CONGRESSIONAL OVERSIGHT OF THE FEDERAL RESERVE SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC FINANCE

OF THE

COMMITTEE ON BANKING AND CURRENCY

HOUSE OF REPRESENTATIVES

NINETY-SECOND CONGRESS

FIRST SESSION

ON

REVIEW OF CURRENT OPERATIONS OF THE FEDERAL RESERVE SYSTEM

SEPTEMBER 27, 1971

Printed for the use of the
Committee on Banking and Currency

U.S. GOVERNMENT PRINTING OFFICE
69-719 WASHINGTON : 1971

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CONGRESSIONAL OVERSIGHT OF THE FEDERAL RESERVE SYSTEM

MONDAY, SEPTEMBER 27, 1971

House of Representatives,
Subcommittee on Domestic Finance of the
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Gettys, Rees, Mitchell, Widnall, Williams, and Frenzel.

The Chairman. The committee will please come to order.

Today, the Domestic Finance Subcommittee begins general oversight hearings of the Federal Reserve System, including the operations of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve regional banks.

Although we have inquired into various operations of the Federal Reserve System when legislation involving the Federal Reserve was before us, not since the 1964 hearings entitled "Fifty Years of the Federal Reserve System" were conducted, have we exclusively devoted ourselves to oversight hearings involving our central banking system.

For the benefit of the members, it is my intention to continue these hearings for some time with Dr. Burns as spokesman for the System. Of course, we may not be able to meet continuously on this subject, due to the press of other legislative business, but it is my hope that by the time these hearings are finished the members of the subcommittee and the public at large will have gained a better understanding as to how the Federal Reserve System works and we may, if necessary, be in a position to offer legislation to make the System work more efficiently and more directly in the public interest.

Among the subjects which I think we should concentrate on initially would include such matters as the following:

(1) The new authorization recently announced by the Federal Reserve Board under which the open market committee will buy and sell Federal agency securities.

(2) The so-called thrift plan for employees of the Federal Reserve System, whereby funds which would otherwise go into the general fund of the U.S. Treasury are used to subsidize Federal Reserve employees who participate in what, in effect, is a form of mutual fund. It is my understanding that for each dollar invested in the thrift plan by an employee, the Federal Reserve contributes 25 cents. It is my un-

derstanding that as far as the executive branch of our Government is concerned any program of this nature would be illegal unless specifically sanctioned by law and I know of no law on the statute books which allows of any of our agencies to undertake such a program.

(3) The expenses of the Federal Reserve Board and Federal Reserve Banks for activities which could not be justified under the rules and regulations of other Government agencies; and

(4) The all-important matter of the Federal Open Market Committee's portfolio of Government securities now amounting to some $66 billion, which I contend has been acquired exclusively through the use of the Federal Government's creidt. The former Chairman of the Federal Reserve Board, Mr. William McChesney Martin, has admitted that these securities have been paid for once and, therefore, should be canceled.

Dr. Burns, the Chairman of the Federal Reserve Board, has a formal statement which he may present at this time. Following Dr. Burns' statement, we will proceed under the 5-minute rule for the initial go-round. We will then proceed with unlimited time for each member, but I want to assure all members that if they remain in the hearing room, they will be given full consideration and have an opportunity to ask all the questions they so desire.

Dr. Burns, we are glad to have you, sir, and you may proceed as you desire.

Mr. WIDNALL. Mr. Chairman.

The CHAIRMAN. I yield to Mr. Widnall first.

Mr. WIDNALL. I would like to join you in welcoming Dr. Burns before the committee. We always appreciate your presence and the fine testimony that you give us.

Mr. Chairman, I would just like to comment on your statement in point number 4. You state:

"The former Chairman of the Federal Reserve Board, Mr. William McChesney Martin, has admitted that these securities have been paid for once and, therefore, should be canceled."

I don't ever recall such an admission having been made by former Chairman Martin.

The CHAIRMAN. That testimony will be presented in the course of the hearings. He admitted it several times. The part "therefore, should be canceled," is my language, not his.

Mr. WIDNALL. That doesn't show in the statement.

The CHAIRMAN. Anyway, that is not only connected with his reply.

Mr. WIDNALL. That is all.

The CHAIRMAN. Dr. Burns, you may proceed.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Dr. BURNS. Mr. Chairman, I am here in response to your invitation to discuss Federal Reserve transactions in obligations issued by Federal agencies, and particularly the decision announced September 16 by the Federal Open Market Committee—to broaden such transactions to include outright purchases and sales as well as repurchase agreements. For your convenience, a copy of the announcement that was issued by the Federal Open Market Committee is attached to my prepared statement which I trust will be placed in the record.

Mr. WIDNALL. Mr. Chairman.

The CHAIRMAN. The whole statement will be placed in the record, Dr. Burns. There will be no objection to that, I am sure. If you have additional views that you would like to express after you conclude your testimony today, when you look over your transcript you may insert anything that is germane to the hearing.

Dr. BURNS. I appreciate that.

This committee will recall that the System's authority to purchase agency issues was broadened in 1966. Up to that time we were authorized to purchase obligations "which are direct obligations of the United States or which are fully guaranteed by the United States." This authority covered some, but not all, agency issues. The principal issues in terms of aggregate size and market activity were ineligible for purchase by the System. These ineligible issues included Federal intermediate credit bank debentures. Federal Home Loan Bank notes and bonds, Federal land bank bonds, bank for cooperatives debentures, and Federal National Mortgage Association debentures and certificates of participation.

In 1966, the Board recommended that the authority for System transactions in agency issues be amended to make all issues eligible. In support of this recommendation, Vice Chairman Robertson testified that it "would increase the potential flexibility of open market transactions and could also serve to make these securities somewhat more attractive to investors." He also pointed out that "it might prove desirable to conduct such operations in the form of repurchase agreements" in order "to reduce the risk of undesired System market dominance associated with sizable outright transactions by the System."

Accordingly, the Congress added to section 14(b) of the Federal Reserve Act authority for the System to buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States.

In commenting on this amendment, the Senate Banking and Currency Committee report included the following statement, reflecting similar comments in Vice Chairman Robertson's testimony:

> By authorizing System transactions in agency issues, the bill would place them on the same footing as direct obligations of the U.S. Government so far as System Open Market operations are concerned. As with direct Treasury debt, System decisions as to whether, when, and how much to buy or sell of agency issues would have to be made with a view to the need for supplying or absorbing reserves as indicated by the stance of monetary policy and in light of developments in the markets, including the need to cope with disorderly market conditions, should they emerge. In any event, it would be important, as at present, to avoid any semblance of rigging the markets or pegging the interest rates for any particular issues, for such actions would give rise to official dominance of the markets that would run counter to many of the broader objectives of Federal financial policies and might in fact harm rather than aid the propitious functioning of the market for such securities.

As you know, System open market operations are conducted to carry out the objectives of monetary policy by affecting the volume of bank reserves, money, bank credit, and conditions in credit markets. In

December 1966, the System started transactions in agency issues with a view to fitting such transactions into its open market operations. In line with the Board's testimony on the 1966 amendment, it was then decided to confine these new transactions to repurchase agreements. From time to time, however, the Federal Open Market Committee has considered broadening operations in agency issues to include outright purchases and sales as well as repurchase agreements. After due deliberation, the committee has now decided to take this step, as the announcement of September 16 indicates, in order to widen the base of System open market operations and at the same time to add breadth to the market for agency securities.

The recent decision to begin outright transactions reflects the fact that the market in agency issues, while less broad than that in Treasury issues, has grown substantially in recent years. The amount of Federal agency issues outstanding in the hands of private investors has risen from about $8 billion at the end of 1960 to $14.1 billion at the close of 1965 and to nearly $45 billion in early August of this year. The $45 billion of agency issues amounted to 28 percent of the amount of Treasury issues outstanding at the time; at the end of 1960 the comparable figure was 5½ percent. Thus there is less risk now that System purchases or sales could dominate the market.

Since the hope is that System operations will help to improve the market for these issues, we must be careful to avoid driving away other investors, as might happen if the System acquired a disproportionately large share of an issue and depressed its yield relative to other investment alternatives. To protect against this risk, the initial guidelines for System purchases include a provision limiting our holdings of any issue to 10 percent of the amount outstanding.

We expect our portfolio of agency issues to grow modestly in the coming months, taking into account the amount of growth in bank reserves that is appropriate for monetary policy, the size of the market in agency issues, and the necessity of continuing operations in Treasury obligations as well. Transactions will be made in the market, at prices set by the market. We will seek quotations from dealers and buy or sell at the most favorable prices quoted. We will not buy any new issue until at least 2 weeks after it is issued, so as to provide an opportunity for establishing a fair price in the market for the issue without interference by the Federal Reserve.

You will notice that the initial guidelines at the end of my statement provide that our holdings of agency issues will be allowed to run off at maturity. This reflects a technical problem, in that the procedures by which agency issues are now marketed do not provide for exchange of maturing issues on the basis that the System now exchanges its holdings of maturing Treasury issues for new issues. Presumably such arrangements could be worked out for agency issues. This illustrates a point made in the announcement of September 16—that the initial guidelines will be subject to review and revision as operating experience is gained.

We plan to buy only taxable securities for which there is an active secondary market. The requirement of an active secondary market will help to insure that the System's portfolio remain liquid; it will also encourage issuing agencies and underwriters to develop secondary markets in their securities.

Under the initial guidelines, an issue will be eligible for purchase if at least $300 million is outstanding; for longer term issues (over 5 years) the cutoff will be $200 million. In early August, when there were about $45 billion of agency issues outstanding, about $32 billion of these met the size test. A breakdown of these eligible issues is shown in the following table:

(The table referred to follows:)

ISSUES ELIGIBLE FOR SYSTEM TRANSACTIONS UNDER INITIAL GUIDELINES [1]

	Amount (in billions)	Number of issues
By maturities:		
0 to 5 years	$25.3	61
Over 5 years	6.8	21
Total	32.2	82
By agencies:		
Farm credit agencies	10.8	25
FHLB	5.6	15
FNMA	10.1	28
GNMA	4.3	10
Export-Import Bank	1.5	4

[1] Minimum issue size is $300,000,000 for issues maturing in 5 years or less and $200,000,000 for issues maturing in more than 5 years.

One cannot say with certainty what the results of our experimental transactions in agency issues will be. We hope they will be beneficial in terms of greater flexibility for System open market operations, broader markets for agency securities, and a narrower spread between such securities and Treasury obligations. If the borrowing costs of Federal agencies are reduced, however modestly, that result will be most welcome to the Federal Reserve as well as the issuing agencies and the public they serve.

Thank you, Mr. Chairman.

(Dr. Burns' prepared statement with an attached announcement by the Federal Open Market Committee of the Federal Reserve System authorizing outright purchase and sale transactions in securities of Federal agencies follows:)

Prepared Statement of Hon. Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System

Mr. Chairman, I am here in response to your invitation to discuss Federal Reserve transactions in obligations issued by Federal agencies, and particularly the decision—announced September 16 by the Federal Open Market Committee—to broaden such transactions to include outright purchases and sales as well as repurchase agreements. For your convenience, a copy of the announcement is attached to my statement.

This Committee will recall that the System's authority to purchase agency issues was broadened in 1966. Up to that time we were authorized to purchase obligations "which are direct obligations of the United States or which are fully guaranteed by the United States." This authority covered some, but not all, agency issues. The principal issues in terms of aggregate size and market activity were ineligible for purchase by the System. These ineligible issues included Federal Intermediate Credit Bank debentures, Federal Home Loan Bank notes and bonds, Federal Land Bank bonds, Bank for Cooperatives debentures, and Federal National Mortgage Asssociation debentures and certificates of participation.

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As you know, System open market operations are connected to carry out the objectives of monetary policy by affecting the volume of bank reserves, money, bank credit, and conditions in credit markets. In December 1966 the System started transactions in agency issues with a view to fitting such transactions into its open market operations. In line with the Board's testimony on the 1966 amendment, it was then decided to confine these new transactions to repurchase agreements. From time to time, however, the Federal Open Market Committee has considered broadening operations in agency issues to include outright purchases and sales as well as repurchase agreements. After due deliberation, the Committee has now decided to take this step, as the announcement of September 16 indicates, in order to widen the base of System open market operations and at the same time to add breadth to the market for agency securities.

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ANNOUNCEMENT BY THE FEDERAL OPEN MARKET COMMITTEE OF THE FEDERAL RESERVE SYSTEM AUTHORIZING OUTRIGHT PURCHASE AND SALE TRANSACTIONS IN SECURITIES OF FEDERAL AGENCIES

SEPTEMBER 16, 1971.

The Federal Open Market Committee of the Federal Reserve System announced today that it has authorized outright purchase and sale transactions in securities of Federal agencies. At present, the System's open market operations involve mainly transactions in U.S. Treasury issues. The transactions in Federal agency securities will be initiated in the near future.

The volume of securities issued by Federal agencies has been growing rapidly in recent years. These securities are marketed to raise funds for a variety of governmental lending activities in such fields as housing, agriculture, and export financing.

System open market operations are conducted to carry out the objectives of monetary policy by affecting the volume of bank reserves, money, bank credit, and conditions in credit markets. The purpose of the new authorization is to widen the base of System open market operations and at the same time to add breadth to the market for agency securities. Up to now, open market operations in Federal agency issues have been confined to repurchase agreements with securities dealers.

Purchases and sales of Federal agency issues will be conducted by the Federal Reserve Bank of New York for the System Open Market Account. Along with other System Account transactions, they will be reflected in the weekly condition statement of the Federal Reserve Banks, which is issued every Thursday.

The Committee has approved the attached initial guidelines for operations in agency issues. They are designed to assure that such operations will be consistent with other open market operations, to minimize technical operating problems, and to avoid dominating the Federal agency market. The guidelines will be subject to review and revision as operating experience is gained. Because the outstanding volume of many agency issues is small relative to that of U.S. Treasury obligations, Federal Reserve operations in such issues will be on a limited scale. They will not be directed at supporting individual sectors of the agency market or at channeling funds into issues of particular agencies.

INITIAL GUIDELINES FOR THE CONDUCT OF SYSTEM OPERATIONS IN FEDERAL AGENCY ISSUES

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.
2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.
3. As an initial objective, the System would aim at building up a modest portfolio of agency issues, with the amount and timing dependent on the ability to make net acquisitions without undue market effects.
4. System holdings of maturing agency issues will be allowed to run off at maturity, at least initially.
5. Purchases will be limited to fully taxable issues for which there is an active secondary market. Purchases will also be limited to issues outstanding in amounts of $300 million or over in cases where the obligations have a maturity of five years or less at the time of purchase, and to issues outstanding in amounts of $200 million or over in cases where the securities have a maturity of more than five years at the time of purchase.
6. System holdings of any one issue at any time will not exceed 10 per cent of the amount of the issue outstanding. There will be no specific limit on aggregate holdings of the issues of any one agency.
7. No new issue will be purchased in the secondary market until at least two weeks after the issue date.
8. All outright purchases, sales and holdings of agency issues will be for the System Open Market Account.

The CHAIRMAN. Thank you, sir. I would like to ask one or two brief questions of you. What will be used for credit and money to purchase these securities, Dr. Burns?

Dr. BURNS. Our procedure in buying agency issues on an outright basis will be exactly the same as our procedure in buying Treasury securities, a procedure that has been used from the inception of these transactions.

The CHAIRMAN. In other words, you will use the credit of the Nation for the purchase of these securities?

Dr. BURNS. In other words, we will give a credit on the books of the Federal Reserve to——

The CHAIRMAN. To compensate them?

Dr. BURNS. Yes, sir.

The CHAIRMAN. And suppose they want Federal Reserve notes, could they get that instead?

Dr. BURNS. Anyone who has a deposit credit with the Federal Reserve could exchange that deposit for Federal Reserve notes in whatever amount he wishes and at any time he wishes.

The CHAIRMAN. These notes are obligations of the U.S. Government, are they not?

Dr. BURNS. These notes are in the first instance obligations of the Federal Reserve System. The Federal Reserve System being an agency of the U.S. Government, they, of course, can be interpreted——

The CHAIRMAN. There is no question.

Dr. BURNS. And I have no objection to your so interpreting it—as obligations of the U.S. Government.

The CHAIRMAN. I think it has been so interpreted over the years. Although there is no provision for the payment of interest, the fact that they are obligations of the U.S. Government I think has been undisputed over a long period of time.

Suppose these correctly state here——

Dr. BURNS. I am sorry I didn't hear you.

The CHAIRMAN. There is no way to turn over these agency obligations like they do Treasury certificates and Government bonds. They will have to be paid off. Now, then, suppose you buy some of these agency obligations and then when they are due, say, in 90 days, or whenever they are due, and they pay you the money and the interest, where does that money and interest go, who does it belong to?

Dr. BURNS. The principal and the interest that the agency will turn over to the Federal Reserve System will be money that the agency has, this money having been made available to the agency in question by the Congress.

The CHAIRMAN. What about the interest, where does it go, which account does it go into?

Dr. BURNS. It will go into the same account as the principal. In due course, as you well know, that interest, the great bulk of it, will be turned back to the Treasury because this has been the practice of the Federal Reserve, in accordance with section 16 of the Federal Reserve Act.

The CHAIRMAN. To compensate the Government for the use of its credit.

Dr. BURNS. No; the Federal Reserve System operates at a profit. It has been set up as an independent agency, but the Congress very properly limits the dividends that can be paid to the stockholders. The Federal Reserve System conducts its operations economically, and the great bulk of the income we receive is turned back to the Treasury. Last year, if my memory is correct, out of a total income of something like $3.9 billion, our expenses came merely to some $350 million, which is a modest figure, Mr. Chairman. I know something about operations of other central banks. The rest of the System earnings were turned back to the Treasury in accordance with law. We have done our work—a massive job for the U.S. Government and taxpayers—on an economical basis.

The CHAIRMAN. Another way of stating it is that you collect the interest on these bonds—$66 billion now, which is a rather large amount—and these bonds, according to the testimony, have been paid for once. You are collecting interest on bonds that have been paid for, and if I understand it correctly, you spend what you want to out of that—the interest on those bonds, which was $3,771 million last fiscal year—and then what you do not spend for expenses, you turn over to the Treasury.

The point I want to make, Dr. Burns, is that these funds are derived from interest on bonds that have already been paid for once.

I will not pursue that now because I have taken too much time, but I will ask you one more question and return to that later on.

When you buy these agency issues, will you buy them directly from the agency or in the market or will you buy them through a dealer of the Federal Reserve System?

Dr. BURNS. We will buy them through a dealer. We will not buy them from the agency any more than we buy Treasury securities from the Treasury. We buy them in the market.

The CHAIRMAN. Yes; and that is one of my objections to it, because it is just an added expense. These dealers, have a rather lucrative franchise anyway, and given the fact that it is so much in the public interest to provide money for housing, why should you have two toll gates for each transaction—one toll gate when you purchase the issues and the dealer gets a clip, and another when you sell the bonds through the dealer and he also gets a percentage there.

Don't you think it would be fairer in view of our emergency, particularly in housing, that we should dispense with this dealer and in this case buy them directly?

Dr. BURNS. Mr. Chairman, we intend to buy the agency issues in the marketplace, not from the agency. We have already started transactions. We are operating that way first of all because that is the law. We can't operate any other way.

Second, Mr. Chairman, the law is a good law. It was designed to limit what the Federal Reserve does and what the Treasury does and what agencies might do. If there was an open door to the Federal Reserve System, if we had to buy directly what the Treasury wanted to sell, or what agencies wanted to sell, our ability to protect the Nation's money might be destroyed. Congress, being aware of its responsibilities, has enacted certain safeguards, and I think the Congress has been very wise.

In any case, at the present time we have no choice; we are simply following the law as the Congress has written it.

