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

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

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.

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

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

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-

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.

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.