GOVERNMENT OWNERSHIP OF THE 12 FEDERAL RESERVE BANKS

TUESDAY, APRIL 12, 1938

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

The committee resumed hearings on H. R. 7230 at 10:35 a. m., Hon. T. Alan Goldsborough presiding.

Other members of the committee present:

Mr. Reilly, Mr. Williams, Mr. Spence, Mr. Ford, Mr. Brown, Mr. Patman, Mr. Transue, Mr. McGranery, Mr. Fish, Mr. Gifford, Mr. Luce, and Mr. Crawford.

Mr. Goldsborough. The committee will come to order, please.

Gentlemen, we have with us this morning Mr. Marriner S. Eccles, chairman of the Board of Governors of the Federal Reserve System, who will speak on H. R. 7230.

The committee will be very glad to have your views, Mr. Eccles.

STATEMENT OF HON. MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Governor Eccles. Mr. Chairman and gentlemen of the committee, the statement that I am about to make is the statement of the Board of Governors, not merely my own statement.

The fundamental purpose of H. R. 7230 is to establish a mechanism that would control the volume of money with a view to maintaining a fixed price level.

Mr. Goldsborough. Mr. Eccles, are your remarks directed also to the amendment which Mr. Patman states he will propose to H. R. 7230, or merely to the bill as originally introduced?

Governor Eccles. Mr. Wyatt advises me that this also has taken into account the amendments to the bill. That would be evident, I think, as the statement is read.

THE MANDATE

In an amendment the Board of Governors is instructed to raise the all-commodity index until full employment of all persons able and willing to work shall have been achieved, and until the price level shall at least reach the all-commodity index of 100, as established by the Department of Labor for the year 1926. The Board is further directed to maintain this price level with variations not to exceed 2 percent. To accomplish this the Board is directed to expand and contract demand deposits by engaging in open-market operations.

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The position of the Board of Governors on the problem of monetary objectives was indicated in a statement issued on August 2, 1937, in response to a congressional inquiry. The Board is in full agreement with the ultimate objective of proposals to promote economic stability, which means the maintenance of a volume of business activity and of national income adequate to assure as full employment of labor and of the productive capacity of the country as can be continuously sustained. The Board is aware that commodity prices are an important element in the Nation's economic life and that violent fluctuations of prices have disastrous effects. It believes, however, that price stability does not necessarily lead to economic stability and, therefore, should not be the principal objective of public policy. In its opinion the objective of economic stability cannot be achieved by monetary means alone, but rather should be sought through coordination of monetary and other major policies of the Government which influence business activity.

The principal difficulty with a stable price level as the objective of economic policy is that it is not in itself a satisfactory indicator of a continuously smooth working of the economic machine. There have been periods in the past when the price level was stable and nevertheless there were developing numerous maladjustments which led to an economic collapse. For example, from the latter part of 1927 to the latter part of 1929 the index of wholesale prices showed little change, but other developments were threatening economic stability. Prices and activity on the stock market were rising rapidly, and brokers' loans grew at an unprecedented rate. Construction of office and apartment buildings was being promoted with a view to quick profits at a rate that endangered the long-time outlook in the building industry. Loans were being made for enterprises abroad without careful investigation of credit risks, and business activity in general was increasing, partly as a result of speculative developments, to a level that could not be sustained. The use of the commodity price level as a guide to credit policy in these circumstances would have been entirely unsatisfactory. There is no assurance that it would be satisfactory in the future.

The proposal is that the Board of Governors bring the commodity price index up to at least the 1926 level. The average for that year is about 25 percent above the present level and an advance of that magnitude, except over an extended period, would cause speculative buying and would lead to boom conditions which would culminate in a break and a depression. Furthermore, in periods of rapid advance disparities between prices of different groups of commodities generally become more pronounced and yet, both from the point of view of justice and of economic stability, the most important thing in regard to prices is the maintenance of proper relationships between prices of different commodities that are exchanged for each other. Activity of producers depends on the relationship between their costs, including principally prices of materials, labor, taxes, and debt service, and the prices at which they can sell their products. In the last quarter of 1936 and in the first qarter of 1937, for example, building costs and prices of new houses rose so rapidly and so far as to discourage buying, and this resulted in a decline in residential building. Moreover, the rise in prices of industrial raw materials at that time was much sharper than the advance in finished goods, and this was

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a factor in causing speculative purchases, forward orders, and building up of inventories, all of which contributed to the subsequent collapse of business.

Present prices of individual commodities in the Bureau of Labor statistics index, compared with 1926, range from a decline of 75 percent to an increase of 100 percent. A restoration of the 1926 level could be achieved through an advance of all commodities, including those that are too high, as well as those that are too low, or through a rise in one or the other group of these commodities. There is nothing in monetary policy that could determine which of the commodities would rise, and yet this would be all important from the point of view of the effects that the rise in prices would have on the economy.

In the Board's view the essential objective of monetary policy is to contribute to the maintenance of a flow of money and income through the channels of trade, industry, and agriculture that would tend to utilize to the full the country's human and material resources. This is the Board's understanding of the broad mandate stated in the Federal Reserve Act as "accommodating commerce and business." To this end and to the maintenance of sound banking conditions the Board devotes its efforts, and there is nothing in the proposed mandate that would add to the Board's desire or ability to achieve those objectives.

In directing the Board to achieve price stability and full employment through open-market operations, the proposed mandate disregards the limitations on the effectiveness of this instrument of credit policy. It assumes that open-market operations can always create or destroy deposits and that changes in the volume of deposits in turn are immediately reflected in the price level. The fact is that open-market operations do not always create deposits, since purchases of securities from the banks do not increase deposits. Whether open-market purchases result directly in an increase in deposits or not, they do result in the creation of a corresponding amount of reserves. These reserves may or may not result in the creation of deposits, depending on whether conditions are favorable for the expansion of loans and investments by banks. The great bulk of deposits in the banks of the United States are created through such an expansion. A given volume fo reserves created by Board action, therefore, might result in no increase in deposits at all; or, in the other hand, might result in a growth of deposits several times as large as the reserves. Which of these developments would actually occur would depend on forces that are largely, if not wholly, outside the control of the Board of Governors.

It is not true, furthermore, that the creation of deposits necessarily results in an equivalent rise in prices. We have had increases in deposits without corresponding increases in prices. The volume of deposits at the present time is greatly in excess of the amount that existed in 1929, and yet the price level is much lower. Nor is it clear that a rise in prices necessarily results in an increase in employment. An unbalanced advance in prices may, on the contrary, be an influence in decreasing employment, as was the case early in 1937.

Aside from many factors that are not under the control of the Government, there are numerous phases of Government activity other

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than monetary action by the Federal Reserve System that have effects on prices and on economic activity. Among such factors are the actions of the United States Treasury in relation to the inactive gold account and the stabilization account; policies in regard to taxation, exchange rates, the volume and character of Government spending; its action in regard to the capital market, to railroads and utilities; the Government's housing program, its agricultural policies, and its policies in regard to labor. All of these Government activities have a distinct bearing on the volume of business activity and on the price level. They are beyond the influence of the Federal Reserve System, and yet without them and their coordination with monetary policy the system would be powerless to achieve either an advance in prices or the restoration of full employment, as would be required under the proposed mandate.

The Board of Governors, therefore, does not favor the adoption of the proposed mandate.

Mr. GOLDSBOROUGH. Mr. Eccles, H. R. 7230 is entitled "A bill providing for Government ownership of the 12 Federal Reserve banks, and for other purposes."

Mr. ECCLES. I have not finished.

Mr. GOLDSBOROUGH. I thought you had finished.

Mr. ECCLES. No; I just finished that part of it.

In addition to prescribing a mandate for the Federal Reserve policy the bill proposes a reorganization of the Federal Reserve System. The reasons offered for this reorganization are that the System 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. The Board of Governors does not believe that any 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 Board in Washington appoints the chairman and deputy chairman of each Reserve bank, and the appointment of all presidents and first vice presidents, as well as the salaries of all officers and employees, are subject to its approval.

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 the seven members of the Board of Governors and five members elected by 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.

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FEDERAL RESERVE BANKS NOT OPERATED FOR PROFIT

During the 23 years of its existence the Federal Reserve System has earned approximately one and a quarter billions of dollars, of which about 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.

Earnings of the Federal Reserve banks above these expenses and reserves for contingencies amounted to $600,000,000. Of this amount approximately $150,000,000 has been paid to the Government as franchise tax, about $140,000,000 has been appropriated by Congress for the Federal Deposit Insurance Corporation as capital, $160,000,000 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 percent of their capital and surplus to the capital of the Reserve banks and receive 6 percent annually on this contribution. In addition, member banks are required to keep balances with the Reserve banks amounting on the average to 16 percent of the member banks' deposits and receive no return on these balances. For example, a member bank having a capital and surplus of $100,000 and deposits of $1,000,000 contributes $3,000 to the Reserve bank's capital and, on the average, would be required to hold $160,000 on deposit with the Reserve bank as legal reserves, on which it receives no interest. The dividends such a bank would receive on its stock in the Reserve bank would be $180 a year.

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 profit 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.

PROPOSALS WOULD NOT IMPROVE BANKING SYSTEM

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 15, including 3 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 15 members proposed in the bill would be too unwieldy to function promptly and effectively. 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 remove all incentive to become members of the System. It would enable all banks to profit by the services of the System so long as it suited them, without contributing anything to its strength or complying with its regulations, and to withdraw their reserves when to maintain them would seem to be burdensome. It would make futile the proposed enlargement of the power to increase

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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.

DISTINCTION BETWEEN MONETARY AND FISCAL AUTHORITIES SHOULD BE MAINTAINED

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 apropriations. 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. In a broad sense the 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 SHOULD BE PRESERVED

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 greatly strengthened insofar 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 advantage would be lost if the appointments of all local directors were handled entirely from Washington. Consequently, the System's ability to render a disinterested public service to all classes of the community would be greatly diminished.

To sum up, the Board is convinced that improvement in our banking system is needed but sees nothing in this bill that would tend in this direction. The Board is convinced that the main objective of the bill is not practicable; that the evils which the reorganization features of the bill propose to correct do not exist; that the organization which it proposes to establish would result in less satisfactory service to the country; and that enactment of the bill would be a backward and not a forward step in the development of the banking system in the public interest.

That is the statement of the Board with reference to this matter, that I would like to have inserted in the record.

Mr. GOLDSBOROUGH. Without objection, of course, it will be inserted in the record.

Gentlemen of the committee, I am sure that Mr. Eccles will now be glad to answer any questions he can which you would like to ask him.

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Mr. PATMAN. I would like to ask some questions, Mr. Chairman.

Mr. GOLDSBOROUGH. Proceed.

Mr. PATMAN. Under the law at present, as you said, I believe, the open-market committee is composed of the members of the Board, 7 when all of the vacancies are filled, and 5 selected by the 12 Federal Reserve banks. That is right, is it not?

Governor ECCLES. Yes; that is correct.

Mr. PATMAN. Do you believe that anyone except members of the Board should be on the open-market committee?

Governor ECCLES. I do not. When the Banking Act of 1935 was up, I made quite an extensive record before this committee on that subject, and I have not changed my views.

Mr. GOLDSBOROUGH. You had considerable support on the committee, too.

Mr. PATMAN. In other words, that particular change you believe is a helpful and constructive one?

Governor ECCLES. So far as I am concerned, and so far as the House was concerned, I think our record speaks for itself on that subject.

Mr. PATMAN. So to that extent the bill is good; to that extent you think it is constructive.

What about the advisory council? Do you believe that you should have a legally established advisory council, composed of private bankers, with the authority that they have today, to confer with the Board relative to open-market transactions and other major matters, or do you believe it would be helpful to abolish the advisory council and leave all matters up to the Board?

