

Secretary SNYDER. Mr. Chairman, do you want me to testify on something I know nothing about? I would have to check back with the Treasury people and see if there has been anything of that sort.

Senator DOUGLAS. I see.

Senator FLANDERS. I might raise the question as to whether an obligation of this sort, if made, is any more sacred than to redeem Government bonds in gold.

Senator DOUGLAS. That is another story.

Any other questions?

Thank you very much, Mr. Secretary.

Secretary SNYDER. One point about Congressman Wolcott's quarter of 1 percent margin on the gold price. That was to permit a handling charge and a handling charge only.

Mr. WOLCOTT. The point was, if they had the authority to set the margin at a quarter of 1 percent, they would also have the authority to set it at 10 percent.

Mr. LYNCH. I think that is giving the words a rather strained meaning. The record indicates that margin was intended to cover only what the conventional handling charge is, and at the same time the Congress, in giving approval to membership in the fund, said no action could be taken as to changing the par value. I do not believe that the margin requirement could in good conscience be stretched into an authority to do by indirection what Congress has forbidden.

The clear record as to the development of that provision shows it was intended only to cover what is a conventional handling charge in connection with the purchase and sale of gold.

Mr. WOLCOTT. The point was that the board of directors of the fund has the authority, even though the United States director might not approve of it, or might absent himself at that time, to provide for these margins. What I was getting at was: If the fund at any time did use this power arbitrarily or otherwise, there would be an effect upon the value of the American dollar.

Mr. LYNCH. It would not necessarily have any effect on the American dollar.

Mr. WOLCOTT. This prohibition in the Bretton Woods Enabling Act against what our director could or could not do without reference to Congress would, of course, be overcome by his being outvoted, which I presume, is not a reasonable assumption.

Mr. LYNCH. But I think that is only part of the picture, Mr. Congressman.

Mr. WOLCOTT. I frankly was discussing it more theoretically.

Mr. LYNCH. A change in the margin would not have the effect of changing the gold value of the dollar, because the restriction on officers of the United States in that respect is clearly stated in the Bretton Woods Agreement Act. The fact is as far as the United States is concerned it would be obligated still, under the mandate of Congress, to maintain, not to change, the par value. And I do not believe anyone would feel he had license to do it by indirection.

Mr. WOLCOTT. If the par value of the currencies of 47 other countries were changed, I am not so sure but that the par value of the American dollar would change almost proportionately.

Mr. LYNCH. Not the par value in the fund, Mr. Congressman.

Mr. WOLCOTT. I should not say "par value," I should say the value of the American dollar.

Mr. LYNCH. I just wanted to make the point and leave it clear. I do not believe we can assume there is available under this provision a means of doing indirectly something that is prescribed by Congress. We would view it in that light.

Mr. WOLCOTT. Thank you.

Senator DOUGLAS. Thank you very much.

Secretary SNYDER. Thank you, Mr. Chairman, and the members of the committee. It has been a very pleasant morning.

Senator DOUGLAS. May I say we will resume our sessions at 2:15 this afternoon when Mr. Sproul, who is the head of the New York Federal Reserve Bank, will testify.

(Whereupon, at 12:30 p. m., the subcommittee adjourned, to reconvene at 2:15 p. m. of the same day.)

AFTERNOON SESSION

Senator DOUGLAS. Ladies and gentlemen, if we may come to order, the witness this afternoon will be Mr. Allan Sproul, who is president of the Federal Reserve Bank of New York.

We are glad indeed to welcome you and will be glad to have you testify.

STATEMENT OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

Mr. SPROUL. Senator Douglas and members of the committee, as I understand it, your interest at these hearings is in exploring the various points of view developed in response to your questionnaire inquiry, rather than in having individual witnesses try to cover all of the ground from the beginning, by means of a long prepared statement. In any case, I have given you my views on the general subject of your inquiry in the extended answers to your questionnaire prepared by a special committee of the Federal Reserve banks, which I sent you with a covering letter of my own.

Today, with your permission, therefore, I shall confine my preliminary remarks to a few brief comments on one or two critical points which, as I see it, need fresh emphasis or elaboration, in view of the other replies and testimony you have received.

(1) In an inquiry as broad as that which you are conducting, there is well-founded and proper concern with a host of questions, many of which, however important in themselves, may tend to divert attention away from the central problem. In the area of monetary, credit, and fiscal policies, and under present conditions, I believe that problem is how to combine effective monetary management with effective debt management.

There cannot be a purposeful monetary policy unless the Federal Reserve System is able to pursue alternating programs of restraint, "neutrality," and ease, in a roughly contracyclical pattern. Such programs must, as they accomplish an increase or contraction in the volume of credit and a tightening or loosening in the availability of credit, affect interest rates, not only for private credit, but for Government securities.

The terms of Treasury offerings for new money, and for refunding issues, must be affected. Yet those effects will, at times, be in-

convenient and burdensome to the Treasury in its management of the enormous public debt, and may conflict with otherwise praiseworthy efforts to minimize expenditures for debt service.

This is an inherent conflict.

Senator DOUGLAS. You would not say it is an irrepressible conflict?

Mr. SPROUL. No; I would not. It will continue to arise, in one form after another, so long as this public debt, huge in relation to our present national income, is with us. It is important, therefore, that better means be found, if possible, for reconciling potential differences between the Treasury and the Federal Reserve System, so that action in the credit sphere may be taken promptly, as needed, in reasonable harmony with the action being taken by the Treasury in the sphere of debt management.

The record of cooperation in the postwar years has been better than might have been expected, and so has the record of our economy, whatever connection there may be between the two. But agreed action, in my opinion, has most often been too little and too late, so far as the aims of an effective monetary program were concerned.

For example, the System wanted to discontinue its preferential discount rate on Government securities maturing within 1 year, before the end of 1945; Treasury acquiescence, and the action, did not come until April 1946.

From the closing months of 1945 through all of 1946, the System was pressing for discontinuance of its artificially low buying rate—three-eighths of 1 percent—on Treasury bills; the action finally came, with Treasury agreement, in July 1947.

From that point on, as inflationary pressures increased, the System wished to follow a program of credit restraint which would have necessitated small but, perhaps, frequent increases in short-term interest rates which would have meant similar increases in rates on Treasury bills and certificates, and some increase in the yield of other short and intermediate Government securities.

The Treasury did a large part of the job, of course, by devoting its substantial cash surpluses to the retirement of debt in such a manner as greatly to aid in achieving the common objective; but the Treasury was generally several months behind in accepting the implications of a tightening policy for the interest rates on its short-term securities.

Now, and so far as we can see into the next fiscal year, there is not much chance of the Treasury's enjoying cash surpluses; in fact, cash deficits with their inevitable bias toward inflationary pressure, when the economy is already working close to capacity, seem to be in the cards.

It may become all the more important under such circumstances, and would become most important if inflation should in fact return, that the Treasury be receptive to rising rates—the same rising rates that would be required in attempting to hold in check any inflationary tendencies in credit expansion to the private sector of the economy.

It is this situation which lends weight to the suggestion that there be a congressional directive, specifying as part of the legislative framework for debt management that the Treasury should work within the structure of interest rates appropriate to the economic situation.

The implication of such a directive would be that the Treasury could not, as a matter of right or of superior position, call upon the

Federal Reserve System to "make a market for its securities" at rates which the System believed to be out of line with the degree of credit restraint considered necessary by the System.

I recognize that there would continue to be differences of opinion about these matters, and I realize that you cannot legislate cooperation between people, but the Congress, as final arbiter, might be able to provide a mandate which would charge debt management as well as monetary management with some responsibility for the objectives specified in the Employment Act of 1946.

The country cannot afford to keep money cheap at all times and in all circumstances, if the counterpart of that action is inflation, rising prices, and a steady deterioration in the purchasing power of the dollar, including the purchasing power of the dollars which the Government itself must spend and the purchasing power of dollars invested by the public in Government securities.

Whether or not a directive is possible or may be forthcoming, there seems to me to be a clear need to study this question of how to bring about a more regular relationship for consultation between the Treasury and the Federal Reserve System than that now temporarily provided through fortunate personal relationships.

One suggestion along these lines which may deserve your consideration is that there be created a national advisory council on domestic financial policy, a consultative body which would bring together the heads of the four or five principal agencies whose activities affect, directly or indirectly, the areas of prime responsibility of the Treasury and Federal Reserve System.

Such a council might also extend its scope to include within its purview, on a purely consultative basis, the lending and loan-guaranty activities of all other Federal financial agencies, in the interests of frequent consideration of overlapping mutual problems. This suggestion is open to the criticism that it might be just another piece of machinery delaying decision but not leading to harmonious action. Nevertheless, it is worth exploring. Another suggestion is that the Secretary of the Treasury be made a member of the Board of Governors of the Federal Reserve System. I have a latent distrust of these ex officio relationships, and it didn't work well in the early years of the System; but the idea should at least be reexamined in the light of present conditions.

(2) If a suitable permanent framework for the relations between debt management and monetary policy can be established, the tasks of monetary control and debt management will not be impossible. While the money market is not so sensitive to slight changes or disturbances as it was from 1946 through much of 1948, when large segments of the swollen public debt had not yet settled into firm hands, it is still sensitive to relatively small changes in the interest rate structure, and to any uncertainty concerning the future direction of rates created by such changes, in terms of its readiness to make funds available for expansion.

Through judicious use of discount rates and flexible open-market operations, it should be possible to make monetary policy reasonably effective without such abrupt and such wide changes in interest rates as used to be considered a necessary part of central banking technique. Such a monetary program would be consistent with very moderate

fluctuations in the cost of servicing the debt, and would not contemplate nor require large changes in the prices of outstanding Government securities.

In this context, the question of par support of Government securities, to which considerable attention has been given at past hearings and which has evoked some comment by witnesses before your committee, would shrink to a relatively minor issue. With the market susceptible to and habituated to small rate changes, any slight and probably temporary decline in prices below par would not be a matter of major concern.

The likelihood that we shall be operating in this sort of climate is strengthened by the fact that we have already passed through the postwar period of most extreme capital demand, in excess of current savings, and an early recurrence of that kind of disparity, with the great upward pressure it exerts upon long-term rates, is improbable.

Moreover, the maturity of the Government debt now outstanding is being shortened automatically by the passage of time, a factor which exerts a mechanical downward pressure on the market rates for these issues—that is, a rise in their price, over time—allowing more and more leeway, each year, so far as outstanding issues are concerned for fluctuations to occur above the par level.

