FEDERAL RESERVE ACT AMENDMENTS

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON BANKING AND CURRENCY

UNITED STATES SENATE

EIGHTY-THIRD CONGRESS

SECOND SESSION

ON

S. 3206

A BILL TO EXTEND AUTHORITY OF FEDERAL RESERVE TO PURCHASE OBLIGATIONS DIRECT FROM TREASURY

AND

S. 3268

A BILL TO REPEAL PROVISIONS WHICH PROHIBIT A FEDERAL RESERVE BANK FROM PAYING OUT NOTES OF ANOTHER FEDERAL RESERVE BANK

MAY 13, 1954

Printed for the use of the Committee on Banking and Currency

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FEDERAL RESERVE ACT AMENDMENTS

THURSDAY, MAY 13, 1954

UNITED STATES SENATE,
SUBCOMMITTEE ON FEDERAL RESERVE MATTERS OF THE
BANKING AND CURRENCY COMMITTEE,
Washington, D. C.

The subcommittee met, pursuant to call, at 10:15 a. m., room 301, Senate Office Building, Senator John W. Bricker (chairman) presiding.

Present: Senator Bricker.

Senator BRICKER. The subcommittee will come to order. There are two bills before us. They were requested bills. They are S. 3206 and S. 3268. Without objection, the bills will be made a part of the record.

(The bills referred to follow:)

[S. 3206, 83d Cong. 2d sess.]

A BILL To amend section 14 (b) of the Federal Reserve Act, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14 (b) of the Federal Reserve Act, as amended (U. S. C., 1952 edition, title 12, sec. 355), is amended by striking out "July 1, 1954" and inserting in lieu thereof "July 1, 1956", and by striking out "June 30, 1954" and inserting in lieu thereof "June 30, 1956".

[S. 3268, 83d Cong. 2d sess.]

A BILL To repeal the provisions of section 16 of the Federal Reserve Act which prohibit a Federal Reserve bank from paying out notes of another Federal Reserve bank

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the third paragraph of section 16 of the Federal Reserve Act, as amended, is amended by striking out the sentences thereof which read as follows: "Whenever Federal Reserve notes issued through one Federal Reserve Bank shall be received by another Federal Reserve bank, they shall be promptly returned for credit or redemption to the Federal Reserve bank through which they were originally issued or, upon direction of such Federal Reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired. No Federal Reserve bank shall pay out notes issued through another under penalty of a tax of 10 per centum upon the face value of notes so paid out.".

Senator BRICKER. We have as witnesses this morning Mr. William McC. Martin, Mr. Randolph Burgess, and Dr. Walter E. Spahr.

At this point in the record we will insert a copy of a letter from the Secretary of the Treasury, dated March 9, 1954, addressed to the President of the Senate. Attached to that are sheets headed, Direct Purchase Authority Holdings on Special Short-Term Treasury Certificates by the Federal Reserve Banks, 1945 to Present and Direct Borrowings From Federal Reserve Banks. We also have a letter from Mr. William McC. Martin, Jr., dated March 31, 1954, addressed to the Honorable Homer E. Capehart, chairman, Committee on Banking and Currency, with enclosures. Without objection those will be made a part of the record at this point.

(The material referred to follows:)

TREASURY DEPARTMENT,
March 9, 1954.

SIR: There is transmitted herewith a draft of a proposed bill to amend section 14 (b) of the Federal Reserve Act, as amended.

The purpose of the proposed legislation is to extend for 2 years the authority of Federal Reserve banks to buy directly from the Treasury, rather than in the open market, direct obligations of the United States or obligations fully guaranteed by the United States in an amount not to exceed $5 billion held at any one time. Under the terms of the present law, the authority will expire on June 30, 1954, and a 2-year extension of the authority is considered desirable.

This direct purchase authority furnishes the Treasury an important instrument for smoothing out the effect of short-run peaks in Treasury cash receipts and disbursements so that the disturbing effect of their flow through the banking system may be held to a minimum. Also, the Treasury, if the direct purchase authority did not exist, would be required to maintain larger cash balances than is now the case in order to meet unanticipated redemptions of public debt obligations on demand and without notice at the option of the owner or other large cash outlays of which the Treasury has not received previous notice.

While the authority is used only occasionally, it represents an essential fiscal mechanism to the Treasury in handling the distribution and utilization of its cash balances and holding them to a minimum. Any borrowing under the authority would, of course, continue to be subject to the statutory public debt limit.

