Testimony 11/22/49

Why should there be Federal supervision over banking?

What reason is there for applying nation-wide reserve requirements in the field of monetary control to all commercial banks.

Bank reserves are now said to be largely for the purpose of influencing the supply, cost and availability of credit. Weren't they originally set up to assure the solvency of individual banks?

What kind of reserves do nonmember banks hold? How do they differ from those held by member banks?

What, if anything, needs to be done to increase the coordination of Federal Reserve and Treasury policies in the field of money and debt management?

How does the Federal Reserve System provide liquidity for the banking systems? Does any other banking agency share in this liquidity function?

How can selective credit controls supplement general monetary controls?

What are the disadvantages of limiting closely Federal Reserve discretion in applying monetary controls?

You have said that the various bank supervisory agencies look upon bank examination from somewhat different points of view. Would you care to be explicit as among supervisory agencies and appraise the effect of such differences?

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What are the legal deterrents to membership in the Federal Reserve System other than higher reserve requirements? Would it be advisable to remove or modify them?

What purpose would be served by a return of this country to the gold coin standard?

November 16, 1949

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Briefly summarized, the principal reasons given for opposing the proposed action are:

1. The FDIC is:

   (a) Primarily concerned with the insurance risk and not with monetary and credit policies. Emphasis on protection of fund might run counter to monetary and credit policies; also, the public interest.

   (b) Not sympathetic with actions of the System and would not be diligent in enforcing regulations imposed by the System. Examples are attitude with respect to enforcement of Regulations Q, U and W.

   (c) Inexperienced. The banks which it has supervised for a relatively short time are themselves a relatively unimportant segment.

   (d) Not entitled to examining power solely as an insuring agency. Other types of insurance are administered without such power.

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2. The Federal Reserve System is:

   (a) Required by law to keep itself informed of the general character and amount of the loans and investments of member banks and the condition of such banks.

   (b) In the final analysis, the real guarantor of bank deposits. During a period of crises, the commercial banks and the FDIC would have to look to the System for the conversion of their assets to meet deposit liabilities.

   (c) Concerned with devising and maintaining bank supervisory policies of a type seeking the objectives of supervision without exerting influence in opposition to national monetary and credit policies.

   (d) Equipped through trained staffs, powers and contacts other than those related directly to examination and supervision to exercise supervisory influence, directly or indirectly, upon both State and national member banks holding a large proportion of all commercial bank assets.

   (e) Decentralized. It has adequate office facilities well placed and general contacts with banks. A reasonable amount of supervisory authority rests with regional or district officers familiar with sectional and local problems.

3. The Federal Reserve System would:

   (a) Lose prestige and influence. It is felt that the System should have an active rather than passive or consultative part in the formation of examining policy.

   (b) Lose contacts. Through examiners in the field the Reserve Banks keep in touch with local conditions and trends. Some other means would need be devised if examining function were removed.

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(c) Lose members, or, at least, such action would not be conducive to increased membership.

(d) Suffer impairment of its ability to discharge its duties effectively and in bank relations.

4. Member banks:

(a) Are believed to regard Federal Reserve examination and supervision as comprehensive, constructive and sympathetic.

(b) Would look with disfavor upon such a transfer.

5. The proposed action would:

(a) Centralize. In fact, with the Comptroller a member of the FDIC board, it may tend to become, in effect, one agency. A considerable degree of decentralization considered desirable and beneficial.

(b) Neither promote efficiency nor accomplish economy.

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MONETARY, CREDIT, AND FISCAL POLICIES

TUESDAY, NOVEMBER 22, 1949

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE OF MONETARY, CREDIT,
AND FISCAL POLICIES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10: 00 a. m. in the caucus room, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas (chairman of the subcommittee) and Representative Wolcott.

Also present: Dr. Grover W. Ensley, acting staff director, and Dr. Lester V. Chandler, economist to the subcommittee.

Senator DOUGLAS. Mr. Eccles, we are very happy indeed to have you with us this morning. We were glad to get the expanded statement of Chairman McCabe, which I suppose represented official Federal Reserve policy on the matters which we raised in our questionnaire, and I assume that may have been one of reasons why you as an individual did not submit a reply to our questionnaire. But we are happy to welcome you here this morning, and I understand that you have a statement which you would like to give first. I think perhaps I should say for the record that you are here on our invitation and not on your solicitation.

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

Mr. ECCLES. I would like to comment on your observation. The reason I did not reply to the questionnaire is that I understood, as did the rest of the Board members, that it was submitted to Chairman McCabe as a personal matter, and I did not see the questionnaire, nor have I seen the replies. The replies to the questionnaire, as Chairman McCabe indicated, were his views and not necessarily those of the Board. I would not say, however, that there may not be a lot of agreement on the Chairman's replies, but at the same time there may be some different points of view and some disagreement. I appreciate this opportunity, Chairman Douglas, to appear before your committee.

Mr. Chairman, I am here, as you know, in response to the invitation in your letter of October 31, 1949, to discuss issues that have been raised during the study initiated by your subcommittee in the field of monetary, credit, and fiscal policies. I shall be glad to try to answer such questions as may be uppermost in your mind, but I should like first to present for your consideration a short statement

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which I hope may anticipate and answer some of your questions. My views are the cumulative results of 15 years of participation in developing and carrying out policies of the Federal Reserve System, preceded by long experience in private banking under State as well as National authority and membership in the Federal Reserve System.

I therefore could not fail to be aware of the vigorous opposition that has so often been voiced against new proposals with respect to Federal authority over banking. In recent years it has seemed that nearly every recommendation emanating from the Federal Reserve Board has been assailed as a threat to destroy the dual banking system. As one who has spent his business life in that system, I have been unable to see the justification for such agitation.

Our commercial banking system is composed of banks that receive deposits subject to withdrawal upon demand, make loans, and perform other services. About half of the total dollar amount of bank deposits are insured up to $5,000 for each depositor by a Federal agency, the Federal Deposit Insurance Corporation. Banks holding 85 percent of the resources of the banking system are in the Federal Reserve System, another Federal agency. Approximately 5,000 of these banks operate under Federal charters, issued by the Comptroller of the Currency, and about 9,100 operate under charters from the 48 States. This is the dual-banking system.

Senator DOUGLAS. May I interrupt a minute? And, of the 9,100 State banks, about 2,000 are in the Federal Reserve System?

Mr. ECCLES. That is correct.

Senator DOUGLAS. About 7,100 outside?

Mr. ECCLES. I do not know the exact figure, but I think it is less than 7,000 that are outside, between 6,000 and 7,000.

While I am sure that those who are its most vociferous supporters would not seriously contend for the abolition of the Federal Reserve System, with the consequent restoration of the intolerable conditions that prevailed before its establishment, they nevertheless constantly oppose measures that would enable the Reserve System to be far more effective in carrying out its intended functions—functions that help to protect not only all banking but the entire economy.

Two proposals, more than any others, stir up this agitation. One is the proposal for the equal application of a fair and adequate system of reserve requirements to all insured commercial banks. The other proposal is that the Federal Government apply the principles and objectives of the Hoover Commission to the Federal agencies concerned with banking, monetary, and credit policy. Bankers believe in the objectives of the Hoover Commission, at least as applied to all other activities of the Government—why not the banking activities?

The red herring of the dual banking system is always brought up to obscure the real merits of the fundamental questions involved in the proper administration of fiscal monetary, and credit policy, which concerns commerce, agriculture, industry, and the public as a whole; it is by no means the sole concern of bankers.

The major responsibility of the Federal Reserve System is that of formulating and administering national monetary policy. It does this chiefly through the exercise of such influence as it may bring to bear upon the volume, availability, and cost of commercial bank reserves. It must operate through the commercial banks of the country,

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because they, together with the Federal Reserve banks, are the institutions through which the money supply is increased or decreased. It is of paramount importance to the entire country that someone have the means as well as the ability to discharge this responsibility. It cannot be left to the voluntary choice of some 14,000 individual and competing banking institutions. It cannot be split up among the various agencies of the Federal and State Governments. The framers of the Federal Reserve Act undoubtedly intended that it should be in the Federal Reserve Board under the direct control of Congress.

Others have pointed out that existing bank reserve requirements are inequitable, unfair, and ineffective at the very time when they are most urgently needed to restrain excessive expansion of bank credit. They should not depend as they do now on whether a bank is located in a central Reserve city or in a Reserve city or whether it is outside of one of these cities or away from its downtown area, nor should they depend on whether a bank is a member or a nonmember. There is no good reason for such distinctions from the standpoint of effectuating monetary policy.

Senator DOUGLAS. May I interrupt a minute? Are you suggesting, therefore, that you should have one set of reserve requirements and abolish the present distinction between central Reserve cities and country banks?

Mr. ECCLES. That is right.

Senator DOUGLAS. That is one set across the board?

Mr. ECCLES. That is right.

Senator DOUGLAS. For banks wherever located?

Mr. ECCLES. The next paragraph will cover that, I think.

In addition to other handicaps of membership, members of the Federal Reserve System are subject to much more onerous reserve requirements than nonmember banks. Member banks are required to carry certain percentages of their demand and time deposits in non-interest-bearing cash balances with the Federal Reserve banks. Apart from these required reserve balances, member banks necessarily carry some vault cash to meet deposit withdrawals, and in addition they carry balances with correspondent banks, none of which can be counted toward statutory reserve requirements. On the other hand, nonmember bank reserve requirements not only are generally lower in amount but may also consist entirely of vault cash and balances carried with city correspondents. In some instances reserves of nonmember banks may be invested in United States Government and other specified securities. Thus to a considerable extent nonmember banks may receive direct or indirect compensation for a substantial part of their reserves. These discrepancies are most obvious and difficult to explain when two banks, one a member and the other not, are doing the same kind of business as competitors on opposite corners of the same town. Member banks therefore bear an undue and unfair share of the responsibility for the execution of national credit policy.

There should be a plan under which the responsibility for holding reserves to promote monetary and general economic stability would be as fairly distributed as possible. This would require a fundamental revision of the existing basis for bank reserve requirements. They should be based on the nature of depoits rather than mere location; they should be somewhat higher upon interbank deposits than upon

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other demand deposits. Vault cash should be given consideration because it has much the same effect as deposits at reserve banks.

In any such revision of reserve requirements, it is of primary importance to take into account the fact that they are a means of contracting or expanding the liquidity position of the banking system and of making other credit instruments more effective. Reserve funds of banks may expand through large gold inflows or silver purchases, or return of currency from circulation, or borrowing from Reserve banks, or Federal Reserve purchases of Government securities through necessary open-market operations. There should be sufficient authority over reserve requirements to permit taking such developments into consideration when necessary.

There is widespread misunderstanding even among bankers of the function of reserve requirements as a means of expanding or contracting the supply of bank credit. In sharp contrast with State reserve requirements, those applied to member banks under the Federal Reserve Act are primarily designed to affect the availability of credit; that is to say, the money supply. The Federal requirements are not primarily applied for the purpose of providing a cushion to protect the individual bank. They are not basically reserves in that sense at all, and incidentally the Reserve banks do not and cannot use them to buy Government securities, as most of the bankers seem to think.

The Federal Reserve System is a creature of the Congress. You can make it weak or you can make it strong. We have recited to the Congress over and over again the dilemma that we face. It is perfectly simple. So long as the Reserve System is expected to support the Government bond market and to the extent that such support requires the System to purchase marketable issues, whether sold by banks or others, this means that the System is deprived of its only really effective instrument for curbing overexpansion of credit. It means that the initiative in the creation of reserves which form a basis on which credit can be pyramided rests with banks or others and not with those responsible for carrying out national monetary policy. To the extent that banks or others can at will obtain reserves, they are thus able to monetize the public debt. In view of this situation, if the Congress intends to have the Reserve System perform its functions, then you should by all means arm it with alternative means of applying restraints. The only effective way to do that is through revision and modernization of the mechanism of reserve requirements. The Congress will not have done the job at all if it fails to include all insured banks. Reserve requirements that are limited only to member banks of the Federal Reserve System impose upon them a wholly unfair and inequitable burden which becomes the more intolerable as the need arises to increase reserve requirements as a means of curbing overexpansion of bank credit. Of course, organized banking and its spokesmen, chiefly large city banks, do not want any change. They never do.

Throughout the long history of banking reform in this country—and it is still very far from complete—the same bankers or their prototypes have been for the status quo. Beginning with the National Banking Act, they have fought every progressive step, including the Federal Reserve Act and creation of the Federal Deposit Insurance Corporation. If you abide by their counsels or wait for their leader-

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ship, you will never do anything in time to safeguard and protect private banking and meet the changing needs of the economy in such a way as to avoid still further intrusion of the Government into the field of private credit, to which I am really very much opposed—an intrusion which the public has demanded in the past because private banking leadership failed.

I may add that whenever Congress sees fit to enact into legislation the principle of equitable reserve requirements applied uniformly without regard to membership in the Federal Reserve System, there might well be changes in other relations of the Federal Reserve System which would be of benefit to all commercial banking, as, for example, to offer the credit facilities of the Reserve banks on equal terms to all banks which maintain their reserves with the Reserve banks, together with further improvements in the check-collection system. These and other beneficial changes could well be brought about with great advantage to banks and to the public in general.

The role of the Reserve System in relation to Government lending to business also should be clarified. This is particularly important to the functions exercised in that field by the Reconstruction Finance Corporation and with respect to the authority of the Reserve banks to extend credit to industrial enterprises under section 13b of the Federal Reserve Act. The latter should be modified as proposed in S. 408, the bill favorably reported by the Senate Banking and Currency Committee in 1947, and the enactment of which was again recommended by the Board in 1948.

There is unquestionably a need for such an agency as the Reconstruction Finance Corporation in emergency periods for direct Government lending for projects outside the field of private credit, but I have always taken the position that the Government should not compete with or invade the domain of private banking and credit institutions. When aid is necessary to facilitate the functioning of private credit, then such aid should take the form of guaranteeing in part the loans made by private institutions, just as was done in the V-loan program of the Federal Reserve for financing war production. That is what S. 408 proposes. The profound difference in the principle at stake here ought to be obvious.

In relation to the second question, that of organization, which I mentioned at the outset, I feel that students of government, and particularly those who endorsed the objectives of the Hoover Commission, ought to be more interested than they appear to have been in the problems of organization of the agencies of Federal Government concerned with bank supervision. Some, however, may have been misled into thinking that there is no problem in this field because the expenses of these agencies are not paid from governmental appropriations.

The establishment of a system of insurance of deposits by the Federal Government was one of the great accomplishments of the Congress in the direction of fostering public confidence in the banking system. I favored Federal deposit-insurance legislation at a time when most of my fellow bankers were denouncing it. But I never expected, and I am certain Congress never intended, that this protection for depositors would be used either to hamper effective national monetary policy or to give any class of banks special advantages over others. I regret to say that the Federal Deposit Insurance Cor-

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poration has been used to discourage membership in the Federal Reserve System and to weaken effective monetary policy.