This does not mean, however, that there has been or can be a commitment, express or implied, to support all Government securities at par at all times. Such a commitment would make any pretense of credit policy over the long run rather ridiculous, since the essence of credit control is fluctuating rates, reflecting credit availability.

And just as the pretense of credit policy would be made ridiculous, the present forms of debt management would be made obsolete. If all Government securities of all maturities can be liquidated at par at any time they become, in effect, demand obligations and need only bear varying rates of interest if we want to reward various kinds of holders in various ways. And again I say it would be a spurious gain to support all Government securities at par or better, *ad infinitum*.

There may be extreme situations, which we cannot now perceive, when there would be greater losses and damage to the economy by reason of unbridled inflation, unrestrained by monetary action, then would result from allowing the price of Government securities to go below par.

(3) I favor the extension of national reserve requirements to all—or at least all insured—commercial banks; I also favor the uniform reserve plan, relating reserve requirements to type of deposit, and abandoning the outmoded geographical classification. But both of these are essentially matters of improved housekeeping; they do not affect the real fundamentals of monetary control. I do not apologize for them on that account.

I think it is unfortunate that needed improvements, which will add to efficiency and remove burdensome inequities, are often dismissed for lack of glamour or lack of urgency. But it is equally unfortunate if, in order to attain these improvements, they are “oversold,” being offered as powerful remedies for problems that can better be solved in other ways.

As I see it, the case of these proposals rests on simple grounds. So far as the application of reserve requirements to State-chartered com-

mercial banks is concerned, it is important to remember that these banks are exercising, by the acquiescence of Congress, a constitutional Federal function—the power to add to or subtract from the money supply.

While no one is more anxious than I to preserve those characteristics of local responsibility and initiative which are fostered by the State chartering of banks, I do question whether the arrangements which permit these advantages should also be used to avoid a proper share in the responsibilities of national monetary policy. To say that it would strike at the foundation of the State banking system to make nonmember banks subject to national reserve requirements seems to me to be putting the cart before the horse and then belaboring the horse.

State chartering and State supervision—the real essence of a “dual banking system”—would not be disturbed by the extension of the System’s reserve requirements to all banks. We have nearly 2,000 State-chartered banks, at present, as voluntary members of the Federal Reserve System. Their aggregate earning assets are nearly twice those of the more than 7,000 State-chartered nonmember banks. The reserve requirements of membership have apparently not prevented the State-chartered members from thriving, nor has their membership destroyed their essential State character.

And, yet, monetary policy can’t be fully effective unless all parts of the banking system, the whole banking community, have some understanding of it and play the game. There should be some direct contact between the Federal Reserve System and all banks—or all insured banks—of the country.

If wider access to the discount privilege on the part of nonmember banks is necessary to make this palatable, it might not be too great a price to pay, and would have collateral advantages in strengthening the emergency liquidity of the banking system. I must confess to some lingering feeling, however, that if banks want—or if in the national interest they should have—all or most of the advantages of membership, they ought to pay their dues. As a counterweight to possible concern that System control over all reserve requirements places too wide a range of authority in a distant Washington body, it should be pointed out that a transfer of authority over reserve requirements from the Board of Governors to the Federal Open Market Committee would assure a representation of regional banking experience in the determination of these requirements.

The type of deposit versus geographical location reserve proposal also rests on considerations of equity among banks and on the desirability of modernizing a control apparatus in order to permit the System to carry out its general mandate from Congress in the most efficient, practicable manner.

(4) No change in the System’s power over reserve requirements should be presented, however, as an alternative to facing head-on the actual and potential conflicts between monetary control and debt management. It has been argued, for example, that increases in reserve requirements, whether primary or secondary or what not, provide a way of tightening up on the availability of credit without affecting interest rates and therefore without trespassing on Treasury prerogatives of debt management. We tried that approach in 1948 without appreciable results. Following the increases in reserve requirements

in that year, the banks sold Government securities to the market in a volume roughly equal to the dollar amount of their increased reserve requirements; the market in turn unloaded an equal volume upon the Federal Reserve banks. That result was inevitable, I believe, so long as the Federal Reserve held its buying rates—that is, held interest rates—virtually unchanged.

Senator DOUGLAS. And, therefore, the lending capacity of banks was not diminished?

Mr. SPROUL. Not diminished, except for the small amount that the leverage factor in reserves was diminished; that is to say, they might lend perhaps $5\frac{1}{2}$ times instead of 6 times the amount of aggregate reserves.

Senator DOUGLAS. They have more money to count as reserves; and, even though the amount of reserves on deposit was increased, the larger amount of reserves permitted them to expand their loans at the same rate.

Mr. SPROUL. In general, that is right.

We saw the reverse operation this past summer. Reserve requirements were lowered and the banks used most of the proceeds to buy Government securities from the market, while the Federal Reserve banks sold, or redeemed, a roughly corresponding volume. There were other factors at work, to be sure, in both of these periods; but full review of the statistical record, making allowance for these other factors, still shows that the 1948 increases and the 1949 reductions in reserve requirements resulted mainly in shifts of Government securities between the Federal Reserve banks and the commercial banks.

The inescapable fact, in my opinion, is that moderate changes in reserve requirements, up or down, will have no appreciable effect upon the availability of credit to the general economy if rates have to be held constant.

Senator DOUGLAS. Interest rates?

Mr. SPROUL. Interest rates; yes. And if rates can vary, changes in reserve requirements are a crude way to do a job that the discount-rate and open-market operations can accomplish with much greater flexibility and precision. The proper role for changes in reserve requirements is in making long-run strategic alterations in the banking structure—in response to sustained gold flows, for example, or shifts in the public's habitual use of currency.

The one exception might be a period of run-away inflation of an extreme form such as has not occurred in the history of the Federal Reserve System. Under such circumstances, when all traditional control instruments have been outdistanced and crude but drastic measures become necessary, it might be effective to make temporary emergency use of very high reserve requirements, perhaps as high as 100 percent, against new deposits in order to immobilize for a time the money-creating capacity of the commercial banking system.

Short of that, given the environment created by the present large national debt, changes in reserve requirements seem to me to have no significant role to play in the day-to-day adaptation of credit policy to the changing business situation. They cannot be substituted for rate flexibility in influencing the availability of bank credit to the economy.

I have given you my views on what seems to me to be a central point of your inquiry with some collateral comments. I shall be

glad to try to answer questions raised by this presentation or questions related to other aspects of your studies if you so desire.

Senator DOUGLAS. I think it is fairly clear that you believe fluctuations in the interest rate are the best means of checking excessively cyclical movements of business.

Mr. SPROUL. I think they are a necessary part of any purposeful monetary control; yes.

Senator DOUGLAS. Well, now, you would not withdraw all support of Government securities, would you?

Mr. SPROUL. Not by any means.

Senator DOUGLAS. And, therefore, the fluctuations in the prices of Government securities which would result from the adoption of the policy you advocate would probably be relatively minor?

Mr. SPROUL. I should think so.

Senator DOUGLAS. Now, would the minor fluctuations in the prices of Government securities and, therefore, in the yields on Government securities be sufficient to really have much of a controlling effect upon business?

Let me give an illustration if I may. With an average interest rate of $2\frac{1}{2}$ percent, a fall of 10 points in the price of Government securities would send the interest rate up by something less than a quarter of 1 percent. Now, that is a rather slight increase in itself, and furthermore interest costs are a relatively small share in total cost of business, so you have what our mathematical friends call a second difference, a slight change in a slight change.

Would that have any more effect than raising the price of nails, let us say, by one-tenth would reduce the demand for houses?

Mr. SPROUL. I would not place the effectiveness on the size nor percentage increase in the interest rate. I think in dealing with the interest rate you are dealing both with expectations as to the future business situation and as to future profits, and the judgment of a responsible body of men as to what those conditions may be, so that I think you have an effect far beyond what I admit is the minor cost of interest in the carrying out of any business undertaking.

Senator DOUGLAS. Yes; but the market would know that the prices of Governments would not be allowed to fall very far and that the maximum increase which they might expect would be something around a quarter of 1 percent. So that the market would not move in this fog of uncertainty as to what was going to happen. It would know that there was a very definite feeling as to the degree to which the interest rate might rise; and, knowing that, would it operate as a deterrent?

Mr. SPROUL. If the market is uncertain, both as to the cost of credit and as to its availability, which are two important parts of the credit picture, and if a policy of restraint with respect to availability of credit is tied in with a policy of small changes in the interest rate—

Senator DOUGLAS. That goes to the question of reserve requirements.

Mr. SPROUL. That need not be a question of reserve requirements. It can also be a question of open-market operations and of the discount rate and of borrowing.

Senator DOUGLAS. But you, yourself, said, suppose the Government sells securities to the private market in a period of inflation in order to draw down their balances, as long as there is any program supporting the market, then the banks, security dealers, can present those

bonds to the Reserve and you will be taking back in one pocket what you took out of the other.

Mr. SPROUL. Well, I said there might be a situation such as has not yet arisen where there would be such an unbridled inflation that we could not operate under such a modest policy, that we would have to seek more drastic means.

But I think that, under the kind of a situation we have experienced ever since the war, a modest policy has been effective without violent fluctuations in interest rates or in prices of Government securities.

Senator DOUGLAS. Do you think investors would be willing to sell securities if the price of these securities would fall so that they would then suffer a capital loss?

Mr. SPROUL. That would be a deterrent to selling in many cases.

Senator DOUGLAS. This therefore would strengthen the stabilizing influence of open-market operations?

Mr. SPROUL. I think it would. I think the main factor, of course, is the demand for capital funds in relation to the supply, and I think we had an extreme disparity in the immediate postwar years. If there is not a disparity or large disparity in the demand for capital in relation to the supply, these people who are selling Government securities will have to buy something else to put their funds to work. They do not go into a vacuum.

Even during that period we were able to sell almost as many short-term securities as we bought long at the time we were supporting the long-term Government-security market; so what we were putting into the system with one hand, the banking system, we were taking out with the other in that instance; but I agree with you that if we had a little more range of fluctuation, and if there was no commitment, expressed or implied, to support at par, and if the prices of some Government securities did go below par, causing the seller a capital loss if he sold, that might be another deterrent to sales.