The CHAIRMAN. We will try to amend the law, Dr. Burns.

Dr. BURNS. I hope you do not succeed, though I wish you every good luck in your many fruitful enterprises for this country.

The CHAIRMAN. You see that $66 billion, if it were paid, would reduce the public debt by that much. Under your system, you have twice that much out. Isn't it inflationary to have both outstanding—both the bonds and the money that paid for the bonds? Shouldn't one of them be canceled?

Dr. BURNS. Mr. Chairman, we have about $65 billion in Treasury securities; that is correct.

The CHAIRMAN. $65 billion?

Dr. BURNS. $65 billion approximately. I don't know the exact figure.

If the $65 billion were canceled, the public debt would be reduced by this amount. If Congress then proceeded to appropriate an additional $65 billion, I think that the inflation that we have been having, which has brought a domestic crisis in our country and has helped to produce an international crisis, would be vastly intensified. I don't like to think of what the future of your children and mine would then be. I am sure this is something you do not want, Mr. Chairman.

You have fought over the years to protect the poor people of the country. You have made great contributions to the poor people of this country. You surely do not want to inflate our currency and thereby destroy the value of their money and in the process also destroy jobs.

The CHAIRMAN. With this comment I will yield to Mr. Widnall. I think inflation has been due solely to the rise in interest rates. Every time you increased the interest rate, prices would go up. Even the goods on the shelves would go up and then wages would have to go up to compensate for the increase in the cost of groceries and everything else. Then prices go up again. First thing you know there is the danger of prices going out the roof unless something is done to stabilize our economy.

And interest rates, I think, caused it. But one of the contributing causes was that the Government, through the Federal Reserve, paid out $65 billion of Federal Reserve notes over here—printed money that you get to pay for these bonds—paid for the bonds and then left both the bonds and the notes outstanding. That is 200 percent. And that is bound to be inflationary.

Now I will yield to Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman. Dr. Burns, I think we should make clear for the record the fact that what is now proposed by the Federal Reserve is the trading of agency issues providing a secondary market; isn't that correct, and not a primary market?

Dr. BURNS. That is our purpose, to strengthen the secondary market for agency issues, not to provide a primary market.

Mr. WIDNALL. I think there has been a misunderstanding by the press, by some Members of Congress and by a lot of people who are very much interested in the operations of the Federal Reserve. There has been a misunderstanding that you are going to provide a prime market and not a secondary market. I think this should be emphasized.

And that you should repeat what you just said to me.

Dr. BURNS. I am very glad that you have made the point so clearly. The agencies will continue to market their issues as they have. We will play no part in underwriting the issues. We will not buy any issues from the agencies directly, any more than we underwrite Treasury issues or buy directly from the Treasury except under very special conditions.

Once an issue has been placed in the market, we will deal with the market, like anybody else. We will not enter the market until the new issue has been in the market for 2 weeks at least. By that time something like a fair market price will have emerged.

As far as outstanding issues are concerned, we will feel free to deal with them at any time that a good purpose, in our judgment, will be served.

We will under no conditions buy any issue directly from an agency. We cannot do so under the law. I think this law is wise and I hope it will remain on the statute books, because when a central bank begins rigging the market for Government paper, that is the high road to destruction of the Nation's finances and the Nation's money.

The CHAIRMAN. Would the gentleman yield to me to finish out the extension of remarks that I intended to ask?

Mr. WIDNALL. I don't believe Dr. Burns had finished what he was saying.

Dr. BURNS. I am finished.

The CHAIRMAN. I ask unanimous consent to extend my remarks by inserting in the record discussion and information on each one of the points that I brought out. Without objection, so ordered. (The material referred to may be found on page 37.)

Thank you, Mr. Widnall.

Mr. WIDNALL. Mr. Chairman, I would just like to ask you a question at this time. I had understood in coming here today that this was going to be a 1-day session, and in your preliminary statement you have opened it up so it is clear you intend to have this possibly run on for weeks.

When do you contemplate having the next session on this important subject matter?

The CHAIRMAN. I have discussed this with Dr. Burns. He will probably have to be the main witness and he has the International Monetary Fund this week and probably next week and he has the price and wage control program which, of course, has taken the stage. It is occupying all of the time of people who are connected with it, and I am sympathetic to the situation in which he is involved, and realize that he is helpless in being able to report to us at any given time.

We will work out with him time that will be mutually convenient and ask him to come back and in the meantime we will submit questions in writing.

Mr. WIDNALL. Mr. Chairman, just another thought in connection with this. It seems to me the subject matter is of extreme importance. I know that the Congress is going to be involved in some most critical legislation within the next few weeks and that other committees will be meeting and that there will be considerable conflicts. I haven't talked to anybody about what I am commenting on now, because your statement at the beginning of the committee session came as a total surprise to me—the agencies that you referred to and the ideas that you want to investigate.

I would think that such an investigation, such hearings, could be well postponed for a matter of weeks until Congress gets its calendar clear and we have the ability to go into it as thoroughly as we might. I don't think that this is the type of problem that we should answer by submitting questions and submitting answers back and forth. The public hasn't the faintest idea what is going on. The Members of Congress don't know what is going on, and one has to wait for weeks in order to get testimony up to date in order to see what the questions are and what the answers are. I don't think that is a right way to handle something that is absolutely critical to the future of the country.

The CHAIRMAN. It is not intended to cover major questions. The details can be worked out that way, at least. You can't ask a witness about details in legislation and always expect to get full and complete answers on the spot. Submitting written questions is one good way of doing it. It is a traditional way that has been done ever since I have been here and I don't know of any objection to it really.

The gentleman may be assured that the minority will be thoroughly advised at the time and consulted about any future hearings or anything that is done in submitting questions. Naturally we will consult with Dr. Burns to make sure that the time that we are suggesting for another hearing will be an appropriate time and mutually convenient with us and I hope that will be satisfactory.

That will save everybody a lot of trouble, especially on detailed questions.

Mr. WIDNALL. I have no further questions.

The CHAIRMAN. Mr. Gettys.

Mr. GETTYS. Dr. Burns, your announcement of September 16 involving outright purchase and sale transactions of Federal agencies, is it related in any way to the emergency order of the President terminating on November 13; has it any relationship to the temporary emergency matters?

Dr. BURNS. No; there is no relation between the two whatsoever. The question of operations in agency issues is one that Members of the Congress have raised with the Federal Reserve from time to time.

Mr. GETTYS. This is an on-going question?

Dr. BURNS. That is right. This is a question which we within the System have considered and debated from time to time. We have reached the decision which has been announced and which I have elaborated upon this morning, but there is no connection whatever between this action and anything that is being done in the sphere of wage-price policy or, for that matter, in any other branch of economic policy.

Mr. GETTYS. I didn't quite get the point that you made. I didn't quite understand it. You are not providing a prime market?

Dr. BURNS. That is right.

Mr. GETTYS. For the agencies outside of Treasury?

Dr. BURNS. That is right.

Mr. GETTYS. You are supplementing, is that the correct word, you are supplementing the secondary mortgage market?

Dr. BURNS. Not a secondary mortgage market. We are aiming to strengthen the secondary market for agency issues.

Mr. GETTYS. Just where will you make your purchases?

Dr. BURNS. Well, we made some purchases the other day. On September 23, we purchased $61 million of agency issues.

Mr. GETTYS. What type would that be, sir.

Dr. BURNS. Yes; we bought $1 million of issues of the Bank for Cooperatives, a little over $12 million of issues of the Federal land banks, $17 million of issues of the Federal intermediate credit banks, about $12½ million of issues of the Federal home loan banks and $18 million of issues of Fannie Mae—the Federal National Mortgage Association.

Mr. GETTYS. Would those purchases immediately give those agencies additional funds with which to operate.

Dr. BURNS. No.

Mr. GETTYS. How does that work, sir, how does it help the money supply?

Dr. BURNS. No; those agencies have already placed the issues. They have sold them. Now they are being traded in the market and——

Mr. GETTYS. They have got their money for them?

Dr. BURNS. That is right. We went into the market and we bought issues in this amount, you see.

Mr. GETTYS. From whomever they might have sold them to or in the course of normal trading?

Dr. BURNS. Well, we bought them from the dealers and the dealers either had these issues in their own portfolios or they bought them from people in the market.

Mr. GETTYS. But the agency cannot sell its issue with a conspiratorial understanding that you are going to buy them.

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Dr. BURNS. That is correct.

Mr. GETTYS. There will be safeguards?

Dr. BURNS. There will be no conspiratorial understanding or any other understanding. We will deal with the agency——

Mr. GETTYS. Doesn't that danger exist though that some of the agencies will anticipate that their excess spending might be backed up by the Federal Reserve and, therefore, will incline them toward making unnecessary expenditures.

Dr. BURNS. I am very glad you have asked that question. We have tried to explain this to the agencies. The fact that you have asked the question, and the fact that I am trying to make it entirely clear that nothing of this sort will ever take place, I hope this will help improve public understanding.

Mr. GETTYS. I see. Thank you, sir.

What is your opinion, Dr. Burns, of the future of the interest rates, say, in the next 3 or 4 years; have you formulated an opinion?

Dr. BURNS. I am convinced that the future of interest rates will depend in very large part on the degree of success that we have in curbing inflation.

A large inflation premium has been built into interest rates. You may have noticed that when the President announced the price-wage freeze one of the major and immediate responses in the marketplace was a reduction of interest rates. What did that mean? It meant that now that expectations about inflation were in process of changing, this inflation premium began to be squeezed out. Therefore, if we succeed in the struggle that we are all engaged in—the Congress, the President, the executive establishment, and we in the Federal Reserve—if we succeed in the fight against inflation, the future of interest rates will be very much better in the sense that interest rates will be lower. That won't be the case if inflation is allowed to rage in our country.

Mr. GETTYS. One other question, Dr. Burns, the Chairman, whose views I have a great regard for, and your views I have a great regard for also, you seem to have a different philosophical approach to this thing. The Chairman believes that high interest rates cause inflation; you believe that inflation causes high interest rates.

Somewhere in between is the truth. Would you comment on that? In my own mind I don't understand these matters too well, the difference in the philosophy that you hold.

Dr. BURNS. Well, the Chairman is a very eloquent exponent of his views and I respect his thinking always. Let me give you a very brief and simple statement of my——

Mr. GETTYS. You do not believe that high interest rates cause inflation?

Dr. BURNS. No, I do not.

Mr. GETTYS. You think it is a result of?

Dr. BURNS. I think it is a result of inflation; yes.

The primary cause of inflation always is the creation of too much money relative to the Nation's output, and the running of governmental deficits. This is the primary cause throughout world history. But, after a certain stage when prices rise, wages begin responding, and a push then develops from the cost side. We have been in that condition for some time now, certainly since 1970.

The wage push has become the basic immediate cause of inflation, although not the sole immediate cause. We somehow have to break this wage-price cycle, and the aim of the President's move is to break this cycle. I hope that this move by the President, which has been well received within the Congress, and by the country, will succeed; but the outcome is uncertain.

Mr. GETTYS. Thank you, and I will not ask any question except that I have been in my own district praising the President's move but I qualify my praise on the fact I think he acted too late, or let me say that, he did not act soon enough. Would you comment on that?

Dr. BURNS. I wish he had acted sooner.

Mr. GETTYS. I thought that was your position.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Williams

Mr. WILLIAMS. Thank you, Mr. Chairman and thank you, Dr. Burns for appearing here this morning.

I do want to say that I agree completely wtih your statement regarding inflation. Interest rates actually have no bearing on inflation. One major cause of inflation is Federal deficit spending. We roll up huge deficits every year to a point where our national debt exceeds $400 billion. This year we are taking out of our budget $27 billion just to pay the interest on the money we owe.

The next fiscal year interest payment will be over $30 billion. And this drastically devalues the dollar and causes inflation. And the other major cause of inflation is constantly rising wages without any increase in productivity. This results in higher prices, again resulting in devaluing of the dollar.

I do want to say that as far as anyone trying to blame big banks or big bankers for high interest rates, the fact of the matter is that our Federal Government and our governmental agencies have been borrowing money at between 8- and 9-percent interest and the banks have got to compete with the Federal agencies.

Things have gotten so bad that I think in the short term borrowing at very high interest rates the Treasury issues the notes in sums of not less than $10,000; is that correct?

Dr. BURNS. I am sorry. I did not hear your question.

Mr. WILLIAMS. I believe the Treasury Department has a minimum note on short term high interest rate borrowing of $10,000?

Dr. BURNS. I am not entirely sure of that. I will have that verified and place the exact facts in the record.

(In response to the request of Mr. Williams, the following information was submitted by Dr. Burns:)

In late February, 1970, the Federal Government raised the minimum denomination of Treasury bills from $1,000 to $10,000. But the minimum denomination of marketable U.S. Treasury notes and bonds has continued to be $1,000.

Mr. WILLIAMS. Now, as far as this bond market is concerned, I think that the usual procedure that is followed is that an agency floats a bond issue and that bond issue is actually purchased by an investment banker; is that correct?

Dr. BURNS. It may be purchased by an investment banker, by a dealer, or by a member of the public.

Mr. WILLIAMS. Fine; but then that person that buys them has the responsibility of selling them to others at the interest rate and face value that he has paid for notes or bonds.

Dr. BURNS. Yes, sir.

Mr. WILLIAMS. So actually if the Federal Reserve is to start buying directly from the Federal agency, what we would be doing is thwarting the effort of the Federal agency, and even the Treasury Department, to get more non-Federal money.

Dr. BURNS. Yes.

Mr. WILLIAMS. For the purposes that that agency is being operated for?

Dr. BURNS. That is entirely correct and that is a very important point because, as you suggest, if we started buying directly from the agency on a significant scale we would certainly weaken the private market for these agency issues. Yet this is something that we want to strengthen because we are all interested in better housing in this country. But, if that goal is to be achieved, money will have to be forthcoming. It can do so in one of three ways. It can come from private sources, or it can come from congressional appropriation, or it can come through the creation of money by the Federal Reserve. Clearly the best way to achieve this result, to have the housing issues that are necessary, the mortgages that are necessary, to make possible more homes for more people, is to have the private market supply the funds.

Here and there subsidies may become advisable. This has been the judgment of the Congress, though I must say as a parenthesis that, looking to the future, I sometimes get worried about the size of the subsidies that the Congress has been appropriating. But, whatever we do, let us not use the printing press of the central bank to finance mortgages or housing issues or Treasury issues.

Mr. WILLIAMS. Doctor, do you agree that the high interest rates being paid by the Federal Government and Federal agencies on their borrowing has forced the banks to raise their interest rates because they have got to pay their depositors a higher interest?

Dr. BURNS. Yes; there is a close connection between the two.

Mr. WILLIAMS. Now, in point 4 on page 2 of the Chairman's opening statement, it states this. "The all-important matter of the Federal Open Market Committee's portfolio, now amounting to some $66 billion, which I contend has been acquired exclusively through the use of Federal Government credit and which the former Chairman of the Federal Reserve Board, Mr. William McChesney Martin, has admitted have been paid for once and, therefore, should be canceled," that second statement I have never heard Mr. Martin make, but just because something has been acquired through credit does not mean that whatever you have acquired through credit has been paid for; does it?

Dr. BURNS. These securities in the first instance have been acquired by private investors and by the banks. When we in the Federal Reserve enter the open market and buy Treasury securities, we have to pay for them, and we do it just as a private citizen would. If I buy a Treasury security, I pay for it. If you come along and you want to buy it from me and we can arrange a deal, you have to pay for it. Now, it is being paid for twice because you have had two transactions.

Mr. WILLIAMS. But at the same time the $66 billion which you have purchased belongs to the Federal Reserve and is there any more logic to say to the Federal Reserve Board cancel your $66 billion than there would be to say to a privately owned bank cancel your $10 million?

Dr. BURNS. As long as the Congress continues to regard the Federal Reserve as an independent agency with its own set of books, there is no logic at all.

Mr. WILLIAMS. Thank you, Doctor.

The CHAIRMAN. Mr. Rees.

Mr. REES. Thank you, Mr. Chairman.

Dr. Burns, you made the statement that right after the August 15 wage-price freeze interest rates went down. I just saw in the paper that Bank of America just raised its interest rate on housing up to a little over 8 percent and that the consumer interest cost is just about what it was on August 15, consumer interest rates don't appear to have gone down.

There is some upward pressure, it seems, on the long-term interest rate, for mortgage lending.

Dr. BURNS. Congressman, the interest rates on open market issues are uniformly lower now than they were on August 13, the market day preceding the President's announcement. That is a fact.

Now, I think what you have reference to is not rates in the open market but the rates that are charged by banks to their customers. The best information that I have is that the interest rates charged by banks to their own customers preponderantly have remained unchanged. There have been a few increases, but there have been more decreases than increases.

As for the specific reference to the Bank of America, I am surprised by your statement. I know nothing of it and I shall check it out.

Mr. REES. As you know, Doctor, I am very much concerned with the problem of the cyclical nature of housing finance. Right now we are reaching a record in new home starts. Two years ago we were reaching a record low in home starts. Part of the problem was that when you have a tight money policy long-term money becomes short-term money and there is not enough mortgage money available.

I understand that the Federal Reserve Board is preparing a housing report. Will it deal with this problem of how to take care of the housing cycle?

Dr. BURNS. The Federal Reserve Board has been studying this problem intensively. Whether we will be able to help the Congress and the country significantly on this problem I cannot be sure, but we are making every effort.

Mr. REES. Of course, you have given a great deal of support to housing paper just in your initial purchase last week of something like $30 million worth of Federal Home Loan Bank and Fanny Mae paper that you have purchased.

Dr. BURNS. Yes; but I want to be sure that the importance of what we did is not exaggerated. I would describe that action on our part as having a marginal significance in the marketplace. The last thing that I want to do is to mislead the Congress or the industry. We have decided to buy and sell agency issues, and we are doing it on an experimental basis since we are moving on untrodden ground. We do not expect that this action of ours have more than a marginal significance in the market. We do think it can and will have that effect and that is something. We are glad to make this contribution, if it works out that way.

Mr. REES. Dr. Burns, one last question, not really dealing with the Open Market Committee activities.

You have been meeting with the finance ministers of the Group of Ten the last few days. Could you give us some ideas as to where you think we might be going this coming week at the IMF meetings?

Dr. BURNS. I will do what I can.

There are two sets of meetings involved. One is a meeting of the Group of Ten. That meeting was held yesterday and that meeting is concluded.

In addition, there is the annual meeting of the International Monetary Fund and the World Bank. These meetings have started this morning and will continue most of the week.

As far as the meeting of the Group of Ten is concerned, a very honest release has been issued. I have not had the opportunity to look over the morning paper, but I would expect that the full release is in the paper. What it conveys is that a cooperative spirit is emerging among the countries represented in the Group of Ten, that a work agenda—which could not be agreed upon in the London meeting held 2 weeks ago—has now been agreed upon, and that the deputies of the Group of Ten will now be actively at work, along with the OECD, in an effort to resolve the difficulties that exist among the various countries.

The problems are many and they are difficult. The import surcharge, as the President explained, is temporary. But, of course, in view of the very serious condition of our balance of payments, we cannot give up that import surcharge until there is some reasonable realignment of exchange rates and also until some trading arrangements of other countries are modified so that American producers will not be at the disadvantage that they now suffer in some markets in the world. We also hope that in the course of these conversations we will succeed in persuading our allies in different parts of the world to share the defense burden on a somewhat more equitable basis.

All of these subjects will be discussed. In private conversations, I have gathered the feeling that there is good will and a willingness to get on with the problem, but, of course, we are dealing here with human affairs. As you well know, and as the history of mankind teaches, while reason should prevail in governing human conduct, there are times when emotion, prejudice, even madness, enter the human scene and interfere with the outcome that we aspire to. I am, however, optimistic about these conversations. I think we will move forward.

Mr. REES. Thank you, sir.

The CHAIRMAN. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman and Dr. Burns. As a new member, some of these items confuse me a little. I guess the one that confuses me most of all is the Chairman's statement that the $65 billion worth of bonds have already been paid for. Let me ask you in your opinion, does that statement refer to the fact that they have been traded rather than that they have already been paid off?

Dr. BURNS. Chairman Patman is a student of this subject. He is extremely eloquent, lucid, and I would not want to speak for him on this subject.

Mr. FRENZEL. Thank you very much. Dr. Burns, you made the statement, and I will paraphrase it, let us not use the printing press of the Federal Reserve to finance housing or Treasury bonds.

Would we be doing this if we in fact canceled the $65 billion of indebtedness that are held now?

Dr. BURNS. In and of itself, no. If you stopped there and did nothing else, you would simply be declaring that the Federal Reserve System is bankrupt, and that Federal Reserve notes which are now backed by Treasury securities would no longer have any backing. So far that would be the only effect. Whether that is good or bad, I leave to your own judgment, Mr. Congressman. Of course, the matter could not stop there. But to draw the scenario beyond this point would require an act of the imagination. I am here to answer factual questions, not to speculate too much.

Mr. FRENZEL. Dr. Burns, to draw that scenario a little further, if Congress then appropriated $65 billion to pay those debts, would that be inflationary?

Dr. BURNS. Well, if the public debt were in the first instance reduced by $65 billion and then as a second step the Congress decided that it should use this leeway to finance an additional $65 billion of expenditures then I say to you, to paraphrase a remark of my old friend George M. Humphrey—I did not like the context in which he made it, but he used a nice phrase—we would then have an inflation of such magnitude that it would make your hair curl and mine.

Mr. FRENZEL. Thank you very much, Doctor.

Mr. Chairman, based on my own ignorance here, I only hope that you would amplify your statement that you are going to introduce as part of your four points.

The CHAIRMAN. Thank you, sir. I shall be very glad to do so when my time comes.

Mr. Mitchell.

Mr. MITCHELL. Thank you, Mr. Chairman.

Dr. Burns, it is delightful to see you again. We had quite a pleasant time the last time we were together in such a setting.

Before asking one or two questions, I would simply like to indicate to you that this troublesome $66 billion is beginning to plague me also, and I hope we would get to a speedy resolution of the $66 billion problem. I intend to become much more conversant with this area of concern.

I just have a few brief questions. First of all, I am fully aware that you will not be buying from the agencies directly, nevertheless, you will be buying paper from Federal agencies and I am concerned about the kind of coordination that was achieved prior to the announcement of September 16.

What was done specifically in terms of coordinating with these agencies? How will coordination be carried out in the future? I am assuming this was not a unilateral move on the part of the System. Could you enlighten me a little bit on that because I share your concern and Congressman Gettys concern about possible conspiratorial actions on the part of agencies.

Dr. BURNS. Let me go to the heart of your question. This was a unilateral action by the Federal Reserve.

Mr. MITCHELL. It was?

Dr. BURNS. Yes, because we are the only ones who can make this decision as a matter of law. However, this is a subject that has been discussed informally with Members of the Congress and other agencies over several years. Before making the announcement, also, a meeting was held with representatives of all the involved agencies. We explained to the representatives of these agencies precisely how we intended to operate in the market, so they were fully informed before any public announcement was made.

Mr. MITCHELL. Thank you. Congressman Rees indicated in one of his earlier questions to you his concern about housing.

This is a major area of concern for me also. Of course, we are encouraged by the $430 million that was put in though it will have only minimal effects according to your testimony. But what troubles me the most in the whole housing sphere is that new housing starts and mortgage moneys are not made available in cities. These are occurring primarily in suburbia. I think we can indicate very, very clearly to you that in the large cities, with their heavy concentrations of black populations, it is increasingly difficult for blacks to enter into home purchasing. There are few, if any, new housing starts in cities. So, unfortunately, in most large cities with heavy concentrations of black populations you find a situation in which those persons can be blatantly and arrogantly exploited by unscrupulous people in the real estate business.

Pushing a little further on this, it would seem to me then, by your action in terms of the whole housing market, you might be wittingly or unwittingly a partner to the further exploitation of these people. Pushing it even a little bit further, given the posture of the President vis-a-vis housing in suburbia, you kind of get a mosaic developing in which those who are caught in a very, very difficult situation find their difficulties increased by virtue of the actions taken by the Federal Reserve System and the executive branch.

Would you comment on that please?

Dr. BURNS. Congressman Mitchell, the question that you have just raised is addressed to the housing legislation of the Congress and also to the way in which that legislation is administered by agencies of the executive branch. As a result of that legislation and of the administration under that legislation, various debt issues are placed in the market by these agencies. All that we at the Fed shall do is now and then trade in these issues in the market. The end result, hopefully, will be to broaden the market for these agency issues.

Now, if these agency issues, Congressman Mitchell, were being used for an unsocial purpose, if that were true, then to the extent that we broaden the market we would be contributing to an unsocial purpose. There is no escape from your logic, you see. Whether or not that is true or to what extent it is true is a matter on which I have no competence. I must say, speaking as a citizen. I would like to learn more about it. And let me take this opportunity to say something else to you. When I was here last I promised to visit with you, something I wanted to do very much. I have not done it. And your raising this question makes me all the more eager to arrange an appointment with you in the very near future. My colleagues who are here, having heard me, will make sure this is done. They run my business in large part.

Mr. MITCHELL. That is hard to believe.

Do I have time for two more questions, Mr. Chairman?

The CHAIRMAN. Go ahead.

Mr. MITCHELL. In light of the statement that you just made, do you feel that the Federal Reserve should attempt to coordinate with the Secretary of Housing and Urban Development and direct purchase of housing paper in the open market in such a manner as to support at least the enunciated national housing goals? I noticed that in all of this there is no reference to HUD operations.

Dr. BURNS. Well, if the Congress should give us this responsibility we would do our very best to discharge it. I feel that if we, as an agency, tried to do that now we would be going beyond the powers granted us by the Congress. But certainly, as citizens—we are not Government officials every hour, every minute of a 24-hour day—I think we can interest ourselves in the broad question you have raised.

Mr. MITCHELL. I have one last question, then I am finished. In your statement you indicate there is a 10-percent ceiling put on holdings of amounts outstanding, and that you have established a 2-week period during which a fair market price can be established. I am a little curious about this because, despite the fact of some very eloquent pronunciamentos coming from the executive branch of Government, it is my overall impression that the market has continued to go through some rather wild gyrations. I am just curious as to whether or not you might want to reconsider the 10-percent figure and the 2-week period given the sort of gyrations the market is going through despite some moves made by the President?

Dr. BURNS. The 10-percent figure and also the 2-week limitation are, as you suggest, arbitrary. They represent our best judgment at the present time and we do not have too much to guide us. These are not necessarily the rules that we will live with a year from now. This is an experimental set of guidelines. We will keep studying them to see how they work and we may then want to revise them.

Mr. MITCHELL. That is what I wanted to be reassured on. I have no further questions. I look forward to our meeting.

Mr. WIDNALL. Dr. Burns, you have been buying Fannie Mae paper, I believe, and that involves mortgage paper.

Isn't there a limitation of $22,000 a unit in the mortgages that are involved so that actually the interest in buying that paper is a low- and middle-income housing; is that not correct?

Dr. BURNS. I think that is true. But, of course, we would not be buying mortgages. Under the program we are discussing, we would be buying the agency issue which is——

Mr. WIDNALL. Fannie Mae paper.

Dr. BURNS (continuing). Which is simply a debt obligation of the agency rather than any mortgage.

Mr. MITCHELL. Mr. Widnall, just in response to you, I think I would like to share some material with you regarding how this whole business of low- and moderate-income housing is working out. It isn't It is not working out primarily because many of the counties regard themselves as citadels. Given the limited amount of housing in cities, and no new housing starts, the program is not working too well.

I will share some information with you on that.

The CHAIRMAN. Dr. Burns, I would like to resume questioning. I will try to make it as short as possible. If we cannot get through by 12 o'clock, could you come back, say, at 2 o'clock or 2:30, something like that?

Dr. BURNS. I am a servant of the Congress, but it has been very difficult for me to get away today, Mr. Chairman. I have obligations in connection with the meetings that are now going forward in the international field. I have made arrangements for the afternoon to participate in some of these meetings, and they are of vital significance.

The CHAIRMAN. We contemplated taking the whole day, but of course, if that was not made plain to you——

Dr. BURNS. No; that was not made plain to me. I was never informed of that, but that may have been a slip, probably a slip in communication. I regret that.

The CHAIRMAN. I can get through before 1 o'clock.

Dr. BURNS. I do want you to know it was very difficult for me to come here this morning. There are representatives here from all over the world. I have important business with them. But since you wanted me here, and recognized my obligations to the Congress, I am here. If you think it is urgent that I be here in the afternoon, I am going to put everything else aside and be here.

The CHAIRMAN. I shall try to finish by reserving some of my remarks for submission in the record. I do not want to impose upon you.

Of course, we offered to meet last week on Wednesday or Thursday, but you preferred Monday.

Dr. BURNS. Well, I preferred Monday, and in all candor, I would have preferred a Monday a month from now because I am running a large institution.

The CHAIRMAN. I am in sympathy with you.

Dr. BURNS. In addition to that, there is this international problem and I have to spend several hours a day on that and there is a wage-price freeze, and I am involved in that every day too.

The CHAIRMAN. I don't know who isn't.

Now, I will first take up the question of buying and selling Federal agency securities.

Suppose that you were to buy securities for $12 million, like the issue you bought, and for some reason, it is not only sour but is illegal and cannot be paid. Who would lose that money?

You know, you have taken $12 million of Federal credit to pay for the bonds and find that it is not legally liable, that you do not have a negotiable instrument that you can compel payment on. Who loses the money?

Dr. BURNS. We have authority under the law to buy agency issues. In buying agency issues, we will be conforming to the law.

Now, if we have an agency capable of putting out an illegal issue, we also have very good attorneys in the Federal Reserve System, and I think they will spot that rather quickly. So I don't think this kind of a problem is going to arise. If it did arise, then Mr. Chairman, we would have a problem at the Federal Reserve, but you Members of the Congress would have a far more serious problem to deal with.

The CHAIRMAN. I brought that up in connection with what you call printing press money. Now, when you buy these bonds, you give Government credit for them—Federal Reserve notes, if they want the Federal Reserve notes; if they don't, you give them credit on the books. Isn't that printing press money?

Dr. BURNS. We are a bank——

The CHAIRMAN. You are what?

Dr. BURNS. We run a bank created by the Congress. The bank that we administer has the power, yes, to create money, but the Congress in its wisdom has sought to limit that power in order to avoid abuse. We have tried to live within the guidelines laid down repeatedly by the Congress.

The CHAIRMAN. Who do you consider owns the $66 billion in bonds for which you paid Federal Reserve notes and other Government obligations?

Dr. BURNS. We are a separate entity established by the Congress. We as an entity created by the Congress own those assets and we in turn have certain liabilities, these liabilities being primarily the reserves held with the Federal Reserve System by the member banks, and also the Federal Reserve notes outstanding.

The CHAIRMAN. A separate entity? You mean by that that you are independent of the Government and independent of other agencies of the Government, independent of the executive branch?

Dr. BURNS. No; all that I am referring to is a legal entity with its own set of books. There are many such agencies within the Federal Government. The question of independence, while in many ways a very important question, is not germane to the issue before us right now. We are an entity. We have a separate set of books; we have assets, and we have liabilities, like any other corporate entity.

The CHAIRMAN. Dr. Burns, you had nothing with which to pay for these bonds except other Government paper. Now, you are a fiscal agent of the U.S. Government too?

Dr. BURNS. We are.

The CHAIRMAN. Don't you think that it is your duty as an agent to safeguard and protect your principal, that you should not let your principal get in a position where it is necessary to have two obligations outstanding in order to pay for one, or to hold one? Those bonds that you claim belong to you, to the Federal Reserve, were paid for once with Government money. It occurs to me that you ought to do like churches probably do when they pay off an obligation. They have a bond burning, and it is a great event.

Don't you think a bond burning would be a wonderful thing for the United States since we paid for these bonds once with Government money?

Dr. BURNS. I don't think I would like to be alive, my good Chairman, at a time when such a bond burning occurred.

The CHAIRMAN. Well, doesn't it scare you to think about the Government putting $2 in circulation for $1?

Here you have $66 billion of bonds and you have paid for them one time with Government obligations, but you have got both outstanding.

You have the money outstanding, you have the bonds outstanding, and you are collecting over $3¾ billion a year interest on those bonds. How do you justify not going through the Congress?

You see, the Constitution says that money shall not be paid by the Government unless it is appropriated by Congress. You get around that by holding these bonds that have been paid for once and collecting interest on them and using the money any way you want to.

For instance, I am going to bring out some of the expenses that you incurred in 1969, the only full year that we have information for, although you have been cooperative, Dr. Burns, in furnishing the information we wanted.

It occurs to me that you can't justify anything like that. Why should people pay their debts more than once, pay them twice? And in the Open Market Committee, you are selling some of these bonds that have been paid for once. You are selling them back into the market, and when the bank that buys that bond holds it a while, and maybe wants to sell it back to you, then you pay for it again. Later on, the same bond is sold to somebody else, and later on, if they want to sell it back, it is paid for again. And this way the Government would be in the business of selling bonds, buying them back, and paying for them again. They have been paid for once or twice.

It occurs to me that is a most inflationary arrangement that any government on earth could engage in. What is your answer to that one?

Dr. Burns. Well, my answer, Congressman, is in brief as follows:

First, the Treasury sells securities in the market. A bank or private investor buys these securities.

Second, as a separate entity established by the Congress, we may enter the market. We may buy or sell. When we buy we pay for it.

The Chairman. Tell me the law that created that separate entity.

Dr. Burns. The law which created that separate entity is the Federal Reserve Act.

The Chairman. The Constitution says that the Congress shall make the laws and the executive shall enforce the law.

Now, I am fairly well acquainted with the Federal Reserve Act. I wasn't here when it was passed, but I was here not so long after that, and I have kept up with it pretty well. And I have never been able to find a sentence in the Federal Reserve Act that indicated that the Federal Reserve should be independent of the Government.

Would you tell me where it is?

Dr. Burns. I have not claimed that the Federal Reserve is independent of the Government.

The Chairman. You said separate entity, you know.

Dr. Burns. I have recognized not only in the past, but again this very morning that the Federal Reserve is a creature of the Congress, and that it is a servant of the Congress. I have put urgent considerations aside in being here this morning, and if you really feel it is basically important to the purposes of the Congress to have me here in the afternoon——

The Chairman. I am trying to get through, but you are doing a lot of talking to keep me from it. If you will not go on so long in your answers——

Mr. Widnall. Mr. Chairman, I am very much interested in Dr.

Burns' reply to your question about paying for these bonds twice. In the middle of his answer, you cut him off, I would like to finish his answer to your question.

The CHAIRMAN. Certainly; you may have the privilebe, I am sorry, Dr. Burns, I cut you off. I didn't think it was at a time——

Dr. BURNS. No; not at all. I am here to answer your questions to the best of my ability. Please feel free to interrupt me. If you really feel my answers are too long—I may surprise you, and start giving very brief answers. But I do think that you want clarifying answers from me.

The CHAIRMAN. That is right. Let's have it understood that if your answer is not sufficient, you have permission to enlarge upon it like a Member of Congress, to extend your remarks.

Dr. BURNS. Well, I appreciate that.

The CHAIRMAN. All right; now, then, the accepted procedure in the banking system for the creation and manufacture of money is that they make a loan to an individual, we will say John Doe, for a certain amount——

Mr. WILLIAMS. Mr. Chairman.

The CHAIRMAN. Wait just a minute. Don't interrupt me.

John Doe gives a promissory note for the amount and this is due in 90 days. In 90 days, John Doe comes back and he pays the amount that he borrowed. They cancel the note, thereby canceling the obligation, thereby destroying the created money. That is the way to stop inflation. That is the way to keep the books balanced. But in this case, you buy the bonds with a Federal obligation. Federal Reserve notes, guaranteed by the Government of the United States—legal tender, good for all debts, public or private—and you keep the bonds that are drawing interest and collect interest on those bonds that have been paid for once. And then the notes continue in circulation indefinitely.

Isn't that entirely different from the monetary system as it was set up, that you create money, and then you destroy it through the process that I mentioned?

Dr. BURNS. Mr. Chairman, Congress could have written the Federal Reserve Act in a very different way than it did. The Congress can do that at any time in the future.

If the Congress had made the Federal Reserve an office of the U.S. Treasury, then the Federal Reserve would have no assets, the Federal Reserve would have no liabilities, and perhaps the kind of world that you have visualized might exist.

The CHAIRMAN. The Federal Reserve has no assets now except what it has created.

Mr. WILLIAMS. I think that Dr. Burns is trying to explain something that he started to explain twice.

The CHAIRMAN. He stopped. I can only tell by the movement of his lips.

Mr. WILLIAMS. He only stopped because you started to talk.

Let's give him a chance to say it.

The CHAIRMAN. I won't accept your complaints.

Mr. WILLIAMS. He hasn't had a chance to complete his answer.

Dr. BURNS. I am not a complaining man. I enjoy my association with this committee. Some questions that we have are by their very nature a little difficult and controversial. And each of us——

Mr. WILLIAMS. You started——

The CHAIRMAN. I am trying to get through.

Mr. WILLIAMS. You started to reply on how the Treasury issues obligations and how others purchase them. You have been talking about assets and liabilities of the Federal Reserve. From that point, would you please continue with your explanation.

The CHAIRMAN. I have the witness now.

Mr. WILLIAMS. Will he please answer your question.

The CHAIRMAN. I am trying to shorten it for Dr. Burns. I know what he is up against, I discussed this with him.

I will take up the question of Federal Reserve purchases of agency paper. I will put this in the record. (See page 39.) I will ask you to go over it, Dr. Burns, when you look over your transcript, and where questions are asked, I wish you would consider answering them. If you can't, of course, I can take them up at some subsequent hearing.

It has been rumored, Dr. Burns, that one of the reasons, if not the reason, the Board took action on September 16 to allow the Federal Reserve Open Market Committee to purchase and sell agency paper was to temper congressional criticisms that might result when your housing study is released.

Speaking for myself, Dr. Burns, I hope this is not so.

Further, I would hope that your study of the housing market, its problems and prospects, would clearly indicate a definite commitment by the Federal Reserve Board and the System to substantially involve itself in meeting the financial needs of our housing industry and mortgage market in a direct way through open market activities.

It is my honest belief, Dr. Burns, that you could furnish money for the needed housing in this country at 5 percent interest without any discounts or under-the-table payments or anything else, and I think it is going to take some revolutionary action like this to furnish people the needed housing. I hope the Federal Reserve will give consideration to that. Since the money doesn't cost you anything, and certainly you could afford to make it available at 5 percent to people who need homes or to furnish environmental quality to the families who are entitled to a stable, strong, sanitary home. I hope that you will give it consideration.

Could you supply us with a list of all of the Federal agencies, including the wholly owned Government agencies and Government-sponsored agencies, whose paper you consider either by law or by interpretation by the Attorney General to be eligible for purchase and sale through the Federal Reserve Open Market Committee?

You may answer that for the record when you get your transcript, Dr. Burns.

(In response to the request of Chairman Patman, the following information was submitted for the record by Dr. Burns:)

REPLY FROM DR. BURNS

Under section 14(b) of the Federal Reserve Act direct obligations of, and obligations fully guaranteed as to principal and interest by, any agency of the United States are eligible for purchase by the Federal Reserve. These include the following:

(1) Federal Intermediate Credit Bank debentures,
(2) Federal Home Loan Bank notes and bonds,
(3) Federal Land Bank bonds,

(4) Bank for Cooperatives debentures,

(5) Federal National Mortgage Association notes, debentures and guaranteed certificates of participation,

(6) Obligations of or fully guaranteed by the Government National Mortgage Association,

(7) Merchant Marine bonds,

(8) Export-Import Bank notes and guaranteed participation certificates,

(9) Farmers Home Administration insured notes,

(10) Notes fully guaranteed as to principal and interest by the Small Business Administration,

(11) Federal Housing Administration debentures,

(12) District of Columbia Armory Board bonds,

(13) Tennessee Valley Authority bonds and notes,

(14) Bonds and notes of local urban renewal or public housing agencies fully supported as to principal and interest by the full faith and credit of the United States pursuant to section 302 of the Housing Act of 1961 (42 U.S.C. 1421a(c), 1452(c)),

(15) Commodity Credit Corporation certificates of interest in a price-support loan pool,

(16) Federal Home Loan Mortgage Corporation notes, debentures, and guaranteed certificates of participation,

(17) United States Postal Service obligations.

It should be noted, however, that under the operating guidelines now governing Federal Reserve open market transactions in Federal agency debt, not all of the securities listed above are eligible for purchase. The nature of these limitations and the reasons for them are discussed in my prepared statement.

The CHAIRMAN. Guideline No. 2 indicates it would not be the function of the Open Market Committee to support individual sectors of the market or to channel funds into issues of particular agencies. Isn't this, in fact, a guideline without meaning since guideline No. 5 indicates that the Open Market Committee purchases of Government agency issues will be limited only to issues outstanding in the amount of $300 million or more?

(In response to the request of Chairman Patman, the following information was submitted for the record by Dr. Burns:)

REPLY FROM DR. BURNS

The objective of guideline 2—to avoid support of individual market sectors or to channel funds into issues of particular agencies—represents a general operating principle. Guideline 5 represents a practical application of this general principle.

Guideline 5 limits System transactions to agency issues of a certain size. The size limit is necessary to insure that System buying will not impede the development of an active secondary market for agency issues. As individual agencies are able to increase the size of their issues to the point where they are actively traded (as defined currently by the size test in guideline 5), they will become eligible for System transactions.

The size limit would not in itself forestall support of individual market sectors, however. This is accomplished in part through guideline 6.

The CHAIRMAN. I will ask you to take the other questions, Doctor, and when you look at your transcript, answer them too..

Now, the next one is the one about the thrift plan.

Under this so-called thrift plan, Dr. Burns, if I understand it correctly, you have 20,000 employees of the Federal Reserve System. You are picking them out as a group of Federal employees and telling them, "if you will contribute so much a month of your salary, the Federal Reserve will put in 25 percent of that amount," give it to them free. Where do you get the money to supply that 25 percent, Dr. Burns?

Dr. BURNS. We get the money to provide that 25 percent in exactly the same way that we get the money to buy stationery, to buy the paper that I have used in my statement for this hearing, to pay salaries, et cetera.

The CHAIRMAN. In other words, by creating money?

Dr. BURNS. No. We have an income from the securities which we have purchased and which are in our portfolio. We use that income in a thrifty way. We turn over the great bulk of it to the Treasury, but we draw upon that income to meet our expenses. We are running our shop as efficiently as we know how.

The CHAIRMAN. It was acquired through the use of created money, Dr. Burns?

Dr. BURNS. We are a bank.

The CHAIRMAN. You couldn't have gotten it otherwise.

Dr. BURNS. We are a bank. When we acquire securities, we give a deposit credit.

The CHAIRMAN. I will attach some questions here that I will ask you to answer too.

Here is a letter from the Comptroller General of the United States. I asked him about this matching of Federal Reserve funds. He said, "Thus, in the absence of specific legislative authority, agencies of the Federal Government whose operations are financed with appropriated funds would not be legally authorized to make contributions to a fund of this type. In the limited time available to us for review of the matter, we have not been able to make a full research, however, we are not aware that such specific authority has been granted to any Federal agency operating with appropriated funds. Also, we are not in a position at this time to state a conclusion with regard to those few Federal agencies which operate with other than appropriated funds."

Without objection, I will insert the letter in the record.

(The letter referred to follows:)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., September 24, 1971.

B-174174.
Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives.

DEAR MR. CHAIRMAN: Your letter of September 21, 1971, requested that our Office look over correspondence that you have had with the Chairman of the Federal Reserve Board, which concerns a thrift plan which the Board has had established for the employees of the Federal Reserve System. Under this plan employees contributions to a fund are matched by the Federal Reserve. You characterize the Federal Reserve's matching as contributions of the Federal Government and ask that by Friday, September 24, you be advised as to whether contributions to such a fund would be legal for any other agency of the United States Government.

Section 3678 of the Revised Statutes of the United States, 31 U.S.C. 628, requires that sums appropriated to the various branches of expenditures in public service shall be applied solely to the objects for which they are made and for no others. Thus, in the absence of specific legislative authority, agencies of the Federal Government whose operations are financed with appropriated funds would not be legally authorized to make contributions to a fund of this type.

In the limited time available to us for review of the matter we have not been able to make a full research, however, we are not aware that such specific authority has been granted to any Federal agency operating with appropriated funds. Also, we are not in a position at this time to state a conclusion with regard to those few Federal agencies which operate with other than appropriated funds.

Sincerely yours,

PAUL G. DEMBLING,
Acting Comptroller General of the United States.

The CHAIRMAN. So all the agencies are restricted on the use of funds, like the Postmaster. If he were to use the stamp money, they would put him in the penitentiary. In other agencies there are other restraints and limitations and criminal penalties are handled in the same way. There might be two or three agencies that do things differently.

Dr. BURNS. I don't think that on the basis of the actions carried out by the Federal Reserve Board, any judge would send any Federal Reserve official to jail, and I don't think in the last analysis that you would recommend it.

The CHAIRMAN. I made it plain that we were not accusing you of that, but I am stating that your results are different. In the Post Office Department or other agencies of the Government you are accountable and couldn't get money except through appropriated funds.

Dr. BURNS. You are quite right.

The CHAIRMAN. But you are getting it from bonds that have already been paid for once, and you don't have to have any funds appropriated, and that way you avoid the surveillance of Congress. Also you are avoiding an audit. You are against an audit, and there has never been a Federal audit of the Federal Reserve System, or any part of it, since it was created. That puts us all in the dark, Dr. Burns, and I wish you would relent and permit the General Accounting Office to audit your books so we could find out.

Do you have an audit, even an office audit, of the Open Market Committee for last year?

Dr. BURNS. We have. I think—and I am assured by counsel—that our auditing system is one of the most exacting in the entire corporate or governmental world.

The CHAIRMAN. But they have been considered self-audits. You don't let any General Accounting Office man come into your agency anywhere, because I at one time made arrangements to have the General Accounting Office go to New York and count the bonds. You see, they are all in the New York Federal Reserve Bank, and they refused to let him come in or give him any information about that at all.

How do you justify the expenditure of Federal Reserve funds for membership in the American Institute of Banking?

Why is it necessary for the Federal Reserve to pay for membership in the National Rifle Association and the American Dietetic Association?

(In response to the questions of Chairman Patman, the following information was submitted for the record by Dr. Burns:)

REPLY FROM DR. BURNS

The American Institute of Banking offers a variety of academic courses directed toward the education and training of people in banking. Its educational program is as relevant and important to the development and training of employees of the Reserve Banks as to employees of commercial banks. The costs of this program are only partially meet by tuition fees and membership dues. Participating banks assist this important source of banking education through contributions in the form of assessments or dues. The various offices of the Reserve Banks, which directly benefit from the Institute's programs, have assumed their fair share of the costs.

Membership in associations such as the National Rifle Association and the American Dietetic Association is held by a few Reserve Banks as a professional aid to employees with special responsibilities. Guards and cafeteria personnel, for example, use the publications and announcements of these associations to keep up with current developments affecting their responsibilities.

69-719—71——5

The CHAIRMAN. In 1969, the Federal Reserve Bank of New York spent nearly $1,500 on the annual kiddie party for children of the members of the Federal Reserve Bank of New York.

What is the purpose of this expenditure? Is it a practice of the Federal Reserve to pay for parking tickets for Federal employees whether or not they are on official business and so forth?

In 1969, more than $7,800 was paid by the Federal Reserve System to the Federal Reserve clubs.

Would you please explain to the committee what these clubs are and how they further the central banking activities of our country?

In connection with these Federal Reserve clubs, has the Federal Reserve System ever paid for Federal Reserve clubs to have parties in Playboy Clubs, complete with accouterments, and can you give the committee some example of the expenditures by Federal Reserve banks which would not be appropriate for reimbursement by the Federal Reserve System?

How many expenditures have the in-house auditors of the Federal Reserve System ever questioned as being unauthorized?

Would you please provide the committee with a list of such expenditures which were listed as not allowable, and I have another one here.

Dr. BURNS. May I just say one word?

The CHAIRMAN. Yes, sir.

Dr. BURNS. I shall answer the questions to the best of my ability. I will look into each of your questions with very great thoroughness. But as far as your reference to a Playboy Club is concerned, I didn't know there was that much imagination on the part of any of my colleagues.

The CHAIRMAN. Well, if they used Federal money for it, don't you think it is worthy of consideration? In other words, this is money that you would create on Government credit and that you invest—I mean, buy bonds with—and you keep these bonds and let the money go, and collect the interest on the bonds which have already been paid for. Since they don't have an audit, and they have been unable to get a bill through Congress to require an audit of the Federal Reserve banking system, don't you think that the Congress should pick out things like this as an example of the unworthiness of certain expenditures and bring it to the attention of the people responsible?

The others I have put in the record, and the expenditures, I think, are something that should receive a lot of consideration, of course.

(In response to the questions of Chairman Patman, the following information was submitted for the record by Dr. Burns:)

REPLY FROM DR. BURNS

Federal Reserve clubs are organizations through which employees of the Reserve Banks can engage in a variety of educational, social, or recreational activities. By providing a means of association not strictly related to work, the clubs contribute to the morale and loyalty of the employees of the Reserve Banks, helping to achieve the employment stability essential to efficient and economical operations. Employee clubs are an effective employee relations tool in common use in and out of Government.

One of the Federal Reserve clubs gave a sports banquet in 1970 honoring 27 men and women employees who had participated in the club's athletic program. The location was the Playboy Club. It was chosen because it submitted the lowest bid of several local restaurants contacted.

In its instructions to the Reserve Banks, the Board has set forth its views on the kinds of expenditures which are appropriate for the Banks, and has given concrete examples of expenditures which are not allowable, such as dues for membership in private clubs or in the American Bankers Association and contributions to community welfare and charitable funds. These instructions guide the officers of the Banks with responsibility for approving expense vouchers, the internal auditors of the Banks, and the Board's examiners. This review system assures that each expenditure receives careful scrutiny by at least three persons. Questionable expenditures are handled by the Banks before the advent of the Board's annual examination. In the relatively rare cases where Board examiners still find questionable expenditures which have not been resolved within a Bank, the matter is settled in conferences with the Bank's officers. No record of such settlements is made or retained, because such work is a normal part of the auditing function.

The CHAIRMAN. Now, on the statement that I have up here, by the staff, there is the cost of a babysitter for an official and his wife to attend two dinners, Federal Reserve Bank of New York, $20.90.

Then, of course, here is the American Institute of Banking $4,256, in New Jersey, and so forth, and a lot of the other banking institutions.

I know that you stopped them from making contributions to the American Bankers Association, Dr. Burns, and I congratulate and commend you for it. But it occurs to me that all of these other expenses are just as far out in the field—like lunches for the new employees in the Federal Reserve Bank of New York, $933—and $4,200 by the Federal Reserve Bank of Kansas City, 25-year activities, $3,279, and certain watches and checks, and——

Mr. WIDNALL. Mr. Chairman.

The CHAIRMAN. And fruit baskets. I am getting through. If you will let me go a little bit, I will be through.

Would you want me to yield for a question?

Mr. WIDNALL. Yes.

The CHAIRMAN. Go right ahead.

Mr. WIDNALL. What pertinence does this have, Mr. Chairman, to the major questions involved in the operations of the Federal Reserve System?

We went into a lot of these things a couple of years ago and I can't see anything that this can do except create headlines and take the minds of the public off the main thrust of our investigation.

The CHAIRMAN. Is the gentleman opposed to audits and investigations of Government expenditures of money, especially when we are spending $2 for every $1 of what you get? And that is what this is.

I have in here the description of an employee who was transferred to Helena, Mont. He made a number of trips. They are all outlined here. It was just for the purpose of getting a home. Usually one trip is allowed. I am putting the other expenses in. Now, I believe I have included everything that I mentioned in the beginning of my statement. Here is one attached to the thrift plan. Therefore, Dr. Burns, it will be all right with me to release you when I get through with this one other question.

You talked about interest rates.

During one period of time, 14 years ago, when everybody could see we were going to get involved in a war in Europe, and the Federal

Reserve and President Roosevelt decided that even if we won the war militarily, it would be lost if interest rates were not kept under control. So they started a campaign in the Federal Reserve, and they said, you name the place where you want the bonds to be maintained, and we can keep it there at 1.99, or 4.01, or 5.27, or any point you want. We have the power and we can keep the bonds at that interest rate.

Well, Mr. Roosevelt suggested that a good wholesale rate for money would be a little less than 2½ percent, and they agreed on that.

Now, Mr. Eccles didn't like that, but he agreed. He was a good patriotic person. He said we must keep interest rates down to keep inflation down, and from 1939 to 1953, the interest rates were kept by the Federal Reserve at less than 2.50, less than 2½, and anyone who had those bonds could get his money at any time he wanted. That was one of the reasons it was done—to make it easy for people to get their money back on the bonds when they needed it.

So for 14 years, those rates were maintained. Because of that, Mr. Truman was able to pay $29 billion on the national debt before he went out of office and we were able to pass the GI bill of rights to provide for 15 million returning servicemen. We sent them to colleges and universities and they received more degrees than had ever been received before in the history of America, and there were more educated young men, all because of low interest rates. And if they wanted to buy a home, they could buy it and get the money from the Government on reasonable terms; if they wanted to go into business, they could borrow the money from the Government on reasonable terms, or they could go to college, as most of them did. Thus we avoided a bad period in making the transition from war to peace.

Now, in 1944—the darkest days of World War II—we commenced working on something to bring these boys back without a depression. Everybody was saying, name one major country in the civilized world that had a major war and did not have a major depression after the war was over. You couldn't name one, because heretofore, they had always had a major depression.

So by enacting the GI bill of rights and taking care of the returning servicemen, we avoided a depression. This was the first time in the history of the world that a major country had a major war and did not have a major depression.

Now, after those 14 years were over, Mr. Eisenhower came into office, and Mr. Humphreys, whom you mentioned a while ago, who was a very nice person. Of course, his views were antagonistic to mine. The first bond issue he put out was for 3¼ percent and it almost caused a depression. The percentage rate rose from 2½ to 3¼. Just before that, when Mr. Eisenhower first came in and took the oath of office on January 20, 1953, a bond issue was put out for 2⅜, oversold, and after that, a bond issue for 2½ was put out and oversold. As that indicates, for 14 years including those first 2 or 3 months of Mr. Eisenhower's administration, interest rates were maintained at 2½ percent and less, which, of course, saved our country in that time. That shows they could do it. That is a demonstration. That is the proof. Nobody can question it.

I will place the following tables in the record at this point showing the interest payments on public and private debt for the years 1953 to 1970, and the yields on long-term Government bonds, 1939 to 1952:

TABLE 1.—INTEREST PAYMENTS ON PUBLIC AND PRIVATE DEBT

[Dollar amounts in billions]

Year	Public and private debt	Interest paid	Interest costs figured at 1952 average	Excess interest paid
1953	$581.6	$21.7	$20.5	$1.2
1954	605.9	23.5	21.4	2.1
1955	664.9	25.8	23.5	2.3
1956	698.3	29.5	24.7	4.8
1957	728.3	33.6	25.8	7.8
1958	769.1	35.5	27.2	8.3
1959	831.4	40.3	29.4	10.9
1960	872.4	44.2	30.9	13.3
1961	929.8	46.8	32.9	13.9
1962	997.1	52.5	35.3	17.2
1963	1,071.7	58.7	37.9	20.8
1964	1,153.7	65.2	39.8	25.4
1965	1,245.6	72.4	44.1	28.3
1966	1,340.8	81.9	47.5	34.4
1967	1,436.4	89.9	50.8	39.1
1968	1,513.6	104.9	53.9	51.0
1969	1,653.6	120.6	58.5	62.1
1970	1,781.2	135.6	63.0	72.6
Total				425.5

Note: National debt as of Sept. 22, 1971, was $414,700,000,000.

Table 2.—Yields on long-term Government bonds (percent per annum) 1939 to 1952

Year:	*Yield*
1939	2.36
1940	2.21
1941	1.95
1942	2.46
1943	2.47
1944	2.48
1945	2.37
1946	2.19
1947	2.25
1948	2.44
1949	2.31
1950	2.32
1951	2.57
1952	2.68
Average for 14-year period	2.36

Now, in the years since then, from 1953 to 1970, we have had a public and private debt in billions of dollars, and we have paid interest in billions, that is, the interest on both public and private debt. You will remember when the so-called accord came up in 1951. Mr. Martin, you know, was taking control of the Federal Reserve System at that time, as Chairman of the Board, and he promised Mr. Truman, I was told, at that time—that was in the early part of 1951—that bonds would not be allowed to go above 2½ percent while Harry Truman was President of the United States. He kept his word on that, although he wanted to take the lid off and take the fixed price off.

If you will notice, in all of the months of 1951 and 1952, none of the bonds were sold at more than 2½ percent. So he did keep his promise to Mr. Truman.

Of course, when Mr. Truman heard that the Board was going to take the lid off the bonds, he called them into the White House. One newspaper reporter said he called them names and said, any time you begin to do that, you are going to ruin this country and your patriotism is going to be questioned. You are going to have lots of trouble, and the Board went back and decided not to pull out the peg. That was some talk on the part of the President. It really got results, and it was helpful.

Low interest rates have been very helpful to this country. If we had maintained those rates as we did for 14 years, and paid interest costs figured at the 1952 average, we would have saved $425.5 billion.

Now, that is quite a saving, that is more than the national debt is now. The national debt is $414 billion. So we wouldn't have a national debt today had it not been for the high interest policies of William McChesney Martin. These policies have caused a great deal of trouble for our country. We should not undertake to throw this lesson aside and pay no attention to it, and start on a binge of high interest again.

Mr. Williams. Will the gentleman yield?

The Chairman. Yes.

Mr. Williams. Would you also please include in your comments what experience the Treasury Department is having now in selling their issues, and would you also please comment on the credit of this country with the national debt standing at $416 billion, and it has increased $100 billion just since I have been in Congress in 4½ years, or close to 5 years.

The Chairman. I am glad the gentleman is interested in that, because I know he will want to cancel the $66 billion of bonds that have been paid for once. I have Mr. Martin's statement on that. Let me read that. You questioned it this morning.

Mr. Williams. What experience is the Treasury having today in selling their issues?

The Chairman. Well, they shouldn't have any trouble.

Mr. Williams. I am telling you they are undersubscribed, every issue they sell.

They have been borrowing money for so long that our credit no longer ranks the way it did when our national debt was just a few billion dollars, which is the time that you are talking about, when President Roosevelt was in.

The Chairman. The Government doesn't have to pay interest at all if it doesn't want to. We are not advocating it, I am not. I believe it should be done in the traditional way.

Mr. Williams. I want the record to show that the Treasury Department today, and under the Johnson administration, was having trouble selling their issues. There has not been an issue oversold in years. We are forced into short-term borrowing at extremely high interest rates and this is due to the deficit spending of this Government which we have been practicing for all too long.

The CHAIRMAN. I assure you that for 14 years and during two wars—World War II and the Korean war— and all kinds of inflation, black markets, all the usual wartime problems, they kept interest rates below 2½ percent. You couldn't have a better case. That is a perfect case.

Mr. WILLIAMS. Do you have any more questions for the record?

The CHAIRMAN. I will decide that right now.

I am quoting from the testimony in which Mr. Martin admits that the bonds in the Federal Reserve portfolio were paid for once by the U.S. Government.

Mr. PATMAN. In other words, each note says on its face: "The United States promises to pay to bearer on demand so many dollars." That is just as much a Government obligation as a U.S. bond maturing 10 years from now, isn't it?

Mr. MARTIN. It is money.

Mr. PATMAN. It is an obligation of the Government.

Of course it was.

And further on in the testimony—I will put in the record, I will not read it all:

Mr. PATMAN. I cannot get the reasoning there at all, Mr. Martin. If that makes sense, I am unable to comprehend it. Of course, there may be something in my background, lack of knowledge, that would account for it. But I do know this: No one should be compelled to pay his debts more than once, but in this instance, you would compel the Government to pay his debts more than once. You would compel the Government to continue to pay interest on bonds that have already been paid for. When you bought these bonds, you paid for them. You will admit that, will you not, Mr. Martin?

Mr. MARTIN. The bonds were paid for in the normal course of business.

The CHAIRMAN. That is right.

Mr. MARTIN. And that is the only time they were paid for.

The CHAIRMAN. Just like we pay debts with checks and credit.

Mr. MARTIN. Exactly.

The CHAIRMAN. In the normal course, they were paid for once, you will admit that, will you not?

Mr. MARTIN. They were paid for once, and that is all.

(The excerpts from testimony of William McChesney Martin referred to by Chairman Patman from hearings on S. 1451 and H.R. 7026, July 16, 1957; and H.R. 7601, July 7, 1965 follow:)

QUESTIONS BY CHAIRMAN WRIGHT PATMAN AND ANSWERS BY WILLIAM MCCHESNEY MARTIN, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Taken in Testimony on S. 1451 and H.R. 7026, the Financial Institutions Act of 1957, Before the Committee on Banking and Currency, House of Representatives, on July 16, 1957, p. 74 of the Printed Hearings]

Mr. PATMAN. Now then, Mr. Martin, isn't it a fact that these Federal Reserve notes that you issue and exchange for these bonds are obligations of the United States Government, just as are the bonds?

Mr. MARTIN. That is right.

Mr. PATMAN. In other words, each note says on its face: "The United States promises to pay to bearer on demand so many dollars."

That is just as much a Government obligation as a United States bond maturing 10 years from now, isn't it?

Mr. MARTIN. It is money.

Mr. PATMAN. It is an obligation of the Government.

Questions by Chairman Wright Patman and Answers by William McChesney Martin, Chairman

[Taken in testimony on H.R. 7601, a bill to provide for the retirement of $30 billion of interest-bearing obligations of the United States held by the 12 Federal Reserve banks, on July 7, 1965, pp. 78–80 of the transcript]

The Chairman (Mr. Patman). I want to clarify this for the record one more time, Mr. Martin. How in the world can you insist that bonds that are paid for once should continue in existence with the taxpayers having to pay interest on them after they have been paid for once? Now, of course, you claim that these bonds have to be there to back up Federal Reserve notes. But that does not conform with your reasoning in 1959 when you presented to Congress a bill, and it was passed on by this committee, which said that you wanted the power to lower reserve requirements and count vault cash as reserves; and that, if you got that power, you would transfer $15 billion of the then portfolio of $24 billion to the private banks. You further stated that the private banks needed the income from these bonds, and that the Federal Reserve does not need it. You do not need the $15 billion. The remaining $9 billion in the portfolio, as you stated in a staff report, would provide enough flexibility for you to operate. Now then, when the Open Market Committee owns $38.5 billion worth of bonds—which of course is about $14.5 billion more than it was then, you insist that it is impossible for those bonds to be canceled, although $15 billion under the same circumstances could be given to the private banks, after giving them (through reducing reserves) the reserves to buy the bonds.

The Fed pays nothing for them; it merely creates new reserves. Then it continues to get interest on those bonds, and then when the bonds become due, they can collect the principal again.

I cannot get the reasoning there at all, Mr. Martin. If that makes sense, I am unable to comprehend it. Of course, there may be something in my background—lack of knowledge—that would account for it, but I do know this: No one should be compelled to pay his debts more than once, but in this instance you would compel the Government to pay its debts more than once. You would compel the Government to continue to pay interest on bonds that have already been paid for. When you bought these bonds, you paid for them. You will admit that, will you not, Mr. Martin?

Mr. Martin. The bonds were paid for in the normal course of business.

The Chairman. That is right.

Mr. Martin. And that is the only time they were paid for.

The Chairman. Just like we pay debts with checks and credits.

Mr. Martin. Exactly.

The Chairman. In the normal course they were paid for once, you will admit that, will you not?

Mr. Martin. They were paid for once, and that is all.

The Chairman. That is right.

The Chairman. He has said that a number of times. I could get you a dozen examples. But every informed person knows that they were paid for once.

Mr. Williams. And not twice.

The Chairman. I know, but they can be paid for twice, if they are sold back into the market and bought back. That is paying for them twice and inflating the currency too.

Dr. Burns. Mr. Chairman, if I buy a Government bond, and I sell it to Mr. Gettys and he sells it to you and you sell it to Mr. Williams, it will be paid for four times.

The Chairman. Well, that is the velocity of credit, the average velocity in the country is 60 times a year. That is the reason why this trickle down theory fails because when money is put into circulation at the top, it goes to a couple of rich people and goes back out of circulation in the bank and doesn't amount to anything. If you pay at the bottom to the poor people who put it into circulation through the channels of trade and distribution, it will probably travel six or eight times in the local community and then start around the country. In the course of the year, it will go to about 60 people, each one paying an income tax, and instead of the $1 costing the Government $1, when it is paid down to the lower level, the Government actually makes money out of it, it wouldn't be carried extensively, but it happens.

Dr. BURNS. To continue my illustration, it has been paid for four times, but three of the men have gotten their money back, sometimes with a profit and sometimes at a loss; therefore, it has been paid for, on balance, once.

The CHAIRMAN. Well, that is not an open market. Only the Federal Reserve can have an open market.

Dr. Burns, thank you very much, and if you will answer those questions when you look over your transcript, it will be appreciated very much.

Dr. BURNS. Thank you very much, Mr. Chairman.

The CHAIRMAN. I had to forgo asking a lot of questions I would like to have asked.

Dr. BURNS. I will be back.

The CHAIRMAN. Glad to accommodate you.

(The following material submitted for inclusion in the record at this point was referred to by Chairman Patman in the four points of his opening statement and also on p. 11:)

FEDERAL RESERVE THRIFT PLAN

Dr. Burns, on July 2, 1971, I wrote you a letter asking that you inform us concerning the operation of the Federal Reserve Board and System's so-called thrift plan. You responded to me in a letter dated July 30 and at some length tried to rationalize the reasons why this plan has been instituted.

It is not pertinent, in my opinion, to discuss the Board's reasons for instituting the plan, but it is pertinent that the committee be told under what section of the Federal Reserve law or other relevant statutes you felt you had the legal authority to take this action.

Before answering this question, however, for the benefit of the Members, let's get a few basic questions answered first.

The so-called thrift plan, as I understand it, Dr. Burns, is a plan whereby the 20,000 employees are allowed to place funds in a savings program which in part has the basic features of a mutual fund. Under the program, Board employees may contribute from 1 to 10 percent of their salary to the plan. The Board will partially subsidize this contribution by adding 25 cents to each dollar contributed. Further, once each year, a lump sum contribution not exceeding 10 percent of the employee's past year's salary may be made, up to the point where contribution and payroll deductions do not exceed 16 percent of the employee's past 12-months' aggregate salary.

Under this program, as your letter indicates, the Federal Reserve Board and Reserve Banks contribute an amount just under $2 million. It should be of no concern to anyone that, as you indicate, Dr. Burns, this is a good management tool in keeping employees and reducing turnover.

What you are doing, in my opinion, is taking money which otherwise would have gone back to the general funds of the U.S. Treasury and without any legal authority whatsoever using these funds for the benefit of employees.

I know full well, Dr. Burns, that no executive agency of the Federal Government has such a program unless it has been specifically authorized by statute, and that in no instance is there such a statute on the books.

Dr. Burns, I wish you would point out to the Committee the precise statute that allows the Board and the Federal Reserve District Banks to participate in this thrift plan by making contributions as I have indicated to the funds of Federal Reserve Board and Bank employees.

Questions Submitted by Chairman Patman on Federal Reserve Board and System Thrift Plan, With Reply From Dr. Burns

1. How many of the Federal Reserve Regional Banks have thrift programs similar or identical to that which the Federal Reserve Board has for its employees?

2. When did these so-called thrift programs begin—by Regional bank?

3. How much has been contributed by the Regional Banks and the Board of Governors to this program—by each Bank, and by the Board?

4. Was an opinion sought to determine the legality of this action before the program was introduced, either by the Board or any of the Regional Banks?

5. What is the average contribution which the Board has made to its employees under this program? What is the largest contribution that the Board has made to an individual participating in this program?

Reply From Dr. Burns

At the outset, a word of clarification is in order. Chairman Patman's opening remarks on the thrift plan included the statement that "for each dollar invested in the thrift plan by an employee, the Federal Reserve contributes 25 cents." This statement is subject to an important qualification: System contributions are limited to 1½ per cent of the employee's salary (or $750, if less) in any year.

Turning now to the question of legal authority, quite a number of provisions of the Federal Reserve Act could be cited as having a bearing on the authority of the Federal Reserve Banks and the Board of Governors to determine their internal management policies, including the approval of expenditures for programs such as that embraced in the thrift plan. Perhaps those set forth below are sufficient to show that there is ample authority for the directors of the Federal Reserve Banks to authorize and for the Board of Governors to sanction the establishment and operation of this program.

1. Section 4, paragraph 6: "Every Federal reserve bank shall be conducted under the supervision and control of a board of directors."

2. Section 4, paragraph 7: "The board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law."

3. Section 4, clause "Seventh" of paragraph 4: ". . . The Federal reserve bank . . . shall have power . . . to exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act."

4. Section 4, paragraph 22: ". . . Any compensation that may be provided by boards of directors of Federal reserve banks for directors, officers or employees shall be subject to the approval of the Board of Governors of the Federal Reserve System."

5. Section 10, paragraph 3: "The Board of Governors of the Federal Reserve System shall have power to levy semiannually upon the Federal reserve banks . . . an assessment sufficient to pay its estimated expenses and the salaries of its members and employees. . . ."

6. Section 10, paragraph 4: ". . . The Board shall determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid, and may leave on deposit in the Federal Reserve banks the proceeds of assessments levied upon them to defray its estimated expenses and the salaries of its members and employees, whose employment, compensation, leave, and expenses shall be governed solely by the provisions of this Act, specific amendments thereof and rules and regulations of the Board not inconsistent therewith; and funds derived from such assessments shall not be construed to be Government funds or appropriated moneys. . . ."

7. Section 11: "The Board of Governors of the Federal Reserve System shall be authorized and empowered:

". . . (j) to exercise general supervision over said Federal reserve banks. . . .

"(1) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January 16, 1883 (volume twenty-two, United States Statutes at Large, page 403), and amendments thereto, or any rule or regulation made in pursuance thereof: Provided, That nothing herein shall prevent the President from placing said employees in the classified service."

These quotations from the Federal Reserve Act show clearly our legal authority to incur or approve expenditures of Federal Reserve funds for the Board or the Reserve Banks for purposes we believe necessary or desirable for carrying out the functions of the System, even though similar expenditures might not be permissible for many Federal Government agencies, including those operating on appropriated funds. The Board must of course be prepared to show that expenditures are for the purpose of enabling the Federal Reserve to carry out its responsibilities effectively and efficiently—a process that involves value judgments on which reasonable persons could differ.

The thrift plan was judged by the directors and officers of the Reserve Banks and by the Board of Governors to contribute to more effective employee performance and service. In fact, it seemed likely that it would result in an actual reduction in the costs of recruitment and retention of desirable staff members. The decision that the use of funds for the thrift plan was appropriate in nature and reasonable in amount was reached only after careful study by those responsible, and with full consideration for the status of the Federal Reserve System within the Government.

With respect to this question of status within the Government, my attention has been called to the fact that, when the Banking Act of 1933 amended section 10 of the Federal Reserve Act to give the Board explicit authority to determine its own obligations and expenses (including compensation of its employees) and to provide that the Board's funds should not be construed to be Government funds or appropriated moneys, the reports of the Banking and Currency Committees of both the House and the Senate stated that the change "leaves to the Board the determination of its own internal management policies." The change clearly was in accord with one of the basic purposes of the 1933 Act, i.e., the "increase of independence of Federal Reserve Board."

Chairman Patman has said that no executive agency of the Federal Government has any program like our thrift plan. Accepting this as correct does not mean that the thrift plan flouts the law or that it is unwise, considering the responsibilities that the Congress has placed on the Reserve Bank directors and the Board of Governors for internal management of the Federal Reserve System.

Although Chairman Patman's comments indicated that he is not concerned with whether the benefits to the System from the thrift plan outweigh the one per cent of payroll cost, it seems worth noting that this plan is highly regarded as an employee benefit by members of the staff in all salary groups. So far as we can judge up to the present time, it appears to have contributed to lower employee turnover and has helped attract new quality personnel to the organization. We sincerely believe that the adoption of this plan and its use within the System is a wise exercise of the authority given to us by the Federal Reserve Act.

We will continue to observe the impact of this and other parts of our employee benefits program with a view to using such arrangements as are appropriate under the law and which will assist in carrying out the primary functions that the Congress has placed on us.

Federal Reserve Purchase of Agency Paper

(Statement and questions submitted by Chairman Patman)

Dr. Burns, as I understand it, as set forth in the Budget of the United States for fiscal year 1972, there currently is outstanding Government agency debt paper which has been sold to the public estimated at the end of 1972 to amount to $8.1 billion and Government-sponsored agency borrowings from the public as of this same time period amounting to $52.5 billion, for a total of approximately $60 billion worth of paper outstanding. This amount includes borrowings from the public by such Federal agencies as the Farmers Home Administration, the Commodity Credit Corporation, College Housing, the Export-Import Bank. Small Business Administration, Tennessee Valley Authority, Federal National Mortgage Association, the Farm Credit Administration, and the Federal Home Loan Bank Board.

The legal authority behind this action of the Federal Reserve is contained in Public Law 89–597, enacted in 1966, which amended Section 14(b) of the Federal Reserve Act to allow the Federal Reserve to buy and sell in the open market any obligation which is a direct obligation of or fully guaranteed as to principal and interest by any agency of the United States. It was before your time, Dr. Burns, but I am sure you have been made aware of the fact that this committee initiated this legislation as a result of the fact that the former head of the Federal Reserve Board refused to use the broad powers of the Open Market Committee, among other things, in assisting the economy, especially the housing sector, which at that time had been all but choked off from a source of funds.

William McChesney Martin refused to use the Federal Open Market Committee to purchase this paper, basing his argument on the fact that the Federal Reserve Act was not broad enough to allow the Open Market Committee to make purchases of agency paper, including paper from the Federal National Mortgage Association, the Federal Home Loan Bank Board, and other Federal agencies, and this is why this language was enacted into law. This authority was not used in a substantive way by the Federal Reserve, under Mr. Martin's Chairmanship. I have said many times since that Mr. Martin violated his commitment to the Congress in not using his authority for such purposes, for the record clearly shows that Mr. Martin committed himself to use the authority if the Congress enacted these changes into the law. The only use which the Federal Reserve made of this authority was to purchase a piddling amount of Government agency paper on a very short-term basis under the Open Market Committee's so-called repurchasing agreement procedure.

Dr. Burns, you and your Board are to be commended for taking this action, feeble though it is. I shall in a moment justify my contention that this action, while basically in the right direction and in accord with Congressional desire, is feeble.

I would like initially, however, to make this observation. It is my understanding that the Federal Reserve Board is about to conclude a study of the home financing industry which has been in progress for several years, and that it will indicate that the Federal Reserve System has made little or no effort to assist our country in meeting some of its goals—in this instance, housing—through the use of its monetary powers to influence the allocation of credit.

It has been rumored, Dr. Burns, that one of the reasons—if not the reason—the Board took action on September 16 to allow the Federal Open Market Committee to purchase and sell agency paper was to temper congressional criticisms that might follow from the release of your housing study. Speaking for myself, Dr. Burns, I hope this is not so. Further, I would hope that your study of the housing market, its problems and prospects, would clearly indicate a definite commitment by the Federal Reserve Board and System to involve itself in meeting the financial needs of our housing industry and mortgage market in a direct way through open market operations. If the study does not indicate ways in which the Federal Reserve can accomplish this directly at the lowest possible cost to the country and the home buyer, you may rest assured that I will take the first opportunity to criticize it. The view that the Federal Reserve System should involve itself directly in meeting these social goals is one that is shared by a number of Members of Congress.

Now, Dr. Burns, to get to the specifics of your newly announced Open Market Committee activities concerning Federal agency paper. During the hearings, I asked several questions on this subject and requested that you submit answers in writing. However, I would like to ask several more to be included in your reply.

1. Dr. Burns, the language in Guideline No. 3 is very similar to the general language you always use in directives to the manager of the Open Market Committee—so general in nature as to provide no insight as to the exact nature of your intent. Guideline No. 3 says that the initial objective of the System would be to build up a "modest portfolio of agency issues . . . without undue market effects." Would you please tell the Committee just how you define "modest" and just what do you mean by "without undue market effects"?

2. Guideline No. 4 states that your holdings of maturing agency issues will be allowed to run off at maturity. Does this mean that upon maturity, the agency in question would be obligated to pay to the Federal Reserve System the full amount of principal, plus accrued interest, and that the System would have the use of those funds for its expenses with any net going back to the Treasury?

3. Guideline No. 5 states further ground rules under which you will allow the Open Market Committee to purchase Federal agency issues. I would like to know the reasoning behind some of these limitations. Why are purchases limited to issues of over $300 million where the maturity of the issue is five years or less, or $200 million or more in cases where the maturity of the issue is five years or more? Under Guideline No. 6, purchases are further limited to a maximum of 10 percent of the outstanding issue even where these qualifications are met. It would seem to me that by these limitations you severely restrict the number of issues in which the Open Market Committee can participate and, perhaps not purchase the paper of some agencies at all, you would because it might not meet these requirements. Depending on the maturities and amounts of issues by agencies, this guideline could conflict with guideline No. 2, in which you state that it is not the function of the Open Market Committee in this instance to support individual sectors of the market.

I know the law states, Mr. Chairman, that you can only purchase agency paper "in the open market." It would seem to me that by buying these agency issues directly from the agency, the cost to the Government would be reduced by the amount of the commission involved. I see no reason why the law should not be amended so that the Open Market Committee could purchase directly from the agency. I would appreciate your comments on this.