There is no logic whatever in the present provisions of law, which say, in effect, to a bank, "You can't joint the Federal Reserve System unless you also join the Federal Deposit Insurance Corporation, but you can join the Federal Deposit Insurance Corporation without joining the Federal Reserve System." The law compels a national bank to join both, but a State bank has the option of joining one or the other or neither. I should like most earnestly to urge upon you the importance of making this a two-way street by providing that a bank can be a member of the Federal Reserve System without joining the Federal Deposit Insurance Corporation, in the same way that a State bank is now privileged to be a member of the Federal Deposit Insurance Corporation without being obliged to join the Federal Reserve System.

Senator DOUGLAS. Mr. Eccles, may I ask a question there? Is this a counterattack which you are proposing that the Federal Reserve System make——

Mr. ECCLES. It is a logical answer to some of the comments.

Senator DOUGLAS. Are you serious about this?

Mr. ECCLES. I have proposed a uniform system of reserves. Certainly, if there is not to be a uniform system of reserves, the Federal Reserve System is weakened, and its position can only be maintained by having a two-way street as proposed. In other words, it seems to me that, unless you have uniform reserve requirements, then certainly this proposal here is an alternative that should be taken into account, not as a counterattack for the purpose of any destructive effects, but merely, as it seems to me, a necessary piece of legislation so that the Federal Reserve is in a position at least to protect itself or to defend itself.

Senator DOUGLAS. This might be a very effective means of bringing the Federal Deposit Insurance Corporation and some of its supporters into line with your proposal for uniform reserve requirements.

Mr. ECCLES. I would hope that would be the result.

Senator DOUGLAS. But if it were not the case, do you think this proposal of yours would strengthen the banking system as a whole?

Mr. ECCLES. I do not think it would hurt it.

Mr. WOLCOTT. Would it strengthen it?

Mr. ECCLES. No; I do not know that it would strengthen it. I think there may be some member banks that would decide they would not need Federal deposit insurance just as there are many State banks now that have decided they do not need the Federal Reserve as long as they have Federal deposit insurance.

I think some of the bigger banks may well say that as members of the Federal Reserve they do not need FDIC.

Senator DOUGLAS. Do you think that Federal deposit insurance has lowered the value of a bank belonging to the Federal Reserve System?

Mr. ECCLES. No; I do not think so. I favored FDIC. Neither do I think that membership in the Federal Reserve System would lower the standards of a bank which is a member of the FDIC.

The Federal Deposit Insurance Corporation was designed in the public interest, and it should be maintained for that purpose; but this is not to say that the continued existence of three Federal agencies performing similar or allied functions in the field of bank supervision,

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regulation, statistical, and other services is justifiable. There is unnecessary duplication and triplication of offices, personnel, effort, time, and expense. While the maintenance of separate and often conflicting viewpoints may serve selfish interests, on the old principle of "divide and conquer," it seems to me that this should not prevent improvements wherever possible in the organization of a Government already overburdened with complexity and bureaucracy.

In this connection various suggestions as to where responsibility should be lodged for the examination of banks subject to Federal supervision have been offered, ranging from the setting up of a new agency with no other responsibility to maintaining the status quo.

The Reserve System must have currently accurate information, procured through examination, bank condition reports, special investigations, constant correspondence, and contacts with the banks. The System must have examiners and other personnel responsible to it, specially trained and directed for the purpose of procuring such information. The Reserve System is in position to determine policies to be pursued by examiners, to coordinate them with credit policies, and at the same time decentralizes the actual administration by utilizing the facilities of the 12 Reserve Banks and their 24 branches. They examine all State member banks, receive copies of examination of all national banks, are in close touch in this and in other ways with all member banks, as well as the State and National supervisory authorities.

Through their daily activities of furnishing currency, collecting checks, seeing that member banks maintain their reserves, and extending credit to them, the Reserve banks obtain current information about banks which is invaluable for purposes of bank supervision. The Federal Reserve is and must be at least as vitally concerned with the soundness of the individual bank as anyone in the organization of the Comptroller or the Federal Deposit Insurance Corporation. The Federal Reserve Act places in the Federal Reserve a specific responsibility for effective supervision over banking in the United States. Soundness of the individual bank and soundness of the economy must go hand in hand. Therefore, Federal Reserve concern with the maintenance of stable economic conditions should be and is in the interest of sound banking as well as the public welfare. It has not destroyed the effectiveness of Federal Reserve supervision over State member banks, and it is absurd to think, as I understand has been suggested to you, that it would destroy the effectiveness of supervision or examination of other banks. Moreover, is it reasonable to believe that the intelligence of the officials of the Federal Reserve banks, combined with the judgment of a seven-man board appointed by the President, confirmed by the Senate, responsible to the Congress, should be regarded as less independent than a bureau in the Treasury under one official whose deputies are appointed by the Secretary of the Treasury? No single individual in the Federal Reserve System determines its policies.

Since examination supplies information essential to the right conduct of the business of the Reserve System and since the Reserve authorities must review reports of examination of all member banks, it is illogical to argue that they should be deprived of all examination authority. Examination procedure is a tool of bank supervision and regulation which should be integrated with and responsive to

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monetary and credit policy. If directed as though it were not concerned with such policy it could nullify what otherwise could be effective monetary and credit policy. In fact, too often in the past, bank examination policy became tighter when conditions grew worse, thus intensifying deflation, and conversely examination policy has gone along with inflationary forces when caution was needed.

Only one of the three Federal supervisory agencies, the Federal Reserve System, is charged by Congress with responsibility over the supply and cost of credit, which is directly affected by reserve requirements, discount policy, and open-market operations. The Reserve System views the economic scene principally from the standpoint of national credit conditions as effected by monetary, fiscal, and related governmental policy. Other agencies do not have these responsibilities. Their differences of interest often lead to prolonged discussions which delay or prevent agreements.

Let me turn now to the question of the composition and responsibilities of the Board of Governors and the Open Market Committee, which committee is composed of the seven members of the Board plus five Reserve bank presidents. The New York bank has one of those five, and the position is continuous. The other banks rotate in their membership on the committee.

I do not suggest that the present system has not worked. It was a compromise and your committee is interested, and properly so, in the question whether the present structure could be improved. I feel that I should point out its defects and how they could be remedied.

While the Board of Governors has final responsibility and authority for determining, within statutory limitations, the amount of reserves that shall be carried by member banks at the Federal Reserve banks, for discount rates charged by the Federal Reserve bank for advances to member banks, and for general regulation and supervision of the lending operations of the Reserve banks, the responsibility and authority under existing law for policy with respect to the Government security market, known as open-market operations, is vested in the Open Market Committee. These operations have become an increasingly vital part of Federal Reserve policy. In practice they are the principal means through which debt-management policies of the Government are effectuated. They are the means by which an orderly market for Government securities is maintained. With the rapid growth of the public debt, chiefly as a result of wartime financing, with the continuance of a budget of extraordinary size, with major refunding operations in view and the prospect of deficit financing, there can be no doubt of the responsibility that will continue to rest with the Federal Reserve System for open-market policy.

Suggestions have been made and I believe will appear in answers to your questionnaire, with a certain degree of logic in their support, that the interrelations between the considerations of policy governing open-market operations and those governing reserve requirements, discount rates, and perhaps other functions, are such as to justify transferring these major instruments of policy to the Federal Open Market Committee, leaving to the Federal Reserve Board as such only matters of secondary importance. This would not justify the continued existence of a seven-man Board of Governors. To the extent, however, that such suggestions recognize the principle that responsibility for over-all credit and monetary policy should be fixed in one

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place, I would agree. On the other hand, they accentuate the major inconsistency in the present set-up.

It should be noted in this connection that the president of a Federal Reserve bank is not a director of that bank but is its chief executive officer. He is elected for a 5-year term by a local board of nine directors, three of whom are appointed by the Board of Governors and the other six by the member banks of the district. In addition to making the appointment, the directors fix his salary. Both of these decisions are subject to approval by the Board of Governors. Neither he nor the directors of the bank have any direct responsibility to the Congress, or the administration, for that matter.

When a Reserve bank president sits as a member of the Federal Open Market Committee, however, he participates in vital policy decisions with full-time members of the Board of Governors, who are appointed by the President of the United States and confirmed by the Senate and whose salaries are fixed by Congress. Those decisions, which must be obeyed by his bank as well as by the other Federal Reserve banks, affect all banking. So far as I know, there is no other major governmental power entrusted to a Federal agency composed in part of representatives of the organizations which are the subject of regulation by that agency. President Woodrow Wilson expressed himself very vigorously on this subject when the original Federal Reserve Act was under consideration. If this principle is not to be discarded, it follows that further inroads should not be made into the functions of the Federal Reserve Board and on the other hand that responsibility for open-market policy should be concentrated in the Board. I am convinced in this connection that there is no need for more than five members, instead of seven as at present, and that the Congress should recognize by more appropriate salaries the great importance of the public responsibilities entrusted to the Federal Reserve System, of which the Federal Reserve Board is the governing body. Such recognition would be more likely to attract to the membership of the Board men fully qualified for the position.

If, however, it is believed preferable for national credit and monetary policy to be determined in part by some of the presidents of the Reserve banks, then the presidents of all 12 Reserve banks should be constituted the monetary and credit authority, and they should take over the functions of the Board of Governors, which body should be abolished. The governmental responsibility of such a body should be recognized by requiring their appointment by the President of the United States and their confirmation by the Senate; their salaries should be fixed by Congress, to whom they should report. May I point out that if the presidents of the Reserve banks can, in addition to performing their manifold duties as chief executive officers of these very important institutions, take on in addition the principal functions of the Federal Reserve Board, it must be that these functions do not justify a full-time seven-man Board, and this would be another reason for abolishing it, and substituting a part-time Board composed of the 12 presidents.

You would have to add, of course, an administrator and a proper staff in Washington, and you would possibly have to add committees made up from the 12.

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I am offering this seriously. This is not a counter-proposal. This is a serious proposal based upon the experience that I have had in Washington over a long period of time.

Senator DOUGLAS. Is this your first choice or is your first choice the abolition of the Open Market Committee and the lodging of powers of the Open Market Committee in the Federal Reserve Board?

Mr. ECCLES. Well, I would be pretty neutral on that. I think either would work. I think it is largely a question of placing responsibility in a governmental body, whether it be the President's or whether it be another board. I think either would work. I would be neutral.

Senator DOUGLAS. But you would prefer either to the present set-up?

Mr. ECCLES. I would.

The views I have expressed have developed out of a long experience in and out of Government and they have not been altered by the fact that I have ceased to be Chairman of the Board after serving in that capacity for more than 12 years or by the fact that I expect sometime to return to the field of private banking.

In the foregoing I have not attempted to include some other important matters which may be of interest to the committee in its deliberations and might well be considered by a national monetary commission, such as that proposed in S. 1559 which I strongly support. Accordingly, I would appreciate it if you would permit me to file a supplemental memorandum for the record in the even that it appears to be desirable to do so in order to complete my statement.

Senator DOUGLAS. Thank you very much, Mr. Eccles. Of course we will be glad to have you file a supplementary statement. I want to thank you for your very interesting testimony.

(The following supplementary statement was later furnished by Mr. Eccles:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
December 1, 1949.

Hon. PAUL H. DOUGLAS,
United States Senate, Washington, D. C.

DEAR SENATOR DOUGLAS: In connection with my testimony presented on November 22 before your committee, I indicated that I had not attempted to include in my statement some important matters which may be helpful to the committee. You granted me the privilege of filing a supplementary statement should that appear desirable.

In the course of my testimony you asked if it would serve a useful purpose if Congress were to instruct the Treasury further as to the policies to be followed in debt management where they are dependent upon the monetary policies of the Federal Reserve System. You also stated that you would appreciate it if you could get some suggested standards of an instruction that might be given to the Treasury by Congress with reference to Treasury relations with the Federal Reserve.

Since presenting my testimony I have given a great deal of thought to this subject. In reading over the record of my remarks, it was apparent to me that I had not responded as fully as I could have to some of your questions. Therefore, I should like to take advantage of the privilege of making a supplementary statement.

A very fundamental dilemma confronts the Federal Reserve System in the discharge of the responsibilities placed on it by Congress. The System has by statute the task of influencing the supply, availability, and cost of money and credit. In peacetime, the objective is to do this in such a way that monetary and credit policy will make the maximum possible contribution to sustained progress toward goals of high employment and rising standards of living. Federal Reserve System powers for carrying out this responsibility are at present basically

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adequate. But the System has not, in fact, been free to use its powers under circumstances when a restrictive monetary policy was highly essential in the public interest. It has been precluded from doing so in the earlier postwar period in part because of the large volume of Government securities held by banks, insurance companies, and others who did not view them as permanent investments. Reasons for supporting the market under these conditions I have already presented before your committee.

This policy of rigid support of Government securities should not be continued indefinitely. The circumstances that made it necessary are no longer compelling. But the Federal Reserve would not be able to change these policies as long as it felt bound to support debt-management decisions made by the Treasury, unless these were in conformity with the same objectives that guide the Federal Reserve. The Treasury, however, is not responsible to Congress for monetary and credit policy and has had for a long time general easy-money bias under almost any and all circumstances. As long as the Federal Reserve policy must be based upon this criterion, it could not pursue a restrictive money policy to combat inflationary pressures.

Decisions regarding management of the public debt set the framework within which monetary and credit action can be taken. As the size of the debt grew through the period of deficit finance in the thirties and particularly over the war period, Treasury needs came to overshadow and finally to dominate completely Federal Reserve monetary and credit policy. When the Treasury announces the issue of securities at a very low rate pattern during a period of credit expansion, as it did last Wednesday, the Federal Reserve is forced to defend these terms unless the System is prepared to let the financing fail, which it could not very well do. To maintain a very low rate pattern when there is a strong demand for credit, the System cannot avoid supplying Federal Reserve credit at the will of the market.

Under these conditions it can hardly be said that the Federal Reserve System retains any effective influence in its own right over the supply of money in the country or over the availability and cost of credit, although these are the major duties for which the System has statutory responsibility. Nor can it be said that the discount rate and open-market operations of the System are determined by Federal Reserve authorities, except in form. They are predetermined by debt-management decisions made by the Treasury. This will be true as long as the System is not in a position to pursue an independent policy but must support in the market any program of financing adopted by the Treasury even though the program may be inconsistent with the monetary and credit policies the System considers appropriate in the public interest.

The Federal Reserve System was established by Congress primarily for the purpose of determining and carrying out credit and monetary policy in the interest of economic stability and is responsible to Congress for that task. There is a seven-man Board of Governors, appointed for 14-year terms with approval of the Senate. The Board is assisted by an experienced and highly qualified staff of experts. There are 12 presidents of the Federal Reserve banks, each with a staff of specialists, and each Federal Reserve bank has a board of directors composed of leading citizens in its district drawn from professional, business, farming, banking, and other activities. There is also the Federal Advisory Council, composed of a leading banker from each of the 12 districts, established by Congress to advise the Board. All of these supply information and advice and many participate in formulation of monetary policies appropriate to the needs of the economy.

Under present circumstances the talents and efforts of these men are largely wasted. Views of the Federal Reserve Board and Open Market Committee regarding debt-management polices are seldom sought by the Treasury before decisions are reached. The System, however, has made suggestions on its own initiative to the Treasury in connection with each financing, but very often these have not been accepted. Decisions are apparently made by the Treasury largely on the basis of its general desire to get money as cheaply as possible.