Senator DOUGLAS. Of course, members of every institution see their own problems and see the possibilities in which they believe that their own institutions can contribute to the greatest stability. You have been emphasizing the stability which might be effected through raising interest rates to check undue borrowing and the uncertainty that might come from that.

I must confess that the fluctuations would be so small that I would like to see a stronger case made out than I think has been made out in the past for dampening off credit by slight changes in the interest rate. I have not seen any proof that in practice that has been effective. Of course, you may say it has not been tried.

Mr. SPROUL. Well, I think it was tried to some extent in 1948, although, as I say, slowly and hesitantly; and I think it did have some effect. But I would have to admit the monetary policy is only one weapon to be used, one factor in the situation. Debt management and fiscal policy are certainly important.

And beyond those factors there is the question of labor policy and wage rates, agricultural policy, support prices; there is the question of productivity of the economy; these are more pervasive and far reaching in effect than the small changes in interest rates we are talking about. But, if you want my monetary policy to make its contribution to this over-all objective, then you have to have some changes

in interest rates; and I think the small changes can be effective insofar as monetary policy can be effective.

On the other hand, the older theory of larger changes, drastic changes, very high levels of interest rates at times to stop gathering inflation and bring a boom to an end, I do not think is practical politics in the present situation. I do not think people will submit to that sort of discipline. That discipline works through reduced supplies of credit, reduced production, reduced employment, reduced income, and depression; and, whether you like it or not, I do not think that is the kind of climate we live in.

Senator DOUGLAS. Have you thought about question of debt management and fiscal policy as well as money and credit policy?

Mr. SPROUL. Well, only in the terms expressed in my reply to the questionnaire and in my letter to you that fiscal policy certainly has an important role to play but that the record so far does not indicate that we can move always in the right direction in terms of fiscal policy and certainly not as promptly as is desirable at times to make it a flexible means of meeting the situation.

Senator DOUGLAS. You subscribe to the principle, do you, that in periods of prosperity the Government should have a surplus and use that surplus to retire a portion of the bank-held public debt, thus diminishing the amount of credit which can be loaned by the banks to private business, thus checking inflationary tendencies?

Mr. SPROUL. Yes; I think that the general objective of fiscal policy is in times of high levels of business activity, income, and employment to be in balance or to have a surplus, and in times of low level of business activity or unemployment to run a deficit.

I think that is a general policy, a general objective to be sought, but the means of doing so are so inflexible, so tardy in application, and the political pressures are so strong which interfere with reaching the objectives through the means that I am not too sanguine about its usefulness in meeting our problems.

Senator DOUGLAS. Witnesses from the National Association of Manufacturers testified yesterday that, in their judgment, except in extraordinary emergencies in peacetime, the Government budget should be balanced in each and every year, in depression as well as in prosperity. Do you agree with that?

Mr. SPROUL. No; I do not. The only reason I can see for such a statement is that, if you think that the pressures toward unbalancing a budget are so strong at all times that with an objective such as that you probably will reach the kind of situation we were talking about, then there might be some basis for it, but I certainly would not agree with it in theory.

Might I say another word on that question of balance? I think, in addition to the question of balancing the budget, there is an important question of size of the budget, which is a part of fiscal policy, and I quote here something I wrote recently to the Board:

There is also the longer-run danger of devitalizing the economy. The problem of budget is not merely that of deficits and surpluses but also one of size. In this respect we might well take a lesson from the experience of Britain, where it is being recognized, even by the Labor government, that the budget is too high on both sides. Carried beyond some point, a large budget destroys incentive throughout the whole community. Today on a per capita basis our tax burden is actually larger than the British. The only thing that makes its burden more

tolerable here is that our economy is more productive, output per capita being approximately twice that in Britain, but we seem to be following the same road, which could result in a similar undermining of incentives and destruction of growth and productivity.

That, I believe, is a greater economic danger to the country than the question of surplus or deficit in the budget in any particular year.

Senator DOUGLAS. In your statement you say that this does not mean, however, that there has been or can be a commitment, express or implied, to support all Government securities at par at all times.

Now when Mr. Harl, the head of the FDIC, testified before us, he said he was a State banking commissioner at the time the first war issues were announced by the Treasury, and that an understanding was given to the banks that the Government would support the price of Government securities at par, and he took the position before our committee that there was an obligation on the part of the Government for the indefinite future to support the price of Government bonds and not allow them to fall below par.

Mr. SPROUL. I think Mr. Harl is grossly mistaken in his facts and in his theories. I was closely connected with the selling of Government securities all during the war and all of the drives and know of no such commitment being given by anyone who had any authority to give such a commitment, and I do not think such a commitment was ever given in a way that the banks of the country believed there was such a commitment.

On the other hand, I was strongly in favor of the support which was given to the long-term Government security market at the time we gave it, at the time we gave that support following the war.

Senator DOUGLAS. Is there any way of establishing which of you gentlemen is correct?

Mr. SPROUL. There were three Secretaries of the Treasury during that time; there are the records of the Treasury; there are the men who led the war-loan campaigns in the various districts, all of whom would have some knowledge or recollection or facts as to what was said or what was not said.

Senator DOUGLAS. That would require quite a dragnet for us to bring all those witnesses in here.

Mr. SPROUL. I think the only people who could have given any such commitment are either the Secretary of the Treasury or the Federal Open Market Committee, and as far as the Federal Open Market Committee is concerned, I could say as a member of that committee all during the period that no such commitment was ever given to anybody.

Senator DOUGLAS. You refer in your statement to the question of a uniform reserve for all banks, whether or not they are members of the Federal Reserve System, or at least of all banks inside the FDIC. It is argued in opposition to this that the deposits in the Federal Reserve System now comprise 85 percent of the total and that it is not necessary for the System to control the reserve ratios of the remaining 15 percent in order to control the total volume of credit; that the tail is relatively small compared with the dog. What would you say to that?

Mr. SPROUL. Well, I would say first that the tail ought to be a part of the dog, whether it is small or large, and I think that the national monetary and credit policy should have the support of all of the banks of the country and that they should meet the requirements of that national monetary and credit policy so far as it relates to the money supply.

On this question of the relatively small amount of deposits in the State nonmember banks, first as I have said, I think that is not a major problem in terms of credit policy and monetary measurement, but there is some deceit in aggregate figures. While 15 percent of total deposits is the aggregate figure, there are parts of the country where the volume of deposits held by nonmember banks is a much larger percentage.

But I think the main point is it is important, it seems to me, to have the requirements and the influence of monetary policy reach out through the whole country to the banking community in every area and the banks, the individual banks in every area, and not to have a system in which a large number of banks, even though their deposits are small, feel that they are outside the flow of national monetary and credit policy and can operate——

Senator DOUGLAS. You mean that they would feel more comfortable inside?

Mr. SPROUL. No; I would not say that. Not that they would feel more comfortable inside, but I think eventually they would gain a feeling of being part of the national banking community.

Senator DOUGLAS. You are doing it for their spiritual benefit?

Mr. SPROUL. No; doing it in terms of equity in dealing with the monetary and credit situation, in terms of some protection to the Federal Reserve System, although I am not greatly concerned about banks going out of the System, and in terms of some minor improvement in the effectiveness of monetary policy. I do not think it is a major matter, but I think it should not be dismissed because it is not a major matter.

Senator DOUGLAS. Well, most of the banks in your district, in fact the overwhelming proportion of the banks in your district, as I remember it, are members.

Mr. SPROUL. Yes, they are.

Senator DOUGLAS. As I remember the figures, roughly about half of all the banks of the country are not members of the System.

Mr. SPROUL. That is right. In our district we have 246 State members or 68 percent of the State banks of the district.

Senator DOUGLAS. As contrasted with about 22 percent of the State banks for the country as a whole.

Mr. SPROUL. Something like that, yes. We have a much larger percentage of State member banks than in most other sections of the country.

Senator DOUGLAS. Why does the Reserve System in New York have a greater attractive power than the Reserve System in other districts? Is it because the State banks are larger than they would be in the West, for example?

Mr. SPROUL. I think that has something to do with it. The State banks may be a little larger; they are older; they are more experienced in banking than in some parts of the West and South.

Senator DOUGLAS. Please don't reflect on the West.

Mr. SPROUL. I come from as far west as you can go myself. Also there is the question of par clearance which has not been a question in our district for many years, and that is one of the sore points about State bank membership.

Senator DOUGLAS. What about the strictness of State laws in the East as compared with the West?

Mr. SPROUL. I think that is important. Both the strictness of State laws and the quality of bank supervision under those laws. I can say that particularly about New York State, where most of our member banks are.

Senator DOUGLAS. The presidents of the various Reserve banks undoubtedly get together in your trade association. Do the presidents of other Reserve banks ever complain about the possibility that some of their State member banks would get out of the System if the reserve requirements were raised?

Mr. SPROUL. Yes; they did fear that possibility when reserve requirements were being increased, and they feel much more strongly about it than I do, that any substantial differences in reserve requirements might result in withdrawals from the System in numbers sufficient to be embarrassing.

But partly because of my own experience in my own district and partly because I think membership in the System is more valuable to those who have it than some of the dollars-and-cents calculations might indicate, as I say, I am not so worried about that as the others are.

Senator DOUGLAS. So it is mostly on the grounds of symmetrical logic that you would want to have uniform reserve requirements extended over all State banks?

Mr. SPROUL. I would resist that characterization.

Senator DOUGLAS. It was a compliment, I thought. When I say a man's reasoning is characterized by symmetrical logic, I mean it as a compliment, since the number of such persons is small.

Mr. SPROUL. It sounds remote from the affairs of New York and Washington.

Senator DOUGLAS. Life is not wholly logical; that is the point, and a great many people who want to fit the Nation into a given pattern do not fully appreciate the diversity of life and the local prides and local interests. If local pride and local interest do not threaten the national interest, why shouldn't they have their day in court?

Mr. SPROUL. I would not want to press too hard on the proposal for requiring all banks to maintain the same reserves, although I do think it would be valuable and has some importance, but I would not press it to the point of sacrificing something else that is more important.

Senator DOUGLAS. I suppose you could say that also if you wanted to restrict credit and tried to do that through alteration of reserve requirements, you would then impose the sole burden of restricting credit at present upon those inside the Reserve System.

Mr. SPROUL. Yes.