Governor ECCLES. The council, although it is a body legally set up, has no legal power; it is an advisory body only. It meets but four times a year, in Washington, and the members bring to the Board their views with respect to various matters, which are very often of a local nature, with reference to the territory that they represent.

I am sure that they do not influence the Board with reference to its monetary policies, other than by furnishing information that would tend to enable the Board to come to its decision. I personally do not feel that the council is able to contribute very much in the situation.

The suggestion made at the time the Banking Act of 1935 was before this committee was that the bank presidents or governors, as they were called at that time, be an advisory committee for the Board with reference to its monetary policy. It would seem that such a program as that, if it had been carried out, would have resulted in there being little or no place for the council. The bank presidents would have been well able to represent the regional areas. and they would, of course, have had no private interests, but would have been public officials well able to represent the public interest.

Mr. PATMAN. Did you favor that change?

Governor ECCLES. I do not think the question of abolishing the council was a part of the bill at that time. I did favor the change of making the bank governors an advisory committee.

Mr. PATMAN. Those who are now the bank presidents?

Governor ECCLES. That is right.

Mr. PATMAN. And, of course, you would be in favor of abolishing the Board in event that change was made?

Governor ECCLES. What board do you mean?

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Mr. PATMAN. I mean the advisory council.

Governor ECCLES. That is a subject——

Mr. PATMAN (continuing). You would not want two advisory councils?

Governor ECCLES. No; I do not think that two would be necessary, and it would seem quite obvious that if the other set-up were created there would be little or no place for the present council.

I feel that inasmuch as the members of the council are bankers, and have always been bankers, their point of view naturally would be that of private bankers engaged currently in the private banking business.

I do not think that it makes very much difference one way or the other, as a matter of fact, whether there is an advisory council or there is not an advisory council. It would make virtually no difference so far as the conduct of the Reserve System is concerned.

Mr. PATMAN. Has the advisory council influenced the Board in the past on any matters?

Governor ECCLES. I cannot speak——

Mr. PATMAN (continuing). In other words——

Governor ECCLES. You say the past. Since I have been on the Board, it would be my view that the Board has not been influenced by the council in undertaking any policy that it would not have undertaken in any case.

Mr. PATMAN. In other words, they have been worthless? They have not influenced the Board either way?

Governor ECCLES. So far as monetary policy is concerned, I would say that they have not influenced the Board in taking any action that the Board would not otherwise have taken. They have kept the Board advised with reference to the banker and business point of view in the various reserve districts. We possibly would have gotten that information anyway from other sources, but we at least did get a cross-section of what we would term the banker point of view in the various areas.

Mr. PATMAN. Would you not consider it a constructive change to use the presidents of the banks as the advisory council in preference to the present advisory council?

Governor ECCLES. I would. I think it would be a constructive move, because in that way——

Mr. PATMAN. The private bankers would be taken off?

Governor ECCLES. In that way you would substitute an advisory council composed entirely of public officials.

Mr. PATMAN. I agree with you on that.

Mr. FORD. Might I inject a question there?

That council, then, would be appointed by the Board, would it not?

Governor ECCLES. No. As I recall the proposal, in the Banking Act of 1935, an advisory committee of bank governors was to be chosen, so that there would be no appointments——

Mr. FORD (interposing). I did not mean it in that sense; but who appoints the presidents of the reserve banks?

Governor ECCLES. The directors of the reserve banks.

Mr. FORD. Who appoints the directors?

Governor ECCLES. The member banks elect six out of nine.

Mr. FORD. Then the president of each Federal Reserve bank is the appointee of the directors of that bank, six out of nine of whom are local bankers?

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Governor ECCLES. They are appointed by a board of nine directors, of whom three are appointed by the Board in Washington and six are appointed by the banks, two by the small banks, two by the medium-sized banks, and two by the large banks. Three of those six are bankers, and three represent commerce, agriculture, and industry.

Mr. FORD. But that is in the local district?

Governor ECCLES. That is right.

Mr. FORD. That is what I am getting at.

Mr. PATMAN. In regard to your first statement, and I did not hear all of it, because I was delayed, but I judge from what I did hear that you do not believe that the quantity of money can determine the price level.

Governor ECCLES. That is right.

Mr. PATMAN. You do not think the quantitative theory of money is sound?

Governor ECCLES. I do not. I wish the problems were that simple.

Mr. PATMAN. You think, of course, that the other factors are so great, such as the expenditures made by the Government, the sterilization of gold, and the stabilization fund, but I see no reason why the sterilizing of gold should have upset the policy. You could have placed more money in circulation through the open-market transactions. I do not know of a single transaction of the stabilization fund that could possibly affect the price level, do you?

Governor ECCLES. How do you figure that we can put more money in circulation?

Mr. PATMAN. You can buy bonds.

Governor ECCLES. Yes; but when you buy bonds, who sells the bonds?

Mr. PATMAN. The banks sometimes sell the bonds.

Governor ECCLES. They usually sell them.

Mr. PATMAN. To increase their reserves.

Governor ECCLES. That is where you get most of the bonds from, and that would run the price so high, and make the interest rate so low, that you would create such a terrific profit in the hands of the investors that they would want to sell and take the profit, and it would leave the Reserve System in the position where they were buying high and selling low.

Mr. PATMAN. I have a feeling that we made a mistake, possibly, and I was guilty of making it with others, in making it so easy for the banks to get additional reserves, for they do not have the incentive to make loans that they used to have. In the days gone by, they were paying interest on demand deposits, and they were paying a higher rate of interest on time deposits, the total aggregating about 500 million dollars more than they are having to pay now. Therefore, when they accumulate these excess reserves, they do not have the incentive to lend. In addition to that, they have inaugurated service charges and from these service charges they obtain a large part of the revenues necessary to carry on their institutions.

So we have reached the place, it occurs to me, where the banks do not have the incentive, but I still believe that if you kept buying bonds, and kept putting money out, the time would come when loans would be extended and money would percolate among the masses of the people.

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Governor ECCLES. You sasy that the banks do not have the incentive. We will say that they have a billion and a half of excess reserves, and that they do not have the incentive to loan or to invest those funds, but if they had two or three billion dollars, they would have the incentive—is that your point?

Mr. PATMAN. If you keep taking their revenue away from them, if you buy their bonds, if they get interest from the Government now, they would want to put that money to work, I would presume.

Governor ECCLES. There is not any question but what the banks would like to put the money to work at the present time. It is not reluctance on the part of banks to put money to work, but a business concern is not going to borrow money to produce goods if the warehouses are full of goods and the community has not got the buying power to buy what has been produced.

The rate of return on short-term money today is almost negligible. The banks, of course, are restricted in their loans and also in their investments as the result of regulations governing investment policy, the Comptroller's regulations, and also the regulations governing the examination policy. You cannot on the one hand build up excess reserves, and expect those reserves to operate in the direction of inducing the banks to loan and invest funds when on the other hand during the period of deflation the available loans and investments are less favorably regarded than they are in a period of business activity. The very effect of a deflationary process reduces the availability of both loans and investments that banks are able to get.

Mr. PATMAN. Mr. Eccles, you have discouraged me so much—you can always give a reason, or what you consider a reason, why you cannot do anything. What would you do? Can't you offer just one suggestion that can be followed to bring us out of this depression?

Governor ECCLES. I have offered——

Mr. PATMAN. You are in the driver's seat.

Governor ECCLES. I have offered a good many——

Mr. PATMAN. If anybody is in position to do anything, it occurs to me that you are in position, together with the Federal Reserve Board, to take some action that would help in this situation. What would you do?

Governor ECCLES. I appeared for two days before the unemployment committee of the Senate. There is a very extensive record over there, which includes my views with respect to this whole subject, and——

Mr. PATMAN. What is No. 1?

Governor ECCLES. And I have made public speeches with reference to what I consider some of the reasons for the present situation, and what might be done about it, and I have advised in private with other officials of the Government with reference to the subject.

Now, so far as the Reserve Board is concerned, we are only one arm of even the monetary or the banking function. You have here the Treasury with monetary powers possibly equal to if not greater than those of the Reserve System. You have the Comptroller. You have the Federal Deposit Insurance Corporation, and you have 48 bank commissioners who also have responsibility with respect to the banking function, and the idea that some people have with reference to this overall power that the Board of Governors has just does not harmonize with the facts.

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Mr. PATMAN. But you are talking about responsibility. I am talking about privileges. You have the privilege of doing certain things.

Governor ECCLES. What?

Mr. PATMAN. You can go into the open market and buy bonds.

Governor ECCLES. Yes. What would we do——

Mr. PATMAN (continuing). You can buy them, and as money begins to get cheaper, people will exchange their money for goods, because goods will be higher.

Governor ECCLES. How would money get cheaper if you buy bonds in the open market? Money is so cheap today that the banks, as you have said——

Mr. PATMAN. You are talking about the interest rate. I am talking about the value of money.

Governor ECCLES. You are talking about raising the price of goods.

Mr. PATMAN. That is right, until there is incentive for people to exchange their deposits for something visible or tangible—goods or services.

Mr. FORD. Is there any corresponding table between the rising price of bonds and the price level? If you went into the market and bought a billion dollars' worth of bonds in the next 30 days, the result would be that you would raise the price of bonds, would it not?

Governor ECCLES. Yes. You would run bonds up so high, and the interest rate so low, that there would be a lot of banks and private individuals that would sell the bonds as they got up high, because they would get a big profit, and all that we would do would be to assure these people that have bought governments at a substantially lower price a profit. Then at any time that we undertook to dispose of or let those bonds run off, of course they would drop, and when they got low enough the people that sold them high would buy them low.

If we could operate in the short-term market, where the prices in the securities would fluctuate but little—for instance, if we bought 90-day Treasury bills, or short-term Treasury notes in the market, that would not, of course, tend to run up the price of bonds, because you would not be bidding on bonds. The interest rate now on short-term Treasury paper has been running at around one-tenth of 1 percent, so it is almost a negligible factor. You could buy that paper, but that paper is held almost exclusively by banks, and you would not create any deposits. All that you would do if you went into the market and bought that paper is that you would give the banks more excess reserves as a substitute for the bills that they now carry. That would not increase in any way the amount of money in circulation or the amount of money on deposit. It would merely increase further the ability of banks to extend credit, but you would have to have somebody willing to borrow, and people are only willing to borrow and put people to work and to buy goods when they feel that they can do so profitably. They can do so profitably only when there is consumer buying power or a willingness on the part of the consumers to buy.

The way to get increased deposits, to get increased buying power, is not through monetary action alone, but it must come through putting money in the hands of people that do not have it, by giving employment to those who are unemployed, and by assuring those who are

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employed that they are not likely to lose their employment and then have no other source of income.

Mr. PATMAN. I agree that that is one good way——

Governor ECCLES. That is the only way, it seems to me, that it can be done.

Now, it can be done by Government or by private business. If private business is willing to use credit in order to put people to work, or whatever the reason may be, to a greater extent than other businesses are contracting credit; that is, if private credit on balance expands, then the need for an expansion of Government credit would be unnecessary, or would be less necessary.

We have in the present situation, and have had for a period possibly of a year, a situation where private bank credit has been contracting, not because the banks were under pressure, not because of the lack of ability of banks to extend credit or to carry existing loans and investments, but because the borrowers were in the process of liquidating inventories or securities, and in doing so paid off their obligations. In some cases, of course, where investments become questionable, or loans become questionable, due to a deflationary process, there has been pressure on the part of the banks to liquidate. This has not been due to the inability, however, of the banks to carry a greater volume of loans and investments. It has been due to conditions, as I said awhile ago, beyond our control. If the banks were putting pressure for liquidation on borrowers because of a shortage of funds, and because of an inability on their part to extend further credit, then the Reserve System would be guilty of maintaining a restrictive credit or monetary policy that was stopping a credit expansion.

