TO MODERNIZE THE FEDERAL RESERVE SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H.R. 7001

A BILL TO MODERNIZE THE FEDERAL RESERVE SYSTEM

MAY 15, 1980

Serial No. 96–62

Printed for the use of the
Committee on Banking, Finance and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
63-971 O WASHINGTON : 1980

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

HENRY S. REUSS, Wisconsin, *Chairman*

THOMAS L. ASHLEY, Ohio
WILLIAM S. MOORHEAD, Pennsylvania
FERNAND J. ST GERMAIN, Rhode Island
HENRY B. GONZALEZ, Texas
JOSEPH G. MINISH, New Jersey
FRANK ANNUNZIO, Illinois
JAMES M. HANLEY, New York
PARREN J. MITCHELL, Maryland
WALTER E. FAUNTROY, District of Columbia
STEPHEN L. NEAL, North Carolina
JERRY M. PATTERSON, California
JAMES J. BLANCHARD, Michigan
CARROLL HUBBARD, Jr., Kentucky
JOHN J. LaFALCE, New York
GLADYS NOON SPELLMAN, Maryland
LES AuCOIN, Oregon
DAVID W. EVANS, Indiana
NORMAN E. D'AMOURS, New Hampshire
STANLEY N. LUNDINE, New York
JOHN J. CAVANAUGH, Nebraska
MARY ROSE OAKAR, Ohio
JIM MATTOX, Texas
BRUCE F. VENTO, Minnesota
DOUG BARNARD, Jr., Georgia
WES WATKINS, Oklahoma
ROBERT GARCIA, New York
MIKE LOWRY, Washington

J. WILLIAM STANTON, Ohio
CHALMERS P. WYLIE, Ohio
STEWART B. McKINNEY, Connecticut
GEORGE HANSEN, Idaho
HENRY J. HYDE, Illinois
RICHARD KELLY, Florida
JIM LEACH, Iowa
THOMAS B. EVANS, Jr., Delaware
S. WILLIAM GREEN, New York
RON PAUL, Texas
ED BETHUNE, Arkansas
NORMAN D. SHUMWAY, California
CARROLL A. CAMPBELL, Jr., South Carolina
DON RITTER, Pennsylvania
JON HINSON, Mississippi
JOHN EDWARD PORTER, Illinois

PAUL NELSON, *Clerk and Staff Director*
MICHAEL P. FLAHERTY, *General Counsel*
JAMES C. SIVON, *Minority Staff Director*

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

PARREN J. MITCHELL, Maryland, *Chairman*

STEPHEN L. NEAL, North Carolina
NORMAN E. D'AMOURS, New Hampshire
DOUG BARNARD, Jr., Georgia
JIM MATTOX, Texas
JOHN J. CAVANAUGH, Nebraska

GEORGE HANSEN, Idaho
RON PAUL, Texas
DON RITTER, Pennsylvania

CONTENTS

TO MODERNIZE THE FEDERAL RESERVE SYSTEM

THURSDAY, MAY 15, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

Present: Representatives Mitchell, Neal, Barnard, Mattox, Hansen, Paul, and Ritter.

Also present: Representative Henry S. Reuss, chairman of the full committee.

Chairman MITCHELL. The subcommittee will come to order.

The Chair has two brief announcements to make. As the members of the subcommittee know, the House went into session at 10 a.m. However, this is a hearing and we are not bound by the 5-minute rule in any respect. So we can proceed and from time to time, if votes are required, we will slip over to the floor and cast our votes.

The second announcement is that Chairman Volcker of the Federal Reserve Board will testify at about 11 o'clock. In the event we finish up the first part of the hearing before that, we will take a brief recess and resume at 11 o'clock.

Today we begin hearings on H.R. 7001, a bill to modernize the Federal Reserve System. This bill was introduced last month by our esteemed full committee chairman, Congressman Henry S. Reuss, for himself, our subcommittee colleague Congressman John J. Cavanaugh, and myself.

[The text of H.R. 7001 and a section-by-section analysis follow:]

96TH CONGRESS
2D SESSION

H. R. 7001

To modernize the Federal Reserve System.

IN THE HOUSE OF REPRESENTATIVES

APRIL 1, 1980

Mr. REUSS (for himself, Mr. MITCHELL of Maryland, and Mr. CAVANAUGH) introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

---

A BILL

To modernize the Federal Reserve System.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Federal Reserve Modernization Act".

TITLE I—RETIREMENT OF FEDERAL RESERVE BANK STOCK

STOCK SUBSCRIPTIONS

SEC. 101. (a) The last sentence of the first paragraph of section 2 of the Federal Reserve Act (12 U.S.C. 222) is

1 amended by striking out "subscribing and paying for stock"
2 and inserting in lieu thereof "obtaining a certificate of
3 membership".

4 (b) The second sentence of the third paragraph of sec-
5 tion 2 of such Act (12 U.S.C. 282) is amended by striking
6 out "subscribe to the capital stock" and all that follows
7 through "gold or gold certificates." and inserting in lieu
8 thereof "obtain a certificate of membership pursuant to the
9 provisions of this Act.".

10 (c) The fourth paragraph of section 2 of such Act (12
11 U.S.C. 502) is amended—

12 (1) by striking out "shareholders" and inserting in
13 lieu thereof "member banks"; and

14 (2) by striking out "the amount of their" and all
15 that follows through the end thereof and by inserting in
16 lieu thereof "an amount equal to 6 per centum of the
17 paid-up capital stock and surplus of such member
18 bank.".

19 (d) The eighth, ninth, tenth, and eleventh paragraphs of
20 section 2 of such Act (12 U.S.C. 283; 285) are hereby
21 repealed.

22 (e) The twelfth paragraph of section 2 of such Act (12
23 U.S.C. 286) is hereby repealed.

24 (f) The first sentence of the last paragraph of section 2
25 of such Act (12 U.S.C. 281) is hereby repealed.

1 ORGANIZATION OF FEDERAL RESERVE BANKS

2 SEC. 102. (a) The second sentence of the first paragraph
3 of section 4 of the Federal Reserve Act is amended by strik-
4 ing out "a subscription to the capital stock of" and inserting
5 in lieu thereof "an application for a certificate of membership
6 in".

7 (b) The second paragraph of section 4 of such Act is
8 amended—

9 (1) by striking out "When the minimum amount
10 of capital stock prescribed by this Act for the organiza-
11 tion of any Federal Reserve bank shall have been sub-
12 scribed and allotted," and inserting in lieu thereof
13 "When the organization committee shall deem that a
14 sufficient proportion of eligible banks have applied for
15 membership in a Federal Reserve bank in the process
16 of organization,";

17 (2) by striking out "the amount of capital stock
18 and the number of shares into which the same is
19 divided,";

20 (3) by striking out "subscribed to the capital stock
21 of" and inserting in lieu thereof "applied for member-
22 ship in";

23 (4) by striking out "and the number of shares sub-
24 scribed by each"; and

1 (5) by striking out "subscribed or may thereafter
2 subscribe to the capital stock of" and inserting in lieu
3 thereof "applied or may thereafter apply for member-
4 ship in".

5 (c) The subparagraph numbered "Eighth" of section 4
6 of such Act (12 U.S.C. 341) is amended by striking out
7 "stock".

8 (d) The tenth paragraph of section 4 of such Act (12
9 U.S.C. 302) is amended by striking out "stock-holding" and
10 inserting in lieu thereof "member".

11 (e) The third sentence of the twelfth paragraph of sec-
12 tion 4 of such Act is amended by striking out "subscriptions
13 to the capital stock" and inserting in lieu thereof "applica-
14 tions for membership".

15 MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM

16 SEC. 103. Section 5 of the Federal Reserve Act (12
17 U.S.C. 287) is amended to read as follows:

18 "APPLICATION FOR MEMBERSHIP

19 "SEC. 5. (a) The Federal Reserve banks shall have no
20 capital stock.

21 "(b) A bank applying for membership in the Federal
22 Reserve System after the effective date of the Federal Re-
23 serve System Structural Reform Act of 1980 shall submit an
24 application for such membership, in accordance with regula-

1 tions of the Board of Governors of the Federal Reserve
2 System, to the Federal Reserve bank of its district.
3 "(c) Upon the approval of an application submitted pur-
4 suant to subsection (b), the Federal Reserve bank involved
5 shall issue to such bank a certificate attesting the member-
6 ship of such bank in such Federal Reserve bank and in the
7 Federal Reserve System.
8 "(d) With respect to any bank which has an application
9 for membership in the Federal Reserve System which is
10 pending on the date of the enactment of the Federal Reserve
11 System Structural Reform Act of 1980, upon the approval of
12 such application of such bank, such Federal Reserve bank
13 shall issue to such bank a certificate attesting the member-
14 ship of such bank in such Federal Reserve bank and in the
15 Federal Reserve System.
16 "(e) When a member bank voluntarily liquidates, it shall
17 surrender its certificate of membership and cease to be a
18 member of the Federal Reserve bank of its district and of the
19 Federal Reserve System.
20 "(f)(1) Any bank which is a member bank on the date of
21 the enactment of the Federal Reserve System Structural
22 Reform Act of 1980 shall be deemed to hold a certificate of
23 membership in the Federal Reserve System and in the Fed-
24 eral Reserve bank of which it is a member on such date.

1 "(2) The Federal Reserve bank involved shall issue a
2 certificate of membership to each such member bank as soon
3 as practicable after the date of the enactment of such Act.".

4 INSOLVENCY OF MEMBER BANKS

5 SEC. 104. (a) The first paragraph of section 6 of the
6 Federal Reserve Act (12 U.S.C. 288, first paragraph) is
7 hereby repealed.

8 (b) The second sentence of the paragraph which prior to
9 the amendment made by subsection (a) of this section was the
10 second paragraph of section 6 of such Act (12 U.S.C. 288,
11 second paragraph) is amended to read as follows: "The certif-
12 icate of membership held by such national bank shall be sur-
13 rendered to the Federal Reserve bank of its district, and such
14 national bank shall cease to be a member of such Federal
15 Reserve bank and of the Federal Reserve System.".

16 DIVISION OF EARNINGS

17 SEC. 105. (a) The first paragraph of section 7 of the
18 Federal Reserve Act (12 U.S.C. 289) is amended by striking
19 out "the stockholders" and all that follows through "have
20 been fully met,".

21 (b) The second sentence of the second paragraph of sec-
22 tion 7 of such Act (12 U.S.C. 290) is amended by striking
23 out ", dividend requirements as hereinbefore provided, and
24 the par value of the stock,".

1 (c) The third paragraph of section 7 of such Act (12
2 U.S.C. 531) is amended by striking out "capital stock and".

3 APPLICATION FOR MEMBERSHIP BY STATE BANKS

4 SEC. 106. (a) The first paragraph of section 9 of the
5 Federal Reserve Act (12 U.S.C. 321, first paragraph) is
6 amended—

7 (1) in the first sentence, by striking out "the right
8 to subscribe to the stock of" and inserting in lieu
9 thereof "membership in";

10 (2) by striking out the second and third sentences
11 thereof; and

12 (3) in the last sentence, by striking out "stock-
13 holder" and inserting in lieu thereof "member".

14 (b) The first sentence of the second paragraph of section
15 9 of such Act (12 U.S.C. 321, second paragraph) is amended
16 by striking out "Federal Reserve bank stock owned by the
17 national bank shall be canceled and paid for as provided in
18 section 5 of this Act." and inserting in lieu thereof "member-
19 ship of such national bank shall be terminated and the certifi-
20 cate of membership canceled by the Federal Reserve bank
21 involved.".

22 (c) The first sentence of the third paragraph of section 9
23 of such Act (12 U.S.C. 321, third paragraph) is amended—

24 (1) by striking out "stockholder" and inserting in
25 lieu thereof "member"; and

1 (2) by striking out "stock" and inserting in lieu
2 thereof "membership".
3 (d) The fifth paragraph of section 9 of such Act (12
4 U.S.C. 323) is hereby repealed.
5 (e) The first sentence of the paragraph which prior to
6 the amendment made by subsection (d) of this section was the
7 ninth paragraph of section 9 of such Act (12 U.S.C. 327) is
8 amended by striking out "stock" and inserting in lieu thereof
9 "certificate of membership".
10 (f) The paragraph which prior to the amendment made
11 by subsection (d) of this section was the tenth paragraph of
12 section 9 of such Act (12 U.S.C. 328) is amended—
13 (1) in the first sentence—
14 (A) by striking out "all of its holdings of cap-
15 ital stock" and inserting in lieu thereof "its certif-
16 icate of membership"; and
17 (B) by striking out ": *Provided, however,*
18 That no" and all that follows through "withdraw-
19 als during that year"; and
20 (2) in the third sentence—
21 (A) by striking out "stock holdings" and in-
22 serting in lieu thereof "certificate of membership";
23 and
24 (B) by striking out "a refund of its cash" and
25 all that follows through "likewise be entitled to".

1 (g) The paragraph which prior to the amendment made
2 by subsection (d) of this section was the sixteenth paragraph
3 of section 9 of such Act (12 U.S.C. 333) is amended—
4 (1) in the first sentence, by striking out ", except
5 that any" and all that follows through "admission to
6 membership";
7 (2) by striking out the second through the seventh
8 sentences thereof; and
9 (3) in the last sentence, by striking out ", except
10 as otherwise hereinbefore provided with respect to cap-
11 ital stock".
12 (h) The last sentence of the last paragraph of section 9
13 of such Act (12 U.S.C. 338) is amended by striking out
14 "stock" and inserting in lieu thereof "certificates of
15 membership".

16 ASSESSMENTS ON FEDERAL RESERVE BANKS

17 SEC. 107. The first sentence of the third paragraph of
18 section 10 of the Federal Reserve Act (12 U.S.C. 243) is
19 amended by striking out "capital stock and surplus" and in-
20 serting in lieu thereof "net earnings for the immediately pre-
21 ceding six-month period".

22 BANKS IN DEPENDENCIES AND INSULAR POSSESSIONS
23 AS MEMBER BANKS

24 SEC. 108. Section 19(h) of the Federal Reserve Act (12
25 U.S.C. 466) is amended by striking out "take stock" and

1 inserting in lieu thereof "apply for membership in the Federal
2 Reserve System".

3 RETIREMENT OF FEDERAL RESERVE BANK STOCK

4 SEC. 109. The Federal Reserve Act is amended by in-
5 serting after section 5 of such Act the following new section:

6 "RETIREMENT OF FEDERAL RESERVE BANK STOCK

7 "SEC. 5A. (a) Not later than five years after the date of
8 the enactment of the Federal Reserve System Structural
9 Reform Act of 1980, upon request of the Federal Reserve
10 bank involved, each holder of stock in such Federal Reserve
11 bank shall surrender such stock to such Federal Reserve
12 bank. During such five-year period, such Federal Reserve
13 bank shall cancel and retire such stock and pay to the former
14 holder of such stock the par value thereof, plus interest at the
15 rate of one-half of 1 per centum per month from the date of
16 the last dividend. The timing of such payments by such Fed-
17 eral Reserve bank during such five-year period shall be con-
18 sistent with the orderly operation of the Federal budget and
19 the monetary control policies of the Board of Governors of
20 the Federal Reserve System.

21 "(b) In any case in which a member bank voluntarily
22 liquidates during such five-year period, upon surrendering its
23 stock and certificate of membership to the Federal Reserve
24 bank involved, such member bank shall promptly receive

1 payment for such stock as specified in subsection (a), less any
2 liability of such member bank to such Federal Reserve bank.
3 "(c) In any case in which a member bank shall be de-
4 clared insolvent during such five-year period and a receiver is
5 appointed for such member bank, or in any case in which a
6 receiver is appointed for a national bank during such five-
7 year period pursuant to the first paragraph of section 6 of
8 this Act, upon surrendering its stock and certificate of mem-
9 bership in the Federal Reserve bank involved, the receiver
10 shall promptly receive payment for such stock as specified in
11 subsection (a), less all debts of such member bank or such
12 national bank to the Federal Reserve bank involved.".

13 TITLE II—STRUCTURAL CHANGES IN THE
14 FEDERAL RESERVE SYSTEM

15 OPEN-MARKET OPERATIONS

16 SEC. 201. (a) Section 12A(a) of the Federal Reserve
17 Act (12 U.S.C. 263(a)) is amended to read as follows:
18 "SEC. 12A. (a) No Federal Reserve bank shall engage
19 or decline to engage in open-market operations under section
20 14 of this Act except in accordance with the direction of and
21 regulations adopted by the Board of Governors of the Federal
22 Reserve System. The Board of Governors of the Federal Re-
23 serve System shall consider, adopt, and transmit regulations
24 to the several Federal Reserve banks relating to the open-
25 market transactions of such Federal Reserve banks.".

1 (b) Section 12A of the Federal Reserve Act (12 U.S.C.
2 263) is amended by striking out subsection (b) and by
3 redesignating subsection (c) as subsection (b).
4 (c) Section 2A of the Federal Reserve Act (12 U.S.C.
5 225a) is amended by striking out "and the Federal Open
6 Market Committee" each place it appears therein.
7 (d) The tenth paragraph of section 10 of such Act is
8 amended—
9 (1) in the first sentence—
10 (A) by striking out "and by the Federal
11 Open Market Committee; and
12 (B) by striking out "and the Committee";
13 and
14 (2) in the second sentence—
15 (A) by inserting "other" after "record with
16 respect to all"; and
17 (B) by inserting "other" after "and with re-
18 spect to the".
19 (e) Section 14(b)(2) of the Federal Reserve Act (12
20 U.S.C. 355) as in effect on the date of the enactment of this
21 Act and as in effect on June 9, 1981 pursuant to section 3(a)
22 of the Act of June 8, 1979 (93 Stat. 35; Public Law 96-18)
23 is amended by striking out "Federal Open Market Commit-
24 tee" each place it appears therein and inserting in lieu there-
25 of "Board of Governors of the Federal Reserve System".

63-971 O - 80 - 2

1 (f) Section 14(h) of the Federal Reserve Act is amended
2 by striking out "Federal Open Market Committee" and in-
3 serting in lieu thereof "Board of Governors of the Federal
4 Reserve System".

5 MEMBERSHIP OF FEDERAL ADVISORY COUNCIL

6 SEC. 202. (a) The first paragraph of section 12 of the
7 Federal Reserve Act (12 U.S.C. 261) is amended to read as
8 follows:

9 "SEC. 12. (a) There is hereby created a Federal Advi-
10 sory Council which shall consist of as many members as
11 there are Federal Reserve districts. The president of each
12 Federal Reserve district shall be the member for such district
13 on the Federal Advisory Council. Meetings of the Federal
14 Advisory Council shall be held in the District of Columbia at
15 least once each month, and additional meetings may be called
16 by the Board of Governors of the Federal Reserve System.
17 In addition to the meetings required in the previous sentence,
18 the Federal Advisory Council may hold such other meetings
19 in the District of Columbia or in any other location it deems
20 necessary. The Federal Advisory Council may select its own
21 officers and adopt its own methods of procedure. A majority
22 of the members of the Federal Advisory Council shall consti-
23 tute a quorum for the transaction of business. In any case in
24 which there is a vacancy in the position of president of a
25 Federal Reserve bank, the first vice president of such Feder-

1 al reserve bank shall serve as a member of the Federal Advi-
2 sory Council until the date on which such vacancy is filled.".
3 (b) The paragraph which prior to the amendment made
4 by subsection (a) of this section was the second paragraph of
5 section 12 of such Act (12 U.S.C. 262) is amended by insert-
6 ing "(b)" before "The".

7 APPOINTMENT OF FEDERAL RESERVE BANK PRESIDENTS

8 SEC. 203. The paragraph numbered "Fifth" of the
9 fourth paragraph of section 4 of the Federal Reserve Act (12
10 U.S.C. 341) is amended—
11 (1) in the second sentence, by striking out ", with
12 the approval of the Board of Governors of the Federal
13 Reserve System,"; and
14 (2) by inserting after the second sentence the fol-
15 lowing: "The president shall be a bona fide resident of
16 the district involved.".

