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THE FEDERAL RESERVE SYSTEM

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

CONDUCTED BY

HON. WRIGHT PATMAN

The Late Vice Chairman of the Joint Economic Committee

JANUARY 3, 1977

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LETTER OF TRANSMITTAL

DECEMBER 28, 1976.

To the Members of the Joint Economic Committee:

This study of the history of the Federal Reserve System, in its way, is an epitaph to a charter member of the committee and one of the most public interest minded Members of Congress, the late Representative Wright Patman, who died March 7, 1976.

It is the last project in his long effort to convince the Congress and the American public that a stable, full employment economy requires meaningful reform of the Federal Reserve System and Federal bank regulatory agencies. To this end the study and the accompanying documents, herewith transmitted to members of the committee, reflect his commitment to "educate" his colleagues and the people throughout the Nation about the Federal Reserve System, how and why it came to be formed, the way in which it functions, the crucial effect its activities have on our economy, and its relationship to the American banking industry and other financial institutions.

In essence, the study is a final demonstration of Wright Patman's unswerving faith in our democratic system and the people of the Nation. He never doubted that the American public would demand change if it was armed with the facts. As a result, he devoted much of his career, both as chairman and vice chairman of the Joint Economic Committee and later as chairman of the House Banking and Currency Committee, to sustaining a public dialog concerning the intricacies of the Federal Reserve and the significance of its monetary policies to the welfare of the Nation.

The core of his concern with the Federal Reserve System was the way in which its monetary policies affect the availability and cost of credit to "the common people—the little people who go out and fight for the Nation during time of war and build it up in peacetime." Many of us who served with him on the Joint Economic Committee, which was established by legislation which he cosponsored, can still hear him lecturing the Federal Reserve on the relationship between monetary policy and interest rates which "affect the price of groceries on the shelf" and all other products and services which are essential to the working people of the Nation.

In this respect he was convinced that establishment of a "good, reliable source of funds at reasonable cost" is essential to meeting the Nation's priority needs—solving the country's chronic low- and moderate-income family housing problems, providing State and local governments with the resources to finance vital public works and facilities and assuring that small business achieves and sustains a position of real competitive strength in the market place.

As chairman of the Subcommittee on Economic Progress of the Joint Economic Committee, Mr. Patman authorized and personally directed this detailed study of the Federal Reserve, which was conducted by Prof. Arthur Keeffe. The project was still underway at the time of Mr. Patman's death. Professor Keeffe completed the research then underway, carrying the history of the agency from its inception in 1913 through the mid-1960's. It is hoped that at some future date the committee will be able to undertake additional research which will complete this historical record of the Federal Reserve.

Among other things the study chronicles the special session of Congress which adopted legislation establishing the Federal Reserve System, how the Federal Reserve banks were organized, how the New York Bank came to occupy its prominent position in the System, the organization and operation of the Open Market Committee, the legislation of 1933 which altered the structure of the System, the removal of Federal Reserve Board Chairman Marriner Eccles by President Truman, and the battle between President Johnson and Federal Reserve Board chairman William McChesney Martin over monetary policy.

There follows an appendix which includes correspondence and speeches by Mr. Patman dealing with operations of bank holding companies, bank disclosure, the adequacy of bank regulation in connection with the failure and subsequent sale of the Franklin National Bank, the advisability of allowing foreign branches of U.S. banks to underwrite securities while they are prohibited from doing so domestically, the controversial Federal Reserve monetary policy actions which resulted in expanding the money supply while President Nixon was running for reelection in 1972, and the restrictive monetary policy adopted by the Federal Reserve in 1975 which ran counter to the tax reductions voted by Congress in that year.

The appendix is highlighted by two well-known law review articles by Mr. Patman, "The Federal Reserve System: A Brief for Legal Reform," and, "What's Wrong With the Federal Reserve System and What To Do About It." These two articles present the basic rationale articulated over the years by Mr. Patman for meaningful reform of the Federal Reserve System—proposals which, thanks in large part to his determined efforts, have in some instances finally been moved to the forefront of congressional consideration.

The reforms proposed by Mr. Patman include:

1. Reducing the terms of Federal Reserve Board members from 14 to 5 years and making the term of Board Chairman coterminus with that of the President to help assure that monetary policy conforms with fiscal policy.

2. Canceling all but $10 billion of the $82 billion in Federal securities held in the Federal Reserve's open market trading portfolio and requiring the System to operate on appropriated funds, thus making it totally accountable to Congress and the administration for its policies and activities. The $10 billion remaining in the portfolio would be sufficient to implement monetary policy decisions.