There is attached a table showing the holdings by the Federal Reserve banks under the direct purchase authority from 1945 to the present time. There is also enclosed a comparative print showing the changes the proposed bill would make in existing law.

It is respectfully requested that you lay the proposed bill before the Senate. A similar bill has been transmitted to the Speaker of the House of Representatives.

The Department has been advised by the Bureau of the Budget that there is no objection to the submission of this proposed legislation to the Congress.

Very truly yours,

G. M. HUMPHREY,
Secretary of the Treasury.

The PRESIDENT OF THE SENATE.

Direct purchase authority holdings of special short-term Treasury certificates by the Federal Reserve banks, 1945 to present

1945:	
Mar. 15	$4, 000, 000
Dec. 4	107, 000, 000
Dec. 5	318, 000, 000
Dec. 6	374, 000, 000
Dec. 7	484, 000, 000
Dec. 8	484, 000, 000
Dec. 9 [1]	484, 000, 000
Dec. 10	202, 000, 000
1946	None
1947	None
1948	None
1949:	
June 15	220, 000, 000
June 16	127, 000, 000
1950:	
Mar. 15	108, 000, 000
June 15	105, 000, 000
1951:	
June 1	100, 000. 000
June 2	100, 000, 000
June 3 [1]	100, 000, 000
Dec. 17	320, 000, 000
1952:	
Jan. 22	55, 000, 000
Jan. 23	22, 000, 000
Mar. 17	811, 000, 000
Mar. 18	442, 000, 000
Mar. 19	311, 000, 000
Mar. 20	338, 000, 000
Mar. 21	338, 000, 000
Mar. 22	338, 000, 000
Mar. 23 [1]	338, 000, 000
Mar. 24	189, 000, 000
Mar. 25	170, 000, 000
Mar. 26	14, 000, 000
Mar. 27	123, 000, 000
June 16	472, 000, 000
June 17	536, 000, 000
June 18	413, 000, 000
June 19	249, 000, 000
June 20	231, 000, 000
June 21	170, 000, 000
June 22 [1]	170, 000, 000
June 23	74, 000, 000
June 24	47, 000, 000
Sept. 15	103, 000, 000
Sept. 16	257, 000, 000
Sept. 17	221, 000, 000
Sept. 18	242, 000, 000
1952—Continued	
Sept. 19	$134, 000, 000
Sept. 20	134, 000, 000
Sept. 21 [1]	134, 000, 000
Sept. 22	6, 000, 000
1953:	
Mar. 18	110, 000, 000
Mar. 19	104, 000, 000
Mar. 20	189, 000, 000
Mar. 21	189, 000, 000
Mar. 22 [1]	189, 000, 000
Mar. 23	333, 000, 000
Mar. 24	186, 000, 000
Mar. 25	63, 000, 000
Mar. 26	49, 000, 000
June 5	196, 000, 000
June 6	196, 000, 000
June 7 [1]	196, 000, 000
June 8	374, 000, 000
June 9	491, 000, 000
June 10	451, 000, 000
June 11	358, 000, 000
June 12	506, 000, 000
June 13	506, 000, 000
June 14 [1]	506, 000, 000
June 15	999, 000, 000
June 16	1, 172, 000, 000
June 17	823, 000, 000
June 18	364, 000, 000
June 19	992, 000, 000
June 20	992, 000, 000
June 21 [1]	992, 000, 000
June 22	908, 000, 000
June 23	608, 000, 000
June 24	296, 000, 000
1954:	
Jan. 14	22, 000, 000
Jan. 15	169, 000, 000
Jan. 16	169, 000, 000
Jan. 17 [1]	169, 000, 000
Jan. 18	323, 000, 000
Jan. 19	424, 000, 000
Jan. 20	323, 000, 000
Jan. 21	306, 000, 000
Jan. 22	283, 000, 000
Jan. 23	283, 000, 000
Jan. 24 [1]	283, 000, 000
Jan. 25	203, 000, 000
Jan. 26	3, 000, 000

[1] Sunday.