Senator DOUGLAS. And that those outside the Reserve System, on the one hand, would get the benefit of the added stability to the business system given by the tapering off of credit by those inside and at the same time enjoy the high earnings which would come from increased loans on their part, and that they would therefore live in the best of all possible worlds at the same time gaining the advantages of stability of the Reserve System and enjoying the lucrative fruits of low-reserve ratios for themselves.

Mr. SPROUL. I think that is so, but having argued myself against the use of increases in reserve requirements as an ordinary means of controlling credit policy, I cannot press that argument too strongly in

urging that nonmember banks be required to observe those reserve requirements of member banks.

But I do think that there is a case in equity for requiring all banks to participate in the national objectives so far as credit policy is concerned. Perhaps equally important in terms of emotion is this feeling of local pride and local prejudice, but there is also, I think, a feeling against free riders, and the nonmember bank to a considerable extent is a free rider in the economy in terms of getting all the stability that the Federal Reserve System provides without observing most of the rules which it must enforce.

Senator DOUGLAS. What about the advantages of the Reserve System which the member banks have but which the nonmember banks do not have?

Mr. SPROUL. Well, it comes down largely to a question of dollars and cents and, as I said recently in a talk I made, anybody with a sharp pencil can figure out how he can save money by not belonging to the Federal Reserve System. You just need a grammar-school knowledge of arithmetic to do that.

Senator DOUGLAS. You mean that with the same amount of capital to make loans a nonmember State bank can make larger loans on a given amount of capital than can a member bank?

Mr. SPROUL. In general that is so.

Senator DOUGLAS. What about the advantages of the clearance of checks?

Mr. SPROUL. The nonmember banks can get their checks cleared just as well and just as rapidly as the member banks. If they are not cleared through the Federal Reserve System—and they can only be cleared through the Federal Reserve System in certain special instances—they are cleared through their correspondent banks, which in turn uses the facilities of the Federal Reserve System.

Senator DOUGLAS. Do you see any advantages which the members of the Federal Reserve System enjoy which nonmembers do not enjoy?

Mr. SPROUL. Members of the Federal Reserve System have access to the borrowing privilege directly, and on the basis of any of their assets, which may be acceptable to the Federal Reserve Banks, a privilege which the nonmember banks have either only indirectly or borrowing against Government securities where there is a special provision which permits nonmember banks to borrow.

Senator DOUGLAS. You mean that only member banks can apply for rediscount on commercial paper?

Mr. SPROUL. Yes.

Senator DOUGLAS. Member banks really do not apply for that much, do they?

Mr. SPROUL. They do not discount very much, and when they do discount, they use Government securities, and nonmember banks could also borrow on the basis of Government securities.

Senator DOUGLAS. The amount of commercial paper discounted amounts at present to \$300,000,000; is that right?

Mr. SPROUL. Discounts now are all based on Government securities. There is practically no commercial paper in the operation at all.

Senator DOUGLAS. Well, then, that is not much of an exclusion privilege that the Federal Reserve members have.

Mr. SPROUL. I think there is a general prestige in many parts of the country which adheres to Federal Reserve System membership, which is considered important by the banks.

Senator DOUGLAS. Hasn't FDIC replaced the Federal Reserve System as a prestige-shedding institution?

Mr. SPROUL. No; I do not think so. According to the law, you have to put on your window that you are a member of the FDIC, and you are not required to put on your window that you are a member of the Federal Reserve System, but I think the prestige quality still adheres to membership in the System, even since the FDIC was established, and the fact that a majority of the larger—

Senator DOUGLAS. What you are saying is that the State banks that are members of the System lose money by being members, but they buy prestige in return for it and, assuming they are good businessmen, the prestige which they buy must be worth the diminished earning power.

Mr. SPROUL. In addition to prestige, I think it should be said that the bankers also have some regard for this national monetary system of ours. They know that for its working it requires the membership of a large number of the banks of the country and a large majority of the deposits of the country, and withdrawals of banks purely on the basis of profit, which would weaken or destroy the System, I think, would be an action which the organized banking community would not take, even though profits are diminished by their continued membership.

Senator DOUGLAS. You would think that the banks inside the System would, therefore, want to have uniform reserve requirements imposed on the banks outside the System, but we had the testimony of Mr. Brown of the First National Bank of Chicago and Mr. Burgess of the National City Bank of New York, that they were opposed to the extension of the reserve requirements to other banks.

They apparently did not object to the free riders. In fact, they thought there should be free riders. They did not call them free riders. They said that they were banks operating under the American dual system, which they wanted to preserve.

Now, can you explain the position taken by these gentlemen, which seems to be at such variance with their economic interests?

Mr. SPROUL. First, I would say as I said before that variance with their economic interests does not outweigh their understanding of the fact that a strong Federal Reserve System is necessary to this country and that their participation in it is absolutely essential, whether everyone is in it or not.

Senator DOUGLAS. But then you would think they would want to have the rules extended to others. You would think that once they themselves made the decision to stay in they would want to have uniform reserve requirements imposed on those outside. Men inside a union generally want to bring the nonunion members into the fold.

Mr. SPROUL. I was coming to that. A position has become established in the American Bankers Association, which represents big banks, small banks, national banks, State banks, member banks, and nonmember banks, and which has to arrive at its official positions as a compromise of a variety of conflicting interests. The position has been reached opposed to the extension of reserve requirements to nonmember banks.

There is also what I consider an emotional attitude toward the dual banking system, which talks in terms of the destruction of the dual banking system, but which evades or ignores the fact that this exten-

sion of member bank reserve requirements to nonmember banks need have and would have no such effect, that the dual banking system would continue to exist and thrive so long as the State banks were competently run and efficiently managed and so long as their community prospered.

Senator DOUGLAS. Is it conceivable that some of the member banks inside the System would prefer to have a considerable number of banks outside the System, because as long as there is this fringe of nonmember banks and the attendant possibility of State banks escaping from the System, there will be a check upon the power of the Federal Reserve Board to increase reserve requirements and, therefore, to diminish earning ratios?

Mr. SPROUL. I think first there is an attitude, which is fairly widely held by bankers and others, that too great a centralization of power in Washington is to be resisted wherever it shows itself and that one of the places it might show itself would be in this question of reserves of nonmember banks.

Senator DOUGLAS. I take it that possibly to meet that situation, as well as because of local pride, you made the suggestion that the reserve requirements might be turned over to the Open Market Committee, rather than to the Board of Governors of the System.

Mr. SPROUL. That was one reason for putting that in. I had others.

Senator DOUGLAS. If that were to happen, wouldn't it probably be well to do away with the Board of Governors?

Mr. SPROUL. I have something on that here. In my reply to your questionnaire I suggest that the responsibility for all major instruments of Federal Reserve policy should be lodged in the group now called the Federal Open Market Committee. Other monetary controls must be integrated with open-market operations, and there is certainly strong logic on the side of unified direction over all of them. Such a change would also assure the regular representation of actual operating experience, and an awareness of differing regional problems, in the formulation of the interrelated aspects of a national monetary policy.

It is not an ideal arrangement, nor even good administrative procedure to place open-market operations under a broadly representative committee, and to place the power over reserve and margin requirements, and the review and determination of discount rates initiated by the Reserve banks, solely under the Board of Governors. The Federal Open Market Committee has worked well in guiding the most important instrument of Federal Reserve policy. The next step should be the transfer of other closely related powers of monetary control to that committee.

This is a question on which men in the System may differ, displaying a bias, perhaps, towards the side they know best. As a Reserve bank president, it is probably natural that I should see advantages in this proposal, while members of the Board may react against it, as an intrusion upon their authority. On this question, just as on the substantive questions of credit policy, both views deserve a hearing.

My own view is that we shall do well to retain, wherever we can, the regional characteristics of the System, both in the matter of decentralized operation and, more important, in the matter of System national policy. No one would deny the need for coordination of general credit policy, but we now have, in the Federal Open Market

Committee, the statutory means of achieving this while retaining some regional participation and responsibility.

This committee is composed, as you know, of the seven members of the Board of Governors and five of the presidents of the Federal Reserve banks. Here are brought together, under statutory auspices and with statutory responsibilities, men who are devoting their full time to the problems of the Federal Reserve System and who are in touch with governmental policies and private views and opinions, in Washington and throughout the country.

It is the best expression which we have of the Federal character of the System, a character which is in tune with our political organization, with the continuously expressed intent of the Congress, and with the desires of our people.

And let me nail right here one or two arguments which have been advanced on the other side.

Senator DOUGLAS. You came loaded for this question.

Mr. SPROUL. That is right.

First, there is the argument that the presidents on the Federal Open Market Committee exercise authority without having responsibility. In the first place, as I have stated, membership on the Federal Open Market Committee, and the duties and responsibilities of the committee are now fixed by statute. Every man who accepts a place on that committee derives his authority from the Congress and assumes a responsibility to the Congress, and through it, to the public.

These presidents are mostly men who have devoted their lives to the Federal Reserve System; they are career men in the public service. It comes with ill grace for anyone who has ever served on the committee to hint that they are swayed by private interests to compromise public duty. You do not plan honor and integrity in a man by bringing him to Washington and giving him an official position in the Government.

Second, there is the argument by threat; by posing a wholly unacceptable solution as the only alternative to the giving of additional powers to the Federal Open Market Committee. This is the argument that if you are going to give additional powers to the committee, you should abolish the Board of Governors.

Such an argument seems to me to miss the whole point of the original suggestion. The essential and unique characteristic of the Federal Open Market Committee is its blend. It is like Scotch whisky in that respect. The Board retails all of its existing duties, but exercises its principal powers through majority membership in the Federal Open Market Committee. The presidents, with their experience gained through carrying out policy in the field, sit as minority members of the committee.

All participate in policy-making discussions, and conflicting views are given the test of thorough debate. You are protected from being blown off your course by either the political winds of Washington or the financial winds of Wall Street.

The compromise solutions which have been brought forward do not impress me. It is not enough, I am sure, to bring the presidents of the Reserve banks into the discussion of these matters of credit policy as advisers. Occasional requests for comments are not enough, nor is it enough to provide for attendance at meetings without membership

or vote. You have to "belong" to be able to insist on consideration of your point of view.

Similarly, I do not believe that the suggestion that two of the Reserve bank presidents come to Washington each year for full-time service on the Board of Governors is practical. Such men would bring valuable lessons of past experience to the Board, but they would have divorced themselves from the insight produced by close contact with current operations.