3. Requiring the Federal Reserve to be subject to full-scale audits conducted by the General Accounting Office.

4. Creating a single Federal bank regulatory agency to perform the duties that are now performed by the Federal Reserve, the Comptroller of the Currency and the Federal Deposit Insur-

ance Corporation in order to eliminate costly overlapping jurisdictions and contradictory regulatory decisions.

It is in his advocacy of reform of the Federal Reserve System that Mr. Patman provided his most valuable service to the Congress and the Nation. No one had equaled the tenacity with which he has endeavored to rivet national attention on the Federal Reserve Board and the Open Market Committee and tried to hold them accountable to the American people. His work in this field alone has proven to be of enormous importance.

It is a source of both pride and pleasure for me, as chairman of the committee, to see the publication of this study. It conveys information of lasting value and it traces dramatic chapters in the congressional career of a man whose place in history as one of the Nation's most dedicated public interest champions is secure.

Arthur John Keeffe, of the JEC staff took major responsibility for the preparation of the manuscript with the assistance of Jane D'Arista of the staff of the House Banking and Currency Committee. The following also provided research and editorial assistance: Robert Abrams, Dennis Braddock, Madelon Campbell, John Cummins, Adele Geffen, Eric Gressman, Faith Grossnickle, Harry Jorgenson, Francine Kushner, Peter Lahey, William Francis Larkin, Robert Lord, Jean Danneberg O'Malley, John D. Raffaelli, and Paul Tierney.

Sincerely,

HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee.

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I. THE FEDERAL RESERVE ACT OF 1913 BECOMES LAW

In 1913 some Americans could recall five panics: Black Friday in 1869 when Jay Gould and "Jubilee" Jim Fisk cornered gold; Black Thursday, 1873, when, after wild speculation in railroad stocks, the Cooke banking house failed; the panic of 1884 when President Grant's brokerage firm, Grant and Ward, and the Marine National Bank, failed: the panic of 1893 when Baring Brothers in London failed, and the panic of 1907 when Heinze and Morse, to their regret, cornered copper, (Robert Sobel, "Panic On Wall Street: A History of America's Financial Disasters," MacMillan Co., New York, 1968).

Black Friday 1869

The panic of 1869 descended on Wall Street after two speculators, Jay Gould and "Jubilee" Fisk, unsuccessfully tried to corner the gold market by purchasing the metal at artificially inflated prices. Their scheme failed when the Treasury, under President Grant's orders, put an additional $10 million in gold on the market. However, before news of the imminent crash became public, Gould and Fisk managed to pull out with their share, leaving other speculators to bear tremendous losses.

Undaunted by the gold fiasco, Gould went on to find success in railroad speculation. "Jubilee" Jim Fisk met quite another fate. When Fisk ceased making payments to Edward Stokes who shared his mistress, Josie Mansfield, Stokes released to the press Fisk's love letters, and on January 6, 1872. shot and killed him as he ascended the stairs of the Grand Central Hotel in New York. (Sobel, supra, 115–143.)

Black Thursday 1873

A year after Fisk's death, Jay Cooke's wild speculation in railroad stocks and the failure of his bank resulted in another panic. With the help of Horace Greeley and other influential personalities, Cooke, himself a well respected Wall Street figure, duped many investors into taking stock in the Northern Pacific Railway. Its problems were no different from those of other railroads at the time, or of real estate investment trusts today, with overexpansion of borrowed money it could not repay.

As a result, Jay Cooke's banking house closed its doors on September 17, 1873, causing the New York Stock Exchange for the first time in its history to close. and the Nation for the next 6 years to wallow in the panic of 1873. (Sobel. supra, 154–196.)

President Grant's Panic of 1884

Just as we were recovering from the devastating effects of the depression of 1873, Wall Street experienced a sudden relapse—the failure of Grant and Ward and the Marine National Bank in 1884. Grant's partner, Ferdinand Ward, and James D. Fish, President of Marine National, used the funds of investors and depositors to play the stock market. Bad investments outnumbered good, and both men sustained heavy losses at the expense of unwary Marine National depositors.

Once the shaky condition of Marine National was revealed its depositors wasted no time in withdrawing their funds. The failure sparked a run on other banks, and the large Metropolitan Bank failed shortly thereafter. Numerous banks and brokerage houses followed suit.

As a partner of the fallen brokerage firm, Grant lost his entire fortune. Aided by one of his administration's most ardent critics, Samuel Longhorne Clemens (Mark Twain), Grant paid his many debts by writing his memoirs which became a best seller. But Grant did not enjoy his new fame as an author for long because he succumbed to cancer of the throat in the fall of 1885. (Sobel, supra 197–299.)