17 POLICIES TO ACHIEVE THE GOALS OF THE EMPLOYMENT
18 ACT OF 1946 AND THE FULL EMPLOYMENT AND BAL-
19 ANCED GROWTH ACT OF 1978

20 SEC. 204. The Federal Reserve Act is amended by
21 adding the following section 2B:
22 "SEC. 2B. The Federal Reserve System shall utilize its
23 resources, and generally conduct its affairs, to foster the poli-
24 cies and purposes of the Employment Act of 1946 and the
25 Full Employment and Balanced Growth Act of 1978, par-

1 ticularly the Nation's effort to achieve a stabler price level,
2 and an improved economic structure.".

3 TITLE III—EFFECTIVE DATE

4 EFFECTIVE DATE

5 SEC. 301. The amendments made by this Act shall take
6 effect on the date of the enactment of this Act, except that
7 the amendments made by section 101(e) and section 105
8 shall take effect five years after such date.

SECTION-BY-SECTION of H.R. 7001

Section 1. Short title: Federal Reserve Modernization Act.

Section 101. Abolishes requirement that member banks subscribe to capital stock in the Federal Reserve, and eliminates all such stock.

Section 102. Provides for membership of banks in Federal Reserve System, instead of subscription of capital.

Section 103. Provides mechanisms for issuance of certificates of membership in the Federal Reserve System.

Section 104. Provides for cancellation of membership in the Federal Reserve if a national bank discontinues operations and a receiver is appointed for such bank by the Comptroller of the Currency.

Section 105. Abolishes dividends payable on capital stock of the Federal Reserve banks.

Section 106. Eliminates capital stock subscription requirements for state-chartered banks applying for Federal Reserve membership, or national banks converting to state charters.

Section 107. Provides for the Board of Governors to levy an assessment on the several Federal Reserve banks for payment of the Board's annual expenses, in proportion to earnings of such banks instead of in proportion to capital stock subscribed.

Section 108. Eliminates stock subscription requirements for banks in the United States dependencies and possessions.

Section 109. Provides for retirement of Federal Reserve stock over a five-year period, except in the event of liquidation or insolvency of a member bank, in which case the stock shall be retired immediately. Provides for ½% interest per month at time of retirement, from date of payment of last dividend, thus effectively maintaining present statutory dividends until and as the stock is retired.

Section 201. Abolished the Federal Open Market Committee and transfers all its functions to the Board of Governors of the Federal Reserve System.

Section 202. Provides that the presidents of the several Federal Reserve banks shall comprise the membership of the Federal Advisory Council, instead of the present system of electing members from each Federal Reserve district.

Section 203. Eliminates the present statutory power of the Board of Governors to disapprove appointment of a president of a Federal Reserve district bank, and provides that the president of such a bank must be a bona fide resident of that Federal Reserve district.

Section 204. Provides that the Federal Reserve System shall be generally guided by the purposes of the Full Employment Act of 1946 and the Humphrey-Hawkins Act, "particularly the Nation's effort to achieve a stabler price level and an improved economic structure."

Section 205. Provides for immediate effectiveness, except for dividends and pertinent rule-making authority of the Board of Governors, which continue until retirement of all Federal Reserve bank stock (5 yrs)

Chairman MITCHELL. Title I of the bill would eliminate the requirement that a bank subscribe to the stock of the Federal Reserve Bank in its district as a prerequisite for becoming a member of the Federal Reserve System. I am certain that Congressman Reuss will elaborate further on this and other points and I will simply give the highlights of each of the titles.

Title II would eliminate the Federal Open Market Committee. All authority for the conduct of open-market operations would be vested in the Board of Governors.

Finally, the bill would direct the Federal Reserve to conduct is affairs in accordance with the policies of the Employment Act of 1946 and the Full Employment and Balanced Growth Act of 1978.

Let me digress just briefly from my prepared statement to indicate that I think it is contemptible that the policy has never been set where we would not implement the Full Employment and Balanced Growth Act, considering the desperate straits of many people in our Nation who have always faced massive unemployment and now are facing increased rates of unemployment. I think it is very foolish to divide the bill up and attempt to implement one part of it, that is to use monetary policy to stop inflation but ignore or put on the back burner the issue of full employment.

Having vented my spleen on that, I will continue with the rest of my statement. In summary, title I of H.R. 7001 would broaden the participation of commercial banks in the housekeeping and organizational activities of the Federal Reserve. Title II would assure that open-market policy, which is the most crucial of all economic policies, will be voted on by only 100 percent pure public officials, while continuing to give the presidents of the regional Reserve Banks on-the-spot opportunity to influence its formulation.

[Chairman Mitchell's opening statement appears along with a memorandum "Brief History of the Federal Open Market Committee," by Louis C. Gasper, Ph. D. The material follows:]

OPENING STATEMENT

of

PARREN J. MITCHELL, CHAIRMAN

hearings on

H.R. 7001: A BILL TO MODERNIZE THE FEDERAL RESERVE SYSTEM

Good morning. Today we begin hearings on H.R. 7001, a bill to modernize the Federal Reserve System. The bill was introduced last month by our esteemed full Committee Chairman, Congressman Reuss, for himself, our Subcommittee colleague Congressman Cavanaugh and me. Title I of the bill would eliminate the requirement that a bank subscribe to the stock of the Federal Reserve Bank in its district as a prerequisite to becoming a member of the Federal Reserve System. Banks currently holding stock subscriptions would have their stock retired over a five-year period. Henceforth, Federal Reserve member banks would be given membership certificates that cost nothing and pay neither dividends nor interest. This change is long overdue, and, in view of the extension of reserve requirements to all banks under PL 96-221, now is essential.

Title II would eliminate the Federal Open Market Committee. All authority for the conduct of open market operations would be vested in the Board of Governors. The presidents of the Reserve Banks, who now serve on the FOMC on a rotating basis, would serve instead on a new Federal Advisory Council. The requirement, under present law, that appointments of new Reserve Bank presidents be approved by the Board of Governors would be repealed. As members of the newly constituted Federal Advisory Council, the Reserve Bank presidents would participate in FOMC meetings as advisers --fearlessly, independently and vigorously. They could review the Board's open market policy and air any differences both before the FOMC and publicly, and separately or collectively as they choose.

Finally, the bill would direct the Federal Reserve to conduct its affairs in accordance with the policies of the Employment Act of 1946 and full Employment and Balanced Growth Act of 1978.

In summary, Title I of H.R. 7001 would broaden the participation of commercial banks in the housekeeping and organizational activities of the Federal Reserve. Title II would assure that open market policy, which is the most crucial of all economic policies, will be voted on by only 100 percent pure public officials, while continuing to give the presidents of the regional Reserve Banks on the spot opportunity to influence its formulation.

Our witnesses today are Chairman Henry Reuss of the Banking Committee, the author of H.R. 7001, and Paul A. Volcker, Chairman of the Federal Reserve Board. We will hear from Chairman Reuss first and then from Chairman Volcker, and I will have something further to say before I recognize Chairman Volcker.

MEMORANDUM

TO: Members of the Subcommittee on Domestic Monetary Policy

FROM: Louis C. Gasper, Ph.D.

IN RE: Brief History of the Federal Open Market Committee

DATE: May 15, 1980

In late 1921 and early 1922, the individual Federal Reserve banks had made independent and uncoordinated purchases of government securities. These disrupted the market, so in May, 1922, a committee of the five eastern banks was formed to make transactions jointly. About a year later, the Board formally established the Open Market Investment Committee for the Federal Reserve System, which had the same five members and the same functions as the less formal committee. The System Open Market Account was established in December, 1923.

In March, 1930, the rest of the banks succeeded in having the Committee reorganized and renamed. There was a representative from each and every bank, and the name was the Open Market Policy Conference.

The Banking Act of 1933 established the Federal Open Market Committee in statute. Other than the change of name, the organization of the Committee remained the same as the Conference, except that the Act specified that open market operations could be undertaken only as recommended and approved by the Committee. But any bank could decline to participate in such operations. What was avoided was Carter Glass' original suggestion that the Committee also include the Board as members, which would have involved an unwieldy number of participants. There was opposition to the Glass proposal on the grounds that it invested too much power in a Washington-rooted central bank.

The Banking Act of 1935 reorganized the Federal Open Market Committee along its present lines, except that it was not required that the members elected by the several banks be either the President or First Vice President of the respective banks; that provision was added in 1942. Also in 1935, it was provided that no bank could decline to engage in operations under the direction of the Committee. Thus, Carter Glass' insistence that the Board of Governors be included was finally agreed to, and the Board in fact makes up a majority of the Committee. At the same time, the unwieldy enlargement of the Committee was avoided by the device of regional representation, rotating the membership among all the banks except New York.

The Committee now consists of the Members of the Board of Governors of the Federal Reserve System--seven in number, appointed by the President with the advice and consent of the Senate--and five representatives (either the president or first vice president) from the several Reserve banks, as follows: New York; one from Cleveland and Chicago, alternating annually; and one from each of the following three groups, rotating annually in each group: Boston, Philadelphia, and Richmond; Atlanta, Dallas, and St. Louis; Minneapolis, Kansas City, and San Francisco. As a rule, though only the enumerated twelve members will vote, all Reserve bank presidents (or vice presidents as alternates) will attend every Committee meeting. These regular meetings are generally held on the third Tuesday of each calendar month. Telephone conference meetings may be held in case of necessity.

The Chairman of the Board of Governors serves as Chairman of the Committee and calls its meetings. The President of the New York Federal Reserve Bank serves as Vice Chairman.

Chairman MITCHELL. We are just delighted that the chairman of the full committee, Chairman Henry S. Reuss, the author of H.R. 7001, is with us this morning. We shall hear from Chairman Reuss now. And then, when Mr. Volcker arrives at about 11 o'clock, we shall hear from him.

Chairman Reuss, we are happy to have you.

STATEMENT OF HON. HENRY S. REUSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN, AND CHAIRMAN OF THE HOUSE BANKING, FINANCE AND URBAN AFAIRS COMMITTEE

The CHAIRMAN. Thank you very much.

Mr. Chairman and members of your subcommittee, I appreciate this opportunity to appear on behalf of H.R. 7001. I have a prepared statement which I would like to submit for inclusion in the record. My thought would then be to summarize.

Chairman MITCHELL. Without objection, the prepared statement will be inserted in the record.

The CHAIRMAN. Since the Federal Reserve was set up in 1913, it has played a vital role. But like every other institution in our society, it can stand revisiting from time to time, particularly to see if it is fully equipped to withstand the challenges of the 1980's, which have so inauspiciously begun with the dose of unemployment and inflation with which we are currently beset.

I suggest that a revisiting is timely, because there are four major tides running in our national consciousness that have some relationship to the Federal Reserve.

The first tide was that set loose by the passage of the truly landmark Depository Institutions Act of just a few weeks ago, which changed and improved the relationship of the Federal Reserve to its members. It used to be that membership in the Federal Reserve, held by owning stock of up to 6 percent of your bank capital in the Fed, had certain benefits and certain burdens.

The burden, of course, was that you held reserves, if you were a member, which paid no interest and were thus a great liability, whereas if you were a nonmember State bank you did not have to hold those reserves.

The benefits were, of course, that you got free check clearing and other services, and you got free access, within limits, to the discount window.

Now—and I think to the credit of this committee and the Congress, that has been changed. Now banks, whether they are members or not, have access to the discount window, have access for a fee to the services, and are required to post reserves whether they are members or not. So that raises the question of whether it is necessary for the Federal Reserve to glom on to 6 percent of a bank's stock in surplus and them an uneconomic 6 percent rate of interest in order to signify membership.

A second tide that is flowing—and it is a good one—has to do with decentralization, decentralization of activities out of Washington into the 50 States, and decentralization, where possible, from the public to the private sector. With that in mind, we need to ask whether it really makes sense for the Washington Federal Reserve Board of Governors to have the veto power, as it does, over whom

the decentralized 12 Federal district banks shall elect as their president.

It also causes us to inquire whether the present carpetbagger system, under which Fed career employees roam the 50 States until they find a snug harbor and then get elected president of that district's Federal Reserve bank really lives up to the highest principles of decentralization.

A third tide has to do with what is called accountability, simplifying Government, making sure that Government officials are responsible for governmental acts. And there we have a superb anomaly, in that while the Presidentially appointed and Senate confirmed seven-person Board of Governors of the Fed has, as it should have, control over the two lesser instruments of monetary policy—the discount window and reserve requirements—they don't have control over the major instrument of monetary policy, open-market policy.

Our forefathers in Congress in 1935, in an absent-minded moment, gave five rotating presidents of the banker-selected district Reserve banks an equal vote in this massive area of governmental policy with the public officials of the Federal Reserve Board. Not only did we do that, but we perpetrated a grievous disproportion and discrimination in favor of, would you believe it, the Cold Belt, which I belong to, and against the Sun Belt, which such fine colleagues of ours as Congressmen Paul and Barnard belong to.

This was utterly unintentional, but utterly sloppy and unforgiveable, and utterly eligible for prompt rectification.

The fourth tide that is flowing is the feeling on the part of sensible people in Government that the old economics, which relied solely on macroeconomic fiscal and monetary policies, doesn't seem to do the job any more. Sure, you need sensible fiscal and monetary policies. But exclusive reliance on them leaves us with unacceptable unemployment and unacceptable inflation.

Those are the four tides and H.R. 7001 attempts to harness them in a constructive way, in the following way:

The first tide is toward a final resolution of the membership problem. Why should you compel banks to practice this charade, this Japanese Kabuki play, of behaving like junior achievement stockholders? Why should we compel them to take 3 percent of their stock, of their capital which is so essential to their safety and soundness and immobilize it in Federal Reserve stock?

The answer is, there is no reason under the Sun why that should be, except it is one of those fusty, dusty relics of the past. H.R. 7001 says do away with it. Do away with it as soon as possible, and in any event under 5 years. Take the billion dollars in stock, repay it to the member banks, and then tell the banks generally that they are welcome to join the Fed if they will simply sign a piece of paper saying, we'd like to be members of the Fed.

That is the way to get democracy and that is the way to remove the dollar sign. I personally want banks to feel free to join the Fed, vote for directors, take part in the decentralized organization. Don't make it an exclusive club of trumped-up stockholders.

So the first section of the bill would provide for the phasing out of the stockownership provision and for making membership truly

voluntary. You would not have to join. There would be no disincentive to join.

The second tide, as I said, is the tide toward decentralization. The present law gives the Washington Federal Reserve a wholly unnecessary veto over the person whom the directors of the 12 district banks elect as their would-be president.

Furthermore, there is no requirement that the presidents be residents of their districts. These are big districts. They cover, each one of them, one-twelfth of the country. And I can't believe that the great Midwest district or the Southwest district or the Southeast district doesn't contain within its corners somebody capable of representing that district. And why you have to import a carpetbagger from outside, I wouldn't really know.

So I would think that the removal of the veto and the imposition of the requirement that the presidents of the district banks need to be residents in good faith of their districts would provide a recognition of the need to decentralize.

The third tide that is flowing, also a good one, is the tide of accountability. Responsibility in government should be fixed. Let's not have any more of the old Army game in which the exact position of the pea under the walnut shell is kept secret, as it is now. The most important element of monetary policy, open market policy which fixes interest rates, the quantity of money, whether businesses survive or fail, whether men and women get jobs or are fired, that should be exercised under our Constitution by officers of the United States. That is what article II, section 2, clause 2 of our Constitution says. Officers of the United States should do the major business of the United States.

We have seven officers of the United States on the Open Market Committee. They are the seven members of the Board of Governors of the Federal Reserve. They are appointed by the President, confirmed by the Senate. It is utterly proper that they should exercise this power, as they exercise the power of reserve requirements and the power of the discount window.

But when it comes to the most important element of monetary policy, having strained at the gnat of the reserve requirements and at the discount window and saying those have got to be exercised by officers of the United States, we swallow the camel of open market policy and say, let private citizens from the 12 reserve districts exercise that governmental power.

So far, I have referred just to commonsense and one's horseback instinct for good political science. However, the Supreme Court has spoken on this in the most unequivocal terms in the great case of *Buckley* v. *Valeo.* That is our friend former Senator James Buckley and Francis Valeo, the Secretary of the Senate.

In the case of Buckley against Valeo, 424 U.S. 1, (1976), the Court had before it an institution we all know, the first incarnation of the Federal Election Commission. And that Federal Election Commission as set up by Congress in another abstracted moment had six voting members, two appointed by the President and confirmed by the Senate. But then there were four more appointed by very respectable people, the Speaker of the House and the President Pro Tempore of the Senate.

This was brought before the Court on the ground that these latter people weren't officers of the United States under the Constitution, and only officers of the United States can exercise governmental powers. And in order to be an officer of the United States, you have to be appointed by the President and confirmed by the Senate. And the Court said on this point without dissent—here I am quoting from page 126:

> The fair import of that "officers of the United States" clause of the Constitution is that any appointee exercising significant authority pursuant to the laws of the United States is a "officer of the United States" and must therefore be appointed in the manner prescribed by section 2, clause 2 of article II."

Now, if the work of the Federal Election Commission is governmental in nature—and it is—how much more governmental in nature is the life and death control of our money supply and the monetary aggregates and interest rates exercised by open market operations?

So while there are many ways of handling this problem, H.R. 7001 approaches it in what seems to me the crispest and simplest way. It says that the actual voting and decisionmaking on open market policy must be confined to officers of the United States, namely the seven Governors of the Fed, the people who handle discount policy and reserve requirement policy.

The presidents of the 12 regional banks, however, are urgently desired by H.R. 7001 to be in there, and so it is provided that at every Open Market Committee meeting not just 5, but all 12 of the bank presidents be there, with a complete voice to give that regional input which is so essential to the formulation of a sensible monetary policy.

In the course of divesting the Federal Reserve of this unconstitutional feature, H.R. 7001 does another useful thing. For some reason known but to God, Congress in 1935 said that the Open Market Committee shall consist of, in addition to the seven Governors, five members at any one time from the district banks. And who are the five? Well, the president of the New York bank, he is on that committee year in and year out. Then there is an almost equally favored status: The presidents of the Cleveland bank and the Chicago bank are on that Open Market Committee every second year. And then the lesser breeds without the law: Boston, Philadelphia, Richmond, Atlanta, Kansas City, St. Louis, Minneapolis, Dallas, and San Francisco, are allowed in under the tent once every 3 years.

I defy anyone to justify that. Now, I happen to be a representative of a Cold Belt city. But I have not conducted a war between the States because of that.

I think that all sections of the country need to participate on a fair and even basis. And so I say to Philadelphia and Dallas and the great districts which house Idaho and Richmond and Atlanta: Be with me on this. I think we need equal treatment.

So, that is the third and greatest commandment; namely, put governmental authority in the hands of governmental officers and, in the process, remove the discrimination.

The fourth and last tide that I discern is the tide to do something to get our economy out of this terrible slump. I will not for 1 minute agree that our friends the Germans and our friends the

Japanese are superpeople, that we can't do what they have done in keeping both unemployment and inflation under control; that we can't evolve what they have: a cooperative spirit between government at all levels and business and industry and labor, who work together for the common good.

And when I look at the Federal Reserve, composed of excellent men and women, as it is, some 22,000 of them, including more than 500 economists, equipped with 70 jet planes and 60 prop planes, and scores of marble halls, magnificent statuary, exquisite amenities, marvelous sophisticated machinery, the most stupendous economic organization in the history of the world—when I look at the way they are forced to spend their time, I say, let's liberate them, let's put them to work on the real problems of the day.

Of course, they have got to attend to monetary policy. Of course, they have got to do their check clearing. But don't tell me that those 500-plus economists and the thousands of trained economic administrators don't have a role to play in the productivity-enhancing, structure-reforming, reindustrializing, inflation-fighting microeconomic tasks that lie ahead.

A few exhibits: Exhibit C, a 17-page document showing the number of publications produced by the Federal Reserve System in just 1 year, last year—17 pages, just to list them. By the hundreds of thousands and the millions they are distributed.

I am not against publications. They are fine. But I do suggest that people in the Fed could, many of them, be used for better purpose than the endless proliferation of articles about M_1, which makes up so much of their daily grist. Not only do they fill the journals of the 12 regional banks, as well as the Washington bank—the Richmond Economic Review, the Philadelphia Business Review, the New York Quarterly Review, the Dallas Review, the St. Louis Review, the San Francisco Economic Review, the Minneapolis Quarterly Review, and so on with these endless duplicating and overlapping articles; but then, having done this, they refry the beans. They produce refritos. [Laughter.]