Direct borrowing from Federal Reserve banks (certificates of indebtedness special series bearing interest at the rate of ¼ of 1 percent per annum)

[In millions]

Date	Amount borrowed	Amount retired	Balance
Total from 1942 to 1951	$5,388	$5,388	
1952—Jan. 22	55		$55
Jan. 23		33	22
Jan. 24		22	
Mar. 17	811		811
Mar. 18		369	442
Mar. 19		131	311
Mar. 20	27		338
Mar. 21			338
Mar. 22			338
Mar. 23 [1]			338
Mar. 24		149	189
Mar. 25		19	170
Mar. 26		156	14
Mar. 27	109		123
Mar. 28		123	
June 16	472		472
June 17	64		536
June 18		123	413
June 19		164	249
June 20		18	231
June 21		61	170
June 22 [1]			170
June 23		96	74
June 24		27	47
June 25		47	
Sept. 15	103		103
Sept. 16	154		257
Sept. 17		36	221
Sept. 18	21		242
Sept. 19		108	134
Sept. 20			134
Sept. 21 [1]			134
Sept. 22		128	6
Sept. 23		6	
1953—Mar. 18	110		110
Mar. 19		6	104
Mar. 20	85		189
Mar. 21			189
Mar. 22 [1]			189
Mar. 23	144		333
Mar. 24		147	186
1953—Mar. 25		$123	$63
Mar. 26		14	49
Mar. 27		49	
June 5	$196		196
June 6			196
June 7 [1]			196
June 8	178		374
June 9	117		491
June 10		40	451
June 11		93	358
June 12	148		506
June 13			506
June 14 [1]			506
June 15	493		999
June 16	173		1,172
June 17		349	823
June 18		459	364
June 19	628		992
June 20			992
June 21 [1]			992
June 22		84	908
June 23		300	608
June 24		312	296
June 25		296	
1954—Jan. 14	22		22
Jan. 15	147		169
Jan. 16			169
Jan. 17 [1]			169
Jan. 18	154		323
Jan. 19	101		424
Jan. 20		101	323
Jan. 21		17	306
Jan. 22		23	283
Jan. 23			283
Jan. 24 [1]			283
Jan. 25		80	203
Jan. 26		200	3
Jan. 27		3	
Mar. 15	134		134
Mar. 16	56		190
May. 17		190	
Total to date	10,090	10,090	

[1] Sunday.

Public Law 405, approved June 23, 1952, extends until July 1, 1954, the authority granted Federal Reserve banks to buy Government securities directly from the Treasury Department.

NOTE.—These figures are net. During the period prior to June 15, 1943, it was the custom for the Treasury to take up a security daily and to issue a new security for either the increased or decreased amount as the case may be. The reason for stating on a net basis is to avoid a padding of the figures due to this method of handling the account.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Washington, March 31, 1954.

The Honorable HOMER E. CAPEHART,
Chairman, Committee on Banking and Currency,
United States Senate, Washington 25, D. C.

MY DEAR MR. CHAIRMAN: The Board of Governors of the Federal Reserve System respectfully recommends the repeal of those provisions of the third paragraph of section 16 of the Federal Reserve Act (12 U. S. C. 413) which prohibit a Federal Reserve bank from paying out Federal Reserve notes issued by another Federal Reserve bank. For the consideration of your committee, there is enclosed a draft of a bill which would accomplish this purpose.

The provisions in question were enacted as a part of the original Federal Reserve Act (and amended in 1917) for purposes which are briefly described in the enclosed memorandum. Experience over the years, however, has shown that these requirements do not contribute to the accomplishment of the objectives for which they were intended, and that they serve no useful purpose.

The cost of sorting "fit" Federal Reserve notes according to the banks of issue and of shipping such notes from one Reserve bank to another is estimated to exceed $750,000 a year. The repeal of the provisions in question would eliminate this valueless expenditure.

A similar letter is being sent to the chairman of the Committee on Banking and Currency of the House of Representatives.

The Budget Bureau advises that it has no objection to the submission of this proposal.

Sincerely yours,

WM. McC. MARTIN, Jr.

MEMORANDUM ON PROPOSED AMENDMENT OF THE FEDERAL RESERVE ACT TO PERMIT EACH FEDERAL RESERVE BANK TO PAY OUT CURRENCY ISSUED BY OTHER FEDERAL RESERVE BANKS

The third paragraph of section 16 of the Federal Reserve Act (12 U. S. C. 413) provides that "Whenever Federal Reserve notes issued through one Federal Reserve bank shall be received by another Federal Reserve bank, they shall be promptly returned for credit or redemption to the Federal Reserve bank through which they were originally issued or, upon direction of such Federal Reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired. No Federal Reserve bank shall pay out notes issued through another under penalty of a tax of 10 per centum upon the face value of notes so paid out."