Panic of 1893

But the panic phenomenon did not end with Grant's death. Along came the panic of 1893. During the last decade of the 19th century the country suffered from a depression that would not be surpassed in severity for 30 years. (Sobel, supra, ch. 7 at 230–272.)

At the turn of the 19th century America was a land of ubiquitous dissent. Business interests wanted a higher tariff to prevent entry of foreign goods into the country. Farmers wanted a new silver purchase act to create more money. To satisfy both, Congress in 1890 passed the Sherman Silver Purchase Act, and in 1890 the McKinley Tariff Act.

Neither act produced the desired effects, and the failure in 1890 of the London banking firm of Baring Bros., which specialized in financing American enterprises, touched off a scare among European creditors who demanded that henceforth American debt be paid in gold. This caused depositors to withdraw their money from the banks, and the tremendous strain put on them by massive withdrawals could not be eased even through the issuance of clearinghouse certificates—scrip which acted as a new currency.

Stocks and brokerage houses soon fell victim to the panic. Anna Roberson Burr, in her biography by James Stillman, tells us that within a year of 1893 panic there were over 600 bank failures, and that 13 out of every 1,000 businesses failed. ("Portrait Of A Banker," Arno Press, New York, 1927.)

The banking community was divided. John D. Rockefeller was mad at Morgan, Jacob Schiff of Kuhn Loeb and Co., was "livid with rage" at the expulsion by the Republicans of Theodore Seligman from the Union League Club because he was Jewish, and gold reserves were down to $9 million, with a check for $12 million about to be presented.

In this aftermath of the 1893 panic it was 56-year-old J. P. Morgan who saved the country from financial disaster, with the aid of European bankers, by negotiating with President Cleveland for the flotation of a $100 million bond issue. (Sobel, supra ch. 7, esp. 249, 265–266.)

Juxtaposed against the severe depression of the 1890's, the revival of economic activity during the infancy of the 20th century was, to many Americans, a sure sign of progress. Exports had nearly doubled, and industrial production was increasing along with the amount of money in circulation. However, a worldwide demand for investment money increased, worldwide gold production decreased, causing a worldwide capital shortage.

In America, concern over the uncertain state of the business world was intensified by the antibusiness stance of Theodore Roosevelt's administration. Unprecedented Government actions against such awesome conglomerates as the Standard Oil Co. of New Jersey prompted banks to become more and more conservative in their investments.

The 1907 Panic

Panic came again on August 12, 1907, when New York City tried in vain to float a high-yielding $15 million bond issue. Many corporate issues met the same fate. There were runs on two of New York's largest trust companies, the Trust Co. of America and the Lincoln Trust Co., and an important investment banking house, Moore and Schley, was about to fail.

The 1907 crash occurred when the Knickerbocker Trust Co., headed by Frederick Augustus Heinze, Charles Morse, and Charles T. Barney, failed as a result of the trio's speculating with depositors' funds. Barney committed suicide and, to forestall financial disaster, John Pierpont Morgan took charge.

During the panic of 1907, Morgan, then three score and ten, again saved the country from financial disaster with profit for himself. He forced Morse and Heinze to resign their positions as directors of the chain, and then organized a group of Wall Street bankers to pour money into the weaker surviving banks. Morgan even asked the clergy to issue reassuring pronouncements from their pulpits.

The scion of Wall Street, however, was given more earthly support from Theodore Roosevelt and Treasury Secretary George B. Cortelyou. Joint action in the nick of time by the Government and bankers such as James Stillman, John D. Rockefeller, and George Baker, enabled Morgan to save the surviving banks with a European loan.

Singlehandedly, Morgan browbeat the other trust companies into raising $25 million, convinced Secretary of the Treasury Cortelyou to deposit $35 million of Government funds in needy New York banks, and prevailed upon both the trust companies and the banks to loan the money. Both trust companies and Moore and Schley were saved. (Sobel, supra. ch. 9, especially pp. 313–314 and 319–320.)

Morgan's action was not entirely altruistic. For his service to his country, Morgan once more collected. His price was to force trust busting Teddy Roosevelt to eat crow and consent to the purchase by United States Steel of the lucrative Tennessee Iron and Coal Co. at a bargain price of $84 a share. (Sobel, supra, ch. 8. at 318–319.)

To Moore and Schley and other stockholders, Big Steel issued bonds worth about $74 a share. The iron ore of Tennessee Coal and Iron Co. alone was worth "in excess of $250 a share." (Sobel, supra, pp. 318–319.)