In a war period or a depression, there is reason for financing a deficit through commercial bank credit—that is, by creating new money. The Federal Reserve System has supported such financing at very low rates by purchasing Government securities in the market at such rates, thus pumping the needed reserves into the banking system. In the early postwar period some support was desirable, especially for the 2½-percent long-term bonds, but it should not have been as inflexible as it was for short-term rates.

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The outlook at the present time is for an expanding economic activity with high employment. We also now anticipate a Government cash deficit of over $6,000,000,000 in the calendar year 1950. It would be inexcusable to finance this deficit at very low rates of interest by creating new money should inflationary pressures resurge. But if the Treasury, under these conditions, insists on continuation of the present very low rates, the Federal Reserve will have to pump new money out into the economy even though it may be in the interest of economic stability to take the opposite action. In making a cheap money market for the Treasury, we cannot avoid making it for everybody. All monetary and credit restraints are gone under such conditions; the Federal Reserve becomes simply an engine of inflation.

With respect to the problem of how future monetary and credit policies are to be established, it seems to me Congress must choose from the following three general alternatives if the present dilemma confronting the Federal Reserve System is to be resolved:

(1) Congress can permit the present arrangement to continue. The Treasury would control in effect the open market and other credit policy as it does now by establishing such rates and terms on its securities as it pleases, with the requirement that the Federal Reserve support them. It should be recognized that under this course, limitations over the volume of bank credit available both to private and public borrowers, and accordingly limitation over the total volume of money in the country, would be largely given up. Such credit and monetary restraint as might be required from time to time to promote economic stability would be entirely dependent upon the willingness of the Treasury to finance at higher interest rates, and in the past the Treasury has been resistant to doing this. If this alternative is followed, which is the present arangement, Congress should recognize that the responsibilities for monetary and credit policies are with the Treasury and not with the Federal Reserve System and that the principal purpose of the Federal Reserve System is then to supply additional bank reserves on the demand of any holder of Government securities at rates of interest in effect established by the Treasury.

(2) The Congress could provide the Federal Reserve System with a partial substitute for the open market and discount powers which debt-management decisions of the Treasury have rendered and can continue to render largely useless for purposes of credit restraint. Some measure of control over the availability of credit under inflationary circumstances could be regained if the System were given substantial additional authority over basic reserve requirements of the entire commercial banking system. With such authority, the System could, if necessary, immobilize new bank reserves arising from a return of currency from circulation, gold inflows, and System purchases of securities from nonbank investors and thereby prevent the multiple expansion of the money supply. In addition, the System would need authority to require banks to hold a special reserve in Government bills and certificates. This would be necessary in case banks entered upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve or in the event it was necessary to assist the Government to finance large deficits without creating additional bank reserves which serve as a basis for multiple credit expansion.

(3) Congress, if it wishes credit and monetary policy to be made by the Federal Reserve System in accordance with the objectives of the Federal Reserve Act and the Employment Act of 1946, could direct the Treasury to consult with the System in the formulation of its debt-management decisions in order that these decisions may be compatible with the general framework of credit and monetary policy being followed by the System in the interest of general economic stability. It is obvious, of course, that Government financing needs must be met and the responsibility of the Federal Reserve to insure successful Treasury financing must continue to be fully recognized. But Treasury financing can be carried out successfully within the framework of a restrictive credit policy, provided the terms of the securities offered are in accordance with that policy.

To sum up briefly my views, I believe that Congress should fix clearly the responsibility for national monetary and credit policy. Although the Federal Reserve System was established as an agency of Congress for determination of monetary and credit policy, as it must function now it is responsible both to Congress and to the Treasury for that policy. These two responsibilities are often conflicting, and both cannot be satisfactorily discharged. The responsibilities and authority of the System need clarification and for that purpose one of three alternative actions might be taken by Congress:

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(1) Recognize in the statute that responsibility for monetary and credit policy is with the Treasury and recognize the Federal Reserve for what it is today—an agent for advising the Treasury and carrying out monetary and credit policy determined by the Treasury.

(2) Give the Federal Reserve System such additional authority over bank reserve requirements as would adequately serve as a partial substitute for discount and open-market powers.

(3) Give the System a mandate to determine monetary and credit policies on the basis of guide posts stated in terms of the language of the Full Employment Act of 1946, with the Treasury required to advise and consult with the Federal Reserve and take into account the mandate of Congress in connection with its debt-management decisions.

I recognize that monetary or credit policy by itself cannot assure economic stability. It should be accompanied by a fiscal policy, as well as a bank supervisory policy, in harmony with it.

I appreciate very much having the opportunity to express my views on this matter.

Sincerely yours,

M. S. Eccles

Senator Douglas. Now, Mr. Eccles, I take it that the three main methods by which the Federal Reserve System attempts to control the general supply of money and credit are first, rediscount; second, open-market operations; and third, the reserve requirements which the Board can impose on member banks; and I would like to ask you whether you think the rediscount powers under the present conditions of banking furnish any appreciable strength to the Reserve System.

Mr. Eccles. By themselves, practically none.

Senator Douglas. We had testimony last week which indicated that the total amount of commercial paper rediscounted by the System and held by the Federal Reserve banks amounted to less than 2 percent of the assets of the System.

Mr. Eccles. So long as the banking system owns such a large amount of Government securities, and there is an immediate market for those securities, banks have little or no use for the rediscount facilities, and therefore the discount rate by itself is not effective.

The discount rate may have some psychological effect, but it must closely adhere to the Open Market Committee's buying rate on short-term Government securities. Otherwise, it would be considered a penalty rate, and would not be used at all to the extent that the buying rate on short-term securities is very close to or below the discount rate.

The banks, in order to meet their reserve requirements, which in the Reserve city and central Reserve city banks are figured on a weekly basis, will sometimes borrow over-night funds, perhaps for 2 or 3 days, rather than go through the market. The sale and the repurchase of securities contains an element of cost in the commissions that they have to pay in the buying and the selling.

If, however, the discount rate is substantially higher than the buying rate, of course, banks will buy and sell bills and certificates to adjust with their reserve position.

Senator Douglas. Now may I ask some questions about the open-market operations which imply not merely the purchase of Government securities by the System, in order to build up the reserves and therefore to expand credit, but I take it also it was at least originally intended to imply the sale of Government securities in order to reduce the member bank reserves and therefore curtail expansion. That is true, is it not?

That is a preliminary question. Then I was going to follow that up. Is that statement correct?

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Mr. ECCLES. If the banks have excess reserves, and the System does not sell its Government securities, that is, the Open Market Committee does not sell out of its portfolio of Government securities, then the banks would bid up the prices of Government securities; interest rates drop, and an exceedingly easy-money situation develops.

An example of that occurred when the emergency authority of the Board to increase reserve requirements was permitted to lapse on the 1st of July. The banking system immediately received very substantial excess reserves. The Open Market Committee did not sell securities in the market, and as banks endeavored to invest their funds the bill rate, which was approximately one and an eighth, went down to three-quarters within a week's time or less. Certificate rates dropped accordingly and bond prices went up. In order to keep the short-term rate from practically going to the vanishing point, the System then permitted the sale of sufficient securities to absorb the excess reserves.

Let me put it this way: The money market banks as well as most of the Reserve city banks generally maintain practically no excess reserves with the Reserve System. They immediately invest any excess reserves that they have in short-term Government paper, almost irrespective of the rate. It has been definitely demonstrated that it is impossible to maintain more than about three-quarers of a billion of excess reserves, which are maintained largely by what are known as the country banks—smaller banks throughout the country.

Reserves are supplied through gold imports, the return of currency and Treasury operations which put funds into the market. The Treasury may also take funds out of the market, as would an increase in currency or a loss of gold. Variations in reserves through all of these immediately affect the short-term rate.

Senator DOUGLAS. Well, I take it that you believe that during the period of expanding prices, and a period in which there is a tendency toward inflation, one way of checking this would be, if it could be made effective, for the System to sell Governments in the open market and thus draw down the——

Mr. ECCLES. It cannot be made effective.

Senator DOUGLAS. That is the next point I was coming to. But if it could be made effective, that is what you would like to have done?

Mr. ECCLES. Oh, yes; if the banks or the public would buy securities out of the portfolio of the System, that would be fine.

Senator DOUGLAS. That would draw down the reserves and therefore diminish the lending power?

Mr. ECCLES. Yes; but there are not any reserves during those periods. What really happens is that not only the banking system but nonbank holders, such as insurance companies and investors, generally may sell Government securities. The only market for the securities during those periods is the Federal Reserve, and System purchases, of course, monetize the public debt. Every dollar's worth of securities that the Federal Reserve buys, whether from banks or otherwise, adds to the total deposits of the banking system and the reserves of the banking system upon which a multiple expansion of credit can be created. What would be required under the conditions which you have indicated would be not that the Federal Reserve, the Open Market Committee, sell securities in the market, but that it withdraw from the market and refuse to buy.

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Senator DOUGLAS. Well, now, that was the next point. Are you saying that the weapon of the open-market operations has been virtually made inoperative to check inflation because of the readiness of the System to buy unlimited quantities of Governments at relatively pegged prices?

Mr. ECCLES. That is correct.

Senator DOUGLAS. And that as long as the banks can take bonds, go to the Federal Reserve System, sell them and get reserves, that the process of selling to them is taking money out of one pocket, which they promptly proceed to put in the other?

Mr. ECCLES. When the System buys securities it creates new reserves upon which the banking system can loan six times that amount of money on the basis of the present reserve requirements.

Senator DOUGLAS. Now who decides whether or not the Federal Reserve System shall buy Governments?

Mr. ECCLES. That is a decision that is made by the Open Market Committee in conjunction with the Treasury.

Senator DOUGLAS. Well, do they determine the amount or do they determine the rate?

Mr. ECCLES. Well, they do not determine the amount. You cannot determine the amount not knowing what the supply of securities is going to be.

The support price is really what is determined, and if you have a support price, then whatever amount is offered is what we take.

The best example of that was last year when there was very heavy selling of the long-term 2½-percent Treasury bonds. They were mostly the 2½ marketable bonds not eligible for purchase by banks. The insurance companies particularly were very, very heavy sellers, and the System over a period of a few months purchased over $3,000,000,000 of these securites in the market and within a year such purchases were nearly $7,000,000,000. In the same period over 2½ billion of bonds—eligible bonds—were purchased by the System.

Senator DOUGLAS. Mr. Eccles, I have never believed that congressional hearings were designed to exploit administrative differences, but you have been a member of this Open Market Committee, a very influential member, and yet now you are saying that this policy that the commitee has followed is in your judgment incorrect?

Mr. ECCLES. I did not say it was incorrect. I merely outlined the effect of it. When I appeared before this committee November 25, 1947, this same committe of which Senator Taft was then chairman and again before this committee on April 13, 1948, I discussed very fully this whole question of monetary policy. You may recall that there were some very important inflationary pressures in existence in the fall of 1947 and in the spring of 1948. On those occasions I requested for the Board certain powers.

I made this statement in April of last year. It is very short:

> So far as the monetary and credit yield is concerned, we have tried to make clear the action on these fronts alone cannot guarantee stability. Nevertheless we believe that the Reserve System should be armed with requisite powers, first to increase basic reserve requirements of all commercial banks, and, later on, if the situation requires it, to provide that all such banks hold an additional special reserve.

That was in the form of short-term Governments.

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Both of these would be protective measures. The first could be used to offset gold acquisitions and purchases of Government securities by the Federal Reserve—

That is, from insurance companies and others. It would neutralize, lock up the effect of such an operation—

and thereby restrict continued expansion and the already excessive money supply. The second would be essential in case banks embark upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve, or to assist the Government in case of large-scale deficit financing.

Now that was the gist of what was recommended at that time.

I supported a policy of maintaining a 2½ percent rate for the longest term Government securities at the time when that policy was being pursued.

That policy likewise had the support of the Reserve bank presidents including Mr. Sproul, who was vice chairman of the Open Market Committee, and also of Mr. Brown, who was the chairman of the Federal Advisory Council of the Board, and of the great majority of the bankers of the country.

Last October, before the Iowa bankers, in answer to Mr. Parkinson, the insurance company executive who criticized that policy, Mr. Leffingwell of J. P. Morgan & Co., and Mr. Burgess of the National City Bank—the three leaders opposed to the support policy—I presented a statement in justification of the support of the long-term 2½ percent rate, at that time, and gave the reasons for it. I will read this later.

Senator DOUGLAS. Then you wanted the short-time interest rate on Government notes, certificates, and so forth, to go up and not the long-time rate?

Mr. ECCLES. Over the last several years the Open Market Committee was, I believe, in almost unanimous agreement on the question of raising the short-term rate. We advocated a much freer short-term rate than was in effect. We ran into resistance always with the Treasury. During the war period we had a pattern of rates for the purpose of carrying out the war financing which seemed very necessary and desirable. We assured the Treasury that we would see to it that whatever deficit financing was required would be carried out at a fixed pattern of rates. We did that because it seemed to us, with the very large amount of deficit financing that the war required, and not knowing, of course, just how large it would be or when it would end, that we could not have a speculative Government bond market. I don't mean to say there wasn't considerable speculation on the "up side." There was too much speculative bidding up of prices which was not our fault—but we realized that it would be exceedingly difficult to finance the Government with increasing interest rates, which would mean declining prices for securities after issuance.

When the war ended we tried to get out of what we called a strait-jacket by raising the short-term rates. We had difficulty with the Treasury, commencing with Secretary Vinson—Secretary Morganthau, of course, left the Treasury prior to the end of the war. We continued to have difficulty with the Treasury in getting them to agree to freeing the short-term rate. That could have been a flexible rate, if it could have been permitted to go wherever it would go, in relation to the 2½ percent long-term rate. It may well have gone as high as the long-term rate—short-term rates in the past have gone

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as high or even higher than long-term rates—and we would have then followed up that change in the short-term rate with an increase in the discount rate.

Senator DOUGLAS. May I ask: When did the Federal Reserve first suggest raising the short-term rate Treasury bills?

Mr. ECCLES. In 1946.

Senator DOUGLAS. But it was not carried into effect until the middle of 1947?

Mr. ECCLES. Yes. I think that is true. We had a buying rate of bills of three-eighths.

Senator DOUGLAS. Was there a disagreement in Government circles?

Mr. ECCLES. There was.

Senator DOUGLAS. You felt the short-time rate should go up?

Mr. ECCLES. The Open Market Committee felt it should go up.

Senator DOUGLAS. The Treasury did not think it should go up?

Mr. ECCLES. That is correct.

Senator DOUGLAS. Why did you think it should go up?

Mr. ECCLES. Well, I felt that you had no flexibility in the market at all. You could, as many of the banks were doing, sell the shorter securities to us and buy the longer-term securities. This practice, which we call playing the pattern of rates, tends to force the long-term rate down as long as short-term rates are not permitted to rise. In other words, we had a spread between short-term rates and long-term rates that didn't make sense, in view of the support policy. Why should anyone want to handle any short-term securities at seven-eighths if you could get 2½ percent for a demand liability in long-term securities?

Senator DOUGLAS. You were in favor of the pegging of the long-term rate?

Mr. ECCLES. I couldn't figure out any alternative. I didn't like it but it seemed to me that we were confronted with a dilemma, that the size of the public debt was so great, the amounts of E. F. & G. bonds outstanding, which were demand liabilities, were likewise very great and—I am going to read this from the Iowa statement, to which I previously referred, because really it is the heart of the problem, and I might just as well cover this point here. [Reading:]

> Now, just what does this type of program actually contemplate?