In general, Dr. Burns, you are to be commended for taking action to implement the 1966 provisions. It is of vital importance that the Federal Reserve Board act to assist the Federal Government in providing for the social and economic needs of our people. The only argument we could have at this time is that Federal Reserve participation in this program is not as great as some of us had hoped it would be. It is my personal feeling that your guidelines are too restrictive and that the degree to which you will participate in the purchase of agency paper will be something less than adequate to help meet our social and economic objectives. In my opinion a sizeable involvement by our central bank in allocating funds will be necessary to accomplish the task of meeting our goals, both domestically and internationally. Again, I commend you in this instance for your action and look forward to further involvement by our central bank in the purchase of Federal agency issues. I also look forward to the time when we can change the law so that you may deal directly in the purchase of agency issues, rather than going through the existing market tollgates.

Reply From Dr. Burns

The questions referred to, and the answers submitted by Mr. Burns, follow:

Question 1. Dr. Burns, the language in Guideline No. 3 is very similar to the general language you always use in directives to the manager of the Open Market Committee—so general in nature as to provide no insight as to the exact nature of your intent. Guideline No. 3 says that the initial objective of the System would be to build up a "modest portfolio of agency issues . . . without undue market effects." Would you please tell the Committee just how you define "modest" and just what do you mean by "without undue market effects?"

Answer. The size of the portfolio of agency issues at any given point in time cannot be foreseen. It will depend in part on the need to supply or absorb reserves in response to factors that are unpredictable. Also, we need more experience with purchases of agency issues to determine how far we can go without undue market effects. The outside limit on the portfolio under our initial guidelines is now about $3 billion. Clearly, it will be a long time before the portfolio approaches that size. In the few weeks since our September announcement, we have purchased agency issues on three occasions, and we now hold $179 million of these securities.

Question 2. Your Guideline No. 4 states that your holdings of maturing agency issues will be allowed to run off at maturity. Does this mean that upon maturity, the agency in question would be obligated to pay to the Federal Reserve System the full amount of principal, plus accrued interest, and that the System would have the use of those funds for its expenses with any net going back to the Treasury?

Answer. The Federal Reserve System, by purchasing an agency issue, becomes entitled to payment of principal and interest, just as any other purchaser. Under the Federal Reserve Act and other statutes the Reserve Banks are authorized to perform certain functions, and to make such expenditures as may be reasonably necessary and appropriate for the performance of those functions. These expenses are met out of the Banks' earnings, including earnings on agency issues. To characterize this arrangement as giving the System "the use of those funds for any expenses whatsoever" gives less recognition than I think should be given to the responsibilities of the Reserve Banks and the Board of Governors to make sure that the System is run economically and efficiently.

Question 3. Guideline No. 5 states further ground rules under which you will allow the Open Market Committee to purchase agency issues. I would like to know the reasoning behind some of these limitations. Why are purchases limited to issues of over $300 million where the maturity of the issue is 5 years or less, or $200 million or more in cases where the maturity of the issue is 5 years or more?

Answer. Dr. Burns' answer to question #3 may be found on page 27.

QUESTIONABLE EXPENDITURES OF THE FEDERAL RESERVE BANKS FOR THE YEAR ENDING DECEMBER 31, 1969

(Statement and material submitted by Chairman Patman)

INTRODUCTION

Since the Federal Reserve Act was signed on December 23, 1913, there has been no audit of the Federal Reserve System as a whole which was not controlled in some manner by the System itself. Although the General Accounting Office was established in 1921, it has never had the authority to audit the entire Federal Reserve System. Until 1933, the GAO did audit the Board of Governors but was not allowed to audit the twelve Federal Reserve banks and their branches. However, the Banking Act of 1933 removed the GAO's authority to audit the Board. The Board does maintain a staff of examiners who audit the twelve Federal Reserve banks and branches and, since 1952, the Board has been audited annually by independent certified public accounting firms.

In testifying before the Domestic Finance Subcommittee in 1964 during hearings reviewing the operations of the Federal Reserve System, then Board Chairman William McChesney Martin explained that the Board had instructed its examiners to fulfill three requirements when auditing the banks and branches of the System. Chairman Martin told the Subcommittee that the examinations are to determine "(a) each bank's financial condition through appraisal of its assets and verification of its assets and liabilities; (b) its proper discharge of all of its responsibilities; and (c) its compliance with all applicable provisions of law and regulations."

Chairman Martin added that, "Each year, an outside commercial auditor, currently Haskins & Sells, accompanies the Board's examiners on their examinations of one of the banks to review and observe the examination procedures. Also, each bank has a resident auditor, responsible directly to the bank's Board of Directors, and not dependent on any of the bank's officers for security of position. Throughout the year, he and his staff make comprehensive audits of all phases of the banks' operations, reporting directly to the Board of Directors of the banks. Copies of these reports are reviewed by the Board of Governors of the Federal Reserve System."

The internal auditing procedures of the Federal Reserve System have been cited in arguments against allowing the General Accounting Office to audit the Federal Reserve System and its banks and branches. It is contended that the GAO audit could not perform the function any better than the present auditing arrangement.

"It is difficult to perceive how the GAO or any other audit group could achieve a more effective result," Chairman Martin told the Subcommittee in 1964 in defense of the status quo.

Despite the assurances that the present audit structure of the Federal Reserve is adequate, various items among the System's expenditures raise serious questions as to the thoroughness of the audit and its scope and as to whether any action is taken to correct deficiencies uncovered by the audits.

During the 1964 hearings before the Domestic Finance Subcommittee, hundreds of expenses were uncovered by the Committee staff which should have been questioned in the course of even the most elementary audit. However, these expenses were not questioned by the Federal Reserve Board, and are still being made by the 36 banks and branches of the Federal Reserve System. The Board of Governors does not take action to correct even the most obvious abuses.

The Federal Reserve System is one of seven agencies of the Government which is not subject to complete GAO audits. The other agencies are the Central Intelligence Agency, Internal Revenue Service, the Comptroller of the Currency, the Office of Alien Property, the Trust Funds of the Smithsonian Institute, and the U.S. Soldiers' Home, Washington. D.C. It should be noted, however, that many of the other agencies which are not subject to full GAO audits have been audited by the GAO on a partial basis. During 1969, for instance, the GAO conducted a review of resources utilization at selected IRS service centers, as well as the activities of the Data Center, Detroit, Michigan. The GAO has also conducted limited audits of the Central Intelligence Agency. However, the Federal Reserve System has not been audited in any manner by the General Accounting Office.

It should also be noted that the Federal Reserve System has the second-highest yearly expenditures among those agencies not subject to total GAO audits. This does not include the Central Intelligence Agency, however, which does not make public its expenditures. The System had total expenses of $300,-238,841 for 1969. This total was exceeded only by the Internal Revenue Service. which had expenditures of $945,902,000. The expenses of the other non-audited agencies are much smaller. For instance, the Comptroller of the Currency had expenses of $26.6 million, the Smithsonian Institute's expenses were $51.4 million, those of the U.S. Soldiers' Home were $10.3 million, and those of the Office of Alien Property in the Justice Department were $3.5 million.

PURPOSE OF EXAMINATION

An examination has been made of the expenditures of the Federal Reserve Banks and their branches for the year 1969 which are listed in the categories of miscellaneous travel, or "all other" expenses. The purpose of the examination was to determine the extent to which Federal Reserve funds are expended by the Federal Reserve Banks for purposes or reasons not considered allowable under Federal laws and regulations applicable to other Federal agencies.

The examination involved only a review of the descriptions of and reasons for expenditures as supplied by the Federal Reserve Banks but did not involve a review of travel vouchers or other such documents. Therefore, the questionable expenditures discussed in this report, especially those relating to travel, do not include those payments by the Federal Reserve Banks in excess of amounts allowed under Government regulations. For example, with certain exceptions, the maximum amount authorized Government employees in a travel status is $25 per day covering the costs of food, lodging and other travel expenses. The examination did not include a comparison of this amount with the daily amounts paid to Federal Reserve employees in a travel status.

"ALL OTHER EXPENSES"

The examination of the 1969 expenditures in the "all other" category showed that, out of the total amount examined (approximately $932,600), about $588,200 was expended by the Federal Reserve Banks for purposes which were either questionable or not considered allowable under Government regulations. Included in the balance of $932,600 was $132,100 of expenditures for which no explanation as to their nature was given. The questionable expenditures which were found in the examination of the "all other" category fell into the following Federal Reserve classifications: (1) meetings, conferences and miscellaneous, (2) membership dues and contributions, (3) employee relations, (4) research and (5) bank relations. The following is an explanation of the various types of questionable expenditures in each classification with appropriate examples.

MEETINGS, CONFERENCES AND MISCELLANEOUS EXPENSES

Questionable expenditures of about $103,900 were incurred by the Federal Reserve Banks for various meetings, conferences, etc., and certain miscellaneous expenses. Included in the above figure are costs for (1) dinners and luncheons for directors, officers, employees of the bank, their wives, and official and visiting/touring guests, (2) flowers for decoration at meetings and corsages for wives of directors, officers and guests, (3) cigars for directors, officers and guests, (4) miscellaneous expenses, such as gifts to retiring directors (usually a $200 to $300 engraved silver tray).

In a decision of January 22, 1970 (B-168774), the Comptroller General noted that, "It is established that the Government may not pay the subsistence expenses of or furnish free food to civilian employees at headquarters in addition to their regular compensation without specific authority of law even though they may be working under unusual conditions." In addition, the Comptroller General stated in 43 Comp. Gen. 305 that "it is a general rule of longstanding that funds appropriated for Government departments and agencies may not be used for entertaining individuals by giving luncheons, etc., except when specifically authorized by statute . . ."

The following are examples of Federal Reserve expenditures in this classification:

(1) Dinner meeting for bankers, businessmen and their wives in connection with Joint Directors meeting of the Federal Reserve Bank of Minneapolis—$584.63.

(2) Luncheon for wives of officers and directors of the Memphis Branch of the Federal Reserve Bank of St. Louis—$97.99.

(3) Flowers for Joint Board of Directors Dinner in the Federal Reserve Bank of Dallas—$337.50.

(4) Flowers for wives of directors and officers of the Federal Reserve Bank of St. Louis, incident to a dinner meeting—$88.50.

(5) Silver trays presented to the Deputy Chairman of the Board of the Federal Reserve Bank of New York—$320.00.

(6) Parking violation due to a delay in the arrival of a plane (Federal Reserve Bank of Minneapolis)—$5.00.

(7) Towing charge and parking fine violation of officer on official duty (Federal Reserve Bank of New York)—$50.00.

(8) Cost of babysitter for official and his wife to attend two dinners (Federal Reserve Bank of New York)—$20.90.

MEMBERSHIP DUES AND CONTRIBUTIONS

The Federal Reserve Banks paid dues and contributions in 1969 to various banking, commercial, professional, civic and other organizations and associations. Total payments of dues and contributions to such groups by the Federal Reserve Banks and branches amounted to approximately $146,500 for 1969. The majority of the payments were made to banking and bank-related associations but some were made to non-bank-related associations, i.e., the National Rifle Association and the American Dietetic Association.

Section 5948 under Title 5 of the United States Code states that, except under specific authorization, appropriated funds may not be used for payment of membership fees or dues of an employee. The only other exception noted is in Section 4109 which states that authorized expenses for training do not include membership fees except to the extent that the fee is a necessary cost directly related to the training itself, or that payment of the fee is a condition precedent to undergoing the training.

As an example of such expenditures, the Head Office of the Federal Reserve Bank of New York paid a total of about $22,000 to various organizations for dues and contributions which include, in part, the following:

American Institute of Banking	$4,256.25
New Jersey chapter	60.00
New York chapter	460.00
New Jersey Bankers Association	1,440.00
New York State Bankers Association	3,300.00
American Bankers Association	2,200.00
Connecticut Bankers Association	375.00
American Bar Association	100.00
American Institute of Industrial Engineers	105.00
American Management Association	325.00
Real Estate Board of New York, Inc	220.00
Building Owners and Managers Association	300.00
Tax Institute of America	30.00
Chamber of Commerce, New York	150.00

EMPLOYEE RELATIONS

It is the policy of the Federal Reserve Banks to provide their employees with a multitude of benefits over and above those authorized for other Government employees. These additional benefits amounted to $219,600 in 1969 and include the following types of employee benefits: employee recognition, athletic activities, and social-recreational activities.

Under Title V of the United States Code, Government employees are forbidden to receive pay or allowances in addition to those fixed by statute or regulation for any services or duties they may perform outside their regular duties. In 5 Op. Atty. Gen. 439, the Attorney General states that "No officer whose pay is fixed by law or regulation is lawfully entitled to any additional pay, extra allowances, or compensation in any form whatever, for any other duty or service, unless the same shall be authorized by law . . .". In addition, the Comptroller General noted that Section 5535 of Title V "provides that no civil officer of the Government shall receive any compensation or perquisites, directly or indirectly from the Treasury of the United States beyond his compensation allowed by law."

As previously noted, civilian employees cannot be provided free lunches or dinners or any other "entertainment" at their headquarters without specific authorization. The Comptroller General (43 Comp. Gen. 305) explains further that "providing a dinner, luncheon or refreshments in conjunction with the annual recognition ceremony would constitute [entertainment]" and therefore, could not be paid out of appropriated funds.

The Federal Reserve expenses for employee recognition involve (1) free lunches to employees on their first day of employment, on their birthdays and on their anniversaries with the banks, (2) retirement parties for employees, (3) banquets for senior employees, (4) flowers and various gifts to employees on special anniversaries with the banks or during periods of extended illness, (5) gifts or checks sent to employees in the armed forces, and (6) flowers to officers and employees on deaths in their families.

For example:

(1) Lunches to new employees in the Federal Reserve Bank of New York—$933.55.

(2) Retirement parties at the Federal Reserve Bank of Kansas City—$4,297.09.

(3) Federal Reserve Bank of Kansas City—contribution to "25-Year Club" activities—$3,278.59.

(4) Sterling tray and watch to 25-year employees by the Birmingham Branch of the Federal Reserve Bank of Atlanta—$124.90 and $111.25.

(5) Fourteen $25 checks sent to employees in the armed forces at Christmas time by the Federal Reserve Bank of Cleveland—$350.00.

(6) Sympathy flowers and fruit baskets to employees of the Federal Reserve Bank of Cleveland—$850.06.

Athletic activities expenditures include the purchase of supplies and equipment for softball, bowling, and table tennis, and all or a portion of the costs for employee participation in various athletic events, i.e., line fees for bowling, entry fees for softball and golf, etc.

(1) Yearly cost of athletic activities at the Federal Reserve Bank of San Francisco—$1,550.43 (nature of activities not explained).

(2) One-half cost of line fees in American Institute of Banking bowling league and Bank's own league (Denver Branch of Federal Reserve Bank of Kansas City)—$1,080.98.

(3) Golf outing at the Federal Reserve Bank of Philadelphia—$176.00.

(4) Bowling shirts with lettering for Bank's team (Federal Reserve Bank of St. Louis)—$171.90.

Other social and recreational activities include the costs of (1) tickets to various sporting and amusement activities, (2) gifts and prizes for employees or employee parties and picnics, (3) special employee activities such as choral groups and art instruction groups, and (4) special holiday luncheons and dinners for employees.

For example:

(1) Tickets for hockey game for Jacksonville Branch of the Federal Reserve Bank of Atlanta—$135.25.

(2) Gift certificates at department store for Jacksonville Branch of the Federal Reserve Bank of Atlanta—$150.00.

(3) Prizes for Bingo night for employees of the Jacksonville Branch of the Federal Reserve Bank of Atlanta—$309.99.

(4) Tickets to livestock show for employees of the Federal Reserve Bank of Kansas City—$171.50.

(5) Turkeys for employees at Federal Reserve Bank of Kansas City—$974.87.

(6) Expenses of a ski trip by Seattle Branch of the Federal Reserve Bank of San Francisco—$43.00.

(7) Annual Kiddie Party for children of employees of the Federal Reserve Bank of New York—$1,472.78.

(8) Annual picnic—dinners, pony rides, movies, prizes and favors at Buffalo Branch of the Federal Reserve Bank of New York—$2,514.11.

RESEARCH

Certain Government agencies can make payments of Government funds to graduate students, professors, and educational institutions in the form of research grants and fellowships, but only under specific legislative authorization. Most agencies, including the Federal Reserve Banks, have not been given this specific authorization.

The Federal Reserve Banks of Chicago, Cleveland and Boston made payments in the form of research grants and fellowships in 1969 of about $41,700. This money was awarded to doctoral candidates to promote research in money and banking and related fields.

The Federal Reserve Bank of Chicago, for example, granted research awards for a 12-month period and expended $12,000 in research funds in 1969. The individual awards granted by this Bank include $500 per month ($6,000 annually) plus the costs of tuition and fees at the university, travel expenses between the university and Chicago, clerical assistance, $500 at the completion of dissertation, and assistance in publishing the research results.

BANK RELATIONS

Each Federal Reserve Bank expends funds for the costs of dinners, luncheons, etc., to entertain various guests of the Bank in its dining room, cafeteria or local restaurants. Bank guests include officials from other Federal Reserve Banks or from their own member banks, local businessmen, educators and students. Federal Reserve Banks expended a total of $76,500 in questionable expenditures for 1969 in the classification of "bank relations."

The sizes of groups being entertained range from individual guests to large committee-type meetings. In addition, certain Banks have held major banquet meetings, inviting a large number of bankers and businessmen. For example, the Federal Reserve Bank of New York held two banquet-type luncheons, one for New York State Bank representatives and the other for New Jersey State Bank representatives. These two luncheons, addressed by the President of the Bank, were held at local hotels and cost the Bank approximately $8,150.

In addition, meals are served to Directors of the Banks and retired Federal Reserve Bank officials visiting the Banks. Also, officials of the Bank attending banking conventions, visiting member banks or other Federal Reserve Banks, or otherwise traveling away from their main office on official business are authorized to entertain various bankers and other guests at the expense of the Federal Reserve Banks.

For example:

(1) Luncheon meetings for representatives of area banks by the Federal Reserve Bank of Minneapolis—$448.63.

(2) Meals and refreshments for meetings, seminars and tour groups at the Federal Reserve Bank of Dallas—$1,503.48.

(3) Luncheon expense for tour group of college students at the Federal Reserve Bank of Richmond—$25.62.

(4) Luncheon expenses of area bank conferences with officials of the Federal Reserve Bank of Boston and member banks—$2,581.52.

(5) Cost of entertaining officers of four member banks during the New York State Bankers meeting—$26.00.

(6) Cost of caddy and locker fees in entertaining four bank officials by officer of the Federal Reserve Bank of New York—$12.50.

TRAVEL EXPENSES

Of the total amount of Federal Reserve travel expenses ($1.6 million) reviewed, questionable expenditures amounted to about $46,200, primarily involving the cost of traveling to various lectures or speaking engagements by various bank officials. It must be noted, however, that about $150,700 of the travel expenses were not explained by certain Federal Reserve Banks.

Although bank officials traveled to numerous meetings of various associations in connection with speaking engagements, only those travel costs connected with addresses to civic and other non-bank-related organizations (i.e., Cattle Raisers Association) were considered questionable when no explanations were offered as to the topics of the addresses. Employees of the Federal Government are authorized to travel at the Government's expense to various organization and association meetings if the employee's participation can be related to the functions or activities of the agency. Under Section 4110 of Title V of the United States Code, appropriations which are available to any agency for travel expenses are only available for the expenses of attending those meetings which are concerned with the functions or activities for which the appropriation is made or which will contribute to improved conduct, supervision or management of the functions or activities. Therefore, expenditures for travel to various association meetings that could be related to the functions or activities of the Banks were not included in the $46,200 figure.

In addition to the above speeches before non-bank-related organizations, travel expenditures were considered questionable when related to lectures to graduate seminars, graduating classes, etc., at various colleges and universities when it appears that the costs of such travel should be assumed by the colleges or universities involved.