Robert L. Owen

The aftermath of these panics was always the same. As Robert L. Owen, chairman of the Senate Banking Committee during the Wilson administration says, frightened creditors would press their debtors enabling them "to take over the property of thousands" on a basis that was "ruinous," causing hundreds of bankruptcies, "violent dislocation of business," and vast unemployment. (Robert L. Owen, "The Federal Reserve Act," The Century Co., New York, 1919.)

Banks, moreover, would refuse even certified checks or greenbacks, and insist on gold. In these panics when banks were out of money, Andrew Mellon and the "Witch of Wall Street," Hetty Green, would pick up bargains. It was in this way in the panic of 1873 that Jay Gould acquired control of the Union Pacific Railroad. (Sobel, supra, at 24–25, 181 and 193.)

During the 1893 panic, Senator Owen, coauthor with Senator Carter Glass of the Federal Reserve bill of 1913, was President of the First National Bank of Muskogee, Okla., which he had organized. His little bank lost 50 percent of its deposits in as many days. (Owen, supra, p. 181.)

To Owen, the panic of 1893 "demonstrated the complete instability of the American banking system and the hazards which businessmen had to meet."

Robert Latham Owen was an interesting figure in American life. He was born on Candlemas, or Groundhog Day, February 2, 1856, of wealthly parents. His father was president of the Virginia and Tennessee Railroad; his mother, Narcissa Chisholm, was a chieftain of the Cherokee Nation. His maternal grandfather was Chief Arni-Kilawki, Thomas Chisholm in English, and a friend of Mr. Thomas Jefferson. Owen's Indian name was "Oconstota" (Groundhog).

On graduation from Washington and Lee in 1877, Owen began the practice of law in Oklahoma where he came to represent the five civilized Indian tribes, recovering over $2 million for the Choctaws in 1891, $800,000 for the Western Cherokees in 1894, and over $5 million for the Eastern Cherokees in the Supreme Court of the United States in 1906. (Ph. D. thesis of Edward Elmer Keso at George Peabody College, Nashville, Tenn. (1938) on file at Federal Reserve Library, Washington, D.C.)

Taking his seat in the Senate in December 1907, Owen was reelected in 1912 and 1918, retiring in March 1929. He died on July 19, 1947.

Fortunately, for his country, Owen was a wealthy, well-educated man, and was determined to reform our inadequate banking system. At the Democratic Convention of 1896, Owen sought in vain to obtain a plank promising currency reform to protect the country against future panics. Then in the summer of 1898 he went to England, France, and Germany studying how the London, Paris, and Berlin banks were able to weather the same panics that raised havoc with our banking system. (Owen, supra, pp. 8–17.)

Owen found that government regulation of banking in those countries was quite different, and that panics, such as the United States experienced, were virtually impossible. In England, for instance in 1866 when Ovend, Gurney and Co. failed, the Bank of England "loaned one day $20 million and in one week $50 million," and when the Baring liquidation threatened, the Bank of England once again borrowed gold. (Owen, supra.)

In his studies abroad, Senator Owen had also seen how timely intervention by the large central bank could prevent a reasonably sound bank from failing. He knew, as few men of his time did, that when currency is scarce the best and most solvent bank will fail. From his personal experience and studies abroad he also knew that this was unnecessary if the country had a proper banking system.

National Bank Notes

Under the act passed in 1863, each national bank deposited with the Comptroller of the Currency U.S. bonds equal to approximately one-third of its capital, and received national bank notes equal to 90 percent of the par or market value of the bonds. The currency of the country then became national bank notes. By 1900 the Congress had taxed State bank notes out of existence.

To protect against loans, the act required banks in certain large reserve cities to maintain in their own vaults a 25-percent reserve in lawful money against deposits. In other large cities one-half the 25-percent reserve could be kept on deposit in New York banks, but country banks were held to only a 15-percent reserve, three-fifths of which could be in a city bank. (Paul Studenski and Herman E. Krooss, "Financial History of the United States," McGraw-Hill Co., New York, 1952, pp. 154–155.)

This put a substantial amount of the country's ready money on deposit with large New York banks which loaned it at high interest rates in the call money market. If one of these banks was unable to pay on demand, the repercussions were felt throughout America. Of course, the depositing banks were paid interest on their balances, but there was no assumption of liability on the currency by the U.S. Government.

Strange as it may seem to us today, the currency of the country from 1865 down to 1913 consisted of these national bank notes, necessitating the use by the Bureau of Engraving in 1913 of some 6,600 plates. (Owen, supra, pp. 34–35.)