Take the case of exhibit A, for instance, concerning the venerable Federal Reserve Bank of New York. A few months ago they produced a document entitled "Federal Reserve Readings on Inflation." Well, guess where the readings on inflation came from? From the Federal Reserve publications that I have just referred to.

And then, as if that were not enough, the equally eminent Federal Reserve Bank of Richmond, a few months later, it produces its rump essays on inflation. Again, where do you suppose essays on inflation appeared? In the Federal Reserve bulletin for the Federal Reserve Bank of Richmond.

Now, whether this refrying of the beans is an effective use of the taxpayer's dollar, I leave to this subcommittee and to the General Accounting Office. But I do know that the people who do this work are admirable people, equipped with marvelous computers and pleasant work places. And I really think they should assist the governmental and private sector on an advisory basis in solving some of the real economic problems.

Suppose, for example—and I could give endless examples—4 years ago, the Federal Reserve bank, particularly that of the Chica-

go district and the Detroit branch, had taken some of their top economists and said:

> Look. Stop writing that article on M_1 for this month's bulletin. We have already had 40 such articles. Go on up to Detroit, put yourself at the service of Father Hesburgh or whoever has been sent up there to see what can be done about automobiles, and come through with a report.

Well, those economists could have tabled before the Congress, I am sure, a splendid report, showing that Detroit was on a collision course, that the OPEC price increases had made compact automobiles a necessity, and that for us to sit by and let the Germans and the Japanese, the French and the Italians make all the transverse-engine, front-wheel drive, 35-mile-per-gallon compacts was madness. And they would have said so and recommended certain things in the financial field, certain things in the labor field, certain things in the regulatory field, which would have given Congress a coherent program. And then we would not have been in the ghoulish role of trying to do something about the gasping Chrysler Corp., because we could have been making good cars in our own country.

The same thing in steel and semiconductors and railroads and consumer electronics and mass transit equipment, in textiles and apparel and shoes, in so many areas of our American economic society, where innovation, productivity, competitiveness, structural reform is so desperately needed.

So, without changing the law in any way, this last mandate of H.R. 7001 simply beseeches the Fed to get with it, to take some of the people off of writing these learned disputations on how many angels can dance on the head of a monetary pin, and instead get with the real microeconomic problems of our day.

As Chairman Volcker, whose usual excellent testimony I have had an opportunity to look at just now, and who will be with you in a few minutes, will testify—well, I guess what his testimony amounts to is: "that now is not the time."

Well, I end with the thought that if you are going to say that, you are never going to do anything.

I would say now is the time for hardheaded, introspective inquiry by this great subcommittee. And I am very honored, Mr. Chairman, that you called this early session on this legislation and the attendance record of your subcommittee does my heart proud.

Thank you very much.

[Chairman Reuss' prepared statement entitled "Modernizing the Federal Reserve System" follows: the exhibits referred to at the end of the statement A and B are retained in the subcommittee file; exhibit C is attached to the statement.]

MODERNIZING THE FEDERAL RESERVE SYSTEM

STATEMENT OF REP, HENRY S. REUSS OF WISCONSIN BEFORE THE SUBCOMMITTEE ON DOMESTIC MONETARY POLICY, HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS, 10 O'CLOCK THURSDAY MORNING MAY 15, 1980 2128 RAYBURN

I deeply appreciate this opportunity to testify on behalf of H.R. 7001, sponsored by the Gentleman from Maryland (Mr. Mitchell), the Gentleman from Nebraska (Mr. Cavanaugh), and myself.

H.R. 7001 provides for the modernization of the Federal Reserve System. Since its foundation in 1913, the independent Federal Reserve System has played a vital role in our democracy. But like other institutions, it needs re-examination to determine whether it is fully equipped to carry out the tasks of the 1980s.

Revisiting the Federal Reserve is appropriate in the light of four major tides that are now flowing in the affairs of our nation.

The first tide was that set in motion by the enactment into law on March 30, 1980, of the Depository Institutions Deregulation and Monetary Control Act. This law imposes mandatory reserve requirements on all depository institutions, charges fees for various Federal Reserve services, and makes available the discount window, whether or not a given institution is a member of the Federal Reserve.

The Act thus removes both the burdens and benefits formerly imposed. Accordingly, membership in the Fed should be truly voluntary.

But present law still requires that each member bank must hold stock in its district Reserve Bank of 3 percent of its paid-in capital stock and surplus, for which it is entitled to a 6 percent return. By mandating an uneconomic return, this now acts as an unnecessary disincentive to membership.

The second tide is the general trend toward greater decentralization of functions out of Washington to the rest of the country, and from the government to the non-governmental sector. Existing law gives the 7-person Washington Board of Governors a veto over the choice of the 12 district Reserve Bank Presidents. The veto is anachronistic. It should be removed.

A third tide has to do with the fixing of clear governmental responsibility for governmental acts. Under present law, the Federal Open Market Committee functions of the Federal Reserve System are carried out in part by non-governmental banker-selected private citizens -- the district bank presidents.

Monetary policy is a function of government. It should be carried out by "Officers of the United States", as common sense and the Constitution provide.

The fourth tide is the increasing realization that inflation and unemployment cannot be mastered by exclusive reliance on fiscal and monetary macroeconomic policies, important though those are. Attention to structure, to reindustrialization, to productivity, is urgently required. That task must be carried out by every level of government from the White House down, and by the private as well as the public sector. The Federal Reserve, with its nationwide blend of public and private economic and administrative expertness, should be encouraged to participate.

H. R. 7001 attempts to harness these four tides.

It restructures the Federal Reserve so as to facilitate voluntary membership in the System without weakening the dual federal-state banking system; it decentralizes the 12 Federal Reserve district banks by removing Washington's present veto over their Presidents; it places the governmental power over monetary policy in government officers, appointed by the President and confirmed by the Senate; and it involves the Federal Reserve System, on an advisory basis, with structural reform, reindustrialization, and productivity.

H.R. 7001 has four main provisions:

1. It Removes the Disincentive to Federal Reserve Membership by Eliminating the Stock Subscription Requirement

Under existing law, member banks are required to hold 3 percent of their surplus and capital in the stock of their district Federal Reserve Bank. Member banks earn 6 percent on this paid-in capital stock.

63-971 O - 80 - 3

Now that the Depository Institutions Deregulation and Monetary Control Act of 1980 in effect treats member and non-member banks alike -- with respect to the holding of reserves, with respect to availability of the discount window, and with respect to obtaining Federal Reserve services for a compensatory fee -- the stock subscription requirement is an anachronism.

Currently, the 12 Federal Reserve Banks have something more than $1 billion in member bank capital stock. In 1979, this generated a return to member banks, at 6 percent, of $67 million.

A 6 percent rate of return is clearly inadequate, and thus constitutes a penalty. Repayment of member banks' capital by the Fed would also improve their frequently inadequate capital ratios.

H.R. 7001 provides for retiring the existing stock subscription to all eligible institutions which wish to participate in the important functions of the Federal Reserve Banks. Membership should involve neither a premium nor a penalty.

Section 109 of H.R. 7001 provides for the retirement of capital stock in no longer than 5 years "consistent with the orderly operation of the Federal budget and the monetary control policies of the Board of Governors". With the capital stock repaid, membership would be open to any eligible institution which signifies its desire to remain a member.

I see no reason why the repayment of the capital stock could not be accomplished in considerably under the 5-year proposed maximum. Specifically, in September, 1981, banking institutions must start paying for Federal Reserve services, under the Depository Institutions Deregulation and Monetary Control Act of 1980. September, 1981, would thus be a good target date for the repayment to the banks of their capital stock.

This provision of H.R. 7001 would have no effect on the dual federal-state banking system. Chartering and examination of state banks, member and non-member alike, would reside in the state regulatory agencies, with a back-up from the Federal Deposit Insurance Corporation. The Federal Reserve, to the extent that it feels it needs to in order to inform its monetary policies, can piggy-back on these primary examining authorities.

2. It Decentralizes the 12 Reserve District Banks by Removing Washington's Veto Over Their Presidents' Appointment

Under present law, the Washington Board of Governors may veto the district-selected choice for district Bank President. A decent respect for a decentralized system requires the elimination of this veto.

To further bring about decentralization, H.R. 7001 requires that each President be a bona fide resident of the district. This will prevent Washington's saddling the 12 district Banks with carpetbagger Presidents.

With their increased authority, the Presidents will join together to form the reconstituted Federal Advisory Council. The present membership of the Federal Advisory Council consists of one representative from each Federal Reserve district, selected annually by the Board of Directors of each bank, and is usually a prominent banker in the district. These bankers typically serve only for a brief period. The Council now meets quarterly.

Under H.R. 7001, the reconstituted Council, composed of the Bank Presidents, will meet monthly, along with the Board, in Washington. The Presidents serve for at least 5 years, and may be reappointed. With this continuity, they could give to the Board of Governors the regional information on monetary credit and general economic conditions that is so urgently needed on a continuing basis.

In all other respects, the Presidents will continue their present status and duties, including their 5-year term.

3. Open Market Monetary Policy is a Governmental Function, and Should be Exercised only by "Officers of the United States"

Presently, the Federal Open Market Committee is composed of the 7 members of the Washington Board of Governors, appointed by the President and confirmed by the Senate, and 5 rotating Presidents, or first vice-presidents, of the 12 regional banks.

No power of government is more truly governmental than the Open Market decisions of the Federal Reserve. This power -- even five-twelfths of it -- should not be exercised by private citizens appointed by their banker constituencies to the top offices in the 12 Federal Reserve District Banks.

As pointed out above, the 7 "Officers of the United States", who are Presidentially appointed and Senate confirmed -- the Federal Reserve Board of Governors -- are responsible for the two lesser elements of monetary policy, reserve requirements and the discount window.

Should we legislators not take another look at what we did back in 1935 when we set up the Open Market Committee? We have knocked ourselves out, and properly so, in seeing to it that two relatively less important functions of monetary policy -- the discount window and reserve requirements -- are in the hands of "Officers of the United States", Presidentially-appointed and Senate-confirmed.

But having strained at these two gnats, we have swallowed a monstrous camel. We have permitted the carrying out of the most important element of monetary policy -- Open Market operations -- by a motley body of governmental and non-governmental persons.

Our 1935 sins are compounded by the ridiculous way in which we set up the 5 rotating Federal Reserve Bank district members on the Federal Open Market Committee. Membership under present law consists of one representative, all the time, of the Federal Reserve Bank of New York; one representative, every second year, of the Federal Reserve Banks of Cleveland and Chicago; and one representative every third year of the "lesser breeds without the law" -- the Federal Reserve Banks of Boston, Philadelphia, Richmond, Atlanta, Dallas, St. Louis, Minneapolis, Kanasas City and San Francisco.

I happen to be a member of the Cold Belt Northeast-Midwest Caucus, and I am mightily sympathetic to the needs of New York, Cleveland and Chicago. But I cannot support a discrimination which gives these three districts outsized representation, and makes the nine other districts subsist on crumbs from the table. I await hearing anyone defend this nonsensical disproportion.

H.R. 7001 gives the Washington Board of Governors undiluted responsibility for the governmental act of Open Market operations, just as it already has this responsibility for reserve requirements and the discount window. The Board of Governors needs, to be sure, the advisory voice of the District Bank Presidents. This would be accomplished by the provision of H.R. 7001 already referred to -- blanketing the 12 District Federal Reserve Bank Presidents into a reconstituted Federal Advisory Council, which would sit with the Board of Governors monthly. These monthly meetings could be timed to coincide with the monthly focusing of the Federal Reserve Board on Open Market policy -- a monthly schedule which has been observed for many years.

H.R. 7001, in consolidating responsibility for Open Market policy in the Board of Governors, is not only in accord with sensible governmental policy. It is also, I believe, in accord with the mandate of the United States Constitution. Article II, Section 2, Clause 2, of the Constitution provides that "Officers of the United States" must be appointed by the President, by and with the advice and consent of the Senate.

Clause 2 further provides that Congress may vest the appointment of such inferior officers as it deems proper in the President alone, in the courts, or in the heads of departments.

Those who make the monetary policy of the United States are clearly "Officers of the United States". A more typical governmental function is hard to imagine. They must thus be appointed by the President and confirmed by the Senate, as is the case with members of the Board of Governors.

This issue was fully considered by the Supreme Court in the case of Buckley v. Valeo, 424 U.S. 1 (1975). In that case the six voting members of the Federal Elections Commission -- two members appointed by the President, two by the President pro tempore of the Senate, two by the Speaker of the House -- were held by the Court to be "Officers of the United States", and the Federal Elections Commission was thus held to violate the "Officers of the United States" clause because all of them were not Presidentially appointed. The Court said:

> "We think its fair import is that any appointee exercising significant authority pursuant to the laws of the United States is an "Officer of the United States," and must, therefore, be appointed in the manner prescribed by Section 2, cl. 2, of that Article." 424 U.S., at 126.

If the members of the Federal Elections Commission, despite the laying on of hands by the Speaker of the House and the President pro tempore of the Senate, are unconstitutional, the privately selected 5 rotating members of the Open Market Committee are even more unconstitutional.

We have made a mistake, practical and constitutional alike. We should set it right. In so doing, incidentally, we will be removing the present New York-Cleveland-Chicago discrimination.

4. Involving the Federal Reserve System with Structure-Reforming, Productivity-Enhancing, Reindustrializing, Inflation-Fighting Microeconomics

The fourth major provision of H.R. 7001 is the direction to the Federal Reserve System to "utilize its resources, and generally conduct its affairs" to carry out the Employment Act of 1946, and the Full Employment and Balanced Growth Act of 1978, "particularly the Nation's effort to achieve a stabler price level, and an improved economic structure."

The Federal Reserve System is the most stupendous economic organization in the history of mankind.

The economic centers of the Federal-Reserve are strategically located throughout the country. The 12 Federal Reserve District Banks are situated in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The 25 branches are placed in Buffalo, Cincinnati, Pittsburgh, Baltimore, Charlotte, Birmingham, Jacksonville, Nashville, New Orleans, Miami, Detroit, Little Rock, Louisville, Memphis, Helena, Denver, Oklahoma City, Omaha, Houston, San Antonio, El Paso, Los Angeles, Portland, Salt Lake City, and Seattle.

The 11 regional check processing centers are situated in Columbus, Ohio; Des Moines, Iowa; Indianapolis, Indiana; Milwaukee, Wisconsin; Utica, New York; Cranford, New Jersey; Jericho, New York; Charleston, West Virginia; Columbia, South Carolina; Windsor Locks, Connecticut; and Lewiston, Maine.

In Washington and in these decentralized economic centers, the Federal Reserve marshalls some 22,000 employees, of whom at least 500 are economists, and many more are skilled economic administrators. They are supported by splendid edifices, sophisticated machinery, succulent amenities.

These great physical and staff resources of the Federal Reserve System should work cooperatively with the rest of America -- the White House, the departments and independent agencies, state and local governments, and preeminently with the private sector -- to the end that the structural, the productivity, the industrial, the inflationary problems of our economy may be alleviated. What is needed is simply a determination to pitch in and help with the expertness which the Federal Reserve System disposes.

No doubt some will argue that the 22,000 employees of the Federal Reserve are fully occupied, and cannot spare the time to pitch in with the battle for economic improvement which must become the major business of us all.

I have not made -- and doubt that anybody has made -- a time-motion study of the work product of these 22,000 employees. I do know that they are intelligent and dedicated men and women.

But I must say that an inordinate amount of their time seems to be spent writing articles, often rethreshing the same wheat. They appear in the 12 periodical journals of the 12 district banks -- The Richmond Economic Review, The Philadelphia Business Review, The New York Quarterly Review, The Dallas Review, The St. Louis Review, The San Francisco Economic Review, The Minneapolis Quarterly Review, and so on. Then, to make sure that the grist is ground once again, these articles find themselves reprinted in still other Federal Reserve publications. For example, see Federal Reserve Bank of New York, Readings on Inflation, (Ex. A) 1979, which reprints a score or more of articles by Federal Reserve economists in Federal Reserve publications. Not to be outdone, along comes the Federal Reserve Bank of Richmond a few months later, with Essays on Inflation, (Ex. B) 1980, reprinting another pile of articles by Federal Reserve economists in Federal Reserve publications. Ex. C takes 17 pages just to list the Federal Reserve output of publications for one year, 1979.

With our steel industry sinking, our automobile industry in shambles, our railroads decaying, our high-technology from consumer electronics to mass transit disappearing overseas, surely the Fed can ease up on publishing, lest we all perish!

I commend H.R. 7001 to your sympathetic attention.

(Exhibits "A" and "B" are retained in the subcommittee file; exhibit "C" follows:)

EXHIBIT C

BOARD OF GOVERNORS

TITLE	DISTRIBUTION
Monthly Federal Reserve Bulletin	24,004 @ $20. per year
Quarterly Federal Reserve Chartbook	4,188 (varies w/each
Anually - Historical Chart Book	1,853 issue)
Z.11 Special Studies	273
K.9.1. Bulletin reprints	129
K.7 IFDP (International Finance Discussion Papers)	600
K.15 Staff Economic Studies	480
1977 Consumer Credit Survey	2,640 @ $2. annually
Improving the Monetary Aggregates: Staff Papers	1,088 @ $4. annually
Annual Statistical Digest 1974-78	425 @ $12.
1979 Annual Report	8,148
Federal Reserve Glossary	38,800
Structure Pamphlets - #1	40,000
#2	32,500
#3	32,500
#4	45,000
Public Information Materials of the Federal Reserve, listing distribution districts title, with description of audience and charge	
The Federal Reserve System -- Purposes and Functions	
Annual Report	
Federal Reserve Bulletin	
Banking and Monetary Statistics	
Annual Statistical Digest	
Federal Reserve Chart Book	
Historical Chart Book	
Capital Market Developments	
Selected Interest and Exchange Rates - Weekly Series of Charts	
The Federal Reserve Act	
Regulations of the Board of Governors of the Federal Reserve System	
Published Interpretations of the Board of Governors	
Industrial Production: 1976 Edition	
Bank Credit-Card and Check-Credit Plans	
Survey of Changes in Family Finances	
Report of the Joint Treasury-Federal Reserve Study of the U.S. Government Securities Market	
Joint Treasury-Federal Reserve Study of the Government Securities Market - Staff Studies	
Open Market Policies and Operating Procedures -- Staff Studies	
Reappraisal of the Federal Discount Mechanism	
The Econometrics of Price Determination Conference	
Federal Reserve Staff Study: Ways to Moderate Fluctuations in Housing Construction.	
Lending Functions of the Federal Reserve Banks	
Improving the Monetary Aggregates: Report of the Advisory Committee On Monetary Statistics	
Annual Percentage Rate Tables	
Federal Reserve Measures of Capacity and Capacity Utilization	
The Bank Holding Company Movement to 1978: A Compendium	
Improving the Monetary Aggregates: Staff Papers	
Flow of Funds	

(cont.)

Consumer Education Pamphlets

The Board of Governors of the Federal Reserve System
Consumer Handbook to Credit Protection Laws
The Equal Credit Opportunity Act and...Age
The Equal Credit Opportunity Act...Credit Rights in Housing
The Equal Credit Opportunity Act and...Doctors, Lawyers, Small Retailers, and Others who May Provide Incidental Credit
The Equal Credit Opportunity Act and...Women
Fair Credit Billing
The Federal Open Market Committee
Federal Reserve Bank Board of Directors
Federal Reserve Banks
Federal Reserve Glossary
How to File a Consumer Credit Complaint
If you Borrow to Buy Stock
If you Use a Credit Card
Truth in Leasing
U.S. Currency
What Truth in Lending Means to You.