They would be cut loose from their own staffs, their directors, and their districts, and transplanted to the somewhat unfamiliar Washington scene, while their institutions would be deprived of chief executive officers for a year at a time, one year out of six.

This is a case where the whole cannot adequately be replaced by either of its parts. In my view, we have developed through the Federal Open Market Committee a unique contribution to the processes of democratic administration. The System will best meet its responsibilities if this successful pioneering experiment is expanded to embrace all of the major policy determination of the System.

Nor am I frightened by the express or implied threats that to insist on placing more powers in the Federal Open Market Committee is to hasten the nationalization of the Federal Reserve System, and the removal of any taint of private participation in its affairs. I think we shall do well to retain the modest measure of private participation in the affairs of the System which we now have, to make effective use of those public-spirited men who are willing to serve as directors of the Federal Reserve banks. And I believe the Congress will feel that way if and when it examines the situation.

We are a successful working example of Government functioning in the economic field, with the aid and support of private business. Our experience in Government-business cooperation—with Government having the dominant and deciding voice—may be one signpost along the way to solution of that major problem, the relation between Government and business in our whole economy.

Senator DOUGLAS. Mr. Sproul, article I, section 8, of the Constitution gives to Congress the power "to coin money and regulate the value thereof," and acting under that power, we delegated authority in fairly specific terms to the Federal Reserve Board, and the members of the Federal Reserve Board are named by the President and have to be confirmed by the Senate, so that we exercise some control over the Board; but the presidents of the various Federal Reserve banks are not chosen by Congress and are not responsible to Congress. Are you not, therefore, proposing that a public function which the Constitution confided in Congress should now be turned over by Congress to a body five-twelfths of which would be outside the control of Congress and, therefore, outside the constitutional process?

Mr. SPROUL. I think Congress has already crossed that bridge by setting up the Federal Open Market Committee by statute and authorizing it to exercise the most important credit control function of the Federal Reserve System. And I am only suggesting that the other credit-control functions be integrated with that most important function which the Congress has already delegated to the Federal Open Market Committee. And the Congress has named the members of that committee.

Senator DOUGLAS. Of course, you could argue that this dualism and apparent contradiction could be cured instead by giving to the Federal Reserve Board the power to control open-market operations.

Mr. SPROUL. Yes; that has been argued, but as I say, I think the better results and retention of Federal regional character of the System would be achieved by putting those powers in the Federal Open Market Committee.

Senator DOUGLAS. It is a very nice question as to how much public power should be delegated to private bodies.

Mr. SPROUL. The Federal Open Market Committee, I would say, is not a private body.

Senator DOUGLAS. The presidents of Federal Reserve banks are not appointed by the Executive, nor are their appointments confirmed by the Senate. They are chosen by the boards of directors of the several Reserve banks, two-thirds of whose members are elected by the member private banks. You see, we have our pride, too, and we have our constitutional duties to perform.

Mr. SPROUL. We perhaps get some remote connection with you by reason of the fact our appointments are subject to the approval of the Board of Governors of the Federal Reserve System.

Senator DOUGLAS. I have no more questions. Mr. Wolcott?

Mr. WOLCOTT. I do not believe so.

Senator DOUGLAS. Senator Flanders?

Senator FLANDERS. Do you find any large body of disapproval of the giving of more flexibility in the interest rate by varying the point at which Government securities are pegged? Do you find objection to that in private bodies or groups to any large measure?

Mr. SPROUL. No; I do not think there is any large body of opinion among private banking, financial, or business groups that would object to it, and I think there is a considerable body of opinion which is in favor of it.

Senator FLANDERS. I may say the Secretary in his statement this morning indicated that he did not feel there was a promise to peg. So this particular Secretary of the Treasury agrees with the statement that you made and disagrees with Mr. Harl.

Mr. SPROUL. Yes.

Senator FLANDERS. Another question I wanted to ask is related to one point in the set of resolutions which had been adopted a year or so ago by the Farm Bureau national convention. It is related to the possibility of varying the gold content of the dollar.

I think for the record it would be useful to have your comments on that.

I might say that I have looked at your San Francisco speech and know that you have discussed that subject, and the idea will not come to you as something on which you have never given any thought.

Mr. SPROUL. I have a copy of that speech here, and I put into it my views on varying the gold content of the dollar. Would it be permissible to have those views placed in the record at this point?

Senator FLANDERS. I think it might be, unless the rest of you have some desire to have them read. I think it might be satisfactory just to put them in.

Mr. SPROUL. I would like to and be glad to.

Senator DOUGLAS. They will be made a part of the record.

(The material referred to above is as follows:)

REMARKS OF ALLAN SPROUL, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK,
AT THE SEVENTY-FIFTH ANNUAL CONVENTION OF THE AMERICAN BANKERS' ASSO-
CIATION, SAN FRANCISCO, CALIF., NOVEMBER 2, 1949

As a native Californian—and a native San Franciscan—I have tried to think of something I might discuss which would be of special interest to our generous hosts at this convention. The fact that this is 1949, and that the whole State of California has been engaged in a 2-year round of celebrations of the one hundredth anniversary of the discovery of gold in California, and of its immediate consequences, gave me an obvious lead. Gold is something in which we are all interested. Nor is this an untimely topic on other grounds. The recent wave of currency devaluations which swept around the world, following upon the devaluation of the British pound sterling 6 weeks ago, has fanned into modest flame the always smoldering fires of the gold controversy. In addition, I was eager to review the gold question because it is a good starting point for an understanding of the place of the Federal Reserve System in the monetary and economic life of the country. When I finish with gold, I shall want to say something more specific about the System, and about your relations with it.

As central bankers, of course, charged with responsibility for our monetary and credit policies, we have the question of gold under more or less constant surveillance. Most of the time, in recent years, we have been under attack from two sides because of our attitude toward gold. Those interested primarily or initially in the price of gold, and in what they call a free gold market, have fired from one side. Those interested primarily and eternally in gold-coin convertibility—in a full and automatic gold standard domestically and internationally—have fired from the other. More recently we have had a brief respite from attack while these two groups fired at each other, each group arrogating to itself responsibility for the only true gospel according to St. Midas. What I have to say will probably bring that brief respite to an end. The fire will again be concentrated on the monetary authorities, for whom I cannot presume to speak except as one individual engaged in the practice of central banking, but who will no doubt be blamed for my views.

Let me take account of each of these two groups separately; those who concentrate, at least initially, on a free gold market, and those who will have none of this heresy, but who want a fixed and immutable gold price and convertibility of currency—and therefore of bank deposits—into gold coin.

The first group, which includes the gold miners, makes its argument on several grounds, trying to combine economics and psychology with self-interest. Let me paraphrase their principal arguments as presented at hearings on bills to permit free trading in gold in the United States and its territories. In this way I may avoid the fact as well as the appearance of building straw opponents. The arguments most frequently presented in favor of these bills were:

1. In the face of rising production costs and fixed selling prices, the gold mining industry has been forced to curtail its operations, and to the extent that it has operated, its profits have been reduced. The higher gold prices which would presumably prevail in a free market would correct this situation. This is the "do something for the gold miners" argument at its baldest.

When this argument is embroidered a little, it is claimed that since the prices of all goods and services have increased so substantially during the past 10 or 15 years, it is necessary to open the way for an increase in the price of gold so as to be sure there will be enough gold to carry on the country's business; to bring the price of gold into adjustment with the prices of everything else.

2. A second group of arguments expresses concern over the unsettling effects of the "premium" prices which are paid for gold abroad, and claims that a free gold market in the United States, with no gold export restrictions, would cause these premium markets abroad to disappear, with beneficial effects upon world trade and international relations.

3. Third, there is an argument in equity—that gold miners should be allowed to sell their product at the best price they can obtain, as do producers of other products; and that American citizens, like the citizens of most other countries, should be free to hold or to buy and sell gold.

4. Finally, there were those who viewed and favored a free gold market as a first step in the direction of a full gold coin standard, and who held that even a free market would act as a "fever chart" of the economy and lead to reform of extravagant Government fiscal policies, remove inflationary tendencies fostered by a managed currency, and lead to sounder conditions, generally.

To take these arguments up in order, it should be pointed out right away that it is quite possible that a free market for gold in the United States would not result in a rise in the price of gold, if for no other reason than that the Secretary of the Treasury is required, by law, to maintain all forms of United States money at parity with the gold dollar which contains one-thirty-fifth of an ounce of fine gold. This means that the Treasury should maintain the price of gold at \$35 a fine ounce in legal gold markets in the United States. To do this, if there were a legal free market for fine gold, the Treasury should sell gold to the extent necessary to maintain the market price at \$35 a fine ounce. We might, therefore, get what would be in effect gold convertibility by way of a free market, but not a rise in the price of gold. Aside from this possible outcome of the establishment of a free market for gold, what is it we are being asked to do? In effect we are being asked to do something to benefit the gold-mining industry, to encourage a shift of productive resources, in this and other countries, into gold production, in order to provide gold for hoarding. This, I submit, would be a witless proceeding, in terms of the welfare of the whole economy, matched only by our bonanza provisions for the special benefit of the miners of silver.

As for the economic embroidery of this request for aid to the gold-mining industry, there is no lack of monetary means of carrying on the business of the country, nor is there likely to be. It is the economics of perpetual inflation to argue that a rise in the commodity price level should be followed by an arbitrary increase in the price of gold and hence in the reserve base, thus permitting and, perhaps, promoting additional deposit expansion and a further upward movement of prices. Even on the basis of statistics, which are not always reliable or comparable, it is interesting to note that the increase in the price of gold in the United States, in 1934, raised the price of gold by 69 percent, whereas wholesale prices in the United States are now only 60 percent above the 1927-29 level. We have been plagued, if anything, with an oversupply of money in recent years, and the United States gold stock, at the present price, is large enough to support whatever further growth in the money supply may be needed for years ahead.

The second group of arguments has to do with the desirability of knocking out of business the premium markets in gold which have existed and still exist in various foreign countries. I share the general dislike of these markets because they are parasites on the world's monetary system and help to siphon into gold hoards the resources of people who need food and clothing and equipment—and who wouldn't need so much help from us if they didn't use scarce foreign exchange to buy gold for private hoards. But I don't think the soundness nor the stability of the United States dollar is actually brought into question by these premium markets. At our official purchase price for gold—\$35 a fine ounce—the United States has been offered and has acquired more gold than the total world production (excepting the U. S. S. R. for which reliable data on gold production, as on everything else, are not available), since 1934, the year of our devaluation. During those years—1934 to 1948 inclusive—estimated world gold production, valued at United States prices, was about 13.5 billion dollars and United States gold stocks increased 16 billion dollars.