The Owen Amendment

One thing the country had learned was that Morgan, with the aid of the Secretary of the Treasury, had been able in the last two panics to save sound banks by advancing to them moneys to meet the demands of frightened depositors.

The amendment to the National Bank Act that Owen had drafted provided for the issuance of U.S. Treasury notes on an emergency basis for 90 percent of the value of U.S. bonds. Senator Aldrich, then in charge of the bill, rejected the amendment. In 1908 Senator Jones wrote Owen that if the amendment had been accepted it would have, in his opinion, prevented the panic of 1907. (Owen, supra, pp. 25–29.)

Instead of accepting the Jones amendment, Owen says that the Republicans—

> Craftily and unfairly expanded the paper currency of the national banks some five hundred millions by authorizing the banks to issue currency against two percent bonds at a profit to the banks of approximately one and one-half percent per annum on such issue by the amendment of the National Bank Act of 1900. This, of course, was no remedy, for the currency remained inelastic although expanded. (Owen, supra, at 6.)

In 1907 Robert Owen and Thomas Gore became Oklahoma's first U.S. Senators. When Owen, as a new Senator, began speaking out against our banking laws, Senator Hale of Maine rebuked him. In his biography of Owen, Edward Keso tells us that the Senator replied "it was unfair to blame him for not arriving sooner as he had come to the Senate from Oklahoma as soon as he could after Oklahoma was made a State."

When the Aldrich-Vreeland Act was passed in 1908, Owen, as Senator, had the satisfaction of reminding Senator Aldrich that if he had accepted the proposed Jones amendment in 1900 there might not have been a panic of 1907.

At Owen's request, Aldrich did put the Jones amendment in the Aldrich-Vreeland Act and, at the last minute, it went into the Federal Reserve Act of 1913. It is said to have averted a panic in 1914, when at the start of World War I, with J. P. Morgan dead, the stock exchange closed for several months. Against Owen's objection, however, the provision accepted in 1908 and 1913 limited the amount of such emergency bank notes to $500 million. (Owen, supra, 46–48.)

Senate Banking Committee

In 1908 there was no Senate Banking Committee. When Senator Owen came to the Senate he wanted one, and was instrumental in forming a Committee on Committees which divided the Senate Finance Committee.

At Owen's urging, the Senate created a Banking Committee on March 18, 1913, at the start of the special session which President Wilson called to rush through his tariff and currency legislation.

Arsene P. Pujo

While in the 62d Congress the Republicans had organized the Senate. In that Congress the Democrats had been able to organize the House of Representatives, and Arsene P. Pujo of Louisiana became chairman of the House Banking Committee.

Born on December 16, 1861, Pujo practiced law in Lake Charles, La., and served in five Congresses, 58–62, March 4, 1903–March 3, 1913. On his resignation from Congress at the close of the 62d Congress in 1913, Pujo resumed the practice of law in Lake Charles, and died in New Orleans December 31, 1939, on a visit for medical treatment. (Biographical Directory of the American Congress, 1774–1961, supra.)

Pujo will be best remembered for his investigation in the 62d Congress of big business, or, as he put it, the "Money Trust" for which he retained Samuel Untermeyer, a member of the New York City bar.

Pujo decided to divide his committee into two sections, one headed by him to concentrate on the "Money Trust," the other section headed by Congressman Carter Glass, as the next-ranking Democrat, "to devise a reserve banking scheme."

Carter Glass

Glass, like Owen, had been born in Lynchburg, Va.; Glass in 1858 and Owen in 1856. (See "Carter Glass: A Biography," by Rixley Smith and Norman Beasley, Longmans, Green and Co., Plainview, N.Y., 1939.)

At 13 Glass had been taken out of school and put to work on his father's newspaper. By 1902 he was editor and owner of the Lynchburg Daily News and Advance. From 1899 to 1903 he was in the State senate. He went to Congress in 1902 when the incumbent (Peter J. Otey) died, and served until 1919 when he resigned to become Secretary of the Treasury. When Senator Thomas S. Martin in the fall of 1919 died Glass became a U.S. Senator and served until his death in 1946. ("Biographical Directory of the American Congress, 1774–1961," U.S. Government Printing Office, 1961.)

Party Platforms

Because of the panics, especially the panic of 1907, there were planks for currency reform in the platforms of all three parties in the 1912 Presidential campaign. "National Party Platforms, 1840–1960," Kirk H. Porter and Donald Bruce Johnson, University of Illinois Press, Urbana, Ill., 1961.)