As a result of these provisions, it is necessary for each Federal Reserve bank to sort all of the millions of Federal Reserve notes fit for further circulation which are received by it from member banks, according to the Reserve bank by which each note was originally issued. In addition, it is necessary for the Reserve bank to return such notes to the Reserve banks that originally issued them.

Such sorting and crisscross shipping of currency are expensive. It is estimated that the annual cost of these activities, which would not be necessary except for the statutory provisions quoted above, is in excess of $750,000 annually.

These statutory provisions (except for one clause, not important for this purpose) were enacted in 1913 as a part of the original Federal Reserve Act, with the purpose of contributing to the adjustment of the amount of Federal Reserve notes in circulation to the requirements of business and industry. It was expected that since such notes would be issued to member banks against the rediscount of the notes of customers of such member banks, the amount of Federal Reserve notes in circulation would automatically fluctuate as borrowings by business enterprises increased or decreased in accordance with seasonal and cyclical changes in business.

Experience over the years, however, definitely indicates that the requirement for the return of fit Federal Reserve notes to the Federal Reserve banks of issue has no effect on the amount of Federal Reserve notes in circulation. The notes that are returned to the Federal Reserve banks of issue, in accordance with the requirements of the law, are again placed in circulation as demand for currency appears. Outstanding currency which is not needed by the economy is returned to the Reserve banks for credit to the reserve accounts of the member banks. In other words, the amount of currency in circulation rises and falls in accordance with changes in the demand for currency on the part of the public, and is in no way affected by the return of fit notes to the bank of issue.

From the foregoing, it appears that the restrictions upon a Federal Reserve bank's paying out currency issued by other Federal Reserve banks serve no useful purpose, and their elimination would effect a substantial reduction in the annual expenses of the Federal Reserve banks. Accordingly, the repeal of these provisions is clearly advisable.

Senator BRICKER. Mr. Martin, if you will take the stand. You have a prepared statement, I think?

STATEMENT OF WILLIAM McC. MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. MARTIN. I have, sir.

Senator BRICKER. You may proceed.

Mr. MARTIN. I am glad to have this opportunity to testify on behalf of the Board of Governors of the Federal Reserve System relative to the proposed legislation which you have before you. The Board of Governors endorses both of these proposed bills.

S. 3206 would extend for another 2 years the authority, continuously provided since 1942, of the Federal Reserve to purchase up to $5 billion of United States securities directly from the Treasury. Without this authority the Treasury and the Federal Reserve on occasions would be unable to prevent the disturbing effects on the money market of the sudden drains that occur at tax-payment periods. The use of this authority prior to tax-payment dates avoids creating unnecessary financial strains that would otherwise occur if the Treasury had to draw heavily on its accounts. Temporary Treasury borrowing through this means followed by prompt repayment from the proceeds of tax payments provides a smooth operating mechanism, without the abrupt money market fluctuations that would otherwise occur, and thus is helpful in the conduct of Federal Reserve policy. Use of this procedure as required by law is reported each year in detail in the Board's annual report. We believe that this authority, under existing safeguards, should remain available.

S. 3268 would repeal the provisions of section 16 of the Federal Reserve Act which prohibit a Federal Reserve bank from paying out notes of another Federal Reserve bank. Under present law it is necessary for each Federal Reserve bank to sort all of the millions of Federal Reserve notes fit for further circulation which are received by it from member banks, according to the Reserve bank by which each note was originally issued. In addition, it is necessary for the Reserve bank to return such notes to the Reserve banks that originally issued them

Such sorting and crisscross shipping of currency are expensive. It is estimated that the annual cost of these operations, which would not be necessary except for the statutory restriction, is in excess of $750,000 annually. The pending legislation would remove a provision of law which was thought to be important in the early days of the system but which in practice has not proved to be so.

Experience over the years definitely establishes that the requirement for the return of fit Federal Reserve notes to the Federal Reserve banks of issue has no important economic effect on the amount of Federal Reserve notes in circulation. The notes that are returned to the Federal Reserve banks of issue, in accordance with the requirements of the law, are again placed in circulation as demand for currency appears. Outstanding currency which is not needed by the economy is returned to the Reserve banks for credit to the reserve accounts of the member banks. In other words, the amount of currency in circulation rises and falls in accordance with changes in the demand for currency on the part of the public, and is in no way affected by the return of fit notes to the bank of issue. Accordingly we think no useful purpose is served by retaining the restriction upon a Federal Reserve bank's paying out of currency issued by other Federal Reserve banks. This matter has been thoroughly studied by the presidents of the Federal Reserve banks and has their approval.

Senator BRICKER. Thank you very much. I do not think there are any questions in regard to that. They are simple bills. What was the reason for the prohibition, in the first place?

Mr. MARTIN. Well, I think the idea was that we wanted to have a regional system. The theory in those days was that you would have it related directly to the operations of each individual district. I think it was a desirable safeguard. I don't want in any way to impair the regional system, the regional grouping of the system. But now that we are trying to be as economic as we can, it doesn't seem very feasible to have 2 notes in my pocket on 2 Federal Reserve banks. As long as they circulate in one given city, and don't get back to the Reserve bank, they could circulate indefinitely.

Senator BRICKER. They could circulate in any area?

Mr. MARTIN. Yes. When they get back to the Reserve bank, they have to be shipped back home again. So it just seemed to us that this was a——

Senator BRICKER. A sort of needless restriction?

Mr. MARTIN. That is right.

Senator BRICKER. Thank you very much, Mr. Martin. Mr. Burgess.

STATEMENT OF W. RANDOLPH BURGESS, DEPUTY TO THE SECRETARY OF THE TREASURY

Mr. BURGESS. Mr. Chairman, I will address my remarks to S. 3206 and appreciate the opportunity to present the Treasury's views on this bill.

I am sorry I haven't mimeographed copies of this statement. There will be some a little later for the press.

The enactment of this bill was requested by Secretary of the Treasury Humphrey in his letter to the President of the Senate, dated March 9, 1954. It has been endorsed, as you just heard, by the Board of Governors of the Federal Reserve System.

The purpose of the bill is to extend for 2 more years the authority of the Federal Reserve banks to purchase securities directly from the Treasury in an amount not to exceed $5 billion outstanding at any one time.

Under the original Federal Reserve Act, the Federal Reserve banks had authority to purchase Government obligations, either in the market or directly from the Treasury. The Banking Act of 1935 limited this authority, however, to open market transactions. In 1942, the Second War Powers Act restored the authority of the Federal Reserve banks to make purchases directly from the Treasury, up to $5 billion outstanding at any one time.

This authority, which was initially granted only through December 31, 1944, was subsequently extended by the Congress from time to time. The most recent extension was for 2 years and will expire on June 30, 1954, unless it is extended further by the Congress.

This direct purchase authority permits the Treasury, in cooperation with the Federal Reserve, to smooth out the effect on the economy of short-run peaks in its cash receipts and disbursements, especially at quarterly tax dates. These short-run peaks involve large figures. Total Treasury deposits in the month of March 1954, for example, exceeded $13 billion, of which $10 billion were concentrated in the last half of the month. Sound financial management requires that the disturbing effect of such a tremendous flow of funds be held to a minimum. This direct borrowing authority is one of the tools that the Treasury and the Federal Reserve use for this purpose.

The authority is used only occasionally and only for short periods. On March 15, 1954, for example, the Treasury borrowed $134 million from the Federal Reserve and the next day an additional $56 million. All of this was paid back on March 17, as tax receipts became available. The Treasury has never used this borrowing authority on other than a temporary basis and has no intention of doing so. When I say that, I don't mean just while we have been in power but right back to the time when it was authorized. There has been only 1 day since the end of World War II when the amount of such borrowing outstanding has exceeded $1 billion, and typically the borrowing has been repaid within 2 weeks. The attached table indicates the amounts of this borrowing since January 1952.

If the Treasury did not have this authority it would have to maintain larger cash balances in order to meet its disbursement requirements just before heavy tax receipts.

The direct borrowing authority is a useful mechanism in handling Treasury funds economically and with least economic disturbance. In addition, it provides flexibility to meet possible emergency situations.

Senator BRICKER. Thank you very much. If you will send down the written or typed copy——

Mr. BURGESS. Yes, that will be here in a few minutes, Senator.

Senator BRICKER. The material that you refer to has already been made a part of the record. Thank you very much.

(The following was received for the record:)

TREASURY DEPARTMENT,
May 21, 1954.

Hon. JOHN W. BRICKER,
Chairman, Subcommittee on Federal Reserve Matters,
Committee on Banking and Currency,
United States Senate, Washington 25, D. C.

DEAR MR. CHAIRMAN: After I had concluded my testimony regarding S. 3206 on May 13, 1954, the suggestion was made that the authority for Treasury direct borrowing at the Federal Reserve be limited to $1½ billion of 1-day certificates, since the Treasury has never used any more than that. As I pointed out in my statement to the committee, however, a very important reason for seeking continuation of the present broader authority is to give the Treasury some flexibility to cover emergency situations as they arise. The $1½ billion limit would not give that flexibility.

At a time when Federal Government receipts and expenditures are running $5 to $6 billion a month on the average, tremendous swings in the movement of funds throughout the economy are involved. The present broad direct borrowing authority is desirable to meet any emergency without carrying a much larger cash balance.

I would appreciate it if this letter could be made a part of the record.

Sincerely yours,

W. RANDOLPH BURGESS,
Deputy to the Secretary.

Senator BRICKER. Dr. Spahr, we are glad to see you again. You will testify on one or both of these bills?

STATEMENT OF WALTER E. SPAHR, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY, AND EXECUTIVE VICE PRESIDENT, ECONOMISTS' NATIONAL COMMITTEE ON MONETARY POLICY

Dr. SPAHR. Both, please.

Senator BRICKER. Please be seated.

Dr. SPAHR. Mr. Chairman, the bill, S. 3206, tends to weaken, rather than increase, the soundness of our monetary system, and, consequently, should not be passed.

It provides for direct monetization of Federal debt by a procedure that is only one step removed from issuance of fiat money.

Under the amendment of March 27, 1942, the life of which it is proposed, by S. 3206, to extend for another 2 years, the Treasury has been able to finance itself legally up to $5 billion at any time by selling its securities directly to the Federal Reserve banks at artificially low rates of interest, thus avoiding the pressures of interest rates in the open market and obtaining Federal Reserve credit in exchange for its I O U's.

May I say there, Senator, that further on in my testimony I am calling your attention to the statement by 60 members of the Commerce Committee which recommended that this provision be limited to this 1-day, so-called, or special overdrafts that I understand they have been buying, the Federal Reserve, from the Treasury from time to time. On that point, apparently the Federal Reserve Board, and the Treasury, as Mr. Burgess and Mr. Martin have pointed out, have confined their remarks to these special overdrafts.

We are in agreement and I am in agreement of the wisdom of continuing that provision. But why do they want to continue this $5 billion limit when apparently their total purchases of these special certificates have never exceeded, so far as I recall, over $1.3 billion at any one time. Everything they have said about those special certificates I personally would agree with, and our members have stated that they approve that sort of procedure. Here, however, is an opportunity to clean up an undesirable provision that was written in in 1942, which would open up the Federal Reserve banks as a dumping ground to $5 billion of any type security.

Neither Mr. Martin nor Mr. Burgess, if I heard this correctly, dealt with that topic. It is toward that point that my remarks are directed, chiefly. The cleanup does not press this provision as it is, but gets rid of everything except provision for these overdrafts, which apparently are quite desirable. So I want to make that clear as to the burden of this testimony here.

If the Federal Reserve banks are going to be opened up as a dumping ground, I should like to point out that it was by this process of direct monetization of Government debt that the German mark was driven to a level of practically zero in value during and after World War I. The history of this procedure, when employed by the central banks, provides a sad commentary on the lack of intelligence of mankind in modern times in the use of credit. The lesson is clear that no central banking system should be permitted to finance a government by converting its I O U's into currency except when, as possibly in time of invasion by an enemy, a government cannot finance its needs by taxation or by borrowing the savings of its own or other people. In such an urgent and dangerous situation, a government may be forced to use fiat money or direct monetization of government debt as a means of national survival and to count the destruction in the value of its currency as one of the costs of the war. But when a government is able to employ the proper means of financing its activities, there is no valid justification for employing fiat money or direct monetization of government debt.

Besides the fact that the $5 billion amendment should be required to expire on June 30, there is the further consideration that as the reports by the Board of Governors of the Federal Reserve System are made to Congress there is apparently no way in which Members of Congress can determine from these reports what proportion of Government securities held by Federal Reserve banks is a consequence of direct purchases.

On that point I should like to call to your attention how the table is set up in the annual report of the Board, using the last one for 1953, and referring to page 65. The heading of that table is "Federal Reserve Bank Holdings for Special Short-Term Treasury Certificates Purchased Directly From the United States, 1949 to 1953." I understand that that is all they have purchased directly, and that refers to these certificates. The caption isn't what it ought to be. It ought to say that this is all the direct purchases.

The table leaves the thought, at least to me, that perhaps there are other direct purchases which are permitted under the law that are not included in this particular table, and consequently in my judgment that table ought to have a footnote stating "This is the total of these direct purchases." That is why I make that reference that that information as it stands is not clear, at least to me. I have been informed by one of the staff members of the Board that that represents the total so far as he knows.

I should like to read as a part of my observation a statement signed by 60 monetary economists who, on March 29, 1954, urged that this $5 billion amendment be terminated. They said:

In the interests of sounder management of this Nation's monetary and fiscal affairs we, the undersigned, members of the Economists' National Committee on Monetary Policy, recommend that those provisions of section 14 of the Federal Reserve Act, which permit the Treasury, until July 1, 1954, to sell directly to the Federal Reserve banks up to $5 billion of "any bonds, notes, or other obligations of the United States or which are fully guaranteed by the United States as to principal and interest," not be renewed.

In lieu of the present authority of the Federal Reserve banks to purchase Government securities, of any type or maturity up to $5 billion, directly from the United States Treasury, and in the interest of orderly money markets, particularly during taxpaying periods, the Federal Reserve banks should be authorized to purchase from the United States Treasury so-called 1-day Treasury overdrafts. The maximum period during which these overdrafts, special certificates, might run probably should not exceed 5 days.

I understand, Mr. Chairman, that they run on the average of about 2½ or 3 days. So 5 days would probably be a safe limit; at least, the Federal Reserve authority should know how much time they actually need.

Apparently the maximum amount of such certificates which the Federal Reserve banks should hold at any one time could safely be put at $1.5 billion, judging by the common stipulations of the Federal Open Market Committee, for example in the Annual Report of the Board of Governors of the Federal Reserve System for 1948, pages 96 to 97.

As a stabilizing mechanism in the money markets and in respect to bank reserves, these Treasury overdrafts are particularly useful during quarterly taxpaying periods when tax receipts do not match Treasury outlays, as, for example, those required for the redemption of Government securities scheduled for retirement at quarterly taxpaying periods. Such limited overdraft accommodation, which is wholly consistent with the fiscal agency functions of the Federal Reserve banks performed on behalf of the United States Treasury, would in no way jeopardize the independence of the former. The establishment and firm maintenance of this independence is a basic condition for sensitive contact with the needs of the money market. Sound procedure in this respect requires termination of present practices.

That is true only if it refers to anything else other than these 1-day or special certificates, 1-day-old drafts or certificates.

The names of those who signed that statement are attached as an appendix to my observations.

As one of the signers, I should like to urge that the Senate and House follow the recommendations made in that well-considered statement.

May I repeat, if I understand the points being made by Mr. Martin and Mr. Burgess, they were dealing with these special certificates but they wanted the $5 billion limit left as it was inserted in 1942. This recommendation here, which would be mine, would be to pull that down to $1½ billion and restrict it to these special certificates.

Now, I am ready to go on to the next bill, if you are ready.

The bill, S. 3268, which proposes to remove the 10 percent tax provision of the Federal Reserve Act, section 16, designed to prevent any Federal Reserve bank from paying out Federal Reserve notes issued by other Federal Reserve banks, is unsound in principle and should not be passed.

The purpose of existing law is to provide, and properly so, one of the desirable features of a money originally designed to be responsive to the needs of business. This law, which it is proposed to repeal, tends to force Federal Reserve notes home to the issuing bank after they have been paid into Federal Reserve banks.

Repeal of that provision of existing law would remove a correct and needed provision for the return of these notes to the issuing banks.

It would convert what is in nature uncollected items into cash which each Reserve bank could then pay out as money.

As I listened to and read Mr. Martin's statement, this point that I am making here was really not dealt with.

To the degree that this were done, each Federal Reserve bank would be able to expand the volume of Federal Reserve notes in circulation without being called upon to supply the reserve and collateral now required if it issues Federal Reserve notes.

Proper pressure of reserve requirements against the issuance of Federal Reserve notes would be removed to the extent a Federal Reserve bank should pay out the notes issued by other Reserve banks.

The bill is designed to remove pressure for the retirement of these notes while all the arrangements for their expansion are left intact. This proposed legislation would weaken, rather than enhance, the soundness of our monetary system.

Senator BRICKER. Then you have appended the list of the signers of the statement?

Dr. SPAHR. Yes.

Senator BRICKER. Without objection, that will be made a part of the record.

(The material referred to follows:)

Appendix

Sixty Members Recommend That the Power of the Treasury To Sell Securities Directly to the Federal Reserve Banks Not Be Extended

John F. Adams,[1] Temple University
Charles C. Arbuthnot, Western Reserve University
John W. Beck, Oklahoma Publishing Co.
James Washington Bell, Northwestern University
Douglas H. Bellemore, Boston University
H. H. Beneke, Miami University, Oxford, Ohio
William A. Berridge, Metropolitan Life Insurance Co., New York, N. Y.
Ernest L. Bogart, New York, N. Y.
Frederick A. Bradford, Lehigh University
Cecil C. Carpenter, University of Kentucky
Arthur W. Crawford, Chevy Chase, Md.
William W. Cumberland, Ladenburg, Thalmann & Co., New York, N. Y.
Rev. Bernard W. Dempsey, S. J., St. Louis University
Raymond de Roover, Wells College
James C. Dolley, the University of Texas
William E. Dunkman, the University of Rochester
William F. Edwards, Brigham Young University
D. W. Ellsworth, E. W. Axe & Co., Inc., Tarrytown, N. Y.
Fred R. Fairchild, Yale University
Charles C. Fichtner, Buffalo, N. Y.
Major B. Foster, Alexander Hamilton Institute and New York University
Roy L. Garis, University of Southern California
Alfred P. Haake, economic consultant, Park Ridge, Ill.
E. C. Harwood, American Institute for Economic Research
Hudson B. Hastings, Yale University
Harold J. Heck, the Tulane University of Louisiana
George H. Hobart, High Point College
John Thom Holdsworth, the University of Miami
Harold Hughes, economic consultant, Fort Worth Tex.
Frederic A. Jackson, Morgan State College
Montfort Jones, the University of Pittsburgh
Donald L. Kemmerer, University of Illinois
Arthur Kemp, Claremont Men's College
J. L. Leonard, Culver City, Calif.
Edmond E. Lincoln, Wilmington, Del.
A. Wilfred May, executive editor, the Commercial and Financial Chronicle, New York, N. Y.
David H. McKinley, the Pennsylvania State College
Austin S. Murphy, Seton Hall University
Fred R. Niehaus, Stanford University
Melchior Palyi, Chicago, Ill.
Frank Parker,[1] University of Pennsylvania
Robert T. Patterson, New York University
Clyde W. Phelps, University of Southern California
Frederick G. Reuss, Goucher College
O. H. Ritter, Stockton, Calif.
Leland Rex Robinson, 76 Beaver Street, New York, N. Y.
R. G. Rodkey,[1] University of Michigan
Olin Glenn Saxon, Yale University
R. Harland Shaw, Conference of American Small Business Organizations, Chicago, Ill.
Murray W. Shields, University of Florida
Walter E. Spahr, New York University
William H. Steiner, Brooklyn College
Gilbert R. Stonesifer, Mount Union College
Charles S. Tippetts, Mercersburg Academy
James B. Trant, Louisiana State University
John V. Van Sickle, Wabash College
V. Orval Watts, economic consultant, Altadena, Calif.
Edward J. Webster, Clearwater, Fla.
G. Carl Wiegand, University of Mississippi
Edward F. Willett, F. Eberstadt & Co., New York, N. Y.

[1] With reservations.

Senator BRICKER. Thank you very much, Doctor. It is good to see you again.

Dr. SPAHR. Thank you very much.

Senator BRICKER. If there are no other witnesses on these bills, the hearing will be adjourned. I will ask the secretary if he will get to the members of the subcommittee—Mr. Bennett, Mr. Payne, Mr. Goldwater, Mr. Maybank, Mr. Robertson, and Mr. Douglas—copies of his testimony. The meeting is adjourned.

(Whereupon, at 10:40 a. m., the hearing was adjourned.)

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