Most of the producers and holders of gold have been quite willing to sell us gold for \$35 a fine ounce despite the quotations of \$45 and \$55 and so on up in the premium markets. The fact is that these premium markets represent insignificant speculative adventures around the fringe of the world supply and demand for gold. They reflect mainly the urgent and often illegal demands of a small group of hoarders, together with some private demand for gold to be used in relatively backward areas, or areas where the forms of civilized government have broken down, and where the metal serves the needs of exchange—or hoarding—better than a paper note. I do not think there would be any appreciable stimulus to United States gold production, if we opened the doors of this largely clandestine trade to our domestic gold miners. But, by legalizing it, we might well create what we are trying to destroy—uncertainty about the stability of the dollar and our own intentions with respect to its gold content.

The third argument—that the miners of gold should be free to sell their product at the best price they can get—is probably the giveaway. It is the argument that gold should be treated as a commodity when you think you can get a higher price for it, and as a monetary metal and an international medium of exchange when you want a floor placed under its price. I would say that you can't have it both ways. If you want the protection of an assured market at a fixed price, because gold is the monetary metal of the country, you should not ask

permission to endanger the stability of the monetary standard by selling gold at fluctuating prices (the gold producers hope higher prices) in a fringe free market. Under present conditions, the only real price for gold is the price the United States Treasury is prepared to pay for it. So long as that is the case, there is no sense in a "make believe" free gold market, in which possible temporary or short-run deviations from the fixed price of the Treasury might have disturbing consequences.

Nor is the argument that citizens of the United States should have the same privileges as the citizens of other countries, when it comes to holding or trading in gold, at all convincing to me. It is true that in a number of foreign countries the holding of gold by private citizens is legal, and in some foreign countries strictly internal free trading in gold is permitted. In many cases, however, this merely represents the shifting around of a certain amount of gold which is already being hoarded in the country, since in practically all of these countries the export and import of gold on private account is either prohibited or subject to license. And, in many countries where gold is produced, some percentage, if not all, of the newly mined gold must be sold to the monetary authorities, a requirement which further limits the amounts available for trading and hoarding. These restricted and circumscribed privileges in other countries are no reflection of a loss of inalienable rights by our people. They are attempts by these foreign countries to adjust their rules with respect to gold to their own self-interest and, so far as possible, to the habits of their people, all under the sheltering umbrella of a world gold market and a world gold price maintained by the Treasury of the United States.

We have deemed it wise to maintain such fixed point of reference, in a disordered world. We have decided by democratic processes and by congressional action, that this policy requires, among other things, that gold should not be available for private use in this country, other than for legitimate industrial, professional, or artistic purposes. We have decided that the place for gold is in the monetary reserves of the country, as a backing for our money supply (currency and demand deposits of banks, and as a means of adjusting international balances, not in the pockets or the hoards of the people. If we want to reverse that decision, the means of reversal are at hand, but it should be a clear cut and a clean cut reversal, restoring convertibility. Providing a dependent free gold market, in which gold miners and a little gold group of speculative traders or frightened gold hoarders (such as those who now take advantage of a provision in the regulations to buy and sell "gold in the natural state") could carry on their business is not the way to meet the problem.

I do not propose to get in the cross fire of those who claim that a free gold market would be a step toward convertibility, and those who claim that a free gold market, without free coinage at a fixed price, would cause us to lose whatever modicum of a gold standard we now have and lead to monetary chaos. That is one of those doctrinal arguments in which the subject abounds. I will merely say here that I think authorization of a free gold market in this country, with no change in the present responsibility of the Secretary of the Treasury to maintain all forms of money coined or issued by the United States at parity with the "gold dollar", would probably lead indirectly to convertibility. The desirability of doing this is another matter, which I shall now try to discuss briefly and dispassionately. This is a hazardous attempt because there is no subject in the field of money and banking which so arouses the passions, and which so readily defies brief analysis.

Two groups of arguments for the reestablishment of a gold coin standard may, perhaps, be distinguished in the writings and speeches of those who propose it, one group relating primarily to the domestic economy and one to the probable effects on international trade and finance. In the first group the arguments run about as follows:

1. Replacement of our "dishonest", inconvertible currency with an "honest" money having intrinsic value would promote confidence in the currency, and encourage savings, investment, long-time commitments, and production.

2. Irredeemable paper money leads to inflation, whereas the upper limits imposed upon currency and credit expansion by a thoroughgoing gold standard serve as a restraining influence on irresponsible politicians and overoptimistic businessmen.

3. Present governmental taxing and spending policies are wrong and dangerous. The gold standard would put a brake on public spending.

4. As a corollary of the preceding argument, since the gold standard would hinder further extension of Government control and planning, it is a necessary implement of human liberty.

The second group of arguments, relating to the international advantages of a gold coin standard, generally make no distinction between the effects of a unilateral adoption of such a standard by the United States, and the multilateral establishment of an unrestricted gold standard by many countries, and of exchange rates fixed by such a standard. The arguments run somewhat as follows:

1. The existence of premium markets in gold abroad and the lack of gold convertibility at home creates—and is representative of—lack of confidence in the gold value of the dollar. In the absence of a thoroughgoing gold coin standard we cannot convince anyone that we may not devalue the dollar.

2. Restoration of "normal" patterns of international trade is being retarded by the inconvertibility of currencies in terms of gold and, therefore, one with another. This inconvertibility has led to tariffs, quotas, exchange controls, and to general bilateralism.

3. Under a managed paper currency system there is always the temptation to solve national problems by devices which lead to international disequilibrium. This, in turn, has led to domestic devices restrictive of foreign trade. The international gold standard, by eliminating the need for restrictive commercial policy, would increase the physical volume of international trade, resulting in an improved division of labor and higher standards of living for everyone.

First, let me say that I perceive no moral problem involved in this question of gold convertibility. Money is a convenience devised by man to facilitate his economic life. It is a standard of value and a medium of exchange. Almost anything will serve as money so long as it is generally acceptable. Many things have served as money over the centuries, gold perhaps longest of all because of its relative scarcity and its intrinsic beauty. In this country we still retain some attachment to gold domestically, and more internationally, but to carry on our internal business we use a paper money (and bank deposit accounts) which has the supreme attribute of general acceptability. There is no widespread fear of the soundness of the dollar in this country, no widespread flight from money into things. The constant cry of wolf by a few has aroused no great public response. Savings, investment, long-term commitments, and the production and exchange of goods have gone forward at record levels.

Much of the nostalgia for gold convertibility is based, I believe, on fragrant memories of a state of affairs which was a special historical case; a state of affairs which no longer exists. The great period of gold convertibility in the world was from 1819 to 1914. It drew its support from the position which Great Britain occupied, during most of the nineteenth century and the early part of the twentieth century, in the field of international production, trade, and finance. The gold coin standard flourished because the organization of world trade under British leadership provided the conditions in which it could, with a few notable aberrations, work reasonably well.

The ability of the British to sustain, to provide a focal point for this system has been declining for many years, however, and the decline was hastened by two world wars which sapped the resources of the British people. The heir apparent to Great Britain, of course, was the United States, but up to now we have not been able to assume the throne and play the role. And until some way has been found to eliminate the lack of balance between our economy and that of the rest of the world, other than by gifts and grants in aid, we won't be able to do so. This is a problem of unravelling and correcting the influences, in international trade and finance, which have compelled worldwide suspension of gold convertibility, not vice versa. The job before us now is to attack the problems of trade and finance directly. We should not deceive ourselves by thinking that gold convertibility, in some indefinable but inexorable way, could solve these underlying problems for us.

Nor is it true, of course, that gold convertibility prevented wide swings in the purchasing power of the dollar, even when we had convertibility. Within my own experience and yours, while we still had a gold coin standard, we had tremendous movements in commodity prices, up and down, which were the other side of changes in the purchasing power of the dollar. What happened to us in 1920-21 and 1931-33 under a gold coin standard should prevent a too easy acceptance of that standard as the answer to the problem of a money with stable purchasing power.

When you boil it all down, however, and try to eliminate mythology from the discussion, the principal argument for restoring the circulation of gold coin in this country seems to be distrust of the money managers and of the fiscal policies of Government. The impelling desire is for something automatic and impersonal which will curb Government spending and throw the money managers out of

the temple, as were the money changers before them. To overcome the inherent weakness of human beings confronted with the necessity of making hard decisions, the gold coin standard is offered as an impersonal and automatic solution. Through this mechanism the public is to regain control over Government spending and bank credit expansion. It is claimed that whenever the public sensed dangerous developments, the reaction of many individuals would be to demand gold in exchange for their currency or their bank deposits. With the monetary reserve being depleted in this way, the Government would be restrained from deficit financing through drawing upon new bank credit; banks would become reluctant to expand credit to their customers because of the drain on their reserves; and the Federal Reserve System would be given a signal to exert a restraining influence upon the money supply. In this way, Congress, the Treasury, and the Federal Reserve System would be forced by indirection to accept policies which they would not otherwise adopt.

In effect, under a gold coin standard, therefore, the initiative for over-all monetary control would, through the device of free public withdrawal of gold from the monetary reserve, be lodged in the instinctive or speculative reactions of the people. No doubt some people would take advantage of their ability to get gold. There would be many reasons for their doing so. Conscientious resistance to large Government spending, or fear of inflation, might well be among these reasons. But speculative motives, a desire for hoards (however motivated), and such panic reactions as are generated by unsettled international conditions or temporary fright concerning the business outlook or one's individual security—all of these, and more—would be among the reasons for gold withdrawals. The gold coin mechanism does not distinguish among motives. Whenever, for any reason, there was a demand for gold, the reserve base of the monetary system would be reduced. Moreover, if only the United States dollar were convertible into gold while practically all other currencies were not, hoarding demands from all over the world would tend to converge upon this country's monetary reserves. Circumvention of the exchange controls of other countries would be stimulated, and dollar supplies which those countries badly need for essential supplies or for development purposes would be diverted to the selfish interests of hoarders.