The Progressive Party of Teddy Roosevelt wanted currency control in the Government, not in the banks, as in the Aldrich currency bill—

> We believe there exists imperative need for prompt legislation for the improvement of our national currency system. We believe the present method of issuing notes through private agencies is harmful and unscientific.
>
> The issue of currency is fundamentally a government function and the system should have as basic principles soundness and elasticity. The control should be lodged with the government and should be protected from domination or manipulation by Wall Street or any special interests.
>
> We are opposed to the so-called Aldrich currency bill, because its provisions would place our currency and credit system in private hands, not subject to effective public control. (Porter and Johnson, supra, 175 and 179.)

The Republican Party of "Big Bill" Taft, while recognizing the need for avoiding money panics, asked for the independence of banks, and warned against either financial or political control. The Republican platform avoided mention of the National Monetary Commission—

> Our banking arrangements today need further revision to meet the requirements of current conditions. We need measures which will prevent the recurrence of money panics and financial disturbances and which will promote the prosperity of business and the welfare of labor by producing constant employment. We need better currency facilities for the movement of crops in the west and south. We need banking arrangements under American auspices for the encouragement and better conduct of our foreign trade. In attaining these ends, the independence of individual banks, whether organized under national or state charters, must be carefully protected and our banking and currency system must be safeguarded from any possibility of domination by sectional financial, or political interests. (Porter and Johnson, supra, 171.)

The Democratic Party of Woodrow Wilson, in accordance with the findings of the Pujo committee, rejected the Aldrich bill proposed by the National Monetary Commission, and favored Government control on the theory that banks exist for the accommodation of the public—

> We oppose the so-called Aldrich bill or the establishment of a central bank; and we believe our country will be largely freed from panics and consequent unemployment and business depression by such a systematic revision of our banking laws as will render temporary relief in localities where such relief is needed, with protection from control of dominion by what is known as the money trust.
>
> Banks exist for the accommodation of the public and not for the control of business. All legislation on the subject of banking and currency should have for

its purpose the securing of these accommodations on terms of absolute security to the public and of complete protection from the misuse of the power that wealth gives to those who possess it. (Porter and Johnson, supra 171.)

Because of these campaign planks, after his election in November of 1912 Woodrow Wilson announced he would call the 63d Congress into special session in April 1913 at the conclusion of the lameduck session of the 62d in March to enact tariff and currency bills.

Inasmuch as the Democrats were to control both the Senate and House in the 63d Congress in 1913, this meant that Senator Robert L. Owen of Oklahoma would chair the newly formed Senate Banking Committee, and that Congressman Carter Glass of Virginia, who had been in Congress since 1902, would succeed Arsene Paulin Pujo as chairman of the House Banking and Currency Committee.

Glass feared the banks would try to thwart his succeeding Pujo, but the threat never materialized. When Pujo retired in 1913 Glass became chairman of the House Banking and Currency Committee, and thus it was that the Owen-Glass bill of these two boys from Lynchburg became the Federal Reserve Act of 1913.

In his book "Adventures in Constructive Finance" (Double-day, Page and Co., pp. 68–69, New York, 1927), Glass tells us that the leading figures in the Pujo investigation were so pleased with themselves that they were "imbued with a desire" to take over his subcommittee, but "a quick end was put to this intrigue" by the refusal of himself and his colleagues "to tolerate interference." Thus, between the election and the special session, Carter Glass was able to prepare a draft of a new currency bill for introduction in the special session of the 63d Congress.

The Glass subcommittee began hearings on January 7, 1913, and heard bankers, businessmen, and specialists on currency whose practical suggestions were incorporated into the technical provisions of the bill by Dr. Henry Parker Willis. (Arthur S. Link, "Woodrow Wilson and the Progressive Era," New York, Harper and Row, 1963, p. 46.) The hearings, concluded February 17, 1913, covered 745 pages of printed material (remarks of Senator Owen, Congressional Record, vol. 50, p. 6002).

Henry Parker Willis

Professor Willis who assisted Senator Glass was born in Racine, Wis., attended Western Reserve University, B.A. 1894, and University of Chicago, Ph. D. 1898. From 1898 to 1901 he was a professor of economics at Washington and Lee University, and later returned to organize its school of commerce. In 1910 he became a professor of finance and dean of the College of Political Science at George Washington University.

Willis was an editorial writer in 1910 for the New York Evening Post and, later, Washington, D.C. correspondent for the New York Journal of Commerce and the Springfield Republican. In 1912 when he joined Glass' subcommittee he was associate editor of the Journal of Commerce and teaching part time at Columbia University. Besides assisting Glass on the Banking and Currency Committee, he was also on the staff of the Ways and Means Committee aiding on the Underwood tariff bill.