Mr. PATMAN. What I cannot understand, Mr. Eccles, is that the Federal Reserve Board has always been able to deflate but has never been able to expand. You take in 1920, I believe, there were about 12 reasons set out by Mr. W. P. G. Harding, 12 ways that deflation could be brought about, and it just occurs to me that at least the reverse of some of those ways would cause some expansion. I have noticed that the Board has taken action in the past that I considered deflationary, but I am just at a loss to understand how it is that you can always get down to deflating but never do anything to expand.

I have always had the idea that the value of money determines the value of everything else and that if you make a statement today that indicates——

Governor ECCLES. You mean by the value of money, the interest rate on money?

Mr. PATMAN. Yes; the value which money determines, measured in commodities and everything else. I do not mean the interest rate. I mean the value of money compared to goods and services, and I have had the idea that if you made a statement indicating that money will be a little cheaper, many people will rush their money now on deposit into goods and services, because there would be an incentive to do it, but as long as goods and services are becoming less valuable every day, there is every incentive for people to keep their money because it is becoming more valuable every day, and if you made a statement or took some action that indicated that the commodity price level was going to rise, going to increase, people would make an effort to exchange their money for these goods and services. Don't you agree with that?

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Governor Eccles. Well, there is such a thing as frightening the public into the belief that you are going to have inflation and causing speculative buying. That might be brought about.

Mr. Patman. I know that the old words "frightening" and "inflation" are used, but don't you think that people are frightened on the other side? They are led to believe that if they keep their money it is going to become more valuable all the time, and as long as that feeling continues, I see no reason in the world for their not holding it

(At this point there was a brief intermission, while Governor Eccles was called to the telephone.)

Mr. Patman. I want to make this observation, and I think I will finish.

This bill has four major provisions. One is the price level. The next is that the open-market committee should be changed so as to have just the Federal Reserve Board members on it. The next is that the advisory committee should be dispensed with, since it consists of private bankers only. The next is that the State banks should have the privileges of the Federal Reserve System by carrying their reserves with a Federal Reserve bank.

Now, the first, of course, you are against the price level. You say that the quantity of money has nothing to do with the price level, and that there are too many other factors.

Governor Eccles. I did not say that it had nothing to do with it.

Mr. Patman. You mean that it cannot alone cause it.

Governor Eccles. Yes.

Mr. Patman. Of course, I think it is the greatest factor and it can influence it. But you take the other side, you say.

Governor Eccles. No. I think it depends a good deal on the time, and I do not underrate at all the importance of an adequate supply of money to——

Mr. Patman. Anyway, you are not in favor of trying to maintain a price level?

Governor Eccles. Well, I am not in favor of the Reserve Board being given a mandate to maintain a certain price level. I——

Mr. Patman. Are you in favor——

Governor Eccles. I am in favor of using such powers as we have to bring about business stability, but, as has been indicated in my statement, there is a distinction between a fixed price level and business stability. You may have a stable price level and have a great disparity within that price level. The thought that you suggested a little while ago—to the effect that if through Board action they could cause people to exchange their money for goods, thus putting into circulation a supply of money, it would tend to put up the price level—that is true if it caused people who had money to go from money to goods for speculative reasons, and that is usually where an inflationary psychology manifests itself. That, however, would tend only to retard a construction program. If you begin to get a speculative inflation in building material prices, it certainly would not in any way stimulate the buying of railroad equipment, or the expansion of the utilities.

So far as the price of cotton is concerned, as well as the price of wheat, they depend upon world prices, so that you could not run up the price of some of the basic commodities that are dependent upon

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the world price merely by a monetary device. They would adjust themselves to the world price level.

Mr. PATMAN. Of course, I do not agree with you there, but since you are opposed to a mandate you do not believe that the Board should have a mandate.

Governor ECCLES. I am not opposed to a mandate. I recommended that the Banking Act of 1935 should have a mandate——

Mr. PATMAN. I mean on the price level.

Governor ECCLES. And this committee inserted in the banking bill of 1935 a mandate, but it was not a mandate of the sort which is proposed here.

Mr. PATMAN. I am talking about the 1926 price level. Are you willing to tell this committee that, although you are opposed to a mandate on the 1926 price level, you are really looking for a higher commodity price level, that you are hoping the price level will go up instead of down, and that you are working in that direction?

Governor ECCLES. I did not feel that the commodity price level, even at the highest point in 1937 or 1936, was too high.

Mr. PATMAN. You do not believe it was too high?

Governor ECCLES. No; I do not. I am in favor of a higher——

Mr. PATMAN. You are willing to do something that will make it go back in that direction?

Governor ECCLES. I am in favor of a higher average price level.

The trouble with the price level was the disequilibrium within the price structure. It was not that the average price level of 1937 was too high. There is no question but what the present average price level is too low, but what you have in your structure today are certain rigid wages and rigid prices within a part of your economy that are as high as or higher than the 1929 level, whereas you have flexible wages and flexible prices in the balance of your economy.

Mr. PATMAN. That is what I object to. You can raise the part that is down through monetary action by placing money in circulation, by causing the value of your money to be lessened, to be worth less.

Governor ECCLES. What assurance have you that that would not put up the existing prices, which are now too high, and make them still higher?

Mr. PATMAN. Let us not talk about exceptions. You can always pick out a few members of a lodge or of a church and condemn the whole church or lodge. Let us talk about the general rule, the average price.

Governor ECCLES. I think that applying your theory would be the exception and not the rule.

Mr. PATMAN. No; I think the exceptions are the cases like steel, where they are the same price today, a week ago, or a month ago.

Governor ECCLES. Not only steel, but there are dozens of prices higher than 1929; and you have the same thing also true with reference to certain great groups of wage rates.

Mr. PATMAN. Anyway, I will not discuss that further, because other members of the committee want to interrogate you; but I do want to suggest this—that out of the four major proposals you oppose the prive-level mandate of 1926; you are not opposed to the open-market committee change, so that it will be composed only of the Board, as we propose in this bill, and you are not opposed to abolishing the

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advisory council, composed of bankers only, also contained in this bill——

Governor ECCLES. I would say——

Mr. PATMAN. But you are opposed to the fourth one—you are in favor of half of it and against half of it?

Governor ECCLES. With reference to the council, if Congress saw fit to abolish the council, I would not appear to make an argument against that proposal, and if Congress did not propose it, I would not propose it. I would not want to come here at the present time and recommend that the council be abolished. However, I would not come here and make an argument in support of retaining it.

Mr. GIFFORD. Right there, has there ever been any difference of opinion between the advisory council and the Board?

Governor ECCLES. What is that question?

Mr. GIFFORD. Has there ever been any violent difference of opinion in your policies?

Governor ECCLES. My experience has been, as a general rule, that the Board is not in agreement with the views of the council, but I do not think that the council has influenced the Board.

Mr. GIFFORD. But their views are generally at variance?

Governor ECCLES. That has been true to quite an extent since I have been on the Board. How it was before, I cannot say.

Mr. CRAWFORD. May I ask one question there?

Mr. GOLDSBOROUGH. Proceed.

Mr. CRAWFORD. Governor Eccles, do I understand that the advisory council goes so far as to lay down before your Board a definite proposal, thereby enabling you to arrive at the conclusion that there is a great variance between the two opinions?

Governor ECCLES. No; I would not say that. The discussion is usually an informal discussion. At times the council might make definite recommendations, and they have passed resolutions on definite proposals, but the relationship between the Board and the council has been a very friendly one, and the discussions are very largely informal, but there is a difference in point of view between the members of the council and the members of the Board at times, but I would not say between all of them. You cannot take a body of men as large as the Board and the council together and expect that there is going to be any unanimity of viewpoint.

Mr. CRAWFORD. But the functions and the powers of the council are so dissimilar to those of the Board——

Governor ECCLES. They have a different responsibility. In fact——

Mr. CRAWFORD (continuing). That you could not really tie the two together?

Governor ECCLES. That is right.

Mr. GIFFORD. I want to press one more question.

Mr. Patman, you asked Governor Eccles what he had to suggest, and he stated to you that he had been before the Senate committee for 2 days——

Governor ECCLES. Well, 1 day.

Mr. GIFFORD. And that he has expresesd himself, and you asked him what was No. 1, and he said either private or governmental activity, and I think that at the moment the committee is very much interested in that phase of his statement, as to what we can do. As I recall it, the gist of that hearing before the Senate committee was

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the spending by the Government at the moment of a billion dollars; is that correct?

Governor ECCLES. Well, that was an extended hearing; it lasted about two and a half hours, and I was asked four questions, and I can state those questions, so that you may have an idea as to the extent of the discussion; and then after I state those questions, if the committee wants to go into that, which will take considerable time——

Mr. GIFFORD (interposing). Can't you boil it down? Do you recommend the Government's spending of a billion dollars?

Governor ECCLES. I cannot answer questions of that sort in a yes or no answer.

Mr. GIFFORD. Can you answer yes or no to whether you would approve the Government's lending the States $1,000,000,000 without interest for 50 years?

Governor ECCLES. I would prefer not to answer that. That is a question up for consideration at the moment by the administration, and I would feel it is not proper for me at this time to express my personal views with reference to a specific program that has not been yet determined upon.

Mr. GIFFORD. Then we cannot get any information except that surrounded by long explanations and under certain conditions and ifs, and so forth—is that correct?

Governor ECCLES. I do not think that questions as important as the questions which you people are interested in can be answered by a yes or no answer.

Mr. GIFFORD. When this proposal to lend a billion dollars for 50 years comes before this committee, and we want you as a witness, will you express yourself then?

Governor ECCLES. Yes; if the matter was before the committee, and I was called upon, I would be glad to express my views with reference to the question.

Mr. PATMAN. One other question. Do you express the unanimous opinion of your Board in the statement that you made?

Governor ECCLES. This is the statement of the Board, unanimous.

Mr. PATMAN. I want to say that I get lots of encouragement from one thing that you say, and I hope that the country will take notice that you say that you are looking upward, that you are looking for a price level even better than the best of 1937.

Governor ECCLES. Yes, sir.

Mr. PATMAN. And if you will go in that direction as effectively as I believe you can, I believe that we will go places.

Governor ECCLES. As a matter of fact, at least some of the members of the committee may have gotten the impression that the Board has pursued only a deflationary policy, with the idea of keeping down the price level.

Mr. PATMAN. That has been my impression.

Governor ECCLES. Now, of course, that is not borne out by the record, and I would like very much to suggest to the members of this committee that they read the first seven or eight pages in the annual report of the Board just filed with Congress. That gives a review of the Board's action for the year 1937, and the reasons therefor, and it seems to me that if the committee would read the first seven pages of that report they would find that the Board

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had not taken action of a deflationary nature and that the Board has throughout the year, through open-market operations and through the requests made to the Treasury that it desterilize, continued to maintain the volume of excess reserves and a money market condition that has been one of ease and one of reasonable stability so far as the money market is concerned.

Mr. FISH. Has the Board got any definite price-level policy? For example, does your Board actually want to get back or try to get back to the price level of 1926?

Governor ECCLES. The Board has no price-level policy that they are working to.

The difficulty when we talk about the price level, as I pointed out in this memorandum with reference to the mandate, is that there is a great difference between an all-commodity price level and the price level of certain commodities, and you may have the all-commodity price level of 1926 and have a very unsound situation developing.

We had in 1934, 1935, and 1936 in this country a condition of reasonable stability. The price level was increasing slowly. There was a condition of equilibrium or balance within the price structure, at least a reasonable one——

Mr. FISH (interposing). Does that apply to copper?

Governor ECCLES. I say 1936. Copper advanced in the winter of 1936–37. Up until that time it was around 9 or 10 cents. It went as high as 17 cents within 4 months.

Mr. GOLDSBOROUGH. You are referring to the general commodity price level, are you not?

Governor ECCLES. Yes; I am referring to the general commodity price level.

Now, it was not the increase in the general comodity price level in the spring of 1937 that brought about the present recession. It was the disequilibrium between certain wages and certain prices in what we termed a group of rigid wages and prices and those prices and wages which are flexible. You had in the field of construction, railroads in particular, in utilities, and what we term the capital goods field——

Mr. FISH (interposing). You understand what I am trying to find out. I think that you are one of the most intelligent witnesses we have.

Governor ECCLES. Thank you.

Mr. FISH. But so far I have not been able to find out just what your price level is and what reference it has to 1926, if any.

Governor ECCLES. Our job is not to regulate prices, and if Congress saw fit to give us the responsibility to regulate prices in connection with this mandate, it would seem to me that we would have to have in addition to the powers we have all of the powers of Congress and all of the powers of the executive departments of the Government. In other words, no group could carry out the provisions of that mandate short of dictatorial powers.

Mr. FISH. Let us assume that. Suppose that you had the powers that you now have and all of the powers that you could get. Do you want to get back to the 1926 basis?

Governor ECCLES. I do not think——

Mr. FISH (interposing). I am trying to get information.

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Governor ECCLES. Yes; that is right.

To get back to the 1926 price level, if you could, quickly, would bring about a great period of inflation. You are today possibly 25 percent in your price level below the 1926 price level. To get back to that level, it should be brought about over a long period of time, that is, over a considerable period of time, because a rapid increase in prices, like a rapid fall in prices, upsets the economy. It makes for speculation on one side and inflation and a later collapse, that is, it makes for a bad situation on the deflationary side.

Now, we talk about the price level as though we were in a vacuum, apart from the rest of the world, just as though the world price level had nothing to do with our price level. We cannot determine upon a certain price level in this country and have any hope of meeting that specific price level aside and apart from other factors and other conditions. It is all right to have an objective of trying to maintain a fair relationship between debtor and creditor, and it is certainly true that deflation is unfair to debtors, as inflation is unfair to creditors. What we would all like to have, of course, is a price level that is reasonably fair to debtors and creditors. In other words, we would like to have a condition of stability.

Mr. FISH. Why do you use the yardstick of 1926, if that is not stability? Why do you use that particular yardstick?

Governor ECCLES. I do not use it. I have not used it.

Mr. FISH. May I ask another question which is a little bit different? Do you approve this recent R. F. C. bill that went through, providing for $1,500,000,000 to be spent without any maturity dates, and without any restriction as to the size of the loans, and without any limitations at all?

Governor ECCLES. That bill has passed, has it not?

Mr. FISH. It has just passed.

Governor ECCLES. Then it is water over the dam, and therefore I see no occasion at this time to express a view with reference to a matter of that sort. If I had been asked to testify when the bill was under consideration, I might have had something to say about it.

Mr. FISH. We had nothing to say ourselves in the House about it, so I thought that I would ask you now.

Governor ECCLES. I am not familiar with the details of the bill.

Mr. FISH. There is just one other question that I want to ask you, and that is this: Has there been any increase in the currency of the United States since 1929, and, if so, how much?

Governor ECCLES. Yes; there has been an increase.

Mr. FISH. Approximately how much? The reason I raise this question is that there is feeling in the country today that there has been an enormous increase.

Governor ECCLES. There has been an increase of about 2 billion dollars.

Mr. FISH. What does that make it? From five to seven billions?

Governor ECCLES. No; from about four billion four hundred million to six billion four hundred million.

Mr. FISH. Therefore we have more currency today than we had in the boom days?

Governor ECCLES. We have about $2,000,000,000 more.

Mr. PATMAN. What about demand deposits?

Governor ECCLES. Demand deposits are also substantially greater.

Mr. PATMAN. How much greater?

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Dr. GOLDENWEISER. About one billion.

Mr. PATMAN. Then compare it with the velocity?

Governor ECCLES. The velocity is very much lower, but you just passed a bill with reference to the undistributed profits tax that will tend to slow up rather than stimulate velocity, and one reason your velocity is slow in part is because of the concentration of these bank balances.

Mr. PATMAN. I want to ask about that——

Mr. TRANSUE (interposing). Will you give us your opinion of that undistributed profits tax?

Governor ECCLES. That is water over the dam, too.

Mr. TRANSUE. No; that will come back. We want your views.

Governor ECCLES. You raised this question, Mr. Patman, about the velocity of money. You have an increase here of about 50 percent in the volume of currency in circulation as compared with 1929, and yet you have a volume of business very much less. You have more demand deposits than you had in 1920. You have a total of about three billions more currency and demand deposits than you had in 1929.

Now, three billions is about 10 or 11 percent more total money than you had in 1929, and that in itself would tend to prove that the volume theory of money does not assure an increased price level or an increased business activity; because here you are with a national income and a total production of possibly 25, 30, or 35 percent below the 1929 figure, with the volume of money almost 11 percent more.

Mr. GIFFORD. Governor, let me ask you one question.

Mr. TRANSUE. May I ask him a question?

Mr. GIFFORD. I beg your pardon.

Mr. TRANSUE. I was just trying to get to the undistributed-profits-tax proposition.

Governor ECCLES. I was going to answer that question now. The indication is, then, that the volume of the means of payment is adequate to supply a very much larger volume of production and employment than we had in 1929, at an average price level which was much higher. It is the velocity of money, or the turnover, that is sluggish, and therefore to find the reasons for the present situation, we must find some of the reasons or consider some of the reasons for the slowness or the inadequacy of the turnover of funds as compared with past experiences.

Mr. GIFFORD. Now, Governor——

Governor ECCLES (interposing). Now, this question of tax is only one factor.

The question of the undistributed profits tax was one of the questions raised. The tax required business to disburse earnings, and the elimination of the tax will make it unnecessary for business to disburse earnings. It will encourage, if anything, the payment of debt. At the present time we are trying to get an expansion of credit and an increase in business activity. To the extent that business as a whole will take more money in than it pays out and uses the funds to liquidate debt, the total supply of the means of payment will be reduced. Someone has to take up the slack, and that is where Government has to come into the picture, if the process of liquidation goes far enough.

Mr. TRANSUE. Let me ask you——

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Governor ECCLES. If business retained earnings, and invested those earnings in capital account, the money would then go back in circulation. It would seem to me that if Congress in the consideration of this tax takes into account the monetary effect of it, and requires corporations either to disburse their earnings in dividends—exempting little companies altogether because they have no access to the capital market, and I have always been in favor of that exemption—or permits companies to invest their funds in expansion of plant and facilities, to give employment, the exemption would be justified because the money would be put into circulation.

Mr. GOLDSBOROUGH. Mr. Eccles——

Mr. TRANSUE. I just want to ask him this one question.

Mr. GOLDSBOROUGH. We have to adjourn.

Mr. TRANSUE. I want to make this one observation to the witness. You do not agree with those who claim that the repeal of this tax will create confidence?

Governor ECCLES. I think the elimination of the tax is deflationary.

Mr. GIFFORD. I am anxious to make an observation.

Governor ECCLES. I think the present tax law should be modified, but the proposal to eliminate it altogether rather than to modify it and encourage expansion is deflationary, and it will be deflationary in its effect.

Mr. GOLDSBOROUGH. Mr. Luce has been wanting to ask a question.

Mr. LUCE. Mr. Chairman, one question.

The President has from time to time committed himself to the proposition that it is desirable for contracts to be executed by the payment of the same purchasing power as that which existed when the contracts were made. If that is to be done, there should be determination of the average life of contracts in order to work the most justice and the least injustice. Has your Board ever attempted to ascertain even roughly what the average life of outstanding contracts of this country is?

Governor ECCLES. Not that I know of.

Do you know, Dr. Goldenweiser?

Dr. GOLDENWEISER. No.

Governor ECCLES. He says not. By contracts, you mean credit instruments?

Mr. LUCE. All kinds of credit instruments.

Would it be possible for you to furnish us with an estimate, at your convenience, as to that, because if we set any figure, 1926 or any other, it would certainly be desirable to have that information.

Governor ECCLES. That of course is constantly changing, and any figure that would be given would certainly have to be a rough estimate, and even then it would no doubt require considerable study. Naturally, on Government securities, and on listed bonds, you could determine the volume, the amount of each issue, and its maturity, but when you get into the question of the numerous debts between individuals, and between corporations and individuals, and various types of contracts and credit instruments which would make up a great part of the total volume of debts, that would have to be purely an estimate.

Mr. GOLDSBOROUGH. Mr. Eccles, there is a bill being read for amendments on the floor, and I think that if the committee meets promptly tomorrow morning at half past 10, we can get through with

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you gentlemen so that you won't have to return any more. Can you come tomorrow morning?

Governor ECCLES. Tomorrow at half past 10?

Mr. GOLDSBOROUGH. Yes.

Governor ECCLES. Yes.

I would like to say this to the committee, that Governor Ransom, the vice chairman of the Board, is here, and also the senior members of our staff are here, and any of them would be prepared to testify with reference to the Reserve System and its present operation in a detailed or technical manner to whatever extent the committee might desire to go into the question of the present operation of the Reserve System or the banking system. But I should be very glad to come back tomorrow.

Mr. GOLDSBOROUGH. I think that there are some members of the committee who would like to interrogate you further.

Mr. GIFFORD. I want to make an observation.

A leading financial expert states that money is being hoarded lately not because of its increase in value, but for safety because of the very action of the Government in insuring bank deposits. That is why they are keeping it safe, and keeping it idle.

Mr. PATMAN. You mean those who have more than $5,000?

Mr. GIFFORD. That is distributed all around.

Mr. REILLY. The committee members have heard a great deal about the English system of controlling the currency, and how they manage things in England. I wonder if Governor Eccles cannot have somebody come before this committee and tell us about the English system, and how it functions?

Governor ECCLES. I think that Dr. Goldenweiser could testify with reference to that matter. We certainly have a lot of data at the Reserve System, and I am sure that we would be able to give to this committee some information with respect to that subject.

Mr. GOLDSBOROUGH. The committee will adjourn until half past 10 tomorrow morning.

(Thereupon, at 12:15 p. m., an adjournment was taken until Wednesday morning, April 13, 1938, at 10:30 a. m.)

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GOVERNMENT OWNERSHIP OF THE 12 FEDERAL RESERVE BANKS

WEDNESDAY, APRIL 13, 1938

HOUSE OF REPRESENTATIVES,
Committee on Banking and Currency,
Washington, D. C.

Hearings on H. R. 7230 were resumed at 10:35 a. m., Hon. T. Alan Goldsborough presiding.

Other members of the committee present: Mr. Reilly, Mr. Williams, Mr. Spence, Mr. Farley, Mr. Ford, Mr. Brown, Mr. Patman, Mr. Transue, Mr. Gifford, Mr. Luce, and Mr. Crawford.

Mr. GOLDSBOROUGH. The committee will come to order.

Is Mr. Eccles here?

Mr. RANSOM. He has not yet arrived.

Mr. GOLDSBOROUGH. Dr. Goldenweiser, it was stated yesterday that you could give us some information about the English system. While we are waiting for Mr. Eccles, will you give us such information as you can, please?

Dr. GOLDENWWEISER. All right, sir.

Mr. GOLDSBOROUGH. Dr. Goldenweiser, you had better give the reporter your name and your association, please.

Dr. GOLDENWEISER. My name is E. A. Goldenweiser, Director of the Division of Research and Statistics of the Board of Governors of the Federal Reserve System.

Mr. GOLDSBOROUGH. How long have you been Director?

Dr. GOLDENWEISER. I have been Director since 1926.

Mr. GOLDSBOROUGH. It seems to me that I have been getting information from you a good deal longer than that.

Dr. GOLDENWEISER. I have been connected with the Federal Reserve Board since 1919, but have been in my present position since 1926.

Mr. GOLDSBOROUGH. Doctor, the committee yesterday expressed interest in information concerning the English system of regulating the supply of money, production, and business generally, and the committee would be very glad to hear from you.

Dr. GOLDENWEISER. Mr. Chairman, I am not as much of an expert on this subject as I wish I could be for your benefit, because my time is given so much——

Mr. GOLDSBOROUGH. Governor Eccles has just come in. Will you please suspend?

Governor ECCLES. I am sorry to be late.

(After a brief conference at the bench between Mr. Goldsborough and Governor Eccles:)

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Mr. Goldsborough. Governor Eccles has to leave here at 11 o'clock to attend what I know is a very important conference. If we can assist him by rushing as rapidly as feasible, let us do it.

Now, Mr. Williams, you have some questions that you want to ask. I believe.

STATEMENT OF HON. MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

Mr. Williams. I understood from your statement yesterday, Governor, that you did not think that the Federal Reserve Board could establish a price level equal to that of 1926, and, if they could, that it would not be desirable. Is that correct?

Governor Eccles. No; I did not say that the 1926 price level would not be desirable, or that the Reserve Board had no power by which it could establish the 1926 price level. I said that a stable price level may not be necessarily satisfactory, that a fixed price level may not be necessarily a satisfactory price level, because within the range of prices you may have some articles very low, and others very high.

Mr. Williams. Do you think that the price level in 1926 is a desirable goal?

Governor Eccles. The price level of what?

Mr. Williams. The general price level as it existed at that time.

Governor Eccles. I would see no objection to that price level if it were arrived at over a sufficient period of time, and if all items within that price level could be brought into balance or an equilibrium maintained.

Mr. Williams. That is the question that I had in mind. Were the individual prices so balanced and adjusted at that time as to be quitable and just?

Governor Eccles. I could not say.

Mr. Williams. You do not know whether that is true or not?

Governor Eccles. I do not know. I think that the agricultural people were not satisfied with the agricultural prices of 1926.

Mr. Williams. Beyond any question, the agricultural prices were not on a parity with others.

Governor Eccles. They were dissatisfied in 1926.

Mr. Williams. And there was a disequilibrium so far as that is concerned. At least, that is my recollection of it.

Governor Eccles. There will always be, no matter what the price level is, a feeling that certain groups are not getting prices that are equitable as compared with other groups.

Mr. Williams. I understood you to say yesterday that the price level was fairly stable during the period from 1927 to 1929 especially.

Governor Eccles. That is right.

Mr. Williams. What, if anything, from your study of the situation, or your knowledge of it at that time, did the Federal Reserve Board have to do with the stabilization of that price level?

Governor Eccles. Well, I do not know that it had anything to do with it, unless by changing the discount rate. The discount rate, Dr. Goldenweiser, was changed several times during that period. Was there any open-market operation?

Dr. Goldenweiser. In 1928 there was a very large one. In 1927 there were purchases, and in 1928 there were very large sales of securities.

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Governor ECCLES. How much?

Dr. GOLDENWEISER. About four hundred million.

Governor ECCLES. And they were bills, in part?

Dr. GOLDENWEISER. Mostly Government securities.

Governor ECCLES. And bankers' acceptances were also——

Dr. GOLDENWEISER. Bankers' acceptances ran off rather later, but the System's open-market investment account was in large part liquidated in 1928, because of the speculative situation that was developing at that time.

Governor ECCLES. You could ask Dr. Goldenweiser that when he goes on. He was with the Board at that time. I do not recall just now what action was taken.

Mr. WILLIAMS. Now, the action of the present Board in raising the reserve requirements took place in the latter part of 1936, as I recall, and the first half of 1937.

Governor ECCLES. August of 1936.

Mr. WILLIAMS. That was the first one?

Governor ECCLES. That is right.

Mr. WILLIAMS. And the second was in 1937, extending from March to May, as I recollect.

Governor ECCLES. That is correct.

Mr. WILLIAMS. What was the purpose of that, Governor? Generally, what did the Board have in mind?

Governor ECCLES. When the Board got power to increase reserve requirements, it was recognized that there was an abnormal amount of gold that had come into the country, and there was a prospect of its continuing to come into the country. That gold added to the excess reserves of the banking system. The excess reserves were such as to enable the banking system to extend a very large additional volume of credit, an amount of credit which, had it been expanded on the basis of the total excess reserves available, would have created an undesirable inflationary condition.

Mr. WILLIAMS. Was there any——

Governor ECCLES (continuing). Now, in the Banking Act of 1935, when this power was given to the Board, it was given for the purpose of meeting the abnormal situation that the gold imports would bring about by adding to the excess reserves.

The Board felt that action should be taken at a time when these excess reserves were universally distributed, and when they were larger than could possibly be used, and at a time when there was a condition of increased prices developing.

It was not a case of eliminating all excess reserves, and it was not a question of creating a tight money situation, and when the first increase was put into effect in August of 1936, it had little, if any, effect. As a matter of fact, the real upturn in prices, particularly in the heavy goods field, in construction costs, and in machinery and equipment, happened in November, December, January, February, March, April, and May of 1936 and 1937.

So the increase of 50 percent in August of 1936 had not the slightest effect in either slowing up the business activity or in affecting the price level, and it was anticipated that it would not. It was merely a question of putting the Reserve System nearer to a position where, if need be, at some time in the future, it could control

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the situation. It would have taken a preliminary step so that it would be nearer to that position of control.

Now, action on the later increase was taken at a time when there was a rapid inflationary development. Particularly was that true in certain fields. The whole thought and spirit of the country was inflationary. There was talk everywhere that there was going to be an uncontrolled inflation. The stock market reflected it. The business interests throughout the country, as the result of anticipating that inflation, bought heavily—not only the current requirements, but they placed orders for weeks and months ahead. The labor situation may have had some effect in placing those orders, but I think that in a great majority of cases it was the prospect of higher prices, and people were buying in anticipation of the profits.

It was that very action of speculative forward buying in itself that tended to force prices up, and it was the expectation of an inflationary development that did it.

Now, certainly the situation that developed no one can say was desirable. But it is my view that had we taken no action whatever with respect to reserves, you would have had approximately the same pattern that has developed. If there was a mistake in the action that we took in 1937 it was that we acted in the spring of 1937 instead of in the fall of 1936. I am sure that had we taken no action in 1936 and 1937 with reference to increasing the reserve requirements you would still have your present situation very largely as it is, because of these other factors that I have referred to, but you may have had a situation much worse than at the present time, because your inflationary development might have gone even further than it did. Our action may have tended to slow it up.

Had it gone further than it did, and you had gotten a futher disequilibrium in prices, the reaction could have been even greater.

Now, I am conscious of the fact that many people say today that because we did not act sooner but continued an abnormal easy money policy, we brought about the inflationary condition that developed, and hence we are responsible for the recession.

I am also conscious of the fact that there is another great body of opinion that says we put on the brakes and tightened up money, and that brought about the recession.

No matter what the Federal Reserve does in the future, and no matter what it has done in the past, it will always be on the spot, and so long as I am on the Board, I expect to be in just that position. You have in the country your debtor and your creditor classes. Your debtor classes as a general rule want inflation, so that they can pay debts with cheaper dollars, and your creditor class wants the opposite, and neither one of them is ever thoroughly satisfied with the purchasing power of the dollar.

Our job is to try to find a middle ground and to try to be fair to all groups so far as the limited powers that we have enable us to contribute in the national picture toward maintaining a condition of full employment, or as full employment as possible, and with full employment I mean full production. That should certainly be our objective, and we should do nothing to restrict the ability of the credit mechanism to furnish an adequate means of payment to meet the requirements of the country.

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As I said last spring, at the time action was taken, so long as you have idle men and idle facilities, it would be a great mistake not to make available a continued supply of funds at the lowest possible interest rates.

Mr. WILLIAMS. Well, then the purpose of the raising of the reserve requirements was to check what appeared to be a threatened undue expansion or inflationary movement.

Governor ECCLES. No. I suggested to the committee yesterday that if they would read the first few pages of the annual report of the Board, it would pretty well cover the reasons that the Board gave for the action taken.

Mr. WILLIAMS. I understood from your statement just now that there was a condition developing in the spring of 1937——

Governor ECCLES. That is right. There was not in 1936, when the Board took action.

Mr. WILLIAMS. But there was in 1937?

Governor ECCLES. That is correct.

Mr. WILLIAMS. What effect on that movement did your action have?

Governor ECCLES. Well, of course, that is something that I cannot say. We did not take any action for the purpose of putting on the brakes or restricting the available supply of credit or increasing the interest rates.

Mr. WILLIAMS. Did you take it with reference to the inflationary movement that was evident?

Governor ECCLES. No.

Mr. WILLIAMS. And you do not know now what effect your action had on that movement?

Governor ECCLES. No. I can give only an opinion, which I have given, with reference to that. That is my personal opinion and, of course, there is a difference of opinion.

Mr. WILLIAMS. Your personal opinion, as I understand it, is that it did not have much to do with it?

Governor ECCLES. That is right. That is my personal opinion.

Mr. PATMAN. Much or any?

Governor ECCLES. Well, it may have—I would not say it did not have any. I think that psychologically it may have tended to sober up the country and to give notice that we were conscious of the situation that was developing and were moving into a position where we could, if need be, take further action.

Mr. GOLDSBOROUGH. All of its effect is psychological, is it not?

Governor ECCLES. That is right.

Mr. WILLIAMS. What effect did it have on the banks? What action became necessary, if any, on the part of the banks to meet those requirements?

Governor ECCLES. Practically none.

Mr. WILLIAMS. It has been stated here that they had to sell considerable bonds.

Governor ECCLES. They did not. Most of the bonds that were sold were not sold because it was necessary to sell them to meet the reserve requirements. You must recall that the Government bond market had been going up almost continuously for several years, and that the interest rate on Government long-term bonds had dropped down to about 2.2 percent; that practically every bank in the country that

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had bought Government bonds had a very large profit in those bonds; that there was very little prospect that the bonds could continue to go higher after such a rise over such a period, and that the interest rate would likely go lower. The fact that we did move in the direction of reducing excess reserves was, of course, notice that there was not likely to be a further increase in the price of bonds at the time; and many banks, I think, sold bonds—they did not have to at all—in order to take the profits which they had.

There may have been a few instances in the money market banks where it was necessary to sell. I think we estimated $122,000,000 as the aggregate of these cases in which individual member banks would be short of the proposed second increase, after allowing for use of half their balances with correspondent banks. Approximately $100,000,000 of that estimated shortage was in the New York money market banks. Only $22,000,000 was in banks outside of New York and only $2,000,000 at banks outside Reserve cities. After the 1937 increases became effective there were approximately $900,000,000 of excess reserves, taking the country as a whole. The estimated $100,000,000 that banks in New York had to provide affected comparatively few banks. These were money-market banks, and the principal reason they sold their Governments was to take their profits, because they had a very large amount of short-term paper that they could have permitted to run off; they were holders of Government bills maturing every month; in fact, most of the Government bills were held by the money-market banks. They were also large holders of call loans; they were holders of bankers' acceptances; so that they were in a position where they could have let the shorter term securities run off, and those banks that had the excess, of course, would have been glad to take them up immediately.

But instead of doing that, they chose to take their profit on long-term Governments, and that adjustment in the price of Government bonds, whether we had increased reserves or not, would have come sooner or later, because you cannot have bonds go up and interest rates go down and have an increasing amount of profits accumulating without having banks wanting to take those profits.

Mr. WILLIAMS. As I understood it, you want to quit at this time, but I wanted to ask some more questions.

Mr. SPENCE. I just want to ask him one question.

Mr. GOLDSBOROUGH. Mr. Crawford has been asking for recognition for some time.

Mr. WILLIAMS. I have a number of questions that I would like to ask, but I understood that you wanted to get away.

Governor ECCLES. I would like to get away within 10 or 15 minutes.

Mr. SPENCE. Right along the line that he has been discussing, I would like to ask just one question.

Mr. GOLDSBOROUGH. Proceed.

Mr. SPENCE. On May 17, 1920, the Senate adopted this resolution:

> *Resolved*, That the Federal Reserve Board be directed to advise the Senate what steps is purposes to take to recommend to the member banks of the Federal Reserve System to meet the existing inflation of the currency and credits and consequent high prices, and what further steps it purposes to take or recommend to mobilize credits in order to move the 1920 crop.

Now, Governor Harding answered that resolution, and he thought that by the control of credits of the member banks he could very

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vitally affect the price level, as I read this report, and I want to know if you agree with that.

Are you familiar with his report?

Governor ECCLES. No, sir; I am not familiar with it. I am somewhat familiar with the condition which existed in 1920 and 1921, which is a very different situation from that which now exists in the banking system.

Mr. GOLDSBOROUGH. He appeared before this committee for 3 hours, and he said that they never contracted credit. He spent 3 hours in trying to say that he had not done it. That is all that we got out of him.

Governor ECCLES. In 1920 the banking system did not have excess reserves, and the discount rate was the most effective instrument at that time for credit control.

Mr. GOLDSBOROUGH. That is what was used.

Governor ECCLES. That is right.

Mr. GOLDSBOROUGH. In some of the southern banks, the discount rate was put up to 87 percent.

Mr. PATMAN. Wait a minute—87 percent? Do you mean the discount rate?

Mr. GOLDSBOROUGH. The rediscount rate.

Mr. PATMAN. 87 percent?

Mr. GOLDSBOROUGH. Correct.

Mr. PATMAN. I never heard of that.

Mr. GOLDSBOROUGH. It is a fact.

Mr. CRAWFORD. May I ask a question?

Were you through, Mr. Spence?

Mr. SPENCE. Yes.

Governor ECCLES. I was going to say that you could increase the discount rate so that the member banks would restrict the use of credit to their customers and that would tend possibly to reduce outstanding credit, which would force a liquidation in the sale of commodities and could stop business expansion. You can certainly bring down the price level and slow up business expansion on a tight money basis. I do not think there is any question, but what if you act promptly enough through monetary action you can control an inflationary credit expansion by the banking system if the excess reserves are not so large that the means available to the Reserve System are inadequate. If the means available to the Reserve System are of sufficient adequacy to absorb excess reserves, so that your discount rate becomes effective, there is no question but what you could control such an inflationary development.

Now, in 1920 the situation was such that the banks were borrowing from the Federal Reserve System during that period, or a good many of them, at least, and the Board raised the discount rate and did create a restrictive money policy.

Compare that with the situation that existed in 1936 and 1937, when it is said we put on the brakes, although there were $900,000,000 of excess reserves, an amount of excess reserves many times as great as ever existed at any time during the period of the 1920's.

Psychologically, the action that we took did have a sobering effect, because it did give notice to the country, just as the Treasury's sterilization gave notice, that the Treasury and the Federal Reserve System were conscious of a situation that seemed to be developing. It served notice that we were prepared to meet a dangerous inflation.

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But certainly we never met it; we never had to meet it. The psychological effect, apparently, was at least partly sufficient, or the very weight of the excess inventories, the very fact that prices went up so fast and inventories became so large, and the building of homes and the buying of railroad equipment stopped or slowed down—that in itself was sufficient without any action, it seems to me, to bring an adjustment. The disequilibrium that was developing in the system between agricultural prices and manufacturing prices as a result of that development is another factor that was sufficient, it seems to me, to create the condition that we have.

Mr. WILLIAMS. What would have been the difference between raising the reserve requirements, as you say, and selling governments?

Governor ECCLES. Well, raising the reserve requirements affects all banks. It was universally applied. The selling of governments would affect only those institutions that bought governments, and it would largely have affected—well, it would affect any institutions that bought them. I was going to say that it would have affected the money market banks, mostly, but that may have been true or may not. It would have been true had we sold bills, because only the money-market banks are purchasers of bills. In selling bonds, they may have been purchased by banks or individuals; I do not know. Open-market operations are a more flexible instrument, without question, for current adjustments, but for absorbing any substantial part of the excess reserves they would have been too drastic, because such operations would involve far greater sales than merely the current selling of governments or buying of governments in small amounts such as the market can absorb, or such as you can pick up in the market, without upsetting prices. Current operations, if not on too large a scale, help to determine the ability both to sell and to buy. If you go into the market and buy a lot of governments—and the law prohibits us from buying them directly from the Treasury—you could very well run up the market, normally, just as undertaking to sell them would do the reverse.

Mr. WILLIAMS. But you did buy following this order, did you not?

Governor ECCLES. We bought along in April, during the period of several weeks, a total of 96 millions, and at the time we announced this order, we made a statement that we had a flexible instrument of monetary control which we could and would use.

Mr. WILLIAMS. What was the purpose of that buying?

Governor ECCLES. The purpose was to give to the banks that were short of reserves, these banks that I mentioned, an opportunity to sell if they wanted to. It was done for the further purpose of stabilizing the capital market, because the Government bond market is the determining factor in the capital market.

Mr. WILLIAMS. The bond market had gone down?

Governor ECCLES. Yes.

Mr. WILLIAMS. What effect did the desterilization of gold have?

Governor ECCLES. It had the effect of keeping the excess reserves from building up from that source. It had the effect——

Mr. SPENCE. He said the desterilization.

Governor ECCLES. I thought you meant the sterilization of gold, when it was started.

Mr. WILLIAMS. Yes; that is it, to the extent that it was desterilized.

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Governor ECCLES. In September 1937?

Mr. WILLIAMS. Yes.

Governor ECCLES. It added to the reserves by the amount of the desterilizing, which was about 300 millions.

Mr. WILLIAMS. Why didn't we desterilize $1,200,000,000 more?

Governor ECCLES. It would add to the excess reserves by that amount.

Mr. WILLIAMS. Would that tend to create an inflationary condition?

Governor ECCLES. It would tend to create a basis for one if the excess reserves were used to the extent that they could be in the expansion of credit. I think psychologically it would be inflationary, just as I think decreasing the reserve requirements would be psychologically inflationary. Those two actions might tend to induce borrowing, or to induce the more rapid flow of existing funds. They would tend to increase the volume of funds to the extent that such action induced borrowing, and to the extent that the action induced owners of money to feel that they should use the money it would be inflationary in increasing the velocity. But so far as the ability of banks as a whole to expand credit is concerned, the action would not be necessary, because they are not using now anywhere near their ability to expand credit.

So the effect of such action as desterilization or decreasing reserve requirements probably would be, psychologically, inflationary.

Mr. WILLIAMS. If that should be done, then we would be in the same position we were before the Board made the order increasing the reserves?

Governor ECCLES. That is correct.

Mr. WILLIAMS. In other words, we would have on account of taking that action almost in the neighborhood of $3,000,000,000?

Governor ECCLES. That is correct; that is, if the desterilization were undertaken. The total excess reserves got up to about three billion three hundred millions at the high point, before we increased reserve requirements in August 1936. At that time we increased them a billion and a half. Excess reserves dropped down to one billion eight hundred millions, and then built up again from gold imports to two billion two hundred millions before we increased reserve requirements again in the spring of 1937.

I would just like to point out the distinction between the increasing of reserve requirements and sterilization. Gold was sterilized largely for the purpose of keeping it from adding further to the excess reserves. Gold was sterilized in December of 1936; that is when the program was first instituted, by the Government borrowing money. It would seem hardly reasonable to expect the Government to borrow money and sterilize gold in order to keep that gold from adding to the excess reserves, while the Board failed to use the powers which Congress had given it to increase reserve requirements, which would have, of course, the same effect.

In other words, Congress gave to the Board the power to increase reserve requirements, which in effect was the same as sterilizing gold imports. That could be done without the Government borrowing any money, or without any cost to the Treasury. That power represented an amount of three billions; that is, we had the power to sterilize up to three billions through increasing reserves. The borrow-

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ing of money by the Treasury to sterilize gold had the effect of keeping that gold from adding further to excess reserves.

As to the proposal to desterilize now, everybody knows that I have favored it, if the funds which are desterilized are spent for public purposes and go into increased buying power. Also when they come back they will add to the deposits of the banks and add to the reserves of the banks. The situation today is very different from what it was at the time either sterilization was undertaken or the increase in reserve requirements of the banks was undertaken. The psycohology is deflationary today, as it was inflationary then. If further excess reserves would tend to stop a deflationary process, psychologically that would be a favorable result. However, it would take more than mere psychology. It must be followed up by consumer buying power. It must be followed up by more than merely speculation in prices, induced by a fear of inflation. To the extent that relief money or other funds for other purposes go into the spending stream, that will increase the flow of money, increase the means of payment in the hands of those that would spend, where merely an increase in the excess reserves alone, if it had any effect, would have a psychological effect of an inflationary nature that might cause certain commodities or securities to rise temporarily, and might cause a further increase in inventories. But unless there was buying power to follow that up, it could bog down again, just as happened after the N. R. A., which tended to put prices up because everyone thought things were going to cost more. At that time production went up very rapidly for 2 or 3 months, but because there was no mass buying power to take away what was produced, you will recall that it soon collapsed.

A merely monetary action to bring people into speculative activity could bog down again and you would be as bad or worse off than you were before unless you did something by way of enabling consumer buying power to move inventories, to carry out a program of construction and general business activity.

Mr. TRANSUE. Can you give us, briefly, your suggestions for furnishing that consumers' buying power?

Governor ECCLES. That is a long story.

Mr. CRAWFORD. Just one question, and I think that he can answer it very briefly.

Referring to your observation relative to eliminating the Open Market Committee, and to the so-called pump-priming announcement in the papers this morning, do you feel that your group would be more inclined to purchase the bonds which will be necessary under this program, if bonds are sold for the Federal System, if that Open Market Committee is thus done away with and the Federal Reserve bank representatives thus removed?

Governor ECCLES. I do not know that that would make any great difference. But let me see if I understand your question. Would the Reserve System be more willing to buy the bonds if——

Mr. CRAWFORD. Would the Reserve System be more likely to buy bonds?

Governor ECCLES. If the power were exclusively in the Board, and if the bank members were off the Open Market Committee?

Mr. CRAWFORD. That is right.

Governor ECCLES. Well, this, of course, is true. The bank representatives on the Open Market Committee are not the appointees of

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the President, nor are they the representatives of Congress at all. They are selected in the first instance by private bankers and business people, and they therefore represent less of a public interest, possibly, than the Board. At least they would be required, if anything, to represent less of a public interest in their point of view, and maybe because of that situation they would act differently. I have felt very strongly that the function of the Open Market Committee should be confined exclusively to members of the Federal Reserve Board, who are the representatives of Congress in dealing with these monetary and credit problems.

Mr. CRAWFORD. And public necessity?

Governor ECCLES. That is right.

Mr. CRAWFORD. That is all that I will take time on now.

Mr. PATMAN. I do not want him to answer these questions now, but I want to ask them so that the reporter may give him the questions, and he can put them in his testimony.

Governor ECCLES. Could I get a copy of them?

Mr. PATMAN. Surely. I want you to get a copy of them and answer them later. Will that be all right?

Governor ECCLES. Yes.

Mr. PATMAN. The first question is that the law prohibits the Federal Reserve System from buying bonds directly from the Treasury. I wonder if you are in favor of changing the law, so that you can buy bonds directly from the Treasury?

(The answer subsequently submitted by Mr. Eccles is as follows:)

The prohibition against direct purchases of securities by the Federal Reserve banks from the Treasury was put in the Banking Act of 1935 not on our recommendation. Apparently, those who placed it there believed that it would prevent the Federal Reserve banks from financing Treasury deficits. As a matter of fact, the provision would not prevent this, as the Federal Reserve banks may time their purchases of Treasury securities in the open market with sales by the Treasury. The only effect the provision has in practice in this regard is to make it necessary for the Reserve banks to pay commissions to brokers. It also makes it impossible for the Reserve banks to accept short-term certificates of indebtedness from the Treasury in anticipation of tax receipts during quarterly financing and income-tax payment periods. Such advances were previously used to avoid large temporary fluctuations in the volume of bank reserves. In view of these considerations I would be glad to see the provision taken out of the law.