Even if a particular reduction in the reserve base did occur for useful "disciplinary" reasons, the impact of such gold withdrawals upon the credit mechanism is likely to be crude and harsh. Since the present ratio between gold reserves and the money supply is about 1 to 5, and since some such ratio will be in effect so long as this country retains a fractional reserve banking system, a withdrawal of gold coins (once any free gold is exhausted) will tend to be multiplied many times in its contractive effect on bank credit and the money supply. In a business recession, the Reserve System might undertake to offset this effect as it does now in the case of gold exports but, if the gold withdrawals attained sufficient volume, the shrinking reserve position of the Federal Reserve banks would eventually prevent them from coming to the rescue.

It was, in part, to offer such arbitrary and extreme influences upon the volume of credit, and to make up for the inflexibility of a money supply based on gold coins (in responding to the fluctuating seasonal, regional, and growth requirements of the economy), that the Federal Reserve System was initially established. During the first two decades of its existence, the System devoted much of its attention to offsetting the capricious or exaggerated effects of the gold movements associated with continuance of a gold coin standard. We had an embarrassing practical experience with gold coin convertibility as recently as 1933, when lines of people finally stormed the Federal Reserve banks seeking gold, and our whole banking mechanism came to a dead stop. The gold coin standard was abandoned, an international gold bullion standard adopted, because repeated experience has shown that internal convertibility of the currency, at best, was no longer exerting a stabilizing influence on the economy, and, at worst, was perverse in its effects. Discipline is necessary in these matters but it should be the discipline of competent and responsible men; not the automatic discipline of a harsh and perverse mechanism.

If you are not willing to trust men with the management of money, history has proved that you will not get protection from a mechanical control. Ignorant, weak, or irresponsible men will pervert that which is already perverse.

Here, I would emphasize my view that the integrity of our money does not depend on domestic gold convertibility. It depends upon the great productive power of the American economy and the competence with which we manage our fiscal and monetary affairs. I suggest that anyone who is worried about the

dollar concentrate on the correction of those tendencies in our economic and political life which have brought us a deficit of several billion dollars in our Federal budget, at a time when taxes are high and production, employment, and income are near record levels. I suggest that, going beyond the immediate situation, they address themselves to the difficult problem of the size of the budget, whether in deficit or surplus or balance. At some point the mere size of the budget, in relation to national product, can destroy incentives throughout the whole community, a dilemma which is even now forcing curtailment of Government expenditures by the Labor government in Great Britain. These are problems gold-coin convertibility cannot solve under present economic and social conditions. Gold has a useful purpose to serve, chiefly as a medium for balancing international accounts among nations and as a guide to necessary disciplines in international trade and finance. It has no useful purpose to serve in the pockets or hoards of the people. To expose our gold reserves to the drains of speculative and hoarding demands at home and abroad strikes me as both unwise and improvident.

Perhaps before I let go of this subject, which has held me and you overlong, I should say a word about merely raising the price of gold, without doing anything about a free gold market or gold-coin convertibility of the currency. This is something which has intrigued Europeans and others who are "short of dollars," has interested some of our own people, and has become a South African war cry. An increase in the price the United States pays for gold would have two major results. It would provide the gold producing countries (and domestic producers), and the countries which have sizable gold reserves or private hoards, with additional windfall dollars with which to purchase American goods. And it would provide the basis for a manifold expansion of credit in this country which might be highly inflationary.

We have been engaged in an unprecedented program of foreign aid for the past 4 years. The Congress has authorized this aid at such times and in such amounts as were deemed to be in the interest of the United States. This is much to be preferred, I suggest, to the haphazard aid which would be granted by an increase in the price of gold, which must be on the basis of a more or less accidental distribution of existing gold stocks and gold-producing capacity. If we raised the price of gold, every country which holds gold would automatically receive an increase in the number of dollars available to it. The largest increases would go to the largest holders which are the Soviet Union, Switzerland, and the United Kingdom. Every country which produces gold would automatically receive an annual increase in its dollar supply, and its gold-mining industry would be stimulated to greater productive effort. The largest increases would go to the largest producers which are South Africa, Canada, and probably the Soviet Union. That would be an indiscriminate way to extend our aid to foreign countries, both as to direction and as to timing.

The domestic results of an increase in the price of gold would be no less haphazard. This country, as I have said, is not now suffering from a shortage of money and it has large gold reserves, which could form the basis of an additional money supply if we needed it. An increase in the dollar price of gold would increase the dollar value of our existing gold reserves in direct proportion to the change in price. There would be an immediate "profit" to the Treasury. The "profit" could be spent by congressional direction or Treasury discretion. This would provide the basis for a multiple expansion of bank credit which, unless offset by appropriate Federal Reserve action, would expose our economy to the threat of an excessive expansion of the domestic money supply. The arbitrary creation of more dollars in this way would certainly be inappropriate under inflationary conditions, and would be an ineffective method of combating a deflationary situation.

At the moment, also, we should have in mind that there has just been an almost world-wide devaluation of currencies. Using the fixed dollar as a fulcrum, individual foreign countries have taken action designed to improve their competitive position vis-à-vis the United States, and to maintain their competitive position vis-à-vis one another. An increase in the dollar price of gold, which is devaluation of the dollar by another name, would undo the possible benefits of a venture in improved currency relationships which already has its doubtful aspects.

For all of these reasons it is encouraging to know that the Secretary of the Treasury has recently reiterated that the gold policy of the United States is directed primarily toward maintaining a stable relationship between gold and the dollar, and that for all practical purposes only the Congress can change that

relationship. We have maintained an international gold bullion standard by buying and selling gold freely at a fixed price of \$35 a fine ounce in transactions with foreign governments and central banks for all legitimate monetary purposes. This has been one fixed point in a world of shifting gold and currency relationships. We should keep it that way as another contribution to international recovery and domestic stability.

This whole discussion of gold has been a long wind-up for what may now seem to you like a small pitch. I want to end my remarks with a few words about the Federal Reserve System and the relations of your organization and you, as bankers and citizens, with that System.

In my gold discussion I tried to emphasize what seems to me to be a fundamental proposition in the case of a country with the domestic and international strength of the United States. We can't have, or we don't want, both an automatic gold-coin standard and discretionary control of the reserve base by a monetary authority. The existence of two independent and frequently incompatible types of control over reserves of our banking system is undesirable. In the light of that finding we abandoned the gold-coin standard as a control over the domestic money supply, and placed our reliance in monetary management by the Federal Reserve System. I think it has become established American policy that a principal means of Government intervention in the economic processes of the country is the administration of broad credit powers by the System. In this way a pervasive influence may be brought to bear on our economy, without intrusion upon specific transactions between individuals, which is likely to be the consequence of more detailed physical controls, and which would spell the end of democratic capitalism as we have known it.

I have thought it reasonable to assume that the public in general, and bankers in particular, clearly recognized the special place of the System in our economy. The fact that the development of a national monetary and credit policy is the responsibility of the Federal Reserve System should fix its place beyond question. This is not a function which can be split up and passed around. Many of the activities of other Government agencies engaged in making or guaranteeing loans, or conducting bank examinations, or insuring bank deposits, have a bearing on the way monetary policy works, but monetary policy, as such, is one and indivisible. It is only the supervisory and service functions performed by the Federal Reserve System which are comparable to the operations of these other Government agencies. The distribution of these incidental duties among such agencies can be largely determined by administrative convenience, historical precedent, and economy of operation, so long as there are arrangements for consultation to avoid unnecessary differences in policy and practice. But over-all responsibility for holding the reserves of the banking system, and influencing the creation of credit by varying the cost and availability of those reserves, can only reside in the one agency designated by Congress as the national monetary authority. The Federal Reserve System is not just one of a number of Federal agencies having to do with banking. Its duties and responsibilities are unique; they range over the whole of our economy and touch the lives of all our people.

I was somewhat dismayed, therefore, by recent reports that the American Bankers Association seemed to hold a different or opposite view. It is reported to have recommended to the Congress the maintenance of parity of compensation of the three Federal bank supervisory agencies (Board of Governors of the Federal Reserve System, Board of Directors of the Federal Deposit Insurance Corporation, and the Comptroller of the Currency), on the theory of equal pay for equal work; equal pay for sharing equally heavy responsibilities. I mean no disrespect of the Office of the Comptroller of the Currency, nor of the Federal Deposit Insurance Corporation, when I say there is and can be no such equality of responsibility. The bank supervisory duties of the Federal Reserve System are a distinctly minor part of its work. There is no desire to increase or add to those duties against the wishes of the banks or the best interests of the public. To represent the Federal Reserve System as just another bank supervisory agency, in the name of maintaining proper checks and balances in Federal bank supervision, seems to me to miss, and to misrepresent, the main reason for our being.

I mention this small but significant item first, because it cuts across the whole concept of the Federal Reserve System and, therefore, cuts across the whole range of our relationships with you. There are other points of apparent difference where we seem to be at odds, or not pulling together effectively, because of mistrust, or lack of proper consultation, or inadequate study of the broad aspects of the questions with which we are mutually concerned. I shall touch on a few of them.

Concentration of power.—The picture of a Federal Reserve System trying to arrogate power to itself, which at times you have painted, obscures the real picture. The real picture would show a Federal Reserve System trying hard to keep its powers in working order so that it can discharge its responsibilities as a monetary authority, with a measure of independence from the pressures of partisan political aims and the exigencies of managing a Federal debt which totals about \$255,000,000,000 and, unfortunately, is growing. To lump the Federal Reserve System with the other bank-supervisory agencies at Washington, and to play one against the other, is not an attack on the real concentration of power; it is giving aid and comfort to those who would seize upon the failure of monetary and credit controls as a pretext for fastening more direct controls upon our economy.

Organization of the Federal Reserve System.—I have been as one with many of you in my opposition to undue centralization of control of the Federal Reserve System by the Board of Governors at Washington. In testimony before congressional committees and in public statements, I have affirmed my belief that we can have in the Federal Reserve System a wise blend of national authority and regional responsibility of Government control and private participation. I think we shall do well to retain and to improve the regional characteristics of the System, both in matters of decentralized operation and, more important, in matters of national credit policy. I should like to see the bankers of the country, and this organization of bankers, give some more thought to this problem, and I should like them to offer some constructive suggestions concerning it. The climate may be right for its calm consideration.

