DIRECT PURCHASES OF UNITED STATES OBLIGATIONS BY FEDERAL RESERVE BANKS

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY HOUSE OF REPRESENTATIVES

EIGHTY-FOURTH CONGRESS

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ON

H. R. 9285

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MONDAY, FEBRUARY 27, 1956

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 11 a. m., Hon. Brent Spence (chairman) presiding.

Present: Chairman Spence, and Messrs. Brown, Patman, Multer, Vanik, Wolcott, Talle, Kilburn, McDonough, Widnall, Betts, Mumma, McVey, and Hiestand.

The Chairman. The committee will be in order.

We will hear testimony on H. R. 9285, a bill to amend section 14 (b) of the Federal Reserve Act, so as to extend for 2 additional years the authority of Federal Reserve banks to purchase United States obligations directly from the Treasury.

(H. R. 9285 is as follows:)

[H. R. 9285, 84th Cong., 2d sess.]

A BILL To amend section 14 (b) of the Federal Reserve Act, so as to extend for two additional years the authority of Federal Reserve Banks to purchase United States obligations directly from the Treasury

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 ed., supp. II, title 12, sec. 355), is amended by striking out "July 1, 1956" and inserting in lieu thereof "July 1, 1958" and by striking out "June 30, 1956" and inserting in lieu thereof "June 30, 1958".

The Chairman. Mr. Burgess, the Under Secretary of the Treasury is here. He will be the first witness.

You may proceed as you please, Mr. Burgess.

STATEMENT OF HON. W. RANDOLPH BURGESS, UNDER SECRETARY OF THE TREASURY, ACCOMPANIED BY WILLIAM T. HEFFELFINGER, FISCAL ASSISTANT TO SECRETARY OF THE TREASURY

Secretary Burgess. Thank you, Mr. Chairman.

If it is satisfactory to you, I would like to read a very brief statement, and then I would be glad to answer any questions.

The Chairman. You may read your statement.

Secretary Burgess. I am glad to appear before you today to present the views of the Treasury Department in support of H. R. 9285. This bill would extend until June 30, 1958, the present authority of the Federal Reserve banks to purchase securities directly from the Treasury in amounts not to exceed five billion dollars outstanding at any one time.

The Treasury Department requested the enactment of this measure in its letter to the Speaker of the House of Representatives on January 24, 1956. It has been endorsed by the Board of Governors of the Federal Reserve System.

Prior to 1935, Federal Reserve banks could purchase Government obligations either in the market or directly from the Treasury. From 1935 until 1942, however, this authority was restricted to open market transactions under the Banking Act of 1935. That is, they could be purchased but only in the open market.

In 1942 the authority of the Federal Reserve banks to purchase securities directly from the Treasury was restored, but a limit of $5 billion was placed on the amount outstanding at any one time. The $5 billion authority was granted initially only through 1944, but the Congress has extended it from time to time. The present authority was granted for 2 years and expires June 30, 1956.

The primary purpose of this direct borrowing authority has been to help the Treasury and the Federal Reserve System work together in minimizing the disturbing effects on the economy of short-run peaks in Treasury cash receipts and disbursements, particularly around the time of quarterly income-tax payments. There short-run movements of funds are large, and precise estimates of their day-to-day patterns are often difficult. This direct borrowing authority is a useful mechanism for the Treasury and the Federal Reserve and its use has avoided unnecessary strains on the money market on a number of occasions.

Treasury borrowing from the Federal Reserve banks under this authority has been used infrequently and then only for short periods. The last time it was used was on March 17, 1954. That is, we didn't use it at all, all of last year. Borrowing exceeded $1 billion only rarely. A table showing the use of the direct borrowing authority since 1942 is attached.

The Treasury and the Federal Reserve have used the direct borrowing authority only to meet temporary requirements of this nature. The authority is also, however, a safeguard that could be used in the event of any sudden nationwide emergency requiring heavy cash payments from the Treasury before securities could be sold.

While it has never been necessary to use as much as $5 billion, we recommend continuation of the present $5 billion authority to give the Federal Reserve and the Treasury sufficient flexibility to cover emergency situations if they should arise. Any borrowing under the authority is, of course, subject to the statutory debt limit.

Then you have this table that shows the number of days in each one of these years that the authority was used, and the maximum amount outstanding at any one time. In 1942, for example, it was used 19 days—not continuously, but at different points; and 422 million was the largest sum. Then under the war stress, the next year, 1943, 48 days, and $1,320,000,000; 1944, none; 1945, small; then 1946, 1947, and 1948 it wasn't used at all.

(The table referred to above is as follows:)

Direct borrowing from Federal Reserve banks

Year	Days used	Maximum amount at any time (millions)	Year	Days used	Maximum amount at any time (millions)
1942	19	$422	1949	2	$220
1943	48	1,320	1950	2	108
1944	None		1951	4	320
1945	8	484	1952	30	811
1946	None		1953	29	1,172
1947	None		1954	15	424
1948	None		1955	None	

Mr. PATMAN. Mr. Chairman, I would like to ask him a question on this fourth paragraph.

The CHAIRMAN. Let him get through his statement.

Mr. PATMAN. I thought he was through.

Secretary BURGESS. The figures are before you. They show that in 1949, 1950, and 1951 it was used very little; 1952 and 1953, a little bit more. When money conditions are tight it is used more than at other times. 1954, we used it very little; 1955, none at all.

I think that completes my statement.

The CHARMAN. What are the maturities of these purchases?

Secretary BURGESS. They were usually 1 day and would mature the next day and roll over, but recently we are making them 3 days, 4 days, whatever is estimated may be required.

The CHAIRMAN. What are the interest rates?

Secretary BURGESS. The practice has been varied on that, but Mr. Heffelfinger tells me that we have used just a nominal rate of one-quarter of 1 percent.

Mr. KILBURN. May I clear one thing up that he says, Mr. Chairman?

When you say "purchased," you mean "borrowed"?

Secretary BURGESS. It is the same thing, yes.

Mr. KILBURN. What makes you say "purchase" and not "borrow"?

Secretary BURGESS. It is the same thing. It means we borrow directly from the "Federal." They buy from us a piece of paper, or note.

The CHAIRMAN. You only use it, then, when the Government's deposits are not sufficient?

Secretary BURGESS. Yes. It takes 3 or 4 days to bring the deposits in. There may be times when we suddenly find at the end of a day that the drain on us had been heavier than expected, and there isn't time to call in deposits from the banks; so we would use this facility. Usually, we plan it out ahead of time; over the tax payment period, for example, the movement of funds is very fast, and it is sometimes hard to move funds into the Reserve banks fast enough to meet the outgo.

The CHAIRMAN. What are the normal balances of the Government for its operational functions?

Secretary BURGESS. We think a comfortable normal balance is about a month's funds. That is, we are spending now at the rate of between five and six billion dollars a month, the Government expenditures.

As a prudent operation, we think we should have in the bank normally something like that amount. Actually, at the moment we are substantially below that. The last figure is about three and a half billion dollars.

The CHAIRMAN. But it is essential that these balances in the banks are near where the functions are performed, in order that the money can be disbursed promptly and properly?

Secretary BURGESS. Just like operating any business, you need a bank account to draw on for your bills.

The CHAIRMAN. I believe Mr. Eccles has contended that that ought to be a permanent authority.

Secretary BURGESS. That is a debatable matter, Mr. Chairman. I think I have appeared personally a number of times before this committee on this particular question. I have always taken the position that it is well to have a time limit on it. I believe that any operation as important as this should be reviewed periodically by this committee and by the Senate committee, just to make sure we are behaving all right. It is a good thing for us to have to come and justify our operations to you from time to time. This is one of those operations between the Treasury and the Federal Reserve where there could be an abuse, and where a review of it from time to time is a good thing.

The CHAIRMAN. As I understand, you said it hadn't been used at all in 1954 or 1955?

Secretary BURGESS. We used it in 1954 but not in 1955, Mr. Chairman. We used it for 15 days in 1954, a maximum amount of $424 million. That was the year when money was relatively easy, and there wasn't any particular occasion to use it. We try not to use it unless it is really necessary.

The CHAIRMAN. What would be the effect if you attempted to avoid selling these certificates and attempted to use the money you had in the banks?

Secretary BURGESS. We do this at times when our bank balances are pretty low, or we do it where we have a sudden need for funds that we cannot plan out in advance, or we do it where doing it this way means less strain on the money market, less putting money in and jerking it out again. You can get a very harsh effect that way if you don't watch out.

The CHAIRMAN. Would the sudden withdrawal of the funds in the banks restrict the money market?

Secretary BURGESS. That is correct.

The CHAIRMAN. This would relieve that pressure; is that correct?

Secretary BURGESS. Yes; from time to time it works out that way.

The CHAIRMAN. Mr. Patman, you have a question?

Mr. PATMAN. Yes, sir.

Mr. Burgess, this is the only instance in which the Treasury borrows directly from the Federal Reserve without their going through the open market; isn't it?

Secretary BURGESS. That is correct, Mr. Patman.

Mr. PATMAN. In other words, if you didn't do this they would have to sell the certificates to the open market and you would buy them and you would pay two brokerage fees, one when the Federal Reserve sold——

Secretary BURGESS. It would be like Treasury bills, for example. We sell them at auction, and then the Federal Reserve buys some.

Mr. PATMAN. They get a brokerage fee. What is the brokerage fee on that?

Secretary BURGESS. That all depends on how the market varies. They sell them at the market price. It is very small, indeed. We may sell them on a 240 yield basis and the Federal Reserve may buy them on a 239 yield basis.

Mr. PATMAN. This way you buy them direct. There is no brokerage fee at all?

Secretary BURGESS. That is correct.

Mr. PATMAN. You talk about the harsh effect that sudden withdrawals cause on the money market, which I am sure is correct. I am not questioning that at all. But isn't the Federal Reserve Act sufficiently broad to cover and provide against that by permitting banks to borrow by putting up Government bonds on repurchasing agreements? In other words, if a bank finds itself in need of funds for 24 hours or 2 weeks it can just pledge certain bonds, and all banks have Government bonds, to the Federal Reserve bank, and with the understanding that they will be repurchased when the need for the credit has expired. That is possible, isn't it?

Secretary BURGESS. That is possible, but the banks may be already very heavily in debt at the Federal Reserve.

Mr. PATMAN. They are not now, are they?

Secretary BURGESS. Today the banks owe the Federal Reserve nearly a billion dollars. They are heavily in debt right now.

Mr. PATMAN. You wouldn't call that heavily in debt, would you?

Secretary BURGESS. Yes, that is heavy.

Mr. PATMAN. With 159 or 160 billion dollars in deposits—of course, I am not a banker, and I don't understand it like you understand it—but just offhand a billion doesn't seem large to me.

Secretary BURGESS. It does to them, curiously enough.

Mr. PATMAN. What about 1921, along there, how much did they owe the Federal Reserve?

Secretary BURGESS. After World War I the banks owed the Federal Reserve up to about $3 billion. What happened, Mr. Congressman, in 1921, was that they wanted to get out of debt, and they restricted credit, and you had farm prices collapsing.

Mr. PATMAN. I understand what happened. In 1932 how much did they owe the Federal Reserve banks?

Secretary BURGESS. I would like to put that in the record. It was upward of a billion dollars, as I remember it.

Mr. PATMAN. Suppose you put it in over a period of years.

Secretary BURGESS. I would be delighted to do that.

(The information referred to is as follows:)

Member bank borrowings at Federal Reserve banks

[Averages of daily figures, millions of dollars]

Period	Average borrowings		Period	Average borrowings	
	Year [1]	For high month [2]		Year [1]	For high month [2]
1919	1,906	2,140	1938	9	11
1920	2,523	2,780	1939	4	8
1921	1,797	2,523	1940	3	7
1922	571	962	1941	5	12
1923	736	873	1942	5	11
1924	373	574	1943	24	90
1925	490	696	1944	135	436
1926	572	668	1945	366	632
1927	442	529	1946	215	526
1928	840	1,090	1947	156	274
1929	943	1,096	1948	140	270
1930	271	501	1949	115	176
1931	323	774	1950	106	163
1932	518	848	1951	289	657
1933	234	999	1952	780	1,593
1934	29	101	1953	768	1,347
1935	7	10	1954	147	293
1936	6	8	1955	607	1,016
1937	14	24			

[1] Prior to 1929 figures include negligible amounts of other discounts and advances.
[2] Prior to 1944 figures include negligible amounts of other discounts and advances.

Source: Board of Governors of the Federal Reserve System.

Mr. PATMAN. From 1920, we will say.

Secretary BURGESS. Yes, sir.

Mr. PATMAN. Mr. Spence, the chairman, asked you about it being necessary to have this money in the banks to pay your bills. You suggested that 1 month's supply would be desirable. Isn't it a fact, Mr. Burgess, that you don't actually draw on those banks at all to pay bills?

Secretary BURGESS. We do the equivalent .

Mr. PATMAN. I am not talking about the equivalent. Isn't it a fact that you draw on Federal Reserve banks to pay the bills of Government? That is true, isn't it?

Secretary BURGESS. We do the equivalent.

Mr. PATMAN. I am asking you a direct question. You can answer it.

Secretary BURGESS. I don't think, Mr. Congressman, that that is the important point.

Mr. PATMAN. I don't want to argue with you, and I don't want you arguing with me, if you please, sir.

Secretary BURGESS. We do not draw checks on them.

Mr. PATMAN. Let me put all the cards on the table. Isn't it a fact that you do not draw on the banks; that you try to keep from $3 to $6 million in the banks at all times, upon which the Government is receiving no interest, but is paying interest all the time, the taxpayers are, and that you do not actually draw on this money at all; that you call the banks to pay in a certain amount to their Federal Reserve banks and then when that money is paid into the Federal Reserve bank you give a check on the Federal Reserve bank; is that correct?

Mr. BURGESS. We draw checks on Federal Reserve against money we know that the banks are sending in there so it is drawn out practically the same day it comes in. That is why I say it is the equivalent of drawing on the commercial banks.

Mr. PATMAN. You got in there what you mean by equivalent, but the fact is you don't give any check on a commercial bank, do you?

Mr. BURGESS. That is correct.

Mr. PATMAN. You usually keep about $250 million in the banks of New York at all times, don't you?

Secretary BURGESS. Not at all times.

Mr. PATMAN. Practically all times, 250 to 500 million?

Secretary BURGESS. That money is turning over like a whirling dirvish, so they don't know how much they are going to have the next week. It is constantly being withdrawn and deposits are filling it up again.

Mr. PATMAN. Don't you usually give them 1 week to 3 weeks in which to pay in the amount to the Federal Reserve?

Secretary BURGESS. No, sir.

Mr. PATMAN. How much time do you give them?

Secretary BURGESS. Some of the New York banks we give 2 days.

Mr. PATMAN. If they are in distress they can get repurchasing agreements through their Federal Reserve banks on Government bonds and remove any distress that might be presently caused?

Secretary BURGESS. May I correct my answer? With the New York City banks, some of the large banks, we now have a 1-day arrangement so that we can draw more quickly. That is, one of the reasons we haven't had to exercise this authority is that we have set up this new class of depositaries, where we can move the money in and out again more rapidly.

Mr. PATMAN. Mr. Burgess, I believe in our present commercial banking system, and I believe it should be operated profitably. I don't want it to fail to make money because it wouldn't be lasting if it didn't. I want bankers to be paid, and banks to be paid for the services rendered, but don't you think that it would be better for the banks to turn in all money to the Federal Reserve banks when they get it, and so the Government can check on it, and it is available for checking, rather than holding it back and getting the benefit of it without any benefit to the Government?

Secretary BURGESS. Mr. Congressman, we tried that, in the days—they established in 1837 what they call the independent treasury in this country——

Mr. PATMAN. What year was that?

Secretary BURGESS. 1837.

Mr. PATMAN. We are talking about the last half century.

Secretary BURGESS. One of the reasons for establishing the Federal Reserve System and working out that method was that that didn't work. With the huge amounts of funds that are being handled now if you pipe that all directly into the Federal Reserve System, piped it out of the market, you would have a continuous turmoil. You would promote a banking panic. This method of depositary banks was worked out partly during World War I by the people in the Treasury who were very good people at that time, and it has been developed gradually over the years and works extremely well as a mechanism so that the huge operations of the Treasury, which, believe me, are very large taxpayment times and other times, can be carried out without disturbance to the monetary market, so that if the State of Georgia, or the State of Texas, wants to borrow some money in the market, they won't suddenly find that all the money is dried up.

Mr. PATMAN. Mr. Burgess, you state in your statement here, paragraph 4:

> The primary purpose of this direct borrowing authority has been to help the Treasury and the Federal Reserve System work together in minimizing the disturbing effects on the economy of short-run peaks in Treasury cash receipts and disbursements, particularly around the time of quarterly income-tax payments.

Although you state it was used particularly during that time, there are no limits or restrictions on its use whatsoever?

Secretary BURGESS. That is correct, except the $5 billion limit.

Mr. PATMAN. Except the $5 billion?

Secretary BURGESS. That is right.

Mr. PATMAN. That is the only restriction?

Secretary BURGESS. The only other restriction is this has to be worked out with the Federal Reserve and the Treasury, who are two groups of reasonable men.

Mr. PATMAN. They can work it out together?

Secretary BURGESS. Yes, sir.

Mr. PATMAN. There has been a lot of talk about changing the reserve requirements for the banks to make them all uniform, and what do you call the class 1 banks, the larger ones?

Secretary BURGESS. We group the banks, the group A banks, group B, and group C.

Mr. PATMAN. C are the country banks, aren't they?

Secretary BURGESS. Those are the banks we have this special arrangement with. That is the big city banks that we check in and out quickly.

Mr. PATMAN. I beg pardon?

Secretary BURGESS. Those are the largest banks. It works the other way. Group A are mostly the country banks that we only call on usually at monthly intervals, and group B are the middle size; group C are the large banks where we have this special arrangement.

Mr. PATMAN. I thought they were the other way. Now, then, on reserve requirements, how are they classed?

Secretary BURGESS. The country banks, the reserve city banks, and central reserve city banks. Country banks have the smallest reserve requirements, and so forth.

Mr. PATMAN. They have the smallest requirement for reserve. In other words, they have about how much, about seven or eight to one?

Secretary BURGESS. Twelve percent. Country banks have 12 percent.

Mr. PATMAN. That is about eight and a third to one?

Secretary BURGESS. That is right.

Mr. PATMAN. The middle-sized banks about what?

Secretary BURGESS. Eighteen percent, and the Central Reserve banks, 20 percent. All of them have 5 percent on time deposits, in addition.

Mr. PATMAN. That is fixed by the Federal Reserve.

Secretary BURGESS. They have a range for the Central Reserve city banks, a minimum of 13 percent, a maximum of 26.

Mr. PATMAN. Mr. Burgess, during the depression there was an amendment to the Federal Reserve Act which was done, I think, on the theory that it was an emergency, and for a temporary period. It certainly wasn't considered for all time to come. There was a provision that it was absolutely unlawful for national banks or banks' members of the Federal Reserve System to pay interest on demand deposits of any kind whatsoever. In other words, just unlawful to do it. It was done on the theory that during the depression banks would bid against one another for funds of counties and cities and States, and thereby jeopardize the security of the institution. That became permanent law. In view of the fact that that deprives cities and counties and different political subdivisions and States and trust funds, and others, of an opportunity to place their money in a safe place and get interest on it all the time, don't you think that should be changed?

Secretary BURGESS. Well, Mr. Congressman, I would like to differ a little on the origin of that. You remember that Senator Glass spent a great deal of time in developing two banking acts—the Banking Act of 1933 and the Banking Act of 1935, and they were based—his studies of that were, and I know because I worked some with him on it—were based on a very careful analysis of the banking troubles that we had been through, and he was seeking something more than something to do about the depression. He was seeking a fundamental reform of the American banking system, and in the Banking Act of 1935, I think it was, the Congress in its wisdom decided that banks should not pay interest on demand deposits. It was not to meet a depression, but because the Congress believed after Mr. Glass' very careful survey, Mr. Stegall's, the chairman of this committee, that it was wiser for them not to do so. Senator Glass was very concerned about one thing, about the fact that the big city banks would bid for the deposits of corresponding banks and pay too high interest, and it led to a concentration of money in the money centers.

Mr. PATMAN. Couldn't you stop that by a law without having to deny an individual or city an opportunity?

Secretary BURGESS. Then you would have to undertake to fix the interest rates that banks would pay. I think that is exactly contrary to the liberal spirit in this country, of not trying to regulate things.

Mr. PATMAN. That is right. It shouldn't be done at all, but you are doing it now. You are doing it by making it unlawful for a person even to receive interest, although the bank is able to pay it, wants to pay it, would like to pay it, but you refuse them by law the opportunity.

Secretary BURGESS. My belief is that the Congress in passing that act was very wise. I think it led to a stronger banking system. The banks were led through competition to pay undue amounts of interest. It made for a wrong concentration of funds in different places. I think it was a wise thing to change. I wouldn't change it back.

Mr. PATMAN. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Wolcott, have you anything?

Mr. Kilburn?

Mr. KILBURN. If the banks did pay interest they would have to charge more for the loan, wouldn't they?

Secretary BURGESS. That is right.

Mr. KILBURN. All the country people who borrowed would have to pay more interest?

Secretary BURGESS. A bank operates on a margin. They borrow money from one person to loan it to someone else.

Mr. PATMAN. You have to become a bird dog to get a loan.

Mr. TALLE. Mr. Chairman.

The CHAIRMAN. Mr. Talle.

Mr. TALLE. Isn't it true, Dr. Burgess, that in slack lending seasons country banks used to send their reserves to New York banks, where they could get interest on demand deposits?

Secretary BURGESS. That is right.

Mr. TALLE. The banks in New York would then lend these reserves on call.

Secretary BURGESS. That is correct.

Mr. TALLE. If some broker who had borrowed on call got notice that his loan was called he would have to go to some other bank and get the money with which to pay his debt to the first bank?

Secretary BURGESS. That is right.

Mr. TALLE. Suppose he couldn't get it there, and suppose this became general among brokers. Then, of course, there would be trouble because brokers would be forced to sell their stocks in order to pay their loans. Stock prices would fall, brokers would go broke, and the New York banks would be unable to return the reserve left with them by the country banks. The result would be a bank panic. That is the reason for not paying interest on demand deposits. If interest is not paid on demand deposits, these reserves do not move to the New York banks.

Secretary BURGESS. That was one of the things that Senator Glass had very much in mind, that he spoke about very frequently.

The CHAIRMAN. Are there any further questions?

Mr. MULTER. Mr. Chairman.

The CHAIRMAN. Mr. Multer.

Mr. MULTER. Have there been any purchases this year under this authority, Mr. Burgess?

Secretary BURGESS. Neither in 1955 or 1956. The last time we borrowed in this way was in the spring of 1954—March 16, 1954.

Mr. MULTER. Mr. Burgess, I am right, am I not, that there has been no change in the basic law in the last 5 years as to the general overall authority of the Treasury Department, and the general overall authority of the Federal Reserve System?

Secretary BURGESS. I think that is correct, Mr. Multer.

Mr. MULTER. They both continue independently of one another?

Mr. BURGESS. That is right.

Mr. MULTER. The Treasury Department is still an independent agency within the Executive Department, and the Federal Reserve Board is still set up as part of the Federal Reserve System, and in accordance with the law making it responsible to Congress?

Secretary BURGESS. That is correct.

Mr. MULTER. I recall that there was a lot of newspaper talk and headlines about the very close relationship and operation of the Federal Reserve Board and the Treasury Department prior to the end of 1952—during 1951 and 1952. They were working very closely together almost to the extent that they did nothing except by agreement between each other. Am I summarizing the newspaper headlines that time?

Secretary BURGESS. That isn't exactly as I would record the history, Mr. Multer. There was a great improvement. There had been prior to the spring of 1951 a very bad situation existing there, where the Treasury and the Federal Reserve were operating at cross-purposes. In the spring of 1951 they reached what was called an accord, and which recognized more fully that they must have a certain amount of independence of action.

These things are natural. During the war the Central Bank gets subordinated to the Treasury, and you get into the habit of operating in a certain way, the Treasury dominating. That was just continued on too long after the war, but in 1951 they got away from it a good deal. Mr. Martin came out of the Treasury and went over as Chairman of the Board of Governors. After that operations were very much more satisfactory, more independent, more in harmony. I wouldn't say that a complete job was done, because the Treasury still, I think, put a good deal of pressure on the Federal Reserve System with respect to rates. They still put out some issues of securities that required very heavy support by the Federal Reserve System.

May I put it that since that time there have been increasingly satisfactory relations between the Federal Reserve and the Treasury.

Mr. MULTER. I think you and Secretary Humphrey certainly are favorably disposed to there being an accord and an understanding between the Treasury Department and the Federal Reserve Board in their operations, and that they should not work at cross-purposes.

Secretary BURGESS. Yes. Senator Douglas used an expression 2 or 3 years ago, that "Good fences make good neighbors." We believe in having good relationships, we believe in respecting each other's respective responsibilities.

Mr. MULTER. Would you say that today there are no pressures being exerted by the Treasury Department on the Federal Reserve Board as to its operations?

Secretary BURGESS. Senator Humphrey commented on that before the Joint Committee on the Economic Report. We both operate in a common field; we both have an influence on the money situation. We are both dealing with the effects that money has on the welfare of the American people. We both naturally express our views on this point. We tell the Federal Reserve what we think; they tell us what they think. Now, if that is pressure, then we have pressure. I think it is our duty to tell each other, and tell each other just as vigorously as we want to. Then it is the duty of each agency to act as the law gives it the responsibility.

That is the situation. Some people might interpret that as pressure. I interpret it as a fulfillment of the proper function of the two agencies.

Mr. WOLCOTT. Mr. Multer, might it also be interpreted as interpleading?

Mr. MULTER. Pleading; yes. I don't know whether we would call it interpleading in the legal sense—probably in the colloquial sense certainly it is interpleading.

Incidentally, I am not critical of that being done.

Secretary BURGESS. I am delighted you asked the question.

Mr. MULTER. I was critical of those who criticized that being done over the years, and I thought maybe this was a good time to clear up the atmosphere in that regard, lest somebody come in now and start attacking the Federal Reserve Board or Treasury, or both, because they are trying to work together. I don't think you can work in a vacuum, either of you. I think you must cooperate together.

Secretary BURGESS. I am glad you gave me the opportunity to make a statement on it, because I agree with you.

Mr. MULTER. Treasury does consult with the Federal Reserve Board as to what rate should be fixed in connection with the new issues?

Secretary BURGESS. Not only that, but as to the whole character of the new issues, and my responsibility is particularly to deal with that. We will ask the Board before every issue, "Will this program of ours interfere in any way with your fulfilling your proper responsibility? I think every issue we have had since I have been in this office we have made that inquiry.

Mr. MULTER. That necessarily encompasses not only the interest rate, but the amount of the flotation and maturity?

Secretary BURGESS. Yes.

Mr. MULTER. Does the Federal Reserve Board consult with the Treasury as to the reserve requirements or proposed changes in reserve requirements?

Secretary BURGESS. Yes, sir.

Mr. MULTER. Also about the discount rate and any change in the discount rate?

Secretary BURGESS. I think they don't make any important policy move before discussing it in advance, because it will affect our market, our program as well.

Mr. MULTER. I think Treasury did issue a financing late in December of 1955?

Secretary BURGESS. That is right.

Mr. MULTER. That was also after you consulted back and forth and decided between you as to what would be the best way to handle it?

Secretary BURGESS. That is right.

Mr. MULTER. Is it fair to say that you ran into some difficulty in disposing of that issue to the public?

Secretary BURGESS. That is right. The market was very tight. The Federal Reserve had raised its discount rate about 10 days before that. There was apprehension about the money situation. People thought it might get tighter, so that the issue didn't go very well at first, and the Federal Reserve jumped in and bought a few, and that gave the market a little more courage and everything worked out pretty well.

Mr. MULTER. So even where you do consult in advance and decide between yourselves on what you think would be the best procedure, sometimes market conditions are such that you just haven't guessed right, or something goes wrong, and you must review the whole situation all over again?

Secretary BURGESS. The money market, Government securities markets, are like everything else. Anybody who is smart enough to predict in advance just what is going to happen, he wouldn't be serving the public. He would be retired to some pleasant island and living on his income.

Mr. MULTER. Thank you, sir.

The CHAIRMAN. Any further questions?

You think this power is essential and as I understand it you will not use it any more than is necessary?

Secretary BURGESS. That is right, Mr. Chairman. I think there is one additional factor referred to as the possible use in emergencies. There may be times, and I always dislike to contemplate them, there might be times when the Congress wasn't in session, or when the money market was very badly disrupted, when it would be very important to be able to borrow directly for a few days.

Mr. MULTER. One other matter, Mr. Chairman, please. Would it have been possible to have used any of the stabilization funds or accounts that the Treasury can draw upon in order to avoid the necessity of the Federal Reserve buying them up or coming into the market?

Secretary BURGESS. We don't have many stabilization funds. We have one that has about $300 million in it. We have used that from time to time. This incident in December was a case where our bank balances were pretty low, and even the stabilization fund, when you use that, you have to use your bank balances in the Federal Reserve bank, so that we didn't have the resources to throw into the breach very easily, without upsetting things.

Mr. MULTER. Thank you.

Secretary BURGESS. This incident could really be exaggerated. It really wasn't a very big affair. When we see a little uneasiness in the market, a little apprehension, a little disturbance, we try to get ahead of it and not let it grow into something that might cause disturbance.

Mr. MULTER. What was the total amount of that issue?

Secretary BURGESS. Twelve billion, but the Federal Reserve had about half of it as I remember—$12,215,000,000 was the total issue.

Mr. MULTER. Thank you, Mr. Chairman.

The CHAIRMAN. Well, Mr. Burgess, it is always very pleasant to the chairman to hear you, and I am sure the rest of the committee has the same sentiment.

We are glad to have your views. We hope you will come back often.

Secretary BURGESS. It is always a pleasure for me to come before this committee.

Mr. MUMMA. The same for the foot of the table.

The CHAIRMAN. The committee will adjourn to meet Wednesday at 10 o'clock.

(Whereupon, at 11:50 a. m., the committee adjourned to Wednesday, February 29, 1956, at 10 a. m.)

DIRECT PURCHASES OF UNITED STATES OBLIGATIONS BY FEDERAL RESERVE BANKS

WEDNESDAY, FEBRUARY 29, 1956

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 10 a. m., the Honorable Brent Spence, chairman, presiding.

Present: Chairman Spence (presiding), and Messrs. Brown, Patman, Multer, O'Hara, Mrs. Sullivan, Mr. Reuss, Mrs. Griffiths, Messrs. Vanik, Holland, Healey, Wolcott, Talle, Kilburn, Widnall, Betts, Mumma, McVey, and Hiestand.

The Chairman. The committee will be in order, and we will resume hearings on H. R. 9285.

We have with us this morning the Honorable William McChesney Martin, Chairman of the Board of Governors of the Federal Reserve System. We are always glad to hear you, Mr. Martin, and you may proceed as you desire. If you have a statement you may read it without interruption and then submit yourself to interrogation, if you will.

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

Mr. Martin. Thank you, Mr. Chairman. I have a prepared statement which I would like to read.

The legislation to which my testimony is directed, namely H. R. 9285, would extend for another 2 years the authority of the Federal Reserve System to purchase up to $5 billion of special securities directly from the Treasury.

This is an operating convenience under which the borrowing is always of a strictly temporary nature and occurs primarily in tax payment periods. The authority has made it possible around such times for the Treasury to bridge temporary gaps between the Treasury's payment needs and its tax receipts, and in this way to smooth out some of the uneven flows of funds through the banking system and the money market that would otherwise result from the Treasury's operations.

Avoidance, through this method of Treasury borrowing, of the sharp strains on the banking system that would otherwise arise from sudden drains on the Treasury's accounts with banks is equally as helpful to the Federal Reserve in carrying out its parallel responsibilities in the field of monetary and credit policy as it is to the Treasury in administering its fiscal responsibilities effectively.

It should be noted that the authority which this legislation would continue requires that the details of all transactions directly with the Treasury be reported in the Annual Report of the Board of Governors. I should also like to add that such borrowing, when it is outstanding, is reported separately in the weekly statement of condition of Federal Reserve banks.

Attached to my statement is a table showing such direct purchases from the Treasury, 1942 to date. The table shows that the use of the privilege has been limited. Last year, it was possible for the Treasury to avoid such borrowing entirely. While such borrowing should be only on a temporary basis and should not be used to meet the permanent financing needs of the Treasury, situations will arise from time to time when such direct borrowing, under existing safeguards, is appropriate and helpful to the orderly functioning of the financial mechanism. The Board of Governors, accordingly, endorses the proposed legislation and recommends its enactment.

I have attached, Mr. Chairman, a table which shows the use which has been made of this power since 1942.

(The table referred to is as follows:)

Federal Reserve bank holdings of special short-term Treasury certificates purchased directly from the United States, 1942–February 1956 [1]

[In millions of dollars]

Date	Amount	Date	Amount
1942—June 16	58	1951—June 1	100
June 19	70	June 2	100
June 20	47	June 3 [2]	100
June 21 [2]	47	Dec. 17	320
June 22	34	1952—Jan. 22	55
June 23	94	Jan. 23	22
Sept. 15	324	Mar. 17	811
Sept. 16	189	Mar. 18	442
Sept. 17	286	Mar. 19	311
Sept. 18	76	Mar. 20	338
Sept. 19	53	Mar. 21	338
Sept. 20 [2]	53	Mar. 22	338
Nov. 27	139	Mar. 23 [2]	338
Nov. 28	329	Mar. 24	189
Nov. 29 [2]	329	Mar. 25	170
Nov. 30	422	Mar. 26	14
Dec. 1	98	Mar. 27	123
Dec. 10	16	June 16	472
Dec. 15	145	June 17	536
1943—Jan. 29	115	June 18	413
Jan. 30	202	June 19	249
Jan. 31 [2]	202	June 20	231
Mar. 2	3	June 21	170
Mar. 4	174	June 22 [2]	170
Mar. 5	354	June 23	74
Mar. 6	543	June 24	47
Mar. 7 [2]	543	Sept. 15	103
Mar. 8	591	Sept. 16	257
Mar. 9	648	Sept. 17	221
Mar. 10	632	Sept. 18	242
Mar. 11	790	Sept. 19	134
Mar. 12	940	Sept. 20	134
Mar. 13	1,043	Sept. 21 [2]	134
Mar. 14 [2]	1,043	Sept. 22	6
Mar. 15	1,302	1953—Mar. 18	110
Mar. 16	1,250	Mar. 19	104
Mar. 17	981	Mar. 20	189
Mar. 18	836	Mar. 21	189
Mar. 19	778	Mar. 22 [2]	189
Mar. 20	768	Mar. 23	333
Mar. 21	768	Mar. 24	186
Mar. 22	603	Mar. 25	63
Mar. 23	700	Mar. 26	49
Mar. 24	512	June 5	196
Mar. 25	432	June 6	196
Mar. 26	384	June 7 [2]	196
Mar. 27	304	June 8	374
Mar. 28 [2]	304	June 9	491
Mar. 29	104	June 10	451
Mar. 30	40	June 11	358
June 15	805	June 12	506
June 16	659	June 13	506
June 17	350	June 14 [2]	506
June 18	256	June 15	999
June 19	212	June 16	1,172
June 20 [2]	212	June 17	823
Sept. 8	11	June 18	364
Sept. 9	126	June 19	992
Sept. 10	243	June 20	992
Sept. 11	246	June 21 [2]	992
Sept. 12 [2]	246	June 22	908
Sept. 13	214	June 23	608
Sept. 14	179	June 24	296
Sept. 15	424	1954—Jan. 14	22
Sept. 16	258	Jan. 15	169
1945—Mar. 15	4	Jan. 16	169
Dec. 4	107	Jan. 17 [2]	169
Dec. 5	318	Jan. 18	323
Dec. 6	374	Jan. 19	424
Dec. 7	484	Jan. 20	323
Dec. 8	484	Jan. 21	306
Dec. 9 [2]	484	Jan. 22	283
Dec. 10	202	Jan. 23	283
1950—June 15	220	Jan. 24 [2]	283
June 16	127	Jan. 25	203
1950—Mar. 15	108	Jan. 26	3
June 15	105	Mar. 15	134
		Mar. 16	190

[1] The power of the Federal Reserve Banks to purchase securities direct from the U. S. Treasury was restored by the Second War Powers Act, approved Mar. 27, 1942. There were no issues during the years 1944, 1946, 1947, 1948, and 1955. Interest rate ¼ percent throughout.

[2] Sunday or holiday.

The CHAIRMAN. How much has this authority been used in the last 3 or 4 years?

Mr. MARTIN. It wasn't used at all last year, Mr. Chairman, and in 1954—March 16, 1954, was the last time that it was used. It was used twice in 1954.

The CHAIRMAN. What is the average length of maturities of the certificates?

Mr. MARTIN. Well, there was one instance, a number of years ago, where it went as long as 25-odd days. Most of the time it has been limited to a few days. That was during the wartime period that we did have the lengthy maturity.

The CHAIRMAN. Before 1935, as I understand it, that authority existed generally, didn't it?

Mr. MARTIN. Yes, sir; that is correct, sir.

The CHAIRMAN. Then from 1935 to 1942, it was repealed?

Mr. MARTIN. That is right.

The CHAIRMAN. And from 1942 to the present time it has been in existence?

Mr. MARTIN. Yes, sir; and it has been particularly useful because of the enormous flows of funds they began to meet when thereafter tax dates coincided with periods of Treasury financing.

The CHAIRMAN. And you feel that this is a mechanism that is essential for the effective operation——

Mr. MARTIN. I think it is very, very desirable and very helpful in having an even and orderly flow of funds in the money market.

The CHAIRMAN. Are all the agencies of the Government affected in favor of this?

Mr. MARTIN. Yes, sir; I think all of them are.

The CHAIRMAN. Are there any questions?

Mr. PATMAN. Mr. Chairman.

The CHAIRMAN. Mr. Patman.

Mr. PATMAN. I notice in your statement, on page 2, you state:

> While such borrowing should be only on a temporary basis and should not be used to meet the permanent financing needs of the Treasury, situations will arise from time to time when such direct borrowing under existing safeguards, is appropriate and helpful to the orderly functioning of the financial mechanism.

I agree with the statement that you have made, it is not for the purpose of financing on a permanent basis, but there are no limitations or restrictions on the use of this credit except the $5 billion, except, of course, that it must be as a result of an agreement between the Treasury and the Board of Governors. Is that right?

Mr. MARTIN. That is right, except that we report such transactions each time. They also appear in our weekly statement.

Mr. PATMAN. I understand. Now, this is a matter that the Board of Governors passes on and not the Open Market Committee, is that correct?

Mr. MARTIN. No, this is in the Open Market Committee.

Mr. PATMAN. It is?

Mr. MARTIN. Yes, sir.

Mr. PATMAN. Why would they come in on this?

Mr. MARTIN. Because it involves the purchase of Government securities.

Mr. PATMAN. I know, but it is not in the open market. It is a direct sale.

Mr. MARTIN. Well, it is made openly.

Mr. PATMAN. I know, but it is direct between the Treasury and the Board of Governors. This is a Washington deal.

Mr. MARTIN. The open market is concerned because it affects the reserves of the banking system, and that is——

Mr. PATMAN. Well, that is the part I don't like at all. I don't see why the private bankers should have anything to say about this. This is a Government deal. This is for an emergency. The Board of Governors is composed of seven members, like yourself, confirmed for 14 years, and they represent the public interest. But the five members representing the bankers, I don't think they have the obligation that you have to represent the public interest. They are elected by the private bankers, and I don't see where they ought to have their hand in this at all. I don't see where they should have any power of decision on this matter. This is a public interest matter.

The CHAIRMAN. This power is not given to the Open Market Committee, it is given to the Federal Reserve Board.

Mr. PATMAN. That is what I thought, but he says the Open Market Committee.

Mr. MARTIN. Well, the Open Market Committee is a part of the Federal Reserve System.

Mr. PATMAN. But it is not part of the Board of Governors.

The CHAIRMAN. But the delegations to the Board of Governors of the Federal Reserve System, is it not?

Mr. PATMAN. Let's see the act. I think it may be interesting.

Mr. MARTIN. It is in the Federal Reserve Act.

Mr. PATMAN. Here it is. The act says:

> *Provided*, That notwithstanding any other provision of this act, until July 1, 1956, any bonds, notes or other obligations which are direct obligations of the United States, or which are fully guaranteed by the United States as to principal and interest, may be bought and sold without regard to securities either in the open market or directly from or to the United States, when all such purchases and sales shall be made in accordance—

and so forth—

> and the aggregate amount of such obligations acquired directly from the United States which at any one time shall not exceed $5 billion.

All right. That is under the heading section 14 (b) of the Federal Reserve Act, and that would be amended by H. R. 9285.

In section 14 it says:

> Every Federal Reserve bank shall have power.

That is the part I want to see. Do you have that, Mr. Martin?

Mr. MARTIN. Yes, I have it, Mr. Patman.

Mr. PATMAN. This is under the heading of Open Market Operations, to buy and sell—that is section 14. Where is the section which defines it?

Mr. MARTIN. Section 12 (a), Mr. Patman, is the section you want.

Mr. PATMAN. Section 12 (a)?

Mr. MARTIN. Yes.

Mr. PATMAN. That has to do with the creation of the Federal Open Market Committee and your contention is that this comes under the heading of the Federal Open Market Committee?

Mr. MARTIN. Well, page 84 of the act says:

> But all such purchases and sales shall be made in accordance with the provisions of section 12 (a) of this act.

Mr. PATMAN. Well, that puts the right under the Open Market Committee, composed of 7 of the Board of Governors, and 5 men selected by the private banks.

The CHAIRMAN. But the Open Market Committee does not make the final decision. It is made by the Board of Governors.

Mr. PATMAN. Under this they do.

Mr. MARTIN. No, it is made by the Open Market Committee, on which the Federal Reserve Board has seven members.

The CHAIRMAN. But the Federal Reserve Board has control over the Open Market Committee.

Mr. MARTIN. That is right.

The CHAIRMAN. The Open Market Committee would never make any of these purchases unless it was approved by the Federal Reserve Board; would it?

Mr. MARTIN. Well, the Federal Reserve Board actually serves on the Open Market Committee in its entirety in making these decisions. The Open Market Committee is an integral part of the Federal Reserve System.

The CHAIRMAN. But the Federal Open Market Committee is an instrument of the Federal Reserve Board, and the Federal Reserve Board has control over the Open Market Committee; does it not?

Mr. PATMAN. Oh, no.

Mr. MARTIN. It has voting control——

The CHAIRMAN. It has a control it can exercise at any time it wants to; can't it?

Mr. MARTIN. Yes, sir.

Mr. PATMAN. Well, now, listen, Mr. Chairman: You see, the Board of Governors of 7 members are only a part of the Open Market Committee. They are 7 members of the 12; is that correct?

The CHAIRMAN. Yes.

Mr. PATMAN. But they vote as a body and if only two of the Federal Reserve members vote with the private banks they have the balance of power. In other words, it is just a vote. Although the Board of Governors members voting together would control, they never vote together on major decisions, I would not think, at least I have not noticed it.

The CHAIRMAN. But the power is vested in the Board of Governors of the Federal Reserve System.

I don't think the Open Market Committee could override the decisions of the Federal Reserve Board.

Mr. PATMAN. With two members of the board of governors they could override it. We have a case in point. Last December, for example. There was a case of the Board of Governors supporting the Treasury on a security issue, and they were divided 4 to 3 on that important issue, and it is seldom that they are not divided. So you take a solid block of 5 that are selected by the private banks, voting together, and they only have to have 2 from the Board to have the power of decision.

Mr. KILBURN. Is this done by the Open Market Committee?

Mr. MARTIN. These transactions with the Treasury are effectuated by the Open Market Committee through the open market desk. They consist of Treasury obligations purchased by the Federal Reserve, just as any other Government security.

Mr. PATMAN. Could I explain how I believe it is a practice and let Mr. Martin confirm or deny this: What actually is done is the Open Market Committee buys the bonds and distributes them according to the resources of the 12 banks. That is correct, is it not?

Mr. MARTIN. Well, not these particular securities.

Mr. PATMAN. I am talking about the open market operation.

Mr. MARTIN. Yes, sir.

Mr. PATMAN. And, of course, these particular bonds, if you are correct that they come under the open market, would have to be distributed in the same way because the only way the Federal Open Market Committee can buy at all is to buy from the 12 banks, isn't it?

Mr. MARTIN. That is correct, but these securities are retired almost immediately.

Mr. PATMAN. That is the reason I say they should not come under the Federal open market, because they are not distributed to the 12 banks. But I was just trying to show in practice——

Mr. KILBURN. He is trying to answer that and I would like to hear his answer.

Mr. PATMAN. What is the reason?

Mr. MARTIN. The only reason they are not distributed is because the bookkeeping becomes quite difficult for such a short period, consequently it seemed to us that we could make the decision to distribute or not permissive. It is just a practical problem of mechanics.

Mr. PATMAN. It is a kind of a hocus-pocus deal.

Mr. MARTIN. There is no hocus-pocus in it at all.

Mr. PATMAN. There is lots of hocus-pocus in the Federal Reserve. You are always carrying gold certificates, so much. Do you actually have any gold certificates at all?

Mr. MARTIN. Oh, yes, certainly.

Mr. PATMAN. Do you have as many as you claim you have?

Mr. MARTIN. Certainly we have.

Mr. PATMAN. I am asking sincerely.

Mr. MARTIN. Of course we do.

Mr. PATMAN. Do you actually print those gold certificates?

Mr. MARTIN. We don't print them.

Mr. PATMAN. That is what I say, that is another hocus-pocus.

Mr. MARTIN. No.

Mr. PATMAN. You don't actually print them. You carry them, but you don't actually have them, do you?

Mr. MARTIN. Well, they represent gold.

Mr. PATMAN. I know they represent the bookkeeping——

Mr. KILBURN. Why don't you let the witness answer?

Mr. PATMAN. I am interrogating the witness. When I am through the gentleman can interrogate the witness.

Mr. KILBURN. I would like to hear his answer.

The CHAIRMAN. Let the witness answer.

Mr. PATMAN. I know it is not pleasant to the gentleman to hear this brought out.

Mr. KILBURN. Let him answer.

Mr. PATMAN. He can't explain it.

Mr. KILBURN. He is trying to explain it and you won't let him.

The CHAIRMAN. It seems to me it is not a question of hocus-pocus. Ask him the question and give him time to answer.

Mr. PATMAN. Do you have an answer, Mr. Martin?

Mr. MARTIN. There is no hocus-pocus involved at all, Mr. Patman. It is merely a matter of bookkeeping.

Mr. PATMAN. I know it is bookkeeping.

Mr. MARTIN. The gold has been verified on several occasions, and we don't actually want to move it around.

Mr. PATMAN. That is right. That is the reason I say it is hocus-pocus. In other words, it is phony. You don't actually distribute the bonds. The law says that you buy the bonds and distribute them. You don't do that. And then the law says that you shall have these gold certificates in these banks, and although they are certifying that they have so much in gold certificates, the certification is not correct because they don't have them. Is that right?

Mr. MARTIN. Well, no; it is a bookkeeping entry.

Mr. PATMAN. I know, but they don't actually have the certificates; do they?

Mr. MARTIN. They don't need to have the certificates.

Mr. PATMAN. I didn't say they didn't need to have them. They don't have them. So that is all phony, too. And I call a deal like that hocus-pocus.

Mr. MARTIN. Well, it is a matter of interpretation.

(The following data was later supplied by Mr. Martin:)

SUPPLEMENTARY MEMORANDUM

Before the enactment of the Gold Reserve Act of 1934, the bulk of the gold reserves of the Federal Reserve banks was held in the custody of the Treasurer of the United States for the Federal Reserve Board. The daily statement of the United States Treasury reported its liability therefor against the caption "Gold Fund, Federal Reserve Board."

The Gold Reserve Act vested in the United States title to gold coin and bullion theretofore owned by the Federal Reserve banks, and, in accordance with that act, the reserve banks received in payment therefor credits in accounts with the Treasury payable in gold certificates in such form and denominations as the Secretary of the Treasury might determine. From January 30, 1934, to June 30, 1953, the Treasury's liability for these gold certificate credits was shown in the Treasury daily statement against the caption "Gold Certificate Fund—Federal Reserve Board (or Board of Governors, Federal Reserve System)." Beginning with July 1, 1953, the daily statement has been issued in condensed form and the Treasury's liability for this gold-certificate fund is now included in the item "Gold certificates, etc." The monthly "Circulation Statement of United States Money" issued by the Treasury continues to show the amount of the gold-certificate fund separately.

In the weekly statement of condition of the Federal Reserve banks on February 29, 1956, the asset item "Gold certificates" amounting to $20,156,351,000 consists of $2,815,555,000 gold certificates held by the Federal Reserve banks and Federal Reserve agents in their own vaults and $17,340,796,000 credits on the books of the Treasury payable in gold certificates.

Mr. PATMAN. Yes, sir; that is right. That is my interpretation. Now, about these open-market operations, in practice and effect it is the same as the New York Federal Reserve Bank sending a truck down to the Bureau of Engraving and Printing and getting a million dollars' worth of Federal Reserve notes, when they get back to New York, and exchanging them for a million dollars' worth of Government securities that draw interest, and then they will distribute this million dollars' worth of Government securities to the 12 banks in proportion to their size, and the banks will hold those Government securities and draw interest when the interest is due. It is a case of exchanging one Government obligation that doesn't cost them a penny—they create it, that is what the Federal Reserve is for, to create money—and they create it out of the thin air, they get this out of the truck and exchange it for a million dollars' worth of Government bonds and they will keep the bonds and draw interest. That is, in effect, what they do in practice. They just give credit on the books of the banks, and then if people want the Federal Reserve notes, call for them, of course, they are paid out. It is all the same thing in the end, but in practice it is done through the bookkeeping operations.

Now, the reason I say this bill is wrong is the Federal Open Market Committee should not have a thing to do with it. This is a Government operation, to relieve an emergency, and it should be done by the board of governors composed of seven members here in Washington, and the Treasury Department, here in Washington. It should not go through the Federal Reserve Bank of New York at all. They should have no connection with it whatsoever. They should not have any power of decision over it. It is a matter within the Government, here in Washington, D. C.

Now up there, if you say it should go through the Open Market Committee, you are saying that Mr. Sproul, who is not selected by the Government, in the sense that a public official is to perform a public duty, he is selected by the private banks of the New York district. He is put in that job as president of the Federal Reserve Bank, and he selects the very man in his bank who performs this operation, supposedly for the Government, and that man is not paid by the Government. He is paid by the Federal Reserve Bank of New York, and Mr. Sproul is paid by the Federal Reserve Bank of New York. He is not paid by the Government either.

I think if we permit this to go on, we are just permitting the New York bankers to, in effect, have too much power and control over our monetary system. The power to make money easy or to make it dear, and I think we ought to change this bill and put this particular power solely under the Board of Governors here in Washington, D. C., and leave the Open Market Committee out of it.

The CHAIRMAN. Has this power been administered to the satisfaction of the Federal Reserve Board in accordance with its wishes?

Mr. MARTIN. Entirely, sir. We recognize the inflationary potential as Mr. Patman has pointed out, that would be there if this authority were used as a permanent financing device.

Mr. PATMAN. I didn't advocate that. I said you were right in saying it should not be used for permanent financing.

Mr. MARTIN. I recognize that. Now, I should make some comments on this question about private bankers' selection, because we have discussed this many times, Mr. Patman.

The individual reserve bank president is not a representative of the private bankers. Each of the Federal Reserve banks——

Mr. PATMAN. They are selected by the board of directors, aren't they?

Mr. MARTIN. They are selected by the board of directors, but the final validation of the man is in the power of the Federal Reserve Board.

Mr. PATMAN. You have never turned one down?

Mr. MARTIN. Mr. Patman, we have turned down a number. I have gone through this a good many times.

Mr. PATMAN. Name me one that you have turned down.

Mr. MARTIN. Well, there was one in Chicago not long ago.

Mr. PATMAN. Did you turn him down or did you just have conversations about whom you are going to select?

Mr. MARTIN. I don't think we ought to be digging up personality questions.

Mr. PATMAN. I agree with you.

Mr. MARTIN. But the fact remains that we have taken a pretty strong stand on the board and we have complete authority in the board to reject the selection of the individual reserve bank.

Mr. PATMAN. You don't pay him. He is paid by the Federal Reserve Bank in New York. He gets $60,000 a year and you get about $15,000.

Mr. MARTIN. We have complete control of the earning assets of the System. The important contribution, really, of Congress in creating the Federal Reserve Act is in the use of the word "System." It effected a merging of public and private interests in a trusteeship of the people's money under the Federal Reserve Act, which has worked effectively. The System is a human institution and from time to time perhaps changes should be made in it. We don't hold ourselves forth as perfect. But the important thing is that the Federal Reserve Act has attempted to merge into a System, representation—not control—of all the people concerned.

Now, Mr. Sproul, for example, than whom there is no finer public servant in this country, was appointed by the board of directors of the Federal Reserve Bank of New York, three of whom were elected to represent the banks, three of whom to represent the business interests—the borrowers—and three of whom are appointed by the Federal Reserve Board. He gets a 5-year term, he is recommended by the board of the New York bank to the Federal Reserve Board, and we approve him or disapprove him. That is our power. We also have control of his salary. If we want, we can withhold payment of his salary. Once he is put in, then you are depending, as you always do in management of this type, upon the integrity of the individual. He is not representing the bankers, he represents the public interest, and when he comes to the Open Market Committee he votes in terms of his own individual integrity. The board of the New York Bank agrees to have nothing to do with the Open Market operation when it meets as Directors, because this operation is set up as a separate statutory operation under the Federal Reserve Act.

Mr. PATMAN. Mr. Martin, I have heard you say before, about the division of these directors, three of them representing the banks, three the borrowers, and three of them the Government. It makes it sound mighty good. But I think that you are just expanding on the law just a little bit in your explanation.

In which section is the qualification of the directors contained? It is important in that connection because six of those directors can be, and I think invariably are, interested in banks. There are only three of them that cannot be interested in banks. They are the three that are selected by the Board of Governors, including the Federal Reserve agent, but they must be of tested, mature banking experience, which would give them a close connection with the banking fraternity.

Mr. MARTIN. Section 14, class B directors: "No director of class B shall be an officer, director, or employee of any bank."

Mr. PATMAN. I know; but it doesn't say they can't own stock in banks. That is the point I make.

Mr. MARTIN. They have in some few instances owned a little stock in banks.

Mr. PATMAN. Well, I think the "few" is an erroneous statement.

Mr. MARTIN. No; very few.

Mr. PATMAN. "No director, class B, shall be an officer, director, or employee of any bank," but they can own stock. And they do own stock. Six of them are bankers. Three of them are selected by the Board of Governors.

Mr. MARTIN. Let me point out the way these directors are developed. The ownership of stock in Federal Reserve System is not proprietorship. It is not ownership in that sense.

Mr. PATMAN. We are now talking about stock in banks, private commercial banks.

Mr. MARTIN. You are raising the point that these class B directors should be prohibited from owning any stock.

Mr. PATMAN. That is right; in other words, two-thirds of them should be prohibited from being interested in commercial banking, because they are performing a Government function. Instead of that, two-thirds of them are connected with the banks.

Mr. MARTIN. Well, in practice, very few of them had any stock.

Mr. PATMAN. Well, now, Mr. Martin, I have asked you about that before in writing, and I think the information was rather conclusive that they were the exception, those who did not own stock in banks.

Mr. MARTIN. No, I think it is just the reverse, Mr. Patman. I would have to check the record on that.

The law does not prohibit class B directors of Federal Reserve Banks from being stockholders of banks. In order to respond to the request of Mr. Patman and Mr. Multer, therefore, it was necessary to ask each Federal Reserve bank to obtain a statement from each of its class B directors of the amount of bank stock now owned and whether there had been any change in ownership during the past 3 years or since their election as directors, whichever is the shorter period.

Under the law, there are 36 class B directors of Federal Reserve banks (3 for each of the 12 banks). At the time of this inquiry there was 1 vacancy, and it was not possible to obtain the information from 2 of such directors who were on extended trips and could not be reached.

The remaining 33 class B directors own stock of banks as follows:

Sixteen own no bank stock and have owned no bank stock since their election as directors.

Eleven own less than one-half of 1 percent of the stock of any 1 bank.

Three own less than 2 percent of the stock of any 1 bank.

One owns 2⅙ percent of the stock of 1 bank (130 of 6,000 shares).

One owns 13 percent of the stock of 1 bank (3,900 of 30,000 shares).

One owns 15$\frac{6}{10}$ percent of the stock of 1 bank (312 of 2,000 shares).

Four of the directors had increased their holdings of bank stock within their term of office or the past 3 years. The increased holdings of three resulted from stock dividends or the exercise of rights in connection with an increase in capital. Only one represented an increase in proportionate ownership. None of the 17 owning bank stock has decreased his holdings since his election as director.

Mr. PATMAN. At any rate, there is no law against it. Six of them can be bankers, out of the nine.

Mr. MARTIN. Well, I don't think that a man who owns 10 shares of stock in a bank is a banker.

Mr. PATMAN. Well, suppose it is 10,000 shares. It is the same situation.

Mr. MARTIN. If it amounts to control, I agree with you, and I think we would look askance on having a class B director that had control of a bank. But I want to point out, to get back to my point about the ownership of stock in the System, the individual Reserve banks, this is a device for electing directors, and not ownership of the System.

Mr. PATMAN. I agree with you on that. The Federal Reserve banks are owned by the Government.

Mr. MARTIN. That is right.

Mr. PATMAN. You have made that plain before and there ase a lot of people keep saying the banks own the Federal Reserve System. They don't own it at all.

Mr. MARTIN. That is right.

Mr. PATMAN. It is a Government institution, owned by the United States Government.

Mr. MARTIN. That is correct. And then in the administration of it we are dealing in money and credit and naturally we have to keep in close connection with the banking community.

Mr. PATMAN. I don't think you have any trouble keeping in close contact.

Mr. MARTIN. I know you think we are in too close connection.

Mr. PATMAN. I asked Mr. Benson, who dictated the interest rates on commodity credit certificates, and the expert sitting to his right, who had charge of that, said, "Mr. Burgess of the Treasury Department told him what to charge." I think that is going on all over Washington. And, of course, the farmers have to pay that that extra charge. It is always extra when it comes from Mr. Burgess.

Mr. WOLCOTT. Will you yield?

Mr. PATMAN. Yes, sir.

Mr. WOLCOTT. I don't know, but I have some memory of the commodity credit law, and doesn't that act provide that the Commodity Credit Corporation shall charge a rate of interest agreeable to the Treasury?

Mr. PATMAN. I don't recall, but I just know that Mr. Burgess dictates it.

Mr. WOLCOTT. All right, he is the Treasury representative.

Mr. MARTIN. The only dictation he does is in accordance with the market.

Mr. PATMAN. Who fixes the market, the Federal Reserve?

Mr. MARTIN. No, Mr. Patman. We have discussed that many times.

Mr. PATMAN. You have admitted it many times.

Mr. MARTIN. No, sir.

Mr. PATMAN. The Federal Reserve makes money easy or hard——

Mr. KILBURN. Mr. Chairman, Mr. Patman is not allowing the witness to answer. I would like to hear Mr. Martin testify. Mr. Patman may know all the answers.

Mr. PATMAN. I don't know all the answers. I am perfectly willing to let him testify.

Mr. MARTIN. I would like to make a statement on the market. I have made the statement repeatedly. I am one of those who believes that the forces of the market are much more important than some people give them credit for being, and that in a free country, a free society such as we have—and all freedom is relative, we are trying to keep things orderly, but liberty is not license—that neither the Treasury nor the Federal Reserve are strong enough to ignore the forces of the market, and whenever they do they get into trouble. These forces of supply and demand, that require adjustments in terms of interest rates—that is what we mean by flexible money and credit policy—are just as important in dealing with the principles upon which the business process is developing, in their way, as are the laws of gravity. You can always get around those by creating a plane that will go up into the air. That is a force. You can ignore the laws of supply and demand by creating a subsidy. But you can't get away from them. They are with you. They have to be met. You have to pay the price for it.

Now, whenever the Treasury or the Federal Reserve tries to dictate what interest rates should be and ignore the forces of the market in a country as big and as dynamic as this country is, then they are just asking for trouble and it means that a subsidy will have to be provided at some point—usually by the Government.

Mr. Patman. To show you that the Federal Reserve does determine the market, on March 4, 1951, you had this so-called accord. Of course, the result of that was that you broke the high interest barrier and permitted Government bonds to just go up and up and up, and if you will notice, ever since that time, just get the line out of the economic indicator, that Mr. Wolcott is familiar with, because it comes from the joint committee, and you will find that from March 4, 1951, farm prices have gone down, down, down, from then until now, and that they have never ceased going down, but other prices have kept on going up, including interest rates, and, of course, the reason for it is that the Federal Reserve Board broke that barrier and permitted interest rates to increase, which ups everybody's budget. That unbalanced everybody's budget and whenever you increase the interest rates you unbalance the budgets of every corporation and utility in America, every city, every county, every State, every political subdivision, every person, firm, corporation, everybody's budget is unbalanced, and you fellows did that on March 4, 1951. That is just one instance of where the Federal Reserve can have control over the market. That is a demonstration of the control, and it is a demonstration of the devastation it brought.

Mr. Martin. Let me take the opposite position, Mr. Patman. That is a demonstration of where the Federal Reserve couldn't control the market except by creating unbridled inflation in the country.

Mr. Patman. I have heard that a lot.

Mr. Martin. The decision to unpeg the Government securities market was essentially a decision to return to the market some of the forces that it had been precluded from exercising for a period of nearly 10 years by Government policy, but we had reached the stage where we would have had to buy such unlimited amounts of Government securities, at a fixed price, so that Government securities had become interest-bearing money and not Government securities, that the business process was virtually negated and we would have had unbridled inflation.

Now, exactly what happened in that period was that people were buying mortgages without even looking at them because they knew they could get a better rate of return on them and they could pay for them by selling long-term United States bonds because they always had a call on the United States Treasury issues at par and 22/32. As long as the volume was not so large that it created a complete depreciation of the dollar, there was perhaps some justification under wartime conditions, for engaging in pegging Government security prices but when it reached that point, it had to be stopped. I am quite confident that if we had ignored those forces of the market and not let this business process of supply and demand function, the process of evaluating whether you wanted to sell a United States security at a loss in order to make this loan at a better rate of interest, that you wouldn't have gotten the stability that by and large we have had since the middle of 1951 to date.

Now, so far as farm prices are concerned, on supply and demand factors, the interest rate has been practically negligible. I would say that the farmer's credit costs have been in the nature of 5 or 6 percent.

Mr. PATMAN. I am not talking about the farmer's credit costs. I am talking about the interest rates charged by people between the farmer and the consumer, and back to the farmer on things that the farmer buys.

Mr. MARTIN. Well, I am just trying to explain why I think the policies we pursued generally have been of help to the farmer.

Mr. PATMAN. They certainly haven't helped him in our part of the country.

Mr. MARTIN. His problem as we see it is a cost problem, and we have regretted very much that any stability has occurred by a decline in farm prices and a rise in industrial prices. That is the gap. But it is the 95 percent of his costs represented by prices of nonfarm commodities is what we have been directing our attention to in the last year in following a modestly restrictive policy in terms of the market, and that has been of more help to the farmer, to keep that disparity, that gulf, from widening, than almost anything I can think of.

Mr. PATMAN. But the farmer hasn't been helped by it.

Mr. MARTIN. Money and credit policy cannot make up for the supply and demand factors in the market. If there is a greater supply of wheat, there is no lack of money to buy wheat. That isn't something that money and credit policy can attack, and we must recognize what the limitations of money and credit policy are and what their responsibilities are.

It seems to me that the closer we keep to a flexible money and credit policy, the best chance we have of equilibrating the economy and getting the stability which will lead to a higher standard of living that we are all seeking, and as I have said to you repeatedly, you and I are in complete agreement as to our goals, we differ a little bit as to the methods of getting there.

Mr. PATMAN. Well, the effect has demonstrated that I was right, Mr. Martin, because ever since March 4, 1951, the price the farmer has received has gone down, down all the time. You claim you wanted to help him. If you did, it didn't actually help him because it has kept on going down.

My interpretation of what that meant was giving to bankers and money lenders unearned interest, and increasing interest charges all over the Nation.

Since 1952, in 3 years' time, the amount received by people who extend loans has increased $4 billion in interest, and during that time the farmers have lost $4 billion in net income.

Now, the reason that the interest rate, on the farmer himself, is not the determining factor—that is a very small part of it, I am not complaining about that, most farm rates to the farmer himself, when he can get a loan, are very reasonable—but the rate that hurts the farmer is when it leaves him and goes to the processor, to the manufacturer, to the transportation company, to the wholesaler, to the broker, to the distributor—it goes through about 10 people at least before it gets to the consumer.

Now, every one of those people, every one of them, can protect himself on interest rates. Interest rates have gone up. If it is one-half of 1 percent, each one of them can add it on. But the farmer cannot because he is the unprotected person. Therefore, out of 10, that 5 percent is taken out of his price, from the time he sells the commodity until it reaches the consumer.

All right. Coming back it is just the opposite. From the iron ore, to the barge that transports the ore, to the pig iron, to the steel, to the fabricator, the transporter, the processor, the distributor, on back to the farmer, and what the farmer buys in farm machinery has added on that increase in interest rate. And he pays it. He loses it going toward the consumer and pays it coming back to him.

And, of course, that means there is only one way for him to go in his economic status and that is downward all the time. And he has been going that way. The charts show it. The Government information shows it. And it will keep on going that way as long as they can pile everything on him and he is not protected.

Mr. WIDNALL. Isn't it a matter of record that the farm prices started down in 1947, not 1951?

Mr. PATMAN. No; it started in 1951, the one I am talking about. Of course, in 1947 there was a little dip, and the barrier of short-term rates was broken, too. You know Mr. Burgess organized that public-debt committee, and they commenced working on the Federal Reserve Board to break that barrier on the three-eighths of 1 percent. They didn't like that. And then finally broke it and that rate began to move up, about 1947, and that is where the farmer slipped a little, too. The gentleman is correct.

But that didn't mean so much until 1951 when they broke all the barriers. That is when it meant so much.

Mr. WOLCOTT. Will you yield?

Mr. PATMAN. I yield.

Mr. WOLCOTT. There is an implication behind what you say that the increase, if there has been one in interest rates, has had quite a material effect upon the cost of living. You have mentioned the fact that I am supposed to know all the charts and lines of the Joint Economic Committee. I remember one of them very, very well, that since the accord, in March 1951, the economy has been notably stable. Since 1953, the economy has been just about as stable as we can possibly get it.

As I recall those figures which you call to my attention and say that I should know, the cost of living index in 1953 was 114.4. The cost of living index in December 1955 was 114.7. There has been a variation of three-tenths of 1 percent in the cost of living in the last 3 years.

Mr. PATMAN. That is right.

Mr. WOLCOTT. I think this accord, if it is due to the accord between the Federal Reserve and the Treasury, somebody somewhere along the line, has done the very best job that could possibly be done in keeping the economy as stable as that, and for 3 years, until the latter part of the summer or early fall of 1955, there hadn't been a variation of more than 2 percent. I think at the present time it shows a variation of three-tenths of 1 percent. What can be better than that? Do you know of any country that has done a better job of stabilizing its economy?

Mr. PATMAN. The gentleman is exactly correct, except in his conclusions. He has been lulled asleep. He has been lulled asleep on what was happening. I want to tell him what has been happening. Every time interest rates went up, farm prices went down. That kept the economy stable. Every time automobiles went up, farm prices went down.

Mr. WOLCOTT. Mr. Patman——

Mr. PATMAN. Just a minute. You have made your statement and I want to answer you.

Mr. WOLCOTT. I am not through.

Mr. PATMAN. All right.

Mr. WOLCOTT. I want to also call attention to the fact that if you refer to those indices, you will find that employment, on the farms, up to the seasonal decline in December 1955, was at an all-time high. Now, where are the farmers getting the money to employ the labor on the farms? I don't know. I think that should be recognized.

Mr. PATMAN. You have brought up a good point.

Mr. WOLCOTT. I hoped that you would reconcile that with Secretary Benson yesterday, but you didn't.

Mr. PATMAN. He is not the only one who has been misled on that deal. He has brought up a good point. I am glad he mentioned it.

He is exactly right about the index. It looks wonderful. But let me show you the fallacies in it. You have taken all this out of the hide of the farmer.

Mr. WOLCOTT. I have taken it out of the hide of the gentleman from Texas.

Mr. PATMAN. No, the increase in interest rate would have caused the cost of living to go up, but farm prices went down. That kept it stable. As automobile prices went up that would have upset the cost of living. But farm prices went down as much and that left the cost of living index stable. As steel prices went up, when the steel companies were producing only 70 percent of capacity, they arbitrarily increased the price of steel $3 a ton. As steel prices went up, that would have upset the cost of living, but farm prices went down enough to where the cost of living kept on an even keel.

So that is true, that the cost of living index has remained about the same, but it is taken out of the hide of the farmers, every bit of it.

Mr. WOLCOTT. Now, may I tell you your fallacies. You and I had a very interesting experience—you had it, I wasn't there very long—on automation. I think we conclude in the report that there have been tremendous technological advances in the last few years, and the costs of production generally have been decreased, because of automation and technological advances.

Now, I assume that these technological advances, in this automation which you and I have studied, have been beneficial to the farmers as well as to anyone else, and perhaps the farmers are getting money somewhere to buy automobiles, there are more automobiles on the roads now than ever before, and they must be buying automobiles. I don't know where they are getting the money. You don't either.

Mr. PATMAN. I know where they are getting it. There are two kinds of farmers. One kind is getting it and the other is not. There are factory-type farmers, kind of a manufacturing-type farmer, and what they call the efficient farm system, and there is a family-type farmer, and then there is a mode of life farmer. These mode of life farmers represent about one-third of the farmers of the country. They are the kind who have done about as much toward our economy as any other group in America, but they have been neglected.

Mr. WOLCOTT. Mr. Benson's statement yesterday was to the effect that when he first took office most of the complaints were made by a group of farmers out in California, who were complaining about farm prices, and the income from the farm. Investigation showed that about 90 percent of these farmers were doctors and lawyers who were farming as an avocation.

Mr. PATMAN. That is right. You see, they are the fellows who bought into the cattle business.

Mr. KILBURN. I think these problems will be solved all right because the President has just announced he is going to run.

Mr. PATMAN. Has announced or——

Mr. KILBURN. It just came over the radio.

The CHAIRMAN. I think the farmers are in bad shape, because the farmers in my State tell me they are in bad shape. I don't think they are doing as well as they should, and are not participating in the general prosperity of the country. That seems to be generally assumed. But this morning we have an issue as to whether or not we shall grant to the Federal Reserve the power to purchase securities from the Treasury. That is the issue. I don't think we can settle all of these issues now. We can probably settle them at the next election.

That power was granted under Democratic administration, wasn't it?

Mr. MARTIN. That is correct, sir.

The CHAIRMAN. And it has been maintained under Republican administration?

Mr. MARTIN. Correct.

The CHAIRMAN. You feel it is essential from your experience to continue it, for the orderly administration of the monetary policies?

Mr. MARTIN. I think it would be very wise to continue it.

The CHAIRMAN. What do you think would be the effect if we did not continue it?

Mr. MARTIN. It would mean that the Treasury would have to hold larger balances than it now holds and we would have difficulties at these tax periods in handling the flow of money. It is just a matter of bridging a gap between Treasury expenditures and Treasury receipts, that are pretty well known, but you can't tell when they will hit the market.

The CHAIRMAN. What balance is it necessary for the Government to carry? What do you think ought to be the usual balance of the Federal Government in these banks?

Mr. MARTIN. That is bound to vary, and it is a Treasury problem. But they need two or three billion dollars.

The CHAIRMAN. If they didn't have the power to purchase these short-term securities it would be necessary to withdraw this money from the banks at those times?

Mr. MARTIN. That is correct.

Mr. PATMAN. That is the Government's own money, Mr. Chairman.

The CHAIRMAN. I know it is their own money, but they have got to have it somewhere. That is the issue, it seems to me, this morning, and the question that we have got to decide is whether we are going to give you this power or not. Do you feel that the power has been exercised all right?

Mr. MARTIN. I feel that it has been exercised in a very satisfactory and useful way and benefits both the Treasury and the Federal Reserve.

The CHAIRMAN. Do you feel the Federal Reserve Board has control over the exercise of this power?

Mr. MARTIN. We do. We are in a position at any time to make an issue of it, if we feel that it isn't.

The CHAIRMAN. This doesn't change the law but merely extends the law that has been in existence under both Democratic and Republican administrations and extends it for 2 additional years.

Mr. MARTIN. That is right.

The CHAIRMAN. The question to be presented to us is whether you will continue to have this power or whether it shall be taken away.

Mr. MARTIN. That is right.

The CHAIRMAN. And the other issues here are collateral.

Mr. MARTIN. I think that is true.

The CHAIRMAN. I think the other issues will have to be settled at the next election by the people. I don't think we can settle them here. That is the thing that is going to be presented to the committee in executive session.

Mr. WOLCOTT. Mr. Chairman.

The CHAIRMAN. Mr. Wolcott.

Mr. WOLCOTT. Mr Martin, the Federal Reserve is a creature of the Congress, is it?

Mr. MARTIN. It is, sir.

Mr. WOLCOTT. Does the law provide for the creation of the Open Market Committee?

Mr. MARTIN. The law does.

Mr. WOLCOTT. Does it provide for the manner in which the Open Market Committee shall be appointed?

Mr. MARTIN. It does.

Mr. WOLCOTT. Any deficiencies in the Federal Reserve law, or the manner of the operation of the Federal Reserve law, including any deficiency in the operation of the Open Market Committee, might be corrected by the Congress?

Mr. MARTIN. At any time, sir.

Mr. WOLCOTT. Has any legislation been introduced that you know of to change the modus operandi of the Federal Reserve, or the Open Market Committee?

Mr. MARTIN. From time to time, Mr. Patman, has introduced some bills.

Mr. WOLCOTT. Has any legislation been introduced that you know of to do away with the Open Market Committee?

Mr. MARTIN. Yes; I think there has been one bill introduced to abolish the Open Market Committee.

Mr. BROWN. There is one pending now.

Mr. WOLCOTT. By Mr. Patman?

Mr. MARTIN. Yes.

Mr. WOLCOTT. And bills have also been introduced to do away with the Federal Reserve System completely, isn't that correct? That is by this method, by authorizing the Government to take over all of the stock of the Federal Reserve banks and then, with the assumption behind that that the banks will all be nationalized under the complete control of the Federal Government. But they haven't gotten anywhere.

Mr. MULTER. Whose bills are those, Mr. Wolcott?

Mr. WOLCOTT. There have been bills introduced to provide that. They have never gotten anywhere on the subject.

Mr. MARTIN. Not yet, sir.

Mr. WOLCOTT. There has been an awful lot of talk about them for, I suppose, 15 years.

Mr. MARTIN. That is right.

Mr. PATMAN. Ask him how many hearings have been conducted on them.

Mr. WOLCOTT. I don't think any were conducted while I was chairman.

The CHAIRMAN. There have been no hearings since I was chairman.

Mr. PATMAN. There have been no hearings in 10 years on the Federal Reserve System. I have had bills up——

The CHAIRMAN. We are having hearings all the time on these subjects. Is the gentleman implying that these hearings have been restrictive in any way?

Mr. PATMAN. I don't say it is hocus-pocus, but we haven't had a hearing.

The CHAIRMAN. What does "hocus-pocus" mean?

Mr. MARTIN. I can assure you, Mr. Patman, the one volume of answers we made to your hearing was not hocus-pocus. We worked it out.

The CHAIRMAN. What is "hocus-pocus"? Do you know what that is?

Mr. MULTER. I think we ought to qualify him as an expert first.

Mr. WOLCOTT. I think we might define it as legerdemain.

Mr. MULTER. Mr. Chairman.

The CHAIRMAN. Mr. Multer.

Mr. MULTER. Mr. Martin, I am in agreement with the chairman as to what we are considering here today, but I do think it is necessary to ask some of these questions to determine whether or not we should extend the law exactly as it is or possibly add some restrictions to it. I am not at all convinced that we must add any restrictions, but I think we ought to try to clear up the record, if we can.

I understand that you have given Mr. Patman certain information on the stockholdings of the banks' directors. Is there any reason why that information can't be spread upon this record?

Mr. MARTIN. No reason at all. You mean as to the class B directors?

Mr. MULTER. Yes.

The CHAIRMAN. That may be incorporated in the record.

Mr. MULTER. May that record also show, as Mr. Patman suggests, the stockholdings of these directors during the last 3-year period?

(For data requested above, see p. 25.)

The CHAIRMAN. Are there further questions?

Mr. MULTER. I have some further questions.

Mr. MARTIN. I would merely like to interject, Mr. Multer, that it may take a little time to get that for the 3-year period.

Mr. MULTER. Whenever it can be done.

Mr. PATMAN. All that now own stock or have owned stock within the last 3 years.

The CHAIRMAN. Gentlemen, we are very proud to have two new Members with us this morning, Mr. Holland of Pennsylvania, and Mr. Healey of New York. I will ask them to stand. [Applause.]

The CHAIRMAN. We are glad to have you as members of the committee and we hope your service here will be pleasing to yourselves. I know that the committee members all feel kindly to you because of your predecessors, who were very fine people, and we feel sure that you will discharge your duties efficiently. We are glad to have you with us, and if there is any way in which we can be of service to you, feel free to call upon us. I hope you may long remain with us.

Mr. MULTER. Mr. Chairman, may I now resume?

The CHAIRMAN. Yes.

Mr. MULTER. Before I do, may I offer the hope that no one will say that the New Yorkers have taken over because we again have another New Yorker in the person of Mr. Healey on our committee.

Mr. Martin, I am one of those who was not at all apprehensive of the fact that a man from the Treasury was going to the Federal Reserve Board when you moved over to that Board. Some of the members will not recall, but there was considerable apprehension voiced about a man from the Treasury going into the Federal Reserve Board. Nor was I alarmed at the conferences and consultations that took place all through the years between Treasury and the Federal Reserve Board, and which have continued under this administration, too. I think it is absolutely essential that there be such consultations between the Treasury and the Federal Reserve Board if our money circulation is to be managed properly and if our debt management is to be handled properly.

With that in mind, and as Mr. Burgess indicated, when he was before us, there were conferences between Treasury and Federal Reserve Board from time to time, under this administration as there were under the last, as to interest rates, as to terms of maturity, sizes of issues, as well as other problems. What we are concerned with at the moment or what may give us some cause for concern is the fact that the interest rate was raised, back in late 1955—I believe November. That, I think, was done in order to restrict credit. Am I right?

Mr. MARTIN. The Federal Reserve discount rate was raised as part of a restrictive policy; yes.

Mr. MULTER. And then at about that same time it was decided to refinance this $12 billion Government issue, Treasury issue. That is correct; is it not?

Mr. MARTIN. That is right.

Mr. MULTER. And it was in connection with that refinancing that it became necessary for the Federal Reserve Board through its Open Market Committee to step into the market to buy some of those securities. Is that right?

Mr. MARTIN. That is right.

Mr. MULTER. Was there some mistake of judgment or did something go wrong between the dates of the two decisions that caused, on the one hand, an action to be taken that would restrict credit and, on the other hand, an expansion of credit through a purchase by the Open Market Committee? The two things are diametrically opposed; are they not?

Mr. MARTIN. No; you have the cost of credit and the availability of credit. The discount rate was raised on November 18. The Treasury announced its financing the following week, November 25. They had to do their financing against a restrictive money and credit policy, and there were some constrictions in the market that we had not foreseen, then matter of judgment came into it, there were differences of opinion in the Federal Reserve System about what ought to be done. It was my view that the wise thing to do to handle this situation at the pre-Christmas time was to lend our assistance to the market, which we did. That was done as an exception to a rule and not as a rule. Generally speaking, we would not intervene.

Mr. MULTER. I am not in a position, nor do I intend to be critical of either action, the raising of the discount rate or the Open Market Committee buying the securities a short time later, but I am trying to find out what the facts were. Obviously there were consultations and conferences between Treasury and Federal Reserve before the rediscount rate was raised, and you took into account certain facts and considerations which in your best judgment required that to be done. I am right, am I not?

Mr. MARTIN. That is right, and the market required, as we approached the Christmas season, quite aside from the fact that the rate had gone up, the market required additional reserves for the Christmas trade. Regardless of whether we had bought them by intervening in the Treasury offering, we would have had to buy something to supply those reserves, quite irrespective of money and credit policy, because we should always see that funds are available in the market when they are being required.

Mr. MULTER. All of this, though, was just before Christmas. It was a matter of maybe 2 weeks between the time you raised the rates and the time when you had to go in and make this purchase of securities. Weren't all of these things taken into account in making both determinations? That it was just in advance of the Christmas holiday when there would be demand for additional moneys?

Mr. MARTIN. It was taken into consideration, but there was a misjudgment of the market. But so far as the supply of reserves were concerned, far from their being diametrically opposite, there was a difference as to the method of how it would be handled, not a matter of disagreement as to the need for supplying additional reserves.

Mr. MULTER. One other thing, Mr. Chairman, that gives me some concern, and I am sorry that in advance of this question being asked they made the announcement that President Eisenhower was going to run today. I intended to ask this question whether he made such an announcement or not. I want you to understand there is no political implication in the question. I think it is very important. When you were before the Committee on Banking and Currency in the other body in January, you made this statement, and I think it is important to quote you verbatim. You said in answer to Senator Robertson's question, who was asking you to indicate why you thought as you did with reference to supporting the market, and you said:

> I would like to because, as I indicated earlier, we had raised the rediscount rate a little bit later than I would have liked to, but this is a difficult situation to judge when you have something like the President's illness coming into it. We might have raised the rediscount rate had it not been for that several weeks earlier than we did, but when we did the money market was tighter than anticipated.

Your statement continues on. What I want to direct myself to is the statement by you that the President's illness had some bearing on the economic situation and on your determination to raise the rediscount rate.

Will you give us some explanation of that, please?

Mr. MARTIN. Well, I think that the psychological and emotional aspects of markets are extremely difficult to gage. Now, the drop in the securities market from September 23 to the bottom was a very sharp drop. There was a very gradual change ever since. I am not assessing it in political terms at all. I am assessing it in economic terms.

Well, if it had not happened, the stock market was virtually at a new high, business plant and equipment expansion was going ahead, all of the factors in the business picture were strong, but on September 23 there was uncertainty and confusion—not permanent, but psychological, injected into the picture, with the President's illness.

Now, we naturally had to reassess everything in the light of that event during the next few weeks. If it had not been for that—although this is hypothetical—it is my judgment that we might have wanted to raise the discount rate 2 weeks earlier than we did.

Mr. MULTER. Is it fair to say—had you finished?

Mr. MARTIN. Yes.

Mr. MULTER. Is it fair to say that the President's illness certainly did not change or affect the economy of the country at all and that it was purely psychological?

Mr. MARTIN. Well, it temporarily changed it, yes.

Mr. MULTER. I mean what happened as a result of his illness. The activity of the market, of course, changed, and then, of course, that brings on an economic change but the President's illness as such had no logical, reasonable economic effect. That was purely psychological, am I not correct?

Mr. MARTIN. That is right, but those factors play a part also.

Mr. MULTER. The result of the psychological reaction brought about an economic change?

Mr. MARTIN. That is right.

Mr. MULTER. Is it fair to say that the President's health or illness should not affect the economic condition of the country?

Mr. MARTIN. Well, I don't know. I mean it would be nice, perhaps, if we didn't have political or psychological factors ever, but in a free society you are going to have an interplay of those forces. And it would happen regardless of who the individual is. If it had been

President Truman or President Roosevelt it would have had a psychological bearing also.

Mr. MULTER. There is no economic reason for such changes?

Mr. MARTIN. Well, the line between economics and psychology gets pretty fine sometimes.

Mr. MULTER. Well, I can understand the psychological having some bearing on the public relations man or the advertising agent, but I don't know how it actually affects the running of any industry, or any factory, or even for that matter, the business of the Government. It might result in a change in personnel in government as it would in business. But the change of the president of General Motors certainly doesn't affect the political situation.

Mr. MARTIN. But it probably has some effect in General Motors, however.

Mr. MULTER. Yes, that is right.

Thank you, Mr. Chairman.

The CHAIRMAN. Are there further questions?

Mr. REUSS. Mr. Chairman.

The CHAIRMAN. Mr. Reuss.

Mr. REUSS. Mr. Martin, on H. R. 9285, which, as has been pointed out, has been in force for many years now, I gather the authorization for which extension is sought is limited both in amount, that is $5 billion, and in the nature of the securities that is short-term, 6 months or under, is that correct?

Mr. MARTIN. Yes, and for the most part, 2 or 3 days, or 4 days.

Mr. REUSS. Although upon occasion, and as recently as June 16, 1953, reading from your tabulation, Federal did hold about $1,172 million of Federal short-term securities?

Mr. MARTIN. That is correct.

Mr. REUSS. I would appreciate your explaining this to me: Suppose that during the holding by the Federal of those securities pursuant to this legislation, the coupon, or whatever it is, matures. As I say whatever it is, because in a short-term note, there isn't a coupon, I guess the note just comes due. The interest is then paid by the Treasury to the Federal Reserve, I take it, is it not?

Mr. MARTIN. Yes, we would let it mature.

Mr. REUSS. And the Treasury pays you not only the full face value of the note, or whatever the form of security, but the accumulated interest as well.

Mr. MARTIN. That is right.

Mr. REUSS. I am under the impression that that accumulated interest, somehow, comes back to the Treasury, and inures to the benefit of the taxpayers, so that essentially it is a bookkeeping transaction.

Mr. MARTIN. That is correct.

Mr. REUSS. Would you spell that out for me a little and explain the circuit?

Mr. MARTIN. Well, it contributes to the earnings of the Federal Reserve, and we pay 90 percent of those earnings to the Treasury each year. It would be a factor in those earnings.

Mr. REUSS. I see. That is a perfect explanation. Then, while ofttimes when the expression "Taking it from one pocket and putting into the other pocket" is used it is a misleading expression, in this case, it probably is not a misleading expression, but is a fairly accurate one, is it not? That is, this interest that the Treasury pays comes back to the Treasury, by and large, does it not?

Mr. MARTIN. Yes, that is right, 90 percent.

Mr. REUSS. Ninety percent of it?

Mr. MARTIN. Yes.

Mr. REUSS. But looking at your testimony that this borrowing should be only on a temporary basis and should not be used to meet the permanent financing needs of the Treasury—and I might say I heartily agree with that statement—is it correct to say that the reason you feel that this should be only temporary and should not be a part of any permanent financing is because to make it other than temporary would present inflationary dangers?

Mr. MARTIN. Exactly.

Mr. REUSS. That is about the whole of your reasoning, isn't it, the danger of inflation you are afraid of?

Mr. MARTIN. That is correct. A very real one. If this became a general practice it would be most unfortunate.

Mr. REUSS. And, of course, since, as you have just explained, it saves money for the taxpayers by taking it from one pocket and putting into another pocket, less 10 percent, that understandably rubs off in the Federal Reserve, there should be a very real attention paid—and I have no doubt there is a very real attention paid—by the Federal Reserve to the outer limits of this mechanism, so that we don't run into inflationary dangers?

Mr. MARTIN. Oh, absolutely, and last year we didn't use it at all, and it is our hope at all times to avoid using it. It is only when you can't gage, or you have a temporary problem at the tax period and you want to bridge a gap for a limited period of time between receipts and expenditures, that it is necessary.

Mr. REUSS. Just a couple of more questions on the subject. When you say an inflationary danger, do you mean an inflationary danger by creating funny money, printing press money, Fiat money, in an amount beyond the immediate productive capacities of the country to absorb, or do you mean an inflation proceeding primarily from psychological causes, or do you mean both, or do you mean both plus other aspects of inflationary dangers?

Mr. MARTIN. There is always a little bit of both in it, but this is actually creation of money, and if you create that money, it is, as Mr. Patman likes to point out to me—we are using this as a means of creating money, for which the authority is given to us—well now that puts reserves into the market, which can be multiplied in the banking system and unless that money comes back and is extinguished, it would be just the same as printing additional currency.

That is the reason that we should use this extremely sparingly, because it used to be done less subtly. You could just print this amount of money, but you would have a dickens of a time getting it back.

Mr. REUSS. So the permission sought by H. R. 9285 is like a drug which, properly administered and controlled, can prove helpful, but of which one must not take too much?

Mr. MARTIN. That is right, we should shun it as much as possible.

Mr. REUSS. Thank you.

Mr. O'HARA. Mr. Chairman.

The CHAIRMAN. Mr. O'Hara.

Mr. O'HARA. Mr. Martin, I notice in your statement that while you have never used more than a billion dollars, and that on a very few occasions, you are not recommending reducing the authorization below $5 billion.

Mr. MARTIN. That has been the amount, Mr. O'Hara, that has been on the books since 1942, and it is conceivable that there might be some drain. I don't see any compelling reason to reduce the amount.

Mr. O'HARA. Is it conceivable that the $5 billion limitation might be used in the event of some unexpected emergency might develop?

Mr. MARTIN That is correct.

Mr. O'HARA. That might serve as a cushion?

Mr. MARTIN. That is correct, yes, sir.

Mr. O'HARA. Thank you very much.

The CHAIRMAN. Are there further question?

Mr. BETTS. What is the average length of the loans?

Mr. MARTIN. They are made for 1 day and renewed each day. It is usually just a 2- or 3- or 4-day period, and we report it in our statement each week, so that the information is public property.

The CHAIRMAN. Are there further questions?

Mr. PATMAN. Just one statement. Mr. Wolcott mentioned no bill having been pending to change the Open Market Committee.

The CHAIRMAN. I don't think that is germane to the subject. It has nothing to do with this hearing.

Mr. PATMAN. I know it hasn't, but he brought it up. I am sorry he is not here. He brought it up. I do have a bill which has been pending in every session of Congress, to change the law to abolish the Federal Open Market Committee and have a Board of Governors of 12 members instead.

The CHAIRMAN. That is true. There is no doubt about that. The chairman knows that.

Mr. PATMAN. You mean knows that I have a bill?

The CHAIRMAN. Absolutely.

Mr. PATMAN. And that I have asked for a hearing.

The CHAIRMAN. If there are no further questions, Mr. Martin, you may stand aside. We are always glad to have your views, of course, and you have been very helpful.

The committee will meet tomorrow morning at 10 o'clock in executive session on the bill.

(Whereupon, at 11:30 a. m., the committee adjourned until 10 a. m., Thursday, March 1, 1956.)

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