Staff Studies

Interest Rate Ceilings and Disintermediation
The Relationship between Reserve Ratios and the Monetary Aggregates Under Reserves and Federal Funds Rate Operating Targets
Tie-Ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies and Other Lenders
Geographic Expansion of Banks and Changes in Banking Structure
Impact of the Dollar Depreciation on the U.S. Price Level; An Analytical Survey of Empirical Estimates
Innovations in Bank Loan Contracting
Measurement of Capacity Utilization: Problems and Tasks
The Market for Federal Funds and Repurchase Agreements
Impact of Bank Holding Companies on Competition and Performance in Banking Markets
The GNMA-Guaranteed Passthrough Security: Market Development and Implications for the Growth and Stability of Home Mortgage Lending

Reprints

Measures of Security Credit
Revision of Bank Credit Series
Assets and Liabilities of Foreign Branches of U.S. Banks
Bank Debits, Deposits, and Deposit Turnover -- Revised Series.
Yields on Newly Issued Corporate Bonds.
One-Bank Holding Companies Before the 1970 Amendments.
Yields on Recently Offered Corporate Bonds.
Rates on Consumer Installment Loans
New Series for Large Manufacturing Corporations
The Structure of Margin Credit
Industrial Electric Power Use
Revision of Money Stock Measures
Revised Series for Member Bank Deposits and Aggregate Reserves

(Cont.)

Industrial Production -- 1976 Revision
Federal Reserve Operations in Payment Mechanisms: A Summary
New Estimates of Capacity Utilization: Manufacturing and Materials
Bank Holding Company Financial Developments in 1976
Survey of Terms of Bank Lending -- New Series
The Commercial Paper Market
The Federal Budget in the 1970's
Redefining the Monetary Aggregates
U.S. International Transactions in 1978.
Implementation of the International Banking Act
Changes in Bank Lending Practices

Weekly Releases

Aggregate Reserves and Member Bank Deposits H.3
Actions of the Board: Applications and Reports H.2
Assets and Liabilities of All Commercial Banks in the United States
Changes in State Member Banks
Deposits, Reserves and Borrowings of Member Banks
Factors Affecting Bank Reserves and Condition Statement of Federal Reserve Banks.
Foreign Exchange Rates
Money Stock Measures
Reserve Positions of Major Reserve City Banks
Selected Interest Rates
Weekly Consolidated Condition Report of Large Commercial Banks and Domestic Subsidiaries
Weekly Summary of Banking and Credit Measures

Semimonthly Release

Research Library--Recent Acquisitions.

Monthly Releases

Capacity Utilization: Manufacturing and Materials
Changes in Status of Banks and Branches
Commercial and Industrial Loans to U.S. Addresses Excluding Bankers' Acceptances and Commercial Paper by Industry
Consumer Installment Credit
Debits and Deposit Turnover at Commercial Banks
Federal Reserve System Memorandum on Exchange Charges
Finance Companies
Foreign Exchange Rates
Industrial Production
Loan Commitments at Selected Large Commercial Banks
Loans and Investments at all Commercial Banks
Loans and Investments at Selected Large Commercial Banks
Major Nondeposit Funds of Commercial Banks
Maturity Distribution of Outstanding Negotiable Time Certificates of Deposit
Monthly Report of Condition for U.S. Agencies, Branches, and Domestic Branching Subsidiaries of Foreign Banks.
Selected Interest Rates
Summary of Equity Security Transactions

Quarterly Releases

Automobile Credit
Finance Rates and Other Terms on Selected Types of Consumer Installment Credit Extended by Major Finance Companies
Flow of Funds: Seasonally adjusted and unadjusted
Geographical Distribution of Assets and Liabilities of Major Foreign Branches of U.S. Banks.
Interest Rates on Selected Consumer Installment Loans at Reporting Commercial Banks
Survey of Terms of Bank Lending

Semiannual Releases

Assets and Liabilities of Commercial Banks, by Class of Bank
Check Collection Services -- Federal Reserve System
List of OTC Margin Stocks
Assets, Liabilities, and Capital Accounts of Commercial and Mutual Savings Banks--Reports of Call (Joint Release of The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency.

Annual Releases

Aggregate Summaries of Annual Surveys of Security Credit Extension
Insured Bank Income by Size of Bank
State Member Banks of Federal Reserve System and Non-member Banks that Maintain Clearing Accounts with Federal Reserve Banks (Supplements Issued Monthly)

FEDERAL RESERVE BANK OF KANSAS CITY

TITLE	DISTRIBUTION
Economic Review	260,000 annually
Financial Letter (with tables)	2,700
Economic Trends	440
Operating Ratios	3,500
Branch Pamphlets	500
Condition & Earnings	1,500
Annual Statement	1,400
Consumer Credit	440 (monthly)
Guidelines	2,300 Each issue
Fed Letter	2,300 " "
Booklets:	
Research Working Papers	40
Farm Real Estate Values	3,000
Youth Unemployment	2,400
Issues in Monetary Policy	5,300
Energy & American Agriculture	5,200
World Agricultural Trade: Potential for Growth	6,500

Economic Review
Inside the Omaha Branch
Inside the Denver Branch
Functional Directory
Year-end Bank Conditions
Consumer Installment Credit at Commercial Banks
10th District Member Bank & Weekly Report of Commercial Bank Statistics
Large Commercial Bank Statistics

Booklets:
World Agricultural Trade: The Potential for Growth
International Trade and American Agriculture
Financial Modern Agriculture: Banking's Problems and Challenges
Farm Real Estate Values: What's Happening and Why
Energy and American Agriculture
Unemployment Insurance: Programs, Procedures, & Problems
The Growth of Youth Unemployment: Characteristics and Causes
Issues in Monetary Policy
Water Resources - Development and Use
Western Water Resources: Coming Problems and the Policy Alternatives

FEDERAL RESERVE BANK OF PHILADELPHIA

Title	Distribution
Pamphlet	
The Rule of 78's	102,421
How the new Equal Credit Opportunity Act Affects You	70,428
The Fair Debt Collection Practices Act	30,203
Your Credit Rating	86,189
How to Establish and Use Credit	131,261
Option for Savers	25,695
How to file a Consumer Credit Complaint	4,879
If you use a Credit Card	70,625
Fair Credit Billing	16,814
The Equal Credit Opportunity Act and Women	29,514
The Dollar of the Future	481,226
The Equal Credit Opportunity Act and ...	6,044
The Equal Credit Opportunity Act...and Age	27,202
Truth in Leasing	11,910
The Equal Opportunity Act and...Credit Rights in Housing	15,115
Consumer Handbook to Credit Protection Laws	92,665
Public Services Department	
Glass Insulation	4,900
The Men Who Made the Fed (Jan. 80)	2,800
The Hats the Federal Reserve Wears	7,250
A Banker's Day	6,050
The Growth of Government	5,350
Economic Man Vs Social Man	5,400
Truth in Lending/What it means for Consumer Credit	5,900
Inflation & Unemployment	7,100
The National Debt	5,750
The New Poverty	5,450
Gold	4,350
The Mystery of Economic Growth	5,400
Cities	3,100
Economic Man Vs Social Man and Other Talks	2,400
Bankbriefs	5,700
1979 Annual Report	2,000
Business Review	
May/June 1979	25,000
July/August 1979	25,000
September/October 1979	25,000
November/December 1979	30,000
January/February 1980	30,000
March/April 1980	25,000
Research Papers	
No. 37	250
No. 38	250
No. 39	250
No. 40	250
No. 41	500
No. 42	250
No. 43	250
No. 44	250
No. 45	250
No. 46	250
Fed Forums	5,000

FEDERAL RESERVE BANK OF BOSTON

TITLE	DISTRIBUTION
Consumer Education Catalog	
Dollar Coin Points	
Teachers Guide for Visit to the Federal Reserve Bank of Boston	
Prison Art Project: Recent Works	
The Ledger (Economic Education Newsletter)	
The Regulation of Financial Institutions (Proceedings of a Conference held in Oct. 1979)- Sponsored by the Federal Reserve Bank of Boston and the National Science Foundation	
Bank Notes (Banks Notes are available without charge)	
Economic Indicators	
Studies of Prejudice and Discrimination in Urban Housing Markets	
New England Economic Review	104,100
New England Economic Indicators	93,888
The Federal Reserve Bank of Boston Conference Series	11,100
Research Reports	3,600
Special Studies	6,048
Bank Notes	
Gross State Product	300
Connecticut Personal Checking	3,000
Consumer Credit - District I	2,100
Selected Assets and Liabilities - District I	5,400
NOW Account Release	14,400
Weekly Condition Report	5,200
Mutual Savings Banks	3,600

FEDERAL RESERVE BANK OF RICHMOND

TITLE	DISTRIBUTION
Economic Review - July/Aug.	25,012
Economic Review - Sept./Oct.	23,764
Economic Reveiw - Nov./Dec.	23,828
Economic Review - Jan./Feb.	23,682
Economic Review - May/June 80	23,880
Economic Review - March/Apr. 80	23,880
Review of Income and Wealth June 1979	unknown
Keys for Business Forecasting - Apr./May 80	6,984
Business Forecasts May 79 - May 80	15,276
Buying Treasury Securities	66,549
Annual Report	11,075
Bank Deposits and the Money Supply Concepts, Measurement, and Interpretation	2,569
Measuring Price Changes	15,735
Final Report and Recommendations	130
FRB of Richmond Working Papers 79-1	75
" " 79-2	75
" " 79-3	75
" " 79-4	75
" " 79-5	75
Economic Review - May/June 79	22,705

FEDERAL RESERVE BANK OF MINNEAPOLIS

TITLE	DISTRIBUTION
Agricultural Credit Conditions Survey	2,900
Industrial Expectations Survey	2,800
Federal Reserve Bank of Minneapolis Quarterly Review	15,100
Staff Report	170
Models of Monetary Economies	1,000
Federal Reserve Bank of Minneapolis Working Paper	

FEDERAL RESERVE BANK OF NEW YORK

TITLE	DISTRIBUTION
Capsule	10,000
The Quarterly Review	42,000
Annual Report	42,000
Monograms - Research Dept.	1,000
Fedpoints	
Coins and Currency	
Fair Debt Collection Practices	
Credit-Ability	
Your Credit Rating (Also in Spanish)	
On Using Credit	
Consumer Credit Terminology Handbook	
Money and Economic Balance	
The Story of Money (Comic Book)	
The Story of Consumer Credit (")	
The Stock of Checks (")	
The Story of Banks (")	
Research Papers	

63-971 O - 80 - 4

THE FEDERAL RESERVE BANK OF DALLAS

TITLE	DISTRIBUTION
Automated Clearing House Services	300
1979 Annual Report	5,000
Federal Reserve Bank of Dallas and Branches 1980 Directory	1,000
Federal Reserve Bank of Dallas Historic Landmark	1,000
Functional Cost Analysis 1978 Average Banks	500
Performance Characteristics of High Earning Banks, Functional Cost Analysis - 1978	500
Employees' Salary Survey	400
Officers' Salary Survey	400
Press Releases (Samples included: Bank Holding Company, Agricultural, New Member Bank, and Voice)	100-300
Research Papers	100
Research Releases	
Statistical Releases	
Voice of the Federal Reserve Bank of Dallas	19,139
Operating Ratios of Commercial Banks Eleventh Federal Reserve District	
Annual Report	
Condition and Income of Member Banks - Eleventh Federal Reserve District	
Operating Ratios of Member Banks - Eleventh Federal District	
Survey of Eleventh District Trust Department Income and Expenses	
Commercial and Industrial Term Loans Outstanding at Weekly Reporting Commercial Banks, by Industry	
"VOICE" - Successor to Review	
Commercial and Industrial Loans Outstanding at Weekly Reporting Commercial Banks	
Condition Report of Weekly Reporting Commercial Banks	
Weekly Department Store Sales in Eleventh District Areas	
Methodology of the Louisiana Industrial Production Index, 1976	
Methodology of the Texas Industrial Production Index	
Methodology of the Texas Manufacturing Capacity Utilization Index, 1975	

FEDERAL RESERVE BANK OF CHICAGO

Title	Distribution
Economic Perspective	26,000
Agricultural Letter	8,500
International Letter	8,000
Fed Wire	4,000
Proceedings of a Conference Bank Structure and Competition (annual)	500
Staff Memoranda (irregular)	400
1979 Annual Report	
Counterfeit	
Readings and Economics and Finance	

FEDERAL RESERVE BANK OF ST. LOUIS

TITLE	DISTRIBUTION
U.S. Financial Data	43,918
The Fed Letter	2,600
Review	38,818
Annual U.S. Economic Data	15,705
Central Mississippi Valley Economic Indicators	2,964
Monetary Trends	29,216
National Economic Trends	26,750
International Economic Conditions	16,698
International Economic Conditions - Annual Data	16,698

FEDERAL RESERVE BANK OF ST. LOUIS

TITLE	DISTRIBUTION
U.S. Financial Data	43,918
The Fed Letter	2,600
Review	38,818
Annual U.S. Economic Data	15,705
Central Mississippi Valley Economic Indicators	2,964
Monetary Trends	29,216
National Economic Trends	26,750
International Economic Conditions	16,698
International Economic Conditions - Annual Data	16,698

FEDERAL RESERVE BANK OF CLEVELAND

TITLE	DISTRIBUTION
Economy Commentary	5,000
Economic Review	4,000
Annual Report	7,000
Economic Presentation	75
Service Line	1,000
Special Publications	
Depository Institutions Deregulation and Monetary Control Act of 1980	5,000
Press Release "Some Questions and Answers Regarding Gold"	350

FEDERAL RESERVE BANK OF SAN FRANCISCO

Title	Distribution
Monetary Policy - The New Look (Remarks of Pres.)	1,800
Bank Regulation and the Public Interest (")	1,800
Inflation and Recession (")	1,800
U.S. - Japan Economic Relations (")	1,800
FRB SF Weekly Letter	13,000
Economic Review	10,500
Economic Review Supplement	
Short-run Monetary Control with Reserves Under Alternative Reserve Accounting Rules (Schedule for Summer 1980 Publications)	
The Role of Money in the Economy (")	1,800
Federal Reserve Notes	6,000

FEDERAL RESERVE BANK OF ATLANTA

TITLE	DISTRIBUTION
Economic Review	18,541
Update	3,497
Caribbean Basin Economic Survey	4,211
Annual Statement	308
Operating Ratios (1978)	931
Historical Southeastern Statistics	578
Accent	1,845 - District
Consumer Installment Credit - release	631 Bankers
Weekly Condition Report - release	1,210
Fundamental Facts About U.S. money -'79	98,832
Federal Reserve System	50,983
Monthly Southeastern Economic Indicators	
Regional Credit Market Intergration	1,123
Distribution February to December	86
Entry, Exit and Market Structure Change...	1,144
Distribution March to December	126
Future Holding Company Lead Banks ...	1,548
Distribution October to December	20
Money - Income Casuality ...	1,583

Chairman MITCHELL. Thank you very much for your testimony, Chairman Reuss.

As usual, you are very informative and enlightening. And as usual, your discussion is threaded throughout with these captivating words and phrases that you use so well, "carpetbaggers," "the pea under the walnut shell," and then to move into Kipling, "lesser breeds without the law," was a true delight. [Laughter.]

We thank you for enhancing your testimony with those charming and delightful words and phrases.

As a person who was honored to introduce this bill along with the chairman and Mr. Cavanaugh, I will forego questioning. I think you know where my heart is on this issue. However, there is one minor thing. You refer to several documents, and I assume you would want those submitted for the record.

The CHAIRMAN. Yes. I would appreciate that, Mr. Chairman, though I specifically ask that they not be printed, because I think the Government Printing Office has already suffered enough through having printed them the first time in the magazines, for the second time in the New York publication, for the third time in the Richmond publication. But I think they should remain in the record.

Chairman MITCHELL. The Chair was going to recommend that the slimmer document, exhibit C, might be printed in the record, but those two other tomes could simply be referred to by title.

[The document referred to by Chairman Mitchell, exhibit C, is attached to Chairman Reuss' prepared statement.]

Chairman MITCHELL. Congressman Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Thank you, Mr. Chairman, for advising us on these problems in your usual eloquent way. I have not had a chance to see your testimony in advance, but I am sure I will find it interesting and informative.

I was just wondering though if we might not be able to solve the problem you describe concerning the selection of this "motley body" by requiring that they individually be confirmed by the Senate, thus making them officers of the Government officially?

The CHAIRMAN. May I say to the gentleman from North Carolina, there is nothing wrong constitutionally with his idea. Indeed,

in earlier years, I had the same thought. It does accomplish my central purpose of having governmental policies decided by governmental people.

The only things to be said against it are, however, these: One, a 19-person board is pretty big, pretty big. That diffuses things quite a bit.

Second, if one believes in the decentralization of the Federal Reserve banks, I would have doubts about subjecting their presidents to Senate confirmation.

But let me be very clear: As opposed to the present situation, I would enthusiastically support the gentleman's suggestion. If that is what the subcommittee in its wisdom determines to do, I will fully support it.

I would have to point out, however, that if it is thought—and I am sure you don't—that you are going to get Mr. Volcker's vote by this variation, no, you won't, because he was asked about this in the Senate, back in 1975. When asked, "Why don't we make this legal by having the President appoint and the Senate confirm the district bank presidents," he said, "I am not prepared to support that provision. It runs at cross-purposes to other procedures specified in the present law and thus could imply a desire for other structural changes."

Also, I know of no precedent for senatorial confirmation of such officials.

So, you wouldn't get Mr. Paul's vote, but that would not mean that maybe you would not want to go that way.

Mr. NEAL. As I understand, the purpose of all of this, it is to improve the nature of our economy, to get a broader perspective on questions before the Federal Reserve, with the ultimate goal in mind of making this a more productive, innovative, vital, and dynamic economy.

The CHAIRMAN. Precisely.

Mr. NEAL. I would assume that is the real purpose for our distinguished chairman introducing this legislation.

I wonder if the chairman would agree with me that we could achieve much of what he seeks by passing legislation which would require that the Federal Reserve, in an orderly fashion, bring down the rate of growth in the money supply over a period of years until it approached the normal or potential rate of growth of our economy, and then essentially leave it there so that we would have a stable, vital economy from now on, instead of us constantly going through these wild swings that we have become so addicted to over the last several years and through which we are going again right now, it looks like, unless the Fed adjusts to a more stable sort of policy.

Then, it seems to me, Mr. Chairman, if we were to adopt the kind of policy I have suggested—which I believe, strongly, would go a long way toward guaranteeing a very vital, healthy economy for many, many years to come—we would not have to worry so much about the personalities of the Open Market Committee. Its job would essentially be to follow the mandate of Congress.

The CHAIRMAN. The gentleman has been a real leader, and I have followed his leadership on the notion, that he has just so well expressed, that our country's monetary policy will be best served if

we bring it down into a range roughly corresponding to the increases in productivity of the economy and then keep it there.

Such a monetary policy, which Mr. Neal and I espouse, could in all frankness be carried out by an educated horse. If we had that, I suppose it would not matter very much who was doing it as long as he had to do it—or she had to do it.

However, I would add this. You can have a monetary policy in this country administered, according to your rule, by an Albert Schweitzer. You can have a fiscal policy of a truly balanced budget administered by an Albert Einstein. And you still are going to have an economy which does not deliver the goods because of structural defects, because of lack of productivity and investment, because of lack of competitiveness.

I am sure, Mr. Neal, that you do not disagree with what I am saying.

In addition to fiscal and monetary policies, you have got to have microeconomic policies that make sense. And whether or not the day of grace has come for the Fed and they are going to follow the Neal secular monetary policy that you have just described, we need all the help we can get from the public sector and the private sector and from independent agencies like the Federal Reserve to see that we have microeconomic policies that are well thought out, sensible, and will conduce toward to just the economic goal with which you started your statement.

Mr. NEAL. Thank you, Mr. Chairman.

Chairman MITCHELL. Before recognizing the distinguished minority leader on the subcommittee, I want to point out that with reference to Congressman Neal's statement and your response—we have an absolutely appalling situation in the first 4 months of 1980, where year over year, M_{1B} growth rose to the height of approximately 9 percent, well above the target that the Fed had established, and then plummeted down below 5 percent, with negative growth in recent months. It is that kind of gyration that you were referring to, Mr. Neal, and you referred Chairman Reuss to, which I find inexcusable.

I don't want to stay on my soapbox too long this morning, but Congress legislated that the Federal Reserve set monetary growth targets and announce them to us. Year after year they have done that, and year after year they have violated their own targets. Now, this development in the first 4 months of 1980, portends a significant new danger for our economy.

Now, having finished my little sermonette, I recognize Mr. Hansen for 5 minutes.

Mr. HANSEN. Thank you, Mr. Chairman.

