May 2, 1938.

My dear Mr. Chairman:

I am returning herewith corrected copies of my testimony before your Committee. I enclose also a separate set of my answers to the questions which were asked by Mr. Patman and other members of the Committee and were left for me to answer subsequent to my appearance.

The same answers have also been typed into the corrected copies of the transcript.

Sincerely yours,

M. S. Eccles,
Chairman.

Honorable Henry B. Steagall, Chairman,
Banking and Currency Committee,
House of Representatives,
Washington, D. C.

enclosures

ET:b

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May 2, 1938.

My dear Mr. Patman:

I have returned to Chairman Steagall corrected copies of my testimony, supplying thereon also the answers to the questions asked by you and other members of the Committee which I was requested to reply to subsequent to my appearance before the Committee.

I enclose a separate set of the questions asked by you as well as by other members of the Committee and my answers thereto.

Sincerely yours,

M. S. Eccles,
Chairman.

Honorable Wright Patman,
House of Representatives,
Washington, D. C.

enclosure

ET:b

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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 six weeks Government bond prices declined about five points with an increase in the yield to maturity on those issues of almost one half of one per cent. 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 per cent 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

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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 one hundred million dollars for the few New York money market banks which I have mentioned and did not exceed twenty-two million dollars for banks outside of New York, yet, all told, the banks sold approximately one billion dollars 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 two hundred and two million dollars of bonds and disposed of one hundred and six million dollars 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 per cent.

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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.

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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.

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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.

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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 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.

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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 the Secretary's custom to invite the members of the Executive Committee of the Open Market Committee to meet with 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.

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Mr. Ford. 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 requirements 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.

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Mr. Crawford. 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

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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.

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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?

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?

(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 familier 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 elécted 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.

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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

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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 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.

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