From 1914 to 1918 Willis was Secretary of the Federal Reserve Board and, thereafter, editor of the New York Journal of Commerce and professor of banking at Columbia University.

In 1915 Willis wrote "The Federal Reserve: A Study of the Banking System of the United States" (Doubleday, Page and Co., 1915), and in 1923 "The Federal Reserve System: Legislation, Organization and Operation" (Ronald Press).

His 1923 work contains a goldmine of pertinent Federal Reserve information. It contains drafts of the legislation from the first shown to Woodrow Wilson, to the last as redrafted by the conference committee into the Federal Reserve Act of 1913.

Willis frankly discusses the rumors he picked up from bankers in New York who hoped to block Carter Glass from becoming chairman of the House Banking and Currency Committee. More importantly, he acknowledges that Glass had hoped to pursuade Wilson to allow three bankers to be made members of the Federal Reserve Board and that, in this, Senator Robert L. Owen opposed Glass. It was Owen and William Jennings Bryan that made sure the Federal Reserve Board was to be a Government agency.

Glass and Willis See Wilson Twice

On December 26, 1912, Senator Glass went to Princeton with Dr. Willis to see President-elect Wilson. The President was then in bed with a cold, but Glass went over with him "a written division memorandum of bill." While Wilson told Glass he was "on the right track," Glass stated he "offered quite a few suggestions, the most notable being one that resulted in the establishment of an altruistic Federal Reserve Board at Washington to supervise the new system."

Glass and Willis had a second meeting with President-elect Wilson, this time in the Governor's executive offices at Trenton. At that meeting Wilson approved "two vitally important provisions not previously mentioned to him," one "for open market transactions by regional banks" which "encountered bitter opposition from the larger banks," and the other for "an abolition of exchange charges and the establishment of par collections" which was "frantically opposed by a combination of small banks." Nevertheless, both provisions remained in the final bill. While not complete, Glass stated the draft he showed Wilson at Trenton "contained nearly every fundamental provision subsequently enacted into law." (Glass, supra, 91–92.)

At that time Glass and Willis had proposed that the Comptroller of the Currency, "already tsaristic head of the national banking system of the country," became the head of the new Federal Reserve System—

> Dr. Wilson laughingly said he was for "a plenty of centralization, but not for too much." Therefore, he asked a separate central board provision be drafted, to be used or not, as might subsequently be determined, "as a capstone" to the system which had been outlined to him. (Glass, supra, 82.)

As Glass tells it, at this first conference he was able to outline the principal parts of what was to become the Federal Reserve System. The conversation covered these points:

1. Regional reserve banks;
2. Use and transfer of reserve balances;

3. Compulsory stock ownership by national banks;
4. Membership for State banks;
5. Rediscounting;
6. Issuance of Federal Reserve notes;
7. Gradual retirement of national bank notes;
8. Joint liability of all regional banks;
9. Regional banks to be fiscal agents of the United States;
10. Conversion of U.S. 2-percent bonds into 3-percent bonds with cancellation of circulation privilege; and
11. Giving the Comptroller of the Currency full supervisory power over the Reserve System. (Glass, supra, pp. 83–84.)

No one anticipated that the new Congress at the special session would pass both the tariff and currency bills. To the last, the New York Times (May 3 and 9, 1913) was predicting that the currency bill would have to go over to the next session of the Congress. It quite rightly reasoned that Republicans opposed to it would prolong their speeches against the tariff bill indefinitely, and Democrats for the bill, loath to linger in Washington through another summer, would go along.

The Times at the same time (April 29, 1913) was pointing out that President Wilson felt he needed the bank bill to protect against the Underwood tariff bill which might bring expansion or depression. In any event, the Times declared the currency bill was to be Wilson's own, and he and his Secretary of the Treasury William G. McAdoo (1913–18) were to deal with Owen and Glass about its passage.

Control of the System

Senator Owen, in an interview with the New York Times (April 30, 1913), made it clear that in his mind the big issue was who should control the currency—the banks or the Government. He pointed out that in France and Germany the government controls the currency, and in England businessmen, not bankers, control the Bank of England.

As soon as his Banking Committee was appointed and his chairmanship secure, Senator Owen announced (New York Times, April 30, 1913) there would be Senate hearings. He circulated a series of 30 questions he expected the witnesses to discuss—11 of these the Times listed as follows:

1. What are the essential defects of our banking and currency system?
2. Should a new system include State as well as national banks?
3. Should there be one central reserve association or a number and, if the latter, how many?
4. What method of preserving an elastic currency should be adopted?
5. Should a central control of reserve associations be established either by them or by the Government, or by both?
6. Should the Aldrich-Vreeland Act be extended after its expiration in 1914? If so. should it be amended?
7. Should additional currency be permanent or temporary?
8. Should individual banks or central associations issue the additional currency?
9. Should reserve associations be stock companies?