That is pegging.

> It seems to involve a continued willingness on the part of the Federal Reserve System to take Government bonds and to supply Reserve bank credit, but at yields higher than 2½ percent.

That is the policy that some were talking about.

> Apparently, however, the System should follow a policy of gradually easing bond prices down and yields up, but buying aggressively, if necessary, to maintain orderliness in the market.
>
> What would be the position of a Government bond owner or a potential bond buyer under such circumstances? Would they have any confidence in the market? Holders would tend to sell and potential buyers to hold back, creating increasing downward pressure on bond prices, until substantially lower prices were reached. If yields should rise only ½ percent on the longest 2½ percent bonds, their price would fall to less than 93. But in a falling bond market, with general credit demand strong, rates on other securities and loans would tend to rise at least proportionately as much. Under these conditions, can it be expected that insurance companies or savings and loan associations or other institutional investors would act materially differently with the yield on Governments at 3 percent than they do now at 2½ percent?

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We have had tax-free Governments, entirely tax free, selling at almost 6 percent in the past with a small public debt.

Loans or investment, other than Government securities, would have as much, if not more, relative attractivenes to lenders and investors. Few, if any, borrowers would be priced out of the market for funds by rate increases of the size contemplated by advocates of this "flexibility" policy.

The long-term rate.

Any moderate rise in long-term interest rates would not, in itself, reduce significantly the demand for money. Investing institutions, which are now switching from long-term Government bonds to private credit forms, would still be motivated to do so by a continuing margin of return between the two kinds of investment.

Thus, under the "flexible" policy, the Federal Reserve System would still be called upon to support the bond market and would thereby continue to create bank reserves. It is possible that the amount of support required under these conditions would be much greater than is now the case. Investors generally would lose confidence in the market and would rush to sell their securities before prices declined further.

Money and reserves created by Federal Reserve purchases below present support prices would be just as high-powered as those created by support at existing prices, and the reserves thus made available could support nearly six times as much in bank loans.

Senator DOUGLAS. Mr. Eccles, may I interrupt for a minute. Your program was not, therefore, to raise the yield on long-time securities?

Mr. ECCLES. That is right.

Senator DOUGLAS. But to raise the yield on short-time securities nearer to the 2½ percent on long-time?

Mr. ECCLES. That is right; that is correct.

Senator DOUGLAS. And this was opposed by the Treasury?

Mr. ECCLES. Well, the Open Market Committee and executive committee of the Open Market Committee meet regularly and discuss the question of the open-market operations in relation to the constant and current problem of debt management. As you know, with the billion dollars of bills falling due every week, and with the 25 billion of certificates, something of that sort, outstanding, falling due, with several billions of bonds falling due periodically, debt management is a current and constant problem. It is important that the Federal Reserve policy be coordinated with the refunding operations, or the "rolling off" operations of the Treasury with reference to short-term debt.

In other words, we couldn't let the short-term rates go completely free. We never proposed that it go free. But what we did propose is that the bill rates and the certificate rates be permitted to go up. The Treasury was unwilling to permit our buing rate to go up as far as we recommended it, and thus permit the rates on short-term Government securities to rise.

Senator DOUGLAS. They didn't want the short-term rate to go up because it meant a greater interest charge on the short-term debt; is that right?

Mr. ECCLES. That was one of the reasons, I suppose.

Senator DOUGLAS. And they, also, did not want fluctuating prices?

Mr. ECCLES. During this period of time, over a period of 2 or 3 years, the rate did go up on the certificates from ⅞ to 1¼. There were three raises of an eighth in a period of a little over a year.

Senator DOUGLAS. Well, this is something that puzzles me a bit: As I remember it, the Federal Reserve System was supposed to be an independent agency; the Treasury, another independent agency. Yet,

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it is inevitable that the views of one be taken into consideration by the other, and highly desirable. What is the machinery for coordinating the policies of the Reserve System with the policies of the Treasury?

Here was a case in which the Federal Reserve Board, or rather the Open Market Committee, wanted a higher rate on short-time Government securities; the Treasury did not. Now, what is the process of osmosis by which the views of one becomes communicated to the other?

Mr. ECCLES. Well, our staff of people are constantly in contact with the Treasury staff people, giving them the point of view of the Federal Reserve; and the Chairman of the Board was in close touch with the Treasury. Mr. Sproul and I met with the Secretary of the Treasury periodically to discuss with him the recommendations of the Open Market Committee with reference to this question. We were successful in persuading the Treasury to permit some modest changes. That is how we got the changes that we did, but we were never able to get the short-term rate as free as we desired to get it, and there has been——

Senator DOUGLAS. Suppose you had gone ahead and raised the short-term rate; what would have happened?

Mr. ECCLES. Well, I suppose that the System could have done that, in defiance of the wishes of the Treasury. My views of the independence of a central bank are these: That the Congress appropriate the money; they levy the taxes; they determine whether or not there shall be deficit financing. The Treasury then is charged with the responsibility of raising whatever funds the Government needs to meet its requirements. They have the responsibility not only for raising new funds and determining the types of issues and the rates that should be paid, but they also have the responsibility for the refunding of the debt.

The mechanism, however, for establishing money-market rates is in the hands of the Open Market Committee.

I do not believe it is consistent to have an agent so independent that it can undertake, if it chooses, to defeat the financing of a large deficit, which is a policy of the Congress.

In other words, it seems to me that it is up to the Federal Reserve, the Open Market Committee, to advise, to recommend, to the Treasury and to the Congress. But it is not the position, I believe, of the Federal Reserve Board, or the Open Market Committee, to enforce its will. It has its day in court. It has its opportunity to make its views known. It has an opportunity to persuade and to influence, to whatever extent it can. I feel, however, that the final responsibility for making the decisions with reference to public financing is up to the Congress and the Treasury.

Any open-market committee, or any central banking system, that for any length of time did not go along with that conception would not survive.

Now, I do think, when the policies pursued by the Government are sufficiently displeasing to the central banking authorities, their redress is to resign, but not to undertake to enforce their will.

Senator DOUGLAS. Mr. Eccles, I can quite understand that during the period of the war, when the amounts collected in taxes and subscribed for bond purchase out of current income were not sufficient to meet the total cost of the war, we had to create credit by banks. But in the period of 1946 and the first part of 1947, of which you speak,

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the Government did not have a deficit; it had a surplus, so that the policy of low rates on short-time securities was not necessary for current financing. You can say that it was desirable for refunding, but not for current financing.

Mr. ECCLES. There was no current financing. It was all a problem of refunding.

Senator DOUGLAS. Then the question comes, For how long will the refunding needs of the Treasury dictate reserve policy? Is this going to continue forever?

Mr. ECCLES. I think so. If Congress would, as a result of hearings of this sort, make it apparent that this support policy on the part of the Open Market Committee was not desirable, I think you would find, maybe, a greater independence on the part of the Open Market Committee. But in the hearings that have been held up here during the past 2 or 3 years we were unable, though the agent of Congress, to get any indication from any of the committees of Congress as to whether or not this support program should be discontinued. I don't think the System expected to get an opinion, but it only indicated that they had to do the best they could under the circumstances that existed.

Senator DOUGLAS. And in default of such a mandate you felt that, while you should advise and conciliate and attempt to persuade the Treasury, you should not act in opposition to its wishes?

Mr. ECCLES. That is correct. We felt that increasing the short-term rates or permitting a long-term rate to go up would not necessarily stop an inflationary development unless we went so far as to withdraw from the market. To buy Government's, whether you buy Government's in the market at par or at 75 cents on the dollar, you still create reserves. To stop the growth of bank credit, it would have been necessary to deny banks Federal funds, either through rediscounting or through the support of the Government bond market. That, of course, would have stopped the growth of bank credit and the supply of money.

An increase in rates of 1 percent or 2 percent, or even more, is not going to stop, in a period of inflationary development, the borrower from desiring to borrow if he needs that credit in order to do what he considers necessary to do business. The psychological effect on borrowers and lenders of such rate increases is, of course, hard to judge. It would depend upon the degree of inflation, and the amount of confidence or lack of confidence in the Government security market.

Senator DOUGLAS. In order to get an appreciable increase in yields and in interest rates, you would have to let the price of Government bonds depreciate markedly?

Mr. ECCLES. A half of 1 percent in interest rate would put the long-term Government bonds to 93. Now, you must consider what would then happen to the fifty-some-odd billion of E, F, and G savings bonds that are outstanding.

Senator DOUGLAS. I understand those are to be redeemed at par.

Mr. ECCLES. No, but they could be redeemed for cash. Those bonds, first, are demand liabilities on the Treasury, and if——

Senator DOUGLAS. The Treasury will redeem at par?

Mr. ECCLES. It will redeem them for cash at stated prices. But, if the Treasury has to redeem those bonds, then the Treasury has got to raise money in the market, in order to pay them off, and the Federal Reserve would have to see to it that the Treasury could raise the money. Therefore, you have a process of monetization there.

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Senator DOUGLAS. In other words, what you are saying is that, for the stability of the banking system, perhaps the stability of the finances of the country, you can only permit minor changes in the price of government; and, therefore, in yields—very minor changes?

Mr. ECCLES. I think so.

Senator DOUGLAS. And that these minor changes will not have very much effect in damping down inflation?

Mr. ECCLES. Well, if the demand for credit is great, or if the lack of confidence in the long-term rates is greatly weakened, if confidence in the purchasing power of the dollar, which usually takes place in a rapid and continuing inflationary condition, developed, then certainly merely a change of a few points in the interest rate is not going to stop your inflationary development.

As was pointed out, there are two ways that inflation must be stopped. One is through fiscal policy, budgetary surpluses. But budgetary surpluses, in and of themselves, will not stop inflationary development, if the effect of budgetary surplus, which is anti-inflationary, is neutralized or nullified by the banking system expanding credit of an amount equal to the budgetary surplus. That is what took place in 1946 and 1947.

Senator DOUGLAS. But couldn't the budgetary surplus be used to purchase a portion of the bank-held public debt?

Mr. ECCLES. It was used entirely for that purpose.

Senator DOUGLAS. That should have diminished the reserves.

Mr. ECCLES. It diminished the amount of deposits and reserves, but the banking system expanded bank credit, for housing particularly under a Government-sponsored program, for consumer credit through commercial loans, and various types of credit, which were encouraged. The banking system expanded credit and created money by an amount in excess of the budgetary surplus which the Government created through a sound fiscal policy.

Senator DOUGLAS. But they expanded by less than would have been the case had there not been a budgetary surplus.

Mr. ECCLES. One largely neutralized the other, or you would have had a much more serious inflationary development.

Now, the principal reason why the Board proposed what was known as the special reserve was in recognition of what I am saying. It was desirable to put the banks under pressure not to loan, not to expand credit. Merely changing the interest rate further encouraged the banks to want to loan. To increase the rates wouldn't discourage bank lending. The small increase in the rates would not discourage borrowers from borrowing. So, what seemed to us to be required was to put pressure on the banks by requiring that a substantial part of their deposits be locked up against the short-term Government securities which in their purchase created the deposits.

And I would like to read, in that connection, what I said on November 25, 1947, to the Joint Committee on the Economic Report, in hearings that were held for the purpose of considering inflationary problems, just a paragraph on this very point. [Reading:]

It is unfortunate, I think, that banking leaders oppose protective measures against inflationary forces arising in the credit field. They seem to forget that, in order to assist in war financing, the Government provided the banking system with additional reserves which enabled the banks to buy Government securities; that this created new deposits in the banks; and that banks have also had the benefit of interest received on the Government securities they have held and will

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continue to hold for an indefinite period. They object even to a temporary limitation on the further use of these funds as a basis for loans to private borrowers, which would in turn create more and more deposits. The Government has an obligation and a duty to step in at this time of national danger to say to the banks, "We are not proposing to deprive you of benefits you have already derived and will continue to derive from the vast increase in bank deposits resulting from your purchases of Government securities, but we do say that you should be willing to accept a reasonable limitation on using a war-created situation to multiply private loans in peacetime when they serve to intensify inflationary pressures."

Senator DOUGLAS. That was to be a limitation on the purchase of short-time securities?

Mr. ECCLES. That was to require a reserve to be held in short-term securities.

Mr. WOLCOTT. May we identify what he is reading from, Mr. Chairman?

Mr. ECCLES. Hearings before the Joint Committee on the Economic Report entitled "Anti-Inflation Program as Recommended in the President's Message of November 17, 1947," page 145.

Mr. WOLCOTT. Testimony which you gave before this committee or the House Banking and Currency Committee?

Mr. ECCLES. Before this committee.

Mr. WOLCOTT. What was the other one you read from; was that testimony before this committee?

Mr. ECCLES. They were both before this committee.

Mr. WOLCOTT. On what dates?

Mr. ECCLES. November 25, 1947, the one that I have just read; and the other was April 13, 1948.

Extensive hearings were held before your committee, Mr. Wolcott, in the House at that time. I appeared for two full days before your committee in connection with this entire subject.

Mr. WOLCOTT. I remember you did. I thought there was something nostalgic about what you were reading.

Mr. ECCLES. That is right. There will always be, of course, nostalgia, I think, about this subject of inflation and monetary and credit control. There is nothing new about it, and there is not likely to be over the ages.

Senator DOUGLAS. Mr. Eccles, when Mr. Burgess testified last week, he contended that an increase in the member-bank reserves ordered by the System could not restrict the growth of credit extended by the banks so long as the Federal Reserve follows the policy of pegging the prices of governments and is therefore committed to purchasing all securities offered to it. Do you agree with that?

Mr. ECCLES. I agree with it.

Senator DOUGLAS. So that, in effect, you are saying that the open-market operations of the Reserve System and the reserve requirements of the System are relatively inoperative as a means of checking inflation because of the debt-management policy?

Mr. ECCLES. Well, I think the debt-management policy is, of course, the most important factor in this whole situation. What Mr. Burgess said, of course, is, like a great many statements, true as far as it goes; but more could be said upon the subject of how to exercise more effective credit controls through increasing reserve requirements to offset the effect in reserves of Federal Reserve purchases of securities sold by nonbank investors. When insurance companies or other long-term investors decide to sell, so long as the Federal Reserve is support-

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ing the long-term 2½-percent rate, reserves are created in the banking system. The banks themselves don't create those reserves. They get reserves and are under pressure then to use the money. Gold imports or silver purchases, or a reduction of currency in circulation, all of those factors add to the excess reserves of the banking system; and the banks themselves, either individually or collectively, have nothing to do with the creating of those reserves. Yet when reserves are available, the banks are under pressure to expend credit, to use those funds to drive interest rates down and to drive prices of securities up.

Now, an increase in reserve requirements sterilizes the effect of reserves going into the banking system from these sources. But to increase reserve requirements very materially and not include nonmember banks would drive member banks out of the System. The Reserve banks would be, in effect, holding an umbrella over the banking system as a whole, and that is why we argue strongly that reserve requirements should be applied to all banks, so as to help the System get new members and to help the System hold the members we have.

Now, there is one other point on that that I want to make. The banker who chooses to sell securities doesn't see how or why he is necessarily creating more money. He only sees that he has a good customer who gets the credit. Even though that customer gets the credit and uses it to compete for goods in short supply, the individual bank doesn't see that you must stop the growth of bank loans and investment in order to stop the growth of bank credit. The special reserve requirement that would require the banks to hold a substantial part of their demand deposits in short-term Governments would put the banks under pressure to restrict loan expansion, because they wouldn't be able to sell their short-term securities. They would have much more hesitancy to sell the longer-term securities which give a higher yield, and they would want to maintain such liquidity as was left to them if a reserve of short-term securities was applied.

Now, I merely mention that as reviewing the proposal made, because we saw this situation fully at the time. We saw the dilemma, and we tried to point out to the committees what we could do as an alternative to withdrawing support from the Government security market, which may have been necessary to prevent monetization of the public debt. We hesitated to withdraw support for the reasons which I have indicated to you: Because of the effect upon the entire problem of management of the public debt, the problem of refunding, and particularly the effect that might be had upon the demand liability in the form of E, F, and G bonds.

Senator Douglas. Mr. Eccles, earlier you said that in default of a congressional mandate you felt that you should not disregard the considered judgment of the Treasury on the question of yield of Government securities.

Mr. Eccles. That is correct.

Senator Douglas. I would like to ask: Would it serve a useful purpose if Congress were to instruct the Treasury further as to the policies to be followed in debt management and the procedures of cooperating with the Federal Reserve System?

Mr. Eccles. I think it would be of great assistance.

Senator Douglas. Do you have any suggestions as to the policies which Congress might instruct the Treasury to follow?

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Mr. Eccles. Well, I hadn't thought of the subject, but I will be glad to do so. I can't think of the practical language of a resolution or bill that would be required. It would require action on the part of Congress. It would certainly be debated plenty within the Congress.

Senator Douglas. But you are saying, if properly constructed, it would be helpful. I take that if such an instruction were unwise it could cause great damage. Therefore, we would appreciate it very much if we might get some suggested standards, standards of instruction.

Mr. Eccles. Of course, the Federal Reserve System—that is, the Board in particular, more than the Open Market Committee—is in a particularly difficult situation. The Members of the Congress and the public blame the Federal Reserve for not restricting credit expansion and not preventing inflationary developments on the one hand, while on the other hand the Board would, of course, be condemned by many who would be opposed to such action. Certainly the Reserve Board is no place for a person who does not have the courage to take unpopular action.

It would be of great assistance, of course, to the Board if that were made perfectly clear, that this responsibility for credit and monetary control is theirs and not the Treasury's.

I don't know that it would be practical to work out an arrangement, for the reasons I stated a while ago, to create an independent Reserve Board, independent to the extent that it was expected to enforce its will. It is now independent and should continue to be independent to the extent that it has an opportunity to recommend and to advise. That is, of course, desirable, and is a better situation than would be the case if the Federal Reserve authority and power were vested in the Treasury itself.

Senator Douglas. Well, would you favor a national monetary council composed of the chief officers of the Gocernment who deal with fiscal and credit policies, so that there might be a formal opportunity for them to meet and try to arrive at common decisions rather than have these matters discussed at informal conferences on a staff level?

Mr. Eccles. I don't think that would improve the situation. It may be desirable to have an interdepartmental statutory council, such as the NAC in the foreign field, for the purpose of coordination of certain credit activities. You have the Farm Credit Administration, and you have the Housing Administration, you have the RFC, and you do have a great many Government agencies whose activities affect the field of money and credit. It might be desirable to have such an interdepartmental committee; but it would seem to me that, whatever the policy of the administration was at the time, it would prevail in such a council; and it would, if anything, reduce the independence of the Board and not increase it.

Senator Douglas. We asked Secretary Snyder a question as to how we could get better coordination of fiscal policies; also, among other questions we asked him, whether he believed that the Secretary of the Treasury should be made a member of the Board of Governors of the Federal Reserve System; and he replied [reading]:

The Secretary of the Treasury is the chief fiscal officer of the Government. It seems to me that any proposal to make him a member of the Board of Governors of the Federal Reserve System for the express purpose of bringing about better coordination of Federal Reserve and Treasury policies would appear to sub-

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ordinate the responsibility of the Treasury Department in fiscal-monetary matters. In the final analysis, the principal responsibility in the fiscal-monetary area must rest with the President and his fiscal officers who are accountable to the electorate for their actions (p. 11 of the committee print on Monetary, Credit, and Fiscal Policies).

Now, if what you have been saying amounts to this, that on these vital matters the Federal Reserve Board defers in its credit policies ultimately to the Secretary of the Treasury, that means that the Secretary of the Treasury ultimately has responsibility both for the fiscal and for credit policies?

Mr. ECCLES. Well, there is no difference between money and credit. They are one and the same thing. We say "money and credit," but credit is merely the basis for creating money.

Senator DOUGLAS. Debt management, perhaps.

Mr. ECCLES. That is right. There is a distinction, of course, between what we call fiscal policy and monetary and credit policy.

Now, I have advocated that the Federal Reserve Board or some organization should have the sole responsibility in the field of monetary and credit policy; and, as I have indicated here, examinations are closely related to that question of monetary and credit policy.

Senator DOUGLAS. Including the management of the public debt?

Mr. ECCLES. No; when it comes to the question of management of the public debt, the Treasury is the huge borrower; and I don't know whether you can, as a practical matter, improve a situation that merely gives to an independent Federal Reserve agency the opportunity to advise—the opportunity to recommend. It is difficult for me to see how you can go further than that. When the administration in power at any given time is put there by the electorate and is responsible to the electorate, to have an independent agency deprive them of the most important tool in the economic kit doesn't seem to me to be very practical.

It has never operated that way in any other country. In Canada, in England, France, and every other country in the world, so far as I know, the central bank has never successfully used its authority to enforce its will over any administration in power.

Senator DOUGLAS. Mr. Eccles, in connection with the responsibilities of the Treasury for debt management, which you now say you do not propose to change, does not that necessarily carry with it, in the final analysis, control over credit policy and therefore over money policy?

Mr. ECCLES. Well, you could make a good argument for that.

Senator DOUGLAS. Isn't that just a statement of fact under the present situation?

Mr. ECCLES. I would question that. Certainly the desirability of it.

Senator DOUGLAS. I am not speaking about the desirability of it. I am just saying, isn't that a statement of the situation?

Mr. ECCLES. Well, I must admit that that is where the logic of the situation leads you; I must admit that. And yet we all know, I think, as a practical matter, that to increase the direct authority of the Treasury over the whole field of money and credit—in other words, set up within the Treasury itself a division or a department of monetary and credit control—may well lead, in time, to a socialization of the credit structure, which, I think, would be very undesirable and very dangerous.

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Senator DOUGLAS. I want to make it clear that I am not advocating that. I am merely raising the question as to whether, in the present situation, the power of the Treasury to manage the debt, which you do not question, does not, as a matter of fact, also carry with it the virtual control over credit and monetary policy. That is all. I am not saying this should be permanent.

Mr. ECCLES. I wouldn't say that it carried the complete control.

Senator DOUGLAS. No; predominant control.

Mr. ECCLES. I would say that it exercised a tremendous influence. I would say that it possibly carries a much greater control than is generally recognized and understood. That control, of course, can be extremely dangerous if the Treasury would be, for political reasons, enforcing a monetary and credit policy in connection with its debt-management responsibility that was contrary to the best interests of the country at a given time. They could do that and it could be dangerous.

Senator DOUGLAS. Mr. Eccles, I am aware of the fact that I have probably asked more questions than I should, in justice to my colleague, Congressman Wolcott, but I do have one or two more questions, and then I will defer to him.

In hearings last week I asked a number of witnesses whether the Federal Reserve Board, in their judgment, should not be given powers to impose uniform reserve requirements on all banks, whether members or nonmembers, and their reply was almost uniformly "No." The chief argument which they brought forward was that already 85 percent of the deposits of the country are in the Federal Reserve banks, and that the dog in the System was a big dog, and that the tail outside of the System was a relatively small tail, and that in practice the Federal Reserve Board did not need this control on reserve requirements to control the total amount of credit.

Now, I replied to this argument of theirs by saying "Yes," but if the Reserve Board raises requirements to check inflation there is always the danger that State banks will resign from the System. They replied, "Have any ever done so," and their implication was, in practice, that the advantages of being in the System are such that even if reserve requirements are raised that State banks, members of the System, holding 35 percent of the total deposits, will not get out.

What is your judgment on that?

Mr. ECCLES. I don't agree with that at all. I think if reserve requirements were substantially increased that you would not only find a substantial number of State banks getting out, but you would find national banks converting to State banks. You would weaken the entire structure of Federal control over the banking system. Not only would that happen but the State banks which are now out of the System would certainly not come into the System.

Senator DOUGLAS. They only have 15 percent of the deposits.

Mr. ECCLES. That is right; but that is a pretty good size hole in the dike. There is always a terrific opposition to an increase in reserve requirements by member banks and national banks because of the discrimination. That is one of the great arguments against further increasing reserve requirements.

Now, as a banker with a good many years of practical experience I can say that I cannot see any good reason why a bank would remain in the Reserve System under conditions of an expanding increase in reserve requirements. The advantages of the System are very minor aside from the use of its credit facilities.

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Senator DOUGLAS. What about the clearance of checks?

Mr. ECCLES. Well, you can clear checks through the banks which are members. That is no problem. They are delighted to have your balances.

In other words, most nonmember banks might get by on 15 percent of their demand deposits held as reserves—in cash and correspondent balances; whereas a member bank today cannot get by on less than 25 or 30 percent. Now, that is already a great penalty.

Senator DOUGLAS. That includes vault cash?

Mr. ECCLES. That is vault cash and correspondent bank balances that member banks must carry, in addition to required balances with the Federal Reserve, in order to get the services that the Reserve System is unable to give them. Nonmember banks can count their vault cash and balances with correspondents to meet any reserve requirements they are subject to. There would be no good reason why banks should stay in the Federal Reserve System so long as they have a large portfolio of Government securities which they are able to sell in order to get funds to meet their situation.

Senator DOUGLAS. May I ask this, Has the fear that the raising of reserve requirements might cause State banks to get out of the Federal Reserve System ever operated to make the Federal Reserve Board abstain from putting into effect an increase in reserve requirements which otherwise it would have thought desirable?

Mr. ECCLES. We didn't have authority to increase reserve requirements any further than we did.

Senator DOUGLAS. Then has this fear operated to restrain you in the past?

Mr. ECCLES. The fear hasn't operated to restrain the Reserve Board, no; but had we gotten the authority that was requested it may well have. I appeared before the committee and said that, unless authority to increase reserve requirements applied to nonmember banks, the Board did not want that authority, because they would be under pressure not to use it, because of the discrimination.

Senator DOUGLAS. How much more did you want to raise it?

Mr. ECCLES. We asked for authority, as I recall, of 10 percent. I think that was in April 1948. In December of 1947 we had suggested authority to impose a special reserve requirement of up to 25 percent of demand deposits in short-term Governments, which would have permitted the banks, of course, to hold their reserves in the form of Governments, which are earning assets.

What I have said here this morning, of course, with reference to this subject, had application in an inflationary situation that existed in 1947 and 1948, and does not have the same application today.

This is now an academic discussion, which does not necessarily have application to the present economic situation.

I see no urgency at the present time for increased authority. If the System had increased authority I can't see any use that they would have for it at the present time. That does not mean, however, looking to the future, that whatever authority may be necessary to deal with inflationary situations, should not be available.

Senator DOUGLAS. I think those are all of the questions I have. Congressman Wolcott.

Mr. WOLCOTT. Mr. Eccles, I don't know as you intended, and I surely am not going to interpret your remarks as critical of the con-

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gressional action, but, of course, you have known for some time of the difficulty which Congress has had in trying to reconcile the policy as it was announced by the Treasury and the Federal Reserve Board—and sometimes, as I recall it, you haven't been in hearty agreement with other members of the Board in respect to these problems——

Mr. ECCLES. I do not think that statement is correct.

Mr. WOLCOTT. Perhaps not on these problems, but on others.

Mr. ECCLES. I think that the statements I have presented are the statements of the Board.

Mr. WOLCOTT. At that time?

Mr. ECCLES. At this time.

Mr. WOLCOTT. What I was leading up to is the statements you are making today and the suggestions and recommendations which you have made—are they your own, or are they the Board's?

Mr. ECCLES. They are my statements. I am not Chairman of the Board, and I was asked to come up here and express my own views.

Mr. WOLCOTT. Do you believe that they substantially conform to the thinking of the other members of the Board?

Mr. ECCLES. Well, it would be my judgment that they do conform, in general, with certainly the majority of the Board. That is my judgment. I may be wrong.

Mr. WOLCOTT. You have been dealing principally here in the past tense as to what our attitude should have been in previous inflations. Do you believe that the Government should, either through the Federal Reserve or the Treasury, continue to support the Government bond market?

Mr. ECCLES. Well, the Open Market Committee is not supporting the Government bond market at this time.

Mr. WOLCOTT. If there should be a case where the Government bond market has to be supported, do you believe they should? They are surely influencing it to a point where it is supported in some measure today.

Mr. ECCLES. Yes; as a matter of fact the Federal Reserve has reduced its holdings of Government securities during this year; it has sold into the market something over $4,000,000,000 of securities; including $3,000,000,000 of bonds.

Mr. WOLCOTT. Why have they sold them?

Mr. ECCLES. Well, they have sold them to meet the demand. We have let the market have securities; otherwise prices would have gone sky high, interest rates would have gone exceedingly low.

Mr. WOLCOTT. All of the operations of the Open Market Committee are predicated upon the desirability of maintaining a stable market, are they not; that is, since 1935, when you were given this authority, these mandatory powers? Before that the Open Market Committee was purely advisory.

Mr. ECCLES. You mean the Board was advisory. The Open Market Committee was composed of the governors of the 12 banks.

Mr. WOLCOTT. Yes.

Mr. ECCLES. The Board was advisory. The Board had the veto power.

Mr. WOLCOTT. Yes.

Mr. ECCLES. But they had no initiative; the initiative was in the hands of the governors of the 12 banks.

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Mr. WOLCOTT. The Open Market Committee had no initiatory powers previous to 1935?

Mr. ECCLES. The Open Market Committee had initiative before 1935. The Open Market Committee was set up in 1933. Prior to that they acted informally. From about 1922 they acted informally, largely under the leadership of New York. But it wasn't until the Banking Act of 1935 that there was an Open Market Committee that had the authority to force the Reserve banks to buy and sell.

Prior to that time all the Open Market Committee could do was to adopt a policy over which the Board had a veto power. But whatever policy they adopted, any Reserve bank could refuse to participate. It was, of course, a very impractical and unsuccessful operation. That is why the Banking Act of 1935 changed that entire open-market structure. At the time of the Banking Act of 1935, and I sponsored that legislation and carried it through Congress, it was recommended that the authority of the Open Market Committee be put in the Board, and the bill passed the House in that form. It was the Senate that set up the present form, and that compromise was accepted in the conference committee.

Mr. WOLCOTT. Mr. Eccles, can you give us some idea as to where you think the bond market should be pegged, where the Government bonds should be pegged?

Mr. ECCLES. It seems to me you asked me the question, Did I feel the Government bond market should be supported?

Mr. WOLCOTT. Yes.

Mr. ECCLES. And I answered by saying that the Government bond market was not requiring support, but the System was selling securities in the market.

Mr. WOLCOTT. Let me put it this way: What we are trying to get at is whether the Congress should enact legislation to help in the stabilization effort. I gather from what you have said that you believe the authority to peg the Government bond market should be continued?

Mr. ECCLES. Well, there is no direct requirement that the Government bond market be pegged. I am not saying, looking to the future that the 2½ rate should be maintained.

It seems to me that nothing could be worse than that the Reserve system be given a mandate, or that it be indicated, either by the Congress or by the Open Market Committee, that it should peg the Government bond market at a 2½-percent rate indefinitely, as Mr. Harl suggested the other day. Nothing could be worse.

It would be perfectly stupid then to have more than one rate. Why on earth, if the Open Market Committee, or the Congress, were to publicly announce that from here on out the long-term rate of 2½ percent on Government securities was going to be maintained on market securities would anyone want a bill or a certificate that yields 1¼ or 1⅛? All the Government would need to have is just one security, which would be a demand liability of 2½ percent.

Why have obligations maturing in 20 years?

Mr. WOLCOTT. That brings up the question of the standards under which you should be given the authority. My point is, Should the Congress just say that either the Treasury or the Federal Reserve, through the Open Market Committee, shall have the authority to support the Government-bond market, and stop there? What more authority would that get you over what you have at the present time?

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Mr. ECCLES. It wouldn't give us any. We have got that authority now.

Mr. WOLCOTT. Then it becomes a question of standards. What standards, as Senator Douglas has suggested, could the Congress enact into law that would clarify your position in respect to supporting the Government-bond market any more than has been done by giving the Open Market Committee initiatory powers under the Banking Act of 1935?

Mr. ECCLES. I don't know.

Mr. WOLCOTT. We don't know. That is what we have been trying to find out here ever since 1935. Surely we should make it flexible enough so that you wouldn't create a situation where you would destroy your market for the short-term stuff.

Mr. ECCLES. What the Board suggested was that the authority that the Open Market Committee has was not in itself sufficient and that further powers were needed; namely, the authority to increase reserve requirements or to apply special reserve requirements, as supplemental to the other authority.

Mr. WOLCOTT. All right.

Mr. ECCLES. The authority of the Open Market Committee was adequate only to the extent that you denied the market Federal Reserve funds by withdrawing.

Mr. WOLCOTT. We did give you authority in respect to reserve requirements, and you say they weren't operative and you couldn't effect your purpose because we did not give you authority over reserves of nonmember banks?

Mr. ECCLES. No; we got authority about a year ago to increase requirements by 4 percent, but it was temporary and lapsed last June.

Mr. WOLCOTT. Yes.

Mr. ECCLES. It applied to member banks only. If you recall, that authority was not given until a year after it was asked, and then we were heading into a recession.

Mr. WOLCOTT. You asked for a 10 percent authority?

Mr. ECCLES. Yes.

Mr. WOLCOTT. The reason that the Congress did not give you the 10 percent was because it was self-evident, it was thought, that if you exerted that authority up to the limit you could have put almost every bank in the United States out of business; we thought it was too broad an authority. We eventually compromised on your 4 percent, and you did not use all of that, did you?

Mr. ECCLES. We pointed out that the 10 percent at the time would still leave the banking system with enough Governments. They had about 50 percent of their deposits in Governments; and a 10 percent increase, we pointed out, would leave them with nearly 50 percent of their deposits in Government securities, and therefore it was not as drastic as you have indicated.

Mr. WOLCOTT. Well, we were told, as I recall, that you would never use that much authority.

Mr. ECCLES. Well, the very fact that we had the authority to use——

Mr. WOLCOTT. Because there was no other alternative given to the Congress, we had to use our own good judgment as to what we considered equitable and what we considered sufficient authority to do the job at the time, so we compromised on 4 percent.

Mr. ECCLES. We got no authority at that time.

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Mr. WOLCOTT. You didn't get the authority, Mr. Eccles, because you asked for this unwarranted amount, in the opinion of the majority of the Congress.

Mr. ECCLES. No; they didn't even give us 4 percent; they gave us nothing at the time.

Mr. WOLCOTT. Because there was no alternative. The Congress had to create an alternative, as between 10 percent and 4 percent; and they did; and you did not use it. That is purely academic, of course.

Mr. ECCLES. But that is just part of the truth of the whole.

Mr. WOLCOTT. This is what I am trying to find out. What do you recommend as a figure that the Congress should enact in respect to the reserve requirements over and above what they are at the present time?

Mr. ECCLES. I am not making any recommendations with reference to what Congress should enact with reference to either reserve requirements or special reserves. I am merely pointing out here what the problem has been and——

Mr. WOLCOTT. Has the Board taken any action as to the amount of authority which it needs in that direction; has the Board agreed upon any figure?

Mr. ECCLES. No; the matter has not been discussed, because at the present time, I think, it is academic. We have been reducing reserve requirements during the past year. Reserve requirements have been reduced below the statutory limit by 2 percent. The Board would have authority, of course, to increase reserve requirements by that amount in the future. There is certainly no immediate problem today with reference to undue bank-credit expansion. Outstanding bank loans today are less than they were at the beginning of the year.

So there is no urgency at the present time. I have suggested in my statement that I think the passing of a resolution—that was Senate bill 1559, which called for the creation of a National Monetary Commission—is very important. I have said that such a Commission should be set up and an extensive study made before any of these questions are determined. I have tried to point out here only a few of the high lights.

Mr. WOLCOTT. Should we give this Monetary Commission the authority to dictate to the Federal Reserve, the Open Market Committee, the point at which Governments should be supported?

Mr. ECCLES. The Monetary Commission was to be set up for the purpose of making a study, and would not, as I understand it, be given any authority.

Mr. WOLCOTT. I am not getting very far. I have been trying to centralize this authority somewhere—perhaps that is the wrong term—but I think we see here a need for coordinating these efforts; and whatever is set up, whether it is a monetary authority or a commission or whether it is a credit council, do you think that any such coordinating body should be given the authority to dictate to the Federal Reserve the point at which the Governments should be pegged?

Mr. ECCLES. No; I don't.

Mr. WOLCOTT. Who should have the authority?

Mr. ECCLES. I think the Federal Reserve should have it.

Mr. WOLCOTT. You are not in favor of transferring that authority to the Treasury?

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Mr. ECCLES. No; I am not. As I have indicated, I think that the Federal Reserve itself needs some reorganization, and I do think that there should be a consolidation of the Federal supervisory agents.

Senator DOUGLAS. I can hardly keep still, because you are saying that the Federal Reserve Board should have the power to determine the price at which Federal securities are purchased, but previously you have said that the Treasury should be given the power over debt management.

Mr. ECCLES. What I meant to say, Senator, is that, whether it be the Board as now constituted or whether it be any other credit, monetary or credit organization, they should have the authority rather than there being a direct authority of the Treasury. They should have the authority to manage the open-market operations, in line with a policy that would have to be agreed upon with the Treasury.

Now they would be independent to the extent that they are able to advise the Treasury, to recommend to the Treasury, and hence, I think, have considerable influence upon the Treasury. I think that that much independence must and should be maintained; whereas if you put it in the Treasury directly, eliminating the Federal Reserve Board, you would not have any agency with any independence of expression on the subject.

Senator DOUGLAS. On the principle that a subordinate can hardly give independent advice to a superior who wants to be advised in a different direction?

Mr. ECCLES. Well, in a degree I think that is correct. And I don't know how you are going to get away from that. I think that the history of central banking throughout the world would indicate that they must be subordinate to treasuries, and particularly is that true now that the public debt is 60 percent of the entire debt.

Now, it was one thing prior to the First World War, and even during the Twenties, and even prior to the Second World War. But, with a public debt the size that the public debt now is and with the prospect of running into another deficit, it seems to me pretty impractical to say that there should be a body with sufficient independence that it can defeat the purposes of an administration that chooses to create public deficits.

Mr. WOLCOTT. Mr. Eccles, do you think the trend, the immediate trend, is toward further inflation, or reflation, or deflation, or are we on a level that will remain more or less static for some time?

Mr. ECCLES. Well, the statistics at the present time point to, I would say, some inflationary developments, and I say that for these reasons: Bank credit is beginning to expand a little. There is an excessively rapid growth in consumer credit on more and more favorable terms. There is a great growth in housing credit on very small down payments. There is a very rapid growth in State and municipal debt. There is a very substantial public deficit, of about $5,000,000,000 in this fiscal year. In addition, there is the payment to the veterans of close to $2,800,000,000 that will be disbursed the first 6 months of next year. There is the agricultural support policy of the Government, which, of course, tends to sustain the inflationary level in the field of agriculture. There is the present labor wage policy that is indicating a further increase in wages that must reflect itself, in many instances, in prices. There are the private corporate pension programs,

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which, I think, are a big mistake, that are equivalent to wage increases and that likewise tend to support or hold up prices.

That is just part of the picture. On the other hand I recognize the increased productivity of our machine, and I think that any inflationary development, unless it is followed up by larger budgets, Federal budgets, which I hope will not be the case, and larger Federal deficits, will be greatly moderated by the fact that supply may well overtake the demand all along the line. It has done so now in many fields, and prices are only being held up by Government action.

I think that our longer-range problem is not one of inflation. It is one of deflationary pressures. It is one not of inadequate production, not of capital for investment—of which I think there is plenty—but it is one of consumption—being able to buy what our machine can produce. That doesn't mean ability to buy through a continued expansion of consumer credit. I think we are going to be confronted with that problem before very long.

Mr. WOLCOTT. What do you think should be done in respect to supporting the Government-bond market in the face of this inflationary threat; what do you suggest should be done by way of letting the Government-bond market find its own level or pegging it at a higher or lower figure than they are selling for on the market at the present time?

Mr. ECCLES. I do not think that support of the Government-bond market will be required for some time to come. The long-term Governments are selling at very high premiums; and I, for one, would like to see those premiums reduced. The long-term rate, in my opinion, is too low and not too high. The rate on the long-term securities on the basis of which they are selling today is about 2¼. So there is quite a way to go before the decision will have to be made as to whether or not it is advisable, under the circumstances that exist, to hold the long-term Governments at 2½.

Mr. WOLCOTT. Would you recommend that the rediscount rate be changed at this time?

Mr. ECCLES. No; I do not.

Mr. WOLCOTT. Do you think the amount of reserve requirements should be increased, provided you have the authority to do it?

Mr. ECCLES. I do not.

Mr. WOLCOTT. What can Congress do to help stop inflation except balance the budget and cut Government expense?

Mr. ECCLES. I thought I made the point that I understood this was a discussion to determine what might be done to deal with a long-range program.

Mr. WOLCOTT. Anything that would deal with a long-range program would, of course, have an immediate psychological effect. The fact that Congress was considering limitations and standards, and so forth, which might result in stabilizing our economy on a long-range basis might have a psychological effect to prevent immediate inflation. That is what I am thinking of in asking that question.

Mr. ECCLES. Well, I am not too much concerned about the psychological effect. I think that is very temporary. I think it is the basic economic factors that are finally the determining factors.

Mr. WOLCOTT. Let me ask you, Do you think that sterilizing any part of the Government debt which is held by the banks, so that no

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more than a certain amount would be monetized, would be of any help?

Mr. ECCLES. I do. That was what we suggested in our special reserve program. That was exactly what it was. I think that would be very helpful if you should begin to get an inflationary development through bank credit expansion. You have to consider your fiscal situation in connection with this. If you are going to operate in a period of great business activity financed in part by Federal deficits. That creates an entirely different problem. It is pretty difficult to adopt a restrictive monetary policy in the banking system under conditions of a peacetime economy if the Federal Government is going to operate heavy Federal deficits.

Mr. WOLCOTT. Because of the importance of the holdings by insurance companies of Government debt, in the stabilizing effort would you recommend that the Federal Government be given more control over insurance reserves?

Mr. ECCLES. I don't think so. I think that you could sterilize pretty largely the effect of the sale of securities held by insurance companies by increasing bank reserves.

I do think howver, the study should take into account the operation of these huge insurance companies. They are very important factors in this whole field of money and credit. It may well be that certain Federal laws, certain controls, would be necessary. I am not prepared at this time to say. But I do think that you cannot ignore the effects of any such large pools of investment money in private hands.

Senator DOUGLAS. May I say that the Investment Subcommittee of our general committee is going into the question of the role of insurance companies and has scheduled about 3 days of hearings when these monetary, credit, and fiscal policy hearings are closed.

Mr. ECCLES. Yes. I just don't want to be put into the position of suggesting anything with reference to that because——

Mr. WOLCOTT. We are dealing with fiscal matters here. It is the influence of insurance holdings, or I can shorten it up by saying, on the value of the American dollar, that is what I was asking about, and whether there was any control you thought necessary over those holdings, which might embrace other large holders of Governments, in addition to insurance companies.

Mr. ECCLES. A heavy sale of Government securities added to the inflationary pressures last year.

Mr. WOLCOTT. You mentioned silver, you slid over it pretty fast, and for which I am thankful, but I wondered if you were in position now to perhaps recommend changes in the Silver Purchase Act.

Mr. ECCLES. Being from, I think, the No. 1 silver State in the Union, maybe I better pass that up.

Mr. WOLCOTT. Well, in the——

Mr. ECCLES. I would like to say, however, that I am just jesting, because I haven't passed it up, and my position on silver is well known. I recognize the program for what it is, a subsidy, but I see no reason why there may not be a silver subsidy as well as many other subsidies. When we take up the question of what to do with the farm and other subsidies, I think it might be well to take up the question of the silver subsidy.

Senator DOUGLAS. And you wouldn't give up the silver subsidy until every other subsidy is given up?

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Mr. ECCLES. I wouldn't say that. I think there are a lot of subsidies that have more merit than the silver subsidy.

Mr. WOLCOTT. In the Banking Act of 1935 we legislated to force all banks to come into the Federal Reserve System in order to participate in the Federal Deposit Insurance Corporation. We let that authority lapse finally. Would you be in favor of restoring that requirement?

Mr. ECCLES. If the recommendations that I have suggested here be adopted it would not be necessary to require that all State banks be members, or all insured banks be members, of the Federal Reserve System. The important thing is that they maintain the same reserves that the member banks of the Reserve System do. Whether they are members or not, and have to buy stock, and have to comply with the other requirements, is not too important, and I would certainly be willing to waive that.

Mr. WOLCOTT. One other question. This $5,000,000,000 overdraft authority of the Treasury, I don't know whether you want to get into that or not, but that expires this next year. I think you sponsored that, didn't you?

Mr. ECCLES. That is right.

Mr. WOLCOTT. Do you think it should be continued?

Mr. ECCLES. I think it is desirable to continue it. I think it is a proper instrument, I think it is a useful instrument, in the case of debt management. It is often desirable to give the Treasury a substantial overdraft in order to avoid undue money market strains during tax payment periods. That authority has been helpful, and over the years that it has existed in the Reserve System I am sure that it has never been abused.

Mr. WOLCOTT. Thank you very much.

Senator DOUGLAS. Thank you very much, Mr. Eccles.

(Whereupon, the committee adjourned until 2:30 p. m.)

AFTERNOON SESSION

Senator DOUGLAS. Mr. Brown, we are very glad indeed to have you here. We appreciate your public spirit in coming from Chicago to testify on this subject.

STATEMENT OF E. E. BROWN, CHAIRMAN OF THE BOARD, FIRST NATIONAL BANK OF CHICAGO

Senator DOUGLAS. Mr. Brown, did you have a prepared statement which you would like to read?

Mr. BROWN. No, Senator; I have no prepared statement. The questionnaire of your committee offered such a wide variety of subjects that it seemed to me difficult to give a prepared statement which would cover the many points in it. I would like to express my views briefly on three points.

Senator DOUGLAS. We will be very glad to have you.

Mr. BROWN. After that I will be very glad to answer any questions which you or the other members of the committee may desire to submit.

These three points are:

(1) The relationship of the Federal Reserve Board to the Treasury and the national administration;

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(2) The power that the Federal Reserve should have to fix the reserves of banks;

(3) The question as to what agency or agencies should examine and supervise banks.

As to the first, the relation of the Federal Reserve Board to the Treasury and the national administration: Originally the Federal Reserve Board was conceived as an independent body. World War I broke out before the system was really functioning. Under the necessity of financing the war the policies of the Board had to be subordinated to those of the administration and the Treasury in practice. After the war came the depression of 1921 and the Board policies continued in practice to be those of the administration during the period up to 1933. When the Banking Act of 1935 was adopted, which gave the Board additional powers, it was still the view of Congress that the Board should be independent.

There were many statements to the effect that the depression wouldn't have occurred if the Board had been an independent organization in the Hoover and Coolidge and Harding administrations, and that the depression was partly caused by the fact that it had been subservient to the administration. To make the Board more independent the Secretary of the Treasury and the Comptroller were removed as ex officio members. The Board, according to the debates in Congress, was to be a supreme court of finance; statements were made that it should be as free as the Supreme Court of political pressures; the members were to have long terms, staggered, and to receive salaries equal to those of Cabinet officers.

Then came deficit financing and World War II with its legacy of a tremendous Federal debt and the problems of its management.

The Federal Reserve Board could not, under such circumstances, have been politically independent at any stage of its history. I do not believe that at any time in the foreseeable future it or any central bank can really be independent of the administration in power. The Board, in the final analysis, must adapt its monetary policies to the policies of the administration, no matter how it may feel about their wisdom. It must bow to the judgment of the Secretary of the Treasury in matters affecting the handling of the public debt and the interest rates thereon.

Granted that the Federal Reserve Board must conform its policies to those of the administration and the Treasury, it does not mean that it should become a subordinate bureau of the Treasury, or some other branch of the administration, or that its members should hold office only at the pleasure of the President or be appointed for short terms, or that their judgment and ability are relatively unimportant.

Decisions and actions in the field of monetary policy affect the whole economy. It takes a high degree of ability, technical experience, and judgment to make them wisely and to appraise their effects in advance.

The giving of sound advice on monetary matters to an administration or to its Secretary of the Treasury that must make the ultimate decision, and skillful carrying out of the monetary policies designed to implement an over-all general policy, are much more probable by a continuing board, made up of men of stature and of long tenure in office, than by any subordinate bureau.

To make it possible to get men of proper caliber and public stature to serve on the Federal Reserve Board, terms should be long and the

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Statement of Marriner S. Eccles before the Subcommittee on Monetary, Credit and Fiscal Policies of the Joint Committee on the Economic Report November 22, 1949 and Supplementary Letter to Senator Douglas of December 1, 1949

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

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STATEMENT OF MARRINER S. ECCLES BEFORE THE SUBCOMMITTEE ON MONETARY, CREDIT AND FISCAL POLICIES OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT*

Mr. Chairman, I am here as you know in response to the invitation in your letter of October 31, 1949, to discuss issues that have been raised during the study initiated by your Subcommittee in the field of monetary, credit and fiscal policies. I shall be glad to try to answer such questions as may be uppermost in your mind but I should like first to present for your consideration a short statement which I hope may anticipate and answer some of your questions. My views are the cumulative results of 15 years of participation in developing and carrying out policies of the Federal Reserve System, preceded by long experience in private banking under State as well as national authority and membership in the Federal Reserve System.

I therefore could not fail to be aware of the vigorous opposition that has so often been voiced against new proposals with respect to Federal authority over banking. In recent years it has seemed that nearly every recommendation emanating from the Federal Reserve Board has been assailed as a threat to destroy the dual banking system. As one who has spent his business life in that system, I have been unable to see the justification for such agitation.

Our commercial banking system is composed of banks that receive deposits subject to withdrawal upon demand, make loans, and perform other services. About half of the total dollar amount of bank deposits are insured up to $5,000 for each depositor by a Federal agency, the Federal Deposit Insurance Corporation. Banks holding eighty-five per cent of the resources of the banking system are in the Federal Reserve System, another Federal agency. Approximately 5,000 of these banks operate under Federal charters, issued by the Comptroller of the Currency, and about 9,100 under charters from the 48 States. This is the dual banking system. While I am sure that those who are its most vociferous supporters would not seriously contend for the abolition of the Federal Reserve System, with the consequent restoration of the intolerable conditions that prevailed before its establishment, they nevertheless constantly oppose measures that would enable the Reserve System to be far more effective in carrying out its intended functions—functions that help to protect not only all banking but the entire economy.

Two proposals—more than any others—stir up this agitation. One is the proposal for the equal application of a fair and adequate system of reserve requirements to all insured commercial banks. The other proposal is that the Federal Government apply the principles and objectives of the Hoover Commission to the Federal agencies concerned with banking, monetary and credit policy. Bankers believe in the objectives of the Hoover Commission, at least as applied to all other activities of the Government—why not the banking activities?

The red herring of the dual banking system is always brought up to obscure the real merits of the fundamental questions involved in the proper administration of fiscal, monetary and credit policy, which concerns commerce, agriculture, industry and the public as a whole; it is by no means the sole concern of bankers.

The major responsibility of the Federal Reserve System is that of formulating and administering national monetary policy. It does this chiefly through the exercise of such influence as it may bring to bear upon the volume, availability and cost of commercial bank reserves. It must operate through the commercial banks of the country because they, together with the Federal Reserve Banks, are the institutions through which the money supply is increased or decreased. It is of paramount importance to the entire country that someone have the means as well as the ability to discharge this responsibility. It cannot be left to the voluntary choice of some 14,000 individual and competing banking institutions. It cannot be split up among the various agencies of the Federal and State Governments. The framers of the Federal Reserve Act undoubtedly intended that it should be in the Federal Reserve Board under the direct control of Congress.

* Presented November 22, 1949.

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Others have pointed out that existing bank reserve requirements are inequitable, unfair and ineffective at the very time when they are most urgently needed to restrain excessive expansion of bank credit. They should not depend as they do now on whether a bank is located in a central reserve city or in a reserve city or whether it is outside of one of these cities or away from its downtown area, nor should they depend on whether a bank is a member or a nonmember. There is no good reason for such distinctions from the standpoint of effectuating monetary policy.

In addition to other handicaps of membership, members of the Federal Reserve System are subject to much more onerous reserve requirements than nonmember banks. Member banks are required to carry certain percentages of their demand and time deposits in non-interest-bearing cash balances with the Federal Reserve Banks. Apart from these required reserve balances, member banks necessarily carry some vault cash to meet deposit withdrawals, and in addition they carry balances with correspondent banks, none of which can be counted toward statutory reserve requirements. On the other hand, nonmember bank reserve requirements not only are generally lower in amount but may also consist entirely of vault cash and balances carried with city correspondents. In some instances reserves of nonmember banks may be invested in U. S. Government and other specified securities. Thus to a considerable extent nonmember banks may receive direct or indirect compensation for a substantial part of their reserves. These discrepancies are most obvious and difficult to explain when two banks, one a member and the other not, are doing the same kind of business as competitors on opposite corners of the same town. Member banks therefore bear an undue and unfair share of the responsibility for the execution of national credit policy.

There should be a plan under which the responsibility for holding reserves to promote monetary and general economic stability would be as fairly distributed as possible. This would require a fundamental revision of the existing basis for bank reserve requirements. They should be based on the nature of deposits rather than mere location; they should be somewhat higher upon interbank deposits than upon other demand deposits. Vault cash should be given consideration because it has much the same effect as deposits at reserve banks.

In any such revision of reserve requirements it is of primary importance to take into account the fact that they are a means of contracting or expanding the liquidity position of the banking system and of making other credit instruments more effective. Reserve funds of banks may expand through large gold inflows or silver purchases, or return of currency from circulation, or borrowing from Reserve Banks, or Federal Reserve purchases of Government securities through necessary open market operations. There should be sufficient authority over reserve requirements to permit taking such developments into consideration when necessary.

There is widespread misunderstanding even among bankers of the function of reserve requirements as a means of expanding or contracting the supply of bank credit. In sharp contrast with State reserve requirements, those applied to member banks under the Federal Reserve Act are primarily designed to affect the availability of credit —that is to say, the money supply. The Federal requirements are not primarily applied for the purpose of providing a cushion to protect the individual bank. They are not basically reserves in that sense at all, and incidentally the Reserve Banks do not and cannot use them to buy Government securities.

The Federal Reserve System is a creature of the Congress. You can make it weak or you can make it strong. We have recited to the Congress over and over again the dilemma that we face. It is perfectly simple. So long as the Reserve System is expected to support the Government bond market and to the extent that such support requires the System to purchase marketable issues, whether sold by banks or others, this means that the System is deprived of its only really effective instrument for curbing overexpansion of credit. It means that the initiative in the creation of reserves which form a basis on which credit can be pyramided rests with banks or others and not with those responsible for carrying out national monetary policy. To the extent that banks can at will obtain reserves they are thus able to monetize the public debt. In view of this situation, if the Congress intends to have the Reserve System perform its functions, then you should by all means arm it with alternative means of applying restraints. The only effective way to do that is through revision and modernization of the mechanism of reserve requirements. The Congress will not have done

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the job at all if it fails to include all insured banks. Reserve requirements that are limited only to member banks of the Federal Reserve System impose upon them a wholly unfair and inequitable burden which becomes the more intolerable as the need arises to increase reserve requirements as a means of curbing overexpansion of credit. Of course, organized banking and its spokesmen, chiefly large city banks, do not want any change. They never do. Throughout the long history of banking reform in this country—and it is still very far from complete—the same bankers or their prototypes have been for the status quo. Beginning with the National Banking Act they have fought every progressive step, including the Federal Reserve Act and creation of the Federal Deposit Insurance Corporation. If you abide by their counsels or wait for their leadership you will never do anything in time to safeguard and protect private banking and meet the changing needs of the economy in such a way as to avoid still further intrusion of the Government into the field of private credit—to which I am really very much opposed—an intrusion which the public has demanded in the past because private banking leadership failed.

I may add that whenever Congress sees fit to enact into legislation the principle of equitable reserve requirements applied uniformly without regard to membership in the Federal Reserve System, there might well be changes in other relations of the Federal Reserve System which would be of benefit to all commercial banking as, for example, to offer the credit facilities of the Reserve Banks on equal terms to all banks which maintain their reserves with the Reserve Banks, together with further improvements in the check collection system. These and other beneficial changes could well be brought about with great advantage to banks and to the public in general.

The role of the Reserve System in relation to Government lending to business also should be clarified. This is particularly important as to the functions exercised in that field by the Reconstruction Finance Corporation and with respect to the authority of the Reserve Banks to extend credit to industrial enterprises under section 13b of the Federal Reserve Act. The latter should be modified as proposed in S. 408, the bill favorably reported by the Senate Banking and Currency Committee in 1947, and the enactment of which was again recommended by the Board in 1948.

There is unquestionably a need for such an agency as the Reconstruction Finance Corporation in emergency periods for direct Government lending for projects outside the field of private credit, but I have always taken the position that the Government should not compete with or invade the domain of private banking and credit institutions. When aid is necessary to facilitate the functioning of private credit, then such aid should take the form of guaranteeing in part the loans made by private institutions, just as was done in the V-loan program of the Federal Reserve for financing war production. That is what S. 408 proposes. The profound difference in the principle at stake here ought to be obvious.

In relation to the second question, that of organization, which I mentioned at the outset, I feel that students of Government and particularly those who endorsed the objectives of the Hoover Commission ought to be more interested than they appear to have been in the problems of organization of the agencies of Federal Government concerned with bank supervision. Some however may have been misled into thinking that there is no problem in this field because the expenses of these agencies are not paid from governmental appropriations.

The establishment of a system of insurance of deposits by the Federal Government was one of the great accomplishments of the Congress in the direction of fostering public confidence in the banking system. I favored Federal Deposit Insurance legislation at a time when most of my fellow bankers were denouncing it. But I never expected, and I am certain Congress never intended, that this protection for depositors would be used either to hamper effective national monetary policy or to give any class of banks special advantages over others. I regret to say that the Federal Deposit Insurance Corporation has been used to discourage membership in the Federal Reserve System and to weaken effective monetary policy.

There is no logic whatever in the present provisions of law which say, in effect, to a bank "You can't join the Federal Reserve System unless you also join the Federal Deposit Insurance Corporation but you can join the Federal Deposit Insurance Corporation without joining the Federal Reserve System." The law compels a national bank

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to join both but a State bank has the option of joining one or the other, or neither. I should like most earnestly to urge upon you the importance of making this a two-way street by providing that a bank can be a member of the Federal Reserve System without joining the Federal Deposit Insurance Corporation, in the same way that a State bank is now privileged to be a member of the Federal Deposit Insurance Corporation without being obliged to join the Federal Reserve System.

The Federal Deposit Insurance Corporation was designed in the public interest and it should be maintained for that purpose, but this is not to say that the continued existence of three Federal agencies performing similar or allied functions in the field of bank supervision, regulation, statistical and other services is justifiable. There is unnecessary duplication and triplication of offices, personnel, effort, time and expense. While the maintenance of separate and often conflicting viewpoints may serve selfish interests, on the old principle of "divide and conquer," it seems to me that this should not prevent improvements wherever possible in the organization of a Government already overburdened with complexity and bureaucracy.

In this connection various suggestions as to where responsibility should be lodged for the examination of banks subject to Federal supervision have been offered, ranging from the setting up of a new agency, with no other responsibility, to maintaining the status quo.

The Reserve System must have currently accurate information, procured through examination, bank condition reports, special investigations, constant correspondence and contacts with the banks. The System must have examiners and other personnel responsible to it, specially trained and directed for the purpose of procuring such information. The Reserve System is in position to determine policies to be pursued by examiners; to coordinate them with credit policies; and at the same time decentralizes the actual administration by utilizing the facilities of the twelve Reserve Banks and their twenty-four branches. They examine all State member banks, receive copies of examination of all national banks, are in close touch in this and in other ways with all member banks, as well as the State and National supervisory authorities. Through their daily activities of furnishing currency, collecting checks, seeing that member banks maintain their reserves, and extending credit to them, the Reserve Banks obtain current information about banks which is invaluable for purposes of bank supervision. The Federal Reserve is and must be at least as vitally concerned with the soundness of the individual bank as any one in the organization of the Comptroller or the Federal Deposit Insurance Corporation. The Federal Reserve Act places in the Federal Reserve a specific responsibility for effective supervision over banking in the United States. Soundness of the individual bank and soundness of the economy must go hand in hand. Therefore, Federal Reserve concern with the maintenance of stable economic conditions should be and is in the interest of sound banking as well as the public welfare. It has not destroyed the effectiveness of Federal Reserve supervision over State member banks, and it is absurd to think, as I understand has been suggested to you, that it would destroy the effectiveness of supervision or examination of other banks. Moreover, is it reasonable to believe that the intelligence of the officials of the Federal Reserve Banks combined with the judgment of a seven-man board appointed by the President, confirmed by the Senate, responsible to the Congress, should be regarded as less independent than a Bureau in the Treasury under one official whose deputies are appointed by the Secretary of the Treasury? No single individual in the Federal Reserve System determines its policies.

Since examination supplies information essential to the right conduct of the business of the Reserve System and since the Reserve authorities must review reports of examination of all member banks, it is illogical to argue that they should be deprived of all examination authority. Examination procedure is a tool of bank supervision and regulation which should be integrated with and responsive to monetary and credit policy. If directed as though it were not concerned with such policy it could nullify what otherwise could be effective monetary and credit policy. In fact, too often in the past, bank examination policy became tighter when conditions grew worse, thus intensifying deflation, and conversely examination policy has gone along with inflationary forces when caution was needed.

Only one of the three Federal supervisory agencies, the Federal Reserve System, is charged by Congress with responsibility over the supply and cost of credit, which is directly affected by reserve requirements, discount policy, and open market opera-

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tions. The Reserve System views the economic scene principally from the standpoint of national credit conditions as effected by monetary, fiscal and related governmental policy. Other agencies do not have these responsibilities. Their differences of interest often lead to prolonged discussions which delay or prevent agreements.

Let me turn now to the question of the composition and responsibilities of the Board of Governors and the Open Market Committee, which Committee is composed of the seven members of the Board plus five Reserve Bank Presidents. I do not suggest that the present system has not worked. It was a compromise and your Committee is interested, and properly so, in the question whether the present structure could be improved. I feel that I should point out its defects and how they could be remedied.

While the Board of Governors has final responsibility and authority for determining, within statutory limitations, the amount of reserves that shall be carried by member banks at the Federal Reserve Banks, for discount rates charged by the Federal Reserve Banks for advances to member banks, and for general regulation and supervision of the lending operations of the Reserve Banks, the responsibility and authority under existing law for policy with respect to the Government security market, known as open market operations, is vested in the Open Market Committee. These operations have become an increasingly vital part of Federal Reserve policy. In practice they are the principal means through which debt management policies of the Government are effectuated. They are the means by which an orderly market for Government securities is maintained. With the rapid growth of the public debt, chiefly as a result of wartime financing, with the continuance of a budget of extraordinary size, with major refunding operations in view and the prospect of deficit financing, there can be no doubt of the responsibility that will continue to rest with the Federal Reserve System for open market policy.

Suggestions have been made and I believe will appear in answers to your questionnaire, with a certain degree of logic in their support, that the interrelations between the considerations of policy governing open market operations and those governing reserve requirements, discount rates, and perhaps other functions, are such as to justify transferring these major instruments of policy to the Federal Open Market Committee, leaving to the Federal Reserve Board as such only matters of secondary importance. This would not justify the continued existence of a seven-man Board of Governors. To the extent, however, that such suggestions recognize the principle that responsibility for overall credit and monetary policy should be fixed in one place, I would agree. On the other hand, they accentuate the major inconsistency in the present setup.

It should be noted in this connection that the President of a Federal Reserve Bank is not a director of that bank but is its chief executive officer. He is elected for a five-year term by a local board of nine directors, three of whom are appointed by the Board of Governors and the other six by the member banks of the district. In addition to making the appointment, the directors fix his salary. Both of these decisions are subject to approval of the Board of Governors. Neither he nor the directors of the bank have any direct responsibility to the Congress. When a Reserve Bank President sits as a member of the Federal Open Market Committee, however, he participates in vital policy decisions with full-time members of the Board of Governors, who are appointed by the President of the United States and confirmed by the Senate and whose salaries are fixed by Congress. Those decisions, which must be obeyed by his bank as well as by the other Federal Reserve Banks, affect all banking. So far as I know, there is no other major governmental power entrusted to a Federal agency composed in part of representatives of the organizations which are the subject of regulation by that agency. President Woodrow Wilson expressed himself very vigorously on this subject when the original Federal Reserve Act was under consideration. If this principle is not to be discarded, it follows that further inroads should not be made into the functions of the Federal Reserve Board and on the other hand that responsibility for open market policy should be concentrated in the Board. I am convinced in this connection that there is no need for more than five members, instead of seven as at present, and that the Congress should recognize by more appropriate salaries the great importance of the public responsibilities entrusted to the Federal Reserve System, of which the Federal Reserve Board is the governing body. Such recognition would be more likely to attract to the membership of the Board men fully qualified for the position.

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If however it is believed preferable for national credit and monetary policy to be determined in part by some of the Presidents of the Reserve Banks, then the Presidents of all twelve Reserve Banks should be constituted the monetary and credit authority and they should take over the functions of the Board of Governors, which body should be abolished. The governmental responsibility of such a body should be recognized by requiring their appointment by the President of the United States and their confirmation by the Senate; their salaries should be fixed by Congress, to whom they should report. May I point out that if the Presidents of the Reserve Banks can, in addition to performing their manifold duties as chief executive officers of these very important institutions, take on in addition the principal functions of the Federal Reserve Board, it must be that these functions do not justify a full-time seven-man Board, and this would be another reason for abolishing it, and substituting a part-time Board composed of the twelve Presidents.

The views I have expressed have developed out of a long experience in and out of Government and they have not been altered by the fact that I have ceased to be Chairman of the Board after serving in that capacity for more than twelve years or by the fact that I expect sometime to return to the field of private banking.

In the foregoing I have not attempted to include some other important matters which may be of interest to the Committee in its deliberations and might well be considered by a National Monetary Commission such as that proposed in S. 1559 which I strongly support. Accordingly, I would appreciate it if you would permit me to file a supplemental memorandum for the record in the event that it appears to be desirable to do so in order to complete my statement.

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SUPPLEMENTARY LETTER TO SENATOR DOUGLAS

Board of Governors of the Federal Reserve System

December 1, 1949.

Dear Senator Douglas:

In connection with my testimony presented on November 22 before your Committee, I indicated that I had not attempted to include in my statement some important matters which may be helpful to the Committee. You granted me the privilege of filing a supplementary statement should that appear desirable.

In the course of my testimony you asked if it would serve a useful purpose if Congress were to instruct the Treasury further as to the policies to be followed in debt management where they are dependent upon the monetary policies of the Federal Reserve System. You also stated that you would appreciate it if you could get some suggested standards of an instruction that might be given to the Treasury by Congress with reference to Treasury relations with the Federal Reserve.

Since presenting my testimony I have given a great deal of thought to this subject. In reading over the record of my remarks, it was apparent to me that I had not responded as fully as I could have to some of your questions. Therefore, I should like to take advantage of the privilege of making a supplementary statement.

A very fundamental dilemma confronts the Federal Reserve System in the discharge of the responsibilities placed on it by Congress. The System has by statute the task of influencing the supply, availability, and cost of money and credit. In peacetime, the objective is to do this in such a way that monetary and credit policy will make the maximum possible contribution to sustained progress toward goals of high employment and rising standards of living. Federal Reserve System powers for carrying out this responsibility are at present basically adequate. But the System has not, in fact, been free to use its powers under circumstances when a restrictive monetary policy was highly essential in the public interest. It has been precluded from doing so in the earlier postwar period in part because of the large volume of Government securities held by banks, insurance companies and others who did not view them as permanent investments. Reasons for supporting the market under these conditions I have already presented before your Committee.

This policy of rigid support of Government securities should not be continued indefinitely. The circumstances that made it necessary are no longer compelling. But the Federal Reserve would not be able to change these policies as long as it felt bound to support debt-management decisions made by the Treasury, unless these were in conformity with the same objectives that guide the Federal Reserve. The Treasury, however, is not responsible to Congress for monetary and credit policy and has had for a long time general easy-money bias under almost any and all circumstances. As long as the Federal Reserve policy must be based upon this criterion, it could not pursue a restrictive money policy to combat inflationary pressures.

Decisions regarding management of the public debt set the framework within which monetary and credit action can be taken. As the size of the debt grew through the period of deficit finance in the 'thirties and particularly over the war period, Treasury needs came to overshadow and finally to dominate completely Federal Reserve monetary and credit policy. When the Treasury announces the issue of securities at a very low rate pattern during a period of credit expansion, as it did last Wednesday, the Federal Reserve is forced to defend these terms unless the System is prepared to let the financing fail, which it could not very well do. To maintain a very low rate pattern when there is a strong demand for credit, the System cannot avoid supplying Federal Reserve credit at the will of the market.

Under these conditions it can hardly be said that the Federal Reserve System retains any effective influence in its own right over the supply of money in the country or over the availability and cost of credit, although these are the major duties for which the System has statutory responsibility. Nor can it be said that the discount rate and open market operations of the System are determined by Federal Reserve authorities, except in form. They are predetermined by debt-management decisions made by the Treasury. This will be true as long as the

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System is not in a position to pursue an independent policy but must support in the market any program of financing adopted by the Treasury even though the program may be inconsistent with the monetary and credit policies the System considers appropriate in the public interest.

The Federal Reserve System was established by Congress primarily for the purpose of determining and carrying out credit and monetary policy in the interest of economic stability and is responsible to Congress for that task. There is a seven-man Board of Governors, appointed for 14-year terms with approval of the Senate. The Board is assisted by an experienced and highly qualified staff of experts. There are twelve presidents of the Federal Reserve Banks, each with a staff of specialists, and each Federal Reserve Bank has a Board of Directors composed of leading citizens in its district drawn from professional, business, farming, banking, and other activities. There is also the Federal Advisory Council, composed of a leading banker from each of the twelve districts, established by Congress to advise the Board. All of these supply information and advice and many participate in formulation of monetary policies appropriate to the needs of the economy.

Under present circumstances the talents and efforts of these men are largely wasted. Views of the Federal Reserve Board and Open Market Committee regarding debt-management policies are seldom sought by the Treasury before decisions are reached. The System, however, has made suggestions on its own initiative to the Treasury in connection with each financing, but very often these have not been accepted. Decisions are apparently made by the Treasury largely on the basis of its general desire to get money as cheaply as possible.

In a war period or a depression, there is reason for financing a deficit through commercial bank credit—that is, by creating new money. The Federal Reserve System has supported such financing at very low rates by purchasing Government securities in the market at such rates, thus pumping the needed reserves into the banking system. In the early postwar period some support was desirable, especially for the 2½ per cent long-term bonds, but it should not have been as inflexible as it was for short-term rates.

The outlook at the present time is for an expanding economic activity with high employment. We also now anticipate a Government cash deficit of over 6 billion dollars in the calendar year 1950. It would be inexcusable to finance this deficit at very low rates of interest by creating new money should inflationary pressures resurge. But if the Treasury, under these conditions, insists on continuation of the present very low rates, the Federal Reserve will have to pump new money out into the economy even though it may be in the interest of economic stability to take the opposite action. In making a cheap money market for the Treasury, we cannot avoid making it for everybody. All monetary and credit restraints are gone under such conditions; the Federal Reserve becomes simply an engine of inflation.

With respect to the problem of how future monetary and credit policies are to be established, it seems to me Congress must choose from the following three general alternatives if the present dilemma confronting the Federal Reserve System is to be resolved:

(1) Congress can permit the present arrangement to continue. The Treasury would control in effect the open market and other credit policy as it does now by establishing such rates and terms on its securities as it pleases, with the requirement that the Federal Reserve support them. It should be recognized that under this course, limitations over the volume of bank credit available both to private and public borrowers, and accordingly limitation over the total volume of money in the country, would be largely given up. Such credit and monetary restraint as might be required from time to time to promote economic stability would be entirely dependent upon the willingness of the Treasury to finance at higher interest rates, and in the past the Treasury has been resistant to doing this. If this alternative is followed, which is the present arrangement, Congress should recognize that the responsibilities for monetary and credit policies are with the Treasury and not with the Federal Reserve System and that the principal purpose of the Federal Reserve System is then to supply additional bank reserves on the demand of any holder of Government securities at rates of interest in effect established by the Treasury.

(2) The Congress could provide the Federal Reserve System with a partial substitute for the open market and discount powers which debt management decisions of the Treasury have rendered and can continue to render largely useless

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for purposes of credit restraint. Some measure of control over the availability of credit under inflationary circumstances could be regained if the System were given substantial additional authority over basic reserve requirements of the entire commercial banking system. With such authority, the System could, if necessary, immobilize new bank reserves arising from a return of currency from circulation, gold inflows, and System purchases of securities from nonbank investors and thereby prevent the multiple expansion of the money supply. In addition, the System would need authority to require banks to hold a special reserve in Government bills and certificates. This would be necessary in case banks entered upon an inflationary credit expansion through the sale of Government securities to the Federal Reserve or in the event it was necessary to assist the Government to finance large deficits without creating additional bank reserves which serve as a basis for multiple credit expansion.

(3) Congress, if it wishes credit and monetary policy to be made by the Federal Reserve System in accordance with the objectives of the Federal Reserve Act and the Employment Act of 1946, could direct the Treasury to consult with the System in the formulation of its debt-management decisions in order that these decisions may be compatible with the general framework of credit and monetary policy being followed by the System in the interest of general economic stability. It is obvious, of course, that Government financing needs must be met and the responsibility of the Federal Reserve to insure successful Treasury financing must continue to be fully recognized. But Treasury financing can be carried out successfully within the framework of a restrictive credit policy, provided the terms of the securities offered are in accordance with that policy.

To sum up briefly my views, I believe that Congress should fix clearly the responsibility for national monetary and credit policy. Although the Federal Reserve System was established as an agency of Congress for determination of monetary and credit policy, as it must function now it is responsible both to Congress and to the Treasury for that policy. These two responsibilities are often conflicting, and both cannot be satisfactorily discharged. The responsibilities and authority of the System need clarification and for that purpose one of three alternative actions might be taken by Congress:

(1) Recognize in the statute that responsibility for monetary and credit policy is with the Treasury and recognize the Federal Reserve for what it is today—an agent for advising the Treasury and carrying out monetary and credit policy determined by the Treasury;

(2) Give the Federal Reserve System such additional authority over bank reserve requirements as would adequately serve as a partial substitute for discount and open market powers;

(3) Give the System a mandate to determine monetary and credit policies on the basis of guide posts stated in terms of the language of the Full Employment Act of 1946, with the Treasury required to advise and consult with the Federal Reserve and take into account the mandate of Congress in connection with its debt-management decisions.

I recognize that monetary or credit policy by itself cannot assure economic stability. It should be accompanied by a fiscal policy, as well as a bank supervisory policy, in harmony with it.

I appreciate very much having the opportunity to express my views on this matter.

Sincerely yours,

(Signed) M. S. Eccles

Honorable Paul H. Douglas,
United States Senate,
Washington, D. C.

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