicial agencies rendering decisions binding on individual parties. What is there of a like judicial nature in the operations of the Open Market Committee, buying and selling Government bills, notes, and bonds; manipulating the market from hour to hour by purchase and sale?

Furthermore, these other independent agencies are not wholly independent. They must have their annual budgets reviewed by the President's Bureau of the Budget and must go before committees of

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Congress for their annual appropriations. The Federal Reserve Board is subject to no such review. It is owned by the banks. It is paid for by the banks. The control that clinches—control of the purse strings—is exercised neither by the President nor by Congress over the Federal Reserve Board.

This is, indeed, a special type of agency, and it is a very special type of independence which it claims for itself. If the current controversy does no more than to bring this up for reexamination, it will have done a good thing.

For our part we think it questionable on its face that an agency owned and paid for by the banks should exercise governmental power free of policy direction by the President. It is bad in theory and it has proved bad in practice.

We have noted, for example, the Treasury Department's account of the Board's lack of cooperation in the period from July 1950 to March 1951—a story of double dealing if ever we heard one.

Senator DOUGLAS. There is some question on whose side the double dealing occurred, I might say.

Mr. MONTGOMERY. This is based on our reading of the reports by the Treasury and the Federal Reserve Board.

Senator DOUGLAS. The Federal Reserve did not make a statement in reply to the statement of the Treasury, and the Treasury's statement is an ex parte statement. I might say the documents in the possession of or which have been seen by this committee indicate that the real story is very different. I make this statement in order to set the record straight.

Mr. MONTGOMERY. If I may express an opinion, too, Senator, we had opportunity only of reading the replies submitted by the two agencies.

Senator DOUGLAS. I have seen the documents involved.

Mr. MONTGOMERY. May I go on and express my opinion.

Senator DOUGLAS. Yes, you may.

Mr. MONTGOMERY. My opinion, on reading the two replies, is that the Treasury addressed itself to the matter of the committee's inquiry, the Federal Reserve Board brushed it off in its usual manner of being above the battle and not concerned with the minor matters that you people are concerned with. The Federal Reserve's response to that important question is not responsive.

Of course I do not have the advantage of these hidden documents that you have seen.

We have observed, for another example, a strong bias in the Board on this subject of credit control. It has asked for and imposed tight controls on consumer credit but has failed to ask for power necessary to prevent inflation of bank loans. Here is the result of its discriminatory policy:

[In billion dollars]

	Consumer installment credit	Commercial loans weekly reporting banks	Total loans all banks
June 1950	12.1	13.6	52.0
July 1951	12.9	19.0	63.7
January 1952	13.3	21.2	67.4
Increase	1.2	7.6	15.4

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I might say, Senator, in the week ending March 19 just reported this morning, commercial loans increased almost a quarter of a billion dollars in one week.

Fortunately, Congress acted in 1951 to curtail somewhat the Board's arbitrary use of its independence in respect of consumer credit.

While failing to restrain inflation of bank credit, the Board turned over the job to a Voluntary Credit Restraint Committee representing banks, insurance companies, and other money lenders. This committee was authorized to coerce banks not to make loans for purposes it does not favor or to borrowers of whom it does not approve. It proceeded to police the borrowings of State and city governments. It frowned on loans to municipalities to acquire power utilities from private companies and it black-balled one such offering in the State of Washington. Loans for this purpose were high-lighted by the committee as inflationary, although private utilities have increased their bank borrowings by more than half a billion dollars during the life of the committee. Fortunately the President just this week directed Mr. Wilson to end this particular phase of the committee's activity. We ask your committee to make a thorough investigation of all the activities of this voluntary committee.

The Federal Reserve Board and its voluntary committee of bankers is now undertaking to kill the public housing program. Originally, the committee quite rightly said it would not restrict loans guaranteed, insured, or authorized as to purpose by a Government agency. Before long, however, Board member Powell, chairman of the voluntary committee, told a press conference of their objections to public housing loans. On February 6, Reserve Board Chairman Martin told the Senate Banking and Currency Committee how disturbed the Board is by the issuance of public housing bonds which, he said, "absorb some of the funds which would otherwise supply a market for * * * mortgages guaranteed by new private construction." He could not have revealed more clearly that he was disturbed not about inflation, but about public housing. Last week, Board member Powell told your committee of the Board's objections to the public housing program and to veterans' home loans. He voiced no objection to mortgage loans on private construction. Is it a proper function of this Government agency to lend itself to the real-estate industry's campaign against public housing? Is this a mark of its independence?

Finally we note in the press that the Federal Reserve Board is making a survey of bank taxes which, the press reports, will be used by the banks to seek action by Congress to reduce bank taxes. The Federal Reserve has already been good to the banks in raising the interest rate.

I hope this committee, in its report, will assess for the public what the resulting increased cost of serving the public debt will be, not merely the actual present cost but what it will be when we get back to the usual ratio of long-term and short-term issues in the public debt.

Despite the higher taxes which Congress quite rightly called on the banks to bear along with the rest of us, they came out of 1951 with only 3 percent less profit after taxes than in 1950, although corporate profits as a whole fell 21 percent between 1950 and 1951. Now the Federal Reserve appears to have put itself at the service of a tax lobby to relieve the banks of bearing their fair share of the burden. Is this an appropriate role for a Government agency?

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These examples of Federal Reserve Board "independence," picked up at random, indicate to us that it considers itself not a part of the Government, but a government apart. We find no provision in the Constitution for a fourth branch of Government.

It is our hope that this committee will recommend measures by which the Federal Reserve Board shall be made to function as part of the Government with the same responsibilities to the Executive and, through him, to the electorate as any other administrative arm of Government.

Senator DOUGLAS. Thank you very much.

You are submitting for the record the letter of Mr. Reuther to Senator Maybank protesting about the action of the Chairman of the Federal Reserve Board in opposing public housing.

Mr. MONTGOMERY. Yes; I would appreciate that.

Senator DOUGLAS. We will do that. Thank you very much.

(The letter referred to is as follows:)

FEBRUARY 19, 1952.

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

DEAR SENATOR MAYBANK: I am advised that at a round-table on mortgage financing conducted by your committee on February 6, opposition to issuance of credit for the financing of public housing was expressed by William McChesney Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System.

From the discussion which then took place it appears that Mr. Martin opposes as inflationary the issuance of bonds by local public-housing authorities for construction under the low-rent public-housing program of any part of the 800,000 starts contemplated for 1952. Under questioning, Mr. Martin made clear that the Board of Governors does not characterize the private financing of 800,000 starts as inflationary.

There are four points which I wish to call to the attention of the committee in connection with this latest statement of Federal Reserve Board policy with respect to public housing.

1. The Reserve Board's disapproval of issuance of credit for public housing, while approving credit expansion for private builders, is an outright discrimination against low-income families who stand most in need of additional housing.

In this respect the Board's position, it should be noted, is consistent with its position on consumer credit. It has stood for tight restriction of consumer credit, which is the only means by which millions of low- and medium-income families can hope to acquire automobiles and other consumer durable goods. Well-to-do and wealthy families are in no degree restricted in their spending by the Board's consumer credit regulations.

2. The Board's position on severe restriction of credit for public housing and of consumer credit stands in marked contrast to its policy and performance with respect to bank loans to private business.

The Board has not asked for authority to impose direct controls on bank credit generally, such as it has asked and received with respect to consumer credit. It has not renewed its request of 1947 for authority to establish special reserves which might provide some effective restraint on the expansion of bank credit. Its only move in this field has been to establish in March 1951 a Voluntary Credit Restraint Committee, composed of bankers, investment houses, and savings and loan associations which has not effectively restrained the expansion of bank credit.

Despite the existence of the Voluntary Credit Restraint Committee, business loans of weekly reporting banks increased by $2½ billion, or 14 percent, in the last 5 months of 1951. More than half of this credit expansion was for nondefense purposes, and $1½ billion of it was for increased financing of business inventories in nondefense industries. Total loans of all banks increased by more than $4 billion during this period.

3. While the Voluntary Credit Restraint Committee has proven an ineffective instrument for restraining loans to private business, it has from the start exerted

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particular pressure against State and local government borrowing. I call your attention to its Bulletin No. 3, issued May 4, 1951, and to the address of Governor Powell May 26, 1951. These documents indicate strong opposition by this voluntary committee to loans for meeting community needs for schools, sewers and hospitals except in expanding communities.

This opposition of the voluntary committee to public financing is most strikingly expressed in its veto of borrowings by public utility districts in the State of Washington for the purpose of acquiring the properties of the Puget Sound Power & Light Co., as reported January 8, 1952. That this action is motivated by opposition to public ownership is sharply emphasized by the fact that bank credit to private utility companies has expanded by several hundred millions of dollars during the past year without interference from the voluntary committee.

4. Chairman Martin's outspoken opposition to public housing loans before your committee represents a reversal of the Board's position with respect to housing financed under the Federal housing program. The program for voluntary credit restraint promulgated by the Board on March 12, 1951, specifically stated that "this program would not seek to restrict loans guaranteed or insured, or authorized as to purpose by a Government agency, on the theory that they should be restricted, in accordance with national policy, at the source of guaranty or authorization."

Governor Powell, Chairman of the Voluntary Credit Restraint Committee, advised Housing Administrator Foley on May 23 that "the program for voluntary credit restraint does not apply to loans to public housing agencies carrying out low rent public housing projects assisted under the United States Housing Act of 1937, as amended, or slum clearance and urban redevelopment projects assisted under title I of the Housing Act of 1949."

At a press conference November 22, 1951, Governor Powell stated that lending institutions are constantly complaining about the inflationary impact of the public housing programs. "The most insistent complaints," he is quoted as saying, "come from the savings and loan associations."

Chairman Martin now advises your committee that the issuance of public housing bonds is of special concern to the Federal Reserve Board because the voluntary committee has been exerting strenuous efforts to keep down the volume of tax-exempt securities.

I submit that the Board's position as stated last March 12—that it should not asume authority to restrict loans guaranteed or insured or authorized as to purpose by a Government agency—was correct.

The decision is one for Congress to make and I urge your committee to take the necessary steps to make sure that the Federal Reserve Board and its Voluntary Credit Restraint Committee confine their exercise of authority to loans not guaranteed or insured or authorized as to purpose by a Government agency.

The need for low-rent public housing, especially to provide for workers' families in critical areas, is desperate. To permit private lending institutions or the Federal Reserve Board or its Voluntary Credit Restraint Committee to destroy that program would create incalculable hardship for middle-income and low-income families. The program which Congress has authorized in this field is certainly a minimum one, and it is unthinkable that the Chairman of the Federal Reserve Board would propose to confine the housing starts of 1952 to high-cost, high-rent units which only well-to-do families can afford.

Sincerely,

WALTER P. REUTHER,
Chairman, National Housing Committee, CIO.

Senator DOUGLAS. The next witness is Mr. Herschel D. Newsom, who is a farmer and master of the National Grange, formerly master of the Indiana State Grange, and a member of numerous public bodies. Mr. Newsom.

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE

Mr. NEWSOM. Thank you, Mr. Chairman. I should like to say first of all that I make no claim at all to being an economist, and I have never been a director of even any local bank. I am a farmer in Indiana, farming on land that is being farmed now by the fifth gen-

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eration of the family. So my remarks will be made entirely from that particular point of view, from the point of view of a farmer who, I think it might be appropriate to point out, at this time, right now, is in the rather unusual position, as I see it, insofar as being compared with his fellow Americans is concerned, of using a rather rare combination of "current" labor and what I choose to refer to as "stored" labor.

The right to store up the fruits or value of labor or productive effort in money or other valuable property purchased by income from that labor or effort and have assurance of a reasonably constant value of that money or other property is fundamental to the pursuit of happiness that has been basic to Americans. I am trying to say to you that the capital requirements in agriculture are terrific now. I am reminding you that the capital required to furnish a full-time employment within this modern agriculture of ours is the highest capital investment of any industry in America by a rather substantial figure.

I am saying that we have a dual concern then in this matter of reward not only for current labor but reward in some reasonable balance upon our stored labor, or our capital investment.

Frankly, I have been a little bit alarmed at certain attacks that have been made on the earning power of stored labor. I have been more than alarmed at the not necessarily deliberate but persistent attack that has been made on the value of that stored labor, not only its earning power but its real value, and I say to you it is my firm conviction that as a Nation and as a Government by ourselves we have no moral right to so nearly destroy the value of stored labor as we have done in recent years. The figures that I have in mind, are, to some extent, round figures, but they are the figures from which my impressions have been developed.

For example, as I recall the figures, our total money supply in December 1939 was something in the neighborhood of $36 billion. Our total money supply in December of 1950 was something in the neighborhood of $118 or $120 billion. That, according to my arithmetic, means that we increased the volume of our money in this country by some 228 to 230 percent.

Now in that same 11 years' stretch of time we were able somehow or other to increase our total production by a little less than 100 percent.

The only reason under the sun that prices did not increase by the full 228 percent, as the money supply increased by that amount, was the fact that we did increase production.

So the value of the stored labor, or we will say the savings for our widows and our children, had declined.

So prices increased and money declined in value by the figure determined by the 100-percent increase in production and 228-percent increase in the volume of money, and I believe the figures are that prices actually rose by 127 percent in that 11-year period of time.

Now that was no accident, that was nothing except the result of our inflationary practice, and the result of our expanded volume of money supply.

Of course I concede right off the reel that perhaps we did not have too much choice in all of the factors that brought this into being.

As I look at it I remind you, from the point of view of an Indiana farmer, the necessity of paying our way through World War II, and

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through the results of that effort probably meant that we had little choice, maybe even no choice, in the matter. But, nevertheless, the fact remains that that is what happened, and we must take a lesson out of that experience.

That, in effect, partially states my conception of the farmer's interest and stake in a monetary policy. I would say that my lay point of view in considering the thing clearly indicates that we must guard judiciously against increasing the Government debt, because I think that was, no doubt, the major factor in this increasing supply of money and its declining purchasing power.

I would say, too, when we view the situation as it developed in fiscal 1951, we realize that in that particular year we had a budgetary balance, or surplus, of about $7½ billion, and that by reason of that and certain credit policies, that I think were to a large extent sound, we did decrease the total money supply of this country, in that particular period of time, up to June 1951, in the amount of about $3½ billion and incidentally lowered the turn-over rate.

Let us look at the thing that happened to our farm prices and to the prices of basic commodities at the same time. They went down somewhat, and, as a matter of fact, the net farm income declined by 21 percent in those months, and I think that decline in farm income and in basic commodity prices was largely because of the decreased money supply, coupled, of course, with the lower turn-over rate (the less number of times that the dollar was actually put into use) which was perhaps, to some extent at least, caused by certain credit policies of the Federal Reserve Board, which perhaps it might have been a mistake to terminate as we did a year ago last June.

Frankly, I am a little bit disturbed at the action of the Senate committee yesterday in regard to their refusal to reinstate, or to make possible the reinstatement, of certain credit restrictions at the hands of the Federal Reserve Board. I try to recognize that regulations X and W, for example, probably were not too well conceived, and maybe they were a little rigid at that time, and that is what required the Congress, in their effort to protect the interests of all the people, to bring those regulations to an end.

Somehow or other I think it should be possible to reinstate those regulations at this particular time.

The Grange policy, as an organization policy, is not too complete on this subject matter. I am injecting some of my own personal impressions here.

It is my firm conviction that the Federal Reserve Board should always be responsible to the Congress and be an agency of the Congress of the United States. I believe that the monetary and fiscal policies of this country should largely be formulated by the Federal Reserve Board and not by the Treasury, an executive department of the Government. That, in turn, imposes immediately and continuously an increase of responsibility on the Congress, which is the only place that I know that it is safe for us, over a long period of time, to rest responsibility, and I think it is in compliance with the Constitution, in compliance with the basic law of this land of ours, that we do rest it there. I think the law imposes the basic responsibility on the Congress to see that the Federal Reserve Board operates within the policy laid down by the Congress, and so even though I have a basic difference of opinion from that which the majority opinion of the Sen-

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ate Committee on Banking and Currency yesterday seemed to dictate. I like the policy of their determining what the Federal Reserve Board shall do. If what I said leaves any implication that they made a mistake, I say it is a mistake in my judgment only in the matter of their particular finding, but I like that procedure. That is the way the rules of the Federal Reserve Board must be established.

Probably I have used up the time that I had assigned to emphasize the importance of this thing that I referred to as the necessity for a reasonable balance between the earning power of our "stored labor," which we have been willing to save, rather than to put into the consumer market immediately and the value of "current labor" in and out of our own industry. I think we must have encouragement for the saving, as an incentive for investment in productive enterprise. That is why I say I am so much concerned about the value and the earning power of our "stored labor," as well as our "current labor."

The fact that we haven't done a very good job of preserving that value is reflected, in my opinion, by the fact that between December 1, 1950, and December 31, 1951, the agricultural loans of this country in the national banks increased by 28 percent.

Of course we could make quite a point, and I think it would be entirely appropriate to make that point, out of the fact that also reflects lack of balance, lack of adequate earning power within agriculture itself.

The major portion of that inadequate earning power in agriculture was in this stored labor. As a matter of fact, though small compared to other labor, we could show a reasonable return on certain current farm labor last year, provided we show no interest on capital investment or no return on our stored labor, and I think that is about the way that the situation stakes up.

I would like to call the committee's attention to the fact, too, that the Production Credit Association loans, which again reflect increasing cost of operation and, to some extent, the continuing effects of inflation, insofar as our costs are concerned—when we are experiencing some deflation insofar as income is concerned—that the Production Credit Association loans increased by 22.8 percent.

The point I am making is just this, that I am as much interested and concerned, I think, as any layman, anybody that does not understand the problem perhaps better than I about a balanced budget and about retiring the Government debt, it seems to me obvious that it is the major responsibility of the Congress in this critical period to determine how much budgetary surplus, in the event we get to the place that we can retire the debt, how much budgetary surplus is desirable in the interest of our economy.

I have modified my feeling in the year I have been in Washington a little bit about how fast we dare pay off the debt when I see what a small budgetary surplus did about prices of basic commodities last year, and yet I know we must retire the debt.

Senator DOUGLAS. You don't think there is imminent danger, do you, that we are going to have such large surpluses?

Mr. NEWSOM. It is my opinion, Senator, that the major responsibility of the Congress, as I see it—and perhaps the Congress has long ago accepted that responsibility—is that we should early in each session determine how much budgetary deficit or surplus the total economy of the country can well stand or absorb, and then basically I

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believe it is sound that we should depend on the Federal Reserve Board, under the supervision and within the jurisdiction of the direct representatives of the people of this country, to carry out the policy.

Senator DOUGLAS. Thank you very much, Mr. Newsom.

The next participant is Boris Shishkin, who is the economist for the American Federation of Labor and has been for many years. He is Secretary of the Federation's housing committee and the committee on social security, and has been, I believe, in the past, Director of the European Labor Division of the Economic Cooperation Administration. Mr. Shishkin, we are very glad to have you with us.

STATEMENT OF BORIS SHISHKIN, ECONOMIST FOR THE AMERICAN FEDERATION OF LABOR

Mr. SHISHKIN. Thank you, Mr. Chairman. I am very glad to have the opportunity to join in this panel before this committee. I want to present a very brief statement indicating some of the things that we consider vital. I would like to preface that by saying with regard to debt management, credit, and monetary policies, the organization I represent has not made any specific policy decisions that could be expressed as a policy, but at the same time, on the issues involved here, organized labor has taken into account and expressed itself on a large number of issues that really add up to fairly definite and concrete policy approach.

There are many elements in the present situation and problems that we are discussing here that concern us a great deal. I want to make brief reference first to some of the underlying considerations.

The decisions made and actions taken by the Congress and the various agencies of the Federal Government in shaping the economic policy of the Nation are too often warped by the notion that these decisions and actions are valid for their own sake. The economic policy of the Government is only a means to an end.

Policy judgments with regard to the budget, taxation, credit, and monetary policies can, therefore, be properly evaluated only in the broader framework of the Nation's economic goals.

The peacetime goals of economic policy are well stated in the Employment Act of 1946. The responsibiilties of the Federal Government to concert its policies toward the achievement of that goal are likewise stated in this act. Yet today the American people are confronted with a threat to their institutions and to the Nation itself.

The ability of the Nation to meet this threat—the threat to our survival—is at present the overriding consideration in all our policy decisions. In other words it seems of extreme importance to recognize the futility of establishing one particular theoretical precept or one particular framework of policy decision, and ignore the larger considerations of national policy that are not, in themselves, either physically or even more broadly economic.

Another force which compels us to give priority to some actions over others is the force of events which is bringing our lives into a much closer relation with the rest of the world. When we are dealing with the question of the public role with regard to investments, the need to recognize the necessity to find ways and means to afford an expansion of investments and to take new steps to safeguard the pre-

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vailing risks that are involved in foreign investments is cooperative to the extent that our country is brought into closer relationship with the rest of the world.

These two problems, the problem of mutual defense and prevention of world war III, and the problem of bringing our productive resources and economic activities into harmony with those of other free nations, are the paramount and the immediate objectives of national policy which must govern all other decisions.

In other words, fiscal credit and debt policies are dictated not only by the fundamental objective of maintaining and encouraging maximum employment of men and of physical and institutional resources of the country, of furthering the growing and expanding economy, but also of meeting the larger challenge confronting the Nation: Its stature and status of its people.

Labor does not believe that a static policy dealing with many aspects of economic equilibrium is proper or defensible. Economic policy must be dynamic.

Labor believes that the budgetary policies of the Federal Government should be sound. By the word "sound" I mean that the Federal Government should be in a position to provide the services necessary to carry out its duties to the people and at the same time to approach as closely as possible the meeting of the cost of its investments and expenditures out of the current income. And by "current income," I do not mean income in the same month, or even in the same year, but income that the current growth and the economic yield of that growth in the shortest practical span of time, and not greater than the productive span of time of the same generation.

The end of the budgetary policy is not to balance the budget annually. In fact, an annually balanced budget may be neither feasible nor desirable. The purpose of the budgetary policy is dictated by the larger requirements of the Nation's security and economic welfare.

The far more important problem is not the elimination of the deficit but the management of the deficit and the manner in which the deficit is met. The same applies to the problem of debt management. Debt management had, of necessity, to pursue a set of different objectives in the recovery period of 1932–40, in the wartime period 1940–46, in the postwar period 1946–50, and in the present post-Korean phase, the defense period at the present time.

Much attention has been paid to the question of how much or how large is the public debt and not enough attention has been paid to the question of who owns the debt, and the equally important question of the composition of the debt.

There have been some developments that are quite important and I think throw an important light on the problem that has been under discussion this morning. The figures that we have on the changes in the ownership of the public debt in the period following 1946 would indicate rather significant shifts. For example, the largest single change in any single class of investors was a reduction of almost $26 billion in the holding of commercial banks. The reduction in the holdings of the Federal Reserve banks, however, was less than $1 billion. It was purely nominal. There was a slight decline in the holdings of the savings banks, about $1.3 billion, and about $8 billion decline in the holdings of the insurance companies. There were increases in the the other sectors, not large increases but significant

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increases: Other corporations and associations, an increase of $3.2 billion; State and local governments, $1.5 billion; individuals, $2.6 billion, $2 billion in other categories; and Federal Government investment accounts, $12 billion.

This throws light on the fact that in the current approach to the debt, the reductions in commercial bank holdings did not in themselves fall into a pattern of an affirmative coordinated policy by the agencies of the Federal Government. In other words, you can see that the policy was dictated by the immediate considerations of the Treasury for immediate need for money.

The transfer of the debt to some extent from banks and banking institutions into the nonbanking sources did occur, but the Federal Reserve Board policy did not contribute to that. I am merely using that as an illustration, because I cannot, in the very short time here, go into detail and analyze the problem. I am using the illustration simply to point out, and I think it is important to point out, that the question of debt management and the part that it plays in the current problem must be put in the proper perspective; that debt management cannot accomplish a great deal toward arresting inflation if the approach is made primarily on the basis of considerations of meeting the immediate cash needs of the Treasury.

But debt management can contribute to economic stabilization a great deal if it is used to reinforce both the fiscal and the monetary policy. So here is the real testing ground for the argument that has already been made, which is now before this committee, for closer coordination between the agencies responsible for the several parts of our monetary, credit and fiscal policy. We should bear in mind that fiscal policy not only determines the Government receipts and expenditures but it also determines the size of the public debt and, consequently the amount of the outstanding debt. Monetary and credit policies, on the other hand, should be formulated to provide for noninflationary absorption of the public debt. Private debt, which is extremely important and which has been rather dramatically left out of the major considerations in our dealing with the problem of inflation in the past 2 years, presents an extremely vital problem.

What I wanted to emphasize in this is that when we are dealing with the present problem we have to recognize that we are still in a phase, of necessity, of inflation. Inflation has come into a new phase, a different phase but, nonetheless, it provides a very special problem in our dealing with the defense segment of our entire policy, both in terms of the amount of expenditures and in terms of the alinement of our resources to support the defense program. That, I say, is still there. The present soft situation should not be misleading.

The kind of adjustments that are taking place are the result of quick inflation which was highly speculative in the initial phase. The first post-Korean phase, was to a large extent speculative and noneconomic in terms of the volume of goods, services, and money available, and in the direction of transactions that went on. The post-Korean speculative cycle, despite subsequent readjustments, still leaves us, in the latter part of this year, with a very serious danger of further inflation that must be met through sound policy.

Now this problem at hand cannot be met solely through the kind of isolated dealing with it that has sometimes been suggested. We feel

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that we need price and wage stabilization policies to be carried on, and labor has supported them. But labor has supported those policies with the understanding that the equally important set of policies will be applied on the monetary credit and tax side.

We are not going into the question of what can be done on taxation. We have made specific recommendations on that and have pointed out both the inequities, loopholes, and the positive means through which a more equitable tax approach could be made that would be anti-inflationary.

In terms of the credit and monetary policy I would like to reinforce the point that has already been made, and that is that the approach that has been made toward the consumer, toward the worker or the family in need of a place to live is one that is completely differentiated from the need of the business community for funds. There has been no equity in the approach as between the two segments. In other words, the selective controls under regulation W and regulation X, regressive as they are, have been much more insistent in providing a limitation on the amount of consumer credit available for the necessities. Yet in the case of the business community there has been no real attempt made on the part of the Government to provide that insistence.

As to the relationship between the Federal Reserve Board and the rest of the economic policy of the Government, we feel it is extremely important to accomplish one result, and I am not going to attempt to spell out any specific recommendation as to how it should be made, and I don't know whether at this stage it would be wise to make a specific recommendation of that kind. But we do feel that the Federal Reserve policy needs to be concerted with the broad requirements of national economic policy, a policy which obviously is subject, in its entirety, to congressional review, which is the ultimate source of policy making. But within the executive branch of the Government there needs to be harmony achieved so we will not have contradictory or conflicting purpose pursued by one agency simultaneously with another. It certainly needs to be started by a direct operating relationship among the representatives of the Council of Economic Advisers, the Treasury and the Federal Reserve Board, there is no question about that.

Finally, it seems to me in any agency such as the Federal Reserve Board, which is a bankers' institution, which is divorced to a very large extent of direct control even by the Congress, and certainly by any executive agency, there is need for consultation with public interest groups.

I am not proposing any advisory committees for the Federal Reserve Board of Governors, or anything of that sort. I am proposing a kind of machinery that has been used, for example, by the Council of Economic Advisers, which has provided means for consulting with all the representative groups and taking into account the current views on the part of the public. In this way, the Board of Governors, which is now just above the angels, can be brought down to earth, in order to find out and take into account the interests and necessities of the public which they serve, beyond those of the select fraternity of bankers.

Those are, in a very general way, the recommendations, Mr. Chairman. We feel, at some stage, it might also occur to those concerned

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with the operation of the System that those involved in the operation of the Federal Reserve System might consider the general public, to include a few men who labor, or who have been in the position to express the labor point of view. Now there have been men in the individual Federal Reserve districts who have been drawn from business, who have been drawn from among the farmers. Mr. Kline is one example of it. He served as a director because he represents a farm organization. But it has yet to happen that the public, as defined by the Federal Reserve System, would include labor.

Now I am not asking for labor representation as such, all I am suggesting is that labor is a member of the public and it should be taken into account.

Thank you.

Senator DOUGLAS. Thank you very much, Mr. Shishkin.

The final witness is Mr. Jerry Voorhis, who, for 10 years was a very valuable Member of the House of Representatives and for the last 5 years has been secretary to the Cooperative League of the United States of America, and who has given a great deal of very careful consideration to the question of money and credit. We are very glad indeed, Mr. Voorhis, to have you take part in the discussion.

STATEMENT OF JERRY VOORHIS, SECRETARY, COOPERATIVE LEAGUE OF THE UNITED STATES OF AMERICA

Mr. VOORHIS. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, and members of the panel:

Cooperatives are owned, controlled, and patronized by large numbers of little people—people of small resources—who by means of cooperatives are able to participate in significant ownership, responsibility, and decision making. The interest of the farmers and consumers who make u the cooperative membership is the same as the general public interest of the whole Nation. So when that general public interest is involved the cooperatives are eager to do what they can to advance and protect it.

Inflation and deflation are wrong, economically and morally. They are violations of contracts, they take bread from peoples mouths, they stifle Nation's production. Inflation means that the money supply is being increased faster than the supply of goods or services to be purchased with that money is being increased. Deflation means that the supply of money is falling below the amount needed to maintain an active demand for the goods and services that are being or could be produced. Both conditions create severe economic maladjustments; both unjustly benefit certain sections of the population at the expense of others; and both could be prevented, if rational monetary policy were laid down by Congress and rational action in the field of money, credit and debt were taken.

We have never in all the long history of this Nation either adopted such a policy or followed such a course of action. We are probably closer to doing so today than has been the case for a long time. The holding of these hearings by this subcommittee, the membership and chairmanship of the committee are good omens indeed.

Furthermore, some sensible things are being said, written, and spoken. Statements are being made now, and listened to, which a

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few years ago fell on relatively deaf ears when some of us made exactly the same statements in Congress. For example, the Federal Reserve Bank of New York has published an excellent pamphlet entitled "A Days' Work" in which we find this statement:

A commercial bank, unlike any other business, can "manufacture" money in the form of checking account deposits. A borrower signs one piece of paper promising to pay the bank a certain sum on a certain date and the banker enters on another piece of paper a deposit in the borrower's checking account.

Even more pointed is the statement of Mr. Charles E. Wilson, president of General Motors Co. in his speech at Michigan State College last October 17, backed with charts and statistical data, to this effect:

Changes in the money supply preceded all sustained changes in the Consumer Price Index. There is not a single instance in which the cost of living has risen appreciably and the rise been sustained except after a prior substantial increase in the money supply in excess of the trend line of need for the country.

In other words, Mr. Wilson is telling the Nation as some of us, including the chairman of this subcommittee have been doing for years, that since 1939 the dollar has lost almost half of its buying power more unhealthy depressions are the result of monetary causes.

President John Adams told us that 150 years ago when he said:

All the perplexities, confusion, and distress in America arise, not from defects in the Constitution or confederation, not from want of honor or virtue, so much as from downright ignorance of the nature of coin, credit, and circulation.

The historical record is not a pretty one. Most people know today that since 1939 the dollars has lost almost half of its buying power due to inflation of bank-credit money. Many people know that between June 1950 and December 1951, the banking system created over $12 billion of new money and loaned it into circulation. Practically everyone knows that this resulted in an increase in wholesale prices of nearly 16 percent. But most of us may have forgotten that in December 1915, using 1926 as base, the dollar had a buying power of $1.35, that this fell to $0.59 by April 1920, rose again to $1.01 in the following year only, during which time farm prices fell to about half their former figures.

Today we hear more alarm about inflation than about deflation. Most of the factors in the present situation, especially the devoting of about a fifth to a quarter of our total production to military supplies which cannot be purchased by those receiving wages or profits for producing them, are inflationary factors. But in my opinion we should view the whole problem as one problem, recognizing that the worst thing about inflation is not the inflation itself so much as the deflation and depression which thus far have always resulted from it.

Of the two evils deflation is the more devastating, the greater threat to our valued institutions and the more difficult to remedy—unless some more or less new measures are applied to it.

While inflation gradually robs every possessor of money in the land of a portion of that money and corresponding benefits debtors, it is nonetheless usually accompanied by full employment for labor, a high volume of business activity and prosperity for the farmer, whose prices are probably more subject to fluctuations in response to monetary influences than those of any other group. Furthermore, a net reduction in the real debt burden, especially where the public debt is very large, has certain desirable aspects to it. Finally, the remedies

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for inflation, while seldom, if ever, yet effectively used, are readily available, with one exception and generally recognized as constructive and acceptable measures. Those remedies, of course, are increased production, taxation, and regulation of the creation of money by the banking system. In the case of deflation, every debt must be repaid in dollars which represent more command over real wealth than they did when they were borrowed. If a 50-percent deflation takes place, for example, a farmer must pay his debt with twice as large a physical volume of crops as would have been required when he contracted the debt. Furthermore, deflation brings about economic stagnation in an economy such as ours.

Mass unemployment of labor and loss of ownership by farmers and other small producers results. The burden of debt multiplies. Since we at present are lacking the decency and intelligence to employ any method of increasing our money supply excepting that of increasing our debt to the banks and since few people in their right mind desire to borrow money that must be repaid in dearer dollars than those they borrowed, the deflation feeds upon itself until the whole economic structure threatens to collapse completely.

In the days before 1929 the classic remedy for deflation was a period of bankruptcy, which while painful and utterly unjust since it tended to the further concentration of property ownership, did have the virtue of wiping out a large portion of the debt.

In the early thirties, however, we decided that we could not stand the bankruptcy remedy for deflation any longer. At bottom what the New Deal represented at least in its early stages was a refusal of the Nation and especially its business community to go through bankruptcy. So what happened was that the Government assumed a great proportion of the private debt that had been contracted by home owners, farmers, business, for example, and itself went into debt to the banks in order to induce them to create the necessary money for the Government to make this operation possible.

In all this discussion it is important to remember that not since the administration of Abraham Lincoln has the United States Government created a single dollar of money of any sort (unless we count such things as silver seignorage). The commercial banking system has been given by Congress that particular aspect of national sovereignty and the commercial banking system alone creates our money supply—or fails to create it as the case may be. During World War II about $108,000,000,000 of interest-bearing Government bonds were given to the banking system for newly created demand deposits on their books, for which no reserves at all, not even fractional ones, were required.

Few will advocate that now, in the face of the fact that it is precisely what the forces of world communism are waiting for, we should contemplate for a moment permitting another period of deflation, mass unemployment, and bankruptcy.

But if we are not to use the bankruptcy road then the only other remedy for deflation is an increase in the supply of our medium of exchange to a point where the natural human need for goods and services will be able to express itself in effective demand in the economic sense. But so long as the commercial banking system—in which I include the Federal Reserve banks—continues to be the sole source of newly created money, the only way to bring about such an increase

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in the money supply is either to persuade private individuals to borrow newly created demand deposits from the banks or else for the Government to still further increase the public debt. Since there is no known way to make people or businesses borrow money against their own personal interests the one method of overcoming deflation that remains to us under present circumstances is a further increase in the public debt.

This is a deeply serious problem because in a dynamic economy where productive capacity and population tend to increase there would be deflation rather than stability if the money supply did not gradually increase from year to year in proportion to the expansion of the economy. The amount of such required expansion is probably between 2 percent and 3 percent a year. I believe our money supply today is about $124,000,000,000. Well, over a period of time that addition to the national debt of let's say 2½ percent of the money supply each year would simply mean a constant increase in that debt until its burden became absolutely insupportable. Already interest charges are $6,000,000,000 a year. In an astronomical budget of over $80,000,000,000 this $6,000,000,000 seems not so large. But suppose we should some day get back to budgets of $30,000,000,000 or so. By that time interest charges may well amount to $10,000,000,000 or more, especially if the rate of interest on Government securities goes up as is likely and if further deficits are allowed from year to year.

The fact is that the only times in modern American history when jobs have been plentiful have been times when the debt of the people was increasing. From 1922 to 1929 total debt, public and private, increased from $124 billion to $174 billion and in these years the value of our production rose from $73 billion to $110 billion. But from 1929 to 1932 the total debt fell from $174 billion to $157 billion, and millions of people lost their jobs as the value of national production dropped from $110 billion to only $58 billion in 1932.

Another example is in 1937. Total debt had been increasing slowly under the forced draft of governmental borrowing and spending. But in 1937 an attempt was made to balance the budget and in a period of a few months total debt went down about $1.5 billion. But this apparently small decline in the debt caused production to fall off from $113 billion in 1937 to only $89 billion in 1938 and the Government took to borrowing and spending again on a much larger scale.

With the coming of the war we began to go into debt as never before in all human history. And, for the simple reason that there was an almost unlimited demand for goods backed by enough money to pay for them, America's production increased to more than double the previous all-time high and so many jobs were created that there were not enough workers to fill them.

What then should we do if we are to free our economy for the kind of assured dynamic expansion of which it is capable and which it could, I believe, achieve if reasonable stability of the buying power of the dollar is to be maintained?

First we should prevent further inflation now. Governmental deficit financing is inflationary and should be avoided. To the extent that the expenditure side of the budget can be safely trimmed that of course should be done. To the extent that a deficit appears still to be likely taxes should be increased to meet it. In stating these measures so bluntly please do not mistake me as implying that they

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will be easy to take. I only say they are necessary elements in effective inflation control, assuming that inflation is still our primary concern at the moment.

Every effort should be made to increase production especially in fields where monopolistic bottlenecks are holding it back. Price controls should be used where really necessary to prevent such extortionate increases as have taken place in some commodities which are vital to the defense program, though all price controls should be recognized as temporary stop-gap, not real solutions. And finally, the creation of further money by the banking system should be stopped or at least regulated to the real needs of the economy for further monetary expansion. Much has been said of the central importance of the support of the price of Government bonds by the Federal Reserve banks as a factor in the further inflation of our money supply. This brings me to the missing factor in our ability to control and prevent inflation. That missing factor is the restriction on the Federal Reserve Board's power to regulate reserve requirements in the banks. It is true that under present circumstances support by Federal Reserve of the price of Government bonds leads to the creation of additional reserves in the banks and hence makes possible more inflation. But I do not think with the size of our present debt we can lightly contemplate an increase in the rate of interest on that debt, even though I agree that this is less serious than a continued severe inflation. The missing factor in the picture is this. If the Federal Reserve Board had the power it must have if we are ever to seek monetary stability in earnest—namely the unrestricted power to regulate reserve requirements then it would be entirely possible for the Federal Reserve to support the bond market and at the same time to prevent this action from resulting in any multple expansion of the money supply. The addition to the money supply would then be limited to the amount of reserve bank credit created by the Federal Reserve itself in the purchase of bonds. I do not believe this would be serious. Indeed it might be the best means of all of providing the proper expansion of the money supply which we need to feed the physical expansion of our productive capacity.

Senator DOUGLAS. Mr. Voorhis, this is a very important point that you are making. I wonder if you would develop that a little bit more fully? ' You say the reserve requirement should be raised as the Federal Reserve Board purchases Government bonds.

Mr. VOORHIS. I am saying that at the time that it was done, to which you have referred and to which Mr. Kline referred, that under the circumstances that existed at that time, that I think the proper thing to have done was not necessarily to have permitted interest rates to rise or the interest on the Government debt to increase, but that had the Board not been limited in its power to regulate reserve requirements it could then have increased the reserve requirements by whatever amount was necessary to offset any increased expansion possibilities that its purchase of the bonds from the banks might have created.

Senator DOUGLAS. You are saying as the Reserve purchases more bonds from the banks and hence builds up the amount of dollar reserve which the banks hold in the Reserve System, that the reserve ratios would be increased, so the amount of bank loans which the banks themselves could make cannot expand.

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Mr. VOORHIS. That is right. But under the present circumstances that cannot be done effectively because of the top limit on the amount of reserve ratio that the Federal Reserve Board can require of the commercial banks.

I cannot refrain from adding that I do not see how we can ever have a smoothly working monetary system—or one that is in accordance with our Constitution for that matter—until the principle of 100 percent reserves at least for demand deposits has been established and the creation of money made an exclusive function of a central bank of issue.

And I would like to ask this question: What would be wrong with regarding Government bonds purchased by the Federal Reserve Board in this manner as having been thereby retired and the debt reduced by that amount? I know there will be several answers—some of them in a tone of shocked surprise. But if we are supposed to regard the Federal Reserve banks as central banks of the Nation then no objection can logically be raised to this proposal, and if we are to regard them as essentially private institutions the only act more immoral than inflation and deflation is the act of giving them the unlimited power they now possess to create the Nation's money and charge the Nation interest on it.

Finally, what should be done in case of a threat of deflation? Just the opposite of course of what should be done to check inflation. The cure for deflation is expansion of the active money supply. The easy answer is to say that the Government should run a deficit and thus let the present generation saddle the next one with the cost of overcoming our deflation. This means a further increase in debt, and what is more serious, it means, if experience is any teacher at all, that, because of the justifiable fear of mounting debt the deficit financing will not be great enough in amount to actually overcome the deflation and prevent the depression. During the New Deal period unemployment was not overcome but only reduced somewhat until the war came and caused gigantic deficit financing. It seems to me we must find a better, more reasonable way. Taxes should be reduced in the face of a deflation. That is fundamental it seems to me. Credit restrictions should of course be eased. But you cannot push a string and however much you may ease credit or cause excess reserves in the banks you will still not have uncovered any major formula whereby you can get willing borrowers together with vice presidents of banks. No, the correction of this deflation depends on getting the money out into the hands of people who will spend it. Reduction of social-security taxes while continuing full benefits might do part of it. Paying off part of the debt might do part of it, especially if the debt were widely held. In that connection I think what Mr. Shishkin had to say of course was entirely pertinent. But the desirable gap between Government revenue and Government expenditure which is the key to overcoming deflation should be closed not by further increase in debt, not be giving away Government bonds to banks to induce them to create the Nation's money. Rather since the whole Nation needs desperately at such a time an increase in its money supply, and since such an increased money supply will bring about increased production of real wealth to support it, therefore, the Nation's credit should be employed directly and without interest payment to anyone to accomplish this purpose.

To this end exactly the same process by which the Federal Reserve

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banks now create reserve bank credit could be used. Federal Reserve could buy non-interest-bearing bonds from the Treasury; or it could simply set up a credit for use by the Social Security Board. Or if Robin Hood's barn is still important, Federal Reserve could buy interest-bearing bonds from the Treasury and the Congress could re-enact the franchise tax which was in the original Federal Reserve Act and repeated in 1934 and which required that all the surplus of the central Federal Reserve banks after the 6-percent dividend to stockholders and after accumulation of, I believe, a reserve equal to 40 percent of capital should be paid into the Treasury for debt retirement purposes.

Rational monetary credit and debt management is possible. It will take courage and vision. It is worth both. For it would give our agricultural and industrial economy, a chance over the long run to expand and flourish, without the danger of having contracts involuntarily altered by changes in the purchasing power of money and without the necessity of being periodically rescued by huge military expenditures, foreign-aid programs, or some other form of colossal waste.

I have only one other thought and that is that the Federal Reserve Board is today nearly as important as I would envisage having it under these circumstances. I think it is no more sensible to have it composed entirely of bankers, than to have the Interstate Commerce Commission composed entirely of railroad executives, or the Commission on Gambling to be composed entirely of gamblers.

I don't mean that in any sense of disparagement, the only reason I say that is to make my point and that is I don't believe any public or quasi-public body should be composed of people with direct interest exclusively. I think it should be representative of the broad public interest.

Senator DOUGLAS. Thank you very much.

We have now reached the hour of 12.

Representative WOLCOTT. There is just one thing, Mr. Chairman, that ought to be cleared up for the record. There seems to be quite a disparity between Mr. Kline's statement and Mr. Lincoln's statement. I wonder what, if any, connection or affiliation there is between the Farm Bureau Federation and the Farm Bureau insurance companies.

Mr. LINCOLN. We are separate institutions.

Representative WOLCOTT. I assumed you were because of the nature of your statements. I did not think it was possible that you represented the same institution.

Mr. LINCOLN. Neither of the two have any relation to each other. He represents the Farm Bureau Federation as an organization, and I just simply represent a series of companies with the "Farm Bureau" name on them.

Senator DOUGLAS. The American system is based on the principle that we can have unity in diversity.

Mr. LINCOLN. I don't think there is any significance at all, Mr. Wolcott, in the similarity of names.

Senator DOUGLAS. Does that answer your question, and is that the only one that you want to ask?

Representative WOLCOTT. It was the only one. As you suggest, there would be difference of opinion. Perhaps I thought it should be cleared up.

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Mr. LINCOLN. Although I am a member of the Farm Bureau, too, both locally and State-wise.

Senator DOUGLAS. Congressman Bolling, do you have any questions?

Representative BOLLING. I have no questions, Mr. Chairman.

Senator DOUGLAS. I regret that I must leave in 2 or 3 minutes on another engagement.

Representative WOLCOTT. I think we will have a call in the House almost momentarily.

Senator DOUGLAS. If the members of the panel would like to continue this discussion with each other, that would be perfectly acceptable.

Mr. Kline, do you have any comments that you would like to make on the testimony this morning?

Mr. KLINE. I can think of a great many comments, Mr. Chairman, but if, as seems likely, you are about to conclude, I am happy to rest with the original statement.

Senator DOUGLAS. Mr. Lincoln?

Mr. LINCOLN. No.

Senator DOUGLAS. Mr. Montgomery?

Mr. MONTGOMERY. No, Mr. Chairman.

Senator DOUGLAS. Mr. Newsom?

Mr. NEWSOM. If it is in order, I would like to make one brief comment, and it is perhaps by way of elaboration of the point I tried to make which I now think maybe I did not make too well, and that is that there is, to the agricultural producers and perhaps to the other producers of basic commodities, a very real danger in too rapid restriction of credit policy, as witness the thing that happened to our agricultural productive plan in 1920–21, and through 1929, and I have the very firm conviction that you cannot do that kind of damage to agriculture or any other segment of the economy without wrecking the whole economy.

Senator DOUGLAS. On the other hand, you do not want the supply of money and credit increasing much more rapidly than the increase in the flow of goods and services?

Mr. NEWSOM. Exactly. I just had the fear that maybe I overemphasized the statement you just made and failed to give proper consideration to the one I made just now.

Senator DOUGLAS. Mr. Shiskin.

Mr. SHISKIN. I had one more point in the way of possible constructive contribution, that I don't know whether your committee has had under consideration, and that is the point I made with regard to the distribution into the public hands of the public obligations. There is a very urgent need to review the status of the present defense bonds.

Senator DOUGLAS. Would you suggest raising the interest rate?

Mr. SHISKIN. To bring them in line with interest rates that have risen. I don't know whether that in itself will make for a very great change, but in the context of other changes with regard to the holding of bonds, the bonds can be made more attractive and the interest rates should be made higher.

I just have one other comment, particularly on what Mr. Voorhis said. Since we do not seem to be all on quite the same track with

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regard to the timing of this, I think it should be recognized that what I said and tried to emphasize so hard in the present phase of our defense is that we have to take into account that we are living in a world in which the Kremlin has taken the initiative. We are meeting it. We are in the defense period, but we must not overlook the fact that if our approach is right, and I believe it is, and peace has been won and there will be no war, we are facing a certain day which I shall call VP-day, victory for peace. At that time when we are sure that this task has been fulfilled, the future stability of our economy must be assured. The imbalance that is going to be encountered has got to be envisioned at this time and plans have got to be made in advance. Therefore it is one of the paramount problems in the realm of a fiscal policy to be considered at this time.

Mr. VOORHIS. I only would like to say, Mr. Chairman, I think the most distressing state of mind of any human being is the state of mind of the Member of Congress when he is in one place and he knows he ought to be in another one, and I would not, therefore, extend this discussion beyond the point that you have time to discuss it.

Senator DOUGLAS. I would like to make one or two comments on your paper, Mr. Voorhis, which is very interesting. I think there is now general acceptance of the fact that banks create monetary purchasing power.

Mr. VOORHIS. Yes.

Senator DOUGLAS. That has been developed time after time. Private bankers have admitted it, and Reserve officials have admitted it, so I think that has now become accepted as a fact.

The second thing that I think is established is that the Federal Reserve System is a public institution, primarily a public institution, utilizing some private cooperation, allowing private interests to charge 6-percent interest on the investment, giving some share in the selection of directors in the regional banks, and, as you know, the Reserve Board turns over 90 percent of its net earnings to the Treasury, amounting to about $200 million a year, and that while an administrative decision has pretty strong force to it, I thing that attempts by private bankers to have these amounts returned to the stockholders would not meet with popular acceptance or approval by the Board itself.

In other words, there is undoubtedly a drifting toward regarding the Federal Reserve as a public institution.

Now the big problem is: Under what system can you get better regulation of the money supply to meet the needs of business and industry? My own feeling has been that the influences which have political effectiveness tend to be inflationary. That is, the banks, in general, want to lend and those who want to borrow want them to lend. If you have on top of this a Treasury policy of maintaining the Government-bond market at all costs, and saying it is primarily forcing the Reserve to buy bonds under tacit pressure, this built-up bank reserve enables them to lend more, and results in increased bank loans and expanding prices. This presents an element of danger. The mere conversion of the Federal Reserve into an outright institution controlled by the Executive, with very little control exercised by the Congress, would involve some grave dangers to the public in periods of full employment.

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Mr. VOORHIS. I am not advocating that. I think the Congress should lay out a mandate in as explicit terms as possible. I think the basic responsibility rests with the Congress in respect to the matter, and I always did.

Senator DOUGLAS. Mr. Baker, I apologize to you. I was not here when you testified and I had not realized that I had overlooked you.

Mr. BAKER. I assume you did not intentionally overlook me.

Senator DOUGLAS. No. I again apologize.

Mr. BAKER. I find it just a little difficult, Mr. Chairman, to follow your reasoning, that we need to put all of our assurance, all of our dependence, on the automatic operating of a privately controlled system, sidestepping the democratic process of public-policy making. But I do not want to labor that point here.

I was even more upset, I would say, by the statement that Mr. Kline made, but which is not in his prepared manuscript, that he was happy with his original statement. As just an ordinary American war veteran and representing full-blooded American farmers, I felt kind of bad and I sort of resented it when he said that Russia was greater than the United States in resources and people.

I would like to add also the comment that I have been through a little bit of the world, and looking around at both hemispheres, I find the American people to be about the most resourceful of anybody that you run into. I do not have the figures with me, but, as I understand it, the resources of the United States alone, not counting Canada and the rest of America, are much greater than the resources of Western Europe.

I am also concerned by some of the comments here that seemed to indicate a lack of faith in the democratic process of the Government established by the Declaration of Independence, the Constitution, including the Bill of Rights. We have got a very good system of government, it seems to me, with the Congress and the executive branch, and if we can't work out a solution to our monetary problem within the framework of the Government we have got I would be greatly surprised.

I don't think we need turn it over to what Mr. Montgomery has called a "government apart," nor do I think we need criticize the political system that we have got in this country as not being able to come out with the right answers on monetary policy. I agree with one of the other witnesses who said that the monetary policy is just like the farm policy, or any other policy. It is not something as and of itself but must be rendered to the common good, as interpreted by the democratic process.

Thank you.

Senator DOUGLAS. Thank you very much.

Mr. KLINE. Mr. Chairman, while I am perfectly happy to rest on my original statement, I certainly do not accept the interpretation of the statement just made. I did not say Russia was stronger than America. I insist that America is the strongest Nation in the world by all odds. What I referred to was land and mineral resources, natural resources, and population.

I believe in the Constitution of the United States. I believe in the strength of the basic position of the American way, and I think there is 150 years of history that proves the strength of our idea of freedom.

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Now I believe further, as I said in the opening statement, that this system cannot operate without freedom of choice.

I believe, in addition, we have to have an adequate monetary management, that if we leave it to a central executive government, then all history shows that these pressures just referred to by Senator Douglas take over.

There is no one better able to testify on this proposition than the president of the American Farm Bureau. We feel these pressures. We have determined that the thing to do is to pay our bills. Immediately you find the agencies of the Government opposing you, creating opposition by all sorts of propaganda. And I mean the agencies of the Government of the United States, lest there be any misunderstanding on this point.

I believe we can face the future with considerable confidence if we believe in our own traditions and if we have real courage, and I believe that it is not appropriate for the people of the United States at this time to act on the basis of fear.

Let me say further that my confidence in this country is so great that I am prepared to say categorically that the defense of freedom as we inherited it in this country, the defense of that sort of freedom in the world depends upon the United States. There is no other country in the world among the free nations, nor any combination of other countries, which would even begin to stand up in defense of freedom, except as they join with us.

The capacity and courage of the United States, the citizens of the United States, in this instance to protect the basic freedoms and to protect the fundamental things which have been creative in the American economy, are absolutely essential to the survival of freedom in the whole world.

Senator DOUGLAS. Thank you very much.

We will adjourn today to meet tomorrow at 10 a. m., and the meeting tomorrow is going to be held in room P–36, the second floor of the Senate wing of the Capitol. The witnesses will be H. Christian Sonne, National Planning Association, and Preston Delano, Comptroller of the Currency.

(Whereupon, at 12:10 p. m., the subcommittee recessed to reconvene at 10 a. m., Friday, March 28, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

FRIDAY, MARCH 28, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10 a. m., in room P–36, United States Capitol Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representatives Patman, Bolling, and Wolcott.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order. We have two witnesses this morning, Mr. H. Christian Sonne and the Comptroller of the Currency, Mr. Delano.

The committee will meet Monday, March 31, 1952, in room 224, Senate Office Building, and then Tuesday we have an executive session for the purpose of discussing what we have done, and then trying to agree on a program for the future. We are not expecting any more hearings, but they are possible.

Mr. Sonne, you have a prepared statement, I notice. Would you like to read your statement or would you like to answer questions? We would do whatever you would like to be done. You could read your statement or we can ask questions or any way you want.

Mr. SONNE. I can read it, and you may interrupt me whenever you like.

Representative PATMAN. Proceed, sir.

STATEMENT OF H. CHRISTIAN SONNE, CHAIRMAN, BOARD OF TRUSTEES, NATIONAL PLANNING ASSOCIATION

Mr. SONNE. My name is H. Christian Sonne. I am chairman of the board of Amsinck, Sonne & Co., 96 Wall Street, New York 5, N. Y. I am also chairman of the board of trustees of the National Planning Association, 800 Twenty-first Street NW., Washington, D. C. The National Planning Association is a nonprofit, nonpolitical association which is devoted to planning for democracy. It is our conviction that American businessmen, farmers, workers, and Government must plan to avoid a planned economy. We have on the board of trustees a number of men who, I believe, represent our various walks of life

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in a very significant manner. The views I am presenting today are my own and are not necessarily shared by my colleagues in the NPA. Through my connection with NPA and also as a businessman in this country for 35 years, I have had occasion to concern myself repeatedly with questions of fiscal and monetary policies. I welcome the broad-gaged examination of the problem, undertaken by this subcommittee. The material published in the background volumes in itself is a treasure of information and is very valuable for every student of the subject.

At the request of the Joint Committee on the Economic Report, the NPA sponsored a meeting on fiscal policy of a group of prominent economists from all over the country in September 1949. In October 1951 we had a similar meeting on monetary policy. Each of these meetings resulted in a statement on which the majority of the participants agreed. I was pleased to note that the statement resulting from NPA's October 1951 conference is included in one of the background volumes published by this subcommittee.

We picked fiscal policy as the first subject for discussion because that topic was more acute at the time. Also we believed that, in spite of the great variety of opinion prevailing on fiscal policy, an attempt should be made to reach an agreement on such a vital issue among economists belonging to different schools of thought and representing great differences in background. The conclusions of that conference were presented to the Subcommittee on Monetary, Credit, and Fiscal Policies under the chairmanship of Senator Douglas in September 1949. I was pleased, and he indicated that he was surprised, to see a report that reflected such a high degree of agreement on a vital issue.

We organized a similar meeting on monetary policy subsequent to that on fiscal policy because the right monetary policy can do a lot in reenforcing the right fiscal policy, and the wrong monetary policy can make the task of fiscal policy much harder. On the other hand, I would not attribute to monetary policy the same significance which I attribute to fiscal policy. It is a much finer tool which will be most effective if used to complement and supplement other policy devices.

The monetary policy is such a fine tool that it can only iron out small movements in the market, but cannot by itself have much effect on big movements.

At a time when we hear so much about deflation and inflation, there is one thing of which I am certain, and that is that there has been a great deal of inflation in the appraisal of what monetary policy can accomplish.

I feel there is a great deal of inflation in the recent debate on monetary policy. We have been told that, with a different credit policy but other factors remaining the same, we could have avoided the post-Korean inflation. We have also been told that the introduction of flexibility into Federal Reserve policy or a rise in interest rates or a drop in the price of Government securities would have created chaos and a panic in the money market. I believe both these claims and fears are exaggerations and need a great deal of deflation. What is required, in my judgment, is that we take a much less dogmatic attitude and more businesslike approach as to what monetary policy can do and cannot do, and then sit down and figure out how we can make the best out of monetary policy.

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Our efforts to reach agreement at the economists' conference on monetary policy—I think you were there, Mr. Ensley—were less successful than in the field of fiscal policy. Our statement had to be rather general in order to achieve consensus. Nevertheless, there remained a greater number of dissents than we had on fiscal policy.

I believe that was natural and resulted, in part, from unreconciled viewpoints in economic theory. To show you what I have in mind, I may mention the question of interest rates. Some hold the view that interest rates should be kept low under all circumstances because low interest rates are needed both to permit financing of the Government debt at low costs and to promote economic expansion. Others say that interest rates in a period of actual or threatening inflationary pressure should be high to discourage less essential business expansion and the holding of large stocks of commodities and merchandise. I personally cannot agree with either of these propositions.

First of all, I believe that in a free society a government can, in the long run, no more control interest rates than it can control the tides of the ocean because interest is a living thing, like commodity prices.

I believe there should be no dogmatic stand on low or high interest rates, even if we could control them, but that the rate should be related to the basic structure of the economy. By that I mean that if in an underdeveloped country a businessman of average ability can earn 7 or 8 percent on his capital it is logical to expect that normal business in such a country will go into the market to borrow at, let us say, 5-percent interest, because it can pay that interest, and yet make a very nice profiit.

If business is willing and able to pay 5 percent for safe loans it would be utterly absurd to expect the Government in a free market to place a large amount of Government bonds at 2 percent.

If, on the other hand, in a highly developed country like Holland in the old days, before the war, business could earn only a moderate yield on its capital, say 3 percent at a time when, for instance, in United States of America, General Motors earned 9, then it is natural that the Government could obtain financing at 2 percent. I believe that in each country interest rates should be allowed to gradually find their own level, determined by the abundance of saving and the opportunity for earnings in the particular country.

As a Wall Street man, I would not regard it as complimentary to American businessmen, if, in the light of the tremendous and profitable use for capital I foresee in this still rather undeveloped country, the interest rate for riskless capital, such as Government bonds, were permanently to settle at a level of 2 or 2½ percent.

I recognize the impact of the interest rate on the huge national debt, and the need to move gradually and in good order toward an interest level that reflects long-range earning opportunities in the United States. When I say that the Government cannot in the long run control interest rates, I do not mean to imply that they have not a right to build dams to let the flood come down in a very slow and deliberate manner. I maintain that if the Government were to go on controlling interest rates for many decades they will accumulate such a flood of water above the dam that one day it will break and you may face a terrific catastrophe.

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These few remarks do not pretend to offer a solution of the delicate problem of interest rates. I made them mainly to illustrate the fact that important questions of monetary policy and theory still remain unsettled.

Another reason why it is difficult to obtain a clear-cut solution of monetary problems is that monetary policy is a tool that can serve and must serve a variety of objectives.

The first objective should be stability of prices; the second, economic development in the creation of jobs; the third, debt management, which must be considered at the time when, unfortunately, large amounts of Government bonds have to be refunded, and, perhaps, new financing provided for.

Then again, many of the current discussions have attempted to answer the question: What is the appropriate monetary policy under the present conditions? And right now we are not sure whether we have inflation or deflation to cope with.

I feel that it is equally important to ask: How should the tool of monetary policy be perfected so that it can be used to meet possible future contingencies?

I use as an example of that the early years of World War II, when we all knew that a very large amount of Government bonds would have to be placed, though we did not know the amounts involved. If at that time the consequence of placing very large amounts of securities for the war effort had been judicially appraised, with a few toward the future, the number of the headaches that have been plaguing us in recent years could have been reduced. At least, we want to learn now from that experience, and give the most careful thought to future repercussions of present policies.

As one instance, I may say that we are spending many billions of dollars for defense so that we can be militarily ready in case of a major conflict that would be forced upon us. What are we doing so that we are also financially prepared for such contingency?

My own feeling is that in a period like this we should avoid adding to our national debt. This may be so because our ability to continue for a great number of years to hold ourselves in readiness may be the very thing that will make us win out. Therefore we have got to be prepared for a long, continuous struggle.

I can see the point that we do not want to raise taxes just to meet a short but rapid rise in expenditures in one fiscal year when taxes, after a short period, may have to be reduced again. But taking the period of the defense build-up, as a whole, it should be financed without recourse to additional borrowing.

Personally, I think, and I wish, we could go beyond that and at least reduce that part of the national debt that is held by the banks. That is about $60,000,000,000.

This would put us in a much better position to finance a further increase in the armament program if world conditions should force that necessity upon us.

The removal of the Government bonds from the banking system might from some angles be likened to the Bank of England, in the old days, going back to the gold standard after a war, with the result that they were ready in case of need, and if other emergencies arose, to again suspend gold payment and use the resulting reserves to face a new emergency.

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It had been my great hope that we would have been able during the first 5 years after the war to accomplish this through surpluses in our budget. But if current taxes cannot produce such a surplus to redeem part of the debt within the next few years, I, as a citizen, do not shrink from the proposition that an extraordinary, one-time levy, presumably based on capital, should be imposed for this purpose. I cannot but feel that citizens of this country, and particularly the practical businessman should pay with good grace a sum that may amount in total to as much as 5 percent of their capital payable over a number of years.

Such an extraordinary and one-time payment would indeed be a small premium to insure that we can continue to do business without threat of disruption because aggression is in evidence.

I am, of course, aware of the constitutional and political problems which are involved in such a suggestion; but I mention this possibility mainly to indicate how strongly a number of us feel about the need for tackling the problem of financial readiness as an indispensable part of our defense readiness program.

Discussion of the adequacy of Federal Reserve powers also has become confused by uncertainty as to whether we are thinking of the monetary policies needed for the immediate situation or of those required for future contingencies.

You will notice that recommendation IV of the NPA statement says:

> The existing powers of the Federal Reserve over the reserve position of the banks should be strengthened by additional legislation.

But you will also find a dissenting footnote by those who believe that additional powers are unnecessary, and another by those who feel that in addition they are undesirable.

I am sure that those who believe that additional powers are unnecessary are thinking mainly of the present circumstances, while those who recommend that Congress should grant additional powers of reserve requirements have in mind perfecting our tools of credit policy in order to meet possible future contingencies. I hope Congress will give serious consideration to such a provision, at least as a stand-by authority.

My discussion of unreconciled viewpoints in monetary theory, such as interest rates and, I may add, gold and exchanges, and the multitude of objectives which must be considered in determining monetary policy, leads me to one conclusion. It may well be that the determination of monetary policy is the final responsibility of Congress; but we are clearly in an area in which it would be as impossible for Congress to determine details of policy as it would be for Congress to legislate on the allocation of steel or any other day-to-day administrative activity of the Government. Congress can fruitfully lay down the basic principles of monetary policy, but their execution must be delegated to proper agencies. This conclusion leads me to the question of organization and administration which is the particular issue with which I would like to deal.

The organizational problem in the field of monetary policy is more difficult than in the field of fiscal policy. This is, perhaps, another reason for the heat and exaggeration in the present controversy. Fiscal policies which include expenditure policy, tax policy, debt-management policy, all relate to functions which naturally belong to

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the domain of government. On the contrary, many aspects of monetary policy have been conducted, in most countries in the past, by organizations which were to a large extent, if not wholly, linked to private enterprise. Only in emergencies, such as war periods, did the privately owned and managed central banks cooperate closely with the Government and subordinate their interests to those of the Government and the country. Our own central banking system was conceived to be neither under the influence of private interests nor under the clear influence of the executive branch of the Government. It was established as an instrumentality of Congrss to interpret the public interest through the judgment of the appropriate officials. Looking at developments all over the world, we find a clear trend toward moving the central bank away from private enterprise into the orbit of government. We also find a growing trend toward closer integration between monetary policy and all other economic policies of the Government.

As long as the currency was on a gold basis, there was a quasi-automatic mechanism for the guidance of monetary policy. Under those circumstances, monetary policy was in a way a technical job that could well be left to an autonomous body. A managed currency, however, requires a much greater integration of monetary with fiscal and other economic policies.

The trend toward increasing integration between monetary policy and other economic and fiscal policies has resulted in part from the repeated war emergencies and the consequent rise in the national debt. It has resulted also from the development of new governmental functions instigated by popular demand in virtually all democratic countries. In the old days, Congress and the President of the United States had a mandate to run the country as best they could without being expected to influence over-all economic conditions which, like the weather, were regarded as being beyond human control. Nowadays, Congress and the President are committed not only to carry out the traditional functions of Government, but also to promote employment opportunities for everybody and prevent disruptive price rises.

The Employment Act of 1946 has specifically incorporated this responsibility in our statute books. Section 2 reads in part:

> The Congress hereby declares that it is the continuing policy and the responsibility of the Federal Government * * * to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining * * * useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

In section 3, it is made the duty of the President to submit an economic report which should include, among other requirements—

> a program for carrying out the policy declared in section 2, together with such recommendations for legislation as he may deem necessary or desirable.

Congress specifically included the aim of counteracting economic fluctuations among the responsibilities of the Executive when it stated in section 4 (c) that—

> it shall be the duty and function of the Council (of Economic Advisers)—

a number of things, and No. 4—

> to develop and recommend to the President national economic policies to foster and promote free competitive enterprise, to avoid economic fluctuations and to

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diminish the effects thereof, and to maintain employment, production, and purchasing power * * *.

In this act, Congress did not exclude monetary policies from the program that the President is required to submit to Congress to carry out the purposes of the act. If anything, I should think that from the wording of these laws it is implied that monetary policy was included, but, perhaps, it would have clarified the situation if Congress had specifically stated that this program should include monetary policies.

In my judgment, it is not desirable for one agency to pursue an independent course of price stabilization through credit policy while the execution of other governmental policies affecting prices, such as fiscal or wage policies can be unified under the supervision of the President. Such a split in responsibilities may lead to confusion and ineffectiveness. It also blurs the basic responsibility which is essential for the functioning of democratic government. If the President fails in his objectives, he may put the blame on the central banking system which is outside his control.

For the reasons already stated, it would be impractical for Congress to go beyond the issuance of general directives and try to achieve the necessary day-to-day coordination of economic policies. It would be absurd to have the central banking system responsible for over-all coordination of issues, including some entirely different from those treated in the Federal Reserve System.

There remains only one solution—that the President, on whom the Constitution puts the responsibility for day-by-day execution of statutes adopted by Congress, be the coordinating agent for the whole national economic program. This, in my judgment, is the only solution which is in accord with our kind of democracy, and gives us a chance of steering our "ship of state" through the troubled waters ahead of us.

I know that my proposing a closer integration and coordination of monetary with all other fiscal economic policies might lead to a misinterpretation. Some may say that I am taking a position against the independence of the Federal Reserve System and against the policies advocated by the Federal Reserve bank in recent years. I was among the first, long before the country talked about it, to point out to the Federal Reserve authorities that interest rates ought to be made more flexible. I regard the monetary policy initiated in the so-called accord of March 1951 as a step in the right direction. I believe, that if the Federal Reserve had belonged more definitely to the Government family in recent years, it would have been in a position to plead more effectively for a change in the rigid postwar support policy and such change might have been adopted much earlier.

I believe it is quite possible that if the Federal Reserve had been in the so-called Government family, certain minor points might have been lost in the way of freedom with which to run the Federal Reserve System, but that other and larger points would have been gained by influencing the whole economic program of the Government.

As far as the problem of so-called independence is concerned, I do not think that a greater integration of policy would necessarily make the Federal Reserve System simply a tool either of the Treasury or the President. Congress has given all agencies in the executive

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branch a certain, and from case to case, different degree of independence. Each agency has its own machine under the laws, which is not in itself incompatible with the coordinating and supervisory functions of the President.

It is wise to have various aspects of economic policy represented and carried out by strong and responsible agencies in the executive branch. I like to see a strong Department of Agriculture concerned with the welfare of the farmer; a strong Department of Labor concerned with the welfare of labor. I also like to see the disbursements of money and the collection of taxes organized in one agency; lending activities centered in other agencies, and the regulation of the supply of money and credit concentrated in a single responsible and powerful agency. All this is good as long as we have a mechanism for reconciling the program of these different agencies in one well-balanced over-all program. This is one of the functions of the President for which he needs an effective staff organization.

This function of the President does not mean that he determines in detail how each of the separate activities is to be performed. Particularly in the case of the Federal Reserve and some of the independent commissions, these activities should and can be performed without undue interference.

I wish particularly to stress the necessity for achieving closer integration between monetary and other economic policies. There may be several ways in which this can be implemented. Now may not be the appropriate time for changing the basic statutes either with respect to the Federal Reserve System or with respect to the organization of the executive branch. Your judgment on that matter would be far superior to mine. I do believe, however, that Congress could help now to bring about clarification by adopting a resolution stating the congressional intent with respect to the coordination of monetary policy with general economic policy. Such a resolution could reaffirm the intent of the Employment Act to make the President responsible for the formulation and execution of the whole governmental economic program under the laws adopted by Congress. It could state specifically that the general direction of monetary and credit policy is included in this general responsibility. It could also authorize the President to establish a coordinating committee of a type that would best aid him in the performance of his duties.

The resolution could further state that if there is a major conflict between the President and the responsible bodies of the Federal Reserve, the President should report promtly to Congress on the nature of the conflict and the Federal Reserve should feel free to submit to Congress its dissenting views. If a dissenting view is presented to Congress, it would be within the province of the Joint Committee on the Economic Report to hold hearings on the subject. It could propose suitable national policy by concurrent resolution. Such a concurrent resolution or other legislative action, if adopted by Congress, would be binding upon all concerned.

Under this procedure, it would be in the national interest that there should be some way of preventing a stalemate until a legislative decision can be made. To this end, it seems to me logical that the President's decisions on disputed issues of monetary policy should prevail until they are settled by appropriate action of Congress.

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I do not here make any specific proposal now for the sort of permanent coordinating device that may be useful on the Executive side. I am not certain that at this time the creation of a statutory advisory committee on domestic monetary policy would be wise. It would add to the many existing coordinating agencies. It might lead to confusion rather than to better coordination of economic policies and may require a coordinator for coordinating all the coordinators.

I believe that once the basic responsibilities have been clarified, even informal coordinating devices, will have a better chance to work. Over the long run, it may be necessary to reexamine the whole complicated set-up of permanent and emergency coordinating machinery in the Executive Office of the President. It would not be unnatural if such deliberations lead to the conclusion that a number of agencies have meanwhile outlived their usefulness and could be dissolved. Perhaps what is needed is a strong, powerful personality in the President's Office who would devote all his time to the subject of coordination of economic policies and work with Congress and the President to the end that, by anticipating events, differences of opinion could be ironed out in good time through the President's authority, if possible, and through legislative action, if necessary. He could be aided in this effort by the Council of Economic Advisers and by the heads of the Federal Reserve Board, the Treasury, the Budget Bureau, and other agencies, who might form an advisory committee under his chairmanship.

Considering the importance of fiscal and monetary policy in the world of today and tomorrow, such a development would be only logical.

It would be welcomed by the average citizen who wants to feel that no stone has been left unturned to solve these important functions in the national interest.

This is, I believe, a long-run proposition and one that may transcend the scope and interest of this subcommittee.

Representative PATMAN. Thank you, sir.

Mr. Wolcott, would you like to ask some questions now?

Representative WOLCOTT. No.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. Yes, Mr. Chairman, I have a number of questions.

Representative PATMAN. You may proceed.

Representative BOLLING. I may be a little bit out of the territory of the committee's investigation, but some of the statements made are so provocative that I would like to get them expanded a little bit for my own thinking.

On page 4 at the top of the page, you spoke of this country as still rather underdeveloped. I agree with that general statement, but I want to be sure I understand what you mean by a country as still being rather underdeveloped.

Mr. SONNE. We deal from time to time with Latin America in our point 4 program, and we have coined a new word for such countries, calling them lesser developed in order not to hurt their feelings. I think I should have said lesser developed here. What I mean is this. If you travel in the old world, or travel in England, you see how every foot of ground is used with a crop on it, and then you see how in

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business one factory, in countries like Holland, is closely knit to another factory and so competitive that a businessman is very lucky if he can earn 3½-percent dividends—there you have what I call an overdeveloped country. By contrast, I would say that large parts of the United States are still lesser-developed areas, meaning that you can still employ billions of dollars to develop this country. Yet, if you did that for 10 years you would not find that the country at large would be as developed as some countries in Europe.

Representative BOLLING. That means that, in effect, although we have so-called full employment today, that there is tremendous room for capital investment to increase our productivity regardless of the fact that all our people are employed——

Mr. SONNE. That is right.

Representative BOLLING (continuing). Or almost all.

Mr. SONNE. If we attack it with skill. But you may find, for instance, in countries that are far less developed, like Latin-American countries, they support, let me say, 5 million people, where they could support 50 million. You can still find panics and unemployment there because they do not handle it skillfully.

Representative BOLLING. You are not one of the people who believes that we are arriving at a point that we cannot support the population that we have in the world?

Mr. SONNE. No; not in this country.

Representative BOLLING. I want to neutralize this question completely. It is involved in your discussion of taxes, and so on. I want to leave out of consideration for the moment all the realities of whether Congress would pass more taxes, and all the politics that are involved in that.

Mr. SONNE. Yes.

Representative BOLLING. I gather from your statement that you do not feel that our present tax structure is such that it has eliminated incentive.

Mr. SONNE. No. That is, of course, a very deep subject. It does not eliminate incentive on the part of the people who are leaders, and really getting on in this world. It might eliminate incentive lower down the line. However, there the rates are much smaller.

What I have in mind is this: As a businessman, I hear people sitting around in the clubs saying that if "we get another 10 percent of taxes on top of this, then we will all stop." But one does not stop, because once you are a leader and trying to do something constructive, you are more interested in the cause than the money you make. Therefore, I think that you have got to go very, very far, not in theory and political talk, but in reality before you get such high tax rates that you really cripple incentive.

Representative BOLLING. On page 6 you discuss this question of the existing powers of the Federal Reserve over the reserve position of banks, suggesting that they should be strengthened by additional legislation. This is a point that, from time to time, I have raised in these hearings. I gather that you mean by that that it might be well, since there is a very substantial legislative lag in any given emergency situation or in any given change in a situation, that it would be well to have on hand the tools that might be needed in foreseeable circumstances.

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Mr. SONNE. That is my point. Even if one did not want to give the tools now, there must be a way to permit their use if so-and-so happened.

Representative BOLLING. What about the psychological aspects of that? I gather from the answers to some of the questions that I have asked along those lines during the hearings, at least part of the reason for some replying, "No, we don't want additional powers," or "No; no additional powers are required at this time," is that if they existed they would only have their existence on a stand-by basis which might have some bad effects.

Mr. SONNE. Well, I have heard that argument, too, and I think that is a wishful argument which I answer this way: If I sit in a house and say that I am insured against a fire, that certainly does not make me scared that the house will burn. Some legislation which can be used in periods of emergencies would be useful, I think, for the Federal Reserve in case they were disappointed in what they think they can do by open-market operations and interest-rate measures alone; if they are disappointed in that, then I think it would be very useful for them to have these reserve requirements as an alternative.

Representative BOLLING. How have those taken form in specific terms in your mind?

Mr. SONNE. The new requirements of the reserve position of the banks, which we want strengthened with additional legislation, can be provided in two or three different ways. There is one scheme which seems to me to outdo the others in efficiency, and that is one they call the secondary reserve plan, which means that new reserves would have to be put in. The banks are given the alternative of putting up either so much cash or a larger amount of Government bonds. That would have one advantage which is that if they took a fine pencil they probably would put up the bonds which earn interest. As a result you would get that desirable sterilization of the bonds in the banking system which prevents their use for creation of money.

But I would say that there are two or three pretty sensible proposals knocking around, and I am pretty sure your subcommittee can put them together and get a pretty sensible stand-by arrangement. Nothing would be more delightful than to feel that it might never need to be used. It would not do any harm to have such a stand-by arrangment.

Representative BOLLING. I gather, it is very clear from your statement, that you feel that monetary policy is but a part of the whole policy and that it ought to be, perhaps not at this particular time of emergency, but at some time in the relatively near future—it ought to be brought into the usual pattern of the executive establishment.

Mr. SONNE. That is the way I feel. Conditions of monetary control in this country should be judged in terms of the experience of the rest of the world.

You see, when things were normal in the British Empire—which, after all, was running with stability for hundreds of years—a change in the interest rates of the Bank of England would have a certain effect; but when something really seriously happened, and the Bank of England raised its rates from 3 to even 5 percent, everybody laughed and said, "Who cares?"

When an incident like the war in Korea starts, and we sit in Wall Street—I always like to see the point of view of the theorists and

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the practical men—and we say, "Let us buy a million dollars' worth of burlap because such a commodity has to be bought." We hear all the arguments as to why we should or should not buy and finally we decide to do so.

As one little question, I may ask, "By the way, what interest rate would you have to pay?" They say, "3½ percent," and I say, "Fine." If they said 8 percent, I would not care. It is a very small consideration, because either you have to buy this or you have not got to buy it. That is what I mean when I say that when big issues are involved, the Bank of England rate, or interest rates in Government bonds of 1, 2, or even 3 percent difference, means nothing as compared with the issue at stake.

But then, later on, when the event is past and you have got up to a level where you expect the market to stay, then you begin to say to your people, "Look, do you realize that the clock is ticking at 8 percent interest against you, and perhaps you had better begin to liquidate out." But you cannot stop what I call a rapid and quick-changing movement resulting from such events as panics or wars by monetary policy.

Representative BOLLING. Apparently the fundamental argument that is made against monetary authority being in the Executive seems to be that for reasons of expediency it is necessary to a certain extent to insulate the agency that operates directly in the field of monetary policy.

I believe, as I analyze that argument, that it has in it implicit the statement that Congress is not responsible. Congress is not sufficiently responsible to be able to manage this difficult matter, and that equally the Executive, operating within the policies which the Congress may or may not lay down, is insufficiently responsible; that, in effect, political pressures of a day-to-day or week-to-week nature are such that they will act on the Executive, or act on the Congress in a manner that would result in actions contrary to public interests.

I believe that is a reasonably fair statement of the arguments that I have heard made for the expediency of maintaining the Federal Reserve in somewhat the same status as it is.

Mr. SONNE. I have heard the same and I agree with most of them. It is not my conception that the President should go down and tell Federal Reserve how to manage interest rates, nor should Congress, because that is a day-to-day operation which is very technical and which they do very well. But I do think that the Congress and the President should sit down and say, "Now, look here, we want full employment," or say, "We have to be prepared and the general policy of this country now must be so-and-so. We must try to finance our preparedness as far as possible out of savings. Therefore, we must try to induce people in this country to save"; and, if that was the situation, I would say we would have to get our bonds up to a price where the general investor would buy them, which might be at a 3¼-percent basis. The Federal Reserve bank should follow their independent judgment in these detailed operations but coordinate them with what is the general policy of the country and Congress as a whole. That we have seen happen in practically all countries.

Representative BOLLING. Of course, the interesting conclusion, or at least a conclusion that can be drawn from that argument about the irresponsibility of Congress and the Executive, is that the democratic

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process in this country, as it operates, is not working very successfully.

Mr. SONNE. Well, I told them down at the Federal Reserve bank one day that with this argument they were preventing the son from taking a drink of whisky but were giving him the key to the wine cellar. If the Congress or the President, or anybody who is responsible for influencing monetary policy, really wanted to raise havoc in this country, they could do it in so many bigger ways that it seemed to me it was absolutely no protection to give them no say on monetary policy.

You see, the volume and velocity of the money in circulation is not decided by monetary policy. It is the outcome and result of the fiscal policy and a number of other policies which have already been determined by Congress, the President, and the business community. So I think that if those men that want to stabilize prices feel that they must hold on to the power of money they are just fooling themselves. They cannot do it by monetary policy alone.

Representative BOLLING. Thank you very much. That is all, Mr. Chairman.

Representative PATMAN. Dr. Murphy?

Mr. MURPHY. No questions.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. Just one question.

Mr. Sonne, on page 4 of your statement down in the second full paragraph you say that monetary policy can serve and must serve a variety of objectives, and then you say:

> Contributing to the stability of prices is one objective. Economic development and the creation of employment opportunities are other objectives.

I believe in your presentation you departed a little bit from that and stated that stability of prices was the first, and I believe you implied the overriding objective. Did I interpret that correctly or do you stand as it is written here?

Mr. SONNE. I think, as it is written here—I want to be quite clear how it is written—"Contributing to the stability of prices is one objective." I would say that that depends on the time. Today I think we would wisely say that stability of prices is No. 1. Economic development to create employment opportunity comes next in line because there is full employment.

Mr. ENSLEY. Where would you put the expansion of our industrial capacity in order to provide for adequate national defense?

Mr. SONNE. I would say that that would probably be taken care of by some other agencies just now, because it is industrial capacity for war purposes.

You see, when we talk about monetary policy we are talking about the kind of capacity that private enterprise would develop if monetary rates are rising.

Mr. ENSLEY. But a lot of that, I gather, has been through private credit expansion.

Mr. SONNE. That is right.

Mr. ENSLEY. As a matter of fact, the emphasis has been on private expansion——

Mr. SONNE. That is right.

Mr. ENSLEY (continuing). Of this capacity.

Mr. SONNE. But if Charlie Wilson really wanted it, and could not get it because credit were not available or interest rates were high, he

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would see to it that the Government would do it anyhow at the present time. That is why I would say that price stabilization today is probably the more urgent objection, then expansion. They are both closely interrelated in the defense program.

Mr. ENSLEY. That is all, Mr. Chairman.

Representative PATMAN. Thank you, Doctor.

Mr. Sonne, you have presented a very interesting and comprehensive statement, and I know it will be helpful to the committee. We appreciate your appearance here.

Mr. SONNE. Thank you.

Representative PATMAN. Mr. Delano?

We have with us this morning Mr. Preston Delano, who has been Comptroller of the Currency since 1938, which is about 14 years. He was formerly Governor of the Federal Home Loan Bank System, and earlier Mr. Delano was General Manager of the Home Owners' Loan Corporation.

Mr. Delano, we are glad to have you, and we shall be very glad to have your statement.

STATEMENT OF PRESTON DELANO, COMPTROLLER OF THE CURRENCY

Mr. DELANO. Mr. Chairman, I have a short introductory statement here which will not take very long to read, and I think it may serve to give our viewpoint of what we are to do.

I should like to summarize very briefly for the members of the committee the functions and the structure of the Bureau of the Comptroller of the Currency, and then to outline our concept of the relationship between our work and the chief subject matter of your investigation—the role of monetary policy and public debt management in achieving national economic stability.

Most of what I shall say is presented and developed somewhat more fully in our replies to the questions addressed to the Comptroller of the Currency, which appear on pages 897 to 937 of part 2 of the joint committee print.

Created in 1863, this Bureau is one of the oldest in the Government. At that time, because of the wildcat banking era immediately preceding, the necessity of establishing a stable currency was a matter of great importance and during the early years of its existence much emphasis was placed upon this work of the Bureau—the control and supervision of a currency known as national bank notes. As the problem of a currency acceptable anywhere at face value reached solution, that function of the Bureau became largely ministerial, and virtually terminated in 1935.

Broadly speaking, the prime concern of our Bureau today is the supervision of the national banking system, consisting of less than 5,000 banks throughout the country, which hold in the aggregate somewhat over half of the deposits and resources of the country's commercial banking system. National banks are of all magnitudes, from the very largest to some of the smallest.

Our office supervises both the organization of new national banks and their operations as active institutions. We are required by statute to examine every national bank at least twice yearly. This work is performed by a staff of about 250 national bank examiners and

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some 550 assistant examiners, aided by 125 clerical employees in our district offices throughout the country.

The central office in Washington employs fewer than 200 persons, who not only review and coordinate the work of the field force, but also handle matters relating to organization of new banks, consolidations, establishment of branches, changes in capital structure, annual and special meetings of shareholders, liquidations, the many legal problems arising in connection with our work, legislative matters, banks' reports of their condition and their earnings and dividends, compilations of banking statistics, issuance and redemption of Federal Reserve notes, and many others.

The general purpose of the examination process is to ascertain in each case—

(*a*) Whether the bank is solvent and its capital satisfactory. This includes a careful check and appraisal of its assets and a proving of its books.

(*b*) Whether the bank is being managed competently and in accordance with legal requirements.

(*c*) What constructive and corrective action, if any, is called for to strengthen the institution or to preserve or enhance its stability and usefulness.

It is perhaps appropriate to mention that bank examination is not the same thing as a bank audit. The primary function of governmental bank examination is to appraise assets and the management of banks, and to effect improvements wherever necessary. It is not contemplated that bank examiners should verify deposit and loans with the depositors and borrowers; that is a function of audit and is properly the bank's responsibility, to be discharged through its own audit department, directors' periodic surveys, and audits conducted by independent public accountants, retained for this purpose.

The matters I have touched upon so far are more fully covered in our answers to the first two questions addressed to us (see pp. 897–904). However, if you would like more detail on any aspect of the organization or operations of our office, I shall try to answer your questions.

We have given much thought to the main thesis of your investigation—the role of monetary policy and the management of the public debt in achieving price stability and high level employment. In its several questionnaires, including that addressed to me, this committee has shown great interest in the role of governmental agencies in the national effort to achieve the maximum economic stability consistent with retention of other beneficial features of our economic system. In our answers to the questionnaire, particularly questions 3 through 7 (pp. 904–912), we have tried to present our concept of the appropriate place of bank regulation and bank supervision in this national effort, and the limitations that we feel should be placed on our activities in that direction.

In any discussion of a stabilized economy, how to fit our somewhat minor part in the huge fiscal operations of government is a problem indeed. Effective bank supervision is built upon honest reporting of facts and factual judgments. An examiner cannot call a bad management good, or a bad asset sound, because we are in a downward swing in the business cycle. To try to control his judgment in such matters would produce confusion and would result in a loss of confidence in the examiner both by the bank and by his superiors.

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If the bank examiners were to serve as active direct tools in a governmental program intended to flatten out the crests and troughs of economic cycles, this change in policy inevitably would become known to bankers, and their confidence in the trustworthiness of reports of examination would be seriously shaken. It is our belief that comments, criticisms, and suggestions in the course of examination, in the examination report, and in our communications thereon are perhaps the greatest single influence our office can bring to bear in keeping a bank on a desirable course or persuading it to abandon unsound policies. This beneficial effect of the examination process would be lost, to a considerable extent, if bankers became convinced that our examiners were forming their judgments not on the basis of existing conditions and facts, but rather with the deliberate purpose of affecting future conditions by encouraging banks to adopt generous or restrictive credit policies in accordance with the current economic program of the Federal Government.

However, it seems to me there is something here we can do—some not inconsequential contribution to the problem which the committee is trying to solve. When the factual reports of the examiners are received in the Washington office—we receive about 40 each working day—they are studied and digested by a highly integrated staff. It is in this group that policies can be determined with due regard to the economic situation in which we find ourselves. These policies are put into effect through modulating our letters of recommendation and criticism to banks, through our almost daily conferences with bankers who come to see us in Washington, and in all the multifarious contacts we have with bankers, their conventions and their organizations throughout the year. I should like to point out that this is a delicate task and requires much balancing of economic and fiscal factors. Sometimes I wonder if any of us is wise enough to know exactly in what portion of the business cycle we find ourselves at any particular moment. But we do our best.

It has been our conviction that the Bureau can make its greatest contribution to the general welfare, as well as to "maximum employment, production, and purchasing power," by concentrating its efforts upon the maintenance of a system of sound and well-managed banks, adequate in number, location, and resources to satisfy the Nation's needs for the services they peform. This attitude has been reexamined, during the past 5 years, in the light of the congressional declaration of policy in the Employment Act of 1946, and our decision was that the underlying purpose of the act, and the declaration of policy, would be best served by this office through a continuation of its traditional approach. In other words, our efforts are directed toward the improvement and maintenance of a great and powerful machine in good condition, but we believe that, over the long run and in the broadest sense, we would injure rather than advance the general welfare if we attempted to dictate also the details of the operation of this machine.

I should like to add a brief word on the adequacy of banking facilities in the United States, which was mentioned in the committee's questionnaire. Despite the fact that the number of commercial banks today is only half of the number a generation ago, it is believed that, as the result of shifts of population to urban areas, improved transportation facilities, and more efficient banking methods, there are

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very few people in this country who do not have reasonably convenient access to banking facilities.

Because of the relatively greater cost of operating a "unit" bank, there are proportionately more bankless communities in States which prohibit branch banking than in those States in which branch systems are permissible. In this matter, the State and Federal Legislatures are confronted with the same problem that is encountered by bank supervisors—that is, they must decide between the relative advantages of encouraging independent local "unit" banks, on the one hand, or permitting operation of the generally more economical branches of a large city bank. It is obviously impossible to preserve the full advantages of both arrangements, so a choice often must be made between allowing a branch to be established or deciding that some small town must do without its own banking facilities. However, I wish to emphasize that this problem is not a major one, and that almost all Americans find adequate banking facilities reasonably accessible to them.

Representative PATMAN. Thank you, Mr. Delano.

Mr. Wolcott, would you like to ask some questions?

Representative WOLCOTT. No.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. I believe not.

Representative PATMAN. Mr. Delano, I would like to ask you some questions on that last point that you have raised about the extension of branch banks. I know that it has been quite a problem for you.

I assume it is your policy, however, to cooperate and not encourage the establishment of branches in States that prohibit branch banks?

Mr. DELANO. That is right, Mr. Chairman.

Representative PATMAN. Either by directly or indirectly encouraging branches.

Mr. DELANO. We are forbidden by statute, of course, to put Federal branches in States which do not permit State branch banking.

Representative PATMAN. Say that again, if you will, please.

Mr. DELANO. I say we are forbidden—well, let us put it this way—we are required to follow the State statutes.

Representative PATMAN. That is the statute, that is the McFadden Act, is it not?

Mr. DELANO. That is right. We are required to follow the State law in the matter of installing Federal branches where States permit or do not permit.

Representative PATMAN. I want to ask you some questions about our own State of Texas. Back in 1876, when the constitution of Texas was adopted, there was a provision inserted against branch banks. You are familiar with that provision?

Mr. DELANO. I am familiar with that provision.

Representative PATMAN. That constitutional provision has remained a part of the constitution all these years, and there has been no effort to change it. The legislature has enacted laws to carry it out.

Notwithstanding that, in recent years, and more particularly in the past 2 or 3 or 4 years, efforts have been made to create what many people believe to be branches by organizing affiliates. You are familiar with that situation, too, I assume?

Mr. DELANO. Yes, sir.

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Representative PATMAN. Could you tell me what the latest is on the policy of your office concerning the affiliate banking situation that exists in our State?

Mr. DELANO. Yes. We are confronted with something in the nature of a dilemma there. The State authorities have chartered, I think about 16 affiliates down in Texas. We have chartered six. The point has quite recently been raised, and raised strongly, that this chartering of affiliates which really owe their allegiance to the large banks in the big cities, is an evasion of the Texas anti-branch-banking law.

There is a legal point involved, of course, and we have been attempting to secure from the Attorney General an opinion on this subject, which we have not been able to get. But right now there is impending a presentation of that point of view before the State authorities when they meet to pass on a new affiliate, new State affiliate, which is coming up, as I understand it, from one of the national banks in Dallas. We are hoping that that will result in a determination of this point.

If it does not, then we also understand that the question will be presented to the courts, and a court determination will be very desirable from our point of view. It would relieve us of some anxiety and some responsibility in the matter of trying to decide for ourselves whether these things are legal under the Texas law or whether they are evasions, either of the spirit or the text of the law. So, we are sort of waiting to see if we can get that decision.

Representative PATMAN. And pending that decision, I assume, you are keeping everything in status quo?

Mr. DELANO. We have been holding things in suspense, Mr. Chairman.

Representative PATMAN. Suspense, and you expect to, probably, for a reasonable time?

Mr. DELANO. Yes, sir; as long as it is a reasonable time.

Representative PATMAN. Yes, sir.

Mr. DELANO. We would not want to take the position, and I do not think anyone would want us to, that we would hold this up indefinitely and let the State go on creating State affiliates, because that would not be quite fair.

Representative PATMAN. That is right.

Mr. DELANO. It would not be quite fair to the national banking system.

Representative PATMAN. I see your point. You cannot afford to sit by and let all of the affiliates become State banks.

Mr. DELANO. I would not think that would be quite equitable.

Representative PATMAN. I would not think it would be expected. At the same time, I do believe that you should follow the State, and I know that is your policy.

Mr. DELANO. That we try to do.

Representative PATMAN. You have to follow the State law in matters of that kind.

Mr. DELANO. That is right.

Representative PATMAN. Therefore, I think it is necessary that something be done right away.

Would you mind stating what you have done toward trying to get an opinion from the attorney general of our State on that matter? I am not talking about recently, but over a period of years.

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Mr. DELANO. I am trying to recall whether—I think we wrote him and asked him for it. I would like to confirm that; at least, the approach was made to him either orally or through letter, asking for an opinion on that subject. I am not quite clear whether we wrote or whether we discussed the matter with him.

APRIL 1, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management, Joint Committee on the Economic Report, House of Representatives, Washington, D. C.

MY DEAR MR. PATMAN: In the course of my testimony before the subcommittee, the question arose whether we had sought to obtain the opinion of the attorney general of Texas on a matter relating to affiliation between banks in that State. I informed the committee that an effort had been made to obtain his opinion, but I was uncertain of the form the effort had taken.

Subsequent examination of our files reveals that we instructed our chief examiner in Dallas to request the national bank interested in the application then pending to approach the Texas banking authorities with a view to obtaining the opinion of the attorney general. It is my understanding that this approach actually was made, but that, in the particular circumstances, it was found to be either impracticable or inappropriate for the attorney general to render an opinion.

I shall be grateful if this clarification of the matter can be inserted in the record of my testimony.

Sincerely yours,

PRESTON DELANO,
Comptroller of the Currency.

Representative PATMAN. Anyway, you sought the advice——

Mr. DELANO. We sought the advice.

Representative PATMAN (continuing). Of the Attorney General. He probably has not been called on or he would give a decision on a matter like that. I am sure he would.

Mr. DELANO. I think he sits on the Board.

Representative PATMAN. Yes. He is a member of the Banking Board.

Mr. DELANO. Yes, a member of the Banking Board; and I think his position is, and this is hearsay, I have not this from him directly, but I think the position from him is that inasmuch as he sits on the Board and they do grant these State affiliates, that constitutes an endorsement of the State affiliate not being in contravention of your law.

Representative PATMAN. Have you acted upon that premise in granting the affiliates charters?

Mr. DELANO. Well, the affiliates that we have granted have been granted on the premise that it was not an evasion.

Representative PATMAN. Although you knew it had not been directly passed on, it has been done by tolerance, we will say, by the State authorities.

Mr. DELANO. That is right; but the State authority, I think, have put in 16 of them, and we thought that was an indication, at least, of State opinion on the subject.

Representative PATMAN. I think that Mr. William A. Blakely raised this question definitely and vigorously.

Mr. DELANO. Yes, sir; he did.

Representative PATMAN. And he expects to carry through his contention through the courts, if necessary, that it is in violation of the law of the State.

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Mr. DELANO. Mr. Blakely tells us that he will present the matter to the next meeting of the Board down there, and that if it is then not passed upon by the Board he will try to secure some court action.

Representative PATMAN. Yes, sir.

I would like to ask you now about dormant accounts, Mr. Delano, and although it is not directly concerned with our inquiry, it is an interesting sidelight, and we wanted to put something in the record concerning it.

It is my understanding that you have made some inquiry of the banks under your jurisdiction as to the status of the dormant accounts?

Mr. DELANO. Yes.

Representative PATMAN. And I have a statement here which, I believe, you furnished me?

Mr. DELANO. That is right. At the last time of the last call upon national banks for reports of condition, we asked for a leaf report, not part of the report, but an enclosure in it. We asked for some figures on the dormant accounts in the national banks, and this is the result. We got them from practically all banks.

I think there were maybe a baker's dozen that did not give us the figures.

The figures roughly are that if you define a dormant account as an account that has been inactive for 10 years, with no contact with the depositor, and no knowledge on the part of the bank officials of where the depositor is or what he is doing or why he has not contacted the bank, then you get about $50 million.

Representative PATMAN. $50 million

Mr. DELANO. $50 million in national banks that fall in that classification, and you also get the knowledge which we asked for, that about $8 million additional have been escheated already to the States.

There is a law, I think it is a Kentucky law, which was passed to escheat dormant accounts in national banks into the State, and that Kentucky law went up to the Supreme Court and was affirmed there to the effect that the States have the sovereign right to escheat these accounts in national banks. But the $50 million are here, and whether the States get it or somebody else, is something——

Representative PATMAN. There are only 5,000 national banks?

Mr. DELANO. Yes; that is right.

Representative PATMAN. Considering that there is that much money in those banks in dormant accounts, I assume that we can presume that there must be a considerable sum in postal savings and building and loan associations and State banks.

Mr. DELANO. Oh, yes; I imagine so.

Representative PATMAN. And credit unions.

Mr. DELANO. Yes, I imagine so.

Representative PATMAN. And all the other different places where deposits can be made.

Mr. DELANO. Yes.

Representative PATMAN. And since the States are the only ones who are the beneficiaries so far, and only a few of the States have passed adequate laws along that line, do you not think it would be well for Congress to consider passing some kind of a law to deal with situations like that for the purpose of permitting people who have reason to believe that there is a dormant account, to make inquiry at some

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central headquarters and to determine whether or not there is a dormant account which is existing?

Mr. DELANO. Well, yes, I think it would be somewhat challenging and possibly futile for the Federal Government to escheat these accounts to the Government, to the Federal Government.

Representative PATMAN. Yes, sir.

Mr. DELANO. Because I am afraid that they would fall then within that Supreme Court decision. But almost any action that could be taken to give some life to these accounts would be a desirable thing; that is, possibly, you might stir up the banks to be more diligent in trying to find the dormant fellow or trying to smoke out what has become of him.

I do not know that I could advise your trying to get these funds into the Federal Government, because I think you would run up against the Supreme Court on that.

Representative PATMAN. Well, I am not talking so much about escheating as I am of making it possible for interested people to find out. If the interested people knew that $50 million are there in these dormant accounts, if they knew where to inquire to find out, they would be $50 million better off.

Mr. DELANO. You say interested people, Mr. Chairman?

Representative PATMAN. I mean heirs and people who are legally entitled to receive it.

Mr. DELANO. Oh, yes.

Representative PATMAN. During the war, soldiers sometimes made deposits in banks, and if killed in action, the relatives have no way of finding out about the deposit or where the money is. After a period of time the unclaimed deposit might be made public by advertising under some congressional act so that interested people could find out.

Mr. DELANO. There has been some action along that line by the banks themselves, I mean some advertising of dormant accounts.

Representative PATMAN. Yes, sir; in some States it is required, I understand.

Mr. DELANO. It is required, but there has been no comprehensive attempt to give validity to that action.

Representative PATMAN. That is right. In the over-all picture it is a very small matter, I know.

Mr. DELANO. Yes; out of $200 billion it is not so large.

Representative PATMAN. That is right; yes, sir.

Dr. Murphy, do you have any questions?

Mr. MURPHY. No.

Representative PATMAN. Dr. Ensley?

Mr. ENSLEY. No questions.

Representative PATMAN. Mr. Wolcott, you said you had no questions?

Representative WOLCOTT. Excepting that I think we, perhaps, might take the leadership with respect to these dormant accounts by laying out a general plan whereby when these accounts are escheated, for example, under the recommendation which we might make with respect to advertising, the States might set up a reserve to meet payments that might occur later on through claims made without any statute of limitations running against them. I think, perhaps, a reserve of 10 percent of escheated funds in the State would be added to that purpose.

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I wonder why something along that line has not been set up?

Mr. DELANO. I do not know. There are all sorts of methods of escheating. Some of it is called custodial. They simply take over the account and they hold it in custody for a certain length of time before it actually escheats to the State, and I think there are some cases where it goes directly to the State. That is a question of the study of the details of the law of these various States, but I would say that what you have to suggest would be very proper because oftentimes people do not know—they find out later about moneys that their fathers or brothers or uncles have put in banks.

I remember a story that has nothing to do with banks, but is illustrative of the point. In the old Calumet and Hecla mine, which is a very famous mine up in Michigan, they had some people on the books who never showed up; dividend checks were mailed, mailed to addresses, and they were returned, and they apparently just disappeared.

One day a little old lady showed up at the main offices, and she said that she was so-and-so, and had some papers to prove it, and that she did not know whether there was anything for him or belonged to her, but her husband had been a ship captain and he had been lost at sea many years ago.

They looked over the books of the company and found out that she had a little over a million dollars, which was a very nice piece of treasure trove that was discovered.

Representative WOLCOTT. Well, I had a similar experience, if you will pardon a personal reference. I had a bank account in a home-town bank when I was a young lawyer, and when I was ambitious to save something, and I had forgotten all about it, and they were cleaning up their old accounts within this last year, and the assistant cashier called my attention to the fact that I had $12 to my account. That is similar to your story only in that it was an amount of money. It was rather a contrast to your little old lady.

Mr. DELANO. Well, this story of the Calumet and Hecla is of interest to me because my father ran the Calument and Hecla for a while, and he told me the yarn. He told me that the little old lady was practically prostrated, and they had to take her out and fan her, but those things do happen.

Representative PATMAN. It occurs to me there should be some way—and it is possible it should be extended through to corporate ownership, I do not know—where funds which are in the possession of corporations or banks, and people are anxious to find out about them could do so. I know a prominent person here in Washington who told me the other day that his mother died within the last 2 years in the West, and she had recently deposited $3,000, either in a building and loan or a bank or some place, and they all knew it, but they could not find it.

Mr. DELANO. Yes.

Representative PATMAN. There is no way of finding it, and I do not know whether it is a problem that is big enough to cause the Congress to take much time or give much attention to it.

Mr. DELANO. Well, it has a human-interest element in it.

We have in our shop some $2½ million for which we are acting as trustee of funds that came out of closed banks, liquidated banks, and all sorts of things that we found in lock boxes, strange jewelry, and

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letters and deeds to cemetery plots, and Confederate money, and all sorts of curious things, for which we act as trustees, and which we deliver to the owners when they can prove ownership.

The actual cash, cash money, that I speak of, of course, we hold in trust, and we have quite a lot of correspondence about it.

I do not know what the score is, but there are letters that come in every day of people trying to prove that they own some of this money. We invest the money, in Government bonds, and the investment just about pays for the expense of running the operation, of answering the letters and taking care of the files and that sort of thing, but it goes to show you what happens.

There are $2½ million just taken out of closed banks, and banks that were in liquidation, besides all the somewhat miscellaneous treasure trove that we have in the vault, which I wish we could get rid of, by the way. I wish the Congress would let us deliver it to somebody or maybe sell it so that we would not have it on our hands. That was quite an interesting thing to go through that vault and see the miscellaneous stuff that is in there.

Representative PATMAN. We realize it is not a major problem, but I am glad you have that information.

Mr. DELANO. It is a human-interest problem.

Representative PATMAN. Without objection we will place in the record the communication concerning this.

(The document referred to is as follows:)

TREASURY DEPARTMENT,
COMPTROLLER OF THE CURRENCY,
Washington, March 7, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management,
Joint Committee on the Economic Report,
House of Representatives, Washington, D. C.

MY DEAR MR. PATMAN: In accordance with your recent request, there is enclosed a copy of schedule Q-1, which was sent to all national banks in January 1952. Information regarding dormant account balances has been furnished by 4,936 national banks, constituting 99.80 percent of all national banks and holding 99.72 percent of all national bank deposits. The enclosed tabulation shows the total number of dormant accounts and total dollar amount thereof in all reporting banks. We have omitted the "cents" figures and have utilized that column to show the average dollar amount of the dormant accounts in each reported category.

If you desire more detailed data on this subject, we will try to furnish it promptly.

Sincerely yours,

PRESTON DELANO,
Comptroller of the Currency.

Enclosure.

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TREASURY DEPARTMENT—COMPTROLLER OF CURRENCY (STAT.) DECEMBER 1951

Charter No. ....
Federal Reserve District No. ....

SCHEDULE Q-1—DORMANT ACCOUNT BALANCES AT CLOSE OF BUSINESS ON DECEMBER 31, 1951

NAME AND LOCATION OF BANK: TOTAL NATIONAL BANKS IN UNITED STATES AND POSSESSIONS (EXCLUDES NONNATIONAL BANKS IN DISTRICT OF COLUMBIA)

(4,936 reporting national banks (10 reports missing): 4,313 banks reported accounts; 623 banks showed "None" in all 4 items)

A dormant deposit balance, either time or demand, for the purpose of this report, must meet each of the following requirements:

1. No deposits or withdrawals have been made by the depositor, or on behalf of the depositor, exclusive of interest credits or service charges, since December 31, 1941.
2. Bank officers or employees have had no contact with the depositor, or an authorized representative of the depositor, since December 31, 1941.
3. The depositor's existence and whereabouts are unknown.

Description	Number of accounts	Amount	
		Dollars	Averages
Item 1. Dormant savings and other time-deposit accounts:			*Dollars*
(a) Accounts with balances of $100 or less	1,216,178	5,418,050	4.45
(b) Accounts with balances of $100.01 up to $1,000	23,774	7,520,348	316.33
(c) Accounts with balances over $1,000	8,068	16,834,863	2,086.62
(d) Subtotal	1,248,020	29,773,261	23.86
Item 2. Dormant demand deposit accounts:			
(a) Accounts with balances of $100 or less	1,047,725	8,545,277	8.16
(b) Accounts with balances of $100.01 up to $1,000	32,443	6,797,282	209.51
(c) Accounts with balances over $1,000	1,490	4,522,068	3,034.94
(d) Subtotal	1,081,658	19,864,627	18.36
Item 3. Grand total of dormant savings and other time-deposit and demand-deposit accounts, item 1 (d) plus item 2(d)	2,329,678	49,637,888	21.31
Item 4. Aggregate amount of dormant account balances paid over to State authorities since Dec. 31, 1941, under the provisions of abandoned property or escheat laws, etc. If none, so state	....	8,240,290	....

I hereby certify that the foregoing statement is correct:

—————, *President or Cashier.*

NOTE.—The above schedule should be prepared in duplicate. The original should be forwarded to the Comptroller of the Currency and the duplicate retained in the bank for inspection by the examiner.

Representative PATMAN. Also without objection any member of the committee can extend his remarks and make such comment as he desires, and insert such statement as he desires in this hearing.

Is there anything else, gentlemen?

Thank you very kindly, Mr. Delano.

(Whereupon, at 11:30 a. m., the subcommittee recessed to reconvene at 10 a. m., Monday, March 31, 1952.)

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MONETARY POLICY AND THE MANAGEMENT OF THE PUBLIC DEBT

MONDAY, MARCH 31, 1952

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON GENERAL CREDIT CONTROL
AND DEBT MANAGEMENT OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to recess, at 10:15 a. m., in room 224, Senate Office Building, Representative Wright Patman (chairman of the subcommittee) presiding.

Present: Representatives Patman (chairman of the subcommittee), and Bolling.

Also present: Grover W. Ensley, staff director; Henry Murphy, economist for the subcommittee; and John W. Lehman, clerk to the full committee.

Representative PATMAN. The committee will please come to order.

We have with us this morning Mr. H. Earl Cook. Mr. Cook is a member of the Board of Directors of the Federal Deposit Insurance Corporation. He was formerly superintendent of banks in the State of Ohio; he was also formerly president of the Ohio Bankers' Association and of the National Bank Division of the American Bankers' Association.

Mr. Cook, I believe you have a prepared statement?

Mr. COOK. I do, Mr. Chairman.

Mr. Chairman, may I say at the outset, with great regret that Chairman Harl, because of serious illness, is unable to be here this morning, and he asked that we convey to you his regrets and his regards.

Representative PATMAN. We wish for him a speedy recovery. You tell him not to bother about this hearing or anything in connection with it, and that his health comes first. I know that you gentlemen can give us the information we desire.

Mr. COOK. We shall endeavor to do that, Mr. Chairman.

May I say that we appreciate the courtesies that you have extended to us, and the splendid work that you are doing; and we also appreciate what Dr. Murphy has done. He has been most courteous and helpful to us in the preparation of material that we feel you want to have.

Representative PATMAN. You may proceed any way you desire. You can read your statement or——

Mr. COOK. I prefer to read it if you will permit me, Mr. Chairman.

Representative PATMAN. That will be all right. You may insert the attachments to your statement, and the charts.

Mr. COOK. That will be submitted for the record, if you so desire.

Representative PATMAN. Yes, sir.

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STATEMENT OF H. EARL COOK, MEMBER, BOARD OF DIRECTORS, FEDERAL DEPOSIT INSURANCE CORPORATION; ACCOMPANIED BY E. H. CRAMER, CHIEF, DIVISION OF RESEARCH AND STATISTICS, AND L. L. ROBERTSON, ASSISTANT TO THE CHAIRMAN, BOARD OF DIRECTORS, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Cook. Mr. Chairman and members of the committee, the opportunity to appear before your committee for the purpose of discussing various aspects of Federal deposit insurance is a source of keen personal satisfaction to me. Your committee is now engaged in an endeavor of profound importance to every citizen of the United States. Its inquiry into the fundamentals of monetary policy and the management of the public debt is monumental in scope. That the committee has found time within its very busy schedule to consider the role of deposit insurance testifies to the thoroughness and comprehensiveness of its work.

The Federal Deposit Insurance Corporation is of fundamental importance to the economic life of the Nation. Its principal purposes are to protect depositors, to maintain the confidence of depositors in banks, to raise standards of bank management, to increase the soundness of the banking system, and to aid in protecting the circulating medium. Although the Corporation was not designed primarily as a tool for implementing credit and monetary policy, by accomplishing its principal purposes it contributes to economic and financial stability and thus serves to further the purposes of the Employment Act of 1946.

A discussion of the reciprocal role of deposit insurance in promoting economic stability and of economic stability in making deposit insurance practicable necessarily centers on depositor confidence and the Corporation's success in creating and maintaining it. Depositor confidence is the vital element in a sound and stable banking system. In analyzing the bases of depositor confidence, the historical approach is most helpful.

Prior to the establishment of the Federal Deposit Insurance Corporation, each bank was dependent upon its own resources and abilities to maintain the confidence of its depositors. To be sure, there were sporadic efforts to bolster depositor confidence by means of State-wide deposit insurance, but these efforts proved unsuccessful largely because the risk was concentrated in relatively small geographical areas. During this era, whenever depositor confidence in the soundness of a bank disappeared, the result always was a competitive struggle among despositors for self-protection. They shifted their funds from bank to bank and they withdraw their deposits in the form of cash in a uiversal self-defeating effort to find a safe place for their money.

Public opinion with respect to financial standing is extremely sensitive. Carried by the winds of idle gossip, rumor of financial unsoundness has in the past wrecked many good banks. The annals of banking history are replete with instances of widespread financial disorganization and panic stemming from the failures of banks in these circumstances . Furthermore, banking troubles have brought about financial repercussions which upset the commercial structure of the entire Nation. Property values were destroyed, and the chain of misfortune

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led to mass unemployment, evergrowing economic paralysis, destitution, and misery.

The basic facts regarding failures in banking and business for the period 1867–1950 are depicted by the accompanying chart No. 29 prepared by our Division of Research and Statistics. These data have been developed from the various sources of statistical information that are available, including compilations and studies by private agencies as well as public authorities. The red silhouette on the chart is indicative of the rate of failures in banking and the black curve relates to failures in other types of business. Many statistical problems are involved in arranging and presenting these data but it is our judgment that the over-all picture is a fair representation of the historical facts.

This graphic record explains in vivid terms why members of Congress as well as leaders in banking and business were concerned with finding the solution to the problem of banking instability for almost 50 years prior to the establishment of Federal deposit insurance. The first bill in the long series of proposed legislation for deposit insurance was introduced in the Congress in 1886. Before the present Federal Deposit Insurance Corporation finally came into existence 150 bills were considered by the Congress. The history of this legislation for the guaranty or insurance of bank deposits is discussed at length in part 3 of our 1950 annual report.

As time went on, it became abundantly clear that depositor confidence was the key to the problem of banking instability. Lack of confidence wrecked many sound banks and there was a tendency for the loss of confidence to spread quickly in ever-widening circles.

Mutual causation was recognized as the dynamic element in banking instability. This causation operates through cycles involving loss of depositor confidence in one bank, bank runs, panic, and failure, and then loss of confidence in nearby banks, further runs, panic, and failure, and so forth. The most dramatic illustration of this progressive deterioration of depositor confidence in banking occurred during the 1929–33 business depression which culminated in the total collapse of the banking system. The establishment of the Federal Deposit Insurance Corporation in 1933 signaled a major advance in the direction of banking stability.

Representative PATMAN. What is the correct date of the signing of the bill that made this law effective?

Mr. COOK. The temporary bill was signed, was it, May of 1933? I do not have the date myself.

Representative PATMAN. May 1933?

Mr. COOK. It is my recollection that the bill which provided a temporary plan for $2,500 protection was enacted in 1933. The permanent plan of insurance became effective in 1935; but the original had its inception in May, I think it is, 1933. We can supply you that date, Mr. Chairman.

Representative PATMAN. I wish you would, please.

Mr. CRAMER. The bill was passed in 1933; it went into operation the 1st of January 1934.

Representative PATMAN. That date in May, May 10, seems a little early.

Mr. CRAMER. No deposits were insured during the year 1933.

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Mr. COOK. As I recall, the bill was introduced, the legislation was in the process at that time, but we will supply you with that exact date.

Representative PATMAN. But the first law, you do not know the date it was actually signed?

Mr. COOK. I do not have that date.

Representative PATMAN. I wish you would get it.

Mr. COOK. We can supply that to you, sir.

Representative PATMAN. Very well.

(The information above requested is as follows:)

The original deposit insurance law was a part of the Banking Act of 1933, which was approved and became effective on June 16, 1933. This law established the Federal Deposit Insurance Corporation and provided for deposit insurance to go into effect on January 1, 1934.

Mr. COOK. It created for the first time a Nation-wide mechanism for rebuilding and maintaining depositor confidence.

Functioning within the framework of our American free enterprise dual banking system, the Corporation enlisted the bankers and the State and Federal bank supervisory authorities in a great cooperative effort to provide sound and stable conditions in the banking community. The success of this endeavor is demonstrated by the present stability in the banking structure and the large number of participating banks. All but approximately 1,000 of the 14,700 banks in the United States are now insured.

Depositors in banks that are insured no longer rely solely upon the banks for safety. They know their accounts are protected up to $10,000 by the Federal Deposit Insurance Corporation. As a result, their instincts of self-preservation no longer force them to participate in a stampede of deposit withdrawals whenever there is a rumor that a bank is unsound. This is the fundamental contribution of Federal deposit insurance. While some may dismiss it as wholly psychological, the fact remains that depositor confidence is an indispensable factor in the economic life of the Nation.

There can be no doubt that the remarkable stability which has characterized banking since 1933 is the result of the profound and widespread confidence engendered in the minds of depositors that their money is safe in the banks. Dramatic evidence of the fundamental change which has taken place in the climate of banking may be seen in two charts which our Division of Research and Statistics has recently prepared. The first is a spot map showing the general pattern of failures in banking over the period 1916–33. That is chart No. 46. Compare this blackened picture with another map, chart No. 47, that shows comparable data for both insured and noninsured banks in a period of corresponding length, that is, 1934–51. In preparing these charts it has been necessary to piece together the information on banking failures and suspensions from the available sources. Reporting, especially in the earlier period, is definitely fragmentary. However, the general impression of widespread failures in the 1916–33 period, and stability in the 1934–51 period, is correct.

Over the entire period since 1933 the Federal Deposit Insurance Corporation has demonstrated that it is possible to preserve the confidence of depositors in their banks and to maintain stability in the entire banking system. There are two principal facets to the Corporation's activities in achieving these objectives. First, the efforts of

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supervisory authorities, both State and Federal, as well as of the banks themselves, have been coordinated in the endeavor to maintain sound banking practices. The banking community has been notably free of excessive speculation. Moreover, there has been a continued effort to improve day-to-day banking practices and to strengthen the management and the capital of the individual banks. The second principal facet of the work of the Corporation has been remedial. Both the banking authorities and the bankers have been alert to developments which required immediate attention. The Corporation has acted speedily whenever necessary to give depositors clear and unequivocal assurance that their accounts were protected.

Sometimes it is asserted that the Federal Deposit Insurance Corporation has never actually been tested because it is a creature of fortunate times. Those who advance this view are blinding their eyes to the turbulent years since the establishment of deposit insurance. Within this period the Nation experienced a recovery from the deepest depression of the twentieth century. There occurred a sharp business recession in 1937 and 1938 which was followed by the Second World War and the period of post-war readjustment and rehabilitation. Now we are in the midst of a great national defense effort. Throughout this long, troublesome era, the Federal Deposit Insurance Corporation has adhered to the fundamental principle that depositor confidence in banking is best maintained by acting promptly whenever confidence is threatened in a bank.

Whether the Federal Deposit Insurance Corporation could withstand an economic collapse of the magnitude experienced in 1929–33 is another question frequently raised in discussions of Federal deposit insurance. That question is wholly academic. The characteristics of the 1929–33 catastrophe set it apart as a unique happening in the long history of this great Nation. However, if the purpose of the question is to consider the ability of the Corporation to function successfully in a period of business adversity, then a study of the 1937–38 recession is definitely in point. At that time the preservation of depositor confidence by the Federal Deposit Insurance Corporation was one of the major buttresses protecting our economy against widespread instability and all the attending misfortunes. Throughout the 1937–28 recession and the subsequent period of economic readjustment, the Federal Deposit Insurance Corporation was able to maintain a hard core of depositor confidence in banking.

The results of the Corporation's efforts since 1933 have affirmed the principle that deposit insurance and economic stability are cast in reciprocal roles. Deposit insurance promotes economic stability and economic stability makes deposit insurance practical.

Your committee has expressed an interest in the available data concerning the withdrawals of large and small deposits, respectively, in precipitating bank failures during the period prior to the establishment of FDIC. For your record, there is attached an exhibit No. 1 presenting the text of a study of the behavior of deposits prior to suspension in a selected group of banks which were suspended in the period 1930–33. This was a Works Progress Administration study which was published in the Federal Reserve Bulletin 13 years ago. The data covered 67 medium-sized banks that failed. The Board of Governors of the Federal Reserve contributed the supervising staff for the project.

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This study indicates that the failing banks experienced a drastic reduction in their deposits as a result of the withdrawals of the larger accounts prior to suspension. Thus, the data may be interpreted to suggest that the so-called "silent runs" by big depositors were the primary cause of failure.

Within very broad outlines the findings of this study of depositor behavior in failing banks are in accord with practical banking experience of 20 years ago. It has long been observed that silent runs on banks by the large depositors always precede the more or less frantic efforts of small depositors to withdraw cash before the failure.

By generalizing the available data and experience, some students of banking have concluded that the depositors who really constitute the element of instability are those with the large and not the small accounts. They conclude, furthermore, that Federal deposit insurance emphasizes unduly the importance of maintaining the confidence of the small depositor. As a corollary, it is contended that depositor confidence cannot be maintained with anything less than complete insurance coverage for all depositors.

This view is not in accord with our analysis and understanding of the facts. Nor was it the view of the Congress when Federal deposit insurance was established. The importance of the silent run as a factor which exhausted the resources of failing banks cannot be emphasized too strongly. However, the crucial question is this: Why was the silent run always the precursor of the final line-up of small depositors in a futile effort to convert their accounts into cash? In our judgment, the silent runs by the large depositors were in anticipation of the final stages of collapse when the small depositors figuratively, and sometimes literally, tore the banks apart.

That the problem of maintaining confidence centers basically on small rather than large depositors is further evidenced by the fact that failures among the large metropolitan "bankers' banks" were rare even in the late 1920's and the early 1930's. Moreover, when the so-called "bankers' banks" experienced difficulty, almost without exception their troubles stemmed from the fact that small customers lined up in the bank lobbies and demanded cash. Had it been possible to maintain the confidence of these depositors the banks would have survived. That, at least, is our judgment.

With reference to the extent of coverage for depositors offered by Federal deposit insurance you will recall that the maximum was increased to $10,000 by the Federal Deposit Insurance Act of 1950. This change, in our judgment, is thoroughly sound. The legislation recognizes that the preservation of depositor confidence is essential for the achievement of stability in banking, and furthermore, that it is the confidence of the small depositor that requires primary consideration.

Full protection is afforded 98½ percent of the accounts under the present Federal deposit insurance law. Accordingly, depositors with large balances need not worry about the prospect that their banks will be undermined by mass withdrawals when small depositors lose confidence. Since that threat has been removed, the large depositors can concentrate attention on such important factors as management and the quality of assets in appraising the soundness of a bank. This makes for stability in the actions of the large depositors.

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The Senate Banking and Currency Committee in its report with respect to the Federal Deposit Insurance Act of 1950 expressed the view that protection should not be increased beyond the $10,000 maximum coverage. Furthermore, the committee recommended to the Congress that it should never adopt the policy of guaranteeing the safety of all deposits in all banks. It has been our experience that the depositor protection afforded by the existing statutes is adequate to maintain depositor confidence and achieve a high degree of stability in banking.

A considerable interest has developed recently in the methods used by the Federal Deposit Insurance Corporation to protect depositors. In order to facilitate a complete understanding of these methods, we believe it advisable to review briefly the philosophy underlying Federal deposit insurance and to summarize the problems and procedures involved in the protection of depositor confidence.

Federal deposit insurance operates within the framework of the State and Federal banking laws. Each of the 48 States has authority to charter and supervise banks. Under the National Bank Act, the Comptroller of the Currency charters and supervises national banks. This vast complexity of State and Federal banking law furnishes the basis of our dual banking system.

The essence of the dual banking system is the coexistence of Federal and State authorities with each complementing and neither dominating the other. Over the years, many attempts have been made to destroy or eliminate State authority in the banking field. But the States continue to retain powerful prerogatives. This is as it should be, because the State banks supervised by the State banking authorities are a strong force in maintaining a proper balance between our Federal and State Governments.

When Federal deposit insurance was under consideration by the Congress in 1933 and 1935, grave fears were voiced that it would be used as a means for destroying the dual banking system. In view of our banking history, these fears are entirely understandable. To allay these fears, Federal deposit insurance was so designed as to strengthen the American dual system of free-enterprise banking.

Federal deposit insurance was developed by men who were mindful of the legal and practical realities of banking in the United States. They developed a statute for depositor protection which would work within the existing structure of Federal and State law. Therein reposes the greatness of their contribution.

A knowledge of this legal background of the dual banking system with all of its State and Federal ramifications is essential to an understanding of the workings of Federal deposit insurance. These laws establish the boundaries for the authority and operations of the Corporation. For instance, the Corporation has no authority whatsoever to close a bank. This power reposes either in the Federal or State chartering agency. Furthermore, the Corporation has no authority to open a closed bank. That can only be done by the authority which closes it, and pursuant to the applicable State or Federal laws. In this connection, it should be mentioned that under the Federal Deposit Insurance Act of 1950 the Corporation may aid in the reopening of a closed insured bank, but the bank may not be reopened by the Corporation. The reopening, if authorized by the applicable State or Federal law, can only be effected by the State supervisory authority or

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the Comptroller of the Currency. In other words, the Corporation must work within the system for bank supervision prescribed by State and Federal law. It cannot override the State or National bank supervisory authorities.

Turning now from this brief discussion of the legal structure within which the Federal Deposit Insurance Corporation operates, let us consider the basic provision of depositor protection found in the Federal deposit insurance law. This can be phrased very simply. Each depositor in every insured bank is entitled to protection up to a maximum of $10,000. This coverage was increased from $5,000 by the Federal Deposit Insurance Act of 1950.

When an insured bank is closed by its supervisory authority, that is, the State banking department or the Comptroller of the Currency, each depositor knows that he has the basic $10,000 coverage. Usually a receivership ensues when an insured bank has been closed by the chartering authority. So for convenience in this discussion of depositor protection, such a situation will be identified as a "receivership case." In a receivership case, the Corporation pays the amount of the claims of the depositors up to a maximum of $10,000 as soon as the claims have been verified. The payment may be in cash or in the form of a deposit in another insured bank payable on demand, or as a deposit in a new insured bank in the same community.

Whether the Federal Deposit Insurance Corporation can do something more than furnish depositors the basic coverage in a closed or failing insured bank depends upon the circumstances of the individual case. Early in the history of Federal deposit insurance, it became apparent that in some cases depositors could be provided with more than the basic coverage at no additional cost or risk to the Corporation. Accordingly, provisions were added to the law which in appropriate circumstances afforded depositors more than basic protection. They are embodied in sections 13 (c) and 13 (e) of the Federal Deposit Insurance Act of 1950.

Rehabilitation of a closed or failing bank may be effected under section 13 (c) of the Federal Deposit Insurance Act of 1950 if in the opinion of the Board continued operation of the bank is essential to provide adequate banking services in the community. Unless the Corporation finds from its consideration of the facts that continued operation is essential for adequate banking services in the community, this section of the law cannot be used as a means for preserving depositor confidence. Moreover, this method cannot be used if the bank has been closed, unless the supervisory authority is permitted by the governing law to reopen the bank and elects to do so. In this connection it should be noted than when section 13 (c) is applicable all depositors may be fully protected. Thus, the section is an extension of the basic $10,000 coverage. This rehabilitation procedure was first authorized by the 1950 revision of the Federal deposit insurance law. Up to now, the Corporation has not had occasion to use this authority.

Section 13 (e) of the Federal Deposit Insurance Act of 1950, which is a restatement of the old law, provides a second method for giving depositors more than the basic $10,000 protection whenever it is applicable. Under this section, the Board has discretionary power to make loans to, or purchase assets from, closed or failing banks. It may guarantee an insured bank against loss by reason of its assump-

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tion of the liabilities and assets of another open or closed insured bank. In such cases, the failing or closed bank is merged with or taken over by another insured bank. This method of protecting depositors is usually identified as the "merger" procedure.

Where the merger is used, the Corporation acquires the unsound assets of a failing bank and advances to the bank sufficient cash to equal the difference between its deposit liaibilities and its sound assets. Concurrently with this transaction the total deposit liabilities of the failing bank are transferred to and assumed by another insured bank which receives all of the good assets plus cash sufficient to equal the amount of the liabilities assumed. The Corporation then liquidates the assets it has acquired for the purpose of recouping its disbursements and interest thereon. Any excess recovered by the Corporation from the proceeds of the liquidation of the assets is returned to the owners of the failed bank.

In the case of a distressed bank, when the Federal Deposit Insurance Corporation can utilize the merger authority in section 13 (e), the result is the full protection of all depositors. The statute provides a standard for determining whether the merger method may be used. The test is: Will the use of this method "reduce the risk or avert a threatened loss" for the Corporation? Unless there is an affirmative answer to this question, the Corporation cannot use the merger procedure to protect depositors. It can only stand by and assure depositors that the basic deposit insurance protection will be furnished them if the bank is closed and is unable to meet depositors' demands.

Whenever it is necessary to decide upon the method of depositor protection to be used in any case, the Corporation must consider more than merely the dollar-and-cents costs of protecting depositors in the failing bank. It is obliged to go beyond that narrow field and give consideration also to the indirect and intangible elements in each case. In so doing, the Corporation cannot avoid consideration of the consequences that would follow if a distressed bank should be placed in receivership.

Generally speaking, the Corporation's experience with protection of depositors in so-called receivership cases has been rather costly business. Not only have the direct effects of receiverships been costly for the Corporation because of the legal and other expenses inherent in receivership liquidations, but the indirect effects—measured in terms of maintaining stability and confidence—have likewise been costly and troublesome to the Corporation as well as for the entire community. When a receivership occurs, there is always an interruptiton in banking services to the depositors and customers of the bank. To be sure, the Corporation makes every effort to minimize the effects of this interruption by paying insured deposits within a few days. However, it has been our experience that the freezing of depositors' funds even for a brief interval is sufficient to weaken the finances of small-business men, and sometimes to cause them to fail. These interruptions are also especially harmful to persons whose resources are limited to a small deposit in a single bank.

The Corporation must also consider the effects of a bank receivership upon other insured banks in the same community and the surrounding area. Many times in the past, a receivership in one bank has set in motion a long chain of bank failures that might otherwise

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have been avoided. So it is that each receivership carries with it the risk of potential loss to the Corporation in other insured banks.

Other more direct consequences are involved when an insured bank is placed in receivership. In a receivership case, all assets of the bank, whether good or bad, must be liquidated. On the other hand, when depositors can be protected through the merger method, the good assets are transferred to the assuming bank. Thus, full recovery is effected on such assets without any liquidation expenses. Furthermore, there are costs in a receivership which do not occur in the case of a merger, such as expenses of paying depositors' claims, the cost of processing and paying dividends, and court and legal costs necessary in the administration of the receivership. These items further reduce total recovery in a receivership as compared with the results in a merger case.

Finally in all liquidations the Corporation is confronted with one always-present loss element—the tendency of debtors to become compromise-minded as soon as the bank is placed in liquidation. Any loss in asset value from this cause is avoided as to all loans transferred to an assuming bank in a merger case. But in a receivership case, it is a source of potential loss on virtually all of the failing bank's loans.

All of the stated disadvantages of receiverships weight heavily in favor of the merger procedure whenever the Corporation is called upon to protect depositors. But these factors are not always conclusive in applying the statutory test.

There are two other considerations of primary importance in every case involving the protection of depositors in a failing insured bank, namely, the amount of uninsured deposits and the amount, if any of the nonbook liabilities; such as liability for improper administration of trust estates. Sometimes the importance of these two factors is sufficient to preclude the use of the merger procedure for protecting depositors. But there are cases where these factors are offset by the advantages inherent in the merger procedure; or, the Corporation may receive guarantees which are sufficient to nullify the effects of the uninsured deposits or nonbook liabilities. The merger method may be used in such cases because it will reduce the risk or avert a threatened loss to the Corporation, as required by the statute.

Over the entire period of its operations, the Corporation has protected deposits in 418 banks. In 245 of these cases, the depositors have received the basic insurance coverage because the banks were in receivership. And in 173 cases, it was possible for the Corporation to employ the merger procedure and thereby protect all deposits. It so happens that since 1944 no insured banks have been placed in receivership. In the course of this period, depositors in a total of 21 banks were accorded full protection of their deposits because the circumstances in these cases were such as to warrant the exercise of merger authority by the Corporation.

In protecting depositors it can be readily seen that the problem of arriving at the determination required by the statute cannot be solved by applying a precise detailed formula to all cases. Our experience has shown that bank failure cases do not fall into neat categories. Each presents its own array of complexities. It is absolutely essential to have a wide degree of latitude in the evalution

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of the factors upon which the judgment in the particular case will be made. The intangible and indirect elements are important in this effort to maintain depositor confidence. Undoubtedly the Congress was aware of the difficulties involved in appraising these vital elements because it did not prescribe detailed criteria when it authorized the merger method of protecting depositors. On the contrary, it vested broad discretionary authority in our Board of Directors. We believe we have used this authority in accordance with the intent of the Congress.

Of course, we are aware of recently expressed apprehension that the merger procedure will be used to extend depositor protection in all cases beyond the basic $10,000 coverage. These fears are entirely groundless. Each case is considered on is own merits and the merger authority is used only where the statutory test can be met.

The Employment Act of 1946 stresses the importance of financial stability in maintaining a healthy economy. The Board of Directors of the Federal Deposit Insurance Corporation has shaped its policies and decisions in accordance with this objective. This, we believe, is one of our major accomplishments under the Federal deposit insurance law.

(The documents referred to in the statement of Mr. Cook follow:)

EXHIBIT NO. 1

[Excerpt from Federal Reserve Bulletin]

BEHAVIOR OF DEPOSITS PRIOR TO SUSPENSION IN A SELECTED GROUP OF BANKS—ANALYSIS BY SIZE OF ACCOUNT

The analysis of the data made available by a Works Progress Administration study of the records of a group of banks that were suspended in the period 1930–33 has now reached the point where it is possible to present from time to time preliminary reports of various aspects of the study.[1] The present is the first of a series of such reports. It deals with withdrawals of deposits experienced by banks in the months prior to suspension.

This, and the succeeding reports, will present statistical analyses of the behavior of deposits by type and size of account. It is hoped that they will throw light on some aspects of bank liquidity on which heretofore no quantitative information was available.

The results of the investigation may be briefly 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

[1] The project as a whole was made possible through the cooperation of many agencies and individuals. The Comptroller of the Currency and various State banking supervisory authorities granted access to records, and their receivers provided accommodation for workers; the Works Progress Administration financed the study; the Board of Governors and the Reserve banks contributed the services of the supervisory staff. Lauchlin Currie directed the project. The present report was prepared by Martin Krost.

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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 of holder (local or nonlocal), or type of holder (business or personal), seems to be of comparatively minor importance.

5. The suspended banks included in the survey were medium-sized banks which may be regarded as broadly representative of the whole group of suspended banks having deposits of $1,000,00 to $25,000,000. Banks of this size held almost half of the deposits involved in suspensions during the period 1930–33. Smaller banks, not represented in the sample, made up 85 percent of the suspensions, and held about a quarter of the deposits involved in suspensions during this period.

The scope of the data.—The group of banks whose deposit withdrawals are analyzed in this study consists of 67 medium-sized banks which were suspended during the period from November 1930 to March 1933. These banks are broadly representative of suspensions involving banks with total deposits of from $1,000,000 to $25,000,000, located in urban areas. Measured as of the date of suspension, the total deposits of the banks included in the sample were $211,000,000, or about 5 percent of the deposits of all banks of comparable size suspended from 1930 to 1933. Although the suspensions involving this class of banks constituted only 15 percent of the total number of suspensions during these years, their deposits made up almost half of the total deposits involved in suspensions. A high proportion of the banks included in the sample study was located in eastern and midwestern industrial centers. Consequently, these sample data, while indicating the character of the deposit withdrawals experienced by medium-sized banks, are not directly applicable to the large number of small banks located in rural areas which suspended during the depression of the early thirties. Further information regarding the composition of the sample group of banks which provided data for this study is presented in table 1.

TABLE 1.—*Distribution of banks supplying data on presuspension deposit movements*

Distribution by location and size	All sample banks	Suspended before June 30, 1931	Suspended between June 30 and Dec. 31, 1931	Suspended after Dec. 31, 1931
Total number of banks	67	9	14	44
Distribution by area:				
New England	6		3	3
Middle Atlantic	20	2	7	11
East North Central	22	5	2	15
West North Central	6			6
South Atlantic	5	1	1	3
East South Central	1	1		
West South Central	1			1
Mountain	1			1
Pacific	5		1	4
Distribution by size of city:				
Cities of 100,000 and over	21	1	5	15
Cities of less than 100,000	28	5	4	19
Suburban areas	18	3	5	10
Distribution by size of total deposits (in millions of dollars):				
1 to 1.9	4		1	3
2 to 4.9	27	7	8	12
5 to 9.9	17		2	15
10 to 24.9	16	1	2	13
25 and over	[1] 3	[1] 1	[2] 1	[3] 1

[1] The largest bank had total deposits of less than $40,000,000.
[2] The largest bank had total deposits of less than $35,000,000.
[3] The largest bank had total deposits of less than $30,000,000.

In measuring the deposit withdrawals experienced by banks prior to suspension, the procedure followed throughout this study was to compare deposits at the time of suspension with deposits at a specified base date. For the 58 banks suspended between the middle of 1931 and March 1933, the base date from which deposits losses were measured was June 30, 1931; for the 9 banks suspended between November 1930 and the middle of 1931, June 30, 1928, was

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adopted as the base date. By far the major portion of the deposit losses revealed by this method undoubtedly reflects withdrawals based upon lack of confidence in particular banks or in the banking system, but some portion represents cyclical, seasonal, and other nonpanic withdrawals. The procedure of measuring deposit losses from a uniform base date necessarily obscures the marked divergencies among individual banks in the timing of their deposit withdrawals.

Deposit withdrawals classified by type of deposit.—The decreases in total deposits shown in table 2 measure the severity of the strain to which the sample banks were exposed.[2] The percentage reduction in total deposits experienced by individual banks range from a negligible figure to almost 75 percent. Of the 67 banks in the sample, 44 experienced reductions in total deposits of over 30 percent in this period.

TABLE 2.—*Percentage changes in deposits between base date and date of suspension, by type of deposit*

Type of deposit	67 sample banks	9 banks suspended before June 30, 1931	14 banks suspended between June 30 and Dec. 31, 1931	44 banks suspended after Dec. 31, 1931
Total, including interbank	−37.6	−38.4	−23.7	−41.2
Demand	−40.2	−37.2	−27.7	−43.6
Time	−30.1	−37.9	−13.3	−34.3
U. S. Government	−11.7	−47.9	(1)	−35.2
Interbank	−59.6	−21.1	−84.5	−60.9
Certified and officers' checks, etc	−59.2	−88.5	−47.5	−51.0

1 Increase of more than 100 percent.

Differences between the percentage reductions in total deposits shown by the various groups of banks are attributable in part to the length of time between the date of suspension and the date from which the loss of deposits is measured. In the case of the nine banks suspended before June 30, 1931, this interval ranges from 28½ months to almost 36 months; in the case of the 14 banks suspended between June 30 and December 31, 1931, it ranges from a few days to almost 6 months; and in the case of the 44 banks suspended after December 31, 1931, it ranges from just over 6 months to just over 20 months. While the period of time over which the loss of deposits is measured has some influence on the magnitude of the percentage reductions which are shown in the table, the fact that the percentage reductions in total deposits shown for the 9 earliest suspensions (where the minimum interval is 28½ months) and the 44 latest suspensions (where the maximum interval is 20 months) are approximately the same, indicates that the type of deposit loss under examination is in general not a slow, steady movement extending over many months, but a steep decline terminated within a few months by the exhaustion of liquid resources and borrowing power, or by the action of supervisory authorities. The factors which determine the magnitude of the deposit losses which the various groups of banks were able to sustain before suspension include the strength of their liquid positions, the extent to which they had become weakened by losses of deposits before the dates indicated in the table, the availability of borrowing facilities, and the attitudes of supervisory authorities and of other members of the local banking community as to the desirability of extending aid to particular institutions in distress.

An analysis of deposit movements by type of deposit shows that the percentage reductions in demand deposits were almost uniformly greater than the percentage reduction in time deposits. The sole exception is the group of banks that suspended before June 30, 1931. A more detailed examination shows that the percentage reduction in time deposits exceeded the percentage reduction in demand deposits for only four banks of the nine included in the group. While

[2] It is not possible to state precisely the percentage changes in total deposits of all surviving member banks over comparable periods, but it can be roughly estimated that total deposits in surviving member banks showed an increase of 2 or 3 percent from June 30, 1928, to June 30, 1931, decreased about 13 percent from June 30, 1931, to December 31, 1931, and decreased between 14 percent and 17 percent from June 30, 1931, to June 30, 1933.

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demand deposits showed sharper reductions than time deposits, the difference between the behavior of the two types of deposits in this respect was not nearly so marked in the period immediately before suspension as it was in the period of cyclical decline in deposits up to June 30, 1931. In this earlier period the percentage reduction in demand deposits was almost three times that in time deposits for the particular group of banks under consideration. Statistics for all member banks and for all commercial banks in table 3 show a similar differentiation between the behavior of demand and time deposits.[3] Interbank deposits show much sharper percentage reductions in the period immediately before suspension than either demand or time deposits (again with the exception of the banks suspended before June 30, 1931) in marked contrast to their behavior during the preceding period of cyclical decline.

TABLE 3.—*Percentage changes between June 30, 1928, and June 30, 1931, in deposit balances, by type of deposit*

Type of deposit	All commercial banks	All member banks	Sample banks suspended after June 30, 1931
Total, including interbank		+0.2	−7.5
Total, excluding interbank	−6.9	−2.6	−10.4
Demand	−9.3	−5.6	−16.4
Time	−4.8	−1.4	−5.9
U. S. Government	+61.5	+53.7	+113.2
Interbank	(1)	+23.7	+28.2
Certified and officers' checks, etc	(2)	+22.0	+14.3

[1] Not available.
[2] Included in demand deposits.

The allocation of the total reduction in deposits by type of deposit is shown for all sample banks in table 4. Demand deposits accounted for about 43 percent of the total loss of deposits in all sample banks, time deposits for 37 percent, and interbank deposits for 15 percent. The small remainder was attributable to reductions in certified and officers' checks outstanding, and in United States Government deposits.

The share of a particular type of deposit in the decrease in deposits is determined in part by its share in total deposits on the date from which the loss is measured, and in part by the magnitude of the percentage decrease which the particular class undergoes during the period. The behavior of interbank deposits demonstrates how a particular type of deposit can contribute to the total loss of deposits more than in proportion to its share in total deposits at the beginning of the drain. In the group of banks suspended between June 30 and December 31, 1931, interbank deposits were responsible for 28 percent of the total loss of funds although their share in total deposits on June 30 was only 10 percent. This was the result of the fact that this type of deposit showed a decrease of 84 percent during the period as contrasted with the decrease of 24 percent in total deposits.

[3] Figures for member banks and all commercial banks restricted to those which remained active over the period would show smaller percentage declines in demand and time deposits.

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TABLE 4.—*Allocation by type of deposit of the decrease in total deposits between base date and date of suspension in all sample banks*

Type of deposit	Percentage composition of the decrease in deposits	Percentage composition of total deposits on base date
Total including interbank	100.0	100.0
Demand	43.5	40.8
Time	37.4	46.7
U. S. Government	.2	.6
Interbank	15.2	9.6
Certified and officers' checks, etc.	3.7	2.3

Deposit withdrawals by size of account.—Percentage reductions in demand deposits by size of balance are shown for all sample banks in table 5 and for groups of sample banks in table 6.

TABLE 5.—*Percentage changes between base date and date of suspension in demand deposit balances, by size of account*

Type of deposit and size on base date	Percentage change
Total demand deposits	−40.2
Public funds	−17.8
Certificates of deposit	−54.0
Other demand deposits	−43.5
Inactive and unlisted	−6.8
Less than $1,000	−15.3
$1,000–$4,999	−39.4
$5,000–$24,999	−48.9
$25,000 and over	−63.8

TABLE 6.—*Percentage changes between base date and suspension in demand deposit balances by size of account, by classes of banks*

Type of deposit and size on base date	9 banks suspended before June 30, 1931	14 banks suspended between June 30 and Dec. 31, 1931	44 banks suspended after Dec. 31, 1931
Total demand deposits	−37.2	−27.7	−43.6
Public funds	+80.4	+2.2	−34.5
Certificates of deposit	−77.5	+208.9	−88.6
Other demand deposits	−47.3	−32.8	−44.8
Inactive and unlisted	−75.3	+2.7	+24.3
Less than $100	+73.2	+77.6	+58.7
$100–$199	+1.0	+12.3	−15.1
$200–$299	−.5	−4.0	−23.3
$300–$399	−32.7	−6.5	−31.1
$400–$499	−21.3	−11.9	−26.2
$500–$999	−27.2	−16.6	−35.6
$1,000–$2,499	−35.8	−24.9	−39.4
$2,500–$4,999	−42.0	−31.0	−45.6
$5,000–$9,999	−55.1	−32.4	−46.6
$10,000–$24,999	−51.4	−41.0	−53.2
$25,000–$49,999	−58.3	−53.8	−56.0
$50,000–$99,999	−40.8	−63.9	−62.4
$100,000 and over	−67.8	−58.7	−73.2

The most striking fact which emerges from the consideration of the accompanying tables is the regularity with which the percentage decrease in the balances of demand depositors rises as the size of the account increases. Decreases much below the general average are characteristic of accounts between the $100 and $200 level.[4] The magnitude of the reduction increases with the size of the

[4] For an explanation of the increases shown in the lowest size classes see the following paragraph.

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account until it exceeds 70 percent in accounts of $100,000 and over.

In interpreting these figures, it should be remembered that demand-deposit accounts existing at the base date were classified according to their size on that date. Since the subsequent drawing down of the balance has no effect on the initial classification, the magnitude of the losses in the higher-size groups is in no sense attributable to a shift of accounts into lower-size groups. This procedure also permits the full loss of balances in accounts closed to be reflected. Accounts opened after the base date were classified according to their size on date of suspension. Since these new accounts, in general, had relatively small balances at the date of suspension, the addition of such new accounts was responsible for the net increases shown by the balances in the lower-size groups.

The figures for different classes of banks show some differences but they are not as striking as the similarities. The resemblance of the general behavior of accounts, especially in the higher-size groups, in banks failing at different times and in widely separated geographical areas, is the more striking in view of the fact that comparatively few accounts fall within the higher groups. For example, in the nine banks suspended before June 30, 1931, there were only 130 accounts with balances of over $25,000 on June 30, 1928; in the 14 banks suspended between June 30 and December 31, 1931, there were only 143 accounts of this size; and in the 44 banks suspended after December 31, 1931, there were only 594 accounts of this size.

The allocation of the total reduction in balances in demand-deposit accounts by size classes is shown for sample banks in table 7.

TABLE 7.—*Allocation by type and size of account of the decrease in demand-deposit balances between base date and date of suspension*

Type of deposit	Percentage composition of the decrease in deposits	Percentage composition of deposits on base date [1]
Total demand deposits	100.0	100.0
Public funds	5.6	13.0
Certificates of deposit	.8	.6
Other demand deposits	93.6	86.4
Inactive and unlisted	.5	3.1
Less than $1,000	8.9	17.2
1,000-4,999	17.2	18.1
5,000-24,999	24.3	20.4
25,000 and over	42.7	27.6

[1] Accounts opened after base date are classified according to their size on date of suspension.

The contribution made by a given size class to the total decrease in deposits depends partly upon the proportion of total deposits held by that size class on the date from which the loss is measured, and partly upon the magnitude of the percentage reduction in that size class. Because the proportion of total deposits held in very small accounts is small, no serious strain would be imposed upon most banks even if all depositors with balances of less than $200 decided to withdraw their accounts entirely. Large accounts hold a very large proportion of total deposits in most banks, but this would not be a source of danger to these institutions if large accounts displayed a high degree of stability in their behavior in times of stress.

An inspection of tables 5 and 7 reveals that large accounts constitute a source of danger to banks both because they hold a large proportion of total deposits, and because they display an exceptional degree of instability in times of stress. For example, deposit balances in accounts of $25,000 and over, made up 28 percent of total demand deposits on the base date, but they accounted for 43 percent of the total loss of deposits that occurred between this date and suspension. This was the result of the fact that accounts of this size showed a decrease of 64 percent during this period as compared with a decrease in total demand deposits of 43 percent. In one sample bank which experienced losses of $6,540,000 in demand deposits, 26 accounts with balances of $100,000 and over showed a reduction of $5,737,000, or 88 percent of the net decrease in the total.

The sample is not representative of banks with total deposits of less than $1,000,000. These smaller banks constitute a high proportion of the total

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number of banks and made up a still higher proportion of the total number of bank suspensions, although they hold a comparatively small proportion of the total deposits of the existing banking structure.

The relative importance of size, type of deposit, residence of depositor, and type of depositor as determinants of deposit behavior.—The difference between the behavior of large and small accounts is more marked than the difference between the behavior of demand and time deposits, or the difference between the behavior of local and nonlocal accounts, or the difference between the behavior of business and personal accounts. These differences are summarized in table 8.

TABLE 8.—*Percentage reductions in deposits between base date and date of suspension, by various types of deposits*

Type of deposit	Total	Deposits of less than $5,000	Deposits of $5,000 and over
Demand deposits, exclusive of public funds	45.2	31.7	58.8
Time deposits, exclusive of public funds	34.4		
Business demand deposits [1]	50.6	29.8	57.6
Personal demand deposits [1]	45.5	37.3	65.0
Total [1]	49.3	33.5	58.4
Local demand deposits [2]	49.3	32.6	60.5
Nonlocal demand deposits [2]	47.3	25.0	51.9
Total [2]	49.0	32.1	58.9

[1] Percentages differ from those on demand deposits given above because they are based on figures which exclude fraternal and charitable accounts and accounts classified as to size but not as to type of holder.

[2] Percentages differ from those on the 2 sets of demand deposits given above because they are based on figures which exclude accounts classified as to size but not as to residence of depositor and include fraternal and charitable accounts.

The figures suggest that the explanation of large-scale deposit withdrawals in times of stress is to be found in the circumstances that differentiate the behavior of the large depositor from the small depositor, rather than in the circumstances which differentiate the behavior of the demand depositor from the time depositor, the nonlocal depositor from the local depositor, or the business depositor from the personal depositor.

BEHAVIOR OF DEPOSITS PRIOR TO SUSPENSION IN A SELECTED GROUP OF BANKS

ANALYSIS BY TYPE OF DEPOSIT HOLDER

The March 1939 Federal Reserve Bulletin presented a preliminary analysis of data recently made available by a Works Progress Administration study [1] of the records of a selected group of banks suspended in the period 1930–33. The data introduced there suggest the inference that large demand deposits not only exhibited a greater instability than small ones, but also that the percentage reduction of balances in the period prior to suspension became progressively greater the greater the size of the account.

The present discussion classifies similar statistical material by type of holder. This classification has a twofold purpose. The first is to discover whether or not significant variations exist in the presuspension behavior of the deposits of different types of holders. The second objective is to explore the possibility that these variations may explain the variations observed in the behavior of deposits of different sizes.

Deposit reductions are measured from a base date to the date of suspension. The base dates selected were dates on which banks suspended at different times had not experienced serious deposit withdrawals. For the nine banks suspended before June 30, 1931, the base date is June 30, 1928. For the 58 banks suspended thereafter, the base date is June 30, 1931. In the following pages, deposit balances on the base date are referred to as normal balances and the composition of total deposits on the base date is referred to as the normal composition. In this article, interbank deposits are treated as a part of total demand deposits.

The results of the investigation may be summarized as follows:

1. Withdrawals from business accounts comprised the largest single item in presuspension demand deposit reductions, accounting for 42 percent of the total.

[1] This report was prepared by R. C. Breithut and Martin Krost.

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The contribution of business balances to presuspension deposit reductions was somewhat greater than their normal contribution to the consumption of total deposits (38.4 percent). The presuspension reduction of business deposits represented 48 percent of normal business balances.

2. Interbank withdrawals were second in importance, comprising 25.9 percent of the total presuspension decline in demand deposits. The substantial contribution of interbank withdrawals to deposit losses can be explained by the volatility of this class of accounts. Interbank deposits decreased 59.6 percent of their normal level, a percentage decline considerably in excess of those shown by personal demand deposits, business demand deposits, or public funds as a whole, and corresponding to the rate of withdrawal characteristic of deposits of large size. Although no analysis was made of interbank deposits by size of account, such accounts are known to be large.

3. Personal deposits contributed 12.9 percent of the total decrease in demand deposits, slightly less than their share (13.3 percent) in the composition of total demand deposits. The presuspension reduction of personal deposits represented 42.6 percent of normal personal balances. Personal accounts are less stable than business accounts of comparable size but because personal balances are predominantly small balances, personal accounts as a whole are more stable than business accounts as a whole.

4. In general, variations distinguishable in the behavior of deposits of different holders are distinctly less pronounced than those discovered in deposits of different sizes. The same general differences in the behavior of accounts of different sizes appear in the data classified by type of holder as in the data for all types of holders. As stated, no analysis was made of the behavior of interbank deposits of different sizes.

5. Comparisons of the presuspension behavior of deposits owned by holders engaged in different types of business show relatively minor differences. There appears to be no consistent tendency for withdrawals of certain types of business demand deposits to exceed others.

Limitations of the data.—The figures presented in this discussion have been drawn from a group of 67 medium-sized banks, suspended during the period November 1930 to March 1933. The size and location of these banks are described in the March 1939 Federal Reserve Bulletin, page 179. As the present analysis consists of a reclassification of the same basic data, it is subject to similar statistical qualifications. It should be noted that the figures for the percentage composition of deposits in this article are based on "Total demand deposits, inclusive of interbank." The category "Miscellaneous demand deposits" includes fraternal, charitable, inactive, unlisted, unidentified, and other nonpersonal deposits as well as certificates of deposit. The largest component of miscellaneous demand deposits is unidentified deposits, that is deposits whose ownership could not be definitely assigned either to a business concern or to a person using the account primarily for nonbusiness transactions. It is probable that the bulk of these deposits are personal balances.

The allocation of the presuspension decrease in deposits.—The figures shown in table 1 indicate the extent to which the withdrawal of different classes of deposit holders contributed to the total decrease in deposits. While the contribution of public funds to the total withdrawal is not large in any group of banks, the behavior of these deposits is somewhat irregular. Personal and business deposit reductions are responsible for more than half (54.9 percent) of all deposit losses, and the bulk of these are withdrawals of business deposits (42 percent). The major part of business withdrawals in turn is attributable to the larger accounts, those in excess of $5,000 being responsible for 37 percent of the total deposit reduction. Interbank withdrawals represent 25.9 percent of the total decline, a share considerably greater than that of all personal accounts. Business and interbank deposits together account for about two-thirds of the total reduction of deposits.

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TABLE 1.—*Allocation of the decrease in total deposits between base date[1] and date of suspension, by type of holder*

Type of holder	67 sample banks	9 banks suspended before June 30, 1931	14 banks suspended between June 30 and Dec. 31, 1931	44 banks suspended after Dec. 31, 1931
Total decrease in demand deposits, inclusive of interbank	100.0	100.0	100.0	100.0
Public funds	4.3	(2)	(2)	8.6
Interbank deposits	25.9	13.6	42.9	25.2
Miscellaneous demand deposits[3]	14.9	31.9	9.2	12.8
Personal and business	54.9	69.4	48.4	53.4
Personal	12.9	16.6	10.7	12.6
Business	42.0	52.8	37.7	40.8
Less than $5,000:				
Personal	7.1	9.1	3.9	7.3
Business	5.0	1.9	2.9	6.0
$5,000 and over:				
Personal	5.8	7.5	6.8	5.3
Business	37.0	50.9	34.8	34.8

[1] June 30, 1931, for banks suspended after that date; June 30, 1928, for those suspended earlier. For a fuller explanation see p. 265.
[2] Increase.
[3] Fraternal, charitable, other nonpersonal, inactive, unlisted, unidentified, and certificates of deposit.

The contribution of a class of deposits to the total deposit decline depends on two factors. The first is the importance of the class in the original composition of total deposits. Clearly any class representing a very large share of a bank's total deposits may be responsible for substantial deposit reductions even though the accounts in this class are less heavily drawn upon than other accounts. The second factor is the stability of the accounts in the class. A group of accounts showing exceptional instability in times of stress may exercise an influence on deposit losses of substantially greater importance than its contribution to the original composition of total deposits.

In table 2, the composition of total deposits is compared with the composition of the deposit decline. Interbank deposits constitute about one-fifth of all deposits, but account for about one-fourth of deposit reduction. Personal deposits account for slightly less than their proportionate share of the deposit decline. The reverse is true of business deposits. If personal and business deposits are divided into comparable size groups, it becomes clear that size is a factor of sufficient importance in deposit reduction to obscure the variations between groups of deposits having different size compositions. Withdrawals from business accounts under $5,000 represented only 5 percent of the total deposit reduction, although these accounts constitute 9.3 percent of total deposits on the base date. Corresponding figures for personal accounts are 7.1 percent and 9.3 percent. In the case of accounts of $5,000 and over, both business and personal accounts show withdrawals representing a larger share of total deposit losses than their original contribution to total deposits. Large business accounts represent 29.1 percent of total deposits, but had a substantially greater share in deposit reduction (37 percent). Large personal accounts constitute only 4 percent of all deposits, but are responsible for 5.8 percent of all deposit losses.

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TABLE 2.—*Allocation of the decrease in demand deposits between base date and date of suspension in all sample banks*

Type of holder	Percentage composition of the decrease in demand deposits	Percentage composition of total demand deposits on base date
Total demand deposits, inclusive of interbank	100.0	100.0
Public funds	4.3	10.5
Interbank deposits	25.9	19.1
Miscellaneous demand deposits [1]	14.9	18.7
Personal and business	54.9	51.7
Persona	12.9	13.3
Business	42.0	38.4
Less than $5,000:		
Personal	7.1	9.3
Business	5.0	9.3
$5,000 and over:		
Personal	5.8	4.0
Business	37.0	29.1

[1] Fraternal, charitable, other nonpersonal, inactive, unlisted, unidentified, and certificates of deposit.

Table 3 measures directly the presuspension instability of deposits owned by different types of holders. The decrease in deposits between base date and date of suspension is measured as a percentage of the deposits in each class on the base date. Considering all sample banks, total demand deposits, inclusive of interbank, decreased 43.9 percent. Over the entire period interbank deposits exhibit considerably greater percentage reductions than personal or business deposits or public funds; in the case of banks suspending during the last 6 months of 1931, more than five-sixths of the normal balances in this class of accounts were withdrawn before suspension. Personal accounts are consistently less stable than business accounts of comparable size, but business balances are predominantly large balances and thus business accounts as a whole are less stable than personal accounts as a whole. The percentage reductions in personal accounts exceed those of business accounts in the case of accounts under $5,000 as well as in the case of accounts of $5,000 and over.

TABLE 3.—*Percentage changes in demand-deposit balances between base date and date of suspension, by type of holder*

Type of holder	67 sample banks	9 banks suspended before June 30, 1931	14 banks suspended between June 30 and Dec. 31, 1931	44 banks suspended after Dec. 31, 1931
Total demand deposits, inclusive of interbank	−43.9	−35.6	−38.9	−47.0
Public funds	−17.8	+80.4	+2.2	−34.5
Interbank deposits	−59.6	−21.1	−84.5	−60.9
Miscellaneous demand deposits [1]	−35.0	−56.3	−17.5	−33.4
Personal and business	−46.6	−44.2	−37.1	−49.3
Personal	−42.6	−40.7	−31.8	−45.5
Business	−48.0	−45.4	−38.9	−50.6
Less than $5,000:				
Personal	−33.4	−30.3	−18.0	−37.3
Business	−23.8	−8.7	−10.9	−29.8
$5,000 and over:				
Personal	−64.5	−69.7	−57.2	−65.0
Business	−55.7	−54.0	−49.4	−57.6

[1] Fraternal, charitable, other nonpersonal, inactive, unlisted, unidentified, and certificates of deposit.

Table 4 presents a more detailed comparison of the behavior of business and personal deposits of different sizes. The presuspension decrease in personal deposits exceeds the decline in business deposits in each size class shown, but the excess is clearly of a different order of magnitude than the difference in variation of large and small deposits.

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TABLE 4.—*Percentage changes in business and personal demand deposits between base date and suspension, by size of account*

Size of deposit on base date	67 sample banks	
	Business	Personal
Less than $500	+11.1	−13.4
$500 to $999	−19.9	−38.9
$1,000 to $2,499	−27.6	−46.4
$2,500 to $4,999	−36.6	−53.8
$5,000 to $9,999	−40.3	−59.2
$10,000 to $24,999	−50.0	−62.5
$25,000 to $49,999	−53.0	
$50,000 to $99,999	−60.4	−70.8
$100,000 and over	−66.7	
Total	−48.0	−42.6

Certain classes of accounts show significant variations of behavior in banks suspended during different periods. Both public funds and small business deposits exhibit a tendency toward increasingly heavy withdrawals over the period. Although the contrast between the behavior of small business accounts and large business accounts is marked throughout the period, the rate of reduction in accounts of less than $5,000 more closely approaches the rate of reduction in larger business accounts in banks suspended after the end of 1931 than in banks suspended earlier. Increasingly heavy withdrawals of small business deposits may reflect the widening spread of apprehension from the middle of 1931 until the banking holiday.

Behavior of business demand deposits classified by type of business.—In table 5, business demand deposits are grouped according to the type of business in which their holders are engaged. The differences in the percentage reductions shown appear to be too small to justify a statement that some types of business accounts are more unstable than others. Such differences as exist become less as the number of banks considered is enlarged. Moreover, no single business class consistently outranks other classes in the percentage of its "normal" balance withdrawn prior to suspension.

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TABLE 5.—*Percentage changes in demand deposit balances between base date and date of suspension, by type of business*

ACCOUNTS OF ALL SIZES

Type of business	67 sample banks	9 banks suspended before June 30, 1931	14 banks suspended between June 30 and Dec. 31, 1931	44 banks suspended after Dec. 31, 1931
All business demand deposits	−48.0	−45.4	−38.9	−50.6
Manufacturing and mining	−51.1	−47.2	−37.4	−54.9
Building and construction	−57.8	−58.8	−53.3	−59.2
Transportation, public utilities, etc	−44.3	−49.7	−28.4	−43.4
Automobile distribution and related services	−53.6	−54.3	−23.0	−57.4
Trade and service	−40.9	−34.0	−31.6	−44.9
Financial	−50.3	−44.8	−55.6	−50.1
Other, including agriculture	−51.9	−54.5	−26.7	−55.3
ACCOUNTS OF LESS THAN $5,000				
All business demand deposits	−23.8	−8.7	−10.9	−29.8
Manufacturing and mining	−14.0	+54.1	−7.9	−28.0
Building and construction	−29.7	−60.4	+18.7	−31.5
Transportation, public utilities, etc	+15.6	+30.9	−6.0	+17.3
Automobile distribution and related services	−39.4	−21.8	−8.8	−47.8
Trade and service	−28.8	−15.4	−16.0	−34.7
Financial	−15.2	−30.0	−2.1	−14.5
Other, including agriculture	−30.8	−20.2	−20.5	−35.3
ACCOUNTS OF $5,000 AND OVER				
All business demand deposits	−55.7	−54.0	−49.4	−57.5
Manufacturing and mining	−57.0	−57.5	−43.7	−59.5
Building and construction	−68.7	−57.6	−67.4	−70.8
Transportation, public utilities, etc	−48.2	−51.7	−31.6	−48.1
Automobile distribution and related services	−66.1	−76.1	−46.8	−65.7
Trade and service	−49.4	−45.2	−42.5	−52.2
Financial	−59.0	−49.1	−66.9	−59.1
Other, including agriculture	−65.3	−76.8	−34.6	−66.7

In the chart the variations in presuspension reductions of deposits of different sizes are compared with those of different types of business. The data plotted in the bar diagrams on the left of this chart were presented in table 6, page 181, in the March 1939 Federal Reserve Bulletin. The diagrams on the right are plotted from the figures presented in table 5 of this article for accounts of all sizes. The bars on the right have been ranked in accordance with the severity of the deposit reductions of different types of business holders when all banks and sizes of accounts are included. The summary bar preceding the size of account diagrams is based on the percentage reductions in total demand deposits; the bar preceding the type of business diagrams is based on total business demand deposits; both sets of basic figures exclude interbank deposits.

The chart illustrates the marked contrast both in the extent and the consistency of variation in deposit behavior. The diagrams measuring variations in presuspension reductions in deposits by size of account exhibit a clearly discernible trend of the percentage reduction to increase as the size of the account becomes greater.[2] This trend becomes more regular as the number of banks considered is increased.

Business deposits, when classified by types of business, show no such distinct variation. There is a comparatively small difference between the largest and smallest percentage reductions shown in the data derived from all the banks in the sample. This reflects the relative importance of the data derived from the 44 banks suspended after December 31, 1931, in the data for all sample banks. It is noteworthy that in the largest group of banks the divergence is less marked than in the two smaller groups of banks.

[2] The figures for classes of accounts where increases in balances are shown because of technical reasons are not charted. For a fuller explanation see March 1939 Federal Reserve Bulletin, p. 182.

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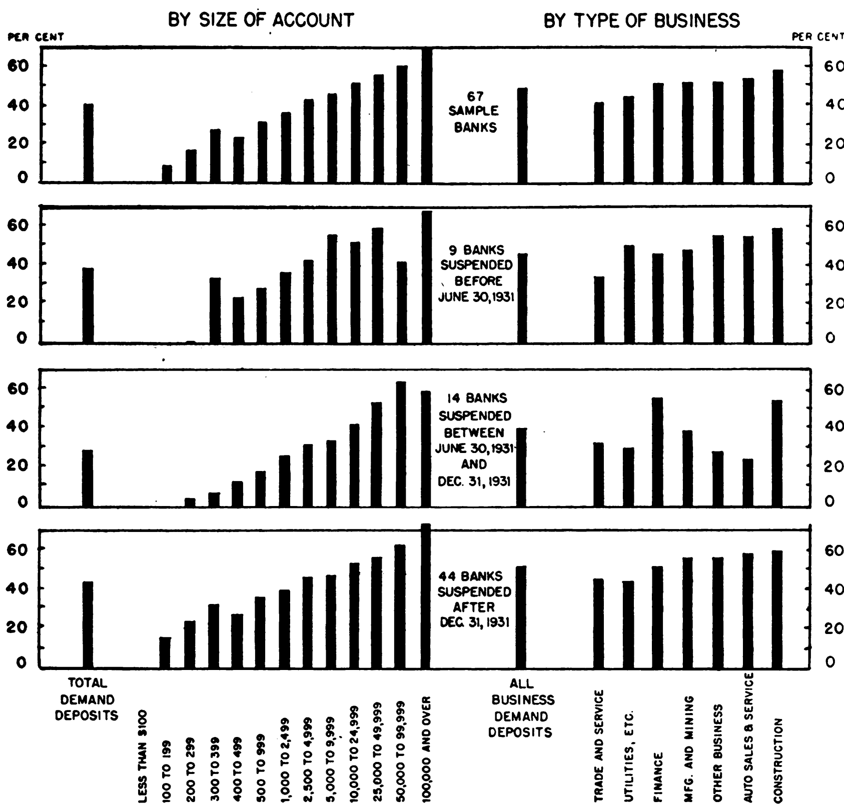

An Analysis of the Timing of Deposit Reductions Prior to Suspension in a Selected Group of Banks

In earlier reports, summarized in the Federal Reserve Bulletin, analysis was made of the comparative severity of the presuspension withdrawals of deposits of different sizes and types. This article makes a similar examination of the timing of reductions in deposit balances.[1]

The results of the investigation may be summarized as follows:

1. The timing of changes in the dollar volume of demand and of time deposits in the 6 months immediately preceding suspension was substantially similar. In the last month before closing the rate of decline of demand deposits was somewhat greater than that of time deposits.

2. Minor variations in the timing of withdrawals appeared as between personal and business demand deposits. Personal demand deposits were reduced at a slightly more rapid rate than business demand deposits until the third month before suspension. Business deposits then showed a somewhat more pronounced decline than personal deposits until the last month before closing when both classes of deposits fell off sharply.

3. There was a wide divergence between the movements of large and of small business demand deposits. Large business deposits were reduced the sixth month preceding suspension and continued an uninterrupted decline to date of suspension. Small business deposits increased in the sixth month before sus-

[1] The basic data for these reports were derived from an investigation, financed by the Works Progress Administration, of the records of a group of banks suspended between 1930–33. Previous reports were published in the Federal Reserve Bulletin for March and April 1939. The present article was prepared by R. C. Breithut.

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pension; remained stable until the fourth month and showed no substantial contraction until the last month before closing.

4. In general, the movements of local and nonlocal business deposits closely coincided.

5. The changes in the deposits of different types of business showed wide variation. In all business groups, however, large business deposits were withdrawn more promptly than small ones.

6. Personal deposits show earlier declines the larger the size of the account. Deposits in accounts of $2,500 and over fell off sooner than deposits of $500 to $2,499 and the deposits in this size group in turn were more promptly withdrawn than those of less than $500.

7. Changes revealed in the number of open demand deposit accounts during the last 6 months before closing were distinctly less sharp and varied than the changes which occurred in demand deposit balances. Most demand deposit drains apparently resulted from a reduction of balances in accounts which remained open rather than from the closing of accounts.

The scope of the data and methods of analysis.—As pointed out in earlier reports, deposit movements discernible in a particular group of suspended banks are not necessarily representative of movements in banks of different sizes or those suspended at different times or under different circumstances. For this analysis the basic data were drawn from a group of 124 banks of varying sizes. Measured on dates prior to severe deposit declines, the smallest bank included in this sample had total deposits of less than $510,000 and the largest slightly in excess of $325,000,000. The bank suspensions discussed here occurred between November 1930 and July 1933. Three of these banks were suspended in 1930; thirty-four in 1931; twenty-eight in 1932; and fifty-nine in 1933. The distribution by location and size of the banks composing the sample is summarized in table 1. In general, the sample banks were much larger than the typical bank suspended at this time; and the proportion of banks located in eastern and midwestern industrial centers is higher in this sample than in all bank suspensions. The combined deposits of all sample banks as of date of suspension represented about 18 percent of the total deposits of all banks suspended during this period.

TABLE 1.—*Distribution of banks supplying data on timing of deposit withdrawals*

Distribution by location and size	All sample banks	Number of banks with total deposits of— (millions of dollars)						Number of banks situated in—		
		Less than 1[1]	1–1.9	2–4.9	5–9.9	10–24.9	25, and over[2]	Places of 100,000 and over	Places under 100,000	Suburban areas
Total	124	2	4	48	32	26	12	43	52	29
Distribution by area:										
New England	13	1		7	3	1	1	6	7	
Middle Atlantic	33			10	12	8	3	16	7	10
East North Central	43		2	19	7	11	4	12	20	11
West North Central	12	1	1	4	4	1	1	1	4	7
South Atlantic	11			4	5	2		2	9	
East South Central	4			1		1	2	3	1	
West South Central	2			1	1				2	
Mountain	1			1					1	
Pacific	5		1	1		2	1	3	1	1

[1] The smallest bank had total deposits less than $510,000.
[2] The largest bank had total deposits of more than $325,000,000.

Certain technical obstacles, however, made it impossible to classify all of the deposits of all of the banks included in the sample. In making this analysis, therefore, it was necessary to adapt the method of measurement to the statistical adequacy of the basic sources. For 82 banks a continuous monthly record of total demand and total deposits from January 1928 to date of suspension was available. This information was used for the purpose of comparing the timing of demand and time deposit withdrawals and for certain other purposes. In examining the movement of different types and sizes of demand deposits, information was drawn from the entire sample of 124 banks.

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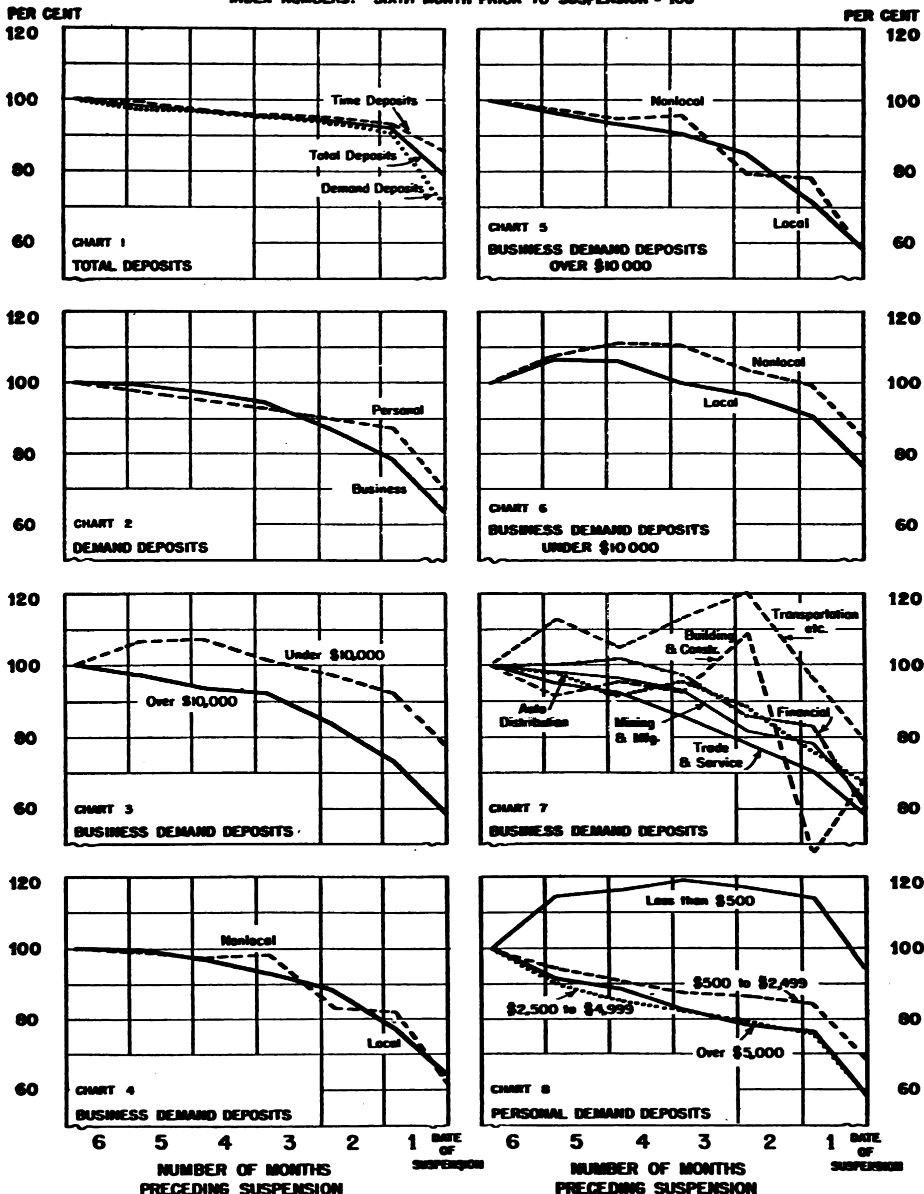

Data for Chart 1 derived from 82 banks and for all other charts from 124 banks. Figures are for Wednesdays between the fifth and the twelfth of each month. For explanation see p. 470.

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The present discussion deals with the timing of the withdrawal of deposits of different types and sizes in the 6 months immediately preceding suspension. It is well to recall that the period in which these suspensions occurred was one in which most banks experienced some reduction of deposits whether or not the shrinkage was terminated by suspension. Moreover not all of the banks in this sample experienced exceptionally severe losses of deposits in the last months before closing and in some banks heavy withdrawals of deposits began more than a year before date of suspension. Investigation indicates, however, that a preponderance of these banks experienced withdrawals during the last 6 months which carried total deposits well below previous levels.

Deposits outstanding in different type and size classes are measured on selected dates in each of the 6 months immediately preceding suspension. Dates were chosen which appeared to yield figures most closely approximating average monthly balances.[2] The deposits in each class in the sixth month preceding suspension are then used as a base for calculating the percentage of deposits in each class outstanding in each of the subsequent months and on date of suspension. Thus for each class the deposits in each of the last 5 months and on date of suspension are expressed as percentages of the deposits outstanding in the sixth month. This method makes it possible to compare the rates of increase and decrease of different classes of deposits and the timing of deposit withdrawals. It should be noted, however, that the absolute figures for deposits in the sixth month will be different for different classes of deposits and that, on the basis of these figures, it is impossible to draw conclusions concerning the dollar volume of the withdrawals allocable to different classes of deposits.[3]

The timing of demand and time deposit withdrawals.—In table 2 and chart 1 the movements of total deposits and of time and demand deposits are compared. The basic information for this table was derived from the 82 sample banks for which a continuous monthly record of total deposits is available. Total deposits show an uninterrupted decline from the sixth month before suspension until date of suspension. During the first 5 months of this period, however, the rate of decline was distinctly less severe than it was in the month immediately preceding suspension. A comparison of time and demand deposits indicates that the sharp reduction in total deposits in the last month before suspension can be traced to heavy withdrawals of demand deposits. The total decline of time deposits for the first 5 months was somewhat less than 7 percent of total time deposits on the sixth month before suspension. In the last month the decline became more rapid, however, resulting in a reduction of 7 percent for this month alone. The record of demand deposits is similar for the first 5 months but the withdrawals of the last month were much more substantial and represented almost 20 percent of total demand deposits at the opening of the period. Thus for both classes of deposits, withdrawals were comparatively light for the first 5 months and accelerated in the last month before suspension. The sharper reductions of demand deposits may be attributable to differences in the size composition of the two classes of deposits.

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[2] After some experimentation, the date chosen for all banks was the Wednesday between the fifth and the twelfth of each month. It should be noted that the interval between these dates may vary from 28 to 35 days and is not, strictly speaking, "a month." The date referred to as "the first month before suspension" is the Wednesday between the fifth and the twelfth of the month in which suspension occurred or, in cases where suspension took place on or before that date, the Wednesday between the fifth and the twelfth of the preceding month. The last month before suspension is, therefore, for most banks a period of less than 30 days. Thus the true monthly rate of change in the last month preceding suspension is somewhat larger than would be indicated by the figures given.

[3] The comparative magnitude of presuspension withdrawals of deposits of different types and sizes is discussed in reports published in the Federal Reserve Bulletin for March and April 1939.

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TABLE 2.—*Movement of different types of deposits*[1] *in the 6 months prior to suspension*

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of deposit	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total deposits, exclusive of U. S. and interbank	100.0	98.2	97.1	95.7	94.4	92.2	79.1
Total time deposits	100.0	99.0	97.2	96.1	95.1	93.4	85.7
Total demand deposits	100.0	97.2	97.0	95.2	93.5	90.7	70.8

[1] Total deposits and total demand and time deposits in 82 banks, on selected dates in each of the 6 months immediately preceding suspension calculated as percentages of deposits in each class outstanding in the sixth month.

Analysis of the timing of demand deposit movements.—In order to make a detailed analysis of the timing of the withdrawal of demand deposits from accounts of different types and sizes, information was collected from the 124 banks described above. For various technical reasons, however, it was impossible to include all demand deposit accounts in all sample banks. Taking the sample as a whole the deposits outstanding on date of suspension in the accounts selected represented 23.5 percent of all demand deposits, and investigation indicates that the movements of deposits in selected accounts approximate those of total demand deposits.

The movement of business and personal accounts.—In table 3 and chart 2 the timing of withdrawals from business and personal accounts is compared. During the early months of the period the movement of both classes of deposits was similar. In the third and second months before suspension, business deposits declined more sharply than personal deposits with the result that a higher proportion of business than personal deposits had been withdrawn by a date 1 month before suspension. The rate of reduction of personal deposits increased markedly in the last month, however, and the discrepancy was smaller on date of suspension than it was a month earlier.

TABLE 3.—*Movement of demand deposits in the 6 months prior to suspension*[1]

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of holder	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total selected demand deposits	100.0	99.2	96.8	94.1	88.0	80.7	65.2
Selected business demand deposits	100.0	99.6	97.3	94.5	87.4	78.4	63.7
Selected personal demand deposits	100.0	97.7	95.4	92.7	90.0	87.6	69.9

[1] Selected demand deposits of different classes outstanding in 124 banks in each of the 6 months immediately preceeding suspension calculated as percentages of deposits outstanding in each class in the sixth month.

Table 4 presents a more detailed analysis of the movement of business demand deposits, and supplies the basic figures for charts 3, 4, 5, and 6. Chart 3 compares the timing of the withdrawal of business deposits under $10,000 and of deposits of $10,000 and over, and reveals a marked contrast in the behavior of these two groups of accounts. Business deposits of $10,000 and over declined uninterruptedly throughout the period. The rate of decline was comparatively slow in the opening months; and became more severe between the third month before suspension and date of suspension. Business deposits under $10,000 increased somewhat during the first 2 months of the period and declined during the last 4 months before closing. The rate of reduction during the last 3 months, however, was slightly less rapid than it was in the case of large business deposits. Chart 4 compares the timing of withdrawals of local and nonlocal business deposits. The two classes of accounts display strikingly similar movement, but local business deposits declined at an approximately consistent rate throughout the period and the shrinkage of nonlocal deposits was less regular. Charts 5 and 6 analyze the rate of reduction of large and small local and nonlocal business deposits independently. The movements of large local and non-

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local business deposits are similar and exhibit characteristics resembling those observed in the comparison of all local and nonlocal business deposits. Such differences as appear in the timing of the reductions of small local and nonlocal deposits indicate that small local deposits decline more promptly than small nonlocal deposits.

Table 4.—*Movement of different classes of business demand deposits in the 6 months prior to suspension* [1]

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of holder	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total selected business demand deposits	100.0	99.6	97.3	94.5	87.4	78.4	63.7
Business deposits under $10,000	100.0	107.0	107.1	101.3	97.7	92.0	77.8
Business deposits $10,000 and over	100.0	97.0	93.7	92.1	83.7	73.5	58.6
Local business deposits	100.0	99.8	97.3	93.4	88.7	77.3	64.3
Nonlocal business deposits	100.0	99.2	97.2	98.1	83.1	81.8	61.7
Local business deposits under $10,000	100.0	106.9	106.6	100.0	96.8	90.9	76.8
Nonlocal business deposits under $10,000	100.0	107.7	111.1	110.6	103.6	99.4	84.7
Local business deposits $10,000 and over	100.0	96.7	93.3	90.6	85.2	71.4	58.8
Nonlocal business deposits $10,000 and over	100.0	97.7	94.9	96.0	79.7	78.8	57.8

[1] Deposits of different classes outstanding in each of the 6 months immediately preceding suspension calculated as percentages of deposits outstanding in each class in the sixth month.

The movement of business demand deposits classified by type of business.—Table 5 and chart 7 present summaries of the timing of withdrawals of business demand deposits classified by type of business. The presuspension movements of the tabulated business classes appear to be divisible into two groups. The variations in the deposits of businesses engaged in mining and manufacturing, in automobile distribution, and in finance were substantially similar. The deposits of building and construction and of transportation and public utility enterprises, however, show violent fluctuations differing markedly from those of the other business groups. Table 6 analyzes the movement of some of these groups in detail. Comparison of the rate of withdrawal of large and small deposits of financial enterprises reveals that pronounced reductions in large deposits occurred well in advance of any substantial shrinkage in small deposits. If large financial deposits are further divided into those held locally and nonlocally, it appears that nonlocal deposits remained stable until the third month before suspension and then began a sharp but interrupted decline. Local financial deposits of $10,000 and over, however, were withdrawn continuously from the sixth month preceding suspension until date of suspension. The deposits of businesses engaged in mining and manufacturing, automobile distribution, and trade and service show a similar discrepancy in the timing of the withdrawals of large and small deposits. Seasonal and cyclical influences may account in part for the erratic movement of the deposits of building and construction companies and transportation and public utility enterprises. In any case a comparison of different sized deposits of these business groups reveals that large deposits generally were withdrawn earlier than small ones.

Table 5.—*Movement of demand deposits of different types of business in the 6 months prior to suspension* [1]

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of business	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total selected business demand deposits	100.0	101.2	98.9	97.7	90.7	80.8	65.6
Mining and manufacturing	100.0	98.8	96.5	93.5	81.6	78.4	62.9
Building and construction	100.0	91.8	95.9	92.5	109.6	47.3	69.0
Transportation, public utilities, etc	100.0	113.1	105.3	113.7	120.1	97.2	79.0
Automobile distribution and related services	100.0	98.3	91.7	95.7	88.7	78.2	67.4
Trade and service	100.0	95.5	92.5	85.8	78.3	70.8	58.1
Financial	100.0	100.4	102.0	97.4	86.0	83.0	60.1

[1] Deposits held by different types of business depositors outstanding in each of the 6 months immediately preceding suspension calculated a percentages of deposits held by each type in the sixth month.

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Table 6.—*Analysis of the movement of demand deposits of certain types of business in the 6 months prior to suspension*

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of business	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Building and construction:							
Local	100.0	93.0	97.4	93.9	111.3	46.5	69.5
Nonlocal	100.0	61.9	56.8	57.3	66.6	69.0	56.0
Less than $1,000	100.0	160.1	170.4	146.6	138.5	130.6	111.1
$1,000-$9,999	100.0	105.1	93.5	92.2	95.5	90.4	100.3
$10,000 and over	100.0	78.0	88.5	86.4	112.7	18.2	49.9
Transportation, public utilities, etc.:							
Local	100.0	113.4	102.7	112.2	125.9	95.8	80.3
Nonlocal	100.0	112.6	110.9	117.2	107.0	100.2	76.0
Less than $1,000	100.0	136.3	187.2	170.3	145.5	142.2	114.5
$1,000-$9,999	100.0	120.7	117.5	121.0	131.3	108.4	92.8
$10,000 and over	100.0	112.3	103.6	112.7	118.9	95.9	77.5
Financial:							
Less than $10,000	100.0	110.5	117.8	114.9	106.7	100.9	79.9
$10,000 and over	100.0	96.0	95.0	89.7	76.8	75.1	51.3
Local over $10,000	100.0	93.8	92.4	85.5	73.7	69.6	50.8
Nonlocal over $10,000	100.0	103.1	103.5	103.5	87.1	93.2	52.7

The timing of personal demand deposit withdrawals.—Table 7 and chart 8 present summaries of the movement of personal demand deposits for different sizes. Deposits in accounts of less than $500 increase markedly in the sixth month before suspension, remained comparatively stable for the next four months and then fell off abruptly. Balances in accounts of $500 to $2,499 began a moderate but continuous decline in the sixth month before closing, which concluded with sharp reductions in the last month of the period. Accounts of $2,500 to $4,999 showed presuspension deposit changes closely resembling those of accounts of $5,000 and over, which maintained a rate of reduction in excess of those of either of the smaller deposit groups throughout the period.

Table 7.—*Movement of personal demand deposits of different sizes in the 6 months prior to suspension* [1]

[Deposit balances outstanding in sixth month prior to suspension=100]

Size of account	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total selected personal demand deposits	100.0	97.7	95.4	92.7	90.0	87.6	69.9
Less than $500	100.0	114.9	116.4	119.3	117.1	114.2	94.0
$500 to $2,499	100.0	94.9	90.7	87.6	86.5	84.2	68.6
$2,500 to $4,999	100.0	90.2	85.1	82.0	79.1	75.4	58.7
$5,000 and over	100.0	91.1	88.9	82.7	78.3	76.7	58.6

[1] Selected personal demand deposits of different sizes outstanding in each of the 6 months immediately preceding suspension calculated as percentages of total personal deposits in each size class outstanding in the sixth month.

Table 8 presents figures for sample banks grouped by the size of the communities in which they are located. These figures are similar to the data for all sample banks discussed above. In general, the changes in the deposit balances in accounts of different types and sizes resemble those observed in the earlier discussion.

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Table 8.—*Detailed analysis of movement of selected demand deposits in the 6 months prior to suspension, by location of banks*[1]

[Deposit balances outstanding in sixth month prior to suspension=100]

Type of holder and size of account	Deposit balances outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
	43 banks in cities of over 100,000						
Total selected demand deposits	100.0	100.1	98.4	96.4	89.0	80.9	64.6
Business deposits	100.0	100.7	98.9	97.2	88.6	78.1	63.2
Business deposits under $10,000	100.0	111.3	112.5	107.2	101.9	97.7	82.4
Business deposits $10,000 and over	100.0	98.1	95.5	94.8	85.3	73.2	58.5
Local business deposits	100.0	101.3	99.7	97.0	91.6	77.8	64.8
Nonlocal business deposits	100.0	99.1	96.5	97.9	79.7	78.7	58.7
Local business deposits under $10,000	100.0	111.3	112.4	106.1	100.8	96.5	81.1
Nonlocal business deposits under $10,000	100.0	111.4	113.5	115.9	110.7	106.6	91.7
Local business deposits over $10,000	100.0	98.3	95.8	94.2	88.8	72.1	59.8
Nonlocal business deposits over $10,000	100.0	97.9	94.8	96.1	76.5	75.9	55.3
Personal deposits	100.0	98.0	96.9	93.2	90.6	91.0	69.6
Less than $500	100.0	118.4	124.2	126.5	124.7	123.7	100.4
$500 to $2,499	100.0	98.9	96.8	92.2	91.5	93.7	72.9
$2,500 to $4,999	100.0	90.8	87.7	86.6	83.6	81.8	62.9
$5,000 and over	100.0	91.7	89.2	83.2	79.2	79.8	58.0
	52 banks in cities of less than 100,000						
Total selected demand deposits	100.0	99.7	97.0	91.6	89.0	84.0	69.8
Business deposits	100.0	101.2	98.1	91.3	88.5	83.8	68.2
Business deposits under $10,000	100.0	111.2	112.6	104.2	101.5	93.0	78.1
Business deposits $10,000 and over	100.0	94.5	88.4	82.6	79.8	77.6	61.6
Local business deposits	100.0	101.9	97.6	89.0	85.9	80.7	66.2
Nonlocal business deposits	100.0	98.8	99.9	99.7	98.0	95.1	75.7
Local business deposits under $10,000	100.0	113.0	113.6	104.0	102.7	93.4	77.7
Nonlocal business deposits under $10,000	100.0	103.4	108.3	104.8	96.4	91.2	80.0
Local business deposits over $10,000	100.0	94.1	86.4	78.4	74.2	71.8	58.1
Nonlocal business deposits over $10,000	100.0	96.2	95.2	96.9	98.8	97.3	73.3
Personal deposits	100.0	95.9	94.2	92.5	90.1	84.6	73.7
Less than $500	100.0	111.0	112.7	115.6	113.2	108.3	91.1
$500 to $2,499	100.0	89.1	84.4	81.8	81.3	75.7	67.9
$2,500 to $4,999	100.0	86.7	80.8	74.0	71.3	70.3	53.2
$5,000 and over	100.0	86.8	87.4	82.7	77.1	67.2	66.8
	29 banks in suburban areas						
Total selected demand deposits	100.0	90.0	83.5	81.7	78.4	71.7	59.8
Business deposits	100.0	83.1	77.5	74.8	71.5	66.5	55.4
Business deposits under $10,000	100.0	83.7	77.6	74.9	75.2	70.2	60.9
Business deposits $10,000 and over	100.0	82.1	77.5	74.7	65.9	61.0	47.2
Local business deposits	100.0	81.2	75.3	73.3	69.8	64.6	54.8
Nonlocal business deposits	100.0	104.1	102.7	92.3	91.0	87.6	61.9
Local business deposits under $10,000	100.0	82.5	75.8	73.1	74.1	68.7	60.9
Nonlocal business deposits under $10,000	100.0	107.6	111.8	107.8	95.9	97.7	60.1
Local business deposits over $10,000	100.0	79.1	74.5	73.4	62.6	57.9	44.9
Nonlocal business deposits over $10,000	100.0	102.1	97.4	83.2	88.1	81.7	63.0
Personal deposits	100.0	99.2	91.5	90.8	87.4	78.6	65.6
Less than $500	100.0	113.9	107.1	111.0	108.2	104.9	86.1
$500 to $2,499	100.0	91.1	81.9	82.2	79.5	68.7	57.8
$2,500 to $4,999	100.0	92.6	81.9	76.7	74.1	60.2	51.4
$5,000 and over	100.0	90.8	87.4	77.3	69.8	57.2	49.6

[1] Deposits of different classes outstanding in 124 banks in each of the 6 months preceding suspension calculated as percentages of the deposits in each class outstanding in sixth month.

Changes in the number of open accounts.—In this article attention has been primarily directed to the timing of reductions of deposit balances. Table 9 analyzes changes in the number of outstanding demand deposit accounts to which balances were credited. It is clear that the presuspension decreases in the number of outstanding accounts were less sharp and less varied than the changes found in demand deposit balances. It is noteworthy also that the greatest declines took place in the number of small personal accounts, a group in which the withdrawals of balances were comparatively tardy and least pronounced. Thus it appears that the most severe demand deposit drains were a result of a reduction of balances rather than the closing of accounts.

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TABLE 9.—*Changes in the number of demand deposit accounts outstanding in the 6 months immediately preceding suspension* [1]

Type of account	Number of accounts outstanding in—						
	Sixth month	Fifth month	Fourth month	Third month	Second month	First month	Date of suspension
Total selected accounts	100.0	98.9	97.7	96.9	94.9	93.0	90.1
Business accounts	100.0	98.8	97.8	96.9	93.2	91.6	92.2
Personal accounts	100.0	98.9	97.7	96.8	95.5	93.6	89.3
Personal accounts less than $500	100.0	98.7	97.3	96.4	94.9	92.8	88.0

[1] Number of demand deposit accounts of different classes open in 124 banks in each of the 6 months before suspension calculated as percentages of the number of accounts in each class open the sixth month before suspension.

Representative PATMAN. Thank you, Mr. Cook.

Mr. Bolling, would you like to ask questions?

Representative BOLLING. Not at this time, Mr. Chairman.

Representative PATMAN. I would like to ask you some questions, Mr. Cook.

To what extent do you examine banks that are insured by the FDIC?

Mr. COOK. The national banks, Mr. Chairman, are examined by the Office of the Comptroller of the Currency; the State banks are examined, if they are members of the Federal Reserve System, by the Federal Reserve examiners, and the State examiners, and the nonmember insured banks are examined by the State authority and by ourselves.

We examine approximately 50 percent numerically of the banks, which are the smaller banks, for the most part.

Representative PATMAN. There is no conflict—in other words, you do not examine any of the banks the Comptroller of the Currency examines; you do not examine any of the banks the Federal Reserve examiners examine?

Mr. COOK. That is right.

Representative PATMAN. You only examine the State banks that are not in the Federal Reserve System?

Mr. COOK. That is correct.

Representative PATMAN. And you insure their deposits?

Mr. COOK. That is correct.

Representative PATMAN. Yes. That part always bothered me about an insurance agency examining the risk—we, of course, understand, and we know that in some types of insurance it is permissable, but what you do does not seem to conflict with the other examining authorities.

Mr. COOK. May I say, Mr. Chairman, that we examine the reports of examination of every insured bank, whether it be a national bank or a State member bank because we have an arrangement with the Comptroller's Office and with the Federal Reserve Board that we get those examination reports in order that we can set up our detailed record to continually watch the condition of banks, whether it be national banks or State member banks, as well as the banks we examine ourselves.

Representative PATMAN. What do you do if you see a bank that is engaging in practices that you do not like?

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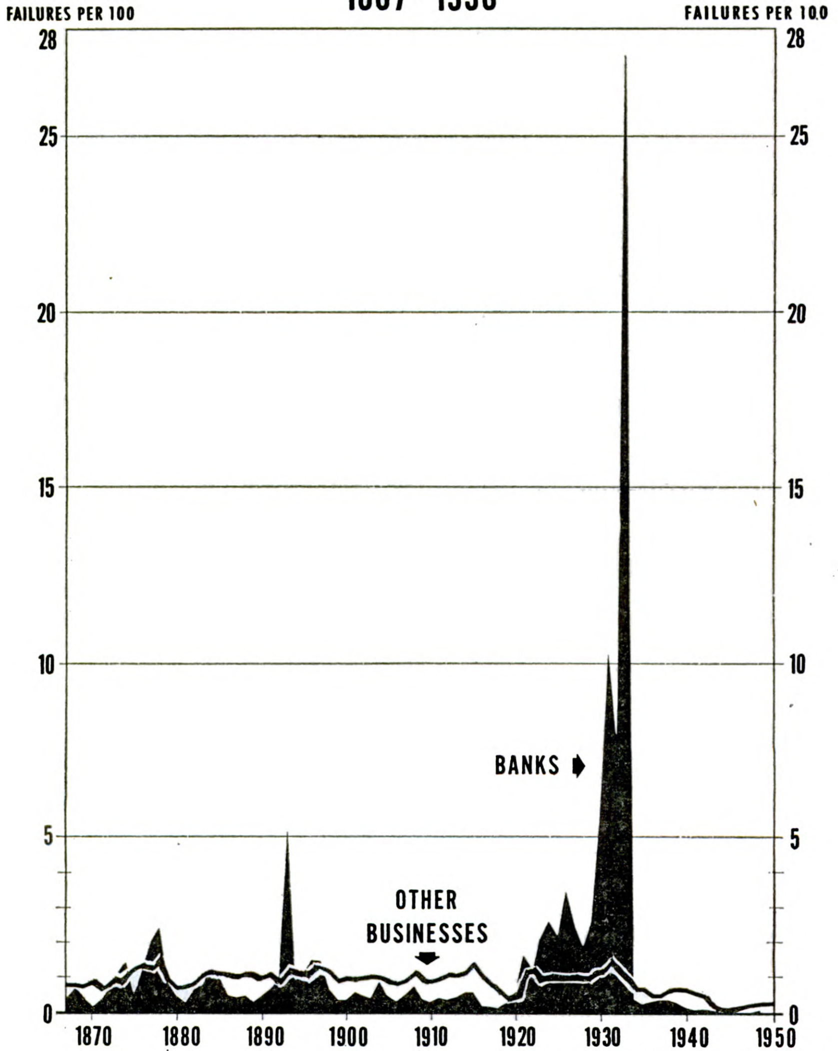

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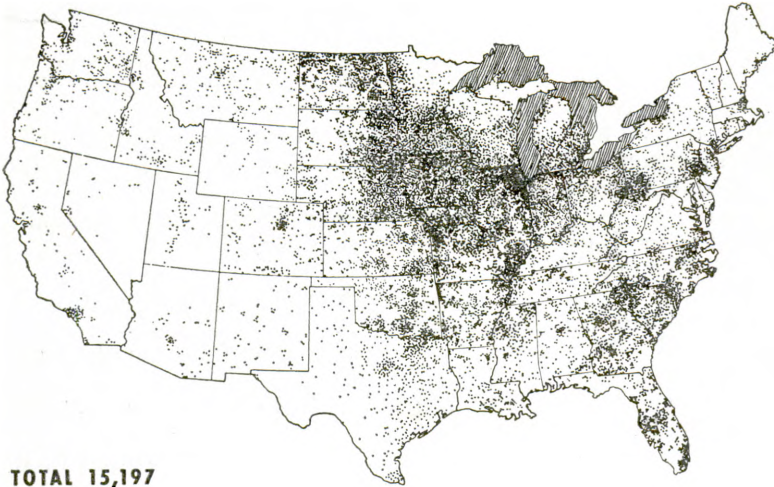
FAILURES IN BANKING 1916 to 1933



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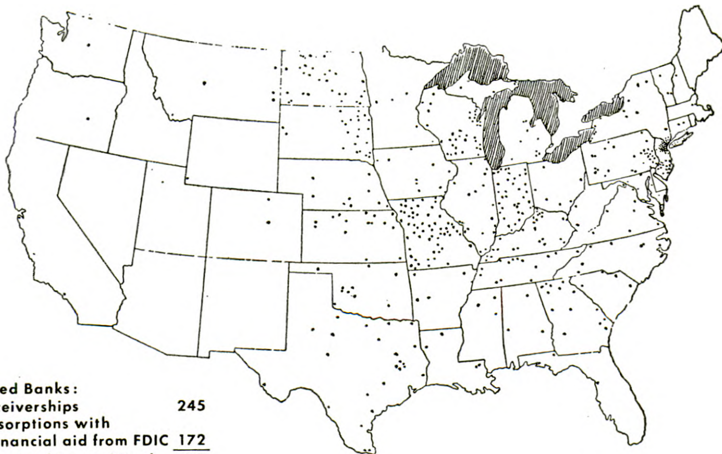
FAILURES IN BANKING 1934 to 1951



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Mr. COOK. We put on every pressure we can to have those things corrected, working through the State authorities, and, I may say, we have a fine relationship with all of the 48 States in our joint examination with them. If it is a Federal Reserve member we, of course, are in constant contact with the Federal Reserve people because they are just as anxious to clean up unsound conditions in their banks as we are, and the same is true with the Comptroller of the Currency. The relationships are reciprocal in those cases because we are the insuring agency and we must keep constant watch upon any bank that is engaging in unsound and unsafe practices and not performing its obligation to its depositors.

Representative PATMAN. Concerning your budget, do you submit your budget to the Bureau of the Budget?

Mr. COOK. We do, sir.

Representative PATMAN. And you pay the cost of the expenses out of your own operations, I assume?

Mr. COOK. Oh, yes; there are no appropriated funds in the Corporation, Mr. Chairman.

Representative PATMAN. But you submit your budget and get the approval of the Bureau of the Budget?

Mr. COOK. Yes, sir; it is submitted to them, and we are also audited by the General Accounting Office.

Representative PATMAN. Audited by the General Accounting Office?

Mr. COOK. Yes, sir. That was placed in the law at our own request.

Mr. ENSLEY. Could I just interrupt, Mr. Chairman? You say your budget is submitted to the Bureau of the Budget, and the chairman asked if you received the approval of the Budget Bureau.

Mr. COOK. I would rather have Mr. Cramer or Mr. Robertson, who are more familiar with that, answer that question.

Representative PATMAN. Yes, sir. Do you get the approval of the Budget, or what action is taken when you submit your budget?

Mr. ROBERTSON. They send it back and say that it is approved in such-and-such amount.

Representative PATMAN. Do they attempt to reconcile it with the policy of the Government in other similar comparable agencies?

Mr. ROBERTSON. I believe they do, Mr. Chairman. I would not want to state what the Bureau of the Budget does, but I believe they do.

Representative PATMAN. Do you collect fees for the examination of banks, Mr. Cook?

Mr. COOK. We do not, sir.

Representative PATMAN. The State banks, you do not collect fees from them?

Mr. COOK. The States, of course, have their own fees—each has its own schedule of fees which it collects. We collect nothing for our examination because our income is derived from the assessment upon the banks which they pay into the Corporation for this insurance.

Representative PATMAN. Is that discrimination against the banks that are not insured, I mean, that are not examined?

Mr. COOK. No.

Representative PATMAN. A national bank across the street, for example, pays the same amount into the fund as a State bank. While you do not have any expenditure for the examination of the national bank, you do have a cost or expenditure for an examination of the State bank across the street?

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Mr. Cook. We do; that is true.
Representative Patman. And to that extent you are not collecting as much from the State bank as you are collecting from the national bank then, because you would have to deduct the amount expended to make the examination, would you not?
Mr. Cook. Of course, the national bank pays for its examination by the Comptroller of the Currency. Having been with a national bank most of my life, I know what it is to pay those fees and, of course, the State banks pay fees to the State. However, a State member bank does not pay the Federal Reserve for its examination.
Representative Patman. The State member bank does not pay the Federal Reserve?
Mr. Cook. That is right.
Representative Patman. Neither does the national bank?
Mr. Cook. No.
Representative Patman. I noticed you did not advocate 100 percent insurance coverage.
Mr. Cook. That is correct, sir.
Representative Patman. You think that the present $10,000 are sufficient?
Mr. Cook. We feel that that is the proper amount in the economy as it now obtains.
Representative Patman. What is the potential liability of the FDIC at this time?
Mr. Cook. We insure about 56 percent of the total deposits in the banks. Dr. Cramer, is that correct?
Mr. Cramer. 54 percent as of September 19, 1951.
Mr. Cook. As of September 19, 1951, 54 percent.
Representative Patman. 54 percent.
You still have not answered my question though. You say it is 54 percent of potential liability, but you do not state what the potential liability is.
Mr. Cook. The deposits in the banks at that time were $170 billion of which we insured $92,131,000,000.
Representative Patman. Excuse me just a moment. How much was that total amount?
Mr. Cook. The total amount of deposits at that time in the banks was $170 billion.
Representative Patman. At what time?
Mr. Cook. September 19, 1951.
Representative Patman. All right.
Mr. Cook. Of which $92 billion were insured, were fully covered by insurance.
Representative Patman. Ninety-two billion insured?
Mr. Cook. That is correct.
Representative Patman. $92 billion insured; that is your potential liability?
Mr. Cook. Yes; at that time.
Representative Patman. What do you have in the way of assets to offset that potential liability?
Mr. Cook. We have in our insurance fund which, at the present time, is approximately $1,300,000,000.
Representative Patman. $1,300,000,000 to insure 92 billion?
Mr. Cook. That is right.

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Representative PATMAN. You have borrowing power, too, in the event of trouble?

Mr. COOK. In the event of trouble we have borrowing power under the law to the amount of $3 billion, which we hope never to use.

Representative PATMAN. If you had to pay the same rates for that as the RFC was charging for loans not so long ago it would be quite expensive.

Mr. COOK. It would be once we have to borrow; that is the reason we are guarding that fund very jealously, sir.

Representative PATMAN. What else do you have besides that? Of course, you have the assets of all the banks and everything, but I mean your own corporation?

Mr. COOK. Well, take the event of a bank's going bad, of course, that capital structure is back of it, to start with.

Representative PATMAN. That is right.

Mr. COOK. The capital structure. If it is a case of defalcation——

Representative PATMAN. I am just talking about your own FDIC. You have the liability of $92 billion, and you have the billion-plus that you have in assets, and you have this $3 billion borrowing ability from the Treasury in the event of distress. What else do you have; I mean the FDIC?

Mr. COOK. Well, we must figure this, Mr. Chairman, that in the event any bank finds itself in difficulty, there is a capital structure of that bank back of it, which is eradicated before it costs us anything. If it is a case of defalcation we have the surety bond to fall back upon. All of those factors enter into this before our fund becomes involved, you see. You will be interested in knowing what the capital structure of the entire insured banking system was.

Representative PATMAN. We are fairly well familiar with that. I was asking you about the FDIC.

Mr. COOK. Of course, naturally, Mr. Chairman, that ties up definitely.

Representative PATMAN. That is right. I know it does, because the assets of the banks come first, then private insurance, if any, and such things are available for meeting losses before any drain falls upon the FDIC.

Mr. COOK. That is right; the assets.

Representative PATMAN. And the surety bonds and everything else.

Mr. COOK. Yes.

Representative PATMAN. Do you have any questions, Dr. Murphy?

Mr. MURPHY. I would just like to clarify one point, Mr. Cook. Is your statute a statute which permits you, strictly interpreted, to take into account any factors other than probable financial loss to the corporation in showing the method by which you will aid the depositors of a failing bank or are you strictly bound to use the method which will result in the least financial loss?

Mr. COOK. The statute, interpreted to my mind, would mean this: That, our Board of Directors, as to any bank which finds itself in difficulty, must take into consideration the method that would best protect the Corporation at the outset.

If we feel the receivership method is the method to be used—of course, you are all familiar with that, and that is the most expensive method of liquidation there is.

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The merger method has proven far more economical, but, in addition to that, there is this intangible factor which is referred to, in the statement, where this could conceivably happen, and it has been mentioned to us, and it would have this effect: There might be a bank in a particular section of a State where conditions were such that the population would become nervous if the receivership method were used. It could conceivably happen that the "smart" money—and when I say "the smart money" I mean that money in excess of $10,000—would be drawn out of banks in surrounding communities, and it might affect them to the point where they find themselves in difficulty. All of us who have been through this banking industry through a good many years, have seen what has happened where sometimes perfectly sound banks were called upon for cash and could not liquidate their loans sufficiently rapidly to meet the situation, and the banks had to close. However, if they had been given a breathing spell—in other words, if the public confidence had been maintained and retained in those communities—those banks never would have closed. It is that chain of public reaction, of the public hysteria, which has closed many banks, and that is what we were trying to avoid by keeping the confidence of the public in the banking system and not permitting this wave of fear to become a panic.

Mr. MURPHY. Would it be possible under your existing statute for a case to arise in which, in the judgment of the Board of Directors or the FDIC, the public interest and the interest of the community would be best served by one method, whereas another method would result in a lesser financial loss to the Corporation?

Mr. COOK. It is conceivable, Dr. Murphy, that such a situation could arise. It has not arisen in a number of years.

Mr. MURPHY. Would you favor an amendment to the law by which the Corporation in such a case would be allowed, in its judgment, to use the method which would best serve the public interest and the interest of economic stability, the general purposes of the Employment Act?

Mr. COOK. On that, Dr. Murphy, I may only give you my own opinion, and you will pardon me when I say that I am not an economist, and I would not attempt to speak for the chairman on matters of policy which might not agree with his thoughts. But I give you my own opinion, that the broader interpretation of the law, as it now stands, gives the Board of Directors the right to take those things into consideration, because the law says "which would avert a threatened loss," and a threatened loss could be a loss in other banks. You understand, we have records of every insured bank, and we know what the reports of condition indicate.

Suppose we had a bank getting into trouble in town A. A bank in a town 15 miles away that we had a report on might be in condition where it could not stand much of a shock, and we might believe that if we did not fully protect the depositors in the first one, we might have the other one on our hands, and have a chain reaction in the communities. Those are things we try to analyze most meticulously, to not only preserve the funds of the Corporation but to maintain the stability of the economy of the surrounding community where these things occur.

Mr. MURPHY. And you feel you already have sufficient authority under your existing law?

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Mr. Cook. I believe we have authority under that law. I am not an attorney myself, but in studying that section of the law, which I have done often, I believe there is a sufficiently broad power implied, because we must take into consideration all of the factors.

Mr. Murphy. Thank you, Mr. Cook. That is all, Mr. Chairman.

Representative Patman. Dr. Ensley?

Mr. Ensley. Just one question: When Mr. Harl, on behalf of the FDIC testified a couple of years ago before the forerunner of this subcommittee, the so-called Douglas subcommittee, he expressed considerable concern that if the Federal Reserve or the monetary authority unpegged or lowered the support price of Government bonds, that the solvency or the possible solvency of the commercial banking system might be impaired. Also, I believe, he expressed some apprehension as to the reserves of the FDIC itself if such a lowering of the support level or the unpegging, complete unpegging, took place.

Now, in light of our experience in the last year, you would not say that any of those things have happened, would you or would you not?

Mr. Cook. I would not say as yet they have happened. I presume, Mr. Ensley—and I am not speaking for the chairman now, because he is very ill in bed——

Mr. Ensley. Yes; I appreciate that.

Mr. Cook. May I say something off the record?

Representative Patman. Yes.

(There was discussion off the record.)

Representative Patman. Back on the record.

Mr. Ensley. You do not believe, as Mr. Harl believed, that if we removed the support or lowered the support price, we would be breaking faith with the banking fraternity? You do not need to answer if you do not care to.

Mr. Cook. If I may I should rather not answer; it would not be fair to the chairman.

Representative Patman. Just read the statement Mr. Harl made at the earlier subcommittee hearings, Mr. Ensley, please.

Mr. Ensley. Senator Douglas asked this question on page 114 of the hearings:

> But suppose the Federal Reserve, for example, should decide either to end the system of support price or to lower the support price. Where yould you be then?

This was Mr. Harl's reply:

> I think, if that were done, that good faith would have been broken with the banking fraternity which has supported, by large investment, Government bonds.

Representative Patman. Government bonds are carried on the books of the banks at par anyway, are they not?

Mr. Cook. The way that is handled by the supervisory authorities, Mr. Chairman, is this: Supposing a bank 2 years ago bought some of these bonds which were selling at a premium and they paid a premium at that time. Well, of course, they amortize those premiums and the bonds are carried on the books at amortized cost. If they bought them at par they are set up at par.

If they bought them at the present market below par, of course, they are set up at what they paid for them, because they would not write them up to par when they bought them below.

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Representative PATMAN. Well, that is not exactly what I asked you, as the way I understand it.

Mr. COOK. I am sorry.

Representative PATMAN. Supposing a bank had bought these bonds at par that are now down to 96, or at least below a hundred. Do they still carry them at par?

Mr. COOK. They may carry them at par. Mr. Chairman, but many banks adopt this practice: When they see that these are selling below par, they set up reserves to offset the difference between the market and the carrying-book value.

Representative PATMAN. The point that I am trying to bring out is this, that the examiners permit them to carry the bonds on the books at par although they are selling below par.

Mr. COOK. Yes, if they paid par for them.

Representative PATMAN. That is right.

Mr. COOK. If they bought them below par——

Represententtaive PATMAN. I understand—if they paid for them at above par they carry them at par.

Mr. COOK. I understand.

Representative PATMAN. Mr. Bolling?

Representative BOLLING. I have no questions.

Representative PATMAN. I believe that is all for the present, Mr. Cook. Thank you very kindly, sir, and we wish your chairman a speedy recovery.

Mr. COOK. When I talk to him I will tell him.

Let me express appreciation not only of myself and my staff but the entire organization for the most courteous treatment by you and Dr. Murphy and your associates, and Mr. Ensley.

Representative PATMAN. Thank you.

I would like to insert in the record at this point: (1) three tables dealing with the capital and profits of insured commercial banks; (2) a letter addressed to me by Mr. Marriner S. Eccles, dated April 3, 1952, which letter is in response to an invitation to appear before the subcommittee which Mr. Eccles was unable to accept; and (3) a letter from Chairman Martin of the Board of Governors supplying legal interpretations requested during the course of the hearings. Mr. McCabe, to whom an invitation to appear at the hearings was also extended, has advised me that he would prefer not to appear or to present a written statement.

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(The material referred to follows:)

INSURED COMMERCIAL BANKS

Estimated earnings on loans guaranteed or insured by agencies of U. S. Government, 1941–50

[Millions of dollars]

Year	Commodity credit [1]	Federal Housing Administration			RFC commitments to banks [5]	Veterans' Administration [6]	Guaranteed or insured total
		Home mortgages[2]	Rental project mortgages [3]	Improvement loans [4]			
1941	30.0	58.5		14.4	1.4		104.3
1942	30.0	68.6		22.0	4.4		125.0
1943	28.9	76.7		71.0	6.6		129.2
1944	39.3	77.8		11.4	5.3		133.8
1945	27.0	79.2	1.0	11.5	3.1	3.8	125.6
1946	6.0	75.1	1.5	17.8	16.3	18.0	134.7
1947	2.6	77.3	7.6	30.3	14.6	41.2	173.6
1948	27.2	83.0	15.6	46.6	9.8	52.7	234.9
1949	45.3	97.1	21.0	58.2	8.1	58.0	287.7
1950	25.2	97.6	36.8	60.6	5.5	67.0	292.7

[1] Average of amounts held June 30 and Dec. 31 each year at average rate of 6 percent estimated by management of CCC.
[2] Face amounts under secs. 203 and 603 reduced by 10 percent estimated average amortization at 4 percent.
[3] Face amounts under secs. 207, 210, 608 reduced by 5 percent estimated amortization at 4 percent maximum.
[4] In absence of data on holdings or outstandings, based upon "origination" data. All national and State banks accounting for ⅔ of origination. Average length of loan 2½ years at 6 percent.
[5] Based on uncalled-for commitments at assumed net earning rate of 5 percent.
[6] Guaranteed portion outstanding after scheduled amortization; bank holdings estimated at 35 to 40 percent of total taken at 4 percent maximum on real estate loans as guaranteed business loans relatively small

Operating earnings, profits, income taxes, and estimated income on obligations of U. S. Government and on loans guaranteed by U. S. Government, 1941–50

[Amounts in millions of dollars]

Year	Total current earnings	Earnings on—			Percentage of total earnings derived from Government and Government guaranteed items	Net profit before income tax	Taxes on net income			Net profit after income taxes
		Obligations of United States Government	Loans guaranteed or insured by United States Government agencies [1]	Government obligations and loans guaranteed or insured by United States Government agencies			State	Federal	Total	
1941	1,729.9	[1] 360.0	104.3	[1] 464.3	27	[1] 504.6	(2)	(2)	50.0	454.6
1942	1,790.7	500.0	125.0	625.0	35	520.2	(2)	(2)	79.5	440.7
1943	1,959.5	750.0	129.2	879.2	45	765.8	(2)	(2)	127.9	637.9
1944	2,214.9	950.0	133.8	1,083.8	49	954.0	(2)	(2)	202.8	751.2
1945	2,482.3	1,133.0	125.6	1,258.6	51	1,204.8	21.3	277.5	298.8	905.9
1946	2,863.9	1,218.5	134.7	1,353.2	47	1,225.7	22.3	301.0	323.3	902.3
1947	3,097.7	1,079.5	173.6	1,253.1	40	1,083.7	19.2	283.0	302.2	781.4
1948	3,403.6	1,008.1	234.9	1,243.0	37	1,020.8	16.9	258.5	275.4	745.3
1949	3,606.9	1,013.5	287.7	1,301.2	36	1,156.5	20.6	304.6	325.2	831.0
1950	3,930.7	1,015.5	292.7	1,308.2	33	1,364.7	25.2	402.6	427.8	936.9

[1] Estimated.
[2] Not available.

Source: Federal Deposit Insurance Corporation annual reports, except column 3 estimated by staff, Joint Committee on the Economic Report.

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Capital accounts and profits, 1941–50

[Amounts in millions of dollars]

Year	Capital stock notes and debentures	Surplus paid-in and accumulated	Undivided profits	Reserves and set-aside for contingencies	Total capital accounts	Net profit before income taxes	Net profit after income taxes	Ratio, profits before taxes to—		Ratio, profits after taxes to—	
								Capital stock	Owners equity	Capital stock	Owners equity
								Pct.	*Pct.*	*Pct.*	*Pct.*
1941	2,849.9	2,687.5	896.1	411.6	6,845.1	504.6	454.6	17.7	7.4	16.0	6.6
1942	2,848.6	2,801.6	972.0	434.0	7,056.2	520.2	440.7	18.3	7.4	15.5	6.2
1943	2,874.5	3,039.8	1,006.4	480.0	7,453.7	765.8	637.9	26.6	10.3	22.2	8.6
1944	2,912.5	3,402.0	1,169.4	506.4	7,990.3	954.0	751.2	32.8	11.9	25.8	9.4
1945	3,032.3	3,784.7	1,293.3	562.1	8,672.4	1,204.8	905.9	39.7	13.9	29.9	10.4
1946	3,141.9	4,060.0	1,495.5	590.7	9,288.1	1,225.7	902.3	39.0	13.2	28.7	9.7
1947	3,193.9	4,316.4	1,650.2	575.2	9,735.8	1,083.7	781.4	33.9	11.1	24.5	8.0
1948	3,264.1	4,504.1	1,872.5	519.7	10,160.4	1,020.8	745.3	31.3	10.0	22.8	7.3
1949	3,395.5	4,803.2	1,954.3	495.7	10,648.7	1,156.0	831.0	34.0	10.9	24.5	7.8
1950	3,518.1	5,200.5	2,093.3	469.0	11,280.9	1,364.7	936.9	38.8	12.1	26.6	8.3

WASHINGTON, D. C., *April 3, 1952.*

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, Washington, D. C.

MY DEAR MR. PATMAN: As I previously advised Mr. Murphy, I greatly appreciated the committee's invitation to testify but concluded that I could add but little to the voluminous replies to your questionnaire or to the testimony and that such points as I should like to emphasize could best be presented to you in this letter.

So far as relations with the Treasury and the circumstances surrounding the so-called accord are concerned, these matters have been adequately covered, particularly in the testimony of Allan Sproul, president of the Federal Reserve Bank of New York, and I am in full agreement with what he had to say with respect to these subjects.

I have so often expressed the importance of safeguarding monetary and credit policy, dealing as it does with the very life blood of the economy, from political, self-seeking or other pressures that it is scarcely necessary for me to reiterate these views. In the light of the testimony before you, however, and my many years of experience as Chairman and member of the Board of Governors of the Federal Reserve System, I should like to express my very deep convictions with reference to three related subjects.

1. Congressional mandate.—I strongly feel that the time is opportune for the Congress to adopt a mandate or directive generally in accordance with Senator Douglas' proposal contained in joint resolution (S. J. Res. 45), introduced in the Senate on March 6, 1951, in which Senators Fulbright, Flanders, Gillette, Tobey, and Thye joined. You may recall that the Banking Act of 1935, as it passed the House, contained a broad mandate which, had it been enacted, would have been helpful to the Reserve System in the intervening years both in clarifying its responsibilities and in strengthening its position in its relations with the Treasury. The reason I expressed at that time for making explicit what is only implicit in the statutes are even more forceful now than they were then, particularly in view of the magnitude of the public debt and the conflicts that have arisen in the past and are likely to recur in the future between debt management and monetary policy. Such a mandate, in my judgement, would make unmistakably clear the congressional purpose to have its creature, the Reserve System, carry out its wishes with respect to monetary and credit policy. It would also help to clarify and make it easier to carry out Treasury responsibilities. From my long and close observation a Secretary of the Treasury is under strong political pressures, irrespective of whatever his personal views may be, to make debt service costs an overriding consideration when debt management and monetary policies are being considered. Both the Treasury and the Federal Reserve System would be relieved of any ambiguity as to their respective responsibilities by an explicit mandate.

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2. *Proposals for a National Advisory Council.*—I agree with Mr. Edward E. Brown, president of the Federal Advisory Council, that such a "superduper advisory council" would be weighted so heavily in favor of the administration that it would largely destroy the independence of the Federal Reserve System. If it were confined, as has been suggested by the Secretary of the Treasury, to debt management and monetary policy it would consist of administration appointees who have no direct responsibility in or close knowledge of either field. The Chairman of the Federal Reserve Board is only one member of the 12-member Federal Open Market Committee which is the statutory body charged with the primary responsibility for credit policy. Unlike the administration representatives who would be on the proposed Council, the Federal Reserve Chairman would be at a serious disadvantage because he could not commit the eleven other coequal members of this important group. It would serve only to create confusion, delay, and frustration, with the Chairman of the Reserve Board outvoted at the will of the administration whenever any vital decision was at stake.

Both the Treasury and the Federal Reserve now have more than adequate advisory groups, representing those who are both informed and directly affected in these fields. The Federal Advisory Council of 12 members, for example, is a statutory body which is required by law to consult periodically with the Reserve Board. Putting another layer of advisory officials, drawn from administration ranks, over all the formal and informal advisory groups now in existence could serve no purpose except administration domination of policy making in monetary and credit matters.

3. *Proposals to subject the Federal Reserve to the Bureau of the Budget and the Comptroller General, or both.*—I cannot too strongly express disapproval of such proposals apparently designed to accomplish by indirection what could not be done openly, that is, subordination of the Reserve System to the will of whatever Administration happened to be in power. Even the Socialist Government of England in acquiring the stock of the Bank of England did not go so far as to take over its housekeeping functions. It would be completely illogical, certainly from the standpoint of economy or efficiency, to subject the Federal Reserve Board in Washington to these supervisory procedures without extending them to the 12 Federal Reserve banks and 24 branches with their more than 250 directors and 18,000 employees, whereas the Board in Washington employs less than 600. I have not heard it seriously suggested that in the nearly 40 years of its existence the Reserve System has failed to subject itself to rigorous and proper disciplines with respect to budgetary, auditing, and related matters affecting its expenditures.

Apart from the Herculean task that would be put on the Comptroller General to supervise the System's manifold activities, such an official superimposition would destroy, by indirection, the basic character of the Reserve System. It would do so in the absence of any evidence of abuses, wasteful practices, or lack of proper housekeeping methods with respect to the expenditure of System funds. Such funds are derived out of the profits and operations of the System and are not appropriated from Government revenues. While the Board in Washington was once subject to administrative audit of expenses by the Office of the Comptroller General, even this was changed in the Banking Act of 1933 at the insistence of Senator Glass. His basic reason was then the same as the one he announced for removing the Secretary of the Treasury from the Reserve Board—specifically that it was the kind of encroachment which, if carried to its logical conclusion, would ultimately hamstring and destroy the independence of judgment and action by the Reserve System.

From the beginning of the System, the Reserve Board has been charged by law with supervisory responsibility for the System's budgetary and auditing procedure and practices and has been required to report annually to Congress with respect to all these matters. I can see nothing that would be gained in the public interest by duplicating or complicating these established supervisory duties which are discharged by a Board of seven members, responsible only to Congress. If the Board is incompetent to perform these duties honestly and economically then it would be logical to replace such a Board with one that would do the job properly instead of superimposing upon it another supervisory layer. The question might well be asked, "Who audits the Comptroller General's Office?", or "Who budgets the Bureau of the Budget?" Responsibility must be placed somewhere, and in prudent hands, but I can see no gain, and I can see a grave

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danger, in substituting other supervisory officials for those already discharging these duties under the law.

The Bureau of the Budget, which is an adjunct of the White House, has virtual power of life or death through its control of the purse strings. A direct mandate to put the Reserve System under Executive dictation could hardly be more calculated to reduce the System to subserviency than to subject it to the administration's budgetary control. Superficially, the argument for subjecting the Federal Reserve to these administrative procedures has a deceptive plausibility. The appearance of independence would remain, but actually there would be subtle Executive domination through the power of the purse.

Nothing by way of greater efficiency and effectiveness could possibly be gained by adding another layer of financial review and control. The System already follows operating and supervisory procedures which provide for careful audit and budgetary controls. From my personal observation the efficiency and economy of operations of the Board and the Reserve banks compare very favorably with those of the best run Government departments operating under appropriated funds and subject to audit by the General Accounting Office. Their operations also compare very favorably with those of the larger private business organizations.

With the long background of independent administration of the System's internal housekeeping, there is no question in my mind as to how congressional action to put the System under audit control by the General Accounting Office and budget supervision by the Bureau of the Budget would be viewed by an informed public. It would be evaluated as effective nationalization. The independent position of the Federal Reserve would be considered a thing of the past and thenceforth the public would feel that its policies were dictated by political expediency. Public confidence in the idea of nonpolitical monetary management would be completely shattered.

I would greatly appreciate it if you would furnish copies of this letter to the other members of your subcommittee and have it placed in the public record of the subcommittee.

Sincerely yours,

MARRINER S. ECCLES.

MARCH 17, 1952.

Hon. WILLIAM McC. MARTIN, JR.,
Chairman, Board of Governors,
Federal Reserve System, Washington, D. C.

DEAR CHAIRMAN MARTIN: Three points, all of a legal character, have come up in the course of the hearings upon which the subcommittee would appreciate an answer at the early convenience of yourself or your counsel.

(1) Do the Federal Reserve banks have the power in their discretion (or in that of the Board of Governors) to refuse or to limit the rediscount privileges of member banks—
  (*a*) on commercial paper or promissory notes secured thereby?
  (*b*) On promissory notes secured by United States obligations?

(2) Do the Federal Reserve banks have the power to dispose of their net earnings otherwise than by paying a maximum cumulative dividend of 6 percent of their paid-in capital stock?

(3) Are dividends on the stock of the Federal Reserve banks tax-exempt in the hands of their recipients?

If any of these questions present difficulties, we would appreciate it if you would answer those not presenting difficulties first, so that the information may be obtainable as soon as possible

Sincerely,

HENRY C. MURPHY, *Economist.*

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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, March 19, 1592.

Dr. HENRY C. MURPHY,
Economist, Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, Congress of the United States, Washington, D. C.

DEAR DR. MURPHY: This is in response to your letter of March 17, 1952, requesting answers to three questions of a legal nature which have come up in the course of the current hearings before the subcommittee. I have taken these points up with the Board's counsel, and I am pleased to advise you as follows:

1. Do the Federal Reserve banks have the power in their discretion (or in that of the Board of Governors) to refuse or to limit the rediscount privileges of member banks—
   (*a*) on commercial paper or promissory notes secured thereby?
   (*b*) on promissory notes secured by United States obligations?

The Federal Reserve banks are not required by any provision of the law to extend credit accommodations upon the request of their member banks. It is discretionary with a Reserve bank whether it will grant or refuse the rediscounting privilege in the light of the circumstances of the particular case. In this respect there is no distinction between the rediscounting of commercial paper and the making of advances to member banks on their notes secured by commercial paper or obligations of the United States.

Throughout the Federal Reserve Act, provisions relating to the granting of credit accommodations by the Reserve banks to member banks are permissive rather than mandatory. Thus, to mention but a few examples, the law provides that any Federal Reserve bank "may discount notes, drafts, and bills of exchange arising out of actual commercial transactions"; "may discount acceptances of the kinds hereinafter described"; "may make advances" to member banks secured by eligible paper or certain Government obligations; and "may make advances to any member bank on its time or demand notes having maturities of not more than four months, and which are secured to the satisfaction of such Federal Reserve bank." In this connection, it may be mentioned that the Supreme Court of the United States has referred to the word "may," as used generally in the Federal Reserve Act, as being permissive in nature rather than mandatory (*Farmers and Merchants Bank* v. *Federal Reserve Bank of Richmond*, 262 U. S. 649, 663 (1923)).

The permissive character of the rediscounting authority of the Reserve banks was confirmed in *Raichle* v. *Federal Reserve Bank of New York* (34 Fed. (2d) 910; C. C. A. 2d (1929)), in which the Court referring to a Federal Reserve bank, stated: "It is important to note that it is not under any compulsion to rediscount eligible paper, for the words of the act in respect to rediscounting are wholly permissive."

All discounts and rediscounts by the Federal Reserve banks under the law are subject to such limitations, regulations, and orders as may be imposed by the Board of Governors of the Federal Reserve System.

2. Do the Federal Reserve banks have the power to dispose of their net earnings otherwise than by paying a maximum cumulative dividend of 6 percent on their paid-in capital stock?

The Federal Reserve Banks have no authority under present law to dispose of their net earnings other than by payment of the 6-percent cumulative dividends to which member banks are entitled under section 7 of the Federal Reserve Act. However, under section 16 of the act, the Board is authorized to require payment of interest on outstanding Federal Reserve notes not covered by gold certificates and, as you know, since 1947, under the requirement of the Board, the Federal Reserve banks have paid such interest to the Treasury in an amount approximately equivalent to 90 percent of their net earnings.

It is to be noted that, under the law, dividends are payable only on paid-in stock of the Reserve banks and that only half of the amount subscribed for such stock by member banks has been paid in. The remaining half is subject to call when deemed necessary by the Board of Governors. It would be possible, therefore, for the Board to call for payment of the remainder of the stock subscriptions of member banks; and, in that event, the 6-percent cumulative dividends prescribed by the statute would be paid on the full amount of each member bank's subscription rather than on half of that amount. No such call has ever been made.

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3. Are dividends on the stock of the Federal Reserve banks tax-exempt in the hands of their recipients?

Section 7 of the Federal Reserve Act provides that the Federal Reserve banks "including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate." Under this provision, all dividends on Federal Reserve bank stock were exempt from taxation prior to 1942. However, the Public Debt Act of March 28, 1942, provided, among other things, that "dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership issued * * * by the United States or any agency or instrumentality thereof" after the date of that act should not have any tax exemption as such. As the result of this statute, dividends on Federal Reserve bank stock issued before March 28, 1942, continue to be exempt from taxation, but dividends on stock issued after that date have no such exemption. This position has been confirmed by the Bureau of Internal Revenue.

We shall, of course, be glad to furnish any additional information that you may wish.

Sincerely yours,

WM. McC. MARTIN, Jr., *Chairman.*

We will now go into executive session.

(Whereupon, at 11:10 a. m., the committee recessed to go into executive session.)

The following material was later submitted for the record in accordance with permission given earlier or in accordance with requests made by the subcommittee, including requests made at the executive session.

MARCH 17, 1952.

STATEMENT OF JAMES WASHINGTON BELL, CHAIRMAN, DEPARTMENT OF ECONOMICS, NORTHWESTERN UNIVERSITY, EVANSTON, ILL., AND ACTING PRESIDENT, ECONOMISTS' NATIONAL COMMITTEE ON MONETARY POLICY

The reading of the replies to the "Questions for Economists," chapter X in part 2 of replies to questions, etc., confirms my belief that economists are reverting to more conventional or traditional views concerning the problems raised by the Patman inquiry.

The two broad questions raised by the Patman questionnaire relate to (1) the appropriate content of monetary policy and (2) the machinery for the formulation of monetary policy. Response to the first group of questions was sought from economists because of their particular interest and concern with theoretical matters.

The mere fact that emphasis of the questionnaire was placed on monetary policies and controls primarily and on debt management secondarily is evidence that attention is again being directed to instrumentalities which were formerly prominent but which in the thirties fell into disfavor because of their alleged inadequacy. Fiscal and direct controls took their place. But, now that we have had experience with unorthodox management extending over a decade and a half, with doubious success, we are veering to the modus operandi quo ante with new faith in mechanisms which worked in the past and which presumably will work again today.

At long last, we are beginning to question the illusion that perennial cheap money is always good for the economy and are now again coming to realize that interest is a cost to the borrower, and that interest does affect the supply of loanable funds. We are again beginning to realize that tighter money may be effective in curbing inflation; that small changes in interest rates have economic effects as well as large. Consciousness of these effects is being felt abroad as well as in the United States. We are becoming cognizant of the dangers of debt monetization, a perennially unbalanced budget, the hazards of insulating particular sectors of the economy against the impact of inflationary forces. Finally, in the welter of piecemeal adjustments we see a new meaning to the injunction that above all we must maintain the value of the dollar for without confidence in a relatively stable dollar no controls can work properly. In the course of time, we may yet discover that a convertible dollar is still the safest and most manageable dollar we have yet been able to devise.

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In submitting my answers to the eight questions asked economists, I am drawing upon excerpts from previous answers, some of which were printed in the replies (in which case the pages are indicated) and some of the excerpts are from my answers to the questions of October 12, 1951.

1. *Effects of changes in interest rates.*—The wording of this question if literally construed, fails to elicit opinions sought concerning the effectiveness of "fractional changes in interest rates" as a means of combating inflation. If it is the "effects of credit policies * * * upon (a) lending policies," etc., then changes in interest rates are the result, as are changes in reserve balances, liquidity, and price of earning assets, etc., and the "specific ways in which restrictive credit policies are expected to restrain inflationary pressures" involve Federal Reserve discount policy, open-market policy, administration of minimum reserve requirements of member banks, etc. I take it that the real issue concerns the effects of changes in interest rates themselves, and this involves all considerations influencing both lenders (commercial bank and nonbank) and borrowers (business and Government) decisions. (With this in mind, I answered the question in part as follows:)

"This question calls for a reappraisal of role of interest rates as an instrumentality of control in stabilizing our economy.

"The view most commonly held since the impact of Keynesian theory seems to be that monetary policy is ineffective as a stabilizing device because its influence is exerted exclusively through its effects on interest rates; that interest-rate changes have no significant functional relationship either to the amount of saving, on the one hand, or the amount of investment, on the other, and no effect on income and prices. In other words, the classical theory of interest is discarded. The classical and neoclassical economists hold that interest is the price of waiting or saving necessary to bring forth capital funds in the market—which funds are in demand by borrowers who see profit prospects in the use of such funds in making capital expenditures.

"My own view is that the old theory still holds despite the attacks of the liquidity preference theorists. I believe that changes in interest rates, both small and large, do exert an influence on businessmen's decisions and can be made effective in stabilizing business. The amount of the change is a matter of degree and the effectiveness depends not only on the rates but also upon business psychology, expectations, etc., and the economic conditions of the time.

"A curiously illogical argument has become popular among Keynesian theorists; viz., that small increases (¼ to ½ percent) in interest rates are not effective in fighting inflation, but that large increases (2 to 4 percent or 5 to 10 percent) will cause chaos and disaster in the money market and will precipitate deflation.

"The origin of this anomalous view can be traced historically to the failure of restrictive credit policies to restrain credit expansion in the late twenties and to the apparent futility of the easy-money policy in stimulating business recovery in the early thirties; and to the rationalization of these experiences by Keynesian theorists.

"These theorists base their arguments on slender empirical evidence provided by an Oxford survey of the effects of interest costs on businessmen's decisions and a similar study at Harvard from which like conclusions were drawn. In Keynesian terminology, the argument is that a modest increase in interest rates is ineffective in significantly reducing personal consumption (C) or increasing personal savings (S) and decreasing possible expenditures on plant equipment or inventories (I) or Government expenditures (G). In other words, these theorists maintain that the market is insensitive to relatively small changes in interest costs and relatively insensitive to moderate inducements to save (liquidity preference) and relatively insensitive also to slight restraints upon expenditures. However, they admit that drastic increases in interest rates are effective in curbing loans and investments (on the demand side), in weakening reserve positions of banks (on the supply side), and even jeopardizing the solvency of financial institutions holding heavy portfolios of securities.

"These arguments are not consistent. Either small increases have some effect in curbing inflation or large increases will not cause collapse (unless we assume that the collapse is due to a breakdown in confidence in the integrity of the monetary unit). High rates, e. g., 4 to 5 percent, would undoubtedly check inflation and might even cause deflation with its attendant fall in production, increased unemployment, etc.; but by the same token, a moderate tightening of money, e. g., ½ to 1 percent, has some effect on savings and investment and on the policies of lending institutions. Rate changes have effect on the demand

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for funds and even greater effect on the supply of funds. Effects on the supply of funds have been practically disregarded by Keynesian economists.

"At bottom, the objection many opponents have to credit restriction policies is that they are too effective. That is, critics fear the consequences of deflation—depression, failures, and unemployment—more than they fear the effects of inflation. They prefer the malady to the cure." (See pp. 1014–1016 of replies.)

After describing commercial-bank operations as they are influenced by interest rate considerations, I continued:

"Under the monetary policy followed in the post-World War II period, banks had no reason for increasing their lending rates because they were able to increase their reserves and lending resources by selling Government securities to the Federal Reserve banks at stabilized prices and at low rates. If, however, the price of Government securities had been allowed to fall, the commercial banks would have been reluctant to take a loss in order to obtain funds to lend to private borrowers or they would have charged higher rates to offset the loss incurred. Again, had they not been assured that future rates would not be allowed to rise appreciably they would have been less liberal with their credit to private borrowers.

"Not all commercial banks are in the same position with regard to their holdings of Government obligations. Some banks interpreted literally the pattern of rates schedules announced by the Treasury and Federal Reserve in 1942 and pursued a policy of heavy holdings of long-term bonds at higher yield on the ground that they were as liquid as short-term Treasury bills. Other banks, either holding that the policy was a mistaken one and not in the best public interest or believing that the policy might suddenly be altered, pursued a more cautious and prudent policy of diversifying their holdings and arranged maturities so that they could weather changes without being forced to sell. In other words, they provided for internal liquidity by holding securities which would provide cash by merely letting them run off rather than depending on the market or Federal Reserve banks for liquidity.
are therefore freer to sell Government securities to take advantage of any storms affecting the price of Government bonds. To the extent that this is the case, we have a stabilizing influence in the money market; Government bonds falling below par will not cause panicky selling. However, without Federal Reserve support, banks have to resort to their own resources or borrow at the Federal Reserve to increase their reserves and lending power, with the effect that credit is tightened.

"(b) Somewhat the same considerations (as in "a") apply to the effects upon the lending policies of nonbank investors through the operations of insurance companies, savings banks, farm and building and loan institutions are not so sensitively affected by credit policies as are commercial banks. They do not have large demand liabilities, nor do they trade on such thin equity. Nor are they so intimately bound to accommodate their customers' credit needs. They are therefore freer to sell Government securities to take advantage of any differential yields in other investments or advances.

"(c) *Consumer saving.*—The classical theory relates the amount of saving to interest rates as a charge or reward for abstinence or waiting. It is a false implication to state that there would be no saving without this price. The classical theory gives ample consideration to negative interest, i. e., saving which would take place even at a cost. But all savings cannot be accounted for on this basis. If only the marginal savings that find the market are interest-induced, the total supply would be affected by changes in interest rates. As an inducement to save, I see no difference between higher interest rates on savings and higher yields on investments. Saving is related to income and also to assets, and it follows that any credit policies resulting in changes in income and capital values must also affect savings.

"(d) *Business-plant expenditures program.*—There is a close relationship between interest rates and capital expenditures. This seems to be admitted by economists quite generally. Even those who deny the influence of interest costs on business decisions generally make an exception of capital industries, e. g., public utilities, housing, real estate, in which the return on capital constitutes an important part of the total costs. The idea that lower interest rates increase capital investments is at least as old in economic literature as Turgot, who, I believe, used the simile of the river overflowing its banks. When the water recedes (lower interest rates), the area of land for cultivation (demand for investment funds) increases. To cite an example: Lower mortgage rates in the postwar period stimulated a housing boom and plant-expansion programs.

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The existence of a backlog of demand hardly accounts for the degree of stimulation that took place.

"(e) *Business inventory policies* are affected by changes in interest rates insofar as they constitute a cost in carrying inventory. Because such a cost may be a relatively minor one does not warrant the charge that it does not influence businessmen's decisions. If the businessman is oblivious of the cost, the banker will usually remind him by making the funds less available or available on stricter terms when inventory loans become speculative." (See pages 5–7 of my manuscript of October 12, 1951.)

2. *Credit expansion a cause of inflation.*—This question also needs interpretation. Can one say which of the two blades of a pair of scissors is responsible for the cutting edge? One many assert that the pressure is being exerted on one blade but without the other, cutting would be ineffective. Thus the post-Korean (and postwar) demand factors activated the money supply already present. In this sense, credit expansion may be said to have been a conditioning factor and it contributed to the inflationary process. Until activated, however, money supply lay dormant. I quote from my answer the parts dealing with general considerations, omitting answers to specific parts:

"Since going off the gold standard, the stage is always set for inflationary movements. Under managed money, the policy has been to keep all bank assets liquid, and this in turn keeps credit easy. The concerted psychological urge to stock up with consumers' goods inventories and to start investment in plant expansion, housing, etc., before war restrictions could be put into effect found the financial system immediately available for providing effective demand for goods, services, and securities.

"The postwar boom of 1945–48 was the result of pent-up forces which had been suppressed during the war. Basically, the monetization of the public debt provided excessive purchasing power which could find an outlet only after controls were lifted and civilian goods became available. Consecutive rounds of wage-rate increases were more than absorbed by higher prices. In the same manner, farm-support prices increased costs and entered into the wage-price farm-support spiral. A tighter credit policy might have contributed to the control of inflation and would not, in my opinion, have done any serious harm. Even a moderate restriction would have done some good. I do not share the view expressed by many economists entering this debate that a moderate credit policy would have had no significant effect but that a drastic policy would have caused catastrophe. Both the reasoning and conclusions of these economists seem to me inconclusive and erroneous. (See question 1.)

"General credit controls obviously cannot be made effective so long as Government debt is supported by the banking system at artificially low rates of interest. This situation is not of recent origin, nor is it a product of war financing alone. We have to go back to the devaluation of the dollar and the abandonment of the gold standard in 1933, with the subsequent deficit financing, easy-money policy of the thirties and the forties to get at the basis cause of our present dilemma. Deficit financing at artificial low rates through credit inflation has so expanded and weakened our credit structure that we are afraid to use orthodox credit controls lest the market collapse. Hence we propose insulating certain sectors from the influence of market forces; e. g., segregating special secondary reserves consisting of United States obligations in the commercial banks. Parenthetically, it may here be observed how one control leads to another and still another. First we segregate the credit and monetary system from market forces by making money irredeemable; then we monetize the debt which we now propose to segregate in part to free it from the operation of market forces. No wonder some serious economists propose going back to the gold standard and the disciplinary influences of a free market.

"General credit controls will not work effectively in the face of expansionist policies only. Interest rates should be allowed to find their own market level. The Federal budget should be balanced and debt monetization stopped. Either credit contraction must take place or production increased to new high levels; that is, we must grow into our inflated monetary structure, which means producing assets for the time being without corresponding increase in debt. The alternative to this policy of checking inflation is the precarious risk of a credit collapse—a collapse, incidentally, which would probably be attributed to the failure of capitalism rather than to poor money management.

"Selective controls involve supervision of the purposes for which bank credit may be extended. This supervision may be exercised by a Government depart-

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ment, a central bank, or by an especially constituted body—informally or in accordance with specific legislation.

"These controls have had their origin during the cheap-money era, when a general rise in interest rates has been prevented (to minimize interest burden on the public debt) and when it was considered necessary or expedient to restrain or guide the use of credit by direct action.

"Various countries have had experience with selective credit controls—all of them, so far as I know, countries pursuing easy-money policies through credit inflation. Control of stock-exchange margins in the United States originating in the Securities and Exchange Act of 1934 was perhaps the first example of statutory controls, but during the war years statutory regulation of installment credit was introduced and in 1950 legal restrictions were put on residential real-estate construction credits. England, France, Sweden, the Netherlands, Canada, Australia, and New Zealand are among the countries resorting to forms of selective-credit controls during the war and postwar years, with Australia having perhaps the most detailed regulations. Experience in these countries as well as in our own is not conclusive. Differences in economic and political conditions, especially with respect to the banking structure and banking methods, would make problematic the conclusion that success or failure in one country would mean success or failure in another.

"In general, I would consider selective-credit controls appropriate instrumentalities only in situations where significant imbalances have occurred and then only as temporary expedients, to be relaxed and suspended when the emergency subsides. I would favor informal arrangements rather than control on a statutory basis and supervision or administration of monetary controls through the Federal Reserve rather than by a Government department or a specially constituted body. If left in the hands of the Federal Reserve authorities, there would seem to be a better chance of sooner abandoning such selective controls in favor of a return to the instruments of quantitative controls and interest rates." (See replies, pp. 1046–1047.)

Continuing from my manuscript of October 12, 1951:

"One is tempted to review here the pattern of perpetual inflation which Government regulation and control seems to be constructing, and the fiction of free prices, free markets, free competition, free contracts, and free enterprise under conditions of so-called controlled inflation. Credit expansion and rising prices soon get beyond the control of money managers. The money managers complain that they are handicapped with weak control laws and that they need more and more power. What they really need is the effective brakes on inflation which currency redemption would provide. What they really need is the restraints of economic forces which the discipline of the gold standard would provide. The most positive countercyclical policy is to stop monetizing unproductive debt. The most convincing test of the people's approval or disapproval of public expenditures and new debt would be provided by the redeemability of our money into gold."

3. *General and selective credit controls and direct controls.*—I agree with the general conclusions of the majority of replies to this question which recognized reliance on general credit controls under conditions (a) and (b), some reliance on selective credit controls when inflationary forces are moving strongly in a special or particular sector of the economy, e. g., installment, real estate, or speculative financing, and direct controls as a last resort to meet emergency conditions.

I take the following from my manuscript of October 12, 1951:

"General credit policy is a powerful instrument of control and if applied with sufficient vigor can curb any inflationary movement. For that very reason, political and economic objections arise to its use, but this does not disqualify it as the best single method of economic control. It has the advantage of flexibility, equitability, and universality. General credit policy cannot be avoided or evaded; the effects are nondiscriminatory and implementation does not require elaborate and costly administrative machinery. It is not difficult to enforce these regulations. They can be more promptly timed and applied and with less economic dislocation than can direct controls. Direct controls are less effective and more disruptive. Selective controls have a place in the arsenal of control weapons but should be considered emergency and temporary weapons. They should be applied only in situations where imbalances or excesses occur in particular sectors of the economy and should be lifted when readjustments have been corrected.

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"A general inflationary situation due primarily to excessive private capital formation can be appropriately controlled by applying general credit policies. Commercial banks respond to forces which operate on their reserve positions. Changes in discount rates, Federal Reserve open-market operations, and direct changes in reserve ratios all operate through their effect on the bank's reserve position. Banks are sensitive to the cost and availability of credit. These two aspects are virtually inseparable in practice.

"Government deficit financing can be even more disrupting than private because of the monopolistic control which Government can exert on the banking system. Banks are virtually forced to buy Government securities at fixed prices; the balance unsold is taken by the Federal Reserve banks. Thus the public debt is monetized and inflates the currency. The simplicity of the operation has deluded many into the belief that management of the debt and of the credit system can be directed more effectively to the social objective of full employment, etc., than can competition in a profit enterprise market. The case has been effectively stated by a prominent author who has described our banking system based on a business paper down to 1929 as the worst possible system and the subsequent monetized Government debt as the best possible. This view is based on the overpowering assumption that business debt is unmanageable and inflationary whereas Government debt is readily adjustable to the financial or monetary needs of business and Government; it assumes that planned control by Government money managers is more effective than competitive forces in the money market and less dangerous, too.

"Federal Reserve powers are adequate but they have not been used effectively as a review of Federal Reserve policy since 1914 would demonstrate. Treasury domination prevented adequate use on two major occasions, namely, the post-war periods, and on other occasions, e. g., the late twenties, and at the present moment when group pressures, such as business, labor, and farmer, exercise restraints upon the implementation of credit controls.

"General credit policy probably works more successfully in controlling expansion than in stemming deflation or stimulating business recovery. The difficulties of curbing inflation are perhaps more political than economic. Since the Government has taken on responsibilities of controlling business fluctuations, political pressures have become a way of life because of the fear which the administration has of a condition of 'less than full employment.' General credit policies are too cautiously used for fear of causing credit contraction, with consequent falling prices, unemployment, business failures, and everything else that goes with depression.

"The classic example of general credit policy initiated to check contraction and induce business recovery is that of the early thirties. It is generally cited as a complete failure of monetary control. It has been stated that trying to stimulate investment and consumption spending by an easy-money policy was like 'pushing on a string' or like 'leading a horse to water'; that the failure of this monetary policy prompted economists to shift emphasis to fiscal policy which provided a more direct influence on income and expenditure. However, this case is not a good example, because the situation was needlessly complicated by a manipulated monetary unit which destroyed public confidence in the integrity of the dollar. Confidence in the dollar as basic to the smooth operation of any monetary and business mechanism. A strong case can even be made in support of the easy-money policy immediately following the passage of the Glass-Steagall Act in February 1932. A careful analysis of the credit pattern of the market from February to June of that year provides convincing proof that the monetary policy was effective until a disruptive political situation in the autumn of 1932 presaged a change in economic policy which threatened to shatter confidence in the monetary unit. This case provides evidence that conditions of relative political and economic stability and sound monetary policies will work but that tampering with the monetary standard does not provide an atmosphere congenial to the smooth operations of any market mechanism."

4. *Insulating the public debt.*—I agree with the majority of economists who did not believe that it would be desirable to insulate public-debt securities from the impact of restrictive policies and for the reasons given: namely, it would interfere with the fluidity of the credit market and, therefore, with the effective functioning of the price system. To be effective, these measures have to be restrictive and either complex or inflexible and serve to hamper and curb the competitive forces in a healthy credit system. Government securities

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should stand the test of the market—should compete with private demands for the existing supply of funds and on an equal basis.

5. *Investment demand for governments.*—My answer to this question was quoted in Replies (p. 1093) as follows:

"Nonbank investors are not greatly attracted by the current low level of interest rates for high-grade fixed-interest-bearing securities. They are influenced more by expectations of higher rates and by fear of continued erosion of the purchasing power of the dollar. Evidence is provided by their preference for short-term commitments and their frantic search for hedges against inflation. With current income at present high levels, savings are correspondingly large, and one would expect heavy demands for Government and other bonds. However, yields in corporate issues are edging upward and conversion privileges are often necessary to induce investment, and the market for Governments is sluggish despite sales efforts and the Treasury drive. The heavy supply of investment funds is finding competitive outlets in housing, real estate, durable consumer goods, and the stock market. The market for Governments and other fixed-interest-bearing securities would be immensely stimulated and stabilized, in my opinion, if our dollar were made redeemable in gold. A multiple-commodity standard would serve the same purpose and would be desirable if the administration of conversion of the dollar into such commodities were feasible."

6. *Guaranteed purchasing power bonds.*—The following excerpt is taken from my manuscript answers to the October 12, 1951, questionnaire:

"The merits of a guaranteed-purchasing-power bond are obvious. It would enable the investor to contract out of the risks of a depreciating dollar—an objective devoutly to be sought, as any present holder of maturing E bonds will attest who cashes in his 1941 100-cent investment for 54-cent dollars today. There is no doubt that a tremendous new market would be found in varying the Treasury offerings to include such an inflation hedge. The demand should also increase as the dollar depreciates. Sale of such bonds would be one of the most effective means of increasing savings we could devise.

"The demerits are equally obvious. Why should a special class of new investors be favored while other investors, including the holders of $256 billion Federal debt, are expected to assume the risks of uncertain dollar values? A big issue of guaranteed-purchasing-power bonds would serve to depreciate the value of unprivileged bonds and might cause heavy loss to holders. To be sure, we have other favored groups, like farmers, who enjoy support prices, and organized-labor groups who are able, with escalator clauses, to tie in wage rates to rising prices. Some argue that we should extend hedging privileges to cover all classes indiscriminately. A more direct and effective approach to the problem would be to follow Civil War precedent in making Government bonds payable, interest and principal, in gold dollars of present weight and fineness. This privilege would not guarantee the bondholders the same purchasing power originally invested; bond prices and gold would still be subject to market readjustments; but such convertibility would give bondholders some assurance that their claims would always be as good as gold. This would mean a return to the gold standard, since to make gold receivable would make them also payable. I believe that a full gold-standard system can under present conditions be more effectively managed than can our present quasi-gold-standard system with its irredeemable domestic currency.

"Our efforts to stabilize the purchasing power of the dollar under a 'managed money' regime have not proved sucessful, because we have no automatic market check on Government economy and debt monetization. The tax burden is approaching the point of diminishing returns. I see no more effective solution to the dilemma than a return to the gold standard. Gold convertibility would prove an effective check to further inflation and would rehabilitate the bond market. The public is growing distrustful of bonds. Something better than a claim to shrinking dollars must be offered if Government credit is to be kept strong. Borrowing will have to be resorted to as expenditures increase, since this is the only way the tax burden can be held to levels that will not discourge productivity on the one hand and dishonesty and evasion on the other.

"The arguments set forth in the Douglas subcommittee report (S. Doc. No. 129, 1950, pp. 41–44) opposing the restoration of the gold standard do not appear to me the least bit convincing. It is stated there that convertibility 'could not prevent a serious inflation * * * if other pressures were inflationary' because of our 'extremely strong gold position * * *' which would support 'at least a threefold increase in the money supply' that inflation 'could probably reach very serious proportions before we began to lose gold reserves to other

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countries. Nor is it at all certain that an internal drain of gold would occur before the inflation had reached serious proportions; that 'any significant demand for gold would be speculative,' etc. It quotes with approval the statement by the Chairman of the Board of Governors of the Federal Reserve System: 'Return to a gold-coin standard * * * 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.'

"One might as logically argue that a building should be built without elevators, a street system without bridges, etc., because of the risks that too many (speculators) might want to use them at the same time. This line of argument would condemn the whole fractional reserve system, the whole banking and credit system as being unsound. And what do these critics of the gold-standard system approve and support? A quasi-fiat money system in which foreign banks and governments have access to our gold (Italy could speculate and hoard in 1950) but our own citizens hold irredeemable debts based on debts the supply and the value of which are subject not to economic forces but to political forces over which they have no direct control. I agree that 'there can be no effective substitutes for responsible monetary, credit, and fiscal management,' but what reason is there to believe that freedom from redemption will promote wiser monetary and credit policies than would a system restrained by the rules of the gold standard and the discipline of market forces?"

7. *Types of securities.*—I would subscribe to the following formula: Issue a variety of marketable securities of every maturity—short, intermediate, and long—to meet the taste of the investment market at rates in line with present and anticipated market rates with minimum resort to commercial banks and without special intervention of the Federal Reserve banks.

The following is quoted from my answer to questions of October 12, 1951:

"We have a fairly good variety of marketable issues to serve most investors' needs and these types should be adequate under present conditions. Perhaps a 3-percent long-term bond, maturing, let us say, in 1975 or 1980, to correspond to some corporate bonds now outstanding, would be a feasible addition. Insurance companies and other financial institutions with substantial uninvested funds might find such a new issue a favorable outlet for their funds.

"In the event of substantial amounts of new borrowing, it would probably not be feasible to offer high enough yields to induce the market to absorb them—at least not immediately. new high-rate bonds would cause depreciation in outstanding bonds bearing lower coupon rates. A gradual compromise position would seem possible. Three-percent mentioned above would be a step in the direction of recognizing competitive market rates.

"Eventually Treasury rates must be raised to conform to market rates. Otherwise a fatal gap will exist which will have to be filled by an inflationary increase of debt monetization. With market rates at, say, 3 percent, the only place the Treasury will be able to sell 2½'s will be at the Federal Reserve banks. The Federal Reserve banks will have to increase the supply of money to buy these Treasuries, doing this by monetizing the debt. This money gets into circulation by serving as a base for member-bank credit expansion and prices rise.

"The process of debt monetization is dangerous because it means that the Treasury virtually takes on the burden of financing all credit demands, Government and private, in terms of cheaper dollars. Such an easy-money policy is like devaluation.

"In order to save the dollar from continuous deterioration, we must stop (or reduce) adding to the supply of high-powered Federal Reserve credit, and we must get away from an easy-money policy which subordinates economic welfare to the narrower objective of supporting the price of Government securities.

"In answer to question 6, reference was made to bonds payable in gold, both principal and interest. This would be the best possible substitute for bond supports. It would be preferable to guaranteeing purchasing power bonds; it would be preferable to issuing new bonds at higher rates conforming to market adjustments; but it would require making our currency redeemable in gold.

"Bond redemption in gold would reassure those who are now selling their bonds because they fear further inflation, and it would induce savers to invest in bonds because of the hedge which gold conversion provides. It would not be a guarantee against further inflation, but it would offer strong protection against shrinkage of the dollar and against substantial increases in interest rates."

8. *Compulsory bond sales.*—It is reassuring to note that most economists oppose compulsory methods under any conditions short of total war. My answer to questions of October 12, 1951, follows:

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"I do not favor resorting to compulsory methods in the sale of securities. Even in an all-out war or under a totalitarian dictatorship we should allow some freedom of choice. Taxation must, of course, be compulsory. If this proves inadequate, borrowing must be resorted to, but it should be on a basis of competitive rates; i. e., at market rates necessary to obtain the funds. This may mean that Government bonds will fall below par, but it should be allowed, even at the risk of impairing confidence in the Government's credit. It is assumed that Federal Reserve open-market operations would cushion any significant change and that orderly market conditions would be maintained.

"I see no reason why distinctions should be made between banks, other financial institutions, other corporations, and individuals in this regard, except that a distinction is warranted in the case of commercial banks if compulsion in this instance means compliance with control regulations."

The second main group of questions raised by the Patman questionnaire pertains to the machinery for the formulation of monetary policy. The final draft of questions directed to economists contained no questions on this subject, although students of economics should be well qualified to throw light on many aspects of this subject and their judgment is less likely to be biased by self-interest than that of either bankers or Government officials.

Administrative processes and the machinery for formulating and implementing policies are always important considerations in achieving economic goals. This is not recognized in the foreword to the Replies and Materials. After indicating the importance of monetary policy as "one of the fundamental determinants of prices production, and employment" (pt. I, p. xv), it is implied that some mechanism needs to be established for the purpose of formulating monetary policy—that the rules of the gold standard had to be abandoned because they were too mechanical; that economic changes of the past generation require the formulation of monetary policy involving discretion.

I cannot subscribe to the view that the rules of the gold standard are too mechanical and involve no discretion. The advent of central banking did indeed complicate the administration of our monetary and credit system under the gold-standard system. The more credit (debt) in the system, the greater are the risks and responsibilities of the policy makers and administrators. However, we have always needed the sound judgment of competent and reasonable men in order to keep expansion of credit within bounds, even under the simple and easily understood rules of the gold standard. The great virtue of the gold standard is that monetary decisions can constantly be checked by the convertibility or redeemability of demand claims on gold reserves. Without such a check, no market test is possible of the judgment of reasonable and competent money managers without a total collapse. If we cannot learn how to manage money and credit under the discipline of convertibility, that is, free choice in the market, the chances are slight that we will be able to manage money without such market controls.

The statements below are excerpts taken from answers to questions included in a preliminary draft sent out September 26, 1951. The answers would apply equally to our present situation or to the gold-standard system.

"10. *The role of bank examination and supervision.*—As a method of attaining economic stability, these should be confined to keeping individual banks liquid and solvent—to appraise assets, management, and to see that the laws are generally obeyed—and should not be used as an instrument of central bank authority to regulate the total volume of credit.

"This question raises the issue of the appropriate functions of the Federal Reserve and the FDIC. The Federal Reserve administration should perform all central bank operations necessary to implement a monetary and credit policy appropriate for insuring a total supply of credit in the market in harmony with the objectives of sound currency, price stability, employment, etc. The Federal Reserve must provide emergency liquidity for the banking system. It holds and manages the reserves of last resort. This does not mean that the Federal Reserve should at all times guarantee liquidity of the members and nonmember banks' assets on an easy-money basis. Bagehot's principle of always lending—but with stricter terms to stem inflation—still holds.

"The FDIC provides deposit insurance for individual banks and its function is to see that the losses due to bank failure are ultimately made up, and in order to preclude this to see that individual banks operate soundly and not in a manner to jeopardize either the equity of the stockholders or the safety and liquidity of depositors' claims. The function of bank supervision and examination is to see that individual bankers conform to prudent practire and to law (laws which have generally proven necessary in a free unit banking system).

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"The burden of providing system-wide liquidity for frozen assets should not be imposed upon the Federal Reserve banks if such frozen assets are the result of imprudent or speculative advancements or investments, but only for temporary frozen assets which are fundamentally sound. If the Federal Reserve were to assume complete responsibility for the liquidity of member bank assets, the FDIC fund would never need to be disturbed. On the other hand, if FDIC funds had to meet mass bank failures because an outlet for frozen bank assets was lacking, only United States Treasury intervention could probably prevent the insolvency of the FDIC.

"If every bank were soundly managed, that is, if every bank served the financial needs of its community in such a manner that each risk taken proved to be well appraised with a little or no loss taken, the FDIC would not be necessary.

"Under depression conditions, where mistakes are made in taking marginal risks, we need both supervision and examination of individual banks and general control of the market, but there should remain a separation of powers and responsibilities. The individual banker should not be entirely bailed out of his mistakes nor should all member banks be guaranteed liquidity by the Federal Reserve. Credit control and deposit guaranty are two different functions and, in my judgment, it would be a mistake to merge the two under one management.

"11. *Extending Federal deposit insurance.*—The obvious purpose of extending Federal deposit insurance to cover all deposits would be to provide complete security to bank deposits regardless of amount. The function of the FDIC is to make good losses which would impair depositors' claims after banks have failed. The assurance of ultimate solvency of deposit accounts might encourage larger deposits, but this seems doubtful. It may be true that some depositors split their accounts in order to increase coverage of protection, but this is probably not a very significant percentage.

"Since no losses have been sustained by depositors under FDIC, it hardly seems necessary to provide extra protection. Even if it were, I do not believe the FDIC should assume contingent liability for all bank deposits. Centralizing liability would tend to concentrate responsibility and this would require the FDIC, in the interests of all member banks of the system, to act with greater power and authority in regulating and controlling the conduct of individual banks. I believe that greater emphasis should be placed on individual responsibility and sound bank management. Individual responsibility is being supplanted more and more by the philosophy of "I am my brother's keeper," the central regulating and supervising agency being the keeper. I regret to see this. Each individual banker should be expected to stand on his own feet in the competitive market. The principle of caveat emptor should not be deadened by assurance to depositors that they no longer take any risk in doing business with a weak or poorly run bank. The assumption of a contingent liability for all deposits by the FDIC would virtually put all banks on the same basis as depositories under the principle of implied warranties. Big depositors should share responsibility of doing business with sound and well-run banks. They are, and should continue to be, in a position to judge risks. Small depositors, perhaps, deserve Government protection, but not on the ground that they should be relieved of all responsibility in selecting sound and well-run banks.

"The proposal of guaranteeing all deposits is consistent with the view that checks are money and should be treated as such. However, checks differ from bank notes or Government currency in many respects and these distinctions should be maintained if we are to avoid any important step toward nationalization of banks. A stereotyped centralized Government guaranty of deposits would, in turn, lead to a stereotyped regulation of bank capital, bank earning assets, and the whole banking business. Already some proposals are being made that regulating authorities use as an instrument of monetary control direct control over bank portfolios. This interference with the banker's conduct means substituting a bureaucrat's generalized judgment for that of a professionally trained and experienced practitioner who knows intimately and lives with his credit risks. I am strongly opposed to such a move, because I feel convinced that it would lead to a socialized, stereotyped administration of a business which needs flexibility in its adaptation to changing conditions; and it would ultimately lead to nationalization.

"FDIC assessments should be revised and geared to actual loss experience.

"12. *Government ownership of Federal Reserve banks.*—Despite the trend toward Government ownership and management, I favor the present private ownership and mixed management of Federal Reserve banks for the following reasons:

"In times of war or great public emergencies, the resources of the banking system are necessarily and rightly put at the disposal of the Government and the

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central bank (Federal Reserve banks) becomes, to all intents and purposes, a Government financial institution; that is, (*a*) it is managed to serve Government financial needs, (*b*) its resources are so devoted, (*c*) its excess earnings are channeled to the Government (and its losses would undoubtedly be absorbed by the Public Treasury, as in the case of the Bank of France in 1931), and (*d*) its owners share in the earnings and losses to no greater extent than usual.

"In peacetime, however, more normal conditions should prevail; i. e., the central bank is not and should not be solely a fiscal agency and banker for the Government; it should also serve commerce, industry, and agriculture. The Federal Reserve System was established to finance commerce and business. The lawmakers framing the Federal Reserve Act wisely provided for private ownership and a mixed management for the Federal Reserve banks. An ingenious and well-balanced arrangement was adopted whereby the public (consumers), banks (lenders), and business (borrowers) are represented on the Federal Reserve bank boards of directors, and other measures provide for appropriate representation of all the interests concerned. The Federal Reserve Board of Governors was constituted a body relatively independent of political or group-interest control. To be sure, the implementation of this system has not always resulted in a board free from dominating influences, and it can hardly be said to have occupied the political independence which used to characterize the Supreme Court. However, I believe that private ownership and all the other characteristics of balanced powers which now exist should be maintained. The Federal Reserve System should serve the economy—the competitive market economy, including both private and Government sectors—and should not be made the agency of any dominating economic or political factor in times of peace. Wartime conditions are necessarily special, and monopolized, single-purpose objectives and methods can be tolerated on such grounds—but should be tolerated 'for the duration' only.

"13. *Open market operations.*—The rationale for the present assignment of control over open-market operations is based historically on the reasonable assumption that buying and selling of eligible securities by the several Federal Reserve banks of the System should be cooperative—the practice of independent action having on occasion proven inconsistent and contradictory. In the beginning the effect of open-market operations on member bank reserves was not fully appreciated. Only after it was discovered that open-market operations could be used as a powerful instrument of credit control was the FROMC legally constituted. At first only the bank officials were members but later the members of the Board of Governors were added.

"There is sound reason for keeping the FROMC a separate body, even though they deal with one of the several instruments of credit control. Were all control powers concentrated at a single point, it would still be expedient for open-market operations to be put into the hands of a special committee and that committee should have on its membership representatives of the operating Federal Reserve banks. Bank operations are appropriately performed by the banks themselves. The bankers are familiar with credit conditions and the money market and are in close touch with private business as well as with Government fiscal operations.

"I favor the present arrangements, which enable an appropriate, specialized body upon which members of the Board of Governors sit to take action on banking operations they are especially qualified to perform. The members of the Board of Governors can reconcile the use of this and other credit-control instrumentalities at initial and at later stages in order to get the desired over-all results.

"14. *A centralizing mechanism to coordinate monetary and fiscal policies.*—I do not favor the proposal that the Federal Reserve System operate under the general direction of the President.

"(*a*) In the event of a conflict of policy, I would favor a requirement which would make the President and agencies under his direction yield ultimately to Federal Reserve policy. This, I believe, is what the lawmakers originally planned. I hesitate to make this statement without qualification, since there is no assurance that the Federal Reserve Board might not become a political body under the President's control, but, on balance and barring 'court packing' practices, the Federal Reserve should be the ultimate monetary authority of the country.

"(*b*) I would oppose the proposal that ultimate monetary powers should rest with the President and the remainder of the executive branch. Neither the Treasury nor other agencies than the Federal Reserve are logical bodies to regulate and control monetary policies. In no case would I favor bringing the Federal Reserve Board more directly under White House control. The Federal Reserve

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Board should be autonomous with respect to source of funds and operating expenses, and I would strongly oppose subjecting its appropriations to the control of the Bureau of the Budget or its audit by the Comptroller General.

"(*c*) The Treasury-Federal Reserve conflict may prove not to be futile. The public hearing which resulted from this clash of policy has led to a temporary 'accord'' but the prospects seem likely that the Treasury will be forced to yield to the broader, more embracing, and long-run views of the Federal Reserve. This should certainly take place if we can assume that we will in the course of time enjoy a period of protracted peace.

"I do not favor the establishment of a national monetary and credit council of the type proposed by the Hoover Commission task force and recommended in paragraph X of the recommendations of the Subcommittee on Monetary Credit and Fiscal Policies, November 7, 1949, which provides that the chairman of the President's Council of Economics Advisers be designated as chairman of such a council. 'An effective coordinating mechanism' was also recommended in a recent report of 17 economists for the National Planning Association. (See Replies, Patman Committee, pt. 2.)

"A complete coordination of financial agencies which has been proposed in one form or another would achieve unity, but at the price of making a banking and credit regulating body like the Federal Reserve Board a political body ancillary to the executive branch of the Government. The temptation to subordinate economic to political ends under such organization would be too great to resist. The proposal is dangerous. It would put too much power into political hands. Even with the gold standard and redeemability of our currency, we would need a separation of powers, but without such a market check, the public has lost its control of the purse and a concentration of monetary power could be used for political ends without check or hindrance. A better device to encourage economic dictatorship could hardly be conceived."

Statement by Dr. W. W. Cumberland, Ladenburg, Thalmann & Co., New York City

RELATIONS BETWEEN GOVERNMENT AND ITS CENTRAL BANK OF ISSUE

In earlier and happier years many foreign countries looked to the United States for assistance in their monetary, fiscal, and debt problems. This is no longer the case, since the United States has amply demonstrated its lack of ability to handle its own financial affairs.

During the decade of the twenties, when greater progress in economic well-being was made by the world as a whole than during any other similar period of time, Prof. E. W. Kemmerer, of Princeton University, was recognized as the leading "money doctor" of the world. He reorganized the finances and currencies of some 30 countries, in many of which he also established central banks of issue and discount. Not only am I one of Professor Kemmerer's students, and learned the principles of money and finance from him, but I also am one of the few Americans who has actually been in charge of the finances and the currency of certain countries. Accordingly, I consider that I had the best possible theoretical training under Professor Kemmerer, and I have several years of actual experience in the problems of money, credit, fiscal policy, and debt policy. Statements in the present memorandum should be judged by that background.

To the best of my judgment and belief there can be no satisfactory fiscal structure on the part of Government and there can be no dynamic economy for a country, except as they are based on currency convertible into gold, a tax system which is not onerous in the aggregate and which tends to stimulate savings and investment, if necessary at the expense of burdens of consumption, and public debt which is reasonable in amount, funded into long-term maturities for the most part, and both having and deserving the belief of the population that it will be paid.

Without exception, those countries which required financial advisers had failed to meet one or more of the foregoing criteria. Unfortunately, these are all being violated at the present time in the United States. Hence this country may confidently look forward to the experiences from which other countries have suffered when they had inconvertible currencies, excessive and ill-placed taxes, and top-heavy public debts, much of which was represented by short-term obligations. It is not a pretty picture for a country

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like the United States, which for decades has been noted for its competence in currency and financial matters.

This is neither the time nor the place to probe into the causes of our present humiliating and dangerous status nor to apportion the blame to the shortsighted, ignorant or untrustworthy leaders who placed our country in its present predicament.

Our present task is to point out the constructive measures which need to be taken and which are readily available to persons with technical knowledge of the subject, courage, determination, and patriotism. Without a convertible currency, experience has amply demonstrated that neither a government treasury nor a central bank, whether the latter be captive or independent, can long maintain a currency system without depreciation. There is little point in discussing relations between the treasury and the central bank, credit and discount policies, management of the public debt or an equitable tax system unless each of these other areas which are so important in producing a wholesome and expanding economy is solidly based on convertible currency. Conditions in the United States justify immediate return to gold. Our gold reserves are ample. Our population is becoming increasingly angry in regard to irresponsible money which penalizes the thrifty, the savers and the constructively minded. Persons with savings bank accounts, insurance policies, pensions or even those owning United States Government bonds have lost patience, and properly so, with a Government which has shown its willingness to sacrifice the interests of these important and essential groups to a noisy minority of self-seekers.

Both the Treasury and the Federal Reserve should take the lead in urging Congress to restore honest money. We have heard enough about "sound money," "managed money" and other devices for impairing the accumulated wealth of the American people, of violating long-range contracts by granting special favors to the debtor at the expense of the creditor, and by bringing into question long-range capital commitments which are essential if our economy is to be dynamic.

Adequate gold exists in the United States to bring about convertibility at once. Safe operating ratios of gold in relation to claims against reserves are well-known, and current gold reserves are far in excess of those which proved to be entirely adequate during long periods of time in this country when no one would have thought of questioning the permanency and validity of the gold standard.

Nor do we need to fear a raid on our gold reserves from foreign holders of American currency or other instruments which would be redeemable in gold. Experience is clear cut and precise that resumption of gold payments usually results in imports of gold rather than exports for that country which restores convertibility to its currency. Reasons are not far to seek. If foreign holders of American currency, for example, prefer the dubious safety of inconvertible American dollars at the present time, as compared with alternative forms of wealth, certainly they would have even more reason to hold such currency if it were convertible into gold on demand.

Finally, there is no need of waiting for an international agreement or for some other extraneous reason for returning to gold. A convertible American dollar would promptly be preferred for writing international contracts, and the United States would be powerfully stimulated toward becoming the world financial center, as it already is the leading industrial and commercial nation. In fact other countries would undoubtedly have to follow our lead and establish convertibility if they expected to retain their relative competitive positions.

There is no such thing as an independent treasury or independent central bank. Each is a creature of circumstance. Each is necessarily guided by the judgments of men, and these judgments may be trained or befuddled, experienced or amateur, economically minded or politically minded. Numerous examples of sensible treasuries and foolish control banks could be cited. Perhaps there are even more examples of foolish treasuries and sensible central banks. So, giving one or the other group a dominant voice is no answer to the problem of skillful treasury management or constructive central-bank policy.

One thing is certain, however. Since the Treasury ordinarily manages the public debt, and since by painful experience it is known that revenues are equated with difficulty as compared with expenditures, there is a strong and inevitable predilection on the part of all but the most experienced and foresighted Treasury officials to slant their thinking in the direction of cheap money. They usually rationalize this weakness on their part by expatiating on the benefit of cheap money to the wealth and growth of the Nation's productive economy. Most persons with business experience would agree that interest cost

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is regarded in the same manner as any other cost of determining whether or not a proposed investment program should be inaugurated. Interest appears in the price of the product or service, and usually that factor is so unimportant that decisions, whether affirmative or negative, are based on considerations quite outside the interest rate.

Hence cheap money cannot properly be regarded as a stimulating factor of great importance in the downward phase of a business cycle or at the bottom of a depression. But it is a powerful force in carrying a boom, both in time and in degree, to dangerous levels which would not otherwise have been reached. As an instrument for controlling or regularizing the economy, the money rate is not of primary importance, provided intelligent credit policies prevail. Of course, cheap money increases the demand for credit, and if those in control of issuing credit are foolish enough to meet the needs of marginal borrowers, particularly in boom times, then the interest rate becomes of some importance. But it is still true that the heart of the problem is found in the intelligence and self-control of those who have the final say in issuing or withholding credit.

Second only to a convertible currency and the establishment and retention of those conditions which permit a currency convertible into gold to function, moderation in credit policy is the principal instrument for supporting a stable economy and for assuring saving and investment on the part of private individuals which alone can guarantee an expanding economy and a rising standard of living. All types of credit institutions have an important role to pay, but experience again demonstrates that a Government agency is one of the poorest administrators of credit which can be devised. In fact, I am not aware of an important governmental credit agency which has handled itself with restraint and effectiveness over a prolonged period of time. Hence the credit function is properly a part of the private economy, rather than of the Government.

It is appropriate for Government to formulate rules of procedure and assure itself that these rules be observed. Fair practices are as essential in the area of credit as in any other important segment of our economy. Standards of conservatism, as well as periodic examination, may properly be established by Government. But at the same time Government itself should not extend or withhold credit. If borrowers are not able to meet requirements which Government itself has formulated for obtaining loans, then such borrowers should not be accorded the alternative of running to a Government agency and obtaining funds which either the discretion of credit managers or regulations of the Government itself, as applied to private credit agenices, have found to be unwarranted.

In my own experience as head of a central bank, my principal problems were to circumvent pressure by Government for credit advances to political favorites or for purposes which would not meet experienced business analysis. There seemed to be no limit either to the quantity or quality of credit which Government was prepared to advocate. And certainly ill-advised issuance of credit is one of the best and quickest methods of causing currency depreciation, loading useless losses into the public debt and causing that general malaise which brings about constriction in production and decline in the standard of living.

On the basis of my experience abroad and observation at home, I believe it fair and accurate to state that a Government Treasury may be confidently expected to focus attention on the cost of supporting the national debt and the machinery for financing Government operations, whether in normal times or in emergencies. There is less concern and perhaps less ability to understand the economic climate which is essential for vigorous production and exchange of goods and services. There is also less urgency on the part of Treasury officials in their determination to maintain stable currency and to prevent or abolish restrictions and controls on prices, exchange rates, operating methods and other factors which determine buoyancy or stagnation in the economy. In short, Treasury officials tend to become routineers, with no large grasp of the dynamics of an expanding economy. These comments are merely presented as statement of fact, and imply no special criticism. It would be surprising if Treasury officials were imbued with the energy and imagination which are essential to an expanding economy. At the same time, this very fact constitutes an excellent reason why the economy should not be put or maintained in a strait-jacket which is devised and operated by the Treasury.

Central banks by their very nature are closer to business than are government treasuries. Probably because of this fact their record of response to business requirements is better than that of government treasuries. This does not signify, however, that central banks should assume rigid and far-reaching controls which might be transferred from government treasuries. Rather, a competitive market

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should normally apply to credit and to interest rates, in precisely the manner that a competitive market has amply demonstrated its superiority to controls in the fields of wages and of commodity prices.

Since central banks are close to the business stream but should not constitute an active part of it, those institutions, when soundly managed, are in a semi-detached position to recognize excesses and excrescences, and they have the duty of taking the leadership in preventing serious damage from these situations. While no mathematical determination can be made of the quantity and quality of credit which should be issued by commercial banks and other lending institutions, it is not too difficult for the public at large to recognize symptoms of an unhealthy boom. Then the central bank should both possess and utilize instruments in the national interest against those various individuals and corporations which may be using credit in unreasonable fashion. Historically, the interest rate of the central bank has proved to be highly effective in restricting unwholesome use of credit. Open-market operations can also be effectively employed. A less favorable conclusion is necessary for attempts to utilize changes in the reserves of commercial banks, and proposals for forcing banks to freeze portions of their resources in unmarketable Government bonds must be rejected altogether.

As suggested earlier, the interest rate has proved to be a powerful weapon in preventing a boom, when applied in timely and courageous fashion. And, if booms are prevented, I have little fear of depressions. They are always a result of previous errors, usually undue credit expansion or irresponsible action in connection with public debts or currencies. If excesses in any one of these three sectors have been pronounced and long continued, there is probably no way of avoiding subsequent punishment. While restrictive action on the part of a central bank might conceivably prevent desirable expansion in the development of new products, new processes, new technologies, and new productive capacity, it would be difficult to cite serious examples in practical experience. On the contrary, economic history teems with the record of excessive and ill-advised expansion of credit. In that direction lies the principal danger, and to prevent excessive credit Government has a real responsibility. At this point it may properly be noted that Government credit institutions have been among the worst sinners in the long list of credit crimes. In fact, Government is not a proper source of credit for business purposes, since it has no funds except those which it derives from savers themselves and since governmental methods and objectives are and should be quite different from those of business organizations. Hence the credit function is a proper segment of the private economy, and under ordinary circumstances the Government should exercise mere police power rather than take the role of an active participant.

Government can do little, whether in the role of the Treasury itself or in that of a central bank, in shortening in time or alleviating in degree the results of a boom which has gotten out of hand. Unwise use of credit, unneeded industrial capacity, and other errors have to be absorbed by the economy, and their effects are gradually overcome by the growth factor which is inherent in an individual enterprise economy. Cheap money, new credit institutions, and the like are apt to do more harm than good. In particular, issuance of Government credit for uneconomic purposes undoubtedly prevents more investment and employment than it creates.

So, the integrated lesson of convertible money, moderate taxes, reasonable public debts, prices established in a free market and credit institutions which act in responsible fashion is that experience has amply proved all of these factors to be essential parts of a healthy economy. Only Government can establish and maintain a reliable currency, a sensible tax structure and a viable public debt.

It can refrain from assuming jurisdiction in the realm of prices, and it should intervene in the credit area only in case of excesses. Beyond that, the private segment of the economy has shown better performance than when Government has taken jurisdiction. Let us hope that the clear lessons of the past, in this and in other countries, will point the way for a future with more sustained prosperity and fewer depressions, with a greater portion of the national income left for the enjoyment of those who produce it, and a climate which stimulates research, saving, and investment. We can more confidently place our hope in such a program than in a structure composed of inconvertible money, illimitable debts and unworkable controls over prices, exchange rates, and economic activities.

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STATEMENT OF DONALD L. KEMMERER, PROFESSOR OF AMERICAN ECONOMIC HISTORY, UNIVERSITY OF ILLINOIS

The central issue in these hearings, I believe, is whether the Federal Reserve System shall be sufficiently independent of the Treasury Department to influence interest rates as it sees fit. Observe that I do not say to set interests rates, for the money markets should do that, but to influence them mildly when it may be necessary to dampen booms, to stimulate recovery, and to preserve an orderly market. From 1942, when the "pattern of rates" was announced, to 1947, when Treasury bills were allowed to find their own level, the Federal Reserve System could have influenced interest rates only by breaking a working agreement with the Treasury Department. This it never did. This condition prevailed for long-term rates, for bonds, down to early March of 1951.

This raises two questions. First, do increases in interest rates discourage borrowing? Second, should the Federal Reserve System be free to influence interest rates as it sees fit? Let us look at these.

Much has been written by economic theorists on the effects of high and low interest rates. The classical economists have generally held that higher rates discourage borrowing. The newer economists have leaned to the belief that higher rates do not necessarily discourage borrowing. Some have pointed to the large amount of borrowing done at high rates in 1929.

I hold to the classical view. Every rule has its exception, and the 1929 episode illustrates an important one. Once an inflation or speculative boom is under way, moderate increases in interest rates are not enough. Only drastic increases will then be effective. But moderate increases can be very effective in stopping a boom in its early stages.

If higher interest rates may not be effective, why should the Treasury and its economic apologists object to them? The answer is that higher rates raise the cost of servicing the public debt. A 1-percent increase on $250 billions of debt means, eventually, $2.5 billions more of taxes to collect. That greatly concerns the Treasury Department and the administration in office. Higher taxes are politically unpopular. Is that not the nub of the matter? And, since the Treasury and administration are so concerned, can they view the matter in an unbiased way? Can they be expected to admit that higher interest rates and higher taxes therefrom may be the cheapest way of controlling inflation?

The Federal Reserve System holds the pulse of the Nation's money markets. It can feel the ebb and flow of loanable funds. It is in a good position to observe. It has no doubts coming due; it is not concerned with taxes and elections; it has "no ax to grind." The Federal Reserve System can be as unbiased as it is possible to be in this human world. That is the fundamental reason for having a Federal Reserve System independent of the President. It is why we have a Federal Reserve Board whose seven members each enjoys a 14-year term, virtually the rest of the active life of any man likely to be appointed to it.

The Federal Reserve System should no more be subject to the Treasury Department than the Supreme Court should be subject to the Department of Justice.

The Federal Reserve System over the years has been exposed to two major hazards. On the one hand, it has at times been too much influenced by powerful private financial interests. Congress sought to avoid that danger in founding it in 1913; that is why there were 12 regional banks and a top Board appointed by the President. Nevertheless, the System probably suffered somewhat from such influences in 1928–29. On the other hand, it has, on occasions, been unduly influenced by the Treasury. That was the case in 1919–20 when the Federal Reserve System, out of deference to the Treasury, was slow to raise rediscount rates. That delayed the 1920 panic and probably made it more severe. The Federal Reserve has also showed undue deference to the Treasury's wishes since the end of World War II.

The Federal Reserve ship should endeavor to keep to the safe channel between the Scylla of undue private financial influences on the one side and the Charybdis of undue governmental influence on the other side. The Board of Governors righted the ship's course somewhat about a year ago, but it is still running too close to the Treasury side of the channel for comfort.

The Nation needs an independent Federal Reserve System today perhaps more than ever before in its history. We need it to protect us from ourselves. Over the centuries we have set up a number of institutions and traditions to protect ourselves against the financial follies of our leaders. The Federal Reserve System is one of the few that we have left.

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Let me mention several of these traditions and institutions. One was the gold-coin standard. We learned the need for hard money in the Revolutionary and Civil War periods. A second was the tradition of an annually balanced budget. A third was that local and State governments are generally more sensitive to the wishes of the people in the matter of taxes and government economy than a distant Central Government. A fourth was respect for thrift. Practiced privately, it had produced savings, investment, capital, and a higher standard of living. Practiced publicly, it kept corruption to a minimum. A fifth was a central bank independent both of Treasury and private financial domination. A sixth was unmanaged prices, including the price of borrowed funds; namely, interest rates.

Now I ask, How many of these traditions and institutions do we still have?

The physical changes of the last century—i. e., steel for wood, steam power for water power, autos for horses, etc.—have been tremendous. They have led people to expect and accept changes in their institutions and traditions. That has been largely a mistake, for these traditions and institutions were the results of centuries of human experience. People themselves have not changed much. Apparently we shall have to learn that fact the hard way.

We abandoned the gold-coin standard in 1933–34. The Federal budget has been balanced in only 2 years since 1930. The Central Government now spends several times what the local and State governments do, instead of less, as before the 1930's. Since the 1930's, thrift has been pilloried publicly and practiced less privately. Witness the great increase in both debt structures. Interest rates have been partly or wholly controlled for a decade, if not longer. The Federal Reserve System has been unable to use some of its chief credit controls, such as open-market selling operations, on any extensive scale, because that would hurt the Government bond market.

Notice, the question recently has not been whether the Federal Reserve System itself might push interest rates up. Rather, the question has been whether it might free them to behave in a more normal competitive fashion. Presumably, that means a rise.

Last year the Federal Reserve System, acting with great courage, partly freed interest rates, and they did rise. For that the Federal Reserve is now being criticized, for I take it that is the real purpose of this investigation. We need a courageous Federal Reserve System, and we need even freer interest rates.

Controlled interest rates, like controlled prices, mean bargains temporarily. In the case of commodities selling at controlled prices, the bargains are snapped up unless rationing is instituted. Soon black markets appear. But with money and controlled-interest rates it is somewhat different. The supply of money does not run out. Something worse happens. Money is manufactured almost endlessly. Government securities are converted into money; the debt is monetized. There are over $150 billions of marketable Government securities which might be converted into money if the Federal Reserve System is made to support the Government's security market. The Federal Reserve can thus become a Frankenstein, a monstrous engine of inflation. If the Federal Reserve System is put under Treasury control again, it would eventually become such an engine. Then the Treasury could maintain whatever interest rate it saw fit, depending on the Federal Reserve to support the Government securities market.

Unless mankind has suddenly changed inwardly as well as outwardly, which I do not believe, the experience of the past suggests that the results would be continued deficits and growing inflation. No Congress could long withstand the temptation of such an easy method of financing the extra things the public wanted but did not have taxes to pay for.

For 12 years, 1939–51, the dollar has lost value at an average rate of 5 percent of its remaining value each year. See the accompanying table. Half of this loss has been in peacetime. Most of it has coincided with Treasury domination of the Federal Reserve System and wholly or partly controlled interest rates. It is time that we put a stop to this erosion of our money. An independent Federal Reserve System and freer interest rates can help do it. Interest rates have risen this past year and the rise in the price level has slowed down. Much of this I attribute to the Federal Reserve action of a year ago. Let us not undo that sensible move, but rather let us grant the Federal Reserve more freedom of action.

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Decline in the purchasing power of the American dollar

Year	Purchasing power of the dollar if it had lost 5 percent of its remaining value each year	Actual purchasing power of the dollar based on the BLS Consumers' Price Index, with 1939 as 100	Year	Purchasing power of the dollar if is had lost 5 percent of its remaining value each year	Actual purchasing power of the dollar based on the BLS Consumers' Price Index, with 1939 as 100
1939	100	100	1946	69.7	71.4
1940	95	99.2	1947	66.2	62.3
1941	90.25	94.5	1948	62.9	57.8
1942	85.7	85.3	1949	59.8	58.4
1943	81.4	80.4	1950	56.8	57.8
1944	77.3	79.2	1951	54.0	53.7
1945	73.4	77.4	1952	51.3	----

STATEMENT OF HOWARD H. PRESTON, PROFESSOR OF MONEY AND BANKING, UNIVERSITY OF WASHINGTON

I am Howard H. Preston, professor of money and banking, University of Washington, Seattle, Wash. Director (chairman, 1951) of the Seattle branch of the Federal Reserve Bank of San Francisco for a 2-year term, January 1, 1950-December 31, 1951.

My participation in this committee hearing is under the auspices of the Economists National Committee on Monetary Policy of which I have been a member for approximately 20 years. May I emphasize, however, that I do not represent my university, the Federal Reserve Bank of San Francisco, or the Economists National Committee. The opinions I present are my own.

I desire to thank this subcommittee for an opportunity to present my views. I shall limit myself to a discussion of two phases of the many-sided problem before the subcommittee: (1) Savings bonds and (2) Treasury-Federal Reserve relationships. Much of what I present will be based upon actual experience and extensive contacts as a teacher, as a Federal Reserve branch director, as a speaker before numerous civic, business, and banking audiences and as a director of the Pacific Coast Banking School.

SAVINGS BONDS

It is universally agreed that the national debt is less inflationary when owned by nonbank investors. My present concern is primarily with the savings bonds. One needs only to visit a Federal Reserve bank or branch to envision the importance of these bonds to the economy. When a Seattle resident is shown through the branch's new building he is almost invariably impressed as he enters the fiscal department to see 31 young persons busily processing a daily average of 5,200 separate bonds for redemption and 4,600 separate certificates representing bonds issued either by the branch or issuing agents under its jurisdiction.

The sales and redemption of savings bonds at the Seattle branch are reported monthly to the directors. After mid-1950 the mounting excess of redemptions over funds received from sales caused the directors and officers of the branch much anxious concern. Even the well organized and vigorously conducted campaigns did not succeed in overcoming the deficit of sales.

The problem is not licked yet. The total amount of savings bonds reported to be outstanding has held its own for a year but redemptions still exceed sales. The reason for this seeming anomaly is not hard to locate. By 1952 a $75 bond purchased in 1942 is carried on the books of the Treasury at $100, 33⅓ percent of which is accrued interest. Accordingly, while the national totals for every month of 1951 shows an excess of redemption over sales, the end of the year figure reported was about $15 million above the corresponding total for 1950.

Two conditions tend to intensify the savings bond problem for the future: First, there are nearly $4 billion maturing in 1952 and over $8 billion in 1954 (peak year) in contrast to about $1 billion series D in 1950 and $1.5 billion series D and E in 1951; second, savings banks across the land are increasing their interest rates. Typical of these changes is the December 1, 1951, announcement

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by the mutual savings banks of Washington of an advance from 2 to 2½ percent on their more than $200 million of deposits. The even more recent increase by the mutual savings banks of New York affects approximately $12 billion of savings deposits. These changes reduce the relative attractiveness of savings bonds.

A year ago one heard much bitter complaint against savings bonds because the purchasing power of the $100 maturing bond was less than that of the $75 invested in it 10 years earlier. This doubtless accounts for the question (No. 6) directed by this committee to the economists regarding the advisability of issuing a savings bond containing an "escalator" clause, i. e., increasing the interest and principal payments according to changes in the cost of living index numbers.

This proposal I reject for several reasons: First, it would be complicated to administer; second, the dollar rather than the savings bond is the culprit; third, if inflation becomes a more serious threat, funds would run to savings bonds as a city of refuge, thereby draining savings from institutions where they are performing an essential role in the economy or force banks to adopt a system of paying savings withdrawals by a cost of living index. In the buyers' splurge of August-September 1950, savings bank deposits were drawn down as well as bonds cashed. The solution is to induce savers to hold their maturing bonds and to add to sales of new bonds by making the terms more attractive. The steps the Treasury has taken to make holding of maturing E bonds easy and equitable is commended. The principal question mark is in the provision for simple interest only. For the first year or two this is a matter of indifference but it may become important when the bond goes to 3 years and beyond. It is imperative that future issues of savings bonds bear a higher rate of interest in the earlier years. The interest rate should be at least 2 percent at the outset, to be compensated by a shorter maturity or less premium for holding to the later years, if it is deemed important to preserve the 10-year maturity. A Portland branch director remarked at a recent conference "The Treasury is trying to sell a 1942 product in 1952." I heartily agree. Our savings bond must be modernized.

It is respectfully suggested also that consideration be given by Congress to exempting at least a given minimum amount of interest accrued or collected per year from savings bonds from income taxation. This is proposed to avoid wholesale evasion through carelessness or ignorance as well as to make bonds more attractive to conscientious savers.

TREASURY-FEDERAL RESERVE RELATIONSHIPS

My interest in the Federal Reserve System spans a period of more than four decades. I had the honor of representing Coe College, Cedar Rapids, Iowa, as a member of a three-man Coe-Park debating team on March 26, 1909. The subject was "*Resolved,* That the United States should establish a central bank of issue." I regret to report that two of the three judges voted for our opponents but our side won in the halls of Congress in December 1913.

I have witnessed many changes in the administration and functioning of the System. Further changes will certainly be made and should be made but I find myself in disagreement regarding certain proposals raised by the questionnaire submitted by this subcommittee. The first of these is the issue of Government ownership of the Federal Reserve banks. In support of continued ownership of the Federal Reserve banks by member banks I present four arguments:

(1) It provides a method for enlisting the active participation of bankers and businessmen in the administration of the System.

(2) It facilitates the operation of the regional plan.

(3) It reduces the danger of Government dominance of the central banking machinery.

(4) It enables the Federal Reserve banks to develop the men on their staffs as professional central bankers.

Before setting forth my positive arguments in favor of the present balance of ownership and control, I desire to discuss two points advanced in support of Government ownership with which I disagree.

(1) It is contended that the capital contributed by the banks is inconsequential and hence does not entitle them to any voice in management.

(2) Advocates of Government ownership point to the trend toward nationalization of central banks in other countries notably England and Canada.

It is true that the present paid-in capital of approximately $250 million could be paid back without seriously affecting the financial strength of the System.

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Surplus and other capital accounts total approximately three times the paid-in capital and could be further increased by retention of earnings. If the capital contribution by the member banks seems inconsequential it may be in order to point out that these same member banks are contributing approximately $20 billion to the financial strength of the system through member bank reserves.

The trend toward nationalization of central banks in other countries should not be given undue weight in reaching a decision as to the proper policy with respect to the Federal Reserve banks. Most noteworthy recent nationalization is that of the Bank of England after 250 years of private ownership. This was one of the early steps in the socialization movement in that country now halted by the change in national leadership. The lessons of history are clearly on the side of freedom from political domination. There is no evidence that the traditions of the Bank of England have been overturned in the few years under the changed ownership. The bank has long functioned in the public interest and may be expected to continue to do so. When I visited the bank in the spring of 1949, I commented half jokingly to the officer who was my guide that the furnishings and art treasures of the board room were beyond what one might expect from an austere socialist government. He replied, "They haven't taken anything away from us yet." Even if nothing is "taken away" the bank of tomorrow may not command the recognition of the bank of today.

Recognition that control of the Reserve System rests with a Government board does not lead me to the conclusion that the Federal Reserve banks should be Government-owned. In fact, it is my major thesis in the section that follows, that banker ownership facilities participation by able bankers and businessmen, which I contend on net balance is good. I turn therefore, to the case for continuing the ownership of the Federal Reserve banks by member banks.

In the first place, ownership by member banks provides a logical method for particiation of banker-elected directors in the administration of the Federal Reserve banks. In my 2 years as director of the Seattle branch, I attended regularly the monthly meetings of our local board, visited a meeting of the Los Angeles board and met on five occasions with the San Francisco board. On the basis of these contacts I can assert that there is no difference in viewpoint and attitude on questions of policy between the banker-elected and the board-appointed directors. A visitor at a board meeting would be unable to differentiate between the two unless already acquainted with their respective roles. But I am confident that the directors have a greater sense of responsibility and more satisfaction in their connection with the bank, because it has an independent administrative status instead of being a Government bureau.

Stock ownership gives a basis for the selection of the majority of the members of the board at the head office and each branch. Other means might be found to enlist the services of able bankers and businessmen but the present system has worked. Why substitute an untried method? To be effective the relationship of the Federal Reserve banks with industry, business, and agriculture, must be official. Unofficial conferences are important and one of the forward steps taken by Federal Reserve banks in recent years is in improved public relations, banker visitations and business contracts generally. But it is only through the directors' meetings and committee conferences at the head office and branches that bankers, businessmen, and agriculturalists meet the officers of the Federal Reserve banks officially.

How much power do directors have? At the branch level it is very little when measured in statutory terms; San Francisco is the higher court as far as the Seattle branch is concerned. Actually, director influence is significant largely because of the caliber of the men and their active interest. Sometimes the branch directors chafe a bit about their lack of final authority. I have even seen the San Francisco directors bore in on the visiting Governors from Washington, in a joint conference of directors, about the way their power is circumscribed by the Board of Governors. All of this is in good spirit and every effort is made to achieve complete understanding. Board-appointed directors enter as freely into critical discussions as their banker-elected colleagues; independence of viewpoint is desired and encouraged.

I desire to pay special tribute to the contribution the directors make to the administration of the System. They bring to their task a wide diversity of business experience and first-hand information about business in their respective fields. This information is fully at the disposal of the officers of the bank and branches. Who is better informed upon foreign trade in the Pacific area than Brayton Wilbur, chairman of the board of directors of the Federal Reserve Bank of San Francisco? Or who can contribute so directly regarding the status of

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their respective fields as Alden Roach on steel, Reese Taylor on oil, or Walter Johnson on lumber products. Especially significant is the contribution of the agricultural representatives—Dr. Harry Wellman at the head office in San Francisco, J. M. McGregor and Ralph Sundquist at the Seattle branch are or have been invaluable members of the team. These agriculturalists are all board appointees, they fit their posts admirably attesting the advantages and effectiveness of the present system. Board meetings are informative and stimulating; the officers testify that the guidance received is significant in shaping their administrative policies. In turn, a director normally faces problems in a different spirit in the board room than he does as an outsider.

Banker ownership of the Federal Reserve banks facilitates the successful operation of the regional system, the preservation of which I deem desirable. The founding fathers conceived a system adapted to the vast and diversified area of the United States and its system of local unit banks. Experience has shown the necessity for centralization of credit policy and this has been achieved. Most of the advantages of the district form of organization, however, have been preserved. The officers of the Federal Reserve bank know the bankers of their district personally; they attend banker conferences and conventions as spokesmen of the bank in the area. They and the directors know the problems and needs of the district. The bank and its branches belong to the banks and they take pride in this ownership. Private ownership makes practicable a separately incorporated bank in each district, a difficult position to maintain under Government ownership.

A further advantage of the ownership of the stock of the Federal Reserve banks by member banks is to minimize the possibility of political domination of the System. I stand solidly upon the conclusion stated by the Douglas subcommittee in its report "that the advantages of avoiding inflation are so great and that a restrictive monetary policy can contribute so much to this end that the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored even if the cost should prove to be a significant increase in service charges on the Federal debt and a greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes." I signed and concur heartily in the statement of March 10, 1952, by 63 members of the Economists National Committee on Monetary Policy which reads in part: "All measures designed to correct weaknesses in the Federal Reserve System should seek to increase, rather than to destroy, its independence of political influence." May I take this opportunity to remind this subcommittee that a member of the Economists Committee is completely free to sign a statement issued by the committee or decline to do so without impairing his standing with fellow members of the committee.

It is unnecessary to remind members of this subcommittee of the effects of political domination of central banks. The reichmarks of Germany in World War I and the currencies of most of the other belligerents where hyperinflation occurred bore the imprint of the central bank of their respective countries. It is my conviction that one reason why inflation in England 1914–25 was held within moderate bounds was that the Bank of England maintained an independent status.

The 100 yuan ("GY") notes of 1948 that I brought home as souvenirs from my 6-months' visit to China have printed on them in English, "The Central Bank of China." The same was true of their predecessors, the Chinese national currency, that were made exchangeable for "GY" at 3,000,000 for 1. When I stepped from the plane in Shanghai, September 20, 1948, a 100 "GY" was fully and firmly worth $25 United States. In Canton in March 1949 I obtained 4,500 "GY" for one United States dollar. It would be unrealistic to argue that the Central Bank was to blame for the debacle, but conferences with eminent financiers such as Chang Kia-ngau, who resigned as manager of the bank a short time before the "GY" were issued, and K. P. Chen, head of the Shanghai Commercial and Savings Bank, convinced me that greater freedom by the bank would either have deferred the ill-fated revaluation of August 1948 or provided greater safeguards for the new currency. I know from first-hand contact that inflation in the war and postwar periods contributed to the Communist sweep.

Private ownership of the Central Bank is no guaranty against currency inflation and, on the other hand, a Government-owned bank may steer safely through troubled waters. But to me, the combination of district banks with bankers, business, and agricultural directors, mobilized through member bank ownership, with policy control exercised by a Government-appointed Board of Governors was one of the far-sighted decisions of the founding fathers of the System.

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Finally, it is my conviction that private ownership of the banks has resulted in developing a profession of central banking more effectively than would be possible if the Federal Reserve banks became in effect a Government bureau. The officers at the outset were recruited from commercial banks. They, and the men who have been developed under them, have made every effort to equip themselves for the responsibility they have assumed. Private ownership facilitates recruiting of new men and rewarding achievement.

Suggestions have been made for modifying the composition of the Board of Governors. Most drastic that has come to my attention is Dr. Goldenweiser's tentative proposal to substitute an administrative officer of Cabinet rank for the seven-man Board of Governors. I reject this because of its seeming political implication. Any means that will strengthen the Board, such as better salaries, is commended. Proposals that have been submitted to your subcommittee for reduction of the Board from seven to five should be fully considered. A survey should be made of the effect of this upon the efficiency of administration of the Board. Special tasks such as serving as hearing officer on the bank holding company case or taking the leadership in the voluntary credit control program appear to require the services of a Governor, not a subordinate.

The question of division of responsibility between the Board and the Open Market Committee has been raised. The present composition of the Open Market Committee was the result of a compromise made in 1935. It has worked well and no adequate reason has been advanced for change. Dr. Goldenweiser states, "Final actions support the Board's position, in most cases by unanimous vote."

It is my general conclusion that adequate means exist under the present ownership and organization to achieve the goals of credit control with which this subcommittee is concerned.

Statement of Leland Rex Robinson, Adjunct Professor of Political Economy, New York University, Vice President, Economists' National Committee on Monetary Policy

OBSERVATIONS ON THE MONETIZATION OF FEDERAL DEBT; ITS CAUSES, CONSEQUENCES, AND CURE

The central problem in relationships between the United States Treasury and the Federal Reserve System lies in the effects these relationships have upon the conversion of governmental indebtedness into immediately circulating currency. Domination by the Treasury greatly encourages this, and over long periods has forced it.

When debt is thus turned into money, passing freely by bank checks and from hand to hand, a strong upward push tends to be exerted on prices and costs. The agencies of Government have already spent or are spending the funds obtained through borrowing; at the same time Government obligations representing this borrowing are building bank reserves, increasing bank deposits subject to withdrawal, and adding to currency in search of goods in the markets. This inflationary process, abetted by devaluation and abandonment of the convertible gold standard in 1933–34, is registered in the deterioration of our money and fired by the complacency with which we have accepted unbalanced Federal budgets during 18 of the past 21 years.

These processes, known as the monetization of debt, are the contemporary "streamlined printing press" in production of incontrovertible paper money. They can continue their reckless course as long as holders of our currency are deprived of a genuine gold anchorage, and the banks, central and commercial, are used as repositories of Government bonds which should be to a greater extent in the hands of genuine individual and institutional investors.

Such investors are encouraged to buy and hold when the terms under which they lend meet the acid test of the money markets, and when price fluctuations of the bonds and notes they buy reflect these markets, rather than arbitrary and inflexible rates dictated by Treasury fiscal considerations. Independence of the Federal Reserve System, serving as fiscal agents for the Government while exercising their chief traditional historic function as guardians of the credit needs of the Nation's economy, encourages these realistic policies. In the longer run it may well save the taxpayers large amounts of money by reducing the inflationary forces set loose by Government borrowing too much for too little, on noncompetitive and deceptively easy terms.

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In brief, the matter may be put this way. Debt incurred by individuals and by business concerns does, to a substantial extent, represent credit advances to facilitate production, and to this degree enhances supplies of commodities and services bidding for the consumer's dollar. In any case, debt incurred by nongovernmental borrowers, whether or not it be commercially self-liquidating in character, must sometime be repaid on penalty of bankruptcy; and this repayment, if it does not arise from sale of goods, must at least involve a "tightening" of the debtor's consumption belt.

With a sovereign government, however, it is otherwise. Debts incurred by the Federal Treasury evidence budgetary deficits. Notably in war, largely also in peace, Government outlays exceeding revenues make comparatively little direct contribution to the country's flow of products which the consuming "all of us" are interested in buying and for which we will part with our money.

Furthermore the Government is under less pressure to repay; it may and it does, in fact, refund and cumulate debt, not experiencing at once the penalties of extravagance which are visited upon Micawber-like persons. This holds so long as Government is able to dominate the market for its bonds and notes—and even to repudiate them in part as it did with the devaluation of the dollar in 1933–34, and as it has been doing ever since by releasing and failing to control inflationary tendencies further depreciating our nonredeemable currency.

This ability of Government to put off indefinitely the day of reckoning, especially if it dominates the banking system through control of the central banking machinery, high lights the contrast between private and public debt in their effects upon money and credit. Our most important circulating money, Federal Reserve notes, may be backed up to 75 percent by United States Government securities, whether or not "eligible paper" arising primarily from economic activities is available. Similarly, the Federal Reserve banks, which at the end of last year owned the prodigious total of nearly $24 millions in "Governments," may use these as backing for their own deposit liabilities up to three-quarters of the whole.

As deposit liabilities of the Reserve banks constitute the reserves of member banks, the latter may make loans, under existing reserve requirements (24, 20, and 14 percent for "central reserve city banks," "reserve city banks" and "county banks" respectively against their "net demand deposits") approximately $5 for every dollar of deposit credit built up for them directly or indirectly, by sale of "Governments" to the central banks. To the extent that these bank-held Government obligations merely represent the failure of the Treasury to take in as much as it pays out, the Nation's bank deposits, circulated by checks as currency, rest in part on nothing more substantial than air.

This situation is of course aggravated if a guaranteed automatic market for "Governments" at par or above, regardless of prevailing interest rates, is maintained by the Federal Reserve banks, through direct purchase from the Treasury, open-market operations, or both. Open-market transactions are a proper and accepted part of the fiscal agency services rendered by the Reserve System to the Treasury; they are in indispensable instrumentality in central bank regulation of reserves and credit. However, if Treasury fiscal demands are allowed to dictate and freeze prices of Federal obligations at artificially low-interest costs to the Government, the holders of such securities, individual and institutional, may regard them as cash, borrow against them or dispose of them without risk whenever expenditures are incurred, more attractive investments desired, or added bank reserves called for.

In brief, then, Government debt differs from private debt, in its influence upon money and credit: (1) in the circumstance that Government bonds and notes generally represent deficits rather than production and tangible assets; (2) in the fact that private debt must be paid off, from producing and selling commodities, from the debtor's reducing expenditures, or both, while Governments may indefinitely delay repayment, may refund and increase debt and even repudiate it in whole or in part; (3) in the substitution of "governments" for "eligible paper" as backing for bank reserves and Federal Reserve notes; and (4) in artificial markets maintained by the central banks for Government debt, to the extent that they are under obligation or pressure to do so.

The chart here submitted pictures changes in the sources of our money supply from 1920 to the end of 1951—the upper chart in dollar, the lower in percentage, breakdowns.

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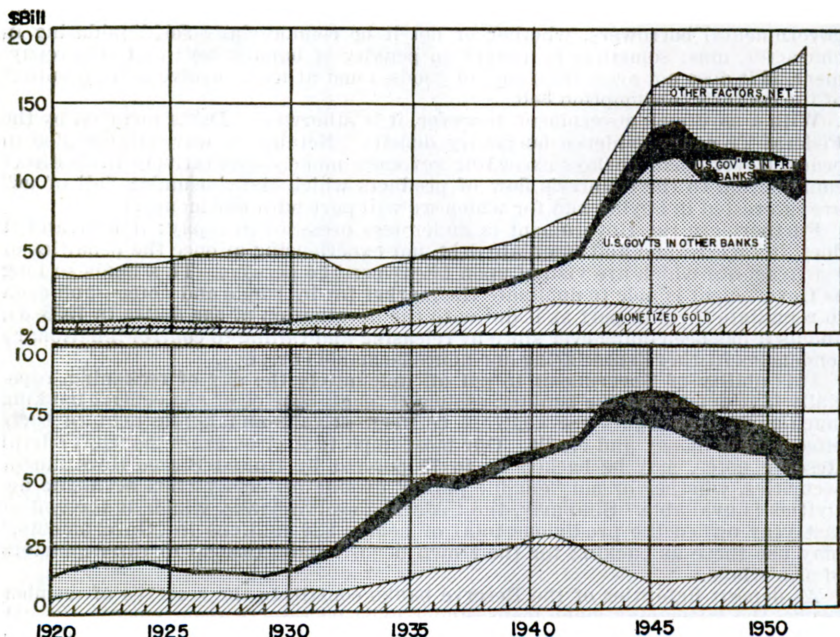
SOURCES OF THE MONEY SUPPLY, 1920-1951[1]



1. All figures are as of June 30th, 1951 figures are for June 30th and December 26th

SOURCE: FEDERAL RESERVE BOARD

Prepared by the research staff of the Economists' National Committee on Monetary Policy.

The huge increase in United States debt held by Federal Reserve banks, and by other banks, appears both quantitatively and proportionately.

The substitution of Federal-deficit-evidencing debt for eligible commercial paper (in "other factors, net") as the principal source of our currency, especially evident from the outbreak of the Second World War, may be compared to a stretched rubber band which lost its elasticity. Or, to change the figure, the decline of resiliency in responsiveness of the Nation's currency supply to its current business and economic needs (which is another way of saying that money has increased far faster than goods to absorb it), may be diagnosed as a hardening of the currency arteries.

However we put it, the malady is due to our abandoning the fully convertible gold standards; to unprecedented deficits in Government spending in both war and peace since the early thirties; to monetizing of Federal debt in the banking system; and to avoidance of the individual and national self-disciplining realism which banking, credit, and monetary policies actuated by economic needs rather than political considerations would have imposed.

The thought has been advanced in some quarters that unbalanced Federal budgets and a subservient Reserve System are desirable means of assuring increases in the volume of money required over the years to accommodate a growing population and a rising volume of business. This is like recommending to a vigorous youth that he have periodic plasma injections to make certain his bloodstream will adequately serve the larger frame and stepped-up activities of later years. It is even worse than that. It is like prescribing a diluted plasma, or blood of a type alien to the patient. Converting Government debt into money, necessary though it may prove in times of national emergency when confidence lags and savings drag; becomes in time a pollution of the Nation's economic bloodstream and should be recognized and treated as such.

So small were Federal Reserve holdings of United States Government obligations in the twenties that the charts hardly show the (for then) large-scale purchases of governments by the Reserve System, later in that period, to ease credit

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in the United States and to help Great Britain and other European countries in efforts to establish or maintain firm gold standards. Later sales of Government bonds, coupled with successive rises in discount rates from 3½ to 5 percent in 1928, and (for the New York district) to 6 percent in August 1929, proved wholly insufficient and too late to stem the tide of stock-market inflation. Government debt held by the Reserve System has risen rapidly and fairly consistently since that time.

The modus vivendi reached by the Federal Reserve Board and the Treasury in March 1951, which freed the former from responsibility for "pegging" prices of Government obligations has brought down the price of the (bank eligible) Federal 2½ percent ('67–'72) bonds (due September 15) from a high of $109 in 1946, and a price of about $100 on the eve of the agreement to less than $98 in latter March 1952. A wholesome and long-overdue strengthening of basic interest rates, and of control of credit is resulting. It is to be greatly hoped that no "integration," or "coordination" of Federal Reserve-Treasury policy, whatever these much-bandied words may mean, will lessen the independence of action and the responsibility of the central banking authorities in protecting the Nation's economy. That this requires careful planning and continuous concern for the Goverment's credit and fiscal needs may be taken for granted. A wise view will place the latter within the broad framework of the former, and not the other way about.

STATEMENT OF WALTER E. SPAHR, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY, EXECUTIVE VICE PRESIDENT, ECONOMISTS' NATIONAL COMMITTEE ON MONETARY POLICY

THE INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM VERSUS THE INTEGRATION OF MONETARY AND FISCAL AFFAIRS UNDER THE EXECUTIVE BRANCH OF OUR GOVERNMENT

The basic issue involved in the hearings conducted by this subcommittee is whether the people of the United States are to have an independent Federal Reserve System, designed to operate in the interests of the people as a whole, or whether it is to be made an instrumentality of the executive branch of our Federal Government.

The world's experiences with central banking systems teach the importance—indeed, the necessity—of establishing and maintaining their independence, if the people of a nation are to preserve representative government and their freedom. The only valid exception to that principle arises in time of severe war when a central government is compelled to utilize every resource at its command. Under such conditions lives, property, freedom, and valuable institutions, including a nation's money and banking structure, may be impaired or destroyed in the effort to defeat a national political enemy. But the necessities of war do not provide criteria as to what are good peacetime institutions.

Various and persistent efforts have been made in this country in recent years to impair or to destroy the independence of our Federal Reserve System as a part of the widespread movement toward socialism and a variety of dictatorship by the executive branch of our Federal Government.

Typical of the movement in this direction have been the activities of those who have been advocating a Federal monetary authority and what some designate as fiscal and monetary integration or coordination under the Federal Executive. Sometimes the proposals for "effective coordination," or integration, of monetary and fiscal affairs have been stated in terms so broad or vague that they probably do not reveal to the casual reader the fact that, if made effective, they would involve Executive dictatorship over the monetary and fiscal affairs of this Nation.

An example of a recommendation of this type is Recommendation X offered by 17 economists in Monetary Policy To Combat Inflation (National Planning Association, 800 Twenty-first Street NW., Washington 6, D. C., January 21, 1952), page 9, reprinted in part II of this subcommittee's Monetary Policy and the Management of the Public Debt (February 29, 1952). That recommendation reads: "Full and effective utilization of monetary powers requires coordination of the policies of the various Government agencies whose actions affect the volume and availability of credit—especially the Treasury Department and the Federal Reserve System. We recommend, therefore, that steps be taken immediately to establish an effective coordinating mechanism to insure that all agencies concerned with monetary problems follow consistent and mutually supporting economic policies."

The nature of the mechanism which would provide the effective coordination recommended is not described. But since the Treasury would be involved, and

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since it is part of the executive branch of our Federal Government, it would seem to follow as a matter of course that the coordinating agency, or "mechanism," would be an instrumentality of the Executive.

In 1946 a recommendation of this same general nature, but stated in more concrete terms, was offered by a research staff of the Committee for Economic Development in a publication called Jobs and Markets (March 1, 1946). The recommendation then was that a central monetary authority, under the President, be established and that it "should be charged with developing and directing a unified program of fiscal, monetary, and price control action to maintain price stability and high employment * * *."

That recommendation, if enacted and made effective, would establish in this Nation a centralized, dictatorial, and totalitarian form of executive control over monetary, price, and fiscal affairs. Two of the signers of that recommendation were also signers of the less specific "Recommendation X," quoted above.

These are typical examples of the many and persistent pressures which have appeared in recent years in behalf of Executive dictatorship in the monetary and fiscal affairs of this Nation.

This proposed integration of fiscal and monetary policies and procedures, involving an irredeemable currency and the destruction of the proper independence of the Federal Reserve System, is a feature of the theory of "the compensatory economy" in accordance with which the managers of the fiscal and monetary affairs of this Nation are to compensate for expansions and contractions by private enterprise in production, consumption, exchange, creation, and distribution of income, prices, investment, employment, and so on.

Such a program, if "successful," would require Executive dictatorship despite the widespread lack of discussion of this fact. Not only is dictatorship required; the dictator would, of necessity, need to know what to do and when to do it, and he would have to have the power to make his will effective. Congress would be compelled to surrender its powers and responsibilities in the fiscal and monetary fields and to become a passive instrumentality of the dictator.

The theory of a compensatory economy, and its integral part, fiscal and monetary integration or coordination, are unworkable in practice in this or in any other nation. No dictator has ever made a success of such a plan. And so long as we maintain the three major divisions in our United States Government, that Government cannot make such a program effective. Beyond this system of checks and balances lie the governments of our 48 States and private initiative. This economy of a nation, the mechanism of government, and the behavior of people—particularly those who have known and cherish freedom—are not as simple in operation as the theory of a compensatory economy implies.

The theory of a "compensatory economy," with fiscal and monetary management by the Executive, is the theory of the would-be dictator. It has no proper place in what is supposed to be our type of economy and government.

The principles and lessons of good central banking have perhaps never been stated better than by Sir Cecil H. Kisch and W. A. Elkin, in their book, Central Banks (Macmillan & Co., Ltd., London, 1932), fourth edition, with a "foreword" (to the first, 1928, edition) by the Right Honorable Montagu C. Norman, then Governor of the Bank of England.

They state (pp. 20–21), regarding the proper relation between the government and the management of a central banking system:

"The theory underlying the conception of a state bank centers on the proposition that since a wise central banking policy is the basis of a sound national economic life, the bank should be under the control of the national government. But the dangers of this course are great. Just because the decisions of the bank react on every aspect of the economic activities of the country, it is essential that its direction should be as unbiased as is humanly practicable, and as continuous as possible. But clearly if the bank is under state control continuity of policy cannot be guaranteed with changing governments, nor can freedom from political bias in its administration be assured. In most economically developed countries the probabilities are that the national government will be the largest individual customer of the local money market. In such circumstances it is evident that, if it also controls the administration of money market policy, it may easily find itself in an equivocal position where it may be called upon to decide between two courses, one of which may be immediately convenient to itself and the other conducive to the ultimate interests of the country as a whole. The creation of such dilemmas should be avoided."

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They continue (pp. 22–23):

"Such extreme abuses of government power [illustrated in the text] are, of course, only possible when a country has ceased to be on a gold basis. As long as convertibility is maintained the worst evils resulting from government intervention in banking and currency control are avoided. Doubtless the governments which have laboriously dragged themselves out of the morass of inflation will not readily slip back; nevertheless, if the control of the operations of the central bank lies directly or indirectly with the government, it becomes fatally easy for the government to finance itself for a time by means of book entries and short loans from the bank, a course which is the first step toward currency depreciation and inconvertibility.

"Even apart from such risks there are other serious dangers from a government-controlled bank. The network of financial and commercial life is so intricate, and the decisions of the bank on important points have such widespread results, that all interests are not affected in the same way. A change in the rate of discount, for example, which benefits some may be unwelcome to others. But if the government has a controlling influence over the bank, there are obvious ways by which the more powerful interests in the country can try to enforce their wishes. The road is open for political intrigue, and there can be no safeguard that the policy of the bank will be carried on without bias as national interests require. It seems a paradox that when the object is to secure the execution of a national policy, this should not most readily be achieved by the creation of a state bank under official control; but even in the countries where the capital of the bank is held by the state, steps have been taken in certain instances to remove its administration from political influences and to give it a measure of independence from the government."

Kisch and Elkin say (p. 13): "Precautions are * * * necessary to insure that the administration of the [central] bank shall not be dominated by the interests of any particular section of the business or industrial world or by political influences."

They say (p. 28): "The complete independence of the bank is perhaps an ideal to which countries can only approximate in different degrees according to their state of economic development and the sense of responsibility inherent in their public and particularly their commercial life." And, on page 37: "* * * It is of cardinal importance that it should be made as difficult as possible for the governments to resort to the expedient of borrowing from the bank, a practice which, if continued, can lead to a repetition of past disasters."

After World War I, the various nations, whose officials understood the principles and lessons stated by Kisch and Elkin, tried to free their central banking systems from that government domination which was recognized to be unsound in principle, except, possibly, in times of a serious war. The Brussels Conference resolution (III) of 1920 crystallized this general belief. It said: "Banks, and especially a bank of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance."[1] The same statement was issued by the Genoa Conference in 1922.

The experience of Germany with the Reischbank, when it was placed under government control, was so disastrous that the German Bank Act of 1924 opened with this sentence: "The Reischbank is a bank independent of government control."

Regarding the unhappy experiences of the Bank of France under the domination of the Treasury, Kisch and Elkin had this to say (p. 22): "There can be no question that the power of the government to force increased loans from the Bank of France intensified the depreciation of the franc and contributed to the financial crisis that culminated in 1926."

During and immediately after World War I our Federal Reserve System was under the domination of the Treasury, the System's policies were controlled by the fiscal interests of the Government rather than by those of sound commercial banking, and the result was a gorging of the banks with Government bonds, a credit expansion until the price level reached its highest point between 1914 and 1921, and an exhaustion of bank reserves with eight of the Reserve banks forced to pay tax penalties for deficient reserves in 1920. With the restoration of the independence of the Federal Reserve System in 1920, it became necessary to force a contraction of credit in order to save the reserves and the monetary and banking structure of the country. A result was the business contraction and liquidation of 1920–21.

[1] Kisch and Elkin, op. cit., p. 17.

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The validity of the principles stated by Kisch and Elkin were recognized and endorsed by 69 monetary economists who, when title II of the Banking Act of 1935 was under debate, said: "The lessons of central banking teach us that the further a central banking system is removed from political domination, the better it is for the country."

* * * * * * *

"All measures designed to correct weaknesses in the Federal Reserve System should seek to increase, rather than destroy, its independence of political influence. They should increase, not reduce, its commercial nature. They should assure, not impair, its liquidity. And they should free it from government financing rather than link it more closely to the fiscal needs of the Government."[2]

On March 10, 1952, 63 monetary economists issued a similar statement in defense of the independence of the Federal Reserve System.

Government financing, in the final analysis, should be looked upon as an intrusion into, and a disturbing factor in, the fields of private finance. And if a well-ordered central banking system performs its functions properly, there will be many times in which it must and should go into the open money markets to combat the effects of government financing. It is not the function of a central banking system to give government credit a higher rating than it would otherwise have in the open money markets to which nongovernment borrowers and lenders must go. It is the function of all commercial banks to give borrowers the exact credit rating to which they are entitled; and it is the function of these banks and of the central banking authorities to give government borrowers exactly the same type of credit rating. To assume that government credit should be given an artificially high value by a central banking system is to assume that it is the function of a central banking system to inflate the currency.

With the general adoption of systems of governmentally managed economies in Europe and elsewhere in recent years, central banks have been made instrumentalities of those governments. The consequences and lessons should be understood. They all emphasize the pertinence of the contentions advanced by Kisch and Elkin. New Zealand, whose central bank had been made a tool of the Government in 1939, learned the old lesson by harsh experience, and, in July 1950, she freed her central bank from direct Treasury control. In 1945, Australia brought her Commonwealth Bank under the domination of her Treasury Department. Now she is seeking to free that bank from subordination to the Treasury.

These cases are what one should expect. After a country has been injured sufficiently by a government dedicated to socialism or some other form of statism, with central banking an instrumentality of such a government, the reversal and attempts at extrication and rebuilding begin. New Zealand and Australia provide illustrations. Other can be expected to follow in due course. The Bank of England, made to embrace the easy money and full employment dogmas under the Socialist government, announced, on November 7, 1951, a change in its course which now points toward a curtailing or ending of the era of easy money and the related Socialist undertakings.

With all these lessons available to us, we would prove ourselves to be obtuse indeed if we were to plunge ourselves into the quicksand of totalitarianism from which we should expect the extrication to be difficult and painful. Yet, it is in the direction of totalitarianism that the various proposals for fiscal and monetary integration or coordination under the control of the Executive, and for a Federal Monetary Authority, would take us if written into law.

The Treasury and Federal Reserve System should each be supreme in its own sphere. Neither should dictate to the other. But when the Treasury enters the money markets to borrow, it should expect to conform to the rates which prevail in free markets over which the Federal Reserve authorities are supposed to exercise the conventional central banking controls in the interest of the general well-being of the Nation.

No borrower, including the United States Treasury, can properly claim that he or it is entitled to favors not available to all borrowers in the same money markets.

The only objective standards of right as to prices and interest rates known to man, and in the science of economics, are those determined in free markets. Every other price or interest rate is the consequence of dictatorship which rests upon subjective, not objective, evaluations—upon the will of the dictator and his ability to make his will law.

[2] Banking Act of 1935, Hearings Before the Committee on Banking and Currency, House of Representatives, on H. R. 5337 (February–April 1935), p. 771.

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It is chiefly by means of interest rates in free markets, freedom to demand redemption of paper money and deposits in a metal of universal acceptability, and a central banking system free of Executive influence, that, aside from the power of the ballot, a people are able to control their government. All these controls should be fully restored to our people. They are the necessary instrumentalities of free men.

STATEMENT BY JAMES B. TRANT, DEAN OF THE COLLEGE OF COMMERCE AND PROFESSOR OF MONEY AND BANKING AT LOUISIANA STATE UNIVERSITY

MONETARY POLICY TO MAINTAIN ECONOMIC STABILITY AND THE DESIRABILITY OF MAINTAINING AN INDEPENDENT FEDERAL RESERVE SYSTEM

I am happy to have the privilege of making a statement on monetary policy to maintain economic stability and on the desirability of Congress maintaining the independence of the Federal Reserve System.

The recent recommendation of the National Planning Association for the coordination of all agencies concerned with monetary problems again brings before the public the constitutional authority and responsibility placed on Congress for regulating the value of money on the one hand, and the desirability of maintaining the independence of the Federal Reserve System on the other. The recommendation referred to is as follows:

"Full and effective utilization of monetary powers requires coordination of the policies of the various Government agencies whose actions affect the volume and availability of credit—especially the Treasury Department and the Federal Reserve System. We recommend, therefore, that steps be taken immediately to establish an effective coordinating mechanism to insure that all agencies concerned with monetary problems follow consistent and mutually supporting economic policies."

The above recommendation deserves the most serious consideration for two reasons:

1. It has considerable merit in recommending "that all agencies concerned with monetary problems follow consistent and mutually supporting economic policies." That can be done, of course, only by all agencies working toward economic stability. Any other course would soon lead to a breakdown of our economic system.

2. The recommendation fails to recognize the fact that the constitutional responsibility for this now rests with Congress, and that the Federal Reserve System is the agency created by Congress for the creation and regulation of our currency and credit system for the purpose of maintaining an adequate supply of credit to meet the needs of our economic system. As such, the Federal Reserve System is the logical agency for coordination of the financial policy of other agencies in line with its general policy of economic stability.

It seems desirable here to review the authority and responsibility of the Congress for maintaining the coinage and banking system and for regulating the value of money.

Article I, section 8, of the Constitution of the United States gives the Congress the power to coin money and to regulate its value. The provision places on Congress an obligation for creating and maintaining a coinage system and to supplement it with a banking system for the creation and control of credit so as to maintain the value of the dollar and to provide a circulating medium for meeting the entire economic needs of the American people.

The Congress fulfilled its obligation under article I, section 8, of the Constitution from the very beginning in 1789, with minor exceptions, until the panic of 1933. In the spring of 1933 Congress attempted by a series of acts to pass its constitutional responsibility with reference to the coinage system to the shoulders of the President and the executive branch of the Government. These acts were the Emergency Banking Act of March 9, 1933, the inflation amendment to the Agricultural Adjustment Act of May 12, 1933, and the joint resolution of June 5, 1933. These were given a further finality by the Gold Reserve Act of January 30, 1934.

The shifting by statute of the responsibility for the coinage system to the executive branch of the Government did not relieve the Congress from its constitutional obligation to establish and maintain a coinage system, but it has deprived the public of the normal redemption test on the soundness of Government financing. This could be remedied by the Congress reasserting its constitutional

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authority and reestablishing our coinage system and all the benefits of the gold standard.

Whether or not Congress reestablishes a system of gold coinage, the constitutional responsibility for maintaining the value of money rests in the legislative branch of the Government.

The Congress is still in a strategic position for regulating the value of money even though it is handicapped by the lack of the redemption test that would be available under a coin standard. The one institution, the Federal Reserve System, which is the creator and regulator of the supply of currency and credit is a statutory creature subject to the will of Congress. The Federal Reserve is privately owned on the one hand and is governed by a public board appointed by the President of the United States on the other, but whose authority and responsibility rests with Congress. This arrangement enables the Board of Governors to establish regulations free of selfish interest on the one hand and of personal politics on the other for the operation of the system so as to maintain general stability of currency and credit and, therefore, to maintain the value of money. Any change in ownership or management from the present System could easily lead to disaster. This is well illustrated in the history of central banking. Specifically:

1. Government ownership of the stock of the Federal Reserve banks would place too much power over our monetary and credit system in the executive branch of the Government.
2. Uncontrolled political influence might lead either to inflation or deflation depending upon political expediency.
3. Such power in the hands of the executive branch of the Government could be used for punishing unfriendly banks as was the case in the early history of the United States.
4. Private ownership as at present but with Government management by the executive branch of the Government would lead to much the same results as listed under Government ownership. The importance of Government financing to the exclusion of private financing would be emphasized. This would prevent a satisfactory basis for supplying currency and credit to meet the entire economic needs of the country.
5. Private ownership with private management on the other hand would overemphasize private finance.
6. The present system with its responsibility to Congress, with its private ownership on the one hand and its regulation by a public board on the other gives the greatest opportunity for complete service to the American people.

In summation and conclusion I want to express the opinion that the economic and social welfare of the United States can be served best by the Congress maintaining its authority and responsibility over our coinage and credit system and that it establish a general policy of economic stability. As a means of making this policy known to the people of the United States and the people of all the other nations with whom we deal, the Congress should by joint resolution announce its general policy of economic stability, and by special acts provide for the following:

1. Reassert its constitutional authority over money and reestablish our coinage system.
2. Reaffirm the Federal Reserve System as the independent and central agency for the creation and regulation of our currency and credit.
3. Direct the Federal Reserve System to establish a general-credit policy, whether dealing with governmental agencies or the public, with primary regard to progressive economic stability.
4. Direct the Secretary of the Treasury and all of the governmental agencies which issue securities which may be bought and sold in the open market to consult with the Federal Reserve Board and the Open Market Committee of the Federal Reserve System for determining both rates and maturities of such securities for which an orderly market may be maintained without undue disturbance to the general-credit policy and the market.

[Release of Economists' National Committee on Monetary Policy, New York, N. Y.]

A Statement by 63 Members in Defense of the Independence of the Federal Reserve System

We, the undersigned, members of the Economists' National Committee on Monetary Policy, regard with concern the possibility that the prospective hearings of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report (Representative Patman, chairman of

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the subcommittee) may lead to an impairment of the desirable independence of the Federal Reserve System.

As pointed out by members of this committee in 1935, the lessons of central banking teach that the farther a central banking system is removed from political domination the better it is for the country.

All measures designed to correct weaknesses in the Federal Reserve System should seek to increase, rather than to destroy, its independence of political influence. They should increase, not reduce, its commercial nature. They should assure, not impair, its liquidity. They should free it from subservience to, or dominance by, Government financing rather than link it more closely to the fiscal needs of the Government.

John F. Adams, Temple University
Charles C. Arbuthnot, Western Reserve University
James Washington Bell, Northwestern University
Douglas H. Bellemore, Boston University
H. H. Beneke, Miami University, Oxford, Ohio
Claude L. Benner, Continental American Life Insurance Co., Wilmington, Del.
William A. Berridge, Metropolitan Life Insurance Co., New York City
Ernest L. Bogart, New York City
Frederick A. Bradford, Lehigh University
Wilbur P. Calhoun, University of Cincinnati
Cecil C. Carpenter, University of Kentucky
Edward H. Collins, The New York Times
Arthur W. Crawford, Chevy Chase, Maryland
William W. Cumberland, Ladenburg, Thalmann & Co., New York City
Rev. Bernard W. Dempsey, S. J., New Delhi, India
Charles A. Dice, the Ohio State University
James C. Dolley, the University of Texas
William E. Dunkman, the University of Rochester
D. W. Ellsworth, E. W. Axe & Co., Inc., Tarrytown, N. Y.
Charles C. Fichtner, Buffalo, N. Y.
J. Anderson Fitzgerald, the University of Texas
Major B. Foster, Alexander Hamilton Institute and New York University
Herbert F. Fraser, Swarthmore College
A. Anton Friedrich, New York University
Roy L. Garis, University of Southern California
Alfred P. Haake, Economic Consultant, Park Ridge, Ill.
Lewis H. Haney, New York University
E. C. Harwood, American Institute for Economic Research
Hudson B. Hastings, Yale University
William F. Hauhart, Dean Emeritus, School of Business Administration, Southern Methodist University
Harold J. Heck, the Tulane University of Louisiana
George H. Hobart, High Point College
John Thom Holdsworth, the University of Miami
Montfort Jones, the University of Pittsburgh
Donald L. Kemmerer, University of Illinois
J. L. Leonard, Harding College, Searcy, Ark.
Edmond E. Lincoln, Wilmington, Del.
A. Wilfred May, Executive Editor, the Commercial and Financial Chronicle, New York City
Roy W. McDonald, Donovan, Leisure, Newton, Lumbard and Irvine, New York City
David H. McKinley, the Pennsylvania State College
Fred R. Niehaus, University of Colorado
William A. Orton, Smith College
Frank Parker, University of Pennsylvania
W. A. Paton, University of Michigan
Clyde W. Phelps, University of Southern California
Chester A. Phillips, the State University of Iowa
Helen C. Potter, University of California
Charles L. Prather, the University of Texas
Howard H. Preston, University of Washington
Leland Rex Robinson, 76 Beaver Street, New York City
R. G. Rodkey, University of Michigan
Olin Glenn Saxon, Yale University
R. Harland Shaw, Conference of American Small Business Organizations, Chicago, Ill.
Murray W. Shields, University of Florida
Walter E. Spahr, New York University
William H. Steiner, Brooklyn College
Gilbert R. Stonesifer, Mount Union College
Charles S. Tippetts, Mercersburg Academy
James B. Trant, Louisiana State University
Rufus S. Tucker, Westfield, N. J.
V. Orval Watts, Economic Consultant, Altadena, California
Edward F. Willett, Smith College
Max Winkler, Bernard, Winkler & Co. New York City

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CORRESPONDENCE ON DEBT MANAGEMENT AND MONETARY POLICY BETWEEN THE FEDERAL RESERVE SYSTEM AND THE TREASURY, AND THE FEDERAL RESERVE SYSTEM AND THE PRESIDENT DURING THE PERIOD FROM THE OUTBREAK IN KOREA (JUNE 25, 1950, TO THE TREASURY-FEDERAL RESERVE ACCORD (MARCH 4, 1951)

THE SECRETARY OF THE TREASURY,
Washington, D. C., April 17, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management, House Office Building, Washington, D. C.

MY DEAR MR. CHAIRMAN: In accordance with your request, the staff of the Treasury Department and of the Board of Governors of the Federal Reserve System have prepared an annotated collection, arranged in chronological order, of the correspondence between the Treasury and the Federal Reserve System, and between the Federal Reserve System and the President, bearing upon the principal problems of debt management and monetary policy during the period between the outbreak of hostilities in Korea in June 1950 and the Treasury-Federal Reserve accord of March 4, 1951. In some cases other documents, such as press releases, have been added in order to assist the reader in interpreting the correspondence.

I am advised that the President will have no objection to the submission to your subcommittee for inclusion in the record of its proceedings copies of letters addressed to him as follows: Under date of December 1, 1950, by the Chairman of the Board of Governors of the Federal Reserve System, and under dates of December 9, 1950, and February 7, 1951, respectively, by the Chairman of the Federal Open Market Committee.

I understand the copies herewith transmitted include all of the material shown to the members of the subcommittee by Chairman Martin at your meeting on Tuesday, March 25, 1952.

Sincerely,

JOHN W. SNYDER,
Secretary of the Treasury.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Washington, D. C., April 21, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management, House Office Building, Washington, D. C.

MY DEAR MR. CHAIRMAN: In accordance with your request, the staff of the Treasury Department and of the Board of Governors of the Federal Reserve System have prepared an annotated collection, arranged in chronological order, of the correspondence between the Treasury and the Federal Reserve System, and between the Federal Reserve System and the President, bearing upon the principal problems of debt management and monetary policy during the period between the outbreak of hostilities in Korea in June 1950 and the Treasury-Federal Reserve accord of March 4, 1951. In some cases other documents, such as press releases, have been added in order to assist the reader in interpreting the correspondence.

I am advised that the President will have no objection to the submission to your Subcommittee for inclusion in the record of its proceedings copies of letters addressed to him as follows: Under date of December 1, 1950, by the Chairman of the Board of Governors of the Federal Reserve System; and under dates of December 9, 1950, and February 7, 1951, respectively, by the Chairman of the Federal Open Market Committee.

The material herewith transmitted include all of those shown to the members of the subcommittee by me at your meeting on Tuesday, March 25, 1952.

As I have previously indicated, while the Board and the Federal Open Market Committee favor the fullest possible disclosure of all matters affecting the public interest, we have questioned whether the public interest would be served by publication of these letters and related material dealing with complex and controversial matters which were satisfactorily resolved more than a year ago.

Sincerely yours,

WILLIAM MCC. MARTIN, *Chairman.*

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LIST OF DOCUMENTS SUBMITTED TO THE SUBCOMMITTEE ON GENERAL CREDIT CONTROL AND DEBT MANAGEMENT OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT IN RESPONSE TO ITS REQUEST FOR SUCH DOCUMENTS MADE IN THE COURSE OF CHAIRMAN MARTIN'S TESTIMONY BEFORE IT ON MARCH 11, 1952

Letter addressed to the Secretary of the Treasury under date of July 12, 1950, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Letter addressed to the Chairman of the Board of Governors under date of July 17, 1950, by the Secretary of the Treasury.
Letter addressed to the Secretary of the Treasury under date of July 31, 1950, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Statement for the press issued by the Treasury Department on August 18, 1950.
Statement for the press issued by the Board of Governors and the Federal Open Market Committee on August 18, 1950.
Statement by the Secretary of the Treasury released to the press on August 21, 1950.
Memorandum from the President dated October 5, 1950, for the heads of departments and agencies of the Federal Government.
Letter addressed to the Secretary of the Treasury under date of October 16, 1950, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Letter addressed to the Secretary of the Treasury under date of October 30, 1950, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Letter addressed to the Chairman of the Federal Reserve Board under date of November 13, 1950, by the Secretary of the Treasury.
Letter addressed to the Secretary of the Treasury under date of November 14, 1950, by the Chairman of the Federal Open Market Committee.
Letter addressed to the Secretary of the Treasury under date of November 17, 1950, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Letter, with attachments, addressed to the President under date of December 1, 1950, by the Chairman of the Board of Governors on behalf of the Board.
Letter addressed to the President under date of December 9, 1950, by the Chairman of the Federal Open Market Committee.
Memorandum expressing the personal views of the Vice Chairman of the Federal Open Market Committee, which was left with the Secretary of the Treasury during a meeting which the Chairman and the Vice Chairman of the Open Market Committee had with the Secretary on January 3, 1951.
Letter addressed to the Chairman of the Board of Governors under date of February 1, 1951, by the President.
Memorandum as released to the press February 3, 1951, prepared for the Federal Open Market Committee covering its meeting with the President on January 31, 1951.
Letter addressed to the President under date of February 7, 1951, by the Chairman of the Federal Open Market Committee on behalf of the Committee.
Letter addressed to the Secretary of the Treasury under date of February 7, 1951, by the Chairman of the Federal Open Market Committee on behalf of the Committee.

(The following is a letter written to the Secretary of the Treasury following a meeting of the executive committee of the Federal Open Market Committee on July 10, 1950:)

JULY 12, 1950.

Confidential.

Hon. JOHN W. SNYDER,
Secretary of the Treasury, Washington, D. C.

DEAR JOHN: The executive committee of the Federal Open Market Committee at a meeting in Washington on July 10, 1950, gave consideration to the open-market operations of the Federal Reserve System and to related instruments of credit policy, particularly as they have been and may be affected by the Korean situation.

It seemed clear to the committee that with our economy operating close to capacity, in terms of aggregate production and employment, there is little slack with which to meet the added requirements of our military operations. The

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impact of this new pressure is already beginning to be apparent. Expansion in both consumer and business expenditures, previously evident, has been accelerated. Commodity prices have risen further, reflecting in part speculative buying. A new round of demands for wage increases is reported in the making. As a consequence, a further demand for bank credit is likely, and bank credit has already shown a substantial expansion this year. In these circumstances, and in the light of probable increases in the Treasury's needs for new money during the remainder of the year, it seems more important than ever that Government borrowing be done outside the banking system to the fullest extent possible. In the light of our previous conversations, we believe that you are in general agreement with this view, although you have had reservations as to the sufficiency of nonbanking funds to warrant such an offering. Under present circumstances, we are convinced that vigorous efforts should be made to obtain such funds as are available.

Conditions in the Government security market, as well as the developing economic situation, now make a prompt implementation of a program along the lines which we last discussed more important than ever. The Government security market in recent weeks has been characterized principally (1) by a strong investment demand for long-term bonds, with a resulting tendency for long-term interest rates to fall; and (2) by market sales of short-term securities, with a resulting tendency for short-term rates to rise. These two tendencies have been checked only by Federal Reserve sales of bonds and purchases of notes and certificates in substantial amounts. System purchases have not only supplied banks with reserves needed to offset those absorbed by System sales of long-term securities but also have provided reserves for a substantial volume of over-all monetary expansion.

We could now either let short-term rates rise or long-term rates fall, but one thing we cannot do for very long with our present portfolio is to prevent both movements and, at the same time, adequately to discharge our responsibilities for credit restraint in the light of prospective inflationary pressures. In view of the Korean situation, we have been holding in abeyance our previous decision to discontinue purchasing large amounts of short-term securities at a rigidly pegged rate structure and to buy such securities only at rising rates after the completion of the Treasury's July 1 financing. We would be prepared to continue to hold this decision in abeyance at least until we have a clearer view of our likely involvement in war production and expenditures and of the expansion of bank credit which may face us, provided the Treasury would announce at an early date the offering of a long-term bond for purchase by nonbank investors.

We believe that a top offering of bonds to nonbank investors of the sort recommended in my letter to you of May 25, 1950, and discussed in the conference which Mr. Sproul and I had with you on June 15, is now essential, rather than merely desirable, both on broad economic grounds and in order to relieve the situation that exists in the Government security market. We strongly urge that the Treasury make an early announcement of such an offering. Sales of such bonds by the Treasury would:

1. Absorb a portion of the nonbank funds available for investment and help to restrain an excessive expansion of private economic activity;
2. Help prevent a rise in long-term bond prices—public and private—an undesirable development under existing conditions.
3. Relieve the Federal Reserve System of the necessity of selling bonds, at least in present volume, and thus remove or reduce one factor which has been causing banks to sell short-term securities to the Federal Reserve banks.

In view of the developing economic situation, the expansion of bank credit which is underway and in prospect, and the likelihood of continuing pressures (in opposite directions) on both the long-term and short-term security market under existing conditions, we believe that an immediate announcement that the Treasury intends to issue such a bond, and its issuance as soon as possible thereafter, would be in the public interest. The announcement would promptly remove some of the existing pressures in the long-term market, and the early issuance of the bonds would complete this relief.

We recognize, of course, that there are other powerful factors in the credit situation, such as the accelerating expansion of mortgage and consumer debt, and we would want to join with you in urging that steps be taken wherever possible to curb this expansion. Within the range of the existing powers of the Treasury and Federal Reserve System, however, we believe that a most effective immediate step which could be taken would be to adopt the program which we have suggested for financing the Treasury's cash needs during the remainder of

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the year. I will be glad to discuss any phases of this problem with you at your earliest convenience.

Sincerely,

THOMAS B. MCCABE, *Chairman.*

This is a letter written by the Secretary of the Treasury to the Executive Committee of the Federal Open Market Committee in reply to its letter of July 12, 1950:

JULY 17, 1950.

Hon. THOMAS B. MCCABE,
Chairman, Board of Governors of the Federal Reserve System,
Washington, D. C.

DEAR TOM: Thank you very much for your letter of July 12, expressing your thoughts and those of the Executive Committee of the Federal Open Market Committee with respect to new financing and the current situation in the Government bond market.

As I asked Mr. Barrett to transmit to the Open Market Committee on June 26, I feel that everything possible should be done to maintain a basically strong position in the Government bond market during the present period of international disturbance. The firmness with which the market has withstood the impact of the events of the past 3 weeks is certainly a testimonial to good management. It is also the best possible evidence of the confidence which has been built up in our ability and determination to maintain a stable market for Federal securities.

I know you will agree with me that it is of the utmost importance at the present time to maintain that confidence and, in addition, to do everything possible to strengthen it. This involves, first of all, avoiding any course which would give rise to a belief that significant changes in the pattern of rates were under consideration. The operations of the Open Market Committee since the beginning of the crisis have been well adapted to this end.

As I have studied the situation, I have become convinced that present circumstances call for one further precaution which is, perhaps, of even greater importance than maintaining a good balance in current market operations. In my view, we must take extreme care to avoid introducing any factor which would run the risk of producing unsettlement in the broad market for Federal securities represented by investors throughout the Nation. It is my belief, in particular, that no new financing program should be undertaken at the present time without maximum assurance that it will be well received and can be carried through to a successful conclusion.

Our future tasks, whatever they might be, would be made very much more difficult by anything less than 100 percent success in a program for raising new money. In my judgment, we cannot attain the maximum assurance of success until the outlook with respect to both the international and the domestic situations has become considerably more clarified.

At present, the defense needs which may have to be financed in the near future, are not known. Our expectations as to revenues are also subject to considerable change as the situation develops. For these reasons, as you know, I recommended that the Congress postpone action on the tax bill now under consideration in the Senate Finance Committee. The same basic considerations lead to my strong belief that no new financing program whose reception is to any considerable extent unpredictable should be introduced into the market at the present time.

There are, of course, occasions which call for quick and bold action. These occasions have occurred with respect to the Federal security market and they may occur again. But every appraisal of the present situation indicates that the maintenance of stability should take priority over all other market considerations. A stable and confident situation in the market for Federal securities is our first line of defense on the financial front, no matter what may be ahead of us.

As you know, developments in the Government bond market have repercussions which fan out through the entire economy. Both the size and the wide distribution of the Federal debt are unprecedented in comparison with the situations which faced us at the start of other periods of crisis. Under these circumstances, we have an obligation of the highest order not only to maintain the finances of the Government in the soundest possible condition, but also to fulfill our responsibilities to the millions of Federal securityholders throughout the Nation.

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There is one further consideration which confirms my view that the present situation calls in the highest degree for caution and prudence. During the present stage of the emergency, it is vital to make use of every opportunity for assuring our citizens that those at the head of their Government have a strong and steady hand on the helm. The response of the Nation to the President's courageous action in the Korean crisis was one of the greatest demonstrations of unity that we have ever had in this country. The Nation is now waiting to learn what domestic programs may be needed in order to utilize our full strength in the interests of national defense. When these programs are brought forward, it will take time for the public to assimilate them. In view of these facts, it is of the utmost importance that no action be taken at the present time which could be construed in any sense as anticipating proposals for defense which may later be outlined by the President.

In short, every circumstance at the present time calls for steadiness and manifest strength in the Federal security market as a primary measure of economic preparedness. That is the net of the situation as I see it. And, as you will note, I am sending my thoughts on to you just as they have occurred to me, in order to let you know the course of my thinking as events unfold.

Sincerely yours,

John W. Snyder,
Secretary of the Treasury.

The letter below is in reply to Secretary Snyder's letter of July 17, 1950:

Board of Governors of the Federal Reserve System,
Washington, July 31, 1950.

Confidential.

Hon. John W. Snyder,
Secretary of the Treasury, Washington, D. C.

Dear John: The executive committee of the Federal Open Market Committee has given consideration to your letter of July 17, 1950, in reply to mine of July 12, 1950, which outlined the serious problems now faced by the Federal Open Market Committee in maintaining an orderly market for Treasury financing. My letter explained why, in our judgment, it was urgent that the Treasury make an early announcement that it had decided to raise funds by means of a long-term 2½-percent nonmarketable issue on a tap basis.

The views expressed in your letter show concern that no move be made in the Government security market which would disturb confidence at this critical juncture. We share this concern.

We think it will greatly contribute to confidence in the value of the dollar and hence in Government bonds to offer such a tap issue. It would signalize the Government's purpose to rely primarily on nonbank financing, thus avoiding as far as possible resort to the highly inflationary process of financing through the banking system. Experience has shown that it is not technically difficult for the Treasury to raise money by selling securities which are either bought directly or indirectly by banks, provided the Federal Reserve supplies banks with the necessary reserves. The market and the public are now fully educated to these technical possibilities and they know that a procedure of this sort feeds the fires of inflation.

In our judgment, every devolpment in the economic situation and the international situation since our letter of July 12 reemphasizes what we said at that time, particularly in paragraph four. It seems more urgent than ever that an early announcement be made of the offering of the long-term bond of the type suggested. We think it will give confidence to the market at this stage. It will constitute notice both to the market and to the country that the Government intends to back up its anti-inflationary tax and other programs by financing its requirements as far as possible with nonbank funds. There is no more effective way to meet these requirements with a minimum of inflationary impact on the economy and also with less repercussion on the level of interest rates.

After consulting the presidents of the Federal Reserve banks last week, we are confident that funds will be available for the purchase of such bonds in substantial amounts. This is particularly true if the issue is continued on tap over the period of emergency. As defense expenditures mount and avenues of peacetime investment are cut back, investment funds will pile up in the hands of institutional investors who will welcome an outlet for these funds such as we have suggested. If the Treasury makes provision to tap these funds from

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day to day as they accrue, there will be less pressure to undertake huge bond drives, which necessarily involve a temporary congestion in the market as well as a large amount of indirect bank financing. Inevitable public discussion of the fiscal policies of the Government and the absolute size and rate of increase of the debt during drives do not make for confidence.

We do not mean to imply that a tap nonmarketable issue should be the sole medium of Treasury financing during the emergency which lies ahead. We regard it, however, as important to the maintenance of public confidence in the value of money and as the instrument of Treasury financing particularly appropriate to a situation in which normal investment outlets are being curtailed.

The period immediately ahead will be a critical one due to the time which will inevitably be consumed in the legislative processes and in the creation of the administrative organization needed to bring into operation the necessary controls. In the interval the stimulation of private spending, already out of hand, will be accelerated. The President has stated in his Midyear Economic Report to the Congress that we should rely in major degree upon fiscal and credit measures, and that the more prompt and vigorous we are with these general measures, the less need there will be for comprehensive direct controls. We share a joint responsibility to cooperate with respect to credit and debt management policies and it is in these two fields that positive and effective action can now be taken to meet the international crisis and its economic effects. The Nation at large has received the President's program in the same spirit with which it acclaimed the President's vigorous reaction to the military crisis posed by the invasion of Southern Korea. We are confident that prompt, purposeful action of the Treasury and the System in furthering the same objectives would receive the same wholehearted support.

In our judgment, the problem of new financing for the Treasury will not soon abate. We must face the long-run implications to the stability of the American economy and the welfare of the American people of the methods of financing we adopt in this critical period. Logic, as well as the bitter experience of recent years, both demonstrate what it means to the economy to rely too heavily on deficit financing through the banks. We believe that you share with us the conviction that at this time, when the needs of our country for defense are paramount, the Government should seek to provide the needed funds with a minimum of reliance on bank finance. The Government's main instruments to this end must be an adequate tax program and a program of debt financing directed primarily to tap nonbank funds.

In view of the extremely important implications for the future that underlie the initial policies to be adopted in meeting the heavy financial requirements of the defense program, we hope that we may have a full discussion of the subject with you at your earliest convenience.

With warmest regards,

Sincerely,

THOMAS B. MCCABE, *Chairman.*

(There was no written reply to the letter of July 31, 1950. The subject matter of the letter was discussed in meetings which the Secretary of the Treasury had with Federal Reserve officials.)

The following press releases are included in this record for the sake of completeness:

TREASURY DEPARTMENT

WASHINGTON, D. C.

INFORMATION SERVICE

Immediate release, Friday, August 18, 1950.

Secretary of the Treasury Snyder announced today that he will offer a 1¼ percent, 13-month Treasury note, dated September 15, 1950, and maturing on October 15, 1951, in exchange for the 2-percent bonds and the 2½-percent bonds called for redemption on September 15, 1950, and the 1⅛-percent certificate of indebtedness maturing on that date; and that he will offer a 13-month, 1¼-percent note dated October 1, 1950, and maturing on November 1, 1951, in exchange for the 1⅛-percent certificate of indebtedness maturing on October 1, 1950.

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The Secretary also announced that institutional investors of the classes defined in Department Circular No. 814, dated September 22, 1947, will be permitted to purchase United States savings bonds of series F and G in amounts in excess of the existing limitations during the following periods:

(*a*) From October 2 through October 10, 1950, for bonds dated October 1, 1950;

(*b*) From November 1 through November 10, 1950, for bonds dated November 1, 1950; and

(*c*) From December 1 through December 11, 1950, for bonds dated December 1, 1950.

Purchases in excess of existing limitations will not be permitted at other times during the remainder of this calendar year.

The Secretary stated that the present offering is designed to attract new money accruing in the hands of institutional investors during the last quarter of the calendar year; and that this offering is in line with his statement of September 5, 1947, when he announced the offering of the Treasury bonds, investment series A–1965, in which he said that "further offerings of securities suitable primarily for institutional investment needs will be made available whenever the situation warrants such action."

The special offering of series F and G bonds will be open to institutional investors holding savings, insurance, and pension funds, which were eligible to purchase the 2½-percent Treasury bonds, investment series A–1965, under Department Circular No. 814, dated September 22, 1947, subject to the following limitations:

(*a*) Each investor in the following categories will be permitted to purchase series F and G savings bonds combined up to a total amount of $1,000,000 (issue price) for the calendar year 1950 in addition to any bonds which may be purchased under the existing limit of $100,000 provided that any bonds in excess of the existing limit are purchased during the periods from October 2 through October 10, 1950, inclusive; November 1 through November 10, 1950, inclusive; and December 1 through December 11, 1950, inclusive:

1. Insurance companies.
2. Savings banks.
3. Savings and loan associations and building and loan associations and cooperative banks.
4. Pension and retirement funds, including those of the Federal, State, and local Governments.
5. Fraternal benefit associations.
6. Endowment funds.
7. Credit unions.

(*b*) Each commercial and industrial bank holding savings deposits or issuing time certificates of deposit in the names of (1) individuals and (2) corporations, associations, and other organizations not operated for profit will be permitted to purchase F and G savings bonds combined up to an aggragate of $100,000 (issue price) during the periods set forth above.

Further details will respect to these offerings will be announced later.

Board of Governors of the Federal Reserve System

Statement for the Press

For immediate release, August 18, 1950.

At meetings today of the Board of Governors and the Federal Open Market Committee, the following statement was approved:

"The Board of Governors of the Federal Reserve System today approved an increase in the discount rate of the Federal Reserve Bank of New York from 1½ percent to 1¾ percent effective at the opening of business Monday, August 21.

"Within the past 6 weeks loans and holdings of corporate and municipal securities have expanded by $1½ billion at banks in leading cities alone. Such an expansion under present conditions is clearly excessive. In view of this development and to support the Government's decision to rely in major degree for the immediate future upon fiscal and credit measures to curb inflation, the Board of Governors of the Federal Reserve System and the Federal Open Market Committee are prepared to use all the means at their command to restrain further

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expansion of bank credit consistent with the policy of maintaining orderly conditions in the Government securities market.

"The Board is also prepared to request the Congress for additional authority should that prove necessary.

"Effective restraint of inflation must depend ultimately on the willingness of the American people to tax themselves adequately to meet the Government's needs on a pay-as-you-go basis. Taxation alone, however, will not do the job. Parallel and prompt restraint in the area of monetary and credit policy is essential."

TREASURY DEPARTMENT

WASHINGTON, D. C.

INFORMATION SERVICE

Immediate release, Monday, August 21, 1950.

STATEMENT BY JOHN W. SNYDER, SECRETARY OF THE TREASURY

Friday's announcement of the refunding of the September and October maturities and the extension of the purchase limitations on series F and G bonds was one more step in the debt management program which the Treasury has followed since the first of the year. Developments in the Government bond market have repercussions which fan out through the entire economy. Both the present size and the wide distribution of the Federal debt are unprecedented in comparison with what faced us at other periods of international crisis. We have an obligation of the highest order not only to maintain the finances of the Government in the soundest possible condition, but also to fulfill our responsibilities to the millions of Federal security holders throughout the Nation. A stable and confident situation in the market for Federal securities is our first line of defense on the financial front.

The debt management program which the Treasury has followed since the first of the year has been fashioned to meet the requirements of the economy. During the first 6 months of this year, Government securities held by the commercial banking system declined $1.7 billion, while the holdings of private nonbank investors increased $3.4 billion. The decline in bank holdings was accounted for by a $1.1 billion decline in holdings of commercial banks and a decline of $553 million in the holdings of Federal Reserve banks. From the data now available, it is apparent that this trend was continued in July. Holdings of weekly reporting member banks declined by $656 million in the 4 weeks ended August 2 and holdings of the Federal Reserve banks declined $362 million from June 30 through July 31.

The private nonbank investors who have been the primary buyers of marketable Government securities have been principally industrial, commercial, and mercantile corporations, State and foreign accounts. They have been buying short-term securities mainly. Another part of the increase in the holdings of private nonbank investors is due to the purchases of individuals—substantially in the form of savings bonds. Longer-term institutional investors, such as insurance companies and savings banks, however, have not been acquiring Government securities on net balance. Instead they have been buying corporate bonds and home mortgages. They have been providing the funds necessary for new housing construction and new plant and equipment for industry. It is now expected that institutional investors may have some funds available for investment in Government securities during the last quarter of the year. For this reason, the Treasury Department has lifted the limits on series F and G savings bonds to absorb these funds as they accrue.

The following is a memorandum from the President to the heads of departments and agencies of the Government, asking for suggestions of subjects for possible inclusion in his forthcoming state of the Union message and Economic Report:

THE WHITE HOUSE,
Washington, October 3, 1950.

MEMORANDUM FOR THE HEADS OF DEPARTMENTS AND AGENCIES OF THE GOVERNMENT:

You are requested to submit to me by December 1, 1950, the subjects which you propose for inclusion in the state of the Union message and the Economic Report

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of the President to be presented to the Congress in January 1951, together with a brief explanation of each subject, its relationship to your current activities and plans, and the relative emphasis which you would recommend. You should include any views which you may care to present at that time concerning special Presidential messages during the forthcoming session of the Eighty-second Congress. The original and nine copies of your reply should be forwarded directly to me at the White House.

You are also requested to submit by December 1, 1950, a report on your final legislative program for the first session of the Eighty-second Congress. This report should restate and bring up to date the preliminary legislative program submitted to the Director of the Bureau of the Budget in accordance with the call for estimates for fiscal year 1952. Your report should include all legislation which you desire to have considered at the forthcoming session. Proposals should be grouped according to their relative importance and urgency from your standpoint. In addition to the information requested in the call for estimates, your report should include your views on the timing of congressional consideration for each item. If a proposal contained in your final program did not appear in the preliminary program, your report should state the circumstances which have led to the addition. The original and nine copies of this final report of your legislative plans for the next session should be forwarded to me through the Director of the Bureau of the Budget. It will not, of course, replace the individual submissions required by Budget Circular No. A–19, although you may, if you desire, present legislative drafts for clearance in connection with your program submission.

The information requested is desired for consideration in connection with the new Congress convening on January 3, 1951. Information concerning any proposals to be made to the present Congress, upon conclusion of the current recess, will be handled separately through usual channels.

The White House staff, the Council of Economic Advisers, or the Bureau of the Budget may make additional requests for material or arrange for discussions with your representatives to whatever extent may be required.

Very sincerely yours,

HARRY S. TRUMAN.

This is a letter written to the Secretary of the Treasury following a meeting of the Federal Open Market Committee on October 11, 1950.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
October 16, 1950.

Hon. JOHN W. SNYDER,
Secretary of the Treasury, Washington 25, D. C.

DEAR JOHN: Two weeks ago Mr. Sproul and I discussed with you the problems of the Treasury and the Federal Reserve System in the fields of debt management and credit policy, as parts of the broader anti-inflationary policy and program of the Government. At that time, the Federal Open Market Committee was in session and we conveyed to you its thinking on open market operations, as well as the thinking of the Board of Governors on reserve requirements and selective controls. Your views, which you then expressed to us, were in turn conveyed to the Federal Open Market Committee, as was your suggestion that you would like a couple more days to think over the matters we had talked about.

The Federal Open Market Committee, in response to our report of our conference with you, asked its executive committee to carry forward these discussions, and it was in response to this direction that Mr. Sproul and I again sought a conference with you before a meeting of the executive committee of the Federal Open Market Committee on October 5. In that conference, we told you of the unanimous view of the Federal Open Market Committee, and of the Board of Governors, that further action should be taken in the field of general credit control to put a brake upon the prevailing ease with which banks can obtain reserve funds for further credit expansion. You told us of your concern about the success of the forthcoming savings bond campaign and of the discussions which have been started to put in motion voluntary action by the commercial banks to restrain credit expansion. At that meeting you also said that you would like to have an opportunity to talk with me again on the following Monday.

You and I have since talked two or three times on the telephone and, in the light of these conversations and of our earlier conferences, a meeting of the Fed-

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eral Open Market Committee was called for Wednesday, October 11. At that meeting your views, as they had developed in our talks, were given fully and frankly to the Committee. As you know, the Committee also expressed its willingness to have you present these views in person if you so desired. You decided, and I think properly, not to deviate from the established procedure which we have adopted for mutual consultation.

After giving thoughtful consideration to your views, the committee again canvassed the business and credit situation as developed by the reports and studies of its research staff and through the contacts of members of the committee in various parts of the country. It seemed clear to the committee that, despite some signs or prospects of moderate abatement of inflationary pressures which might be detected in certain fields, the underlying forces in our economy are still strongly inflationary and will be accelerated by increasing Government expenditures as the rearmament program really begins to bring its huge demands upon our economy, unless stern fiscal policies such as you have advocated and further credit restraints are adopted.

The President announced the anti-inflationary policy of the Government when, in the midyear economic report, he stated that:

"First of all, for the immediate situation, we should rely in major degree upon fiscal and credit measures. These general measures can be helpful not only in restraining inflationary pressures, but also in reducing the civilian demand for some specific products, such as automobiles and housing, thus making available for necessary military use a larger proportion of an already short supply of some critical materials. The more prompt and vigorous we are with these general measures, the less need there will be for all of the comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative."

In the light of this policy and of the statutory responsibility of the Federal open-market committee, which provides that the time, character, and volume of open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country, the committee felt that it had no option but to proceed with the action we had advised you orally, 2 weeks ago, that it had in mind. Since the Treasury will have no refunding operations until December, the present is an especially propitious time for the system to proceed with this somewhat more restrictive open-market policy, even though the action results in a moderate increase in short-term rates. Any resultant increase in the costs of carrying the public debt will be directly saved, many times over, if it helps to curb the rising costs of Government procurement, and the benefits to the people of the country, of course, will be greatly multiplied.

We realize that the action we are taking in our open-market operations will need to be supplemented in order to exercise effective restraint on the mounting inflationary pressures that threaten the economy. Consequently, we are unanimous in the conviction that we can only meet our responsibilities by going ahead with the weapons at our command, including increases in reserve requirements, application of real estate credit controls, and tightening up of consumer credit regulations. We sincerely believe that the combination of these restraints on credit expansion will have a profound effect in the effort to hold the line until the heavier taxation promised for next year begins to bite into incomes.

We can assure you that these actions will not affect the maintenance of the 2½ percent rate for the outstanding longest term Government bonds, and we are convinced that this further evidence of a resolute will to fight inflation and to protect the purchasing power of the dollar will promote, not discourage, the sale of E bonds. No one knows better than you that confidence in E bonds, as well as all other types of savings, is based on confidence in the purchasing power of the dollar.

Although in this instance we have not been able to bring about a complete meeting of minds in our discussions with respect to System policy and debt management, we have both thoroughly considered in all of the aspects of the difficult problems confronting us and we have earnestly sought to achieve that accord which I know you desire as much as we do in meeting our respective responsibilities. At your convenience we would like to sit down with you to explore further the problems for which we both seek solutions that are in the best interests of this country.

With warmest regards, I am

Sincerely,

THOMAS B. MCCABE, *Chairman.*

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(As indicated in the letter of October 16, 1950, Secretary Snyder and Chairman McCabe were in frequent consultation during this period about the matters involved; and there was, therefore, no need for a written reply to this letter.)

This is a letter written following a meeting of the Federal Open Market Committee on October 30, 1950.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, October 30, 1950.

Hon. JOHN W. SNYDER,
Secretary of the Treasury,
Washington, D. C.

DEAR JOHN: Since our meeting on Thursday, October 26, a meeting of the Federal Open Market Committee has been held. The Committee has been and is in complete agreement that under present conditions it is necessary to protect the 2½ percent rate (par) on the longest term Treasury bonds now outstanding. The Committee's policies have been determined in accordance with that conclusion.

For the reasons outlined in my letter of October 16, 1950, the Committee is convinced that continued flexibility in the short-term money market is essential to carrying out an effective credit policy. It believes, however, that for the present the market yield on Government securities on a 1-year basis (now about 1½ percent) may have worked as high as is necessary in the light of present economic conditions and as high as it can without having such an impact on the market for the longest term Government securities as might interfere with our policy of credit restraint. Accordingly, for the present, the Committee will endeavor to maintain an orderly and flexible market within a maximum of 1½ percent per annum for any securities maturing within 1 year.

If further inflationary or market forces should develop at any time in the future which would make it necessary for the committee to reconsider these decisions, we would, of course, feel it desirable and compelling to seek your counsel. In the meantime, we should like to consult with you freely concerning our mutual problems in the light of market developments and the general credit situation.

With warmest regards
Sincerely,

THOMAS B. MCCABE, *Chairman.*

[Secretary Snyder and Chairman McCabe were in touch with each other regularly during this period and the letter of October 30, 1950, which was a formal statement of facts, did not require a written acknowledgment.]

NOVEMBER 13, 1950.

Hon. THOMAS B. MCCABE,
Chairman, Federal Reserve Board,
Washington, D. C.

DEAR TOM: As a decision will be necessary shortly in reference to the December, possibly January, refunding, I would be glad to have the views of the Open Market Committee as early as possible.

Sincerely,

JOHN W. SNYDER.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, November 14, 1950.

Hon. JOHN W. SNYDER,
Secretary of the Treasury, Washington, D. C.

DEAR JOHN: We have a scheduled meeting of the executive committee of the Open Market Committee for Friday morning, November 17. Allen Sproul and I will be very glad to call to see you any time after 12 or before 3:30 that day to discuss the December-January refunding problem, as mentioned in your letter of November 13.

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Since I expect to be in New York tomorrow, I will appreciate it if Miss Kelly will call my office and let me know the time that is the most convenient to you.

Sincerely,

THOMAS B. MCCABE.

This is a letter written to the Secretary of the Treasury in reply to his letter of November 13, 1950, following a meeting of the executive committee of the Federal Open Market Committee on November 17, 1950.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, November 17, 1950.

Confidential.

Hon. JOHN W. SNYDER,
Secretary of the Treasury, Washington, D. C.

DEAR JOHN: As indicated in my reply to your letter of November 13, the executive committee of the Federal Open Market Committee has been meeting in Washington today to consider the request contained in your letter for our views on the December and possibly the January refunding. The committee appreciates very much this opportunity to express its views.

We have reviewed the whole matter from the standpoint of (1) our knowledge as to the situation in the money and capital markets, (2) the needs of effective credit policies in the light of current and prospective economic developments, and (3) a long-run debt management program. In the light of these considerations, and having in mind the large proportion of the marketable debt that has been accumulating in the short area it is our unanimous view that all or a major part of this financing should be done with intermediate securities. There are various possibilities in the 5- to 10-year area which would carry a coupon of 1¾, 1⅞, or 2 percent, or a combination of two of these issues.

While we generally favor strongly the view that the refunding should take this form, we have also given consideration to what might be done in the short-term area and believe that among the possibilities are a 1¼ percent 1-year certificate which would be offered at 99¾, a 1½ percent 1-year certificate, or a 15-month 1⅝ percent note. If one of these issues were used in the refunding it would seem to us to be desirable to offer an intermediate issue for the December maturity and a combination of a short and intermediate security for the January refunding. The objective would still be to place a major part of the securities offered in the intermediate area.

We shall be glad to discuss with you the relative advantages of these various possibilities when we meet next Monday.

With warmest regards.

Sincerely,

THOMAS B. MCCABE, *Chairman.*

(The November 17, 1950, letter was given to Secretary Snyder personally by Chairman McCabe on November 17 at a meeting in which the December 1950-January 1951 refunding was discussed; and did not, therefore, require a written reply.)

Below is a letter with attachments from the Board of Governors of the Federal Reserve System to the President in response to his memorandum dated October 5, 1950, requesting suggestions of subjects for possible inclusion in his forthcoming State of the Union message and economic report.

DECEMBER 1, 1950.

The PRESIDENT,
The White House,
Washington, D. C.

MY DEAR MR. PRESIDENT: The Board appreciates the opportunity to suggest, in response to your memorandum of October 5, subjects for possible inclusion in your State of the Union Message and Economic Report.

In view of the rapidly changing character of the national defense emergency and the threat that international crisis may at any time force a total mobilization, it is highly important that both your message and report focus on the basic economic problems which this country is obliged to face. It seems to us that there are three such paramount problems. Only the degree of their urgency will

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be affected by whether or not full mobilization becomes necessary. These problems are:

1. *The need to divert manpower and industrial resources to whatever extent necessary from civilian purposes to provide over-all defense needs.*—This diversion cannot be achieved without a narrower choice of goods in the market than the public has enjoyed in the recent past and some hardships on the workers, farmers, and businessmen directly and indirectly affected. If full mobilization becomes necessary, living standards will have to be reduced substantially and all citizens will be called upon to make heavy sacrifices and to accept increased governmental direction affecting their activities.

2. *The need to expand further industrial capacity and total production, as well as to use manpower more effectively in order to meet our defense needs and maintain the underlying economic strength upon which national security ultimately rests.*—Over the short run, potentialities for further expansion are generally limited, since over-all production and employment are already close to capacity and supplies of some basic materials, particularly metals, even now are inadequate to meet civilian and military demands. Because present resources are being utilized so fully, particularly where defense needs are greatest, it is highly essential that every effort be made to increase productivity and to lower costs in order that the purchasing power of our military appropriations can be maintained and that rising prices in the domestic economy can be checked. Emphasis should be placed on conservation of scarce skills, modernization of production techniques, and development of substitutes for imported strategic commodities and for scarce domestic materials. To the extent that shortage of manpower becomes a bottleneck on essential production, present policies with respect to maximum hours of work at which overtime pay begins during the emergency may require review.

3. *The need to prevent inflation in order to sustain confidence in the value of the dollar and in the value of money savings.*—It is as imperative to maintain our financial strength as it is to enlarge our productive and military strength. Without one, we cannot have the other. Inflation is becoming as deadly an enemy as would be the armed forces of a foreign aggressor.

The Federal Reserve is charged with primary responsibility for national monetary and credit policies that will help to counteract, so far as possible within the scope of its authority, the development of inflationary pressures and threats to the value of the dollar. The scale and duration of inflationary pressures from credit and monetary sources in the period ahead will depend largely on military developments, as well as on self-restraint in spending on the part of businesses, individuals, and governments.

In the strongly inflationary situation since the outbreak of hostilities in Korea the Federal Reserve has been given increased powers in the credit field and has exercised these powers, together with its other authority, to curb credit and monetary expansion and thus to contribute to the struggle against inflation. The System's actions in recent months have moderated the growth of inflationary pressures. A memorandum summarizing the actions taken by the System is attached. It would be helpful if you would indicate general concurrence with this anti-inflationary program.

In spite of these restraining actions, credit and monetary expansion as a result of private and municipal borrowing is still contributing to inflationary pressures. The Board is deeply concerned about this continuing credit expansion. The System's ability to apply additional restraints is limited by the policy of keeping the Government securities market orderly, of supporting the refinancing of maturing Government issues, and of maintaining the existing 2½-percent rate on outstanding long-term Government bonds. As long as this policy prevails, the System should be given broader powers over bank reserves with which to combat further inflationary credit development. At an appropriate time the Board will submit a program for increased powers over the reserves of the banking system. In your Economic Report of January 1949 you stated:

"On previous occasions I have recommended that adequate means be provided in order that monetary authorities may at all times be in a position to carry out their traditional function of exerting effective restraint upon excessive credit expansion in an inflationary period and conversely of easing credit conditions in a time of deflationary pressures."

Events have now made it clear that the authorities provided in the Defense Production Act of 1950 will be required for a longer period than the statutory expiration dates. Accordingly, the Board recommends an extension of this act. The Board also recommends that the particular authority in the act to regulate

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credit extended in connection with new construction be widened to include similar powers to regulate credit in connection with existing housing and other real property.

A memorandum is attached setting forth the Board's general viewpoint respecting the role of fiscal, credit, and monetary measures in the present emergency. In the event that full mobilization becomes necessary, the Board may wish to make recommendations for further legislation in order that the economy's savings and credit resources may be made fully available for the support of war finance.

Very sincerely yours,

(Signed) Tom.
(Typed) THOMAS B. MCCABE,
Chairman.

Attachments.

DECEMBER 1, 1950.

RESTRICTIVE CREDIT AND MONETARY ACTIONS TAKEN BY THE FEDERAL RESERVE SYSTEM SINCE KOREA

Since the outbreak of hostilities in Korea the Federal Reserve has been given increased powers in the monetary and credit fields and has exercised these powers together with other authority to place curbs on credit expansion. In August, the Federal Reserve Board and the Federal Open Market Committee inaugurated a positive program of restraint on further credit and monetary expansion. In view of this decision and the additional authority provided under the Defense Production Act of 1950, the following actions have been taken:

(1) Early in August, the Board of Governors joined with other Federal and State bank supervisory agencies, including the Home Loan Bank Board, in a statement requesting the voluntary cooperation of banks and other lenders in restricting their lending and investment activities.

(2) In August, discount rates were raised from 1½ to 1¾ percent at all Federal Reserve banks in order to discourage borrowing by member banks of additional reserves to support further credit expansion.

(3) Since that time, open-market operations have been conducted with the particular aim of making the holding of short-term United States Government securities more attractive to investors and discouraging sales of such securities to the Federal Reserve System, including sales by banks to obtain funds for extending other types of credit.

(4) Effective September 18, under authority of the Defense Production Act, the Board of Governors again placed consumer installment credit under regulation.

(5) Effective October 12, the Board of Governors with the concurrence of the Housing and Home Finance Administrator, placed under regulation credit not extended, insured, or guaranteed by the Federal Government for constructing, purchasing, and financing new houses or major improvements or additions to existing houses. At the same time, the Federal Housing Administration and the Veterans' Administration issued new regulations designed to produce a similar tightening of credit with respect to new and used houses under Federal programs.

(6) Effective October 16, the Board stiffened the regulatory limits on consumer installment credit by increasing the minimum down payments and reducing the maximum maturities on certain installment credits, and by lowering the price below which down payments are not required.

(7) On November 17, the Board addressed a letter to all member banks requesting them to screen their loans carefully and to discourage the types of loans that do not make a definite contribution to the defense effort.

These actions by the Federal Reserve have been in line with the basic policy stated in your Midyear Economic Report:

"First of all, for the immediate situation, we should rely in major degree upon fiscal and credit measures. These general measures can be helpful not only in restraining inflationary pressures but also in reducing the civilian demand for some specific products, such as automobiles and housing, thus making available for necessary military use a larger proportion of an already short supply of some critical materials. The more prompt and vigorous we are with these general measures, the less need there will be for all of the comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative."

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DECEMBER 1, 1950.

ROLE OF FISCAL, CREDIT, AND MONETARY MEASURES IN THE PRESENT EMERGENCY

The Board strongly endorses a program of fiscal, credit, and monetary measures as the main anti-inflation reliance. The Board feels that only by this approach can our country preserve the significant characteristics of its economic system; namely, individual freedom of opportunity and choice in work, in spending, and in investing.

The core of individual opportunity and freedom of choice lies in the price mechanism—the changes in market prices which help to channel consumption or investment into one field and away from another and direct purchases toward some products and suppliers and away from others. Price movements do this impersonally and for the most part efficiently. Control systems tend to break down and to distribute resources inefficiently, especially if controls continue for a long time or if the public loses confidence in their equitable administration or enforcement. Moreover, extensive direct controls cannot solve the basic problem of inflation unless they are backed up by adequate fiscal and monetary policies which serve to sterilize or absorb the excess purchasing power created by defense spending.

The inflation problem that confronts a national defense emergency of indefinite duration has its source in the fact that those engaged in expanding our industrial capacity, those engaged in producing for defense, and those in the Armed Forces are paid for their services and equipment without there being possible an enlarged supply of consumers' goods and services to match the higher income. This creates a gap between current income and the supply of things to buy at prevailing prices. Under these circumstances, as businesses and individuals generally attempt to spend the larger income they bid up prices against each other.

At any time, because of the public's huge holdings of liquid assets and because of the great elasticity of our credit supply, this disparity between buying power and goods may be widened by an increased use of liquid assets and credit to augment buying out of current income. This is what happened on a considerable scale this summer as businesses and consumers rushed to protect themselves against future price advances or against disappearance of goods from the market.

If the attack on inflationary pressures is to be effective, it must be focused on reducing this gap between buying power and supplies of civilian goods and services. The first line of attack is through a fiscal policy that will restrain private spending, curb less essential private investment, and limit public outlays wherever possible. Tax policy should aim at a pay-as-we-go objective. On the basis of present and contemplated military programs, this will require a substantial increase in taxes. For greatest anti-inflationary effects, the taxes to be increased are those that curb purchasing power throughout the economy, particularly for those goods that are in short supply.

Government policy to encourage savings is another powerful force that can be brought to bear in combating inflation. Policy which discourages the expansion of private and State and local government debt and encourages the repayment of such debt is in the right direction. Federal debt management policy, including the aggressive selling of savings bonds, should be aimed at absorbing real savings and funds that otherwise would be spent for consumption or used for less essential investment. Insofar as the Government finds it necessary to refinance its outstanding issues, or to finance its rapidly expanding defense expenditures through borrowing, such borrowing should be as largely as possible from individual and corporate investors and as little as possible from the banking system. The latter is highly inflationary because it creates new deposits and thus adds to the country's money supply. The liquidity position of the banks is greatly affected by the types of Government securities which are offered, and adequate consideration should be given to this factor in determining the securities to be issued.

Effective fiscal policy and programs to encourage savings are closely related to restrictive credit and monetary policy which also attack inflationary pressures at their source. It accomplishes little in the fight against inflation, if dollars taxed out of the public's pocketbook or held as savings are replaced by credit dollars. Moreover, it stores up trouble for the future.

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Under present circumstances, restrictive credit and monetary policy is complicated by the large volume of public debt outstanding, which not only presents difficult debt management problems for the Government but also gives ready access to funds for individuals, businesses, and financial institutions by liquidation of Government securities. Similarly banks are able to obtain reserves on which they can pyramid credit expansion. The principal means available for restraint on credit expansion are as follows:

Selective-credit instruments.—Some types of credit can be restrained by imposing conditions as to the terms on which credit is advanced. Outstanding examples are maturity and down payment requirements on consumer installment credit and on mortgage loans, and margin requirements on security loans. These selective instruments, while of secondary importance, are effective in their respective spheres of operation.

Selective-credit measures are not generally suitable to other types of credit, such as loans to farmers, working-capital loans to business, or some loans to finance expansion of industrial plant and equipment. Expansion of these credits, as well as those subject to selective regulation, can be restrained to some extent through voluntary cooperation of lending institutions and increased efforts should be made along these lines. The most effective means of their restraint, however, are general credit instruments which would limit bank reserves.

General credit instruments.—General instruments of credit policy include open-market operations, discount rates, and changes in member bank reserve requirements. Although these are interrelated methods of monetary influence, they have tended in recent years to be regarded as separate and alternative instruments. As a result, considerable misunderstanding has developed about the way in which they function together in restraining bank credit expansion.

Under present conditions, the major source of funds for credit extension is the sale by private investors and financial institutions of Government securities in the market. Sales of such securities, if purchased in the open market by the Federal Reserve System, create bank reserves which can be used for multiple expansion of bank credit. The Federal Reserve can restrict the availability of bank reserves by restrictive open-market operations within the limits permitted by the necessity of maintaining orderly conditions in the Government securities market, of supporting the refinancing of maturing Government issues, and of maintaining the existing 2½-percent rate on outstanding long-term Government bonds. Such a policy can be effective only if accompanied by flexibility of short-term money rates and Reserve System discount rates. Flexible money rates in turn are necessary as an anti-inflation restraint to make the holding of short-term Government securities more attractive to investors—bank and nonbank—to impose a penalty on those investors who would shift out of them to finance inflationary lending or spending, and to encourage bank investors to rediscount with the Federal Reserve banks in place of selling short-term Government securities. Such rediscounting, which puts banks into debt, makes banks reluctant to extend new loans until the indebtedness is paid off.

Changes in discount rates on member-bank borrowing are thus an important supplementary instrument of monetary policy. In addition, such changes have a considerable psychological influence because they reflect to the financial markets the Reserve System's judgment of the over-all credit situation. For greater effectiveness in curbing bank-credit expansion, changes in discount rates need to be related closely to open market operations.

An increase in reserve requirements is a complementary means of restraining excessive bank-credit expansion. It may be used when the joint mechanism of open-market operations and discount rates, for reasons of debt management policy, need to be supplemented in order to apply additional restraint.

In summary, a vigorous fiscal program, a policy to increase savings and to lodge Federal debt as far as possible with nonbank investors, greater emphasis on voluntary restraint by lenders and borrowers, and a restrictive monetary program would go far to meet the inflation problem and make less necessary the adoption of extensive direct price, wage, and rationing measures if the military situation remains one of partial war. If full mobilization is required and a comprehensive program of direct controls is adopted, it will still be necessary to follow a vigorous policy of indirect controls in order to backstop the direct measures.

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This is a letter from Mr. McCabe to the President in response to a communication from the President, dated December 4, 1950.

DECEMBER 9, 1950.

Personal and confidential.

The PRESIDENT,
The White House.

DEAR MR. PRESIDENT: As you can imagine, your telephone call a few days ago and your subsequent letter of December 4 gave me great concern because I was distressed that you should have another problem added to the many critical ones before you.

The newspaper clipping to which you referred had not been previously called to my attention. I would not have considered it of special significance because it is such a distortion of the facts. We suspect that it was written by a man who we know makes a practice of baiting the Federal Reserve and creating an appearance of controversy. You can rest assured that we are full conscious of the magnitude of the financial problems that face us, and that we will do all in our power to insure the successful financing of the Government's needs.

You will recall that I mailed you a copy of my letter of October 30 to John Snyder in which I outlined the policy to be pursued by the Open Market Committee in accordance with the assurance which I previously gave to you and John in your office on October 26.

We heartily subscribed to the Treasury's latest refunding announcement and I assured John Snyder that the Open Market Committee would do everything possible to make it a success. I told him that we might have to purchase between $2 billion and $4 billion of the new issue before the refunding was completed, but that we were prepared to do it. I told him further that we would make every attempt to sell an equivalent amount of other securities in our portfolio in order to try to offset purchases. Excess of purchases over sales would tend to increase bank reserves. The creation of additional bank reserves in a period like this only adds more fuel to the fire of inflation. We have conducted our operations in strict accord with the policy which I outlined to you and John.

Actually we have purchased more than $2.5 billion of the maturing issue in support of the Treasury refinancing. In addition, we have continued to buy long-term 2½-percent restricted bonds in the narrow range of from 23/32 to 26/32 above par. Since November 22 we have made a net increase in our portfolio of well over $1 billion. We hope to sell enough Government securities in the coming weeks to offset the effects these purchases have had on bank reserves.

You can see from these figures that we have faithfully followed the policy as outlined to you.

It is our view that moderate fluctuations in price in response to market forces serve a useful purpose and help to maintain public confidence. Our feeling is that too rigidly pegged prices of securities encourage greater selling by investors. Our experiences over the past several months, in which we have had both rigid pegs for an extended period and slight fluctuations on the long-term restricted bonds, have convinced us that a moderate degree of flexibility is preferable. Since the end of November, covering the period when the subscription books to the new Treasury refunding issue were open, we have maintained a fixed buying price for the long-term restricted bonds.

I would prefer not to take up with the Open Market Committee the question of notifying the New York bankers of a fixed peg until I have had an opportunity fully to discuss with you the possible adverse consequences of such an action.

I expect to be in Birmingham, Ala., and Chicago until December 15. I will be pleased to see you either on Friday, the 15th, or Monday, the 18th, if either of those dates is convenient to you. I can assure you that in the meantime our operations will be directed toward maintaining stability in the market.

Faithfully yours,

THOMAS B. MCCABE, *Chairman.*

The following memorandum, which expressed the personal views of Mr. Sproul, Vice Chairman of the Federal Open Market Committee, but which had not been submitted to or discussed by the Federal Open Market Committee, was read to and left with Secretary Snyder at a meeting which Mr. McCabe, Chair-

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man of the Open Market Committee, and Mr. Sproul had with the Secretary on January 3, 1951:

JANUARY 2, 1951.

DEBT MANAGEMENT AND CREDIT POLICY

DANGERS

1. We will try to get mobilization and rearmament wholly as a byproduct of a continuing peacetime business boom. This is the tempting idea of increased production, increased national income, and increased Government revenues, which will take care of our civilian and military needs without civilian sacrifice and Government borrowing. It would relieve the pressure for cuts in nondefense Government expenditures and for some reduction in civilian consumption. Resilience and expansive power of our economy is great, but time is a controlling factor. The economy is already stretched and the necessary increases in production can't be expected in 1951 even if work hours are increased, the number of workers expanded, and normal productivity gains are obtained. An inflationary stimulus under such circumstances would raise prices, not production.

2. Reliance will come to be placed too largely on direct controls, and stern resolves about fiscal and credit policy will be forgotten. Both kinds of controls now appear to be needed, but the exemption of agricultural prices and softness toward wage increases, weaken direct controls, which will fail, in any case, unless backed by strong fiscal and credit measures.

3. We won't tax enough and in the right places (in order to cut down consumer purchasing power not savings) and we won't have the wisdom or the power to apply credit controls effectively.

Admittedly, too high taxes may dull incentive or may themselves become inflationary, through union pressure for higher wages or corporate action to raise prices, or lowered management interest in cost control. It is not likely, however, that the necessary tax increases to meet Government expenditures during the calendar year 1951 will breach these points.

Admittedly, credit controls, by themselves, cannot wholly check inflationary pressures when other strong forces are working to increase costs and prices, but we must do all we can to hold down the money supply, and that means we should use general or quantitative controls which affect interest rates, as well as selective controls. The next 6 months, while the Treasury will be largely out of the market, offer the best chance to get our house in order, through general credit measures. After that the requirements of credit policy and Government financing needs—refunding and new money—may be in conflict and financing needs will take precedence.

4. Looking ahead to tremendous armament expenditures over a period of years, and talking about plans and appropriations instead of cash outlay, we may lose sight of the fact that the problem is still of manageable proportions, as of the year 1951. If we hit an annual rate of Government spending for defense of $45 billion by the end of calendar 1951, the cash deficit on the basis of present tax rates (omitting the just-passed excess-profits tax) would still be only about $6 billion. It is too early to dismiss "pay as you go" as merely a pious proposal, and to talk of tremendous deficit financing, and of a frozen pattern of interest rates to hop up the Government security market.

NEAR-TERM CREDIT POLICY AND DEBT MANAGEMENT

It is in the light of these present dangers, and in preparation for meeting the more difficult longer-term problems of financing full-scale mobilization of war, that near-term policy should be determined.

5. If present inflationary advances in the credit sector continue, as it appears they may during the next few months, further action to restrict the availability of bank reserves would be in order. Whether this is accomplished through open-market operations or further power (and use of that power) to increase reserve requirements, or both, it must have some influence on interest rates to be effective. This would impose a further marginal tightening in the availability of credit, and it would permit the Federal Reserve System to offer additional resistance to the unloading of shorter-term securities on the open-market account. In terms of longer-range objectives, it would also move us closer to a horizontal yield curve, which will tend to "pin in" existing holders of Government securities and prevent playing of the pattern of rates in the period of renewed deficit financing which may lie further ahead.

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6. The immediate problem of debt management is in the area of long-term rates, and includes the problem of maturing savings bonds and the sale of new savings bonds.

The lesson to be learned from the financing of the last war is that long-term financing at rates which won't hold up in the market, without Federal Reserve support, is to be avoided. This suggests a slightly higher rate than 2½ percent for long-term financing. The attraction of a slightly higher yield (almost regardless of maturity), particularly for institutional investors facing actuarial income requirements, could effect a significant diversion of new investment funds into new Treasury issues. Such investors will not, of course, neglect attractive alternative private investments, but the competitive position of Treasury offerings would be greatly improved, having in mind the desire of these investors to find the safest lodgment for their funds consistent with their actuarial requirements.

In a technical sense, also, the Treasury will face a problem unless it offers a higher long-term rate. The fact that present outstanding restricted issues running only 17 years to call date, have to be heavily supported, suggests strongly that no net sales of new securities of longer maturity, at the same rate, would be possible. Nor would it be desirable, in terms of orderly debt management, to place any more new bonds within this 17-year period.

In terms of immediate as well as longer-term debt management, as well as credit policy, this suggests that if market pressures continue the price of outstanding restricted bonds of 1967–72 be allowed to decline to par, or only slightly above, so that they may stand on their own feet as soon as possible, so that forced injections of reserve credit into the banking system may be stopped, and so that the ground will be prepared for the long-term financing which lies ahead. Never before has the Treasury faced unknown new borrowing requirements in the face of a very large outstanding debt. If it is to obtain new money from long-term investors rather than merely effect a churning about in old holdings it must break away from old patterns. The only way to reduce switching of outstanding securities into new Treasury offerings will be through Treasury action to set a higher long-term rate, and through removing the premium on the longest-term outstanding restricted bonds. In the long run debt management (as well as credit policy) must be judged by the success of new offerings in attracting savings. Mere switching out of old issues into new, with actual requirements being met, indirectly, by bank money carries an explosive charge of inflationary pressures that would disrupt all other Government efforts to control inflation.

7. Savings bonds: Since 1951 marks the beginning of substantial maturities of savings bonds, methods of encouraging retention and stimulating further sales will have to be worked out very soon. Terms on this type of security, sold to the general public, cannot practicably be changed except infrequently; consequently, changes worked out in 1951 should be designed to meet requirements for some years ahead.

A System committee has been working on this problem for some time, and has now been directed by the Federal Open Marget Committee to discuss its ideas with the Treasury staff. It is hoped that out of these consultations will come recommendations which the Committee can promptly submit to you. So far as thinking has gone, it suggests among other things that terms of present E bonds be revamped, and that individuals be offered, in automatic extension of existing holdings and for cash, a bond which will return about one-half of 1 percent more if held to maturity.

In addition to improving the terms of savings bonds, it seems to me only slightly less important to revitalize the savings-bond sales organization, and to provide it with sufficient appropriated funds to do an aggressive, all-out selling job. Consumer incomes will continue to rise in excess of currently available goods; we won't tax away the whole of the excess, and we must attract some of this excess into savings or it will express itself in higher prices, thus undermining the whole savings-bond program.

8. This is a program for the immediate future, which also looks ahead to the time when large Government deficits may make necessary a fixed pattern of Government financing and some recourse to the banking system to meet the Government's needs. At that time we shall need to have at least three things:

(*a*) A method of bank financing which will cut down or eliminate the leverage in the fractional reserve system; short-term rates then in effect need not be the rates applied to bank borrowing, which may well have to be fixed, arbitrarily, at some lower level.

(*b*) A long-term bond which will attract new investment funds (other than individual) and which will take care of itself in the market under ordinary

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conditions. It may be that some form of compulsion will become necessary in this area, also, to assure continued holding.

(c) A savings bond which will attract and hold individual savings. The possibility of a refundable tax, or compulsory saving, should be again explored.

In preparing for this longer-term program we should continually keep in mind that it may (we hope) lack the stimulus of actual war, and that it may be of indefinite duration. We must avoid, insofar as possible, doing those things which have been excused during past wars as the lesser of the evils which temporarily we faced.

This is a letter from the President to the Federal Open Market Committee following the meeting of the Federal Open Market Committee with the President on January 31, 1951. It was released to the press on February 2, 1951.

THE WHITE HOUSE,
Washington, February 1, 1951.

Hon. THOMAS B. MCCABE,
Chairman, Board of Governors, Federal Reserve System,
Washington, D. C.

DEAR TOM: I want the members of the Federal Reserve Board and the members of the Federal Open Market Committee to know how deeply I appreciate their expression of full cooperation given to me yesterday in our meeting.

As I expressed to you, I am deeply concerned over the international situation and its implications upon our economic stability.

Your assurance that you would fully support the Treasury Defense financing program, both as to refunding and new issues, is of vital importance to me. As I understand it, I have your assurance that the market on Government securities will be stabilized and maintained at present levels in order to assure the successful financing requirements and to establish in the minds of the people confidence concerning Government credit.

I wish you would convey to all members of your group my warm appreciation of their cooperative attitude.

Sincerely yours,

HARRY TRUMAN.

(This was released by the White House on February 2, 1951.)

This is a memorandum prepared for the Federal Open Market Committee covering its meeting with the President on January 31, 1951. It was released to the press by Gov. Marriner S. Eccles on February 3, 1951, on his personal responsibility.

MEMORANDUM OF MEETING OF FEDERAL OPEN MARKET COMMITTEE WITH THE PRESIDENT JANUARY 31, 1951

The full Federal Open Market Committee met with President Truman in the Cabinet Room shortly after 4 p. m. on Wednesday, January 31, 1951. Chairman McCabe had met with the President in his office a few minutes earlier and came into the Cabinet Room with him. The President shook hands cordially with everyone present.

The President stated that during the past few weeks he had met with many groups in Government because he wanted them to know the seriousness of the present emergency and to ask for their full assistance and cooperation. He stated that the present emergency is the greatest this country has ever faced, including the two World Wars and all the preceding wars.

He gave a brief sketch of the difficulty of dealing with the Russians and said they had broken 32 parts of the agreements entered into at Cairo, Potsdam, and Yalta. He mentioned that these agreement, among other things, provided for a unified Germany, unified Poland, cooperation with Nationalist China, and a unified Korea, which would select its own Government by democratic process. He stated that the Americans provided Nationalist China with about $3½ billion of war equipment, much of which Chinese generals and other leaders disposed of to the Communist forces. He characterized the Nationalists as being the most corrupt government in history.

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He stated that General Eisenhower's report to the Cabinet today, after his visit to 12 North Atlantic countries, emphasized the seriousness of the situation but that the General believed Europe has the will to rearm and resist with our help. He mentioned some figures about the number of troops involved, in support of his statement that the emergency is very serious indeed.

The President emphasized that we must combat Communist influence on many fronts. He said one way to do this is to maintain confidence in the Government's credit and in Government securities. He felt that if people lose confidence in Government securities all we hope to gain from our military mobilization, and war if need be, might be jeopardized. He recalled his wartime experience when he bought Liberty bonds out of his soldier's pay. When he returned from France and had to sell his bonds to buy clothes and other civilian things, he got only $80 or a little more for his $100 bonds and later they were run up to $125. He said that he did not want the people who hold our bonds now to have done to them what was done to him.

He stated that most politicians would not ask for higher taxes prior to election but that he had vetoed a reduction in taxes before election and won anyway. If it had not been for that irresponsible reduction in taxes, he said, the Federal budget would have been in balance all these years. He stated that he wanted to levy all the taxes necessary to pay the cost of the defense effort, which he felt would be between $100 billion and $120 billion over the next few years. He stated that he had just met with the congressional leaders and asked for $16½ billion in taxes and that he expected to get this in two bites—a quick tax bill yielding about $10 billion and the other $6½ billion to come after more careful study. He wanted us to understand that he is doing all he can on the tax front to combat inflation..

The President gave each member of the committee a copy of The Federal Budget in Brief. He expressed the opinion that the budget had been pared to an irreducible minimum. He said that he had participated in the preparation of 16 budgets and felt he was competent to judge and understand them. Maybe something could be cut out but it would make a hole in the defense effort and that, he would not do.

The President said that he felt we had done a good job and wanted us to continue to do a good job in maintaining the financial structure of the country. He further stated that he had had a number of conferences with our Chairman but this was his first opportunity to meet and talk with the entire Committee. He made no mention of recent discussions with the Treasury.

Chairman McCabe thanked the President for receiving us and indicated that we all share his concern for the maintenance of the Government credit. He stated that although the support of the Government bond market was something in the nature of an extracurricular activity for the Federal Open Market Committee, it had performed this service for the past 9 years or more and had done a very good job. He stated that the Committee had always carefully weighed its responsibilities to the Government and to the general economy as well and that these are statutory responsibilities which it could not assign, if it would.

The President interjected that he was familiar with that but wanted the Committee to continue its good work during the defense period. He emphasized that he was speaking of the defense period only.

Chairman McCabe referred to the fact that in the last few days the Government bond market had gone up a few thirty-seconds and then had come down a few thirty-seconds, which he considered to be a proper market operational technique. The President said he would not undertake to discuss details of that kind, that he was principally concerned with maintaining the confidence of the public in Government securities as one way of presenting a unified front against communism. He did not indicate exactly the details of what he had in mind, but he reiterated that we should do everything possible to maintain confidence in the Government securities market. The Chairman outlined concisely some of the responsibilities with which we were charged, principally to promote stability in the economy by regulating the volume, cost, and availability of money, keeping in mind at all times the best interests of the whole economy. The Chairman turned to the members of the Federal Open Market Committee and said the President could depend on everyone in the group to do what they could to protect the Government credit.

Chairman McCabe stated that with a group of men such as those composing the Federal Open Market Committee (and with responsibilities in conjunction with those of the Treasury) there would, of course, be differences of opinion as to just how the best results could be obtained. The President nodded, indicating

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that he understood this. The Chairman suggested the following procedure—that we consult frequently with the Secretary of the Treasury giving him our views at all times and presenting our point of view strongly, and that by every means possible we try to reach an agreement. If this could not be accomplished, he (the Chairman) would like to discuss the matter with the President. The President said this was entirely satisfactory and closed the meeting on the same note as it was opened—namely, that he wanted us to do everything possible to maintain confidence in the credit of the Government and in the Government securities market and to support the President of the United States in achieving this end.

The Chairman stated at the end of the meeting that he presumed that any statement concerning this meeting would be made by the President. The President said he would have no objection to our making a statement and thought that it might be a good thing. The Chairman then asked him what would be the general nature of the statement and he said it can be said that we discussed the general emergency situation, the defense effort, budget, and taxes, and that he had stressed the need for public confidence in the Government's credit. He said further that he would be talking to the press the next morning and that he would be prepared to answer any questions that might be raised. Since the President indicated that he would be discussing it with the press, the Chairman said he felt it would be best for us not to issue any statement to the press at this time. The President did not seem to be particularly concerned about whether or not a statement was issued. The press conference scheduled for the following morning was canceled because of General Eisenhower's appearance at the Capitol. The White House press secretary gave the press the following statement which appeared on the ticker about noontime:

"WASHINGTON (AP).—The Federal Reserve Board has pledged its support to President Truman to maintain the stability of Government securities as long as the emergency lasts.

"White House Press Secretary Joseph Short announced this today, saying there have been reports of differences of opinion between the Treasury and the Federal Reserve Board.

" 'This is to quiet those rumors,' Short said.

"Members of the Federal Reserve Board conferred with Mr. Truman yesterday. Secretary of the Treasury Snyder did not attend the meeting."

A little later the following statement appeared on the ticker:

"WASHINGTON (AP).—A Treasury spokesman said the White House announcement means the market for Government securities will be stabilized at present levels and that these levels will be maintained during the present emergency."

NOTE.—This was released by Marriner S. Eccles on February 3, 1951.

This is a letter from the Federal Open Market Committee to the President in response to his letter of February 1, 1951.

FEBRUARY 7, 1951.

The PRESIDENT,
The White House.

MY DEAR MR. PRESIDENT: You as President of the United States and we as members of the Federal Open Market Committee have unintentionally been drawn into a false position before the American public—you as if you were committing us to a policy which we believe to be contrary to what we all truly desire and we as if we were questioning your word or defying your wishes as the Chief Executive of the country in this critical period. We would betray our duty to the country as well as to you if we failed to do all in our power to clear up these misunderstandings.

In your recent meeting with us you clearly stated as your objective one which underlies Federal Reserve operations—the maintenance of confidence in the integrity of the dollar and therefore in Government securities. In your recent economic report to the Nation you said: "If inflation continues to gain cumulative force it will multiply the cost of the defense program. It will undermine production, destroy confidence, generate friction and economic strife, impair the value of the dollar, dissipate the value of savings, and impose an intolerable burden upon fixed-income groups. This must not happen."

We propose to do all in our power to prevent it happening. We are dedicated to the preservation of the purchasing power of the dollar. Any policy which eats away this purchasing power—which increases the cost of living—at the same time and to the same degree undermines confidence in the credit of the

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United States. The credit of the United States Government in the final analysis rests with the American people. It depends upon the public's willingness to buy and hold Government securities.

The heart of the problem which confronts us is this: How can we stop the decline in the purchasing power of the dollar? How can we curb the dangerously rising tide of credit which is adding to the country's supply of dollars at an unprecedented rate? How can we arrest the flight of dollars into hedges against inflation when the supply of dollars is growing so fast? How can we best encourage people to hold and increase their savings and to spend less so long as inflationary dangers threaten?

Without confidence in sound financial management, this flood of newly created dollars in the form of credit cannot be controlled. It will overwhelm whatever price, wage, and similar controls, including selective credit measures, that may be contrived. This problem was not present in the mobilization period preceding World War II. Then the country had an abundance of unused plant, materials, and manpower. Savings had been depleted. Liquid assets were low and the public did not fear rising prices or shortages of goods and therefore did not anticipate the possibilities of inflation.

Today our concern and our responsibility is with the basic problem of bank reserves which continue to generate a rising tide of money. In the face of existing inflationary pressures there is no effective way of stemming this tide that will not reflect itself in interest rates. It merely confuses the issue to charge that the Open Market Committee favors higher interest rates per se. We favor the lowest rate of interest on Government securities that will cause true investors to buy and hold these securities.

Today's inflation is not due to deficit financing by the Government. It is due to mounting civilian expenditures largely financed directly or indirectly by sale of Government securities to the Federal Reserve. You have taken a courageous and forthright stand for increased taxes to finance the defense effort on a pay-as-we-go basis. If the additional taxes which you have recommended are enacted, little or no new Government borrowing will be needed. The experience of the past year, however, has clearly demonstrated that a balanced budget alone cannot stop inflation. We shall still need to deal with inflationary threats arising from civilian spending based largely upon the present excessive money supply. augmented by the liquidation of Government securities by the banks and other holders.

It continues to be, as it has always been, the policy of the Federal Reserve System and of its Federal Open-Market Committee to adapt credit policy to the needs and requirements of the Government as well as of the country. Our support of Treasury financing in time of war and in time of peace has given clear proof of this policy.

However, in inflationary times like these our buying of Government securities does not provide confidence. It undermines confidence. The inevitable result is more and more money and cheaper and cheaper dollars. This means less and less public confidence. Mr. President, you did not ask us in our recent meeting to commit ourselves to continue on this dangerous road. Such a course would seriously weaken the financial stability of the United States and encourage a further flight from money into goods. It would not be consistent with our responsibility to the Congress and to the people of this country to follow such a program.

In your meeting with us you mentioned the experience of returned veterans and other small holders with Liberty bonds after World War I. As you know, the savings bonds of today are specifically designed to avoid a repetition of this experience. The Liberty bonds were marketable securities subject to market fluctuations in price. These fluctuations were excessive following World War I, particularly because a large volume of Liberty bonds were not purchased out of savings but with bank-borrowed funds. Later many of these were dumped on the market to repay loans. As a result, in the absence of any provision for support to maintain orderly conditions in the market, they reacted excessively in price.

The savings bonds of today, unlike Liberty bonds of World War I, are redeemable on demand at specified values. The holder of savings bonds need not be concerned with market fluctuations because he will always get back dollars he has put into such bonds with a stated amount of interest.

In our open-market operations we are concerned only with the marketable issues, which are largely held by banks, other financial institutions, and experienced market-wise corporate and individual investors. We have maintained,

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and plan to continue to maintain, orderly conditions in these issues. These holders are accustomed to changes in prices of securities and to shifting their investments in order to take advantage of more profitable opportunities. Today they are able to sell their Government bonds to the Federal Reserve at a premium, whereas the owners of savings bonds, in which savings of the mass of the people are invested, must accept a lower interest return if they redeem their bonds before maturity.

In accordance with our assurances to you, we shall seek to work out with the Secretary of the Treasury as promptly as possible a program which is practicable, feasible, and adequate in the light of the defense emergency, which will safeguard and maintain public confidence in the values of outstanding Government bonds, and which at the same time will protect the purchasing power of the dollar.

Finally, at this critical time, when the cooperation of everyone is desperately needed, we sincerely trust that the decisions which are made will be for the best interests of the people of the United States.

With warmest regards.

Sincerely,

THOMAS B. MCCABE, *Chairman.*

Below is a letter to the Secretary of the Treasury following a meeting of the Federal Open Market Committee on February 7, 1951.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, February 7, 1951.

The Honorable JOHN W. SNYDER,
Secretary of the Treasury,
Washington, D. C.

DEAR JOHN: Following the meeting of the Federal Open Market Committee with the President on January 31, at which the President expressed the wish that the committee provide support to the Government securities market during the emergency period, the committee has considered what policies might be advisable in the immediate future. We should like to discuss with you at an early date a coordinated credit policy and debt-management program which would assist in the highly important fight against inflation and improve public confidence in the market for Government securities. We would suggest as a basis for that discussion a program along the following lines:

(1) The Federal Reserve, for the present, would purchase the longest-term restricted Treasury bonds now outstanding in amounts necessary to prevent them from falling below par.

(2) If substantial Federal Reserve support of the longest-term restricted bond is required, you would be prepared to announce that at an appropriate time the Treasury would offer a longer-term bond with a coupon sufficiently attractive so that the bond would be accepted and held by investors. It would be announced that outstanding long-term restricted bonds would be exchangeable for the new bond and that the new bond would be offered for cash subscription by nonbank investors on a basis to be determined.

We should like to discuss with you possible features for the new bond that would remove or reduce the need for Federal Reserve support of the market in the future.

(3) For the purpose of restricting the creation of bank reserves through sales of short-term securities to the Federal Reserve, particularly by banks, the committee would keep its purchases of such securities to the minimum amounts needed to maintain an orderly money market.

Under this policy, banks would be expected to obtain needed reserves primarily by borrowing from the Federal Reserve banks. If demands for expansion of bank credit and bank reserves should continue, short-term interest rates presumably would adjust to a level around the discount rate.

This is the time to inaugurate the suggested program. It appears that the Treasury will not need any financing either for new funds or for refunding until next summer. It is important that rate adjustments be made before that time so that your large refunding and new money financing in the second half of this year may be carried out smoothly and successfully without undue support by the System.

Only through policies such as these can restraint on credit expansion be exercised in the degree that is so necessary to avoid continued erosion of the purchas-

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ing power of the dollar and to maintain the strength of our economy in this critical period. Both the Treasury and the Federal Reserve have a vital interest in this objective.

We hope that we may have an early opportunity of discussing this matter with you.

With warmest regards,

Sincerely,

THOMAS B. MCCABE, *Chairman.*

(The above letter, February 7, 1951, was handed to Secretary Snyder by Chairman McCabe, Thursday, February 8, in a meeting at the Treasury. It did not, therefore, require a written reply.)

MISCELLANEOUS MATERIAL REQUESTED OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In accordance with requests made at the meeting of the subcommittee on March 31, and in subsequent telephone conversations with members of the Board's staff, the following material have been furnished by the Board of Governors, Federal Reserve System:

1. Statement of Condition of the Twelve Federal Reserve Banks Combined at End of Year (Five-Year Intervals 1915–40 and Each Year 1941–51).
2. Federal Reserve Note Statement. End of Year Figures (Five-Year Intervals 1915–40 and Each Year 1941–51).
3. Maturity Distribution of Loans and Securities of Federal Reserve Banks. December 31, 1951.
4. Statement of Bank Premises of Federal Reserve Banks, and Other Real Estate Acquired for Banking House Purposes, at End of Year (Five-Year Intervals 1915–40 and Each Year 1941–51).
5. Statement of Taxes on Bank Premises Paid by Federal Reserve Banks (At Five Year Intervals 1915–40 and by Years 1941–51).
6. Volume of Checks Handled by Federal Reserve Banks (At Five Year Intervals 1915–40 and by Years 1941–51).
7. Number of Officers and Employees of the Federal Reserve System. As of December 31 of each year 1940–51.
8. Breakdown showing Average Number of Officers and Employees of the Federal Reserve Banks Assigned to Various Functions, for the Fourth Quarter 1951.
9. Breakdown of Staff of Board of Governors of the Federal Reserve System by Divisions as of December 31, 1951.
10. Comparison Between Benefits of Civil Service and Federal Reserve Retirement Systems.
11. Factors in the Rise in Currency in Circulation Since 1939.
12. Statement showing Number of Motor Vehicles operated by the Board of Governors and the Federal Reserve Banks, and the Types of License Plates Used.
13. Tax Status of Board of Governors of the Federal Reserve System and Federal Reserve Banks.
14. Applicability of State or Local Retail Sales or Excise Taxes to Luncheon Facilities, Snack Bars, Canteens, Etc., Operated at Board of Governors and Federal Reserve Banks.
15. Reimbursable Fiscal Agency Expenses of the Federal Reserve Banks Year 1950.

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1. Statement of Condition of the 12 Federal Reserve Banks Combined at End of Year (5-Year Intervals 1915–40 and Each Year 1941–51)

[In thousands of dollars]

	1915	1920	1925	1930	1935	1940	1941	1942	1943
ASSETS									
Gold and gold certificates	541, 585	1, 897, 053	2, 647, 224	2, 906. 008	7, 553, 357	19, 750, 781	20, 490, 015	20, 523, 281	19, 532, 580
Redemption fund, Federal Reserve notes	1, 125	162, 433	54, 091	35, 211	17, 444	9, 692	13, 668	30, 449	233, 671
Other reserve cash	12, 721	190, 914	123, 056	140, 298	264, 550	275. 109	260, 678	354, 084	329, 822
Total reserves	555, 431	2, 250, 400	2, 824, 371	3, 081, 517	7, 835, 351	20, 035, 582	20, 764, 361	20, 907, 814	20, 096, 073
Nonreserve cash	4, 142	59, 944	63, 137	79, 932					
Redemption fund, Federal Reserve bank notes		12, 588							
Discounts and advances	56, 023	2, 947, 799	1, 017, 349	615, 242	9, 328	2, 915	2, 955	5, 571	5, 255
Industrial loans					32 493	7 538	9, 504	13, 649	10, 134
U. S. Government securities:									
Bills				24, 181	572, 958		10, 370	1, 009, 995	6, 768, 268
Certificates		260, 645	126, 678	315, 028				1, 041, 000	2, 467, 300
Notes		73	187. 065	226, 473	1, 641, 597	899, 500	777, 300	1, 345, 059	677, 900
Bonds	15, 856	26, 311	60, 825	163, 785	216, 176	1, 284, 600	1, 466, 805	2, 792, 581	1, 629, 479
Total U. S. Government securities, direct and guaranteed	15, 856	287, 029	374, 568	729, 467	2, 430, 731	2, 184, 100	2, 254, 475	6, 188, 635	11, 542, 947
Other securities	12, 300		3 205	7, 143	181				
Total loans and securities	84, 179	3, 234, 828	1, 395, 122	1, 351, 852	2. 472, 733	2, 194, 553	2, 266, 934	6, 207, 855	11, 558, 336
Gold held abroad		3, 300							
Due from foreign banks		1, 120	641	704	665	47	47	47	136
Federal Reserve notes of other banks	207	31, 131	20, 931	21, 993	27, 445	31, 628	36, 287	57, 053	90, 598
Uncollected cash items	50, 792	637, 218	729, 256	584, 783	603, 789	912. 398	1, 200, 724	1, 717, 800	2, 113, 044
Bank premises	145	16, 632	59, 176	57, 843	47, 723	40, 062	40, 767	39, 285	35, 205
All other assets	1, 944	6, 944	16. 770	22, 024	38, 094	47, 596	43, 724	88, 788	61, 174
Total assets	696, 840	6, 254, 105	5, 109, 404	5, 200, 648	11, 025, 800	23, 261, 866	24, 352, 844	29, 018, 642	33, 954, 566

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1. STATEMENT OF CONDITION OF THE 12 FEDERAL RESERVE BANKS COMBINED AT END OF YEAR (5-YEAR INTERVALS 1915–40 AND EACH YEAR 1941–51)—Continued

	1944	1945	1946	1947	1948	1949	1950	1951
ASSETS								
Gold and gold certificates	17, 850, 365	17, 062, 565	17, 587, 177	20, 810, 170	22, 335, 430	22, 622, 430	20, 880, 403	20, 753, 952
Redemption fund, Federal Reserve notes	594, 126	800, 359	794, 116	687, 127	630, 650	553. 793	577, 229	714, 115
Other reserve cash	242, 189	----	----	----	----	----	----	----
Total reserves	18, 686, 680	17, 862, 924	18, 381, 293	21, 497, 297	22, 966, 080	23, 176, 223	21, 457, 632	21, 468, 067
Nonreserve cash	----	236, 315	267, 890	272, 631	292, 303	257, 845	266, 716	323, 175
Redemption fund, Federal Reserves bank notes	----	----	----	----	----	----	----	----
Discounts and advances	79. 825	248, 905	163, 079	85, 425	222, 805	77, 845	67, 395	19. 347
Industrial loans	3, 751	1, 941	550	1, 387	832	2, 070	2, 556	4, 637
U. S. Government securities:								
Bills	11, 147, 918	12, 831, 245	14, 744, 983	11, 433, 410	5, 487, 406	4. 829, 247	1, 296, 071	596, 360
Certificates	4, 886, 640	8, 364, 461	7, 496, 012	6, 796, 505	6, 077, 569	6, 275, 450	2, 334, 195	12, 792, 798
Notes	1, 568, 221	2, 119, 650	355, 300	1, 476, 550	790, 550	562, 200	12, 527, 226	5, 068, 073
Bonds	1, 243, 426	946, 892	753, 390	2, 852, 869	10, 977, 221	7, 217, 700	4, 620, 075	5. 344, 127
Total U. S. Government securities, direct and guaranteed	18, 846, 205	24, 262, 248	23, 349, 685	22, 559, 334	23, 332, 746	18, 884, 597	20, 777, 567	23, 801. 358
Other securities	----	----	----	----	----	----	----	----
Total loans and securities	18, 929, 781	24, 513, 094	23, 513, 314	22, 646, 146	23, 556, 383	18, 964, 512	20, 847, 518	23, 825, 342
Gold held abroad	----	----	----	----	----	----	----	----
Due from foreign banks	136	110	102	95	49	38	24	28
Federal Reserve notes of other banks	112, 514	153. 226	163. 385	162, 242	186, 738	162, 306	170, 088	201, 141
Uncollected cash items	2, 448, 145	2, 197, 932	2, 599, 574	2, 984, 999	2, 860, 271	2, 946, 781	4, 270, 008	3, 905, 327
Bank premises	34, 278	33. 382	32, 406	33, 007	32, 348	33. 738	39. 972	43. 599
All other assets	57. 077	65, 915	48, 449	115. 237	148, 699	101, 654	120, 356	133, 157
Total assets	40, 268, 611	45, 062. 898	45, 006, 413	47, 711, 654	50, 042, 871	45, 643, 097	47, 172, 314	49, 899, 836

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	1915	1920	1925	1930	1935	1940	1941	1942	1943
LIABILITIES									
Federal Reserve notes	188,817	3,336,281	1,838,164	1,663,538	3,709,074	5,930,997	8,192,169	12,192,986	16,906,359
Federal Reserve bank note circulation, net		216,641							
Deposits:									
Member bank reserve accounts	401,175	1,780,679	2,212,098	2,470,583	5,587,208	14,025,633	12,450,333	13,116,809	12,885,984
U. S. Treasurer, general account	17,209	57,415	16,432	18,819	543,770	368,481	867,493	799,449	578,617
Foreign		5,494	8,247	5,761	28,935	1,132,909	774,062	792,790	1,360,488
Other deposits	34,082	17,910	20,611	21,970	225,896	599,544	586,170	485,147	355,936
Total deposits	452,466	1,861,498	2,257,388	2,517,133	6,385,809	16,126,567	14,678,058	15,194,195	15,181,025
Deferred availability cash items		518,534	665,847	564,007	591,556	832,779	1,106,929	1,247,053	1,432,303
Other liabilities	643	19,294	10,458	11,694	4,032	2,196	2,195	3,568	5,589
Total liabilities	641,926	5,952,248	4,771,857	4,756,372	10,690,471	22,892,539	23,979,351	28,637,802	33,525,276
CAPITAL ACCOUNTS									
Capital paid in	54,914	99,821	117,237	169,640	130,512	138,579	142,180	146,026	154,104
Surplus (sec. 7)		202,036	220,310	274,636	145,501	157,064	157,501	160,411	188,097
Surplus (sec. 13b)					24,235	26,785	26,780	26,829	26,965
Other capital accounts					35,081	46,899	47,032	47,574	60,124
Total liabilities and capital accounts	696,840	6,254,105	5,109,404	5,200,648	11,025,800	23,261,866	24,352,844	29,018,642	33,954,566
Ratio of total reserves to deposit and Federal Reserve note liabilities combined (percent)	94.1	43.3	69.0	73.7	77.6	90.8	90.8	76.3	62.6
Contingent liability on acceptances purchased for foreign correspondents		16,204	70,344	439,288					
Industrial loan commitments					27,649	5,226	14,597	10,661	9,270

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1. STATEMENT OF CONDITION OF THE 12 FEDERAL RESERVE BANKS COMBINED AT END OF YEAR (5-YEAR INTERVALS 1915–40 AND EACH YEAR 1941–51)—Continued

	1944	1945	1946	1947	1948	1949	1950	1951
LIABILITIES								
Federal Reserve notes	21,731,017	24,649,132	24,945,304	24,820,434	24,161,103	23,482,646	23,587,018	25,064,109
Federal Reserve bank note circulation, net	-----	-----	-----	-----	-----	-----	-----	-----
Deposits:								
Member bank reserve accounts	14,372,899	15,914,950	16,138,878	17,899,371	20,479,200	16,568,088	17,680,744	20,055,716
U. S. Treasurer, general account	440,487	976,668	392,869	870,031	1,122,900	821,354	668,454	246,687
Foreign	1,203,703	862,320	508,016	391.849	641,692	766,521	895,442	526,375
Other deposits	393,881	445,572	313,638	569,433	547,252	750,269	564,913	362,798
Total deposits	16,410,970	18,199,510	17,353,401	19,730,684	22,791,044	18,906,232	19,809,553	21,191,576
Deferred availability cash items	1,633,226	1,619,770	2,019,896	2,449,763	2,319,336	2,412,620	2,901,599	2,721,490
Other liabilities	7,071	7,661	9,392	14,806	10,652	9,474	5,600	13,809
Total liabilities	39,782,284	44,476,073	44,327,993	47,015,687	49,282,135	44,810,972	46,303,770	48,990,984
CAPITAL ACCOUNTS								
Capital paid in	162,531	177,095	186,830	195,517	201,351	210,891	225.102	236,613
Surplus (sec. 7)	228,153	358,355	439,823	448,189	466 711	488,173	510,022	538.342
Surplus (sec. 13b)	27.165	27,428	27,455	27,543	27.543	27.543	27,543	27,543
Other capital accounts	68,478	23,947	24 312	24,718	65,131	105,518	105,877	106,354
Total liabilities and capital accounts	40,268,611	45,062,898	45.006,413	47,711,651	50,042,871	45,643.097	47,172,314	49,899,836
Ratio of total reserves to deposit and Federal Reserve note liabilities combined (percent)	49.0	41.7	43.5	48.3	48.9	54.7	49.4	46.4
Contingent liability on acceptances purchased for foreign correspondents	-----	-----	6,547	2,460	3,329	10,507	21,430	20,913
Industrial loan commitments	4,165	1,644	8,309	7,434	1,643	2.288	3,754	6,036

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2. Federal Reserve Note Statement End of Year Figures (5-Year Intervals 1915–40 and Each Year 1941–51)

[In thousands of dollars]

	1915	1920	1925	1930	1935	1940	1941	1942	1943
Federal Reserve notes:									
Issued to Federal Reserve bank by Federal Reserve agent	214, 125	3, 735, 731	2, 205, 560	2, 093, 625	4, 047, 052	6, 256, 650	8, 611, 926	12, 672, 151	17, 512, 088
Held by Federal Reserve bank and forwarded for redemption	25, 308	399, 450	367, 398	430, 087	337, 978	325, 653	419, 757	479, 165	605, 729
Federal Reserve notes, net [1]	188, 817	3, 336, 281	1, 838, 162	1, 663, 538	3, 709, 074	5, 930, 997	8, 192, 169	12, 192, 986	16, 906, 359
Collateral held by Federal Reserve agent for notes issued to bank:									
Gold and gold certificates	197, 450	1, 277, 875	1, 372, 281	1, 730, 439	3, 970, 843	6, 379, 500	8, 724, 000	12, 467, 000	13, 266, 000
Eligible paper	16, 740	2, 854, 980	948, 803	507, 788	2, 716	1, 688	2, 567	2, 830	4, 990
U. S. Government securities					127, 500			355, 000	4, 488, 690
Total collateral held	214, 190	4, 132, 855	2, 321, 084	2, 238, 227	4, 101, 059	6, 381, 188	8, 726, 567	12, 824, 830	17, 759, 680

	1944	1945	1946	1947	1948	1949	1950	1951
Federal Reserve notes:								
Issued to Federal Reserve bank by Federal Reserve agent	22, 507, 705	25, 633, 380	25, 741, 606	25, 705, 984	25, 127, 171	24, 358, 525	24, 548, 029	26, 130, 543
Held by Federal Reserve bank and forwarded for redemption	776, 688	984, 248	796, 302	885, 550	966, 068	875, 879	961, 011	1, 066, 434
Federal Reserve notes, net [1]	21, 731, 017	24, 649, 132	24, 945, 304	24, 820, 434	24, 161, 103	23, 482, 646	23, 587, 018	25, 064, 109
Collateral held by Federal Reserve agent for notes issued to bank:								
Gold and gold certificates	11, 298, 000	10, 523, 000	11, 053, 000	12, 719, 000	13, 579, 000	14, 359, 000	13, 604, 000	12, 484, 000
Eligible paper	79, 625	201, 455	12, 812	32, 410	30, 080	7, 701	73, 065	17, 936
U. S. Government securities	11, 534, 902	15, 403, 201	15, 226, 565	13, 550, 000	12, 200, 000	10, 800, 000	11, 665, 000	14, 050, 000
Total collateral held	22, 912, 527	26, 127, 656	26, 292, 377	26, 301, 410	25, 809, 080	25, 166, 701	25, 342, 065	26, 551, 936

[1] Includes Federal Reserve notes held by the U. S. Treasury and by Federal Reserve banks other than the issuing bank.

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3. Maturity Distribution of Loans and Securities of Federal Reserve Banks, Dec. 31, 1951

[In thousands of dollars]

	Discounts and advances	Industrial loans	U. S. Government securities [1]
Within 15 days	11,215	616	259,908
16 to 90 days	8,110	689	452,052
91 days to 1 year	22	2,125	14,344,823
Over 1 year to 5 years		1,207	5,102,256
Over 5 years to 10 years			1,013,614
Over 10 years			2,628,705
Total	19,347	4,637	23,801,358

[1] Callable Government securities classified according to nearest call date.

4. Bank Premises of Federal Reserve Banks, and Other Real Estate Acquired for Banking-House Purposes, at End of Year (Five-Year Intervals 1915–40 and Each Year 1941–51), Includes Land, Building and Vaults, and Fixed Machinery and Equipment

[In thousands of dollars]

End of year	Bank premises		Other real estate	
	Cost	Net book value	Cost	Net book value
1915	145	145		
1920	23,403	16,985	(1)	(1)
1925	79,352	58,103	1,152	1,074
1930	82,640	53,349	6,790	4,496
1935	90,946	47,724	4,094	1,837
1940	95,022	40,062	2,995	978
1941	96,585	40,766	2,995	969
1942	97,486	39,285	2,698	1,076
1943	98,263	35,205	2,060	830
1944	98,391	34,278	3,071	1,031
1945	98,727	33,382	2,829	1,655
1946	98,780	32,404	3,290	2,353
1947	101,228	33,007	2,457	1,944
1948	101,428	32,348	2,489	1,955
1949	104,083	33,738	2,517	2,006
1950	111,464	39,974	1,261	940
1951	116,791	43,600	2,205	1,834

[1] Included in "Bank premises."

5. Taxes on Bank Premises Paid by Federal Reserve Banks (At 5-Year Intervals, 1915–40, and by Years 1941–51)

Year	*Amount*	Year	*Amount*
1915		1944	$1,495,612
1920	$56,582	1945	1,510,801
1925	1,293,059	1946	1,615,314
1930	1,374,368	1947	1,786,651
1935	1,401,641	1948	1,850,018
1940	1,493,058	1949	1,937,416
1941	1,498,243	1950	1,954,043
1942	1,508,451	1951	2,071,841
1943	1,475,344		

Note.—Most of the Reserve bank buildings were occupied during the early twenties.

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6. Volume of Checks Handled by Federal Reserve Banks (at 5-Year Intervals and by Years 1941–51)

Year	Number of checks handled (in thousands)			Amount of checks handled (in thousands of dollars)		
	U. S. Government [1]	All other [1]	Total	U. S. Government [1]	All other [1]	Total
1915			(2)			(2)
1920			504,198			179,505,223
1925			778,686			258,611,276
1930			904,975			324,883,021
1935			885,190			202,989,742
1940	127,284	1,057,072	1,184,356	18,750,260	261,685,832	280,436,092
1941	123,128	1,142,465	1,265,593	27,732,559	334,336,667	362,069,226
1942	130,895	1,204,648	1,335,543	67,834,790	409,273,478	477,108,268
1943	266,686	1,246,384	1,513,070	113,791,554	509,640,311	623,431,865
1944	426,460	1,288,465	1,714,925	127,931,710	532,755,045	660,686,755
1945	510,608	1,341,342	1,851,950	124,610,917	563,498,349	688,109,266
1946	380,634	1,597,377	1,978,011	80,419,096	651,457,054	731,876,150
1947	331,914	1,668,651	2,000,565	72,577,329	719,630,054	792,207,383
1948	331,866	1,780,185	2,112,051	69,605,341	799,771,839	869,377,180
1949	357,044	1,847,807	2,204,851	64,379,607	758,342,771	822,722,378
1950	365,812	1,955,232	2,321,044	64,569,739	856,952,849	921,522,588
1951	412,865	[3] 2,122,147	[3] 2,535,012	89,648,061	[3] 799,891,846	[3] 889,539,907

[1] Not available 1915–35.
[2] Not available.
[3] Not including checks on the Federal Reserve banks, included in prior years. In 1950 there were 1,785,000 of these items amounting to $178,120,377,000.

NOTE.—Two or more checks handled as a single item are counted as one piece.

7. Number of Officers and Employees of the Federal Reserve System

	As of Dec. 31—											
	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951
Federal Reserve banks (including branches):												
Boston	720	924	1,257	1,409	1,417	1,403	1,369	1,266	1,285	1,240	1,257	1,461
New York	2,520	3,095	3,871	4,680	4,644	4,574	4,414	3,985	4,010	3,673	3,611	4,038
Philadelphia	793	944	1,252	1,546	1,594	1,706	1,265	1,117	1,082	1,068	1,097	1,238
Cleveland	956	1,157	1,902	2,283	2,302	2,224	1,916	1,830	1,778	1,687	1,688	1,815
Richmond	674	794	1,177	1,448	1,532	1,534	1,411	1,357	1,308	1,246	1,216	1,316
Atlanta	750	885	1,177	1,485	1,550	1,527	1,320	1,085	1,028	953	960	1,094
Chicago	1,849	1,996	2,963	3,865	3,760	3,371	3,156	2,895	2,941	2,723	2,656	2,924
St. Louis	695	824	1,136	1,551	1,484	1,521	1,359	1,219	1,161	1,097	1,121	1,263
Minneapolis	441	590	880	904	814	786	699	657	644	638	689	714
Kansas City	692	831	1,179	1,370	1,397	1,346	1,223	1,128	1,139	1,060	1,064	1,102
Dallas	647	757	1,127	1,473	1,297	1,222	1,097	920	954	951	935	949
San Francisco	903	1,286	2,051	2,727	2,651	2,308	2,201	1,905	1,751	1,631	1,699	1,918
Subtotal	11,640	14,083	19,972	24,741	24,442	23,522	21,430	19,364	19,081	17,967	17,993	19,832
Board of Governors [1]	449	464	432	469	450	460	489	506	522	545	574	584
System total	12,089	14,547	20,404	25,210	24,892	23,982	21,919	19,870	19,603	18,512	18,567	20,416
Index (1940=100)	100	120	169	208	206	198	181	164	162	153	154	169

[1] Does not include members of the Board.

NOTE.—Includes part-time employees. Each such employee counted as one.

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8. Average Number of Officers and Employees of Federal Reserve Banks, Fourth Quarter 1951

Total officers		349
Employees assigned to various functions:[1]		
Check collection		4,890
Fiscal agency:		
Public debt	2,465	
Government checks	607	
Post-office money orders	535	
Federal taxes	103	
Other fiscal agency units	379	
		4,089
General service:		
Mail and express	587	
Protection and vault maintenance	1,006	
Other general service units	901	
		2,494
Currency and coin		2,018
Provision of space (operation and maintenance of buildings)		1,409
Accounting		947
Provision of personnel		770
Research and statistical		479
Bank examination		449
Noncash collection		281
Auditing		271
Consumer credit		261
Securities		257
All other functions		654
Total employees		19,269
Total officers and employees		19,618

[1] Part-time employees included only for proportionate part of day worked (i. e., an employee working one-half of a day is counted as 0.50).

9. Staff of Board of Governors of the Federal Reserve System by Division as of Dec. 31, 1951

Office or division:	*Number of persons*
Board members' staff	21
Secretary	37
Legal	20
Solicitor	5
Research and statistics	133
International finance	48
Examinations	53
Bank operations	53
Personnel administration	18
Administrative services	177
Selective credit regulation	19
Total employees of the Board (excluding Board members)	584

10. Comparison Between Benefits of Civil Service and Federal Reserve Retirement Systems

The Federal Reserve retirement system contains two plans, one applicable to the employees of the Federal Reserve banks and the other applicable to the majority of the employees of the Federal Reserve Board. Certain other employees of the Board are members of the civil-service retirement system, having had such status at the time they were employed. The remarks below pertain to the plan applicable to the Reserve banks. The benefits and cost to the employee of the other plan at the Board of Governors are the same as those of the civil-service retirement system.

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The Federal Reserve retirement system is a combination of a fixed retirement allowance and an annuity purchase plan. The pension portion of the retirement allowance, i. e., the amount provided by the Reserve banks, is on a straight-life basis while the annuity portion, i. e., the amount provided by the employee's contributions, is on a cash-refund basis.

The civil-service retirement allowance, on the other hand, is on a fixed-formula basis with both the pension and the annuity on a straight-life basis except that a member must receive back in benefits at least an amount equal to his accumulated contributions.

The basic retirement allowance provided by the Federal Reserve retirement system is an amount equivalent to—

1. An annuity equal to the value of his accumulated contributions,
2. A pension equal to 1 percent of highest average salary for five consecutive years of service multiplied by the years of service. If the member is also a member of social security, his pension is equal to one-half of 1 percent of the first $3,600 of his salary. (The Reserve bank and the employee make contributions to social security.) As in civil service, the lower salaried members of the Federal Reserve retirement system receive proportionately more than those in the higher salary brackets in that a minimum allowance equal to $32 for each year of service is guaranteed.

Under civil service, the basic allowance is equal to 1½ percent of highest average salary for five consecutive years multiplied by years of service or 1 percent of such salary for each year of service plus $25 for each year of service, depending upon which formula gives the higher allowance.

Under the Federal Reserve retirement system, the retirement age is 65. Any person, regardless of the amount of service, retiring before that age, has his allowance reduced actuarially to his attained age. Under civil service, retirement age is 70 with provision for optional retirement at a reduction much less than the actuarial equivalent being made in cases where a person retires before age 60.

Unlike civil service, the Federal Reserve retirement system gives credit only for service rendered for the Federal Reserve System or for military service occurring during the tenure of employment. Civil service provides that any service for the Federal Government whether civilian or military, and regardless of when performed, is creditable for retirement purposes. If an employee ceases to be a member of the Federal Reserve retirement system and is subsequently reemployed, his previous service credit is not restored to him.

Members of the Federal Reserve retirement system pay a level premium to the retirement system based on age at entrance. These rates vary from 5.40 percent for a male aged 18 years to 11.18 percent for a female aged 64 years. Under current civil-service rules, the contribution rate is 6 percent.

Certain beneficiaries of an employee dying in service receive an allowance from the civil-service retirement system based partly on need and the rights accrued by the employee at the time of death. The beneficiaries of a member of the Federal Reserve retirement system dying in service receive an amount equal to the salary the member received during the last 12 months of service, with a maximum of $25,000.

In the attached table certain data are shown for the last 25 members to retire under the Federal Reserve retirement system.

The designation of "special service" retirement corresponds with optional retirement under the Civil Service Retirement Act and the "service" retirement corresponds to retirement under civil service because of age.

The asterisk (*) indicates that the employee would not be eligible for retirement under the civil-service retirement system. The Federal Reserve retirement system provides immediate allowances after 10 years of service at age 50 actuarily reduced from age 65. Under civil service there is no provision for an immediate allowance unless the member is 55 and has at least 30 years of service.

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Comparison of benefits provided by bank plan of Federal Reserve retirement system with those provided by civil service retirement system

Number	Type of retirement	Years of service	Average salary	Member's contribution rate	Amount of regular allowance	
					Federal Reserve	Civil Service
				Percent		
1	Special service (54)	25	$2,509	4.50	$538	(1)
2	Special service (59)	10	2,223	7.40	323	(1)
3	Service	9	2,609	7.52	427	$459
4	do	33	5,360	6.96	2,842	2,640
5	Disability	35	5,825	6.21	3,163	3,045
6	Service	31	2,145	6.39	1,257	1,426
7	do	33	5,717	7.07	3,004	2,805
8	do	7	2,478	7.80	349	343
9	Special service (58)	12	2,787	7.00	375	(1)
10	Service	31	4,922	6.84	2,617	2,294
11	Special service (62)	34	5,129	6.56	2,252	2,618
12	Service	34	3,293	6.51	1,841	1,972
13	do	8	2,537	7.66	360	400
14	Special service (55)	15	2,896	5.61	379	(1)
15	Special service (59)	31	2,784	6.35	938	1,564
16	Special service (54)	32	3,932	5.55	858	(1)
17	Special service (58)	23	2,756	5.71	667	(1)
18	Special service (51)	30	4,344	5.29	829	(1)
19	Service	20	2,497	4.95	856	1,000
20	Special service (59)	20	2,548	4.50	587	(1)
21	Service	19	5,005	6.90	1,437	1,425
22	Disability	32	3,056	5.41	1,458	1,760
23	Service	33	4,177	5.23	2,204	2,178
24	Disability	9	2,413	6.39	603	441
25	Special service (55)	31	3,300	5.99	872	1,529

1 Not eligible for retirement in Civil Service Retirement System.

Since there were no retirements of higher salaried employees during the period covered by the foregoing table—or during the 25 retirements previous to that—comparisons of three of the latest retirements of higher salaried employees are given below:

Type of retirement	Years of service	Average salary	Member's contribution rate	Amount of regular allowance	
				Federal Reserve	Civil Service
			Percent		
Special service (61)	35	$25,000	7.54	$9,538	$13,125
Service	32	11,717	8.13	6,407	5,600
Do	35	13,067	8.13	8,146	6,860

11. Factors in the Rise in Currency in Circulation Since 1939

This study discusses the probable factors responsible for the large rise in the volume of currency in circulation since before World War II. Questions have been raised as to whether the present high level is due in substantial part to foreign or domestic hoards and whether a significant proportion of currency has been lost or destroyed.

The study is based largely on estimation and yields only rough approximations. This is necessary because only fragmentary data are available on who holds currency and for what reasons.

The total volume of currency in circulation outside banks, as is shown in table 1, increased from $6.4 to about $26 billion from the end of 1939 to the end of 1951. Also shown in the table is a broad breakdown of currency ownership for the two dates as reported in the estimates of liquid asset holdings of individuals and businesses, published annually in the Federal Reserve Bulletin.

Since most of the increase in currency holdings is estimated to have occurred in personal holdings, this study will be confined to an explanation of this part of the increase. The other parts of the increase have been small and can be largely explained as needed for "current spending" or "transactions" purposes.

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TABLE 1.—*Estimated distribution of currency holdings outside banks, end of 1939 and 1951*

[In billions of dollars]

Holder	1951 [1]	1939
Total	26	6.4
Personal	20	4.2
Business	5	1.6
All other [2]	1	.6

[1] Preliminary.
[2] Includes foreign, all levels of Government, Government agencies, financial institutions other than banks, and nonprofit associations.

Changes in the personal need for currency for current spending or transactions purposes and as a form of liquid savings may be estimated by (1) projecting from 1939 to 1951 the relationship between currency and personal consumption expenditures; (2) similarly projecting the relationship of currency to estimated individual holdings of liquid assets; and (3) adding on an adjustment to take into account the shift in the distribution of personal incomes between these 2 years. This method of estimation is very crude and deals only with the broad aggregates of spending and saving. It makes no allowance either for changes in the payment practices of individuals and businesses or for changes in the velocity of currency use since 1939. It has been assumed that these factors remained constant over the period from 1939 to date.

An estimate of the personal currency need in 1939 and 1951 is shown in table 2. Personal currency holdings in 1939 amounted to $4.2 billion. For the purposes of an earlier staff study made at the Federal Reserve Board, this amount was divided into a fund for transactions purposes and a fund for savings on the assumption that most small denomination currency in circulation outside the banks ($20 and below) was used for transactions purposes.

The percentage relationship of the current spending or transactions fund to personal consumption expenditures as computed for 1939 was applied to personal consumption expenditures in 1951. As may be seen in table 2 this resulted in a threefold expansion of currency needed for current spending purposes in 1951.

TABLE 2.—*Rough estimates of personal currency needs, end of 1939 and 1951*

[In billions of dollars]

	1951	1939
Total personal currency holdings	20.0	4.2
Needed for current spending or transactions purposes on the assumption of a constant (1939) distribution of personal income [1]	6	2.0
Needed for savings [2]	8	2.2
Additional current spending and savings currency attributable to shift in distribution of personal income [3]	2	--------
Unexplained residual	4	--------

[1] 2.96 percent of personal consumption expenditures ($67.5 billion in 1939 and $205.5 billion in 1951).
[2] 4.88 percent of personal liquid asset holdings other than in trust funds ($45.1 billion in 1939 and an estimated $161.6 billion in 1951).
[3] The increased need for personal currency holdings in 1951 because of (1) a greater concentration of income among the lower-income groups in 1951 than in 1939; and (2) the fact that lower-income groups apparently hold more currency per dollar of liquid assets and income than the upper-income groups.

The estimated savings in currency was similarly estimated for 1951 by assuming the same relationship between estimated personal currency savings and personal liquid assets other than in trust funds in 1939. This resulted in nearly a fourfold increase of currency held by domestic savers.

Changes in the various denominations of currency in circulation since 1939 suggest that both current spending and savings requirements were important factors in the currency rise. The changes have been concentrated in the $20, $50, and $100 denominations as shown in table 3. The increase in $20 bills is presumably associated largely with the expansion in commercial transactions, but a significant portion of this increase may also have been saved or hoarded in

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recent years because of the practice of recording transactions in the larger bills. An increasing proportion of the $50 and $100 bills may now be used for transactions purposes because of the large rise in prices and incomes since 1939 and the tendency toward payments in larger denomination currency in some industries—for example, construction.

TABLE 3.—*Increase in currency in circulation by denomination, end of 1939 to end of 1951*

[Dollars in millions]

Denomination	Amount in circulation		Increase	
	End of 1951	End of 1939	Amount	Percent
Total	29,207	7,599	21,608	284
Coin	1,654	590	1,064	180
$1, $2, and $5 bills	3,369	1,614	1,755	109
$10 bills	6,329	1,772	4,557	257
$20 bills	9,177	1,576	7,601	482
$50 and $100 bills	7,751	1,379	6,372	462
Over $100 bills	927	668	259	39

NOTE.—The figures in this table differ from those in table 1 because of the inclusion of private bank vault cash.

In addition to these aggregative relationships there is an additional influence—the shift in the distribution of personal incomes since 1939—which may have exerted an influence toward a greater personal need for currency. The "Surveys of Consumer Finances," undertaken for the Federal Reserve Board by the University of Michigan's Survey Research Center, for instance, have brought to light the fact that lower income groups hold a higher proportion of their total assets in liquid form than do upper income groups.[1] Although the liquid asset figures reported in these surveys exclude currency holdings, it may be presumed that lower income groups, since they have relatively fewer bank accounts, also hold a higher proportion of their total assets in currency. A further point of general evidence is that lower income groups in postwar years have accounted for a somewhat larger proportion of total personal liquid assets, excluding currency, than they have of total personal income.

In order to estimate the amount of additional currency that might be needed as the result of the shift in the distribution of incomes from 1939 through 1951, 1939 personal currency holdings were recomputed to reflect the greater proportion of income held by the lower income groups in 1951. Since there is apparently a progressively larger percentage of currency to income held by each group moving down the income scale from the highest income recipients to the lowest, this meant that the amount of currency needed in the case of the 1951 distribution of income was about $2 billion more than that required for the 1939 distribution. It should be stressed that in view of the paucity of data in this area and the number of assumptions that had to be made, this estimate is extremely rough.

After these estimates for changes in the most important personal currency needs from 1939 to 1951 are made, an unexplained residual amount of $4 billion of individual currency holdings remains. It is very difficult to find a reasonable basis for allocating this residual as between transactions and savings purposes, and in addition some part of it represents currency lost or destroyed. The following are some of the factors which help to account for this residual:

Three factors would seem to indicate that a part of the residual could be accounted for by larger transactions requirements. In the first place, there has been considerably more labor mobility recently than was the case in 1939. Since the transfer of liquid assets is often conveniently accomplished by transitory workers by means of currency, we could expect some additional transactions need for currency, supplementary to those discussed above, as a result of such movements.

In the second place, the Armed Forces increased from less than 400,000 in 1939 to about 3.6 million by late 1951. Armed Forces personnel probably carry substan-

[1] See Federal Reserve Bulletin, 1950 Survey of Consumer Finances, December 1950, pp. 1591 ff.

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tially greater currency balances relative to their total liquid assets than the more permanently established population groups. This is partly because of the frequent lack of banking facilities in the vicinity of military installations and the high proportion of payments to military personnel in currency. The more or less temporary status of these personnel at any one location may also tend to make banking connections inconvenient. On balance, therefore, we might expect the comparatively large size of the war and postwar Armed Forces to be a contributory factor in the increase of circulating currency.

Finally, rising bank service charges may have been an influence tending toward the substitution of currency for payment by check, particularly by individuals who ordinarily maintain comparatively small, high-cost, demand-deposit balances.

Two other factors would tend to support the belief that savings or hoarding motives were also responsible for part of the residual increase of $4 billion in personal currency holdings. First, it is probably reasonable to assume that the comparatively high war and postwar tax level has had the effect of increasing the currency hoards of tax evaders. It is impossible at present to estimate the dollar magnitude of this motive, but it may account for substantial sums.

Second, an increase of foreign hoards could also have been responsible for a part of the residual. No adequate statistical data are available on movements of United States currency to and from the United States. Data for currency shipments between the United States and Europe have been reported by certain banks in New York City for a number of years, but not until recent months have figures been supplemented by reported shipments between other sections of the United States and the rest of the world. In addition, of course, it must be recognized that reported movements of currency, even assuming all bank shipments were known, represent only a portion of the total currency movement because of the currency that moves to and from abroad through the mails or with tourists, military personnel, and so forth.

Losses and destruction of currency are not believed to be of great significance in explaining the large volume of currency now in circulation. A clue to this is found in the amounts still reported as in circulation of certain types of currency which have not been issued for many years and which are canceled and retired when received from circulation.

Thus, the $41 million of the old large-size Federal Reserve notes reported as in circulation is 2.4 percent of the $1,693 million which was in circulation on June 30, 1929—the last month end before present small-size currency was first issued. Gold certificates now outstanding ($38 million) are 5.8 percent of the amount which was outstanding at the end of February 1933 ($649 million), the last month end before the issuance of gold certificates was discontinued. The $1.1 million of Treasury notes of 1890 still in circulation is only 0.7 percent of the $156 million which was outstanding in 1893, when their issuance was discontinued. The $2.1 million of old large-size Federal Reserve bank notes in circulation is 1.0 percent of the largest amount of this issue which was in circulation in 1920.

Large-size Federal Reserve notes and gold certificates are still being redeemed in significant amounts, the former at a rate of about a million dollars a year and the latter at a rate of about $2 million. However, the amount of Treasury notes of 1890 in circulation is now declining very slowly, only $2,300 of such notes having been retired since June 1947. Only $31,300 of the large-size Federal Reserve bank notes have been retired during the past 6 years.

It may be presumed that most of the outstanding amounts of these types of currency that are being retired when received from circulation have been lost, destroyed, or are held by collectors. So many factors enter the picture, such as the denominations involved, the times and circumstances under which the notes were issued, and so forth, however, that any estimate of the amount of the total volume of currency in circulation which has been lost or destroyed can be only an informed guess. The amount might be around half a billion dollars, but is probably less.

In conclusion, it should again be emphasized that this study regarding the amount of currency in circulation does not represent considered conclusions based on adequate statistical data. It reflects rather speculations on the basis of certain assumptions and some statistics. It is submitted in response to a request for such comments in the hope that it may be of some interest. It may also suggest other assumptions and other approaches that might be made in attempting to answer the question as to how much the circulation figures may overstate the amount that is actually used in the business of the Nation.

(Board of Governors of the Federal Reserve System, April 11, 1952.)

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12. NUMBER OF MOTOR VEHICLES OPERATED BY THE BOARD OF GOVERNORS AND THE FEDERAL RESERVE BANKS AND BRANCHES, AND THE TYPES OF LICENSE PLATES CARRIED

BOARD OF GOVERNORS

The Board of Governors operates five motor vehicles. All of these vehicles carry United States Government license plates only, which are issued by the District of Columbia at no charge.

FEDERAL RESERVE BANKS AND BRANCHES

The 36 Federal Reserve banks and branches operate a total of 156 motor vehicles. None of these vehicles carry United States Government license plates. All such vehicles, except one, bear State license plates. A truck used for transporting mail between the Oklahoma City branch of the Kansas City Reserve Bank and the local post office, a distance of less than 100 yards, does not have license plates.

License plates for 60 of the vehicles included in the above total are issued without charge.

State license plates for the remaining 95 vehicles are paid for, and in addition 38 carry city license plates and another 5 carry both county and city license plates, which are also paid for.

Attached is a tabulation showing by offices the number of vehicles and type of license plates carried.

Number of motor vehicles operated by Federal Reserve banks; type of license plate; and whether tags are paid for or received gratuitously

	Number of motor vehicles	Type of license plate	How obtained?
Boston	6	State	Paid for.
New York	14	do	Gratuitous, by State.
Buffalo	2	do	Do.
Philadelphia	9	do	Do.
Cleveland	10	do	Do.
Cincinnati	4	do	Do.
Pittsburgh	6	do	Do.
Richmond	8	State and city	Paid for.
Baltimore	2	State	Do.
Charlotte	2	State and city	Do.
Atlanta	8	State	Do.
Birmingham	2	do	Do.
Jacksonville	2	do	Do.
Nashville	2	do	Do.
New Orleans	3	do	Do.
Chicago	6	State and city	Do.
Detroit	2	State	Do.
St. Louis	16	State and city	Do.
Little Rock	3	do	Do.
Louisville	2	State	Do.
Memphis	5	State, county and city	Do.
Minneapolis	3	State	Do.
Helena	1	do	Gratuitous, by State.
Kansas City	3	State and city	Paid for.
Denver	1	State	Do.
Oklahoma City	2	[1] do	Do.
Omaha	None		
Dallas	3	State	Do.
El Paso	1	do	Do.
Houston	1	do	Do.
San Antonio	1	do	Do.
San Francisco	8	do	Gratuitous, by State.
Los Angeles	6	do	Do.
Portland	3	do	Paid for.
Salt Lake City	5	do	Do.
Seattle	4	do	Do.
Total	156		

[1] For 1 vehicle; no license plates issued for the other vehicle.

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13. Tax Status of Board of Governors of the Federal Reserve System and Federal Reserve Banks

Because of the different character of the Board of Governors of the Federal Reserve System and the Federal Reserve banks, the tax status of each is outlined separately below.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

The tax status of the Board of Governors of the Federal Reserve System is essentially the same as that of any other agency of the United States Government.

Federal taxes.—Since the enactment of the Revenue Act of 1943, Government agencies, including the Board of Governors of the Federal Reserve System, have in general paid Federal excise taxes except to the extent that the Secretary of the Treasury has authorized certain exemptions. Accordingly, the Board of Governors, like other United States Government agencies, pays Federal excise taxes on its purchase of such items as automobiles, tires and tubes, tpyewriters, miscellaneous office devices, etc. Like other Government agencies, it does not pay Federal tax on communications or on the transportation of persons or property.

State (District of Columbia) taxes.—With respect to State (District of Columbia) taxes, the Board of Governors has the general tax immunity that applies to other agencies of the United States Government. For this reason it is exempt from the District of Columbia gasoline and motor oil tax, sales tax, personal-property tax, and real-estate tax. Like other United States Government agencies, the Board is not assessed for the District of Columbia personal-property tax on its automobiles. They are registered "United States Government—Board of Governors of the Federal Reserve System," and United States Government license tags are furnished without charge by the District of Columbia Department of Vehicles and Traffic.

FEDERAL RESERVE BANKS

The tax status of the Federal Reserve bank is governed by the third paragraph of section 7 of the Federal Reserve Act (U. S. C., title 12, sec. 531), which provides that—

"Federal Reserve banks, including the capital stock and surplus therein, and the income derived therefrom, shall be exempt from Federal, State, and local taxation, except taxes upon real estate."

This provision is similar to those applicable to a number of other corporations which are chartered under Federal law. The operation of such an exemption depends upon the nature of the levy in question. It exempts from excise taxes only when the legal incidence of the tax would otherwise fall upon the particular corporation.

Federal taxes.—With respect to Federal excise taxes, the operation of this exemption, and of similar exemptions that apply to certain other federally chartered corporations, is explained in the ruling of the Bureau of Internal Revenue (M. T. 21) published in the Internal Revenue Bulletin at 1944 C. B. 594. This ruling states generally that the legal incidence of Federal retailers' or manufacturers' excise taxes falls upon the retailer or manufacturer of the article rather than upon the purchaser. Accordingly, the Federal Reserve banks, and other corporations with exemptions like that quoted above, are not exempted from the tax in their purchases of these articles. On the other hand, the Federal excise taxes on communications and on the transportation of persons or property are considered to be imposed upon the persons purchasing such communications or transportation. Therefore, a Federal Reserve bank, or other corporation having an exemption like that quoted above, is exempt from such communications or transportation taxes.

State taxes.—As indicated in the provision of section 7 of the Federal Reserve Act quoted above, the Federal Reserve banks pay State and local taxes upon real estate. Other State and local taxes vary widely both in their nature and their incidence. As a general proposition, Federal Reserve banks are exempt from State or local excise taxes which would have their legal incidence upon the Reserve bank. On the other hand, the Reserve banks do not get a tax exemption when the incidence of the tax would fall elsewhere.

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14. Applicability of State or Local Retail Sales or Excise Taxes to Luncheon Facilities, Snack Bars, Canteens, Etc., Operated at Board of Governors and Federal Reserve Banks

BOARD OF GOVERNORS

Sales of meals through the luncheon and snack bar facilities operated by the Board of Governors have been ruled exempt from the District of Columbia sales tax on food and beverages.

FEDERAL RESERVE BANKS AND BRANCHES

No applicable State or local retail sales or excise taxes are in effect at the following Reserve bank and branch locations: Philadelphia, Pittsburgh, Richmond, Louisville, Minneapolis, Helena, Omaha, Dallas, El Paso, Houston, San Antonio, and Portland.

At the following Reserve bank and branch locations there are such taxes, but either no sales are made by the Federal Reserve or they are exempted for reasons (such as, for example, the fact that they are below minimum amount or are made only to employees) that are unrelated to the special Federal status of the Reserve banks: Buffalo, Baltimore, Jacksonville, St. Louis, Kansas City, Denver, San Francisco, and Los Angeles.

The Federal Reserve offices at Boston, New York, Chicago, and Detroit operate their luncheon facilities under the exemption provision of section 7 of the Federal Reserve Act.

Applicable taxes are collected and remitted by the following Federal Reserve offices: Charlotte, Atlanta, Birmingham, New Orleans, Oklahoma City, Salt Lake City, and Seattle.

Applicable taxes are collected and remitted by concessionaire or employee groups operating luncheon facilities at Cleveland, Cincinnati, Nashville, Little Rock, and Memphis. (At all Federal Reserve banks and branches where vending machines or other outlets are operated by concessionaire or by employee groups, applicable taxes are collected and remitted.)

15. Reimbursable Fiscal Agency Expenses of the Federal Reserve Banks, Year 1950

Incurred for the account of:

Treasury Department		$12,975,640
Reimbursable expenses incurred in 1950 for the account of the Treasury were reported to the Board in total only. However, other collateral information indicates that the distribution of these expenses is approximately as follows:		
Public debt	$12,090,000	
Federal taxes	850,000	
All other	35,000	
Others:		
Commodity Credit Corporation	761,987	
Reconstruction Finance Corporation	411,146	
V-loan prorgam	33,397	
International bank for reconstruction and development	17,770	
Alien property custodian	17,625	
Housing and Home Finance Agency	9,439	
Federal intermediate credit banks	8,250	
Federal land banks	5,219	
General Services Administration	1,742	
War Department	1,609	
Miscellaneous	7,873	
		1,276,057
Total		14,251,697

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FINANCIAL RESPONSIBILITY OF MEMBER BANKS ON ACCOUNT OF MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington 25, D. C., April 18, 1952.

Dr. HENRY C. MURPHY,
Economist for the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, United States Capitol, Washington 25, D. C.

DEAR HENRY: Our attention has been called to the fact that during the hearings before your subcommittee on March 17, 1952 [during the testimony of Mr. Hemingway], question was raised as to whether a member bank has any financial responsibility or obligation as a member of the System other than the possibility that it may be required to pay in the balance of its subscription to Federal Reserve bank stock.

In this connection, it should be noted that member banks do have a financial responsibility which was not mentioned during the hearings. Under the fourth paragraph of section 2 of the Federal Reserve Act, each shareholding member bank is individually responsible for all contracts, debts, and engagements of the Federal Reserve bank to the extent of the amount of its subscription to Federal Reserve bank stock at the par value thereof in addition to the amount subscribed, whether or not its subscription has been paid up in whole or in part.

You may wish to consider inserting this statement at some point in the record or in the appendix thereto.

Sincerely,

RALPH YOUNG,
Director, Division of Research and Statistics.

LETTER RECEIVED FROM ALLAN SPROUL, PRESIDENT OF THE FEDERAL RESERVE BANK OF NEW YORK, ON THE INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM

FEDERAL RESERVE BANK OF NEW YORK,
New York, N. Y., April 22, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, House of Representatives, Washington, D. C.

DEAR MR. PATMAN: In the course of the recent hearings of your committee there were certain recurring questions which were never definitely answered, so far as I know, and which perhaps cannot be definitely answered. Nevertheless, the fact that they were not answered or, perhaps, cannot be answered definitively and categorically, should not be taken to mean that they contain proof of argument by default of opposition.

I have in mind such questions as the following, which may not have been asked in exactly this form but contained this substance:

Is not the argument for an "independent" Federal Reserve System, a denial of our democratic ability to function properly through the legislative and executive branches of the Government?

Why should monetary policy be treated differently from, say, foreign policy or defense policy, in terms of the administrative arrangements and relations with Congress and the executive?

Hasn't the trend in all other countries been to "nationalize" the central banks, where they were not already "nationalized" and to make them directly responsible to the "government" through the "Treasury"?

Does not the growing interest of governments in economic affairs, and their growing participation in such affairs make this trend logical and necessary?

These are questions which compel thought and analysis, even though one may feel, as I do, that the right answer does not follow the lead of the questioning.

In the first place, I think it should be continuously borne in mind that whenever stress is placed upon the need for the independence of the Federal Reserve System it does not mean independence from the Government but independence within the Government. In performing its major task—the administration of monetary policy—the Federal Reserve System is an agency of the Congress

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set up in a special form to bear the responsibility for that particular task which constitutionally belongs to the legislative branch of the Government.

It is in no sense a denial of our democratic form of government to have the Reserve System set up the way it is. It is rather an expression of the ability of our democratic powers to meet new or changing conditions. The Congress, as the sovereign power in this area, has developed a special means of performing a function with respect to which it has final authority, but which it cannot administer from day to day. The Congress has, of necessity, had to delegate some segments of its power to agencies of its own creation which, in turn, are responsible to it. The Federal Reserve System as one of these agencies attempts, as does the Congress itself, to maintain close relations with the executive branch of the Government, for the purpose of achieving a coherent and generally unified economic program. But that does not mean that physical merger of the Congress or its agencies with the executive branch of the Government is necessary or desirable.

It really takes us little way along the road to understanding to ask why monetary policy should be treated differently from foreign policy or defense policy in terms of administrative arrangements. The form of the question implies that here are matters (defense policy and foreign policy) of greater importance to the country than monetary policy which are administered by the executive branch of the Government, through the State Department and the Defense Department, and not by an independent agency. No one, of course, would want to enter into a footless argument about the relative importance of policy in these areas to the citizens of the country—they are all of vital importance. It may suggest a difference between them, however, to remember that the Federal Reserve is trying to help guide, regulate, and to some extent control the functioning of the private economy, and primarily the domestic economy, whereas foreign policy and military policy, while they affect our private and domestic affairs, deal largely with our relations with other countries and governments. It is in the general area of regulation of domestic economic affairs that the Congress has found repeated use for independent agencies.

The underlying question is whether it is better to have the legislative branch in full and final control of the purse and the money of the country, directly and through an agency responsible to it, or whether these matters should be turned over to the executive branch for administration along with most other governmental affairs. The Constitution, insofar as its language may be applied to present-day conditions, leaves this matter with the Congress. Wisdom and experience support this early separation of powers. Over the years and within our constitutional framework, the people have preferred to keep all aspects of the money power as the prerogative of their duly elected representatives in the Congress. The temptation to tamper with money for temporary gain or narrow purpose is always present, and particularly in times of economic stress. The power to do so should be kept where it can be most readily observed and its abuse most quickly punished. That place is not under the protective wing of the Chief Executive or hidden in one of the big departments of the executive branch of the Government.

It may be instructive in this regard to compare the role of Congress with respect to debt management with its role in relation to monetary policy during the past three or four decades. It is significant, I think, that Congress, at frequent intervals, has conducted comprehensive and useful inquiries into the conduct of monetary policy by the Federal Reserve System. It has not made similar inquiries into debt management; even during the investigations of this committee, which have been most far reaching, debt management has been considered only in its broadest aspects and, essentially, only when it had become intertwined with credit policy. Yet debt management is a concern of the Congress, particularly under present-day conditions. To be sure there are specific acts of Congress which authorize whatever is done in the name of debt management, but the economic ramifications of the decisions taken with such legal authority are generally unobserved or unexamined. There seems to have been a gradual and more or less tacit acceptance of the assumption that debt management is a function of the executive branch of Government with which Congress need not concern itself once it has passed the enabling legislation. That is what might happen to monetary policy if it became imbedded in the executive branch of the Government. That would, I think, be a disservice to the country. The inquiry of this committee, and other congressional investigations which have preceded it, would seem to provide a clear-cut demonstration of the contributions which can be made to the Nation's economic welfare by arrangements which lead the Congress to appraise performance of its own agent from time to time.

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The particular forms and administrative arrangements which have worked in foreign countries for the administration of monetary policy are not a usable guide for us. In most such countries, of similar economic maturity and with similar economic systems, the "government" comprises both the executive and legislative branches in one responsible body or parliament. The executive must explain and justify policy from day to day, and is exposed to legislative questioning and the possibility of legislative repudiation without the protection of a fixed term of office. The trend of relationship in such countries between governments and central banks has been a process of evolution. No matter what their beginnings the central banks have evolved as "public" institutions. Changes from private ownership to public ownership, where they have occurred, have quite often confirmed what had already happened. They have been changes of form rather than of substance and have usually tended to perpetuate some independence (as I would define independence) for the central bank rather than to snuff it out.

It is more useful, as a guide, for us to observe that in most of these countries, and certainly in the economically more mature countries, central banking is regarded as a field requiring special technical competence and continuity of management rather than complete subordination to the government of the day. The head of the central bank in these countries is not brought directly into the government and does not necessarily change with changes in the government. The central bank is still a place where views on economic matters and monetary policy can be independently developed and candidly put forward no matter what the precise relations to the government may be. It is chiefly in the countries which are less advanced economically, where monetary policy is likely to be less developed, and where the central bank is primarily the fiscal agent of the government, that central bankers are political appointees responsible to and changing with each new executive.

I come back to the conclusion that neither our form of government nor the experience of foreign countries require or recommend the placing of the Federal Reserve System in the executive branch of the Government. It is the pursuit of a doubtful logic and of neatness in administrative chart making which suggests this solution of our problem. The fact that there have been unfortunate differences of opinion between the Treasury and the Federal Reserve during recent years does not require the Congress to abandon its agent to the executive branch in order to bring about a better coordination of powers. It has already been pointed out that Congress, through its specialized committees, reviews from time to time the manner in which the powers it has delegated to the Federal Reserve System are exercised. If, in the course of such reviews, the Congress finds that relationships between its delegated agent and the executive branch of the Government are not what it wishes to be it has remedies at hand. It can define more fully and more clearly what it expects these relationships to be, an approach which recommended itself to the Douglas subcommittee of the Joint Committee on the Economic Report when it reviewed the problem.

On the basis of my experience which now comprises over 30 years in the Federal Reserve System at two Federal Reserve banks, and attempting to make allowance for the bias which such long association can foster, I believe that the Federal Reserve System is an expression of an adaptable creative government. The System is by no means perfect; it needs improvement. But it can provide a competent mechanism, and a continuity of able personnel, which will enable us to cope with the day-to-day intricacies of monetary policy, while remaining responsive to the general economic purposes of the Government. The inquiry of your committee, and the congressional investigations which have preceded it, provide a demonstration, I believe, of the advantages of continuing the existing direct relationship of the Federal Reserve System to the Congress, which causes the Congress to undertake periodic comprehensive appraisals of System performance.

If there is still time and if you think it would serve a useful purpose, I would like to have this statement added to my testimony before the committee.

Yours faithfully,

ALLAN SPROUL, *President.*

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CORRESPONDENCE WITH THE COMPTROLLER GENERAL CONCERNING GOVERNMENTAL AGENCIES NOT AUDITED BY THE GENERAL ACCOUNTING OFFICE AND THE REASONS THEREFOR

MARCH 13, 1952.

Hon. LINDSAY C. WARREN,
Comptroller General of the United States,
Washington, D. C.

DEAR MR. WARREN: I should appreciate it very much if you would furnish me with a list of the agencies of the Government that are not now subject to audit by your office. In each case would you indicate whether or not you believe that the agency should be audited by your office, and, if so, the type of audit to which it should be subjected, stating the principal reasons for your belief on each point.

I should also appreciate it if you would furnish me with your definition of the phrase "independent agency of Congress." I feel that you are especially qualified to define this phrase as your own agency constitutes perhaps the most indisputable case in point.

I am asking for this material on behalf of the Subcommittee on General Credit Control and Debt Management, of which I am chairman. This subcommittee expects to close the hearings which it is now conducting about the end of March, and I should appreciate it if we could have your reply in time to insert it in our record while the hearings are still continuing.

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, April 28, 1952.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on General Credit Control and Debt Management, Joint Committee on the Economic Report.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter of March 13, 1952, acknowledged by telephone, requesting among other things, a list of the agencies of the Government which are not now subject to audit by the General Accounting Office.

In response to your request, I wish to advise that in the case of the following governmental agencies and activities the law either does not require an audit by the General Accounting Office or is not adequate to permit an effective audit by the Office.

1. Federal Reserve System.
2. Comptroller of the Currency.
3. The Gold Reserve Act (The Stabilization Fund).
4. Bureau of Internal Revenue (tax-collection matters).
5. Office of Alien Property.
6. National Academy of Sciences.
7. Smithsonian Institution (certain trust-fund accounts).
8. Various activities carried on with nonappropriated funds.

In order to more fully acquaint you with the background of the agencies and activities listed above, a brief statement with respect to each of them is furnished for your information.

1. Federal Reserve System

The Board of Governors of the Federal Reserve System is authorized by law (12 U. S. C. 243) to levy assessments against Federal Reserve banks to pay the expenses of the Board. The Board is authorized to determine and prescribe the manner in which its obligations shall be incurred and its expenses allowed and paid. Further, it specifically is provided (12 U. S. C. 244) that funds derived from the assessments against Federal Reserve banks to defray the expenses of the Board "shall not be construed to be Government funds or appropriated moneys."

In view of the broad authority conferred upon the Board to determine and prescribe the manner of incurring obligations and to pay its expenses and the fact that funds used to defray the expenses of the Board are not Government funds or appropriated moneys, together with the rule, as set out in 12 U. S. C. 484 that no bank is subject to any visitorial powers other than authorized by law, or vested in the courts, or as shall be exercised or directed by the Congress or by either House thereof or by any committee of Congress or of either House

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duly authorized, it is my opinion that the General Accounting Office would be unable to undertake an audit of the activities of the Board and the Federal Reserve banks without specific authority of the Congress.

2. Comptroller of the Currency

The Comptroller of the Currency is the chief officer in the bureau established within the Treasury Department which bureau is charged with the execution of all laws relating to the issue and regulation of a national currency secured by United States bonds, and, under the general supervision of the Board of Governors of the Federal Reserve System, of all Federal Reserve notes. The Comptroller of the Currency performs his duties under the general directions of the Secretary of the Treasury. (12 U. S. C. 1). His most important current duties relate to the organization, operation, and liquidation of national banks.

The expenses of the Office of the Comptroller of the Currency, aside from his annual salary as fixed by law, are paid from assessments levied against member banks and affiliates of the Federal Reserve System. With respect to funds derived from such assessments, it specifically is provided (12 U. S. C. 481) that they shall not be construed to be Government funds or appropriated moneys—language identical to that used to describe the funds obtained by assessment upon Federal Reserve banks to defray the expenses of the Board of Governors of the Federal Reserve System. As a consequence, what was stated above with respect to the audit jurisdiction of the General Accounting Office over the Board of Governors of the Federal Reserve System and Federal Reserve banks likewise is applicable to the functions of the Comptroller of the Currency.

3. Gold Reserve Act of 1934 (the stabilization fund) (48 Stat. 337; 341, as amended)

Under section 10 of the referred-to act there were appropriated funds to be deposited with the Treasurer of the United States in a stabilization fund for the purpose of stabilizing the exchange value of the dollar. It is further provided in that section, as now amended, that "An anual audit of such fund shall be made and a report thereof submitted to the President and to the Congress."

The legislative history of the 1934 statute discloses that the Congress gave thorough consideration to the matter of the audit of such fund and determined that, in recognition of the purposes for which the fund was designed, and in order that every precaution should be taken to maintain absolute secrecy, an annual audit by the Secretary of the Treasury was desirable. Accordingly, it clearly appears that an audit of the stabilization fund by the General Accounting Office is neither authorized nor required under existing legislation.

4. Bureau of Internal Revenue (tax-collection matters)

While an adequate audit of administrative expenditures of the Bureau of Internal Revenue can be made under existing law, no effective audit of tax collections, refunds, abatements, etc., is possible in view of the provisions of section 55 of the Internal Revenue Code and the regulations issued thereunder which, except in rare instances and under a cumbersome and impracticable procedure, deny access to tax returns. Not only has the General Accounting Office been denied access to tax returns but also to basic documents pertaining to the disposition of tax indebtedness through compromise, abatement, and write-off of uncollectible taxes. To evaluate properly the tax collections and refunds, rebates, etc., it is necessary to have access to the tax returns. However, in view of the provisions of section 55 of the Internal Revenue Code mentioned above, the Office now is without authority to examine such returns, and, as a consequence, an effective audit of those collections, refunds, etc., is precluded.

5. Office of Alien Property

The Office of Alien Property, in the Department of Justice, is under the jurisdiction of the Attorney General. Necessary expenses incurred in carrying out the powers and duties conferred upon the Attorney General pursuant to the Trading With the Enemy Act of October 6, 1917, as amended (50 U. S. C., app. 6), are authorized to be paid out of any funds or other property or interest vested in him pursuant to that act. Annual reports to the Congress as to the expenses incurred and the activities carried on by the Office are required by statute.

In view of the fact that activities of the Office are carried on with non-appropriated funds together with the reporting requirements mentioned above, it has been considered that the Offie of Alien Property is exempt from any duty to account to the General Accounting Office with respect to its fiscal transactions.

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6. National Academy of Sciences

The National Academy of Sciences was incorporated by the act of March 3, 1863 (12 Stat. 806, 36 U. S. C. 251), to "investigate, examine, experiment, and report upon any subject of science or art," when called upon by any department. The incorporating act further provides that the actual expense of such investigations, examinations, experiments, and reports shall be paid from appropriations which may be made for the purpose, but that the Academy shall receive no compensation whatever for any services to the Government of the United States. No Government funds are appropriated to the Academy.

Considering the quasi-governmental character of the Academy and the fact that no appropriated funds are used to carry on its duties, no audit of its transactions has been undertaken by the General Accounting Office.

7. Smithsonian Institution (trust funds)

The Institution was created by act of Congress approved August 10, 1846, to carry out the terms of the will of James Smithson, to create an establishment "for the increase and diffusion of knowledge among men." Besides the original Smithson endownment, the Institution holds and administers a number of different special funds for the prosecution of scientific researches or for other purposes stipulated by their donors.

The administrative expenses of the Institution are paid from appropriated funds and are audited by the General Accounting Office. However, the trust funds mentioned above are deposited with the Treasurer of the United States and checks are drawn by the Institution against such deposits. The Institution is required by law to submit to the Congress, at each session thereof, a report of the operations, expenditures, and condition of the Institution.

In view of the character of the funds comprising the trust funds and the statutory reporting requirements, no audit of such trust funds has been undertaken by the Office.

8. Various activities carried on with nonappropriated funds

As you doubtless are aware, there are many activities carried on by Government agencies, particularly the Military and Naval Establishments, which are not subject to audit by the General Accounting Office. These activities include, among others, the operation of post exchanges, restaurants, concessions, canteens, welfare activities, vending-machine operations, etc.

Ovor the years, such revenue-producing activities have grown to the status of big business. Existing legislation is inadequate to bring all such activities within the reach of an effective audit by the Office. The entire subject matter of the inadequacy of present-day controls over such revenue-producing activities has been brought to the attention of the Congress on many occasions and, while the matter is merely mentioned here in a general way, a complete disclosure of this entire picture was contained in the Comptroller General's report to the Congress under date of August 10, 1949, a copy of which is attached.

The foregoing information deals only with agencies and activities which are not considered as being subject to the audit jurisdiction of the General Accounting Office. However, there is a correlative matter to which it is deemed appropriate to invite your attention. This concerns the numerous situations in which the Congress has seen fit to grant to administrative agencies the authority to make determinations which are final and conclusive upon the accounting officers of the Government. Obviously such powers severely restrict the effectiveness of the audit of the transactions involved. In such cases, objectionable administrative practices and decisions can be brought to light only through the medium of reports thereon to the Congress. And while such course of action has a deterring effect upon administrative officials, it cannot be denied that in such cases much of the effectiveness of the audit is lost. On the many occasions upon which the Comptroller General and I have had the privilege of addressing committees of the Congress on this matter and in numerous reports to the Congress, we have stressed the weakness of control exercised in such situations, and reiterated our firm belief that there should be an outside, nonpolitical, independent check on the activities of every agency of the Government. For your information, there is transmitted herewith a copy of the Comptroller General's statement before the Joint Committee on Reduction of Nonessential Federal Expenditures on September 26. 1951.

In your letter you also requested to be advised whether or not it is believed that the agencies not now subject to the audit of the office should be so subject and, if so, the type of audit to which they should be subjected. In that connec-

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tion the following observations are made with respect to some of the more important agencies listed above.

The question as to whether the Board of Governors of the Federal Reserve System and the Federal Reserve banks should be made subject to audit by the General Accounting Office was discussed at the time of enactment of the Government Corporation Control Act of 1945, (31 U. S. C. 841) but it was determined that they should be excluded from the audit provisions of that act since a strong control was exercised over the banks through the Board and all of the stock of the banks was owned by member banks. There has occurred nothing since that time which would require any different view. However, should the Congress decide that such an audit should be undertaken, it is thought that language similar to that contained in section 17 of the Federal Deposit Insurance Act, as amended (12 U. S. C. 1827), would be sufficient for such purposes. The referred-to language requires an annual audit of the financial transactions of the Federal Deposit Insurance Corporation in accordance with the principles and procedures applicable to commercial corporate transactions. Also, there could be considered legislation along the lines of section 4 of the act of June 27, 1950 (12 U. S. C. 1431), requiring audits by the General Accounting Office of the financial transactions of the Federal home-loan banks under the Government Corporation Control Act, notwithstanding a withdrawal of Government capital from the banks.

With respect to the Bureau of Internal Revenue tax matters, I strongly urge that such matters be brought within the scope of the audit jurisdiction of the General Accounting Office. I believe that an independent check upon the disposition of tax matters would be a potent deterrent to improper or unlawful administrative practices within the Bureau. However, at this time, should authority be given the Office to have free access to tax returns, it is not believed that a complete audit of all current collections, refunds, etc., of the Bureau, would be necessary. Rather, I feel that if tax returns were made available there could be made a general audit, on a selective and spot-audit basis, which would serve the desired purpose. As a result of selective audit, backed by detailed examination where found necessary, comprehensive reports could be rendered to the Bureau, the President, and the Congress where considered necessary.

Respecting the various activities carried on with nonappropriated funds, such as post exchanges, canteens, concessions, etc., discussed above, the Comptroller General consistently has urged that legislation be enacted to specifically bring them within the audit jurisdiction of the General Accounting Office. Large sums of money officially received by representatives of the Government are being withheld from the Treasury in a manner giving rise to serious doubt as to the legality of such withholding. The moneys are diverted to purposes which are not specifically authorized by law, and no adequate check or accounting control is maintained of the receipt, custody, or disbursement thereof. In view of the varied characteristics of the numerous revenue-producing activities comprising this group, no over-all statement of audit policy is attempted at this time. However, there are perceived no particular difficulties which may arise in formulating an adequate audit procedure for such activities.

As to the Office of Alien Property, you are advised that, considering the source of funds used to defray its expenses and the specific reporting requirements mentioned before, it is my opinion that specific legislation is needed to permit the General Accounting Office to audit its transactions. If Congress is disposed to provide such statutory authority, it is suggested that there be prescribed the commercial-type audit now authorized in the case of Government corporations.

While administrative expenses of the Smithsonian Institution are audited by the General Accounting Office, it may be stated with respect to the trust funds under the control of the Institution that, considering the private nature of the sources of such funds and the reporting requirements imposed upon the Institution with respect to its activities, no compelling need for enlarging the scope of the audit coverage is seen at this time. Likewise, since the National Academy of Sciences has no appropriated funds and is reimbursed on an actual-cost basis for all work performed for Government agencies, an audit thereof by the Office is not considered necessary, at least not at present, since available manpower must be concentrated upon the audit of defense activities and the larger departments and agencies of the Government.

With respect to the further request in your letter that you be furnished with a definition of the phrase "independent agency of Congress," I have to advise that no precise definition of the quoted phrase is known to me. The General Accounting Office, by statute, is an agency of the Congress, and, as such, is in the legislative branch of the Government. Used in that sense, it might be

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said that the Office is an "independent agency of Congress." The phrase "independent agency" often is used to denote agencies in the executive branch of the Government which have been established independently of any direct control of the "executive departments," which latter phrase technically is applicable only to those departments enumerated in 5 U. S. C. 1. I am unaware of any agency in the executive branch of the Government to which the term "independent agency of Congress" properly might be applied, although there are agencies in the executive branch to which functions have been directly delegated by the Congress.

I trust that the foregoing will serve the purposes of your inquiry.

Sincerely yours,

FRANK L. YATES,
Acting Comptroller General of the United States.

(The enclosures with this letter are not here reprinted because they do not pertain to agencies performing the functions of credit control or debt management.)

EDITORIAL IN THE NEW YORK JOURNAL OF COMMERCE, MARCH 25, 1952, CONCERNING THE TESTIMONY OF PROFESSOR SEYMOUR HARRIS; PROFESSOR HARRIS' ANSWER THERETO, PRINTED IN THE JOURNAL ON APRIL 22, 1952, AND A REJOINDER BY THE EDITOR OF THE JOURNAL

[Editorial, New York Journal of Commerce, March 25, 1952]

INFLATION UNLIMITED

Inflation is a good thing!

The best and surest way to secure desirable inflation is to monetize the public debt!

We should be worrying about how to increase the money supply of the Nation by $360 billion over the next 25 years, instead of how to curb inflationary monetary expansion!

These statements, dear readers, are not culled for your amusement from a latter-day Alice in Wonderland. They are not quoted from the talk of a post-prandial cynical humorist. They are not the statements of a neo-Populist political rabble rouser.

Rather, they are the essence of the testimony of a professor of economics of Harvard University before the Patman subcommittee of the Joint Congressional Committee on the Economic Report. These ideas were advanced with deadly seriousness by Prof. Seymour E. Harris in his appearance before that subcommittee in Washington last week.

* * *

Professor Harris' unorthodox views cannot be lightly dismissed as mere academic theorizing.

We know that this type of thinking did play a dominant role in administration policies over much of the past two decades. At the moment, with the economy straining leash because of the stimulus of rearmament, it is distinctly a minority viewpoint. With any material business recession, however, who can doubt that there will be widespread support again for deliberate inflation as a national policy and as a way of life?

Then the program of unlimited inflation which Professor Harris urges with so much enthusiasm and assurance could again become the platform of powerful economic and political groups.

It is not enough, therefore, to laugh at the Harris plan for a perpetual merry-go-round of inflation to keep our people happy. His arguments must be met and answered squarely, if inflation is not to become a permanent fixture of American economic policy.

* * *

One basic argument against inflation is that it leads inevitably to drastic Government controls over the economy, and so to the end of the free enterprise system.

Professor Harris unintentionally said as much in his testimony.

"The postwar and pre-Korean inflation, which was 1½ times that of the war inflation," he testified, "may be associated with the premature freeing of markets

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before the economy had an opportunity to grow up to the increased monetary supplies and not primarily with monetary policy or conflict between the Reserve authority and the Treasury."

Dr. Harris thus wanted us to retain the rigid price, rationing, and other controls of World War II until we had "grown up to" the increased money supply. But since the money supply was tripled during the war years, we would have had to keep controls clamped on the economy until production had approximately tripled. This could be done, perhaps, in a generation or so, but hardly with the economy shackled by all these controls.

As ordinary mortals who are not Harvard professors would be quick to point out, all these controls could have been avoided if we had not tripled the money supply during the war years. It was inflation of the money supply, not removal of controls, that prevented the swollen money supply from doing its work, which was at the root cause of inflation, the man in the street has always assumed.

* * *

Inflation robs the thrifty of much of the fruits of their savings. It confiscates part of the income and wealth of those who live on fixed incomes. It puts at a grave disadvantage that very large part of the population that does not possess the protection of escalator clauses of one kind or another.

After a decade of experience with this economic disease, the rank and file of the American people want to check its ravages.

That does not mean that they want to go back to the depression of the 1930's. It does not signify that they want deflation, which is another economic disease that can be just as bad or worse.

A dollar of reasonably stable purchasing power, such as we have enjoyed over considerable periods of our history when the economy has not been distorted by war or postwar adjustments, is quite consistent with economic growth and prosperity. It is consistent with a moderate rate of expansion of the money supply to keep pace with the growth of a dynamic economy.

But we cannot possibly achieve stability for the dollar's purchasing power if monetary policy is designed to blow up the money supply from the present $180 billion to a $540 billion level by 1976, as Professor Harris would have us do.

[New York Journal of Commerce, April 22, 1952]

HARRIS SEES PUBLIC DEBT MONETIZATION AS ECONOMIC NECESSITY

EDITOR, JOURNAL OF COMMERCE: In your March 25 issue, you presented an editorial (Inflation Unlimited) on my testimony before the Patman committee.

I am indeed surprised that such a distinguished journal should give so distorted an interpretation of what I said. I hope that you will give this letter as much prominence of your editorial. I am particularly annoyed at the inflationary interpretation of my testimony, since in the last 12 years I have consistently fought against inflation.

NOT SEEKING INFLATION

You assume that because I envisage large additional monetary requirements in the next 30 years I am therefore seeking inflation. Nothing could be further from the truth.

Here is the theme that I tried to develop both in my statement to the Joint Congressional Committee on the Economic Report and in my discussion, particularly with Senator Paul Douglas:

1. It is too readily assumed that monetization of the debt is an evil. Both looking backward and forward, I conclude that monetization of the debt is a necessary condition for providing the economy with required supplies of money. Incidentally, financial writers tend to get immersed in the current events and do not put current developments (e. g., the rise in monetary supplies) in their historical perspective.

2. A great mobilization is bound to bring some inflation. The pressure on resources and speculative anticipations raise prices before corrective action can be taken. The inflation is the price that has to be paid to induce increased output and reallocation of resources. But this inflation should be kept down to a minimum. As a matter of fact, I showed that in World War II the inflation was but 1¼ that of the Civil War and 1⁄14 that of World War I, when allowance is made for the proportion of resources going to war.

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3. I also drew the conclusion from this that monetary policy had only a limited role to play and particularly the market (e. g., higher rates of interest) type of monetary control. No practical form of monetary control ever did (and in my opinion never will) contend with the major inflationary forces in such periods as 1940–41, 1950–51. Monetary supplies respond to the other forces much more than they control them.

4. I drew the attention of the committee to the following:

(*a*) From 1914 to 1951, the following occurred.

	Rise	
	In billion dollars	Number of times
Bank deposits	132	7.6
Bank loans	37	3.1
Bank securities	66	17.8
Prices—wholesale		1.1
National income	246	8.6

The above shows the indispensable contribution of monetization of the debt. Without it do you assume that we would have monetized an economic growth of 8.6 times (deflated by a price increase of 1.1 times)?

BETTER 50 THAN 110

I added that it would have been better to have had a price rise of 50 percent instead of 110 percent. But the rise of 110 percent is much to be preferred to a decline of 50 percent or more.

(*b*) The major cause of the growth of debt and of money has been mobilizations and war. Over 163 years of American history, war and associated outlays account for 80.5 percent of all Federal outlays. These are the primary factors, not, as you imply, New Deal policies. Indeed, I would strongly support additional supplies of money in depression periods. These are not substantially inflationary. My projected rise, however, assumes continued prosperity.

(*c*) Looking forward, I anticipate a required rise of money from $180 to $540 billion. These are, of course, nothing but informed guesses for the next 20 to 30 years.

The assumptions are a rise in prices of 50 percent (little more than 1 percent per year cumulatively, surely a conservative projection) and a doubling of real income.

Compare this increase of money of two times with a rise of 3,500 times in our history and the increase shown in the table over the last 37 years, and then reflect again before you interpret this as an inflationary position. (I do not even allow for the increased percentage of money held to national income as real income rises—a fairly consistent phenomenon throughout our history.) Inflation is related not only to supply of money but also to demand.

NOT FRIENDLY TO CONTROLS

Finally let me add that I am not nearly as friendly to controls as your editorial suggests. The experience since 1945 suggests to me that controls are in no small part a mechanism for postponing inflation rather than treating it. They can be supported only on grounds of equity and proper allocation of resources in periods of great stress.

My position was fully presented in my last book (Economics of Mobilization and Inflation, Norton, 1951), where I urged only a subsidiary position for controls. The New York Times, in its review of my book, by the way, criticized me severely for being too much concerned with stopping inflation and not enough with a rise of output.

May I conclude that my distinguished colleague, Professor Slichter (certainly not a New Dealer), on more than one occasion has pointed out that the growth of the national debt is in part a mechanism for providing the Nation with required supplies of money.

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In his What's Ahead for Business, he anticipates a required rise of the money supply from $180 to $260 billion by 1960. The rise is 45 percent (p. 179). At similar rates of growth in the years 1960–70 and 1970–80. Professor Slichter's figures, arrived at a different way than mine, would also show an increase of money to $540 billion in 30 years, and apparently without any assumption of a price rise.

SEYMOUR E. HARRIS,
Harvard University Graduate School of Public Administration.

CAUSE OF INFLATION

Professor Harris, in his letter, contends that price inflation is inevitable, and that monetization of the public debt by the banks is the best way to provide the added money supply to support higher commodity prices.

The Journal of Commerce holds that public-debt monetization is both the immediate and the ultimate cause of inflation, and that the best way to prevent further serious deterioration in the purchasing power of the dollar is to avoid large-scale deficit borrowing by the Treasury from the banks.

The reader must decide for himself whether we should expand the money supply to keep pace with rising prices in the future, or seek to stabilize the money supply so as to remove this stimulus to advances in the price level.—THE EDITOR

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