Further, it was noted that an official of the Federal Reserve Bank of Minneapolis was allowed to make a number of trips at the Bank's expense for the purpose of locating a new residence in connection with his transfer to the Helena Branch. An employee of the Federal Government being permanently transferred to a new duty station is permitted under Public Law 89-516, approved July 21, 1966, to make only one round trip visit with his spouse to his new duty station at the Government's expense for this purpose.

Those travel expenditures which appear to relate to the transfer of the official are presented below. Due to the limited descriptions given for each visit to Helena, no exact number of trips or related cost was determined.

FEDERAL RESERVE BANK OF MINNEAPOLIS—HOWARD KNOUS—TRANSFER TO BRANCH AT HELENA, MONT.

Description	Date	Voucher No.	Amount
Main office expenses:			
Air fare: Feb. 13-19—Helena to select home prior to transfer	Mar. 14, 1969	25116	$156.00
Air fare: Feb. 25—Helena to select home prior to transfer	do	25116	162.00
Visit FRB Helena in connection with transfer	Feb. 21, 1969	24707	129.70
Trip to Helena, Mont., to select home for family on transfer	Mar. 12, 1969	25054	199.40
Do	do	25055	92.05
Visit Helena branch Mar. 17-19	Mar. 20, 1969	25209	51.65
Air fare: Feb. 28-Mar. 2—Family fare to visit Helena in connection with transfer.	Apr. 8, 1969	25461	355.50
Air fare: Mar. 17-19—Visit Helena in connection with transfer	do	25461	162.00
Visit Helena in connection with transfer Apr. 8-11	Apr. 14, 1969	25555	71.95
Air fare: Apr. 8-11—Trip to Helena branch	May 9, 1969	25999	162.00
Helena branch expenses:			
Apr. 15-25—Travel between Minneapolis and Helena and living expenses in Helena.	Apr. 30, 1969	43226	227.27
Apr. 28-May 2—Travel between Helena and Minneapolis and living expenses in Helena	May 6, 1969	43269	89.82
May 2-6—Round trip air fare to Minneapolis from Helena	May 1, 1969	43233	152.00
May 23-27—Round trip air fare Helena to Minneapolis	May 20, 1969	43311	158.00
May 29-June 2—Round trip air fare Helena to Minneapolis	May 27, 1969	43335	158.00
May 18-29—Living expense in Helena and travel between Helena and Minneapolis	June 3, 1969	43369	14.73
Do	do	43370	150.00
1-way air fare from Helena to Minneapolis—Preparatory to move	June 9, 1969	43394	81.00
Living expenses in Helena June 2-4 and travel between Helena and Minneapolis to attend meeting June 5, 1969	June 12, 1969	43402	50.71
Expense over travel advance for moving family June 12-16	June 17, 1969	43425	34.26
Living expenses in Helena and expense of moving family June 9-16	do	43426	500.00
Shipment of household goods	July 14, 1969	43518	1,713.50
Expense of disconnecting appliances	July 22, 1969	43549	23.15
Reimbursement for expenses incurred with transfer from Minneapolis to Helena	Aug. 19, 1969	43660	3,771.38
Total			8,675.07

QUESTIONABLE EXPENDITURES OF THE FEDERAL RESERVE BANKS AND BRANCHES IN THE CATEGORY OF "ALL OTHER" EXPENSES FOR THE YEAR ENDING DECEMBER 31, 1969

Federal Reserve Bank and branches	Meetings, conferences and miscellaneous	Membership dues and contributions	Employee relations	Research	Bank relations	Total
Atlanta	$3,690	$9,436	$5,263	0	$258	$18,647
Birmingham	528	1,732	1,795	0	442	4,497
Jacksonville	854	1,610	3,185	0	160	5,809
Nashville	291	1,056	1,100	0	0	2,447
New Orleans	322	1,500	3,217	0	1,174	6,213
Boston	6,291	10,530	15,419	21,000	8,091	61,331
Chicago	4,978	15,501	17,239	12,029	3,637	53,384
Detroit	547	2,342	6,356	0	310	9,555
Cleveland	8,229	5,146	10,293	8,640	8,700	41,008
Cincinnati	1,110	858	6,600	0	3,062	11,630
Pittsburgh	909	1,412	6,048	0	413	8,782
Dallas	1,928	8,378	6,463	0	6,205	22,974
El Paso	1,873	495	1,000	0	127	3,495
Houston	329	649	1,979	0	2,746	5,703
San Antonio	739	685	1,935	0	1,268	4,627
Kansas City	6,711	3,193	13,052	0	766	23,722
Denver	3,575	1,352	4,457	0	0	9,384
Oklahoma City	1,770	335	3,888	0	0	5,993
Omaha	1,606	824	1,357	0	4	3,791
Minneapolis	10,682	12,481	8,948	0	4,942	37,053
Helena	2,451	350	1,644	0	2	4,447
New York	3,915	21,893	23,849	0	19,893	69,550
Buffalo	2,644	2,012	8,723	0	248	13,627
Philadelphia	5,659	7,867	16,284	0	3,113	32,923
Richmond	8,474	9,235	7,870	0	4,164	29,743
Baltimore	1,137	1,681	1,123	0	1,210	5,151
Charlotte	1,420	1,389	2,155	0	111	5,075
San Francisco	3,374	7,346	7,542	0	1,602	19,864
Los Angeles	2,617	544	6,595	0	200	9,956
Portland	685	865	2,692	0	39	4,281
Salt Lake City	304	390	2,654	0	95	3,443
Seattle	280	1,429	3,053	0	68	4,830
St. Louis	8,133	8,471	9,586	0	2,403	28,593
Little Rock	1,002	1,598	1,266	0	552	4,418
Louisville	1,931	958	2,507	0	541	5,937
Memphis	2,926	913	2,467	0	0	6,306
Total of all other questionable expenditures	103,914	146,456	219,604	41,669	76,546	588,189

ALL OTHER

Head offices:	
Boston	$219,067
New York	1,022,855
Philadelphia	179,669
Cleveland	187,487
Richmond	117,550
Atlanta	129,549
Chicago	783,550
St. Louis	159,902
Minneapolis	189,042
Kansas City	209,320
Dallas	277,194
San Francisco	93,445
Total	3,568,630
Branches:	
Buffalo	30,714
Cincinnati	168,920
Pittsburgh	56,011
Baltimore	36,537
Charlotte	18,906

ALL OTHER—continued

Branches—Continued	
Birmingham	$22,483
Jacksonville	23,142
Nashville	12,442
New Orleans	21,969
Detroit	105,554
Little Rock	14,103
Louisville	16,978
Memphis	16,546
Helena	9,384
Denver	37,274
Oklahoma City	17,463
Omaha	25,011
El Paso	21,802
Houston	29,883
San Antonio	42,079
Los Angeles	45,135
Portland	11,998
Salt Lake City	8,829
Seattle	16,351
Total	809,514

ALL OTHER—continued

District offices:	
Culpeper	$6,960
Boston	219,067
New York	1,053,569
Philadelphia	179,669
Cleveland	412,418
Richmond	179,953
Atlanta	209,585
Chicago	889,104
St. Louis	207,529
Minneapolis	198,426
Kansas City	289,068
Dallas	370,958
San Francisco	175,758
System total	4,385,104

TRAVELING EXPENSES

Head offices:	
Boston	194,864
New York	525,118
Philadelphia	129,579
Cleveland	202,402
Richmond	173,362
Atlanta	245,633
Chicago	332,305
St. Louis	181,644
Minneapolis	207,535
Kansas City	161,879
Dallas	168,958
San Francisco	255,737
Total	2,779,016
Branches:	
Buffalo	16,745
Cincinnati	15,184
Pittsburgh	10,070
Baltimore	23,301
Charlotte	34,671
Birmingham	26,273
Jacksonville	30,610
Nashville	27,597
New Orleans	47,248
Detroit	40,760
Little Rock	15,387
Louisville	17,843
Memphis	18,526
Helena	33,197
Denver	20,716
Oklahoma City	16,601
Omaha	14,790
El Paso	22,705
Houston	20,598
San Antonio	16,562
Los Angeles	26,305
Portland	15,852
Salt Lake City	15,568
Seattle	17,050
Total	544,159

TRAVELING EXPENSES—continued

District offices:	
Culpeper	$12,467
Boston	194,864
New York	541,863
Philadelphia	129,579
Cleveland	227,656
Richmond	243,801
Atlanta	377,361
Chicago	373,065
St. Louis	233,400
Minneapolis	240,732
Kansas City	213,986
Dallas	228,823
San Francisco	330,512
System total	3,335,642

EMPLOYEE RECOGNITION

Head offices:	
Boston	3,418
New York	5,955
Philadelphia	5,650
Cleveland	2,215
Richmond	2,711
Atlanta	2,382
Chicago	5,013
St. Louis	4,668
Minneapolis	1,840
Kansas City	4,297
Dallas	2,076
San Francisco	1,331
Total	41,556
Branches:	
Buffalo	370
Cincinnati	1,498
Pittsburgh	891
Baltimore	619
Charlotte	1,649
Birmingham	831
Jacksonville	1,431
Nashville	515
New Orleans	1,395
Detroit	630
Little Rock	697
Louisville	853
Memphis	1,307
Helena	188
Denver	1,295
Oklahoma City	831
Omaha	1,304
El Paso	74
Houston	229
San Antonio	369
Los Angeles	577
Portland	277
Salt Lake City	240
Seattle	403
Total	18,260
Culpeper	6
System total	59,822

FEDERAL RESERVE CLUB

Head offices:	
Boston	$12,000
New York	--------
Philadelphia	--------
Cleveland	8,329
Richmond	--------
Atlanta	106
Chicago	--------
St. Louis	--------
Minneapolis	4,400
Kansas City	75
Dallas	4,394
San Francisco	344
Total	29,648
Branches:	
Buffalo	1,110
Cincinnati	5,367
Pittsburgh	5,417
Baltimore	--------
Charlotte	--------
Birmingham	441
Jacksonville	--------
Nashville	6
New Orleans	239
Detroit	--------
Little Rock	--------
Louisville	--------
Memphis	--------
Helena	1,468
Denver	--------
Oklahoma City	--------
Omaha	--------
El Paso	997
Houston	1,751
San Antonio	1,500
Los Angeles	391
Portland	38
Salt Lake City	118
Seattle	199
Total	19,042
Culpeper	--------
System total	48,690

SOCIAL AND RECREATIONAL ACTIVITIES

Head offices:	
Boston	--------
New York	17,269
Philadelphia	6,844
Cleveland	--------
Richmond	4,324
Atlanta	2,891
Chicago	15,903
St. Louis	3,990
Minneapolis	2,708
Kansas City	3,766
Dallas	62
San Francisco	4,522
Total	62,279

SOCIAL AND RECREATIONAL ACTIVITIES—continued

Branches:	
Buffalo	$7,270
Cincinnati	
Pittsburgh	
Baltimore	300
Charlotte	259
Birmingham	538
Jacksonville	1,781
Nashville	579
New Orleans	1,503
Detroit	5,740
Little Rock	568
Louisville	1,472
Memphis	1,307
Helena	50
Denver	2,080
Oklahoma City	2,748
Omaha	53
El Paso	--------
Houston	--------
San Antonio	--------
Los Angeles	4,798
Portland	1,390
Salt Lake City	1,498
Seattle	1,517
Total	35,451
Culpeper	360
System total	98,090

ATHLETIC ACTIVITIES

Head offices:	
Boston	--------
New York	2
Philadelphia	4,635
Cleveland	--------
Richmond	369
Atlanta	--------
Chicago	--------
St. Louis	925
Minneapolis	--------
Kansas City	1,485
Dallas	10
San Francisco	1,550
Total	8,976
Branches:	
Buffalo	--------
Cincinnati	--------
Pittsburgh	--------
Baltimore	339
Charlotte	300
Birmingham	--------
Jacksonville	--------
Nashville	--------
New Orleans	80
Detroit	--------
Little Rock	--------
Louisville	152
Memphis	156
Helena	--------

ATHLETIC ACTIVITIES—continued

Branches—Continued	
Denver	$1,081
Oklahoma City	352
Omaha	
El Paso	
Houston	
San Antonio	
Los Angles	894
Portland	987
Salt Lake City	$828
Seattle	934
Total	6,103
Culpeper	
System total	15,079

Dues and contributions to banking organizations by Federal Reserve System banks and branches

Dues and contributions:	
American Bankers Association	$27,460.64
American Bankers Association, State, city, and regional banking associations	45,559.31
Total Dues and contributions: all banking operations	101,470.35

RICHMOND

Virginia Bankers Association	750.00
West Virginia Bankers Association	500.00
Group 2 Virginia Bankers Association	25.00
Robert Morris Associates	455.00
Group III Virginia Bankers Association	50.00
Bank Administration Institute	420.00
American Bankers Association	2,200.00
North Carolina Bankers Association	100.00
American Institute of Banking	100.00
Total:	
American Bankers Association	2,200.00
American Bankers Association and State and city	3,625.00
All	4,600.00
Total, Richmond and branches:	
American Bankers Association	2,229.00
ABA and State and city bank associations	4,725.00
All	6,954.50

BALTIMORE

Maryland Bankers Association	$483.00
American Institute of Banking	595.00
West Virginia Bankers Association	75.00
Bank Personnel Association	5.00
Robert Morris Associates	20.00
Bank Administration Institute	172.50
Association of Agricultural Bankers	5.00
Total:	
American Bankers Association	
ABA and State and city bank associations	563.00
All	1,355.50

BOSTON (NO BRANCHES)

Robert Morris Associates	$500.00
Vermont Bankers Associations	150.00
Massachusetts Bankers Association	1,000.00
American Institute of Banking	2,495.00
Bank Administration Institute	420.00
Connecticut Bankers Association	750.00
Rhode Island Bankers Association	5.00
Maine Bankers Associations	200.00
New Hampshire Bankers Association	200.00
American Bankers Association	2,200.00
Total:	
American Bankers Association	2,200.00
ABA and State and City Bank Associations	4,505.00
All	7,920.00

Dues and contributions to banking organizations by Federal Reserve System banks and branches—Continued

NEW YORK

American Institute of Banking	$4,271.25
Robert Morris Associates	35.00
New Jersey Bankers Association	1,440.00
New York State Bankers Association	3,300.00
Bank Administration Institute	520.00
Connecticut Bankers Association	375.00
Bank Credit Associates	18.00
American Bankers Association	2,200.000
National Association of Bank Women	25.00
New York total:	
All Bank organization related dues	12,184.25
American Bankers Association	2,200.00
ABA and State and city bank associations	7,315.00
Grand total, New York and Buffalo branch:	
All bank organization related dues	13,479.25
American Bankers Association	2,235.00
ABA and State and city bank associations	7,475.00

BUFFALO

American Institute of Banking	1,065.70
Robert Morris Associates	30.00
Bank Administration Institute	40.00
Group I, New York State Bankers Association	125.00
American Bankers Association	35.00
Total:	
All Bank organization related dues	1,295.00
ABA and State and city bank associations	160.00
American Bankers Association	35.00

CLEVELAND

Bank Public Relations & Marketing Association	100.00
Cleveland Clearing House	599.00
Robert Morris Associates	400.00
American Institute of Banking	472.94
Robert Morris Associates	6.00
Group 9 Ohio Bankers Association	150.00
Bank Administration Institute	420.00
American Bankers Association	2,200.00
American Institute of Banking	511.27
Cleveland total:	
American Bankers Association	2,200.00
All	4,266.20
ABA and State and city bank associations	2,350.00
Grand total, Cleveland and branches:	
American Bankers Association	2,275.00
All	6,484.00
ABA and State and city bank associations	4,072.00

CINCINNATI

Kentucky Bankers Association	500.00
American Institute of Banking	384.80
Ohio Bankers Association	2.00
Robert Morris Associates	30.00
Bank Administration Institute	30.00
American Bankers Association	35.00
ABA and State and city bank associations	537.00
American Bankers Association total	35.00
Total	981.80

Dues and contributions to banking organizations by Federal Reserve System banks and branches—Continued

PITTSBURGH

West Virginia Bankers Association	$75.00
The Bankers Club of Pittsburgh	175.00
Group 8 Pittsburgh Bankers Association	200.00
Pittsburgh Bankers Association	700.00
Robert Morris Associates	10.00
Bank Administration Institute	41.00
American Bankers Association	35.00
ABA and State and city bank associations	1,185.00
American Bankers Association total	35.00
All	1,236.00

CHICAGO

American Institute of Banking	587.00
Wisconsin Bankers Association	60.00
Illinois Bankers Association	100.00
Robert Morris Associates	466.00
Michigan Bankers Association	100.00
Indiana Bankers Association	100.00
Bank Administration Institute	425.00
Association of Chicago Bank Women	20.00
Chicago District Illinois Bankers Association	430.00
American Bankers Association	2,200.00
Iowa Bankers Association	100.00
Chicago total:	
All bank organization related dues	4,588.00
American Bankers Association	2,200.00
ABA and State and city bank associations	3,090.00
Grand total, Chicago and branches:	
All bank organization related dues	6,008.00
American Bankers Association	2,229.00
ABA and State and city bank associations	3,179.00

DETROIT

Group 10 Michigan Bankers Association	60.00
Bank Administration Institute	45.00
Robert Morris Associates	74.00
American Bankers Association	29.00
American Institute of Banking	1,212.66
Total	
All	1,420.66
American Bankers Association	29.00
ABA and State and city bank associations	89.00

DALLAS

American Bankers Association	1,566.64
Arizona Bankers Association	50.00
Texas Bankers Association	1,000.00
Louisiana Bankers Association	100.00
New Mexico Bankers Association	50.00
American Institute of Banking	2,497.00
Oklahoma Bankers Association	100.00
Robert Morris Associates	415.00
Bank Administration Institute	610.00
Texas Robert Morris Associates	15.00
Bank association dues	6,403.64
American Bankers Association dues	1,566.64
ABA and State and city bank associations	1,300.00
Grand total, Dallas and branches:	
ABA and State and city bank associations	2,005.00
American Bankers Association	1,671.64
All	7,875.36

Dues and contributions to banking organizations by Federal Reserve System banks and branches—Continued

EL PASO

Arizona Bankers Association	$50.00
Texas Bankers Association	200.00
Robert Morris Associates	15.00
New Mexico Bankers Association	50.00
Bank Administration Institute	37.50
American Bankers Association	35.00
ABA and State and city bank associations	335.00
American Bankers Association	35.00
Total	422.50

HOUSTON

Texas Bankers Association	100.00
Robert Morris Associates	20.00
Bank Administration Institute	30.00
American Institute of Banking	348.87
American Bankers Association	35.00
ABA and State and city bank associations	135.00
American Bankers Association	35.00
Total	533.87

SAN ANTONIO

Texas Bankers Association	200.00
Robert Morris Associates	20.00
Bank Administration Institute	37.50
American Institute of Banking	222.85
American Bankers Association	35.00
ABA and State and city bank associations	235.00
American Bankers Association	35.00
Total	515.35

Membership dues to bank-oriented organizations

PHILADELPHIA

New Jersey Bankers Association	560.00
Robert Morris Associates	460.00
Bank Administration Institute	435.00
Pennsylvania Bankers Association	1,400.00
Robert Morris Associates	30.00
Bank Method Discussion Group	35.00
American Bankers Association	2,200.00
American Bankers Association total	2,200.00
ABA and State and city bank associations	4,160.00
Total	5,120.00

MINNEAPOLIS

Independent Bankers Association	75.00
North Dakota Bankers Association	75.00
South Dakota Bankers Association	50.00
Wisconsin Bankers Association	60.00
American Institute of Banking	5,876.40
Bank Administration Institute	550.00
Michigan Bankers Association	100.00
Minnesota Bankers Association	750.00
Robert Morris Associates	430.00
American Bankers Association	2,200.00
Minneapolis total:	
All bank organization related dues	10,166.40
American Bankers Association	2,200,00
ABA and State and city bank associations	3,310.00
Grand total, Minneapolis and Helena branch:	
All bank organization related dues	10,915.48
American Bankers Association	2,235.00
ABA and State and city bank associations	3,585.31

Membership dues to bank-oriented organizations—Continued

HELENA

Montana Bankers Association	$240.31
Bank Administration Institute	473.77
American Bankers Association	35.00
Total:	
All bank organization related dues	749.08
American Bankers Association	35.00
ABA and State and city bank associations	275.31

SAN FRANCISCO

Arizona Bankers Association	50.00
Nevada Bankers Association	25.00
Washington Bankers Association	20.00
Bank Administration Institute	435.00
Robert Morris Associates	415.00
Oregon Bankers Association	50.00
Utah Bankers Association	25.00
American Institute of Banking	2,384.83
California Bankers Association	500.00
Group 6 California Bankers Association	235.00
American Bankers Association	2,340.00
San Francisco Total:	
All bank organization related dues	6,479.83
American Bankers Association	2,340.00
ABA and State and city bank associations	3,245.00
Grand total, San Francisco and branches:	
All bank organization related dues	9,162.17
American Bankers Association	2,340.00
ABA and State and city bank associations	3,828.00

SALT LAKE

Nevada Bankers Association	25.00
American Institute of Banking	70,00
Bank Administration Institute	40.00
Robert Morris Associates	30.00
Utah Bankers Association	25.00
Total:	
All bank organization related dues	190.00
American Bankers Association	([1])
ABA and State and city bank association	50.00

SEATTLE

Alaska Bankers Association	50.00
Robert Morris Associates	30.00
Bank Administartion Institute	35.00
Washington Bankers Association	50.00
American Institute of Banking	[2] 265.48
American Institute of Banking	913.86
Total:	
All bank organization related dues	1,344.34
American Bankers Association	([3])
ABA and State and city bank associations	100.00

LOS ANGELES

Arizona Bankers Association	50.00
Nevada Bankers Association	25.00
Robert Morris Associates	30.00
Bank Administration Institute	60.00
California Bankers Association Group 5	250.00
Los Angeles Bank Credit Men's Association	8.00
Total:	
All bank organization related dues	423.00
American Bankers Association	([4])
ABA and State and city bank associations	333.00

[1] Included in San Francisco total.
[2] Refurbishment of AIB classrooms.
[3] Included in San Francisco total.
[4] Included in San Francisco total.