And, Mr. Chairman, it is good to have you in the hot seat. I have been very interested in your proposed legislation, Mr. Chairman, because I think it addresses something that we need to sink our teeth into—modernization of the Fed—whatever the word is, I think that it needs to be more responsive. And I think, if I interpret it right, that is what you are trying to accomplish.

I sent a couple of people to New York not long ago, when we were having these high interest rate problems, to see if the New York Fed, as well as some of the other Fed districts, really under-

stood what the plight of the more rural areas were since New York has such huge influence in the Federal Reserve system.

I found that they are so preoccupied apparently with international situations and loans and concerns that they have put on the back burner, almost to a point of nonrecognition, the concerns that were expressed to them, but really not taken up, of upstate New York, which is more rural than, of course, Manhattan Island.

I think that there is a real problem. I would like to ask you if your legislation would maybe address itself to such things as breaking up this sheltered bureaucracy that seems to be building, where no difference of opinion is tolerated?

Such a thing happened recently in Atlanta, where the Fed decided, because a person had a different economic philosophy, that apparently they would not take him as the president of that bank.

I am wondering if your legislation would address itself to this type of thing?

The CHAIRMAN. That is precisely what it does, Congressman Hansen.

I believe in decentralization. I think that the original concept of the Fed as a federation representing these various great regions of the country was a good one. But as it is now, with the veto power existing in the Fed, and with the power of the Washington Fed to cut out the salary of some fellow out in Idaho or down in Texas that rubs against the grain, you have a serious impairment of that local control.

I have nothing but praise for the civil service bureaucracy of the Fed. They are fine, devoted men and women. But we should not allow that to interfere with the principal of decentralization. The Fed likes to put one of its own bureaucrats in charge of what is essentially a regional bank, and they do that by their veto power. And they should not do that.

We should have, in all of the 12 great regions of the country, a native son or daughter, elected by the community out there. And if he or she makes a mistake, well, that is fine, let them make a mistake. Washington should not try to second-guess them.

I completely agree with you. I think you are on sound ground.

Mr. HANSEN. I think we have made certain strides in our subcommittee and in the full committee in making changes, trying to alter the term of the Fed Chairman, the securities draw certain things that have helped streamline and upgrade the Fed.

I do think that we need to address this, but I have a concern on the other side for what you are attempting to accomplish, Mr. Chairman. And that is whether any effort is being directed here to make the Fed more responsive to political pressure—I don't mean Democrat or Republican—but political pressure in the country. Are you heading toward some kind of a national economic plan or planning type program or credit allocation type operation or anything like this? Is this envisioned in your legislation?

The CHAIRMAN. No; it is not. That is not to say that there might not be other bills with other purposes. But that is not the purpose of this bill.

Mr. HANSEN. My time is up. Thank you very much, Mr. Chairman.

Chairman MITCHELL. Mr. Barnard is recognized for 5 minutes.

Mr. BARNARD. Thank you, Mr. Chairman. I certainly commend you for bringing this very important subject up at this time. I think it is something that does need consideration, and I am pleased it has been brought up at this particular time.

Like other members of the committee, I believe there is a lot about this bill that we really need to study. I see that you have given it deep thought and consideration, and I would certainly respect that.

Mr. Chairman, would you say that eliminating the stockownership in the Fed is going to encourage more membership in the Fed?

The CHAIRMAN. I believe so. I believe so because right now stockownership requires any bank to take 6 percent of its capital stock and surplus—3 percent actually paid in—and segregate that as Federal Reserve stock on which it gets 6-percent interest. Well, banks quite reasonably like to get the prime rate or something like it, so this is a real economic disincentive to membership.

Furthermore, setting aside this much of their capital—and bank capital is hard to get—means that their capital/loan ratio looks worse and worse, and when they appear before our friends at the regulatory agencies, they get criticized for that ratio.

So, it is a disincentive, and I would say let there be neither an incentive nor a disincentive. Let's make membership entirely a voluntary thing.

Mr. BARNARD. How do you think that will affect the dual banking system?

The CHAIRMAN. Not in any way—though this is a very important point. And I subscribe to the dual banking system.

Incidentally, on just this point I have been in touch with the Association of State Bank Supervisors. Though a bank would elect to become a member of the Fed by signing a membership card, as today a bank can elect membership by buying the stock, in my judgment the State regulatory agency should have the exclusive jurisdiction to charter and also to examine.

Mr. BARNARD. It does not have that now.

The CHAIRMAN. That is—what you say is correct. I want to go on to finish my statement.

There needs to be, of course, a backup by the Federal Deposit Insurance Corporation which, after all, wants to make sure that a State banking agency has done a thorough job. And that dual feature is not touched by this bill.

However, as far as I am concerned, I would like to see the Federal Reserve get out of the examining business. It is on its way out, and I would like to see it complete that exit.

Now, the Federal Reserve argues—and you will hear Chairman Volcker argue this morning—that it needs this examining power, this second- and third-guessing power, after the State examiner has been there and the FDIC has been there. The Fed would like to go there too, because in some mysterious way it gives it the flavor of banking so that it can carry on a better monetary policy.

Well, I am always disposed to give the Federal Reserve the benefit of the doubt. But what I say is: if they need the flavor, let them piggyback on the FDIC and send a flavor gatherer around—no harm in that—if they think they need it. But let us not have a

messy system whereby the Fed in effect duplicates what the State does.

Mr. BARNARD. I hate to jump from one subject to the next, but this time does flee so fast. I certainly appreciate what you had to say about regional representation in this very august body, and I feel that the input of the various presidents would have some impact. Of course, we don't have a regional representation on the Board of Governors, do we?

The CHAIRMAN. No. The law, as you know, simply provides that of the seven, no two can be from the same district, and sometimes that is observed in a Pickwickian sense. There have been quick moves around in hotel rooms in order to qualify somebody.

Mr. BARNARD. One further question. How do you feel that this legislation affects the independence of the Fed, which we have debated in the past—I am not going to say we have agreed on. How do you relate this bill to the independence of the Fed? Would it affect the Fed's independence?

The CHAIRMAN. I believe in the independence of the Federal Reserve, and this bill confirms and ratifies that independence. It doesn't affect it in any way, and I would not want to. As I say, other bills may want to do something about that. Not this bill.

Mr. BARNARD. And with the terms of office of the members, I would guess that that would transcend any loyalty to any administration wouldn't you say?

The CHAIRMAN. The 14-year term is a good thing. I have not wanted to change that.

Mr. BARNARD. Is my time expired? Let me do this before I sign off.

I want to take this opportunity to congratulate you and to congratulate the distinguished chairman of our subcommittee on an outstanding victory at the polls yesterday, which further identifies him as our stalwart leader. I understand he got 80 percent of the vote.

Chairman MITCHELL. I thank the gentleman for his congratulations; however, I would caution members not to make any quotes from P. T. Barnum or other persons about the number of people, nonthinking people, who exist in the world.

Thank you, Mr. Reuss. We would be delighted if you could join the subcommittee for the balance of the hearing. I will at this point, with the cooperation of the members of the subcommittee, hold up on further questions to the Chairman and ask Mr. Volcker if he could come and give his testimony at this time.

We welcome you, Mr. Volcker. Thank you for taking the time to be here. In all fairness, I have made some statements before you arrived which were not related directly to the bill. I will take just a moment before you make your statement, to indicate some of my concerns.

As you know, last fall I wrote to you and expressed my unqualified support for your announcement that the Federal Reserve Board was going to concentrate on hitting its money supply targets. Now, I must confess, 7½ months later, I am somewhat bewildered by the present course of monetary policy, simply because the Board is not hitting its own targets.

I think we are undershooting very badly right now. Based on your own 1980 target range for M_{1B}, as presented to the Congress in February, the number of M_{1B} dollars should have averaged between $392 and $396 billion in April. It did not. The weekly numbers indicate an average of $388 billion for April, and the latest reporting week, it averaged only $383 billion.

Mr. Volcker, I again commend you for many of your efforts toward moving this Nation in the direction of economic stability. But, in my humble opinion, I think the better course of monetary policy would be to shoot for the upper ranges rather than where we are at the present time: undershooting. I think we should shoot for 6 to 6½ percent growth for M_{1B} this year. I know that you are seeking economic stability, and I encourage you. But, as I said, this is one Member's personal fear that we are not going to achieve that if we undershoot our targets. The way to promote economic stability is to get M_{1B} back on track and reduce its growth slowly.

I thought, in all fairness to you, because I made statements along those lines before you got here, that you should be made aware of them.

[Excerpt of statement of Chairman Mitchell follows:]

Since I became Chairman of the Subcommittee in January 1977, I have expressed concern on several occasions because the growth of the money supply was too fast. I did not define "too fast." I complained only when the Federal Reserve allowed the nation's money supply, measured conventionally by the supply of coin, currency and bank and other deposits subject to withdrawal by check, to grow for prolonged periods above its own targets. I warned in 1977, again in 1978 and still again in 1979 that allowing the money supply to grow above target, as it did in 1977, 1978 and 1979, would cause inflation to accelerate and thereby lay the foundation for another recession. As far back as 1978, I said that the recession would start late in 1979 or early in 1980.

I have long recognized and continue to recognize the need to gradually reduce money growth in order to reverse and stop inflation. Last fall, in a letter to the Wall Street Journal (Oct. 11, 1979), I expressed my full and unqualified support for your announcement, Chairman Volcker, that from October 6, 1979 on, the Federal Reserve was going to concentrate on hitting its money supply targets. I said that this would make possible the gradual slowing of money growth. I understood that, as money growth slowly but surely tapered off, real growth would be sluggish and could even recede for a time, that unemployment would rise for a time and that interest rates could be very volatile until inflation was firmly in check. However, these risks are worth the effort to stop inflation, as that is a prerequiste for achieving economic stability and, in the final analysis, full employment.

Now 7½ months later, I want to state my profound bewilderment about the present course of monetary policy. You and your colleagues, Chairman Volcker, are not hitting your own money supply targets. You are undershooting them badly. Based on your 1980 target range for M1B, as presented to the Congress in February, the number of M1B dollars should have averaged between $392 and 396 billion in April. It didn't. The weekly numbers indicate an average of $388 billion for April, and the latest reporting week it averaged only $383 billion.

In my opinion, the prudent course for monetary policy to follow this year is the top of your target range, 6½ percent M1B growth. This is 1½ percentage points below actual M1B growth in 1979, 1978 and 1977. It is low enough to start us on the path to price level stability and yet high enough for the economy to proceed through the year without dropping into another deep recession. Currently, M1B should be about $396 billion. It is $13 billion below that prudent disinflationary level. If the shortfall isn't made up, we will sustain an $80 billion loss of output above and beyond what we have to suffer to win the fight against inflation.

Chairman Volcker, I am encouraged by your commitment to economic stability. I believe you took the right risks to get money growth back on course when it accelerated in late January and early February. By dramatically reducing money growth after early February, you broke the back of the then emerging near hyper-inflationary psychology. Now it is time to make up the shortfall in money supply that has developed in recent weeks.

We won't achieve economic stability and you won't promote it unless you get M1B back on target. Getting back on target may require you and your Federal Reserve colleagues to ignore developments in credit, capital and foreign exchange markets; to watch only M1B and conduct open market operations so as to increase M1B when it is below the level dictated by prudent 6½ percent growth during 1980, and to decrease it when it is above that level. That isn't hard to do. When M1B is below target, as now, you only have to step-up open market purchases and persist until M1B rises back to target. When M1B is too high, you only have to reduce purchases, and sell if necessary, until it falls back to the target level.

For the record, so that everyone will know exactly where I am coming from and want you to go, appropriate M1B levels for the near future are as follows:

June	$400 billion
September	$406 billion
December	$413 billion

I strongly urge and advise that you and your colleagues hit these targets.

Mr. VOLCKER. I am glad to hear your comments, Mr. Chairman.

Let me just say briefly that I am very much aware that the April figure, in particular—that is the one that is really at issue here—fell rather sharply.

I think I have said before this subcommittee and before the full committee, in all my statements, that these figures do move erratically from month to month. Whatever technique we use there is a lot of volatility in the short run. There is no question that the April figure is low; April has been a difficult month—mostly high in the past, but this particular year it came out low. There are a lot of technical problems with April, because it is a big tax-collection month.

This year, it appears that the IRS was cashing tax checks much more quickly than it has in the past, which appears to have had an influence on that April figure. But I do not want to suggest that it is all due to the change in the speed with which the checks were collected. There is no question the figure has moved low. I would expect to see it move higher, consistent with our targets over time.

I would expect to see some reversal of that April figure, but I would want to say again that we just can't hit these things month by month. Our techniques are just not that good. I am not sure it is totally desirable to hit them every month, either. They were high in January and February, as you remember. Markets were extremely tight at that time, and, consistent with our operating techniques, we certainly resisted increases. But there were big increases at that time. Now it is reversed itself, and we are, as you say, below the target range, but I don't want to attach too much significance to one month.

Chairman MITCHELL. Thank you. I certainly will not prolong this. We want to hear your testimony. I just want to indicate that this is one more fervent plea to the Federal Reserve to stay within its own targets. That is the thrust of my comments.

Mr. VOLCKER. I understand.

Chairman MITCHELL. Thank you very much. We would be delighted to hear your testimony.

STATEMENT OF HON. PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. VOLCKER. Mr. Chairman, I think you have received my prepared statement. I will read most of it, if that is helpful.

The two points I would like to make at the outset: First, I do want to thank Chairman Reuss, the committee as a whole, and your subcommittee for the really enormous legislative achievement that has already been enacted this year—the Monetary Control Act. It gives us a lot of work to do—I think, constructive work—in extending the range of our authority over additional institutions to deal with the membership problem, as it was called in a shorthand way.

Flowing out of that, I also make the point in my testimony that this is a time of both challenge and opportunity, as we adapt to that new mass of legislation. And we have some concern, quite frankly, about making other major changes in the structure and the governance of the Federal Reserve at this particular time, before we fully absorb those structural changes.

I do not want to argue that the structure of the Federal Reserve is perfection in every respect or that it can't be changed, but I do argue that I think it has served the country well over a long period of time and reflects a fine balance of independence and regional participation that the Congress has shepherded for the 60-some-odd years that the Federal Reserve has been in existence. I think we want to move in ways that preserve both the independence and the regional nature of the system. We have a unique agency here, a unique instrumentality of Government, and I think it is appropriate that we move somewhat cautiously in changing it.

So, those two factors that we are adapting to, the changes flowing out of a very major piece of legislation passed just a few months ago, and the need for continuity—the need for preserving what, by general consent, have been the healthy attributes of the Federal Reserve—do instill a good deal of caution into our approach toward this legislation.

I do have some concern that when one looks at the proposed bill as a whole—I am not thinking of the details or a section-by-section analysis, but of net result—whether it is the intention or not, there could be felt to be some dilution of both the independence of the Federal Reserve and the regional attributes that have been characteristic of the System.

So far as the specifics of the bill are concerned, I think the easiest way to proceed would be for me to read the relevant portions of the statement, Mr. Chairman.

The most significant proposals seem to me to begin with the provisions of title II, dealing with structural changes in the Federal Reserve System.

Sections 201 and 202 are interrelated. Section 201 would abolish the Federal Open Market Committee and give sole authority for the conduct of open market operations to the Federal Reserve Board. It would remove the presidents of the Federal Reserve banks from having any policy-deciding role in the formation of monetary policy. Section 202 would revise the Federal Advisory Council by changing the membership from each Federal Reserve district from a representative of private industry selected by the Board of Directors of the banks to the president of the Federal Reserve bank for each district. This would place the presidents of the Federal Reserve banks in an advisory role to the Board, so far as open market policy questions are concerned.

The Board believes that both of these changes would detract from the effective functioning of the Federal Reserve System. From its inception, the Federal Reserve has been based upon a combination of central and regional elements. From a desire to insulate the System from short-term and partisan political pressure, 12 Federal Reserve banks were established and given a significant role in the operation of the System in order to insure a proper consideration of viewpoints and needs from all sections of the country. The premise was that all wisdom does not reside in Washington and that a degree of insulation from immediate political considerations would be enhanced by an important role for the Reserve banks.

Removing the Reserve bank presidents from membership in the Federal Open Market Committee inevitably erodes these objectives. The Reserve bank presidents and their research staffs not only

bring to the Federal Open Market Committee an element of experience, continuity, and insight that might be lacking in a purely Washington-based policymaking organization, but they are also an important source of knowledge and informed opinion about regional interests and needs.

Inevitably, there would be a profound difference between an advisory role and the role of a participant sharing responsibilty for policymaking. Removal of the presidents from the Federal Open Market Committee could only have the effect of making the Federal Reserve more Washington-oriented, less sensitive to regional concerns and potentially without the same professional career commitment now characteristic of many of the bank presidents. I should note, in this connection, that Members of Congress have recently expressed the view that the composition of the Board itself should be more representative of regional and sectoral interests. The proposal in H.R. 7001 to reduce the role of the regional Reserve bank presidents in the conduct of monetary policy seems quite contrary to meeting that overall concern.

The Federal Reserve System has also benefited from a unique capacity within its structure to receive informed and constructive criticism from those concerned with its operations and policies. This capacity would be weakened, in effect, by abolishing the Federal Advisory Council as presently constituted. That Council, consisting of leading commercial bankers from each Federal Reserve district, provides an opportunity for the Board of Governors to obtain a considered point of view of the economy and the credit conditions of the country. It provides a channel for criticism and suggestions ranging from broad policy to operational concerns. The insights gained have helped the Board to implement policies and operations with more knowledge of their implications than would otherwise be possible.

We recognize the same purposes could be approached in other ways. But, the question arises: Why change an arrangement that is functioning well and which the participants understand? Is the purpose to weaken the regional elements or the consultative processes of the system? If not, what is it?

Section 203 would revise the provisions for the appointment of Federal Reserve bank presidents by removing the requirement of approval by the Board of Governors of the Federal Reserve System and by requiring that the presidents shall be bona fide residents of the district involved.

The Board appreciates the importance of independent-minded people serving as bank presidents, individuals able to participate in policy and operations alongside Board members. We also believe that while the initiative and choice lies with the regional boards, some review of the appointment by public officials is an essential part of the appointment process, given the nature of the duties. We know of no better way to accomplish that result than the arrangements embodied in the Federal Reserve Act for almost 70 years. In that connection, we note the importance of mutual respect and an ability to interact harmoniously between the Board and the presidents of the Federal Reserve banks.

With respect to residency, the Board agrees that, and it has been a practice for, the president of the Federal Reserve bank to be a

bona fide resident of the district. However, we would oppose a requirement for residency prior to employment, because it would detract from the ability to obtain individuals of the highest caliber for the posts, including our ability to attract career people to the Federal Reserve who might conceive of moving from one district to another as an avenue for promotion and development.

Section 204 provides that the Federal Reserve System shall utilize its resources and generally conduct its affairs to foster the policies and purposes of the Employment Act of 1946 and the Full Employment and Balanced Growth Act of 1978, particularly the Nation's effort to achieve a stabler price level and an improved economic structure.

The Board is unclear on the intent of this section. We are unclear because the Board now accepts the Employment Act and the Full Employment and Balanced Growth Act as guiding principles. We are, of course, concerned with price stability. In these respects, the addition of this section would not appear to be necessary. However, the section speaks specifically to the System using its resources to improve the Nation's economic structure. We are uncertain as to the meaning, and would desire further clarification, of this proposed charge to the system.

I would now like to address the provisions of title I, which would provide for the retirement of Federal Reserve stock and substitute a certificate of membership for stock ownership. In connection with previous proposals for retirement of Federal Reserve stock, the Board has advised this subcommittee that on balance it believed ownership of Federal Reserve bank stock is desirable because of the tangible indication it provides of the interest of its members in the operations and efficiency of the System.

Chairman Reuss has suggested that the provisions of the Monetary Control Act of 1980 make the present stock requirements for member banks anachronistic. While it is true that the rights attached to ownership of stock in a Reserve bank are, in fact, extremely limited, that does not dispose of the question. Voluntary membership still has an important role to play in the Federal Reserve System. Members elect some of the directors of the Federal Reserve banks, who in turn elect the bank presidents and maintain surveillance over the efficiency and effectiveness of Reserve bank management and operation. In those respects, the public and private interest broadly coincide, and the participation of able men and women as directors, including among them persons chosen by stockholding members, I believe contribute importantly to our efficiency and operational effectiveness. The Board would not wish to see any changes made that would weaken either its ability to attract outstanding individuals as directors of the Federal Reserve banks and branches or their continuing dedication to their work. However attenuated the rights of a stockholder may be compared to a normal corporation, that tangible evidence of continued interest, we believe, helps enhance our ability to obtain qualified, independent-minded directors concerned and interested in the effectiveness of the System.

In this connection, the provisions of H.R. 3257, a bill you are sponsoring, Mr. Chairman, will increase the number of class C directors appointed by the Board and thus permit the Board to

increase the representation on the boards of directors of consumers, labor, and service interests. We believe this approach is appropriate.

I recognize that some directors could continue to be elected by members holding only a membership certificate. But the Federal Reserve banks are corporations and do have capital. The alternative, presumably, would be in effect to transfer the stock evidence of that capital to a Government agency. But what would be achieved by such a change? Would it not, whatever is intended, lead to an implication or allegation of Treasury control? Would it not, again whatever is intended, weaken the healthy concerns of banks with how the Fed is managed?

We do believe that consideration also needs to be given to the participation of nonbank financial institutions on the boards of the Federal Reserve banks; whether they should participate in the election of directors and, if so, how this should be accomplished. We also recognize that limiting payment of the dividends to 6 percent on Federal Reserve stock can be a small disincentive to membership, and if it is concluded that membership should be broadened and stock retained, consideration might also be given to providing a rate of return on that stock more comparable to that on Government securities. Considerations of this sort lead us to the conclusion that elimination of Federal Reserve stock would be undesirable, but that consideration of which institutions might be eligible for membership, the formula for acquiring such stock, and the rate of dividends will be in order as we gain experience with the Monetary Control Act of 1980, and its impact on the Federal Reserve System.

The provisions of H.R. 7001 do not change the role of the Federal Reserve System with respect to the supervision and examination of member banks. However, in Chairman Reuss' introductory statement, he said, "Chartering and examination of State banks, member and nonmember alike, would reside in the State regulatory agencies rather than in the Fed." In view of that statement, I would be remiss if I did not address the subject of the role of the Federal Reserve in the supervision and examination of member banks.

As Chairman Reuss just indicated, the Board has stated on a number of occasions that it believes that the condition of the banking system and information about individual banks is an important input for monetary policy formulation which would be lost or substantially reduced if the Federal Reserve had no role in the regulation or examination function. Our experience in recent years has only served to strengthen the conviction that information which the System obtains in the course of exercising its supervisory functions provides key insights into such matters as the state of liquidity and viability of the Nation's banking institutions, indispensable elements in the formulation and implementation of monetary policy. The borderline between monetary, regulatory, and supervisory powers is sometimes indistinguishable. We believe all would be weakened by trying to enforce a strict separation. Obviously, there are a number of issues in the relationships among supervisory agencies, some of which have been addressed in recent legislation. As we gain experience under that legislation, we may

have further proposals. But the Board strongly recommends that it continue to have a role in this area, and that the Board retain responsibilities for supervision and examination.

In summary, Mr. Chairman, the Board is concerned that the proposed structural revisions would weaken certain traditional elements in the Federal Reserve structure that significantly and substantively have contributed to the independence, the regional balance, and the efficiency, effectiveness, and integrity of our operations.

However, we do agree further consideration of the nature of membership and the eligibility and terms of stockownership in the Federal Reserve System will be needed in light of the enactment of the Monetary Control Act. Attention should be given to the participation in the operations of the Federal Reserve banks by nonbank financial institutions that will now maintain reserves with the Federal Reserve, as well as their representation on the boards of directors of those banks. And we continue to feel that those boards should be expanded in size in order to accommodate a broader representative segment of the public as a whole.

As experience is gained under the Monetary Control Act, we will be happy to work with you and your committee and its staff in evaluating and developing possible legislative proposals that might accommodate these needs.

Chairman MITCHELL. Thank you very much, Mr. Volcker, for your testimony. There is a wondrous phrase we use around Congress when we hear testimony like that. Someone says: "I take it the gentleman is opposed to the bill." [Laughter.]

I am sorry that you have not been able to find any redeeming features in this democratizing piece of legislation. I do not know how my colleagues feel, but we will start with Mr. Neal for questions. We will limit questioning to 5 minutes for each Member.

Mr. VOLCKER. I am not sure it is "democratizing," if I may just enter that caveat, Mr. Chairman.

Chairman MITCHELL. It is so entered.

Mr. NEAL. Mr. Chairman, I would like to commend you, first of all, for your leadership at the Fed. I think if you had not changed the direction of the Federal Reserve policies when you did, we would not have had interest rates in the 20-percent range, they would now be approaching 30 percent. We would not have had serious problems, we would have had chaos in this country. I would just like to commend you for taking the action you have taken.

Mr. Chairman, it seems to me that if we can stick with a moderate, consistent reduction in the rate of growth of the money supply, the result will be a real and lasting reduction in the rate of inflation and real and lasting reduction in interest rates. As I understand it, this is the course that you are attempting to follow.

Again, I just want to commend you for taking the lead in this effort. I think the country owes you a deep debt of gratitude.

But, Mr. Chairman, I am very concerned about the recent rapid decline in the rate of growth in the money supply. I would like to get a commitment from you that it is your intent to stay on a path of moderate reductions, so that we do not, on the other hand in our attempt to fight inflation, create chaos in the society by creating recession.

63-971 O - 80 - 5

Mr. VOLCKER. That is correct. As I indicated earlier, Mr. Neal, we have a series of those aggregates to look at. They are all low; some are lower than others; but we have to take a balanced look at all of them. They have all taken a bit of a nosedive recently.

Mr. NEAL. You are fully aware of that.

Mr. VOLCKER. I am indeed.

Mr. NEAL. You are much more knowledgeable than I am but I am going to be monitoring this situation carefully also. Following balanced policies now can lead to a long period of stability and prosperity for our country and it is critically important that we take a balanced approach.

As to the bill before us, the purpose of the chairman, in introducing this bill, is to bring about a healthy economic climate in this country. Frankly, it seems to me that if we were going to make any change in the Federal Reserve System in the area of setting policy for the system, that we could much better bring about the kind of stable, noninflationary, full employment, low interest rate conditions that the Chairman, and I think all of us, seek by staying on a path of moderate reduction of the rate of growth of the money supply until it approximates the rate of growth in our economy.

I personally think that we should make a change in the charter of the Fed to require that it stay on such a course, because I know that although you want to stay on that course, you may not be with us forever. No telling how long any of us here will be in the Congress. On looking at the history of Fed action over many, many years it is clear that the Fed simply has not stayed on that kind of course. And it seems to me that, having gone through the pain for our country of bringing Fed policy into adjustment, that the very best way to provide a stable economy, the kind of climate that will encourage investment, productivity, full employment, low inflation and low interest rates, would be to require that the Fed in fact stay on such a course from now on.

I would just like for you to comment.

Mr. VOLCKER. I think you are really referring to legislating something different than what is incorporated in H.R. 7001.

Mr. NEAL. But the purposes are the same. If you ask the authors of both bills what the purposes are, they will tell you they are precisely the same.

Mr. VOLCKER. That is not totally apparent to me, although, it may be so.

We had some discussion last fall, as I recall, about the wisdom of actually legislating a particular target for the money supply and various monetary aggregates, and about legislating a particular rate of deceleration. I don't know that I have much to add at this point.

The Board has had very great reservations that an attempt to try to legislate in this area. At one extreme, even the technical difficulties of defining the money supply and therefore incorporating it in a piece of legislation that would last over a period of time, are of concern, to say the least; and at the other extreme, our concern is whether legislation could be written in such a way as to follow that goal—which I think, in general terms, we share—yet still preserve what flexibility may be necessary in particular, unforeseen situations in the future.

I think all I can say is that I would greatly prefer to continue within the present framework, where we have legislation that forces us to set forth our goals in terms of the aggregates each year, as you well know, and to review those goals with this committee and with your Senate counterparts.

I would continue to feel at this stage, certainly, that that is the appropriate approach.

Mr. NEAL. Thank you.

Chairman MITCHELL. The bills indicate that a vote is in progress. It necessitates at least one member on this subcommittee going over to cast his vote, since this is the food stamp authorization. How are you for time; Mr. Volcker?

Mr. VOLCKER. I am fine.

Chairman MITCHELL. Then the subcommittee will take a 10-minute recess to vote. We will come right back.

[Brief recess.]

Chairman MITCHELL. The hearing will resume. Mr. Paul is recognized for 5 minutes.

Mr. PAUL. Thank you, Mr. Chairman. Mr. Volcker, I find your statement regarding H.R. 7001 very helpful. It helps me very much to understand the bill. I think you make the points very clear, and your position very clear.

In the first part of your testimony, you talked about the Monetary Control Act recently passed. I would, if I could, like to ask you a few questions regarding this bill. When H.R. 7 first came before our Banking Committee, the first and second time, there was no mention about collateral and changing the definition of collateral. In the third version, the definition of collateral was changed. It was given a very loose meaning, referring to any financial asset as collateral.

This was removed on the House floor. I understand that when it went to the Senate and into conference committee, this was of great importance to the Federal Reserve, to have this new definition put back in. I would like to get your comments on that, with regard to the Monetary Control Act.

I would like to ask about the real thrust of the act, in terms of monetary policy, as compared to monetary policy as we have seen it under your leadership. For instance, the way I understand the bill, the reserves, if anything, have been greatly reduced. I know you have more institutions under your control now. But the percentages of reserves are greatly reduced, which to me means a looser monetary policy, rather than a tighter one. If necessary, the Fed can resort to having zero reserve requirements for a renewable period of 180 days.

I would interpret this to mean that the Fed was actually looking for authority or ability to have this in place, rather than having to execute a tight monetary policy. And in the same light, the definition of collateral to me means that possibly this is a preparation for more inflation, rather than a tighter, less inflationary policy.

Mr. VOLCKER. I am glad you raised the question, because I do not think that interpretation is correct.

First of all, smaller reserves do not necessarily mean—and should not have any implication of—easier monetary policy, because we control the amount of reserves, in the last analysis. But

we are interested in the relationship between reserves and deposits, and therefore the money supply; we are interested that that be as predictible and as firm as possible. So far as the amount of reserves are concerned, if we have a firm relationship between the total reserves and the money supply; that is, not very relevant.

Now, I was concerned, frankly, that the total amount of reserves be higher than it was in H.R. 7, not because that directly implies firmer monetary policy, but because it implies a more stable relationship between the reserve base and the money supply, and I wanted to make sure the reserve base was high enough to have a stable relationship between reserves and deposits.

We will control the volume of reserves, whatever the requirement is, in line with our objectives with respect to the money supply and credit and, in that respect, the amount of reserves, whether high or low, does not in itself imply easy or tight policy.

Now, the problem that we ran into on the collateral was with the existing collateral provisions. With a reduction in reserve requirements, the collateral provisions against currency created the possibility, and even the probability, at some time, that we would not have enough collateral to back the currency. The collateral consisted of gold, valued at the official price, in the form of gold certificates and Government security holdings. Most of our liabilities are Federal Reserve notes—in other words, currency. They tend to follow the volume of economic activity. And we did not want to be put in a position where we had to buy Government securities, simply for the purpose of providing collateral. That would have meant inadvertently easier money, forced upon us by the technical requirement for collateral.

We did not want to be in the position of having to go out to the market and buy Government securities to provide collateral.

The version of H.R. 7 you refer to—I was not here at the time; it is my recollection the provision was taken out on the House floor—would have allowed any asset of the Federal Reserve to be used as collateral. My feeling was, given the congressional sentiment—and I shared that feeling, a little bit—that any old asset may be too loose that we would provide, instead, a listing of assets that were, in effect, similar to our holdings of Government securities so that we could use the securities of Government-sponsored agencies we have in our portfolios and so that we could clearly use repurchasing agreements. We also took the opportunity to fix up what I think was a technical defect in the Federal Reserve Act about our ability to hold foreign government securities. Now we can use any of these as collateral, and—according to the bill as passed—we do not have to hold collateral against Federal Reserve notes we hold in our own vault. That did not seem to serve any purpose, since they are not even in circulation. But with the provisions in the bill as passed, we feel satisfied we will not be put in a bind where we have to go out in the market and buy Government securities simply for the purpose of providing collateral behind notes that are already outstanding.

Mr. PAUL. Back to the reserve requirement. I am still a little bit confused on this, because it seems to me that if we have a 50-percent reserve requirement versus a 10-percent reserve require-

ment. There would be a big difference in the money supply. The lower the reserve, the more inflation.

Mr. VOLCKER. All things equal, if we did nothing but impose a 50-percent reserve requirement, instead of the current reserve requirement, money would tighten enormously; the money supply would decline. But if we did not desire that reduction in the money supply, all other things equal—let us say we have not changed our policies—we are not looking toward a big decline in the money supply, then if reserve requirements were increased—let us say, to 50 percent—we would simply engage in open market operations to expand the volume of reserves to meet the requirements.

Mr. PAUL. Haven't you emphasized more the reserve requirements for monetary control, rather than the Open Market Committee? I thought I had heard you make that statement.

Mr. VOLCKER. Here, the distinction is perhaps a subtle one. But reserve requirements and open market operations serve two different purposes. The reserve requirement fixes the relationship between reserves and the supply of money. I am overlooking a few technical complications, but broadly, once we have set the reserve requirements, we know the relationship between reserves and the volume of money.

Then, to affect the volume of reserves, and therefore to affect the money supply, we engage in open market operations. With rather rare exceptions, we rely upon open market operations to affect the volume of reserves.

Now, in concept and occasionally, we can achieve the effect on the money supply that we want by changing the reserve requirement percentage rather than engaging in open market operations. But 99 times out of 100, or 999 times out of 1,000, we will do that by engaging in open market operations, rather than by changing reserve requirements. I do not mean reserve requirements are not important—they are important to fix the relationship, in a sense, between open market operations and the money supply.

Mr. PAUL. Thank you. My time has expired.

Chairman MITCHELL. Chairman Reuss, perhaps you can induce some simpatico feelings on the part of the chairman of the Federal Reserve.

The CHAIRMAN. Thank you very much, Mr. Chairman, and thank you, Mr. Volcker.

On the basis of your testimony on my little bill, I will have to put you down as doubtful for the moment. [Laughter.]

Mr. VOLCKER. You want to put me down as one of our loan classifications. The worst one is lost, but you are not going to put me down as that.

The CHAIRMAN. I would, however, like to have you explain to the Representatives of—well, the Baltimore area and the Texas area, to take two at random, whether it really is just that the New York bank gets a vote every year, and the Chicago and Cleveland bank every other year, but all the rest are heard from in the voting department just once every 3 years.

I can't see the justice, though it happens that I come from a favored area.

Mr. VOLCKER. It happens that I come from New York, which is even more favored, so perhaps you won't get an unprejudiced answer to that particular question.

As you know, that provision goes back to the revision of the Federal Reserve in 1935, when the Open Market Committee was given a statutory basis. I am sure the thinking at that time—and I must say, I don't believe that thinking is entirely wrong today—was that the New York bank, as the principal operating arm of the system——

The CHAIRMAN. Leaving New York aside—let's talk about Cleveland.

Mr. VOLCKER. If I may just complete the thought, the New York bank is the principal operating arm and it is located in the financial center, and so that decision was made, I think, for obvious reasons. The Chicago or Cleveland situation, I suppose, is slightly different. We were left with 11 banks in a rotational scheme, and it does not work out exactly the same for all 11 banks.

I don't think that particular arrangement is sacrosanct in any sense of the word.

The CHAIRMAN. Having failed to budge you on H.R. 7001, let me turn to a more congenial area. I read in the papers what you said yesterday in Florida about wanting to relax some of the aspects of the credit control program. I would urge you to move immediately on that part of the March 14 program which clamps down on consumer credit and on credit cards in particular.

Credit cards are very largely used for meals in restaurants, rooms in hotels and motels, for apparel. I know of no inflationary undersupply of restaurant meals, hotel rooms, apparel—indeed, by zapping them, you deprive a ghetto young man of the job as a dishwasher, or a Latin American woman of a job as a chambermaid in a motel, or a central city person in the needle trades of their chance to make a shirt for somebody.

Whatever it may have had in its favor on March 14, this aspect of the credit control program is no longer needed now. With unemployment increasing today, and with the fact that by a stroke of the pen you could repeal it and it would not cost the taxpayers a dime, can't we agree that it would be just fine for you to act, say, tomorrow?

Mr. VOLCKER. That is, of course, among the items that we have under review. I am interested in your comments, because we get mixed advice on this one, particularly, I think, from the Congress and from members of this committee. I was surprised several weeks ago when we had our Consumer Advisory Council meeting. I don't want you to overinterpret what I am about to say; I was talking to a very limited group of members, but the council happens to be a group that has both lenders and consumer groups. I asked them precisely the question that you raised, and I was quite surprised that from both points of view they wanted to keep the controls on. You almost had the feeling of the longer the better. That may be a bit of an exaggeration.

The CHAIRMAN. Would you file, for the record, later on, who the members are of that group?

[Chairman Volcker subsequently submitted the following list of members of the 1980 Consumer Advisory Council:]

MEMBERS OF THE 1980 CONSUMER ADVISORY COUNCIL

Chairman

William D. Warren
Dean
U.C.L.A. School of Law
Los Angeles, California
December 31, 1980

Vice Chairman

Marcia A. Hakala
Assistant to the Vice Chancellor
The University of Nebraska
Medical Center
Omaha, Nebraska
December 31, 1980

Julia H. Boyd
Director of Credit
Woodward & Lothrop, Inc.
Washington, D.C.
December 31, 1982

Roland E. Brandel, Partner
Morrison & Foerster
San Francisco, California
December 31, 1980

Ellen Broadman
Attorney
Consumers Union
Washington, D.C.
December 31, 1982

James L. Brown, Director
Center for Consumer Affairs
University of Wisconsin Extension
Milwaukee, Wisconsin
December 31, 1981

Mark E. Budnitz
Associate Professor
Emory University School of Law
Atlanta, Georgia
December 31, 1981

Robert V. Bullock
Assistant Attorney General
Commonwealth of Kentucky
Frankfort, Kentucky
December 31, 1980

Richard S. D'Agostino
Senior Vice President
Girard Bank
Philadelphia, Pennsylvania
December 31, 1982

Joanne S. Faulkner
Attorney
New Haven Legal Assistance
Association, Inc.
New Haven, Connecticut
December 31, 1982

Vernard W. Henley
President
Consolidated Bank and
Trust Company
Richmond, Virginia
December 31, 1982

Juan Jesus Hinojosa
Partner
Hinojosa & Ortiz
McAllen, Texas
December 31, 1982

Shirley T. Hosoi
Assistant Vice President,
Marketing
Western Bancorporation
Los Angeles, California
December 31, 1982

F. Thomas Juster
Director
Institute for Social Research
Survey Research Center
University of Michigan
Ann Arbor, Michigan
December 31, 1982

Richard F. Kerr
Operating Vice President
Federated Department Stores
Cincinnati, Ohio
December 31, 1981

Robert J. Klein
Senior Editor
Money Magazine
New York, New York
December 31, 1980

* Date indicates expiration of term.

Harvey M. Kuhnley
President and Chairman of
the Board
Twin City Federal Savings &
Loan Association
Minneapolis, Minnesota
December 31, 1981

Robert J. McEwen, S.J.
Professor of Economics
Boston College
Chestnut Hill, Massachusetts
December 31, 1982

R. C. Morgan, President
Government Employees Federal
Credit Union of El Paso
El Paso, Texas
December 31, 1980

Margaret Reilly-Petrone
Professor of Economics
Montclair College
Upper Montclair, New Jersey
December 31, 1982

Rene Reixach
Staff Attorney
Greater Upstate Law Project
Rochester, New York
December 31, 1982

Florence M. Rice, President
Harlem Consumer Education Council
New York, New York
December 31, 1981

Ralph Rohner, Professor
Catholic University Law School
Washington, D.C.
December 31, 1981

Henry B. Schechter, Director
Office of Housing and
Monetary Policy
AFL-CIO
Washington, D.C.
December 31, 1981

Peter D. Schellie, Partner
Baker & Daniels
Washington, D.C.
December 31, 1982

E. G. Schuhart
Farmer and Rancher
Dalhart, Texas
December 31, 1980

Charlotte H. Scott
Professor of Business
Administration and Commerce
University of Virginia
Charlottesville, Virginia
December 31, 1982

Richard A. Van Winkle, President
Lockhart Finance Company
Salt Lake City, Utah
December 31, 1981

Richard D. Wagner, President
Wagner Ford Sales, Inc.
Simsbury, Connecticut
December 31, 1980

Mary W. Walker, President
National Bank of Walton County
Monroe, Georgia
December 31, 1981

Chairman Emeritus

Leonor K. Sullivan
St. Louis, Missouri
December 31, 1980

The CHAIRMAN. I can offer a theory about the group.

Mr. VOLCKER. I have a theory, too. You offer your theory.

The CHAIRMAN. Let me offer mine. I will bet the lenders in that group were banks and credit card issuers who were delighted to be taken off the spot because they found that, owing to the usury statutes and other things, they weren't making any money on their credit cards. So they were just delighted to have Uncle Paul be the fall guy.

And I will bet the consumer advocates were well-meaning people, but hadn't really thought it through. They thought that credit cards were of a class of vanities against which the monk Savonarola inveighed 400 years ago.

Whereas, in fact, most credit card purchases help central city black young people get jobs as dishwashers and Latin ladies make beds in hotels, and Jewish couples make shirts—none of which activities I find either reprehensible or inflationary.

Mr. VOLCKER. My surmises are very similar to yours. At the same time, I don't think that those particular areas of the economy are ones that have been most affected by recessionary tendencies recently, and there has been an argument, which is repressed very strongly by some people, that when one looks at all the competing demands for credit in the economy, these are not of the greatest priority even now. I don't fully share the feeling that I can make that distinction as to which is of highest priority; I simply mentioned that that case is made by many people.

The CHAIRMAN. Well, I know. But you are in the driver's seat, and since I, who have been known to flirt with credit allocation in my day and generation, say "forget it" on this. I really wish you would.

I think you would be doing a lot of people a great favor. And send the advisory committee over to see me.

Mr. VOLCKER. I shall only say——

The CHAIRMAN. I would be glad to talk to them.

Mr. VOLCKER. I am interested in your comments.

The CHAIRMAN. That would be my No. 1 candidate for emancipation, in the March 14 program.

Mr. VOLCKER. I might say the indication is that that requirement is not particularly binding in any real sense now. It may be binding psychologically but, in fact, the amounts of credit do not appear to be rising to the point where any substantial number of people have to put up these deposits.

The CHAIRMAN. Right, which is all the more reason for removing the heavy hand of government. However, there is something that I wish you would keep until the last of the credit program. That is your excellent admonition first delivered last October to the banks in general to cut down on loans for speculation in commodities.

You were dead right when you first said it, and every time you have repeated it you have been dead right. And very frankly, I was a little shocked to find that 10 very big banks—billion dollar banks, every one of them, led by First National of Chicago, were grubstaking the Hunt brothers in March, right when they were engaged in their not very constructive activities. That is a different thing from coming to the rescue later on.

Mr. VOLCKER. I understand.

The CHAIRMAN. Those banks actually took as collateral, as I read it, bars of silver. Now, do they have the unparalleled gall to tell you that they did not know that their little loan was being used for silver speculation?

Mr. VOLCKER. I, of course, was not aware of those activities at the time they were undertaken. I have, I think I can say, been surprised and even shocked by the amount of that lending activity.

I am not thinking entirely of that particular loan that you mentioned, which, I understand, is part of the picture. But it also was my understanding that it was part of a credit line from two banks that had been arranged some time earlier, for presumably general purposes. It turned out it was secured by silver, as you point out, which should have raised some suspicions.

The CHAIRMAN. It is like finding a trout in the milk.

Mr. VOLCKER. I understand that. I don't know what can be said.

The CHAIRMAN. I think it would be useful, Mr. Volcker, if you could file for this subcommittee a complete account of it, including what the banks have to say about it. If they clean house, fine, let us hear about it; if they were innocent victims, and the bars were candy, all right, let us hear it. [Laughter.]

Mr. VOLCKER. We are preparing a full report about this whole period. We would be glad to make it available to this subcommitee or to the full committee.

The CHAIRMAN. I think Mr. Mitchell's subcommittee is the proper place, because they are tigers on this.

Mr. VOLCKER. That should be completed within a few days.

The CHAIRMAN. That would be fine.

[Mr. Volcker submitted the following report "Interim Report on Financial Aspects of the Silver Market Situation in Early 1980" for inclusion in the record:]

INTERIM REPORT ON FINANCIAL ASPECTS OF THE SILVER MARKET SITUATION IN EARLY 1980

Introduction

The purpose of this report is to set forth the facts and information currently available to the Federal Reserve in connection with the financial aspects of the sharp fall in silver prices that occurred in the late winter and early spring of 1980. Of particular concern in connection with this Interim Report are the questions pertaining to the extent and nature of the use of bank credit in connection with the overall episode, especially in the context of the Federal Reserve's credit restraint program. It appears clear that a combination of events -- including the general unsettled and speculative atmosphere surrounding severe inflation -- did produce a situation which had the potential for creating serious problems for individual financial institutions and for the financial markets generally. Many of the larger questions, including the underlying issues of the nature and extent of regulatory or legislative actions that might prevent a similar occurrence in the future, will be answered more fully in a further report.

The episode as a whole, and specifically the involvement of the Hunt and Hunt-related entities, is extremely complex, involving a large number of institutions, some with broad public ownership, others closely held; some domestic, others foreign or foreign-related; some financial, others nonfinancial. Also, the credit and credit exposures that ultimately emerged in the wake of the sharp drop in silver prices took a number of forms. There were direct "conventional" bank loans by both U.S. and foreign based banks to the Hunt and Hunt-related interests -- most of which were collateralized by silver. There were bank loans -- both domestic and foreign-related -- to brokers and commodity dealers and there were broker loans, financed by

internal sources of funds, to the Hunts. There was also credit extended by brokers and other corporate entities in the form of unmet margin calls on Hunt forward and future contracts in silver. Finally, there were bank loans, broker loans and unmet margin calls associated with the International Metals Investment Co., Ltd. (IMIC). The obligations in the United States of that venture in which the Hunts own a substantial interest are, as we understand it, guaranteed by the Hunts. Because of the many entities involved -- including foreign entities -- and the complexity of the transactions, all of the facts of the case may never be known with precision.

In light of the dimensions of the case, this report traces developments and events in chronological order and provides specific information regarding credit-related aspects of the episode.

1. Events prior to March 26

In the late summer and early fall of 1979, the Federal Reserve had been concerned about developments in commodity markets and particularly the apparent speculative attitudes that had driven commodity prices, and particularly precious metals prices, markedly higher. This concern was reflected in the Federal Reserve's October 6 policy changes, the announcement of which called specific attention to speculative tendencies in commodities markets. At that time, the Federal Reserve requested banks to avoid making speculative loans. The request at that time was in the form of "moral suasion" and did not have the backing of either regulation or specific reporting requirements. The message was contained in a letter which was sent to all U.S. banks, branches and agencies of foreign banks operating in the U.S., and to foreign central banks. In the ensuing several weeks, the prices of commodities in general eased. The price of silver stabilized at about $16 to $17 per ounce -- up from the level of $10 to $10.50 that had prevailed at the end of August.

In late November and early December, the silver price again rose sharply, as did some other commodity prices. That renewed outburst of price increases seemed, at the time, to be related to unsettled conditions growing in part out of heightened concern about oil prices and supplies and international political events. In this time frame, however, there were press reports and market rumors of irregularities in the silver market. Because of this, and because of the damaging impact on inflation and inflationary expectations of a renewed outburst of speculatively driven price increases in precious metals, the Federal Reserve made inquiries about the silver situation to the Commodity Futures Trading Commission. While we did not obtain any significant information beyond that generally available in the press, we were left with the impression that initiatives of the CFTC and the exchanges had the situation under close review. The price of silver continued to climb sharply, reaching an intra-day high of $50.36 on January 18. In retrospect, it is clear from published reports of the CFTC, that by this time the Hunts had and apparently were continuing to acquire massive positions in physical silver, silver futures and silver forwards.

During late 1979, and particularly in January 1980, the exchanges took a number of steps in the silver market, including imposing higher and graduated margin requirements, position limits, and limits on trading.

Throughout this period, the evidence available to us suggests that bank credit was not a major factor in connection with the acquisition or maintenance of silver positions by Hunt and Hunt-related interests. Indeed, the Hunts had apparently acquired a large amount of silver and silver positions prior to the sharp rise in prices and, to an unknown extent, may have pyramided those positions by using daily cash payouts on existing positions to acquire still larger positions when the silver price was rising. At this point, we have no evidence as to whether individuals and institutions on

the other side of the market were forced to finance their margin calls (which were paid out to the Hunts) via bank borrowing. However, it seems fair to assume that industrial firms that were short sellers of silver may have used existing bank lines to help meet the cash flow needed to make such payments. For such market participants, such bank loans, to the extent they occurred, would seem wholly appropriate. And, in those circumstances a refusal to lend to the shorts in the market by banks would have added still further upward pressures on the price of silver. In any event, the pattern of behavior on the upside of the episode is an area of continuing investigation.

The price of silver broke sharply lower in late January, but then stabilized in the $30 to $36 range until early to mid-March when the price again broke sharply, falling to a low of $11.10 at the close of business on March 27. Since that time, the price has fluctuated in the $12 to $16 range, even though it appears that a substantial volume of silver was sold into the market in late March and April. There remains, of course, the question of who acquired the silver that has been liquidated and for what purpose.

From the information we have been able to compile, it appears that substantially all of the bank and other credit accumulated by the Hunt interests related to silver was incurred in the first quarter of 1980 and most of that was incurred beginning in early February through the end of March. This would suggest that such funds may have initially been used in some limited way to meet higher initial margin requirements and, to a much larger extent, to meet maintenance margin calls as the price of silver dropped. At the time the Federal Reserve had no direct knowledge of the size of the Hunt positions or of the fact that they were financing margin calls by borrowings of any kind.

Beginning at mid-day March 26, when Chairman Volcker was first notified of the failure of the Hunts to meet margin calls, the Federal Reserve, in cooperation with the Office of the Comptroller of the Currency, undertook a series of special initiatives aimed at fact finding and analysis of the situation. Extensive discussions were held with other government agencies and officials aimed in part at initiating special inspections of involved brokers by the appropriate government agencies and the various exchanges. Special examinations of a number of banks were undertaken by the Federal Reserve and the Comptroller of the Currency which included sample verifications of silver warehouse receipts and silver. All involved banks were contacted to obtain information regarding loans to the Hunts; and all involved banks have been asked to provide written explanations of why such loans were made in the presence of the Federal Reserve request to avoid speculative lending; and, for the first time, under residual power contained in the International Banking Act, special examinations of branches and agencies of foreign banks were undertaken by the Federal Reserve.

Despite the scope and intensity of those efforts — which are continuing -- there are many aspects of the case, particularly those related to overseas activities and those relating to the circumstances that permitted the situation to develop in the first instance, that are still unanswered. However, from those investigations, it quickly became apparent that during February and March, the break in the price of silver gave rise to a substantial amount of borrowing by the Hunts. Credit to the Hunts, as it developed, took several forms which are described below. In looking at these data, it should be emphasized that in many instances, the data supplied is based on information gathered from a variety of sources and is therefore subject to some margin of error.

A. Direct Loans of U.S. Banks to the Hunts ($195 Million)

We have been able to account for about $150 million in direct silver-related loans to the Hunts by U.S. banks. These loans were secured largely by silver and to a much lesser extent by Hunt properties. An additional $45 million in borrowings secured by assets other than silver were taken down in March and early April. We do not know to what extent these funds were or were not used to meet silver-related obligations but the timing of the loans suggests that they may have been used for that purpose. Of the overall total $5 million was outstanding as of August 1979; $50 million was taken down in the first half of February; $95 million in the first half of March; and $45 million in the second half of March and the first week in April. The rates of interest on the loans ranged from prime plus 1/4% to prime plus 1%. Of the $195 million, $15 million was repaid on April 1; and $100 million was repaid on April 8, from funds advanced by banks that will be part of the $1.1 billion syndicated loan to Placid Oil. Thus, $80 million is still outstanding and of that total, we now expect that $35 million will be rolled into the $1.1 billion credit line.

B. Loans by U.S. Banks through Placid Oil Company ($115 Million)

Between mid-March and early April, we have reason to believe Placid Oil loaned or advanced at least $110 million to the Hunt brothers. While we do not have full details on these loans, it does appear that most of these advances may have been funded by loans from U.S. banks to Placid. For example, $50 million in bank loans were extended to Placid in mid-March and another $65 million on April 1. These loans were at rates of prime plus 1/2% to prime plus 1%. The banks loans have since been reduced to $80 million which presumably will be repaid or rolled into the new syndicated loan to Placid.

C. Direct Loans by U.S. Branches and Agencies of Foreign Banks to the Hunts ($230 Million)

As we now understand it, direct loans by foreign banks to the Hunts secured by silver peaked at about $230 million in mid-March. These loans appear to have been funded out of the U.S. branches of the foreign banks and thus would seem to qualify as "domestic" credit. Of the total, $65 million was taken down in 1979; $50 million in the first half of February; $68 million in the second half of February; and $47 million in the first half of March. The rates of interest were 3/4 of 1% to 1% above prime. The loans have been reduced by about $65 million from their peak level, in part by advances to Placid Oil by U.S. banks in anticipation of the large syndicated loan to Placid/Hunt. The balance due now totals approximately $175 million and presumably will be repaid by the proceeds of the new syndicated loan to Placid.

D. Indirect Loans by U.S. Banks ($260 Million)

There were also about $260 million in silver-related loans by U.S. banks to a brokerage house, the proceeds of which were then made availabe to the Hunts by the brokerage house -- presumably to meet margin calls. Some of these loans were advanced under existing lines of credit and were secured by silver. The interest rates to the brokerage house were generally at prime. From our discussions with the lending banks, it appears that most of the banks had the impression that they were providing funds to the broker against fully hedged positions and certain banks indicated that initially they were not even aware that funds advanced were used to support Hunt silver positions. One of these banks holds both silver and gold bullion as collateral. Of the total, $33 million was advanced in 1979; $26 million in January of 1980; $143 in early February; and $60 million during the last week of February. Most of these loans were substantially

63-971 O - 80 - 6

reduced or liquidated in early April by the proceeds from the sale of collateral. Of the indebtedness remaining after the silver liquidations, about $34 million of the balance will be reduced from the settlement of silver already sold for future delivery, which will leave approximately $10 million outstanding.

E. Indirect Loans and Credits by Foreign Banks and U.S. Branches and Agencies of Foreign Banks ($215 Million)

It now appears that about $215 million was indirectly supplied to the Hunts by foreign banks and their branches and agencies in the U.S. About $115 million of this was in the form of silver backed loans to brokers (the proceeds of which were advanced to the Hunts). These loans (a small part of which were actually funded by a U.S. bank) appear to have been funded out of the U.S. agencies and branches of the foreign banks and thus are "domestic credit." And, up to another $100 million in obligations was in the form of margin calls on silver forwards at the overseas offices of foreign banks. At this time we do not have detailed information on the terms and timing of these obligations. Of this overall total, about $100 million remains outstanding and the remainder was paid off by funds advanced by U.S. banks in anticipation of the Placid syndicated loan.

F. Direct Broker Loans ($100 Million)

We understand that brokers also supplied the Hunts with silver backed loans in excess of $100 million from their own funds. We believe about $75 million of such loans are still outstanding and will be repaid from the proceeds of the Placid/Hunt syndicated loan.

G. Obligations of the International Metals Investment Co., Ltd. (IMIC) ($200 Million)

As noted earlier, the Hunts own a substantial interest in IMIC and fully guarantee certain of that company's obligations in the United States. As we

understand it, IMIC obligations in the U.S. secured largely by silver include: (a) a $25 million bank loan made on October 10, 1979; (b) a broker loan of about $25 million that was reportedly made sometime in early 1980; and (c) as of early May about $150 million in various broker-related obligations. The latter obligation may have been considerably larger early in April and is being reduced by liquidations of silver futures and forwards. (We do not know the nature and extent of IMIC obligations or positions abroad.) All of these U.S. obligations are secured largely by silver but we do not have details on the precise time when such obligations were incurred. The broker loan and the other U.S. obligations of IMIC to brokers presumably will be paid off by the proceeds of the syndicated loan to Placid Oil.

H. Obligations to Nonfinancial Concerns ($450 Million)

We know of one major Hunt obligation to a nonfinancial concern (The Engelhard Mineral and Chemicals Corp.) that arose out of Hunt forward contracts to buy silver at prices well in excess of the price of silver at the time of delivery. We understand that those contracts entailed a gross obligation of about $700 million which was only partially secured by silver and/or other collateral held by Engelhard. Because of these circumstances, settlement of the contracts on March 31 would have required the Hunts to make a cash payment to Engelhard that is estimated to have been in the range of $400 to $450 million. This obligation, as noted below, was settled by an exchange of assets.

To summarize, on or about March 31, we have been able to identify Hunt and Hunt-related obligations associated with silver as follows:

Direct Loans by U.S. Banks to the Hunts	$ 195
Loans by U.S. Banks through Placid Oil Company	115
Direct Loans by U.S. Branches and Agencies of Foreign Banks to the Hunts	230
Indirect Loans by U.S. Banks	260
Indirect Loans and Credits by Foreign Banks and U.S. Branches and Agencies of Foreign Banks	215
Direct Broker Loans	100
Obligations of the International Metals Investment Co., Ltd. (IMIC)	200
Obligations to Nonfinancial Concerns	450
Total	$1,765

In a number of instances, particularly in respect to obligations of IMIC and the obligations to foreign banks, we do not know, with precision, the timing and other details as to when the obligations were incurred. However, by making some assumptions about timing in these areas, we have pieced together a week by week estimate of debts incurred by various classes of institutions. These estimates suggest that the level of total obligations increased sharply first in late January and early February. This surge in borrowing broadly coincides with the initial drop in the price of silver for its high of about $50 per ounce to a price in the area of $35 per ounce. The Hunt borrowings trended higher during February but then moved sharply higher in mid to late March when the price of silver declined to the $12 range.

Looking just at bank credit, it appears that total bank credit associated with the episode probably peaked at $1.0 to $1.1 billion level in late March or early April. Of that total, it appears that $100 million was funded from abroad so that at

the peak, $900 million to $1 billion of domestic bank credit was involved. Of that total, about $125 million dates back to 1979. The major increases in domestic bank credit occurred in early February when such loans rose by $350 million and between March 6 and April 1 when the aggregate domestic loans rose by more than $250 million. For the months of February and March combined, the use of domestic bank credit in connection with this situation increased by $800 million. By contrast, total business loans and total bank loans rose by $6.2 billion and $9.3 billion on a nonseasonally adjusted basis, respectively during this two month period.

There were a total of 12 U.S. banks, 4 branches and agencies of foreign banks and 1 foreign bank that, as of early April, were significant silver-related creditors of the Hunts. In eight out of 12 cases involving U.S. banks, the amounts of loans outstanding were relatively modest and were, in most cases, in the form of loans to brokers. Five of the eight banks with such loans used the discount window on at least one day during February/March. However, the patterns of discount window use by all of these institutions are not unusual during the period particularly in the light of overall money market conditions and the modest size of the Hunt loans.

The four banks that were somewhat larger creditors to the Hunts all used the discount window during February/March; one bank on one occasion; one bank on two occasions; and two banks on four occasions. Most of these borrowings were on Tuesday or Wednesday, and therefore were associated with ends of statement weeks. In the case of two of the four banks, the timing of the use of the window relative to the timing of the Hunt loans makes it clear that there is no -- or at the very worst a very indirect -- relationship between the two. In the case of one of the remaining two banks that were larger creditors to the Hunts, the institution did borrow several times during a statement week in early March. At that time, the institution was not

increasing its loans to the Hunts. Thus, while those borrowings were relatively large, amounting to $80 million on average for the statement week, they do not appear to be directly related to Hunt lending. Finally, in the case of the remaining bank, there is an approximate coincidence of timing in two statement weeks between discount window borrowings and Hunt loans in the second half of March. In both cases the borrowings were for one day only on a Wednesday (the end of the statement week) and the amounts were not unusual. On a daily average basis, for the three weeks in question, the borrowings amounted to about $25 million which, as a matter of pure arithmetic, may be said to have funded part of a Hunt-related loan at the institution in question. However, neither the Hunt loan nor the timing or amount of the discount window borrowings were not out of keeping with the size of the bank. In summary, therefore, we can find no evidence of unusual activity at the discount window during this period that can be related to the silver market situation or to the Hunts.

As the amount of Hunt obligations became apparent to the Federal Reserve in late March, the immediate concern of the Federal Reserve and that of other government agencies related to the potential implications of the situation for the financial markets generally. Those concerns reflected not only the situation in the silver market but the uneasiness that characterized markets in general at that time. While all of these obligations were secured, the collateral in most cases was silver. And, as the price of silver declined, the margin on such loans became very thin and in some cases the value of the collateral actually fell below the amount of the loans. Thus, in the extreme, the creditors were faced with the prospect of recouping their funds by forced liquidation of silver that could, from their viewpoint, further undermine the value of the collateral and accentuate their risk. And, in these circumstances, there was always the threat that a localized problem could quickly spill over to affect other institutions and markets.

As Chairman Volcker has indicated in his Congressional testimony, during the period immediately after the sharp break in the silver price, the Federal Reserve, the Treasury, the SEC and the CFTC spent considerable time and effort trying to ascertain the facts of the case -- which while reasonably clear now -- were far from evident at that time. Subsequently, the price of silver -- which is a world price -- did stabilize on Friday, March 28, thereby halting the erosion of the value of the collateral being used to secure most of the obligations referred to above.

2. The March 28 - April 5 Interval

In the days immediately following March 28, some of the edge was taken off the situation by two developments: first, agreement was reached for a settlement of the Hunt indebtedness to the Engelhard firm referred to above; and second, the continued stability of the silver price at $12 to $14 per ounce permitted other creditors to begin to liquidate silver in an orderly fashion and thereby eliminate their exposure. For example, one brokerage firm was apparently able to sell a significant amount of the silver it held against its own bank loans and thereby repay most of that bank credit in early April. It appears that such silver sales were undertaken both in the U.S. and abroad.

The Hunt/Engelhard transactions which were negotiated on Monday, March 31, have been the subject of much confusion. As noted earlier, this situation grew out of several substantial forward contracts entered into by the Hunts and Engelhard in mid-January 1980. Under these contracts the Hunts were to take delivery on physical silver over the period January 31 to July 1. The contract prices generally reflected market prices in mid-January when the transitions were made and some deliveries were made prior to the sharp drop in silver prices in late March.

Late on Friday, March 28, the Federal Reserve learned of these large forward contracts. Settlement on most of them was due after the weekend, with no apparent prospect for payment, and the collateral held by Engelhard was far short of the total obligation. Engelhard, while itself in a strong profits and asset position, felt they might be faced with a decision on Monday to sue the Hunts for payment, forcing probable bankruptcy and possibly triggering massive liquidation of silver positions to the peril of all creditor institutions (and indirectly placing in jeopardy the customers and creditors of those institutions in a financial chain reaction). The alternative, as the company saw it, was to negotiate with the help of some banks a credit to the Hunts or intermediaries that could provide time for repayment and avoid forced liquidation of silver in an already nervous, depressed market. On March 29, the Federal Reserve was informed in a very general way that the parties intended to explore such an approach to resolving the Engelhard situation. In that time frame the question immediately arose as to whether such a credit would be considered "speculative" within the context of our credit restraint program.

After informing other government agencies of this development and considering with them all the implications of the matter, Chairman Volcker interposed no objection to Engelhard pursuing whatever negotiations the company felt essential to protect its own position, but made it quite clear that the net result should not be to free funds for renewed speculative activity by any of the parties. In view of the wider implications, Chairman Volcker asked to be kept informed of the progress of any negotiations and the nature of any implications of their negotiations for the market and for speculative activity.

While fulfilling a speaking engagement before the Reserve City Bankers Association meeting in Boca Raton, Florida, that weekend, Chairman Volcker learned

that the Engelhard and Hunt interests would together approach a group of banks with a refinancing proposal late in the evening on March 30 in Boca Raton. While the nature of that proposal was not known to Chairman Volcker, he again asked to be kept informed because of the potential implications for the silver and financial markets. Subsequent to the negotiation (and well after midnight), he again was informed that the banks had, or planned to, reject the proposal by the Hunts and Engelhard on business grounds. Neither Chairman Volcker, nor any other government official, either instigated or guided those negotiations.

Following the rejection of the proposal to consolidate and restructure the Hunt silver indebtedness, negotiations proceeded through much of the night directly between the Hunts and Engelhard. The results of those negotiations, involving in part the transfer of certain oil properties owned by the Hunts to Engelhard, became known to Chairman Volcker in the morning of March 31, and were announced the same day. This settlement which essentially involved an exchange of assets and involved no credit, have the effect of fully clearing up all outstanding contracts and obligations of the Hunts to Engelhard. That transaction has not yet been consummated in part because the exchange of assets required the release of nonsilver assets that had been securing bank loans and because of the need to obtain the approval of the Canadian Government for the transfer of certain oil leases in Canada to Engelhard.

In the following days, the Federal Reserve and other agencies continued efforts to develop more comprehensive information on the extent of Hunt and Hunt-related obligations and to appraise the potential vulnerability of banks and other intermediaries. While very large amounts of credit remained outstanding, those creditors who had appeared to be in the most vulnerable position appeared to have extricated themselves, albeit with some losses (some of which, at least, have since

been recouped). Together with representatives of other agencies, the Federal Reserve turned its attention to ways of developing means of avoiding extreme speculative episodes of this kind in the future, with all their implications for the stability of financial institutions and financial markets.

3. The Period from April 5 to the Present

The large syndicated bank loan to Placid Oil which has been the subject of so much attention first came to the attention of the Federal Reserve on Saturday, April 5, when the general thrust of the concept was relayed to Chairman Volcker in a telephone call from a senior official of one of the lead banks. From that discussion, the Federal Reserve concluded that the banks and other creditors had, by then, more fully appraised their overall exposure to the Hunt interests in the context of the nature and amount of collateral available in connection with those existing credits.

The concept, discussed in general terms at that time and elaborated in a later call, entailed a method of restructuring the Hunt silver indebtedness in a manner that would greatly strengthen the security position of creditors with outstanding silver loans or contracts and facilitated the release of certain collateral by banks. In the process, new creditors would in some instances replace existing creditors, while other creditors would essentially exchange old loans with new. The new bank loans would be to and secured by the assets and earning power of perhaps the strongest of the Hunt-related companies, the Placid Oil Company. Control over the silver and silver contracts, with appropriate safeguards, would pass into the hands of that same company. Silver-related loans to the Hunts would be paid off. The immediate result would be to protect more securely the interests of existing Hunt silver creditors, bank and nonbank. In doing so, the risk associated with such positions diminished with obvious implications for the institutions and the markets generally. That result, in

itself, was not, and is not, contrary to the broad public interest in the stability of financial markets and institutions.

At that time, and in a general way, Chairman Volcker made it clear that his primary concern about any such loan would be that it not free funds for renewed speculation and that any such transaction would have to provide adequate safeguards in that regard. It was also indicated that such a loan would not receive special consideration within the framework of the Federal Reserve's 6 to 9 per cent guideline on loan growth. Chairman Volcker again asked to be kept informed of developments. Other government officials were informed of their discussions.

On Thursday, April 10, at the request of the banks, a meeting was held at the Office of the Comptroller of the Currency at which time further information concerning the negotiations was made available to the staffs of the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller. At that time, it was clear that the negotiations were proceeding along the general lines described above. But it was also apparent that the transaction was far from complete. There was clear evidence that the banks were seriously endeavoring to structure into the loan agreement the kinds of restrictions on speculation that Chairman Volcker had mentioned in his earlier conversation. The Federal Reserve again asked to be kept informed of the progress and status of the negotiations and subsequently suggested that at the appropriate time information about the loan and the restrictions should be provided to the Federal Reserve in writing. In the ensuing week the negotiations proceeded between the parties. At no point in the process was the Federal Reserve or any government official a party to such negotiations. Our only contact with the negotiations was via the officials of the lead banks and was directed solely at securing the appropriate restrictions on speculation.

The following week, the lead banks requested a meeting with the Federal Reserve to discuss further the specifics of the restrictions and limitations on speculation that would be part of the transaction partly so that those responsible for drafting the agreement understood our concerns first hand. Officials of the lead banks and attorneys representing the various parties met with Chairman Volcker and staff on Friday, April 18, at which time specific language concerning such restrictions was discussed. At that time, it was also made clear that the loan agreement would have to provide language to ensure the orderly liquidation of the remaining Hunt silver.

During the following several weeks the parties to the prospective transaction continued their private negotiations and the Federal Reserve staff was kept generally apprised of the status of the matter. In those negotiations between the banks and the Hunt interests, the nature and dimensions of the prospective transaction evolved further. As we now understand it -- and recognizing that the arrangement is not yet complete -- the essentials of the transactions are as follows:

(a) A syndicate of 11 domestic banks and 2 foreign banks would establish a line of credit to Placid Oil (which is owned by the Hunt family trusts but not by the Hunt brothers) in the amount of $1.1 billion. The credit line would be fully secured by substantially all of the oil and gas properties of the Placid Oil Company thereby isolating the creditors from vulnerabilities associated with a further fall in the price of silver.

(b) The Hunt brothers and a newly formed wholly-owned subsidiary of Placid would form a limited partnership. The Placid subsidiary would be the sole general partner and the Hunts the limited partners. The Hunts could exercise no control or influence over the partnership. The proceeds of the loan would fund Placid's contribution to the partnership. The remaining

Hunt silver and certain of their other assets would be transferred to the partnership, subject to existing Hunt silver loans. Thus, while the creditors are protected from a fall in the price of silver, the Hunts and the partnership are not.

(c) Over time, and with the assistance of independent third party expertise, the silver (and, if needed) other assets contributed to the partnership by the Hunts will be liquidated and the proceeds of such liquidations would be required to be distributed to the partners to pay the interest and principal on the loan to Placid. The pressures associated with servicing this debt, to say nothing of repaying its principal, should help ensure that such liquidations will occur in a reasonable time frame.

(d) The loan will be guaranteed by all material Placid subsidiaries and by the Hunt brothers, and the Hunt guarantee will be secured by liens on substantially all assets of the Hunt brothers. The loan will be further secured by the general partner's right to receive distribution from the partnership.

(e) The agreements relating to the partnership and the Hunt guarantee provide that the Hunts and all related entities cannot make any new investments in securities (except appropriate money market instruments) or take any position in commodities or any other futures position for <u>any speculative purpose or otherwise</u> while the Placid loan is outstanding or the partnership is in existence except investments necessary for the prudent operation of the farm, ranching and sugar businesses owned by the Hunts. Furthermore, the Placid loan agreement prohibits Placid, while the loan is outstanding, from engaging in any similar speculative activity including using the

proceeds of the loan to finance acquisitions that would be inconsistent with the intent and purpose of the credit facility.

(f) Special accounts, subject to independent audits by a major public accounting firm, will be established to control all such funds.

(g) Records regarding the use of funds, the liquidation of assets, and other relevant aspects of the transactions of the Hunts and the Partnership will be available to the Federal bank regulatory agencies.

As noted above, the line of credit under the agreement will be $1.1 billion; however, it is presently estimated that the amounts to be actually advanced will total about $950 to $990 million.

In order to reconcile the prospective payments of $950 to $990 million with the total obligations of $1.765 billion noted earlier, it must be kept in mind that the estimate of $1.765 billion has been significantly reduced by (a) the Hunt/Engelhard exchange of assets ($450 million) and (b) the liquidation of silver collateral and silver positions by brokers which, in turn has permitted the repayment of bank loans and the reduction of the brokers own direct exposure to the Hunts. While we do not have information on all of these latter transactions, the information which is available suggests that such liquidations probably have reduced the total Hunt obligations by at least $300 million and perhaps by as much as $400 million since late March. Other things being equal, these developments would place the current level of the Hunt obligations in a range of $900 million to $1 billion which is not out of line with the payments we now expect will be made from the $1.1 billion credit facility to Placid Oil.

However, in looking at these prospective payments, it must also be kept in mind that beginning on April 8, a group of the banks that comprise the syndicate that will make available the $1.1 billion credit facility to Placid advanced about $300

million to Placid. In turn, Placid used those funds to pay off some of the then existing creditors of the Hunts. Thus, these advances by U.S. banks to Placid have already had the effect of restructuring some of the Hunt obligations as of March 31. After making allowance for these developments, we anticipate -- in very approximate terms -- that the loan takedowns under the $1.1 billion credit facility will be used in the following manner:

(a)	Repayment of interim U.S. bank loans to Placid Oil made in anticipation of the $1.1 billion credit facility which in turn had been used to repay (1) $100 million in direct U.S. bank loans to the Hunts; (2) $50 million in indirect loans to Hunts (via brokers) made by U.S. branches of foreign banks; (3) almost $100 million in obligations to foreign banks; and (4) $50 million in miscellaneous obligations to brokers and others.	$300M
(b)	Repayment of other advances by Placid Oil which should permit Placid to repay $80 million in outstanding silver secured loans to U.S. banks.	$110M
(c)	Repayment of direct Hunt loans by U.S. branches and agencies of foreign banks.	$175M
(d)	Repayment of indirect loans to Hunts (via brokers) made largely by U.S. branches of foreign banks.	$100M
(e)	Repayment of remaining Hunt and IMIC broker loans and obligations.	$260M
(f)	Repayment of direct loans by U.S. banks to Hunts	$ 35M
		$980M

The difference between the anticipated takedown of $950 to $990 million and the total credit facility of $1.1 billion reflect, in part, a cushion that will cover any shortfall arising from liquidations of remaining forward or future positions and/or the sale of assets. That cushion may never be used and, to the extent it is, those disbursements are subject to the same terms and conditions governing the overall agreement.

The amount of this credit is, of course, very large and the circumstances under which it arose are clearly extraordinary. However, looked at in its totality, the transaction may fairly be viewed as a complex debt restructuring in which current and prospective creditors are seeking to strengthen their positions and one in which the debtors are seeking to consolidate obligations and insulate themselves from any of several eventualities that could result in further needs for cash. The credit is, and always has been, a strictly private transaction in which business, credit and other judgments have been made by the parties themselves with no guidance, suasion or other efforts by the Federal Reserve to influence the nature and the terms of the credit other than those related to the limitations on speculation. And, while it should be clear that the credit, taken in its totality is, in fact, a restructuring of existing obligations rather than the creation of new credit, total bank loans will increase somewhat under the credit because they will be, in some instances, substituted for existing credit supplied by brokers from their own funds. Finally, by virtue of the fact that the debt restructuring strengthens the position of creditors, it is not contrary to the broad public interest in the stability of financial markets and institutions.

The credit also has the result of stabilizing, to some unknown extent, the financial position of the Hunts themselves. We do not know the financial position of the Hunt brothers when allowance is made for the fact that the brothers do not have

access to the principal amount of the family trusts. It is clear, however, that they have assets and relationships that have permitted this transaction to be put together to the satisfaction of the prospective creditors. In the absence of the Federal Reserve Special Credit Restraint Program the credit may well have been arranged and put in place without any prior knowledge of the Federal Reserve or other government officials. Looked at in that light, the fact of the Credit Restraint Program has permitted the Federal Reserve to insist on the limitations on speculation which are a part of the transaction and which are in the public interest.

In short, the $1.1 billion restructuring of debt is the result of an unhappy chain of events that had occurred earlier and, in the extreme, posed a serious threat to certain financial institutions and to the markets generally. Thus, the focus of public policy should be on the conditions and circumstances in the fall of 1979 and in early 1980 that permitted the situation to develop in the first instance. It is to that end the Federal Reserve, in consultation with other government agencies and representatives of the private sector, has now turned its attention.

The CHAIRMAN. I am sorry we are not closer together on H.R. 7001. I will listen to you——

Chairman MITCHELL. If the Chair could interrupt this congenial conversation, the House is now back on the business of building up the military budget. I believe that we might have to get to the floor.

I do thank you, Mr. Chairman and Chairman Volcker, for being here. However, I am sorry that you, Chairman Volcker, did not find any redeeming features in the bill. I have a vintage bottle of Madeira that maybe we can share, and perhaps under that circumstance you might be able to see some redeeming features.

Mr. VOLCKER. I would not want to be in the position of saying "no redeeming features," Mr. Chairman.

Chairman MITCHELL. Could I amend that to "few, if any"?

Mr. VOLCKER. I have had to look pretty hard to find them, I must say. [Laughter.]

But I do have the feeling, if I may just repeat the point I started with, that we are in the midst of a rather massive structural change, I suppose I can call it, a change in the structure of the Federal Reserve System, with all these new institutions holding reserves, and with other additional powers under the new bill. I think this does raise questions in some of these areas of governance.

My answers would not necessarily be in the same direction as Mr. Reuss; but I think, as things settle down a bit, there are

questions here that should be resolved—dealing with the stockholding issue and other aspects.

Chairman MITCHELL. Yours is a close call approach, rather than do it immediately.

Mr. VOLCKER. Right.

Chairman MITCHELL. All right. Before this hearing adjourns, I just want to again take the opportunity to plead with you to watch M_{1B} closely. I think if the money supply does not grow in the next couple of months, this country is in for serious difficulty. You have already expressed your concern, but I want to reiterate my concern. I do not think the recent undershooting spells disaster, but it will cause something approaching a disaster if it is not corrected quickly.

Mr. VOLCKER. I understand.

Chairman MITCHELL. Thank you very much.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[The following letter was received from the American Bankers Association for inclusion in the record:]

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

EXECUTIVE DIRECTOR
GOVERNMENT RELATIONS

Gerald M. Lowrie
202/467-4097

May 8, 1980

Honorable Henry S. Reuss
Chairman, Committee on Banking,
Finance and Urban Affairs
United States House of Representatives
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your request for comments on HR 7001, a bill to alter the structure of the Federal Reserve System. This bill was discussed at our Banking Leadership Conference on April 28th and 29th. The Banking Leadership Conference is composed of over 400 involved bankers from every size and type of bank and every state in the nation. The Conference provides a forum for developing a consensus on major issues affecting the entire banking community. I would like to relay to you the results of the discussion of HR 7001 at our April Conference.

We believe that this legislation would not improve the structure of the Federal Reserve System. We specifically object to eliminating the opportunity of Reserve Bank Presidents to vote on open market policy, the primary tool of monetary policy. A similar proposal was considered and rejected during the legislative process that led to the creation of the Federal Open Market Committee in the Banking Act of 1935. Eliminating the vote of Reserve Bank Presidents on open market policy would lead to an unwarranted centralization of power within the Federal Reserve System. Concern over excessive centralization within the Federal Reserve System has always been an important factor in the evolution of its structure. This concern dates back to politicization of financial management that occurred under the First and Second Banks of the United States. We believe this concern is as important today as it has ever been.

HR 7001 would give Reserve Bank Presidents the responsibility to advise on open market policy through the reconstituted Federal Advisory Council. We do not believe this is sufficient. To have any real influence on open market policy, the Reserve Bank Presidents must have some vote in that policy. The influence of the Reserve Bank Presidents is important in the formulation of open market policy, partly because they have access to information about business and financial conditions in various regions of the country that may not be readily available to members of the Board of Governors based in Washington. Through frequent contact with individuals and institutions in their districts, the Reserve Bank Presidents gain an understanding of regional business and financial conditions that may never be captured in national data. This valuable information should be considered in making decisions on monetary policy. We do not believe it will receive adequate consideration if Reserve Bank Presidents are denied a vote on open market policy.

We view the proposed retirement of Federal Reserve stock more favorably. The holding of Federal Reserve stock has less significance now that most depository institutions are subject to reserve requirements set by the Federal Reserve. We would be willing to explore with the Chairman the conditions under which the Federal Reserve stock might be retired. Nevertheless, we are unwilling to do so in conjunction with the proposals described above, which we feel would result in a less effective process for determining open market policy.

We appreciate the opportunity to present our view on this issue.

Sincerely,

Gerald M. Lowrie

GML/rbh