10. Should national banks be required to keep their reserves in their own vaults and with their own reserve association?

11. Should the rate on discounts be the same for all, and should this rate be published weekly?

In April at the home of Hugh Campbell Wallace, a member of the Democratic National Committee, Glass read his draft bill to William Gibbs McAdoo, Secretary of the Treasury, and Col .E. M. House, friend and adviser to the President. Thereafter, the President requested a copy which Colonel House obtained and passed on to Paul M. Warburg of Kuhn, Loeb & Co. When Glass learned later that Colonel House was showing his draft to bankers, Glass showed it to banker friends of his own, and then, for the first time, sent Senator Owen a copy.

It was not until June 3, 1913, that the House Banking and Currency Committee was appointed and Glass made its chairman. Until that time Glass was in doubt as to who were to be members of his committee and, of course, could not be positive he was to be chairman. As Glass explained, this made it important that he keep his draft bill secret.

As previously mentioned, in January 1913 Dr. Willis had "nervously" warned Glass that "a very powerful banker" in New York had told him that "there is such a thing as a committee chairman who will accept our plan." Also, the "air was filled with rumors" of an effort to set aside the rule of seniority in selecting the new chairman of the committee.

Whether or not this was related to the delay in naming the committee is not clear. Glass never specifically criticized the leadership for the delay, although he regretted it, but it may have been a factor in his much-criticized secrecy in handling the bill. Furthermore, Glass stated every other currency bill had been battered to pieces by hostile interests, so he kept his "closely guarded." (Glass, supra, pp. 86–87, 94.)

In addition, Carter Glass wanted to keep his draft of the bill secret until it was cleared by President Wilson. It was well he did. When Senator Owen saw the Glass draft he was outraged—here is how he tells it—

> The Glass tentative draft avoided the establishment of a central bank with branches, and provided twenty Federal Reserve district banks under control, however, of a Federal Reserve Board, *with forty out of fifty-three members chosen by the banks.*" (Owen, supra, emphasis Senator Owen's.)

At the time he gave his draft to Owen, Glass planned to add a provision under which the directors of the Reserve banks selected by member banks would name the Federal Reserve Board. But Owen says—

> I was strongly opposed to either provision because it would *not* give to the United States control of the system. I regarded it as practically the same as the Aldrich Bill which would have put the management of the system in the hands of persons chosen to represent the banks, and I insisted that the control of the system was a governing function to be exercised alone by the Government of the United States. About this feature I felt great anxiety because a powerful impression had been created that the banks of the country would not enter a government-controlled system, would not take stock in the Reserve banks, and would not put their reserves in the Reserve banks unless they could control the Federal Reserve Board. (Owen, supra, pp. 73–74, emphasis Senator Owen's.)

In the debate in the Senate on the Owen-Glass bill, Senator Reed of Missouri charged that Glass' first draft gave "the banks absolute control of the system," and that it was a "half-baked measure" drawn by

H. Parker Willis, editor of the Journal of Commerce, a Wall Street publication. In a lengthy statement Glass denied this. (New York Times, Nov. 10, 1913, p. 1, col. 1.)

When Owen and Glass discussed the matter, Glass agreed to have four members of the seven "chosen by the Government and three by the banks" but this was as far "as he felt it safe to go." Unable to reach an agreement with him, Senator Owen brought "the vital difference" to President Wilson at a night meeting in the White House. (Owen, supra, pp. 74–75.)

Wilson Decides Control Issue for Owen and Bryan

Glass stated frankly he "was very definitely committed to giving the banks some voice" and the "feature of the bill" in dispute "gave the banks minority representattion on the Federal Reserve Board." He also agreed the question was "crucial" as "Senator Owen of the Senate committee had sided with Mr. Bryan" against banker control, and there was fear that "Bryan and his following might revolt." (Glass, supra, pp. 112–113.)

Glass underestimated President Wilson, for whom he had great respect. This is what happened as Owen told it—

> After a discussion of two hours, approximately, *the President coincided with my contention that the Government should control every member of the Board on the ground that it was the function of the government to supervise this system, and no individual, however respectable should be on this Board representing private interests.* (Emphasis Senator Owen's.)

Glass stated that Secretary McAdoo who was present "at first" agreed with him, but later "proposed a compromise." (Glass, supra, p. 113.) However, Owen declares that McAdoo agreed with the view he presented. