W. Eccles -

Confidential draft

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THE PATMAN BILL

The fundamental objective of H.R.7203 is to establish a mechanism that would control the volume of money with a view to maintaining a fixed price level.

Monetary objectives

The Board of Governors of the Federal Reserve System has given constant study to the problem of objectives of monetary policy. Under date of July 30, 1937 the Board issued a statement expressing the conclusion that economic stability, rather than price stability should be the general objective of public policy, because stability of the price level does not necessarily prevent serious economic maladjustment. It stated that in its judgment the Reserve System's duty, in addition to working toward the maintenance of sound banking conditions, is to exert its influence toward maintaining a flow of funds conducive to as full a use of the country's productive resources as can be continuously sustained. The Board also stated its belief that efforts of all the departments of the Government should be directed toward the achievement of this broader objective, and that neither objective can be achieved by monetary means alone.

Federal Reserve System operates in the public interest

In proposing a reorganization of the Federal Reserve System, the author of the bill contends that it has not been operated in the public interest; that it has been dominated by bankers; that it has been conducted in the selfish interests of a small group, and that it has made large profits at the expense of the community. None of these assertions can be sustained by the record.

Ownership of stock by member banks does not enable the bankers to control the Federal Reserve System. It is more nearly in the nature of a compulsory capital contribution than stock ownership. Although the member banks elect two-thirds of the directors of the Reserve banks, the large banks elect only two out of nine directors. The small banks elect two, the medium-sized banks elect two and the Board of Governors in Washington appoints three. Only a third of the directors can be bankers and all directors and officers are subject to removal by the Board of Governors. The appointment of all Presidents and First Vice Presidents and the salaries of all officers and employees are subject to approval by the Board in Washington.

Complete authority over all matters of major national policy, such as the determination of discount rates, reserve requirements, margin requirements on security loans, and maximum rates of interest to be paid on time deposits is vested in the Board of Governors. Authority over open market operations is vested in an open market committee consisting of seven members of the Board of Governors and five members elected by the Reserve banks. Not only has the Board a majority of the committee, but the other members are subject to the Board's approval in their positions as presidents of the Reserve banks.

It is clear, therefore, that in matters with which the bill is primarily concerned the System is dominated, not by banks, but by the Board of Governors, a governmental body whose members are appointed by the President and confirmed by the Senate.

Earnings and expenses of the Federal Reserve banks.

During the twenty-three years of its existence the Federal Reserve System has earned approximately one and a quarter billions of dollars, of which one-half has been used for operating expenses incurred largely in performing public services, such as the clearing and collection of checks, the supplying of currency to the banks and to the public, the performance of many duties for the United States Government, and in furnishing rediscount facilities for the member banks.

Of the six hundred million dollars of earnings above expenses, approximately one-fourth has been paid to the Government as franchise tax, nearly one-fourth has been turned over to the Federal Deposit Insurance Corporation as capital, one-fourth has been paid as the statutory dividends to member banks, and the remainder is held in a surplus account which in case of liquidation becomes the property of the Government.

Member banks contribute 3 per cent of their capital and surplus to the capital of the Reserve banks and receive not more than 6 per cent annually on this amount. A member bank having a capital and surplus of $100,000 contributes $3,000 to the Reserve bank's capital and receives annual dividends of $180, or at a rate of less than two-tenths of 1 per cent on its own capital and surplus.

The System was established and is operated in the public interest and dominated by public officials; it performs a service that saves the people of the country far more than the cost of the System, and it makes no profits for any private interest other than the amount paid annually to stockholders at a fixed rate, which has been prescribed and can be changed by Congress.

The evils which the bill is designed to correct, therefore, do not exist in reality.

The proposals in the bill

Proposals in the bill for reorganizing the Reserve System would transfer ownership of the stock in the Federal Reserve Banks to the Government and would have all the directors of the Reserve banks appointed by the President and approved by the Senate. It would enlarge the membership of the Board of Governors to fifteen, including three ex-officio members -- the Secretary of the Treasury, the Comptroller of the Currency, and the Chairman of the Federal Deposit Insurance Corporation.

A Board of Governors of fifteen members proposed in the bill would be too unwieldy to function promptly and effectively. Appointment of Reserve bank directors by the President would tend to introduce party politics into the System, and would make it more difficult for it to work toward economic stability. The proposal in the bill to offer all the privileges of membership to nonmember banks so long as they choose to keep their reserves in a Federal Reserve bank would enable all banks to profit by the services of the System so long as it suited them and to withdraw from it whenever the maintenance of reserves or compliance with any regulation by the Board appeared to them to be burdensome. It would make futile the proposed enlargement of the power to increase reserve requirements. It would remove all incentive to membership and would make it impossible for the System to discharge its responsibility for maintaining sound credit conditions.

The Board is convinced that improvement in our banking system is urgently needed but sees nothing in the proposed bill that would tend in this direction.

Monetary authorities and fiscal authorities

The primary function of the Treasury is to collect taxes, borrow money, and provide funds for the various agencies of the Government in accordance with Congressional appropriations. The primary function of the Federal Reserve System is to influence the flow of money and to contribute to the soundness of the banking situation. The ultimate objectives of both agencies are the same, namely, to serve the public interest, but their points of view and experience, and their approach to current problems may at times be different. The maintenance of an organization for the regulation of credit separate from the fiscal arm of the Government has been found advantageous in most countries of the world, and its abandonment, which is proposed in the bill, would, in this Board's opinion, be a backward step.

Local autonomy in local matters

Since its establishment in 1914, the Federal Reserve System has undergone many changes in the direction of increased control by the Board of Governors. With the passage of the Banking Act of 1935 this control has been made complete in so far as national policies are concerned. In regard to local matters, the maintenance of local autonomy under general supervision and close Government regulation is advantageous in a country like the United States, consisting of various regions with diverse economic interests. The maintenance of locally elected directors on Federal Reserve bank boards is of great advantage in creating local pride and local interest in the System and in inspiring the business community with confidence in its management. This would be largely destroyed if the appointments of local directors were handled entirely from Washington. There would also be the danger that partisan political considerations would enter into the appointments and the directors and through them the personnel of the banks might become subject to political patronage. There is nothing that would be more destructive than this of the ability of the System to render a disinterested public service to all classes of the community.