Mr. PATMAN. The next question is, Did you take into consideration the money that was being paid to the veterans on their adjusted service certificates commencing June 15, 1936, when the Board ordered the reserve requirements to be raised in the summer and fall of 1936?

Is it not a fact that you took that into consideration, and you were making an effort to offset those payments?

(The answer furnished later by Mr. Eccles is as follows:)

In determining upon raising reserve requirements in July 1936 the Board was guided by the fact that there was a large amount of member bank reserves brought about by gold imports and was in no way influenced by the payment of the veterans' adjusted service certificates. The payment of these certificates had no direct relationship to the reserve position of member banks and was not a factor in the Board's decision.

Mr. PATMAN. The next question is, I want you to insert in the record a definition of the word "inflationary."

(The answer furnished by Mr. Eccles is as follows:)

It is not easy to define "inflationary." Sometimes the word is used to mean anything that results in a rise of activity or an advance in prices; often it is

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limited only to monetary developments that result in rising prices. I would say that the word "inflationary" describes conditions where a large element of speculation comes into the picture so that activity is motivated in part by the expectation of advancing prices and costs. It is usually characterized by excessive forward buying and inventory accumulation. I would distinguish such conditions sharply from those where expansion of activity is orderly in character, and production is motivated by and geared in with the current requirements of consumption. The latter set of conditions can be longer sustained and result in a rising standard of living. The former are usually short-lived and invariably have a painful aftermath.

Mr. PATMAN. Next, on February 16 of last year, following the increase in reserve requirements, you testified that you did not believe this action would raise long-term interest rates. Within 6 weeks Government bond prices declined about five points with an increase in the yield to maturity on those issues of almost one-half of 1 percent. Was this demoralization of the money market due to the fact that the representatives of the Federal Reserve banks on the open-market committee refused to engage in prompt open-market purchases?

(The answer subsequently furnished by Mr. Eccles is as follows:)

When I said that I did not think long-term interest rates would advance I did not mean that there would not be temporary fluctuations and perhaps some upward adjustment in those rates, which were exceedingly low as compared with all past standards. The average rate of long-term Government bonds had gone down to 2¼ percent and a readjustment in those rates and in rates on high-grade corporate bonds was not surprising. The readjustment that took place last March was not necessitated by the action on reserves. As I have previously explained, the comparatively few banks in New York that did not have enough excess reserves to meet the increase had a very large profit in Government bonds and decided to realize the profit on these bonds, which, of course, had an influence on the long-term rate at that time. Had these banks been concerned merely with meeting the reserve requirements, they could have permitted some of their holdings of short-term paper to run off or they could have reduced their call loans or bankers' acceptances, which would not have had the same effect on long-term rates and at the same time would have provided them with such additional reserves as they might need. The entire estimated shortage of reserves amounted to not more than $100,000,000 for the few New York money-market banks which I have mentioned and did not exceed $22,000,000 for banks outside of New York, yet, all told, the banks sold approximately $1,000,000,000 of bonds in the first half of 1937. There had already been a fall in bond prices in England beginning in October of 1936 which exceeded the drop in our market and, of course, there was no increase in reserve requirements in England. As a matter of fact, the Federal Reserve System acted to temper the decline. During March and April of 1937 the System purchased $202,000,000 of bonds and disposed of $106,000,000 of its short-term holdings. Subsequently prices rose somewhat, and since the end of last year long-term Treasury bond yields have averaged approximately 2½ percent.

As to the position of the bank representatives on the open-market committee, as you know, I am on record as favoring their removal from the committee. However, it would not be fair to the bank representatives, who, of course, are not a majority of the committee in any case, to give the impression that because of a refusal or obstructive attitude they had failed to act or had prevented prompt action at this period.

Mr. GOLDSBOROUGH. Now, Mr. Eccles, if you desire to leave, the committee appreciates very much your coming down, and we were very much helped by your discussion.

Mr. REILLY. The Governor can come back again. We like to have him visit with the committee.

Mr. GOLDSBOROUGH. We are always happy to have the Governor.

Mr. PATMAN. I wish that you could answer that first question now, as to whether or not the Federal Reserve System——

Governor ECCLES. I would like to answer all four of them, but it would take a little time.

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Mr. CRAWFORD. May I put in, with those questions, this question also?

Mr. GOLDSBOROUGH. Without objection; yes.

Mr. CRAWFORD. It is to be addressed to the Chairman of the Board. What inducements, if any, has the Board to offer nonmember State banks in order to bring them into the Federal Reserve System, and this question is directed to the impression I got that Chairman Eccles is opposed to the provisions of the Patman bill which would bring into the System present nonmember State banks.

I just throw that question in.

(The answer subsequently submitted is as follows:)

The principal inducements that the Federal Reserve System offers to nonmember banks are, first, the prestige of membership, growing out of public knowledge that member banks must conform to established standards, are subject to Federal supervision, and can resort to the Federal Reserve banks for assistance in case of need, and, second, the definite assurance to the banks themselves that they can always obtain accommodation from the Federal Reserve banks. It is well known that correspondent banks are likely to be under pressure themselves at a time when their correspondents want help and that it may be difficult for them to get help in that way. In addition, facilities for clearing and collection of checks and other items and for obtaining currency are provided to member banks. It is true that in most cases nonmember banks may obtain similar facilities through city correspondents, but the correspondents are aided in providing them by being members of the Reserve System. Balances required to be carried by country banks with city correspondents in order to obtain these privileges have resulted in building up the importance and dominance of large city banks in our financial structure. As I understand the Patman bill, it would not bring State nonmember banks into the System, but on the contrary would remove all inducements for their joining because it would make it possible for them to get all the privileges of membership without joining whenever they chose to hold their reserves with the Reserve banks. The banks would, therefore, be able to go in and out at their own whim and pleasure, and many banks now belonging to the System might withdraw from membership. This would weaken the ability of the System to serve the public interest.

Mr. FORD. Might I put a question in there?

What effect would an amendment to the Federal Reserve Act providing for the segregation of demand deposits and time deposits, so far as reserve requirements, have? For instance, they could make the reserve requirement on demand deposits different from what it is now but leave the reserve requirement on time deposits where it was prior to the reserve requirements being raised.

My question is, What effect would that have?

(The answer subsequently submitted is as follows:)

Time deposits and demand deposits now have different reserve requirements. Under the terms of the Banking Act of 1935, it is possible for the Board to vary, within limits, the required reserves for time and demand deposits separately, and it has done so.

Mr. GIFFORD. Mr. Chairman, I should like to ask a question, if I may.

Mr. GOLDSBOROUGH. Proceed, sir.

Mr. GIFFORD. Because the Federal Reserve Board is compelled to work in harmony with the policies of the Treasury, does that deter them from proceeding with plans of their own?

(The answer subsequently furnished is as follows:)

The Treasury and the Federal Reserve Board have many questions in common, and as a regular thing have consultations on these problems. Mr. Ransom and I have regular meetings with the Secretary of the Treasury, and it is

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the Secretary's custom to invite the members of the executive committee of the open-market committee to meet wih him when problems of Treasury financing are discussed. Likewise, in considering the adoption of measures that may affect the Treasury there is consultation with the Secretary. The two bodies are independent, however, and the Board is not obliged to follow Treasury suggestions.

Mr. WILLIAMS. I would like to put in this question.

Mr. PATMAN. Isn't the Vice Chairman here? Why couldn't we ask him some of these questions?

Mr. GOLDSBOROUGH. I think that we had better finish this line of questions first.

Mr. WILLIAMS. What effect, if any, on the open-market policy of the open-market committee have these five members representing the banks of the country had?

Mr. CRAWFORD. May I ask you a question there, Mr. Williams?

Mr. WILLIAMS. Yes.

Mr. CRAWFORD. Do you mean effect or influence? There is a question there in my mind.

Mr. WILLIAMS. What has been the effect or the result of their being on the open-market committee whether they have affected the Board's policy or not.

Mr. PATMAN. If they have affected it, they should not be there. If they have not, they are of no use.

Mr. WILLIAMS. I think that that is something we might be interested in.

(The answer of Governor Eccles is as follows:)

The Federal Reserve bank representatives on the open-market committee are five individuals, each one of whom has a vote and the right to his own opinions. They bring to the meetings a knowledge of conditions in different parts of the country, and the New York representative in particular is familiar with conditions in the money market. As I have said before, I am in favor of placing the open-market committee's functions with the Board of Governors, which is a public body appointed by the President and confirmed by the Senate, to represent the public interest. I do not wish to imply that the bank representatives are less conscientious than Board members or that they do not act in good faith and with the best of intentions. But since they are presidents of the Reserve banks and are elected by the directors of those banks, two-thirds of whom are in turn elected by the member banks, their viewpoint necessarily is likely to reflect that of member banks. I feel that a committee which is entrusted with monetary policies as important as those given to this committee should consist entirely of persons representing the public interest.

Broadly, it seems to me, there are two important considerations in this connection. One is that the open-market committee should be in a position to act promptly in an emergency, and it is not always possible to assemble a committee from all over the country at a moment's notice. Furthermore, the problems before the committee should be constantly studied and discussed by the body charged with the responsibility of making decisions, and yet this is impossible when the members are scattered.

The second, and perhaps the more important, consideration is that the Board of Governors has full authority over changes in reserve requirements, discount rates, margin requirements, and maximum interest rates on time deposits. To have one of the most important instruments of credit policy in the hands of a different body from the Board, which has authority over the other instruments, could result in a policy adopted by the Board being nullified by the committee. To be sure, the Board has a majority of the committee, but this means that the Board, in order to make its policy prevail against the unanimous opposition of the bank representatives on the open-market committee, must be unanimous itself. The Board might, for example, reduce reserve requirements and thereby increase excess reserves. It might conceivably do so by a vote of 5 to 2. The open-market committee might be opposed to an increase in reserves, and by combining the five votes of the presidents with the two minority votes of the

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Board, might decide to reduce the open-market portfolio by an amount sufficient to offset the decrease in reserve requirements. Whether this course of events is probable or not, it is certainly possible under the existing law. In my opinion, it should not be possible.

Mr. GOLDSBOROUGH. Mr. Ransom, could we ask you a few questions?

Mr. RANSOM. All right, sir.

Mr. GOLDSBOROUGH. Will you give the reporter your name?

STATEMENT OF HON. RONALD RANSOM, VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. RANSOM. My name is Ronald Ransom, Vice Chairman of the Board of Governors of the Federal Reserve System.

Mr. GOLDSBOROUGH. The question that I am now about to ask you cannot be complete, because it must be short, but I would like to open the discussion in this way: All of the testimony which we have received from the Federal Reserve Board for the last several years has been based almost entirely on what has been spoken of as the psychological effect of their action. Now, the psychological effect of their action means simply their guess as to what the effect of their action will be, which in turn means, as I see it, that the opinion of a small group of men decides very largely the opportunities, the fate of 127,000,000 people.

Now, that, of course, presents a tremendously serious situation.

The Chairman of the Board has said a few minutes ago, and very properly so, that this whole question resolves itself around the question of consumption, the question of having consuming power, and that unless the opinion of the Board which results in its action does develop consuming power, it can have nothing but temporary effect and an effect which will cause a greater collapse than no action at all.

Now, last August bill H. R. 7188 was taken up for consideration in this committee, which was a bill looking to a serious investigation of the problem of a sustained relation between consumption and production. At that time you were present when I addressed the committee. The request was made by me that that question, which certainly is the fundamental question, be considered by the Board, and that when Congress opened in January the Board make such suggestions as to the merits of the bill which was then under consideration or make some recommendation as to what could be done to directly affect consumption with relation to production.