Reserve requirements.—The Federal Reserve System is charged with the responsibility of formulating and administering national credit policy. It does this chiefly through its influence upon the cost and availability of bank reserves. This is a proper exercise of Federal power, and its point of incidence is upon the commercial banks of the country because only they, among all of our financial institutions, have the ability to add to or subtract from the money supply of the Nation. I question whether there is good and sufficient reason for exempting any commercial banks from a minimum participation in this national undertaking. It only requires a moderately sharp pencil and a grammar-school knowledge of arithmetic to figure out how you can save money by not being a member of the Federal Reserve System as things now stand. But I don't think this country really likes "free riders," and nonmember banks, in that sense, are "free riders." I know the objections to compulsory membership in the Federal Reserve System; I recognize some of its dangers; and I think it is probably politically impossible. But it should not be beyond our ingenuity to devise appropriate powers of fixing reserve requirements, to be exercised within statutory limits by an appropriate body within the Federal Reserve System; reserve requirements which would be adequate for our national purpose, and which would apply to member and nonmember banks alike.

Here is another instance, I believe, where your theory of checks and balances runs the danger of being all check and no balance. And let it be clear that this is no attack on the dual banking system. State member banks have lived within the Federal Reserve System for years, and submitted to its reserve requirements, without loss of identity. We welcome this continued relationship. Nor am I frightened by the existence of a fringe of nonmembers, and the ability of State banks to move from one group to the other. A mass exodus of State member banks from the Federal Reserve System seems to me to be so unlikely as to be outside the range of practical consideration. But I do think that all commercial banks have a common obligation and a common responsibility in this matter of reserve requirements, and that they should assume the obligation and share the responsibility.

Correspondent bank relationships.—Somehow there has grown up a feeling in some places that we in the Federal Reserve System are out to undermine the network of correspondent bank relationships which you have built up over the years. Every time we suggest some change in the method of assessing reserve requirements, or make some minor improvement in our check-collection system, or in our methods of providing coin and currency, or in some other detail of our operations, the question seems to be raised. I can assure you that these things are suggested or done in an effort to improve the efficiency and economy of our operations in terms of the whole banking system, the business community, and the general public. There is no hidden purpose. We recognize that there are some things which correspondent banks can do better than we can, and we are glad to have them perform these services. At the same time we would caution

them against competition in providing services which really do not pay their way, and remind them that there are some things which, perhaps, the Federal Reserve System can do better than they. Surely here is an area, if our motives be reasonably pure on both sides, where there is no need for friction between us.

Selective credit controls.—We have differed on the matter of selective credit controls or, more specifically, on the matter of control of consumer installment credit. I have advocated the continuance of the control which the Federal Reserve System exercised, briefly, over consumer installment credit. I would be concerned over the dangers of any further significant extension of selective controls, whether over the credit used in commodity markets, in real-estate transactions, in inventory financing, or in other forms of business lending. Requests for further powers should meet two tests—is the power really needed and will its use still leave an effectively functioning private economy? I have argued and still believe that control of consumer installment credit meets these tests. Your official position has been opposed to this view. I would ask you, however, whether you are happy about the way things are now going in this field of finance. I am not. I suggest that we might sit down together and reexamine the problem to our mutual advantage and to the advantage of the public which we both serve.

These are some of the matters which I think deserve your constructive attention. A negative approach has been and will continue to be effective in stopping the passage of individual pieces of legislation, which you happen to dislike, but it won't check the progress of the idea of Government controls and intervention, if you have little constructive to offer in the face of difficult economic problems. Over the years you will win a lot of battles but you will lose the war.

I recognize and share your dislike for Government controls and your distrust of too much centralized power. But I recognize, as I think you must, that a certain amount of Government intervention is necessary to the preservation of our political and economic system. The central problem in our country, and in all countries but Russia and its satellites, is how far such Government guidance and control can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we have preferred to keep such guidance to a practical minimum, and to have it exercised largely through broad and impersonal controls—controls which affect the general environment. One cornerstone of such a philosophy is a competent and adequately powered monetary authority which can administer an effective monetary policy. In making monetary policy work to the limit of its capacity, we have one of the best defenses against control by Government intrusion in our personal and private affairs.

That is why I should like to see the American Bankers Association adopt an affirmative, constructive attitude toward the Federal Reserve System. If you don't like it, as it stands, put some real time and effort into the study of ways to improve it—its personnel, its powers, its organization, its functioning. In such an undertaking you will have the cooperation of all of us who are devoting our lives and our energies to what we believe to be a worth-while public service. In the struggle of ideas and ideals which now divides the world this is a minor front. But it is a fighting front. It is no place for a neutral.

Senator FLANDERS. We have had much to say both in your testimony and in the testimony of others regarding the use of the varying interest rate in controlling the supply of money. The importance and general effectiveness of that was something that I became rather skeptical of during the 1930's. I wonder if you feel variations in the interest rate are always an available means of controlling the money supply, particularly of encouraging it under conditions of depression.

Mr. SPROUL. I think they are very little use under conditions of extreme depression such as we had in the 1930's. Then we had a situation where there were tremendous excess reserves in the banking system, the interest rate approached zero in the case of the shortest term, highest grade securities, and the effect upon business, production and employment was very slight.

I think variations in the interest rate and the use of monetary measures of control and restraint can have their greatest effect in times of

inflationary pressures before the economy has gone over the top and gotten into a depression.

Certainly there should be relaxation of any restraint on the credit supply and low rates of interest in depression circumstances, but they would not by themselves bring the economy back to high production, income, and employment.

Senator FLANDERS. Speaking of high rates in times of inflation, I do not remember what the call money rate went to on Wall Street in the first half or three-quarters of 1929, but it went pretty high without doing much to restrain borrowing. But perhaps that is a special case.

Mr. SPROUL. That was a special case in some ways, and we think the loophole was closed when Congress gave authority to the System to fix margin requirements, which is a selective credit control instrument which, I think, has its uses and its practical forcefulness.

We also have a different situation now from any which we have had before, and that is what I referred to in speaking of the sensitivity of the market. With a Government debt of the size of our Government debt and forming so large a part of the whole debt structure of the country, the System has a homogeneous market wherein which it can operate at all levels of rates such as it has never had before. So that we can step into the market and have our effect felt almost immediately, and I think have the reverberations spread out through the whole corporate security market and out through the whole banking and business community in a way not possible before the Government debt became such a large part of the whole debt structure.

Senator FLANDERS. Thank you.

Senator DOUGLAS. I have one further question that I should like to ask.

For some years it was a question as to whom the profits of the Federal Reserve System belonged. The Federal Reserve Board by administrative order is now turning over 90 percent of these profits to the Federal Government. But, as I understand it, they are doing it by administrative regulation and not by statute.

Do you have any opinion as to whether that situation should be formalized by legislation?

Mr. SPROUL. Of course, let me say I think there is no disagreement either within or without the System of the view that the majority of profits of the Federal Reserve System should go to the United States Treasury.

When it comes to how you get them there, I think the present method, while it seems to be working all right, is a perversion of the statute which authorized the charge of interest on uncovered Federal Reserve notes, and there is no reason why we should not make a cleaner and clearer-cut situation out of it and restore the franchise tax which formerly applied to the Federal Reserve banks.

Senator DOUGLAS. But you would have the franchise tax so it would take a larger proportion of the profits of the Federal Reserve banks than was originally the case?

Mr. SPROUL. The statute, as amended, applied, I think, to 90 percent of their net earnings after expenses and dividends. And I think that is an appropriate division at least until the Federal Reserve banks have built up their capital funds beyond their present modest amount.

Senator FLANDERS. Mr. Chairman, that leads me to another question.

So long as the Federal Reserve banks' open-market operations are directed toward pegging the price of Government securities, it seems to me the System has the surest-fire earning operation the world has ever seen. You are directed to buy low and you are directed to sell high, and are given the opportunity to buy low and the opportunity to sell high. And that is something for which the world has been looking for thousands of years.

But when you come to your open-market operations, a different basis, which is that of more directly gearing your operations into the maintenance of production and employment and general high level of activity, may you not run into conditions in which the desirable operations will result in losses instead of profits?

Mr. SPROUL. That is possible, and that is why I say we still should be permitted to put some of our earnings into capital accounts so that we will have a cushion to carry us over a year or 2 years or 3 years when we might run into losses instead of profits.

Senator DOUGLAS. The vast proportion of the earnings, however, of the Federal Reserve banks comes not from speculative gains on Government securities but rather from interest on the Government securities which they hold. Am I not right?

Mr. SPROUL. Yes; our earnings are much more largely from interest on our holdings than they are from profits on sales.

The other side of Senator Flanders' operation is a whole private banking and business community which at times seems to want to sell at low prices and then buy back at high prices. That is the private-enterprise system at work.

Senator DOUGLAS. Any further questions?

Mr. WOLCOTT. Mr. Chairman, I think Mr. Sproul should be given an opportunity, if he cares to do so, to offer whatever recommendations he might make as to what the Congress could do, or what this committee could recommend to the Congress to be done, to prevent the ups and downs in our economic life.

Mr. SPROUL. I would like to have permission to write you a memorandum or a book on that subject. I do not think I could cover it free hand here.

Mr. WOLCOTT. I assume that is what we are looking for; that is our objective, anyway.

Mr. SPROUL. I have discussed it both in my answers to your questionnaire and in my covering letter, and somewhat in my testimony, insofar as it relates to monetary and credit policy, debt management, and fiscal policy. But maybe I misunderstood you. I thought you were going into the much broader question outside of the range of monetary credit policy.

Mr. WOLCOTT. No; in the field of money and credit and fiscal matters, what recommendations have you that the Congress enact into law to help?

Mr. SPROUL. As I said, I think the central problem of the whole situation as it exists under present-day conditions is the possible conflict between debt management and credit policy. And I suggest a consideration there, first, of a mandate from the Congress which would give a direction to the Treasury as well as to the System to direct its operations toward the general purposes of the Employment Act of 1946.

I also suggested in support of a systematic and logical monetary credit policy that the nonmember banks should meet the same reserve requirements as member banks.

I suggested that the principal credit control powers of the Federal Reserve System be placed in the Federal Open Market Committee to preserve the regional characteristics of the System while at the same time integrating those monetary and credit powers.

I think those are the principal suggestions or recommendations which I would have to make.

Mr. WOLCOTT. I thought you might want to get them in 1, 2, 3 order very briefly.

Mr. SPROUL. That is just about it in 1, 2, 3 order.

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

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 4 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Saturday, December 3, 1949.)