Membership dues to bank-oriented organizations—Continued

PORTLAND

American Institute of Banking	$555.35
Robert Morris Associates	30.00
Oregon Bankers Association	100.00
Bank Administration Institute	40.00
Total:	
All bank organization related dues	725.00
American Bankers Association	([5])
ABA and State and city bank associates	100.00

ATLANTA

National Association of Bank Women	90.00
Robert Morris Associates	492.50
Georgia Bankers Association	500.00
Bank Administration Institute	400.00
American Bankers Association	2,340.00
American Institute of Banking	3,301.20
Atlanta total:	
American Bankers Association	2,340.00
ABA and State and city bank associations	2,930.00
All	7,123.70
Grand total, Atlanta and branches:	
American Bankers Association	2,340.00
ABA and State and city bank associations	4,190.00
All	10,335.99

JACKSONVILLE

Florida Bankers Association	915.00
Bank Administration Institute	55.00
American Institute of Banking	327.29
Total	1,297.29

NASHVILLE

Tennessee Bankers Association	220.00
American Institute of Banking	500.00
Bank Administration Institute	40.00
Total	760.00

NEW ORLEANS

Louisiana Bankers Association	100.00
Bank Administration Institute	100.00
American Institute of Banking	930.00
National Association of Bank Women	25.00
Total	1,155.00

KANSAS CITY

Missouri Bankers Association	500.00
Colorado Bankers Association	50.00
Bankers Consumer Credit Association	10.00
Wyoming Bankers Association	50.00
Oklahoma Bankers Association	100.00
Robert Morris Associates	400.00
Bank Administration Institute	415.00
New Mexico Bankers Association	50.00
Nebraska Bankers Association	25.00
American Bankers Association	2,200.00
Kansas Bankers Association	375.00
American Institute of Banking	3,193.00
Total:	
American Bankers Association	2,200.00
American Bankers Association and State and city	3,350.00
All	7,368.00
Grand total, Kansas City and branches:	
All	9,182.13
American Bankers Association	2,305.00
ABA and State and city bank associations	3,835.00

[5] Included in San Francisco total.

Membership dues to bank-oriented organizations—Continued

DENVER

American Institute of Banking	$832.13
Robert Morris Associates	15.00
New Mexico Bankers Association	50.00
Bank Administration Institute	45.00
American Bankers Association	35.00
Total:	
All	977.13
American Bankers Association	35.00
ABA and State and city bank associations	85.00

OKLAHOMA CITY

Robert Morris Associates	15.00
Oklahoma Bankers Association	100.00
Bank Administration Institute	40.00
American Bankers Association	35.00
Total:	
All	190.00
American Bankers Association	35.00
ABA and State and city bank associations	135.00

OMAHA

Nebraska Bankers Association	180.00
Wyoming Bankers Association	50.00
Robert Morris Associates	15.00
Bank Administration Institute	40.00
American Institute of Banking	327.00
American Bankers Association	35.00
Total:	
All	647.00
American Bankers Association	35.00
ABA and State and city bank associations	265.00

CHARLOTTE

South Carolina Bankers Association	625.00
Association of Agricultural Bankers	5.00
Group 9 North Carolina Bankers Association	12.00
Robert Morris Associates	30.00
Bank Administration Institute	48.00
American Bankers Association	29.00
American Institute of Banking	250.00
Total:	
American Bankers Association	29.00
ABA and State and city bank associations	671.00
All	999.00

ST. LOUIS

Missouri Bankers Association	500.00
Mortgage Bankers Association	40.00
Illinois Bankers Association	100.00
Bank Administration Institute	410.00
Indiana Bankers Association	100.00
National Association of Bank Women	25.00
American Bankers Association	2,200.00
American Institute of Banking	2,005.50
ABA and State and city bank associations	2,940.00
American Bankers Association total	2,200.00
All	5,380.50
Grand total, St. Louis and branches:	
ABA State and city bank associations	4,335.00
American Bankers Association	2,305.00
All	8,033.95

Membership dues to bank-oriented organizations—Continued

MEMPHIS

National Association of Bank Women	$25.00
Tennessee Bankers Association	87.50
Tennessee Bankers Association	87.50
Robert Morris Associates	15.00
Bank Administration Institute	55.00
Robert Morris Associates	7.50
American Institute of Banking	292.95
American Bankers Association	35.00
ABA and State and city bank associations	210.00
American Bankers Association total	35.00
All	605.45

LOUISVILLE

National Association of Bank Women	28.00
Bankers Transit Club	60.00
Robert Morris Associates	15.00
Bank Administration Institute	80.00
Indiana Bankers Association	100.00
Robert Morris Associates	7.50
Kentucky Bankers Association	500.00
American Bankers Association	35.00
ABA and State and city bank associations	635.00
American Bankers Association total	35.00
All	825.00

LITTLE ROCK

American Institute of Banking	575.00
Junior Banker Section of Arkansas Bankers Association	10.00
Robert Morris Associates	15.00
Arkansas Bankers Association	500.00
Bank Administration Institute	45.00
Robert Morris Associates	7.50
American Bankers Association	35.00
ABA and State and city bank associations	550.00
American Bankers Association total	35.00
All	1,222.50

Statement Submitted for the Record by Dr. Burns

The Board has reviewed carefully the statement issued by Chairman Patman on expenditures by the Federal Reserve Banks. The review found that the great bulk of the payments listed were proper and justified in enabling the Reserve Banks to perform their functions. This review found no illegal payments. It did find, however, that a few expenditures were not appropriate and should not have been made.

The Board has utilized this review period to consider in detail the existing procedures governing expenditures. It has discussed these questions with the president of each Federal Reserve Bank. We have sought to make certain that all types of expenditures are carefully re-examined to insure that they can be justified on a cost-benefit basis, as contributing to efficient performance of the Reserve Banks' functions. The operations of the Reserve Banks change constantly over time. We strive to make certain that each expenditure is justified in relationship to the existing situation and that no expenditure occurs simply because it may have occurred in the past. As an example, the Reserve Banks recently discontinued payment of dues to the American Bankers Association.

When we examined the items listed by Chairman Patman, we found that they could be separated into three groups:

1. Those items which exist because the Reserve Banks have been established as regional-community institutions with personnel policies adapted to each locality in which they operate. This means, for one thing, that the Reserve Banks

do not follow the somewhat higher scales of salaries established for the Civil Service in Washington.

2. Items for which specific statutory authorization is required in the case of agencies that use appropriated funds, but which are authorized under general provisions of the Federal Reserve Act for Reserve Banks, who expenses are met from earnings, not appropriations.

3. A handful of items, involving small amounts, where expenditures were approved on the basis of special circumstances even though they were of a type not ordinarily authorized. Expenditures for baby sitting services and parking fines fall in this category. Such expenditures are not appropriate for Reserve Banks under any circumstances and they will not be repeated.

Chairman Patman has listed as "questionable" all expenditures made by the Reserve Banks in 1969 for "employee relations," a category that includes contributions to employees' associations, flowers to employees in the hospital, or annual parties for employees, although practices vary among the Reserve Banks. The expenditures in this category amounted to $220,000, over one-third of the total expenditures listed. They averaged about ten dollars per employee.

Modest expenditures of this kind have helped the Reserve Banks in attracting and keeping good personnel. The same is true of employee benefits in the sphere of pensions, survivor benefits, and the thrift plan. As noted in an answer to a separate question, the legal justification of the thrift plan is clear; the justification based on efficiency and productivity is equally clear. We have found the one per cent of salary spent on the thrift plan to be a most efficient fringe benefit. My impression is that even a considerably larger increase in salaries would not serve to raise the morale and efficiency of the staff as much.

The personnel policies of the Reserve Banks have followed the pattern of the Federal Reserve Act. The actual salary scales and benefits are not established on a uniform base throughout the country, since a scale adequate in Washington could be overbountiful in cities of 150 or 200 thousand and inadequate in New York. Rather, they try to be competitive with the private firms in each specific locality, although at times they lag behind that competition. Experience has shown that this policy saves money, reduces employment turnover, and attracts competent personnel.

The Federal Reserve System thus benefits from a regional structure—one which, incidentally, seems to be the trend of the future. Salaries and benefits are structured to each local situation; this means not only a considerable saving of money, but also that total satisfaction is greater.

Also included on Chairman Patman's list are expenditures for research, meetings, conferences, and contributions to educational endeavors such as the American Institute of Banking. These are expenditures of a type specifically authorized and conducted by many government agencies.

In the early sixties, several Members of Congress were, I believe, properly critical of the failure of the Federal Reserve to develop fully its monetary views, theories, and policies. Monetary policy was pictured as excessively mysterious even to informed individuals. I believe that money carefully spent by the Reserve Banks to improve the System's actions in these spheres is well spent. We must constantly upgrade our knowledge of monetary matters. In some cases the most efficient way to gain this knowledge is to make research grants to outside experts and to subscribe to various publications and services.

At the same time, we must keep the public informed about our actions and the reasons for them. We want monetary policy not only to be based on an accurate understanding of what is happening in the economy, but to be made clear to a wide audience. Conferences and meetings serve this purpose.

With respect to the American Institute of Banking it should be clear that this is an educational institution and the payments noted are directly related to educational services. The Reserve Banks strive to open to all their personnel possibilities for growth in service and promotions to higher positions. Many of their most promising people come from families too poor to afford higher education. Through in-service training provided by organizations such as the AIB, they are able eventually to make outstanding contributions to themselves, the Reserve Banks, and our nation. This upward mobility should be encouraged. National policy is placing more stress than ever in this sphere. Lines of promotion must be kept open to those without formal education, to minority groups, to women. The specialized courses given by the AIB are a major aid in this endeavor.

As I made clear at the start, we recognize that the Federal Reserve System must always be able to justify any expenditure in terms of its benefits in relation to its costs. We feel certain that, with the exception of some obvious cases of human error, the Federal Reserve System does this. I can assure the Congress that, along with the presidents of the Reserve Banks and the other members of the Board, I am personally taking all necessary steps to insure that we get our money's worth on every dollar spent.

THE FEDERAL RESERVE PORTFOLIO OF GOVERNMENT BONDS

(Statement submitted by Chairman Patman)

As you know, questions concerning the Federal Reserve's portfolio of Government bonds have been of concern to me over the years. With all due respect Dr. Burns, I do not believe that your answer to my questions on this subject last spring dealt fully with the substantive issues involved. Currently there are $65 billion of Government securities in that portfolio and your predecessor, William McChesney Martin, and many others have agreed with me that it is an excessive amount and that the amount has no real bearing on the conduct of monetary policy. When in 1965 I proposed that a majority of the bonds held by the Federal Reserve be cancelled, leaving only the amount of negotiable bonds required for the conduct of open market operations, Mr. Martin admitted that cancellation would be "just a bookkeeping entry." But, like you, he argued that the current arrangement which permits the System to hold the bonds and collect some $4 billion annually in interest on bonds which have already been paid for by the Treasury does no harm.

In fact, you argue, Dr. Burns, that it does good because it gives the Federal Reserve System an independent income and thus protects its independence. But you do not deny that there really is no reason to keep those bonds in the Federal Open Market Committee portfolio other than that they serve as a source of income for the System and thus allow it to by-pass the appropriational process.

It does not, in my opinion, alleviate the situation to point out that the Federal Reserve pays the unused portion of the interest over to the Treasury. Before making such payments, the System uses as much as in its judgment it needs for expenses without the benefit to the public of the appropriational process, Congressional sanction or executive department approval. This procedure, as we all know, is normally required of the other agencies of the Government.

Perhaps it would be useful to review the question of Federal Reserve independence and Federal Reserve income. When the System was first established in 1913, the Federal Reserve banks were capitalized with funds paid in by the member banks, bank reserves were actually paid in by the member banks, and the Federal Reserve banks got their income from rediscounting commercial paper for the member banks. Purchases in the open market were not a primary source of income until 1922, when an open market committee was formed and open market operations came to play a significant part in the conduct of monetary policy.

This development could not have been foreseen in 1913 because there was hardly any market for bankers' acceptances, there was only a limited amount of municipal warrants, and there were no more than $2 billion of Government bonds outstanding, most of which were securing the national bank currency. World War I and the rise of the Federal debt to $25 billion made the development of open market operations possible, created a new source of bank reserves and shifted the source of income to cover the expenses of the System and build its surplus accounts.

The main argument for Federal Reserve independence in 1913 had been that the System was to be created and sustained with funds supplied by the member banks. During the 1920's this had ceased to be the case. The original $1.5 billion of reserves paid in by the member banks in 1914 has remained approximately the same to date. The immense increase in the volume of reserves since 1914 has been created by the Government by virtue of the fact that it has given monetary status to the obligations—Federal Reserve notes and deposits—of the Federal Reserve banks.

It is also relevant to point out that commercial banks can operate as they do now only because the Federal Government permits their demand deposits to circulate as money. By permitting demand deposits of commercial banks to be used as money and by the Government itself accepting demand deposits in payment, commercial banks have conferred upon them a status shared by no other financial institution in this country.

I know that you nor any other member of the Federal Reserve Board would argue that the Federal Reserve System ought to remain independent because of its obligations to the private banking system. A lot of people still think that, but it is no longer respectable to say it. Still, it is possible that some member of the Federal Reserve Board might come before this Committee and suggest—as Mr. Martin did in 1959—that since all those bonds in the Federal Open Market Committee portfolio serve no purpose, and since they constitute the basis on which member bank reserves are calculated, why not just give some of them to the member banks to hold as reserves? That's what I'm afraid of, because I think it would be a catastrophe. The interest on those bonds would then go to the commercial banks. The loss to the Treasury would be staggering. It would represent the biggest subsidy to private enterprise that the American taxpayers have ever been called on to pay. I'd like to prevent it, if I can, and I think we should prevent it by law with the active help and encouragement of the Federal Reserve Board. We can't depend on the present views and good intentions of men currently in office.

I am asking you to cooperate on this issue, Dr. Burns, and I'd like to point out another reason why you should. Since it was Mr. Martin's policy for so long not to buy long-term Government issues, a substantial amount of the Federal Open Market Committee portfolio is in short-term maturities averaging about five years. This means that a substantial volume of refunding operations are involved and that the manager of the open market account must necessarily be in the market any number of times for reasons which have nothing to do with the objectives of monetary policy. Payments to dealers in these operations represent a loss to the Treasury of some of the funds which the Federal Reserve System repays the Treasury from its earnings on Government securities and thus a needless subsidy to the dealers from the American taxpayer.

One reason that the portfolio continues to grow and that refunding operations are necessary is to prevent a double payment for the bonds by the United States Government. When the bonds are bought by the Federal Open Market Committee, they are paid for once, as I have so often noted, either with Federal Reserve notes which are issued by the United States Treasury and for which the Federal Government is responsible, or with Federal Reserve credit which is given monetary status by the Government and for which the Government is responsible. If the bonds in the Federal Reserve portfolio were not exchanged for other Government securities when they mature—if they were paid—then the Government would be in the absurd position of paying for its own securities twice.

These refunding operations cannot fail to be destabilizing. On the other hand, it would be highly destabilizing to attempt to solve the problem by lengthening the overall maturity of the portfolio. Cancellation of the amount not needed in the conduct of monetary policy is a far more rational approach. Then shifts in the maturity of a smaller portfolio would contribute to achieving the objectives of monetary policy rather than represent attempts to minimize the effects of needless and destabilizing refunding operations.

Meanwhile, there is another and more significant way in which the present monetary system involves Government subsidies. In 1917, at the beginning of World War I, the Federal Reserve Board suggested an arrangement whereby member banks could purchase Government bonds by merely creating a deposit for the Government. The banks were permitted to borrow from the Federal Reserve banks using the bond as collateral. They paid a lower rate on the loan than they got from the Government on the bond, and could use the money, without paying interest to the Government to lend to customers at an additional profit until such time as the Government deposit was finally withdrawn. This arrangement has been in effect ever since. It is one of the ways new money is created, the other being the Federal Reserve's purchases of securities.

There is some misconception to the effect that the Federal deficit is largely borrowed from private citizens out of their savings. Actually a major portion of the interest paid for Government borrowing goes to commercial banks because they, unlike private citizens, are permitted to create the money to pay for Government obligations. I pointed out to Marriner Eccles that this constituted a subsidy and he agreed. However, he argued that if this were not the case, banks would have to increase their charges to customers. I happen to think that an increase in bank charges would be preferable to a subsidy provided by the taxpayer. Banks might be induced to lower their charges to compete for customers.

All these issues are related, Dr. Burns. They all stem from the fact that our collateral requirements require the Government to assume a needless double liability—to be liable both for Federal Reserve notes and for the Government obligations which back those notes. They all result in the fact that the taxpayer pays an exorbitant amount of interest on the money that he uses and that the issuance of money is inextricably tied to the marketing of the public debt.

These are serious matters and should be considered as such. It is unfortunate that our monetary system is tied up also with the question of Federal Reserve income. It has tended, I think, to make the System somewhat myopic and to discourage rational examination of the monetary process. This is one reason why I advocate Congressional appropriations to cover the expenses of the System. The System might well take a more disinterested view of the problem if it were not for the fact that this particular process guarantees so much income that System expenses seem miniscule as a percentage of the whole.

(Whereupon, at 12:15 p.m., the committee adjourned subject to the call of the Chair.)

O