Now, a great section of the country is discussing the problem of poverty in the midst of plenty. The fact that we have been unable to bring consumption up to production, the fact that we do not appear to be trying to bring consumption up to production, the fact that instead of doing that we appear to be adopting a policy of scarcity of production so as to enable what consumption we have to take up that production—that is the problem that is being discussed among sociologists, that democracy itself is in danger, in serious danger, for this reason, that one of the fundamentals of democracy is the profits system, the capitalistic system. Those two systems are the very fundamentals of democracy, and the situation is being discussed very, very seriously.

We have this situation, that consumption—and I mean consumption as an entity, just as production is an entity—that consumption has to bear the profits of the prime producer, of the manufacturer, of the wholesaler, and of the retailer, and in addition to that consumption

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has to bear the nonwage-producing work of machinery, which does not get into consumption and a great part of which is piled up in reserves, and unless we can invent something which will solve that problem, the destruction of democracy itself is inevitable.

Now, then, among financiers, among bankers, among members of the Federal Reserve System, and in the Treasury Department, apparently there is not a single solitary bit of consideration being given to that fundamental problem, and to me that discussion is absolutely necessary.

To be specific, since the meeting of last August, has the Board given any specific consideration to solving the problem which to me is the whole fundamental problem? Do you mind telling us?

Mr. RANSOM. No; not at all.

I was present when you made your statement about your bill. I was greatly impressed, first, by your sincerity, and secondly, by your very clear statement, which you have in large part repeated this morning, as to the great national problem which is involved, and, thirdly, by the fact that you did appeal not only to all of the agencies of government, but to all private interests to devote all the time possible to the study of the problem which you propounded.

I may say in the first place, if I may go back to the beginning of your question, that I myself am a little weary of the use of the words "psychological effect," but I do not know of any better words to use in relation to many of the things with which we deal. While weary of those words, I have not a substitute.

We must recognize the fact that there is a herd instinct, that people do respond in the mass to influences which are brought to bear upon them, and that that simple truth must be borne in mind in relation to many actions which would be wholly unrealistic if they were not adjusted to that.

In the second place, I think that there is perhaps some lack of understanding of the fact that the Board of Governors is charged with a great many responsibilities which are perfectly proper which do lie outside of the fields of monetary and fiscal matters, and which do require the time of the Board. If we had either one or the other, I think the organization would be very incomplete. Having both accounts in part for the chairman's statement that we are always on a hot spot. We are, and we recognize that.

Getting down specifically to the answer to your question, I would say that in all of our discussions since that time, and preceding that time, we have not been at all unconscious of the national problem which you put in your statement, and that any action the Board may have taken has not been taken without some realization that consumption and production and the other factors mentioned do bear a part.

Specifically, again, on your particular bill, there has been consideration and discussion. It has not been possible up to the present time, because we have not, as I recall, been asked other than by you at the time you made that statement, to make a report on that bill. I would say that it would be perfectly proper and entirely correct for you to ask us specifically to report as to what we think might be done.

I say that with some trepidation, Mr. Goldsborough, because inevitably a central bank authority, in a modern economy, has to go

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pretty far afield and cannot always stick to its own back yard. Your question is going to open up a tremendously wide field of exploration.

Mr. GOLDSBOROUGH. Let us see how far afield you have gotten, if you do not mind my interrupting.

I noticed in the chairman's statement this morning several reasons why the Board took its action in raising reserves. It was because it was indicated that the business people of the country were buying heavily and filling up their shelves too rapidly, and that therefore, although that was not a monetary phenomenon at all, and did not constitute true inflation because there were millions of people still unemployed, the Board nevertheless undertook to control the mental operation of the businessmen of the country by their action.

Now, I do not criticize that, not for the present at least, but it seems to me you could not go much further afield than that.

Mr. RANSOM. Well, let me say, Mr. Goldsborough, that I think the chairman, in answer to that question, was referring to the second action which took place in January of 1937. That did not refer to the Board's action, as I recall his answer, the first time.

Now, might I take this opportunity, to say in regard to this mechanism of credit control, that I think it is a new mechanism. I think it is necessarily an experimental mechanism. I think that we can learn much from trial and experience. I think that we must recognize the fact that, with our experience of two years as a background, it may be quite desirable for us to suggest some changes in that mechanism. I would not like this morning to undertake specifically to say what I think those changes should be, because in the first place I think that, if it ever crystallized, it should be a matter of Board recommendation and not the recommendation of an individual member of the Board, but I do not see how Congress could have done other than it did when it created that mechanism. I think the limitations put upon it at the time were wise, and whether those limitations should be relaxed or constricted, I think, remains an open question, certainly in my own mind.

But one thing that I feel definite about is that you cannot be dogmatic at the present time in regard to the use by a central banking agency of that particular mechanism of control, if you can be dogmatic about the use of any other.

Mr. TRANSUE. Will you say what mechanism you are referring to?

Mr. RANSOM. I was referring to the mechanism of controlling credit through changing the required bank reserves. You see, the report—and I have a copy of it here—made by Mr. Steagall at the time the Banking Act of 1935 was considered is quite clear as to what was then in the minds of Congress. This refers to section 209 of the Banking Act of 1935, which is the section dealing with the reserve requirements:

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

Clearly indicating, as the act indicates, that this thing is a two-way street, that changes in reserve requirements are similar in their effects to open-market operations, although they differ from those

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operations in the fact that they directly and immediately affect a wider group of banks.

It is probable that these powers would not be used, but in view of the very large volume of available excess reserves, and the possibility of credit expansion on these reserves, it is important to clarify the Federal Reserve Board's power to arrest inflation.

The excess reserves at that time were $2,614,000,000. At the time the Board first increased reserve requirements, and I am speaking of the day before the action became effective, those reserves had reached the figure of $3,258,000,000. At the time the second step was taken, and you will recall that there were two steps, the first and second increase, which exhausted the powers of the Board, and that is on February 28, 1937, there were $2,078,000,000 in excess reserves. At the time the last step went into effect, and I am talking of the day before it became operative, April 30, 1937, excess reserves were still $1,594,000,000.

Now, in reaching a determination as to whether or not the Board should exercise this mechanism of credit control, it seems to me important to get the legislative background as well as the existing conditions.

Mr. TRANSUE. The observation that I wish to make is this, that at the time you made those reserve requirement raises there was not complete employment in this country, and the increases of prices on the stock market would indicate that money was going for this purpose instead of for the production of goods that were wanted.

Is that a correct observation?

Mr. RANSOM. I think it would be correct in part, as to the second step. I do not think that, at the time the first step was taken, there was evidence of the momentum which an inflationary condition had developed at the time the second step was taken.

I am perfectly well aware of the fact that unemployment then was very substantial, and that was stated in our explanation of our action, that we were well aware of the fact that unemployment was at a large figure. I do not think, however, that the sole fact of unemployment would be the determining factor in the Board's decision as to whether this mechanism should be used, because it is quite possible, as I see it, to have a very large volume of unemployment and at the same time to have an inflationary condition developing which might add greatly to that unemployment and to the problem of the Government in taking care of that unemployment.

I know that in answering that question that way, I am running head first into the question that my friend Mr. Patman asked the Chairman, to define "inflation," which is quite a difficult thing to do.

Mr. TRANSUE. Were farm prices prior to 1929 comparable to the unemployment that existed at the time you raised your requirements?

Mr. RANSOM. I do not seem to be able to relate the question of unemployment at that time to farm prices in 1929.

Mr. TRANSUE. What I was trying to get at is that prior to 1929, in my mind, there was a large segment of our population that had a very small income, and in that way it was related to the people that were out of employment at the time you raised the reserve requirements. There is a comparison there, and we did have an inflation in 1929 when a large segment of the population were not receiving an adequate income.

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Mr. RANSOM. Might I ask if the low income of that particular group in 1929 might not be due to the very low farm prices which then existed?

Mr. TRANSUE. For whatever reason, we did have a low income, and that does relate itself to the question of stabilizing prices by monetary action.

Mr. RANSOM. Now, there is still one other aspect of the action of the Board in regard to raising reserves that I think should be borne in mind. It was getting the reserve requirements more nearly in relation to existing conditions, and getting them to a point where the Board, through the more ordinary and usual mechanism of open-market operations, did have some chance to influence the situation either one way or the other, and at the time we took action on both of these occasions we were very careful to explain that we did reserve the thought that by the use of open-market operations we could produce a result which might expand or contract the situation as it might thereafter develop.

Of course, with a perfectly huge volume of excess reserves of almost astronomical propositions, the System might not have adequate securities in its portfolio to accomplish the result that might then seem desirable. That, I think, is a factor which should be borne in mind when you consider the Board's action.

Mr. SPENCE. To what extent do the nonmember State banks respond to the policies of the Federal Reserve when you adopt these monetary policies? Is it then immediately reflected in the State banks?

Mr. RANSOM. I do not know any mechanical reason why it should be, but I would say that in the field of banking I thought it might produce results.

Mr. SPENCE. From your experience, haven't you observed those results?

Mr. RANSOM. No; I do not recall at the moment an illustration that would prove that, but I think it quite possible that the nonmember bank might be influenced by the action of member banks in the System.

Mr. CRAWFORD. May I ask a question on that point?

Are you through, Mr. Spence?

Mr. SPENCE. Yes.

Mr. CRAWFORD. Mr. Governor, do I understand that, for instance, a nonmember bank out in middle Iowa, or southwestern Texas, or eastern Missouri will tend to change its rate of interest on commercial or industrial paper, or agricultural paper, when the Board changes the rediscount rates through the member banks?

Do you mean to convey that idea?

Mr. RANSOM. I mean to convey the thought that there might be a natural competitive response to that situation. It does not necessarily follow, but let us assume that an easy-money policy is put into operation by action of the Federal Reserve System, and all the banks that are members of the Federal Reserve System respond to that easy-money policy. I take it as a matter of course that the competitive nonmember bank would have to more or less fall in line, or it would be in a rather awkward position.

As I said, there is no mechanical connection. It is a question of competitive response.

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Mr. CRAWFORD. I had gotten a distinct impression otherwise, in two ways, one by actual experience and the other by reading testimony. For instance, just a few days ago there appeared before this committee Prof. Ray B. Leffler, of Dartmouth College, and in going over his testimony last evening, I got the very distinct impression from his statement, based on surveys and studies which he has made, that these nonmember banks run along through the years without making any practical change whatsoever in the rates that they charge to the agricultural, small industrial, and commercial customers; and I think that my own practical experience, limited as it has been with nonmember banks, proves that to be true.

So, if you do have information which shows otherwise, I should be delighted to have it.

Mr. RANSOM. I was not answering from information, but mostly from impression or from deduction, which may be wholly wrong. As a matter of fact, isn't it true that small country banks do not consider an easy-money policy at any time? Their rates seem to me to be pretty rigid and pretty stiff, but I do not know——

Mr. CRAWFORD. That is the point that I am making.

Mr. RANSOM. But I do not know that the member banks, for that matter, in the rural sections necessarily respond to actions which do produce a result in the larger banks and the money center banks. I think that perhaps my answer to your question, in part, should be that perhaps some of them do not respond.

Mr. REILLY (presiding). I think the committee will have to suspend now, and come back tomorrow at half past 10.

Mr. RANSOM. Do you want further testimony, sir?

Mr. REILLY. Have you anything else you wish to add?

Mr. RANSOM. As far as the Board is concerned, if we have put into the record all that you gentlemen want, we have nothing further to add, and I do not want to take up the time of the committee when I know that you are busy on other matters. But there is one specific question, as to what has been done in the British banking system, that we could answer by a memorandum, which I think might take care of that question very fully.

Mr. REILLY. I would like to have that given to us orally.

Mr. RANSOM. Very well, sir.

(Thereupon, at 12:05 p. m., an adjournment was taken until Thursday morning, April 14, 1938, at 10:30 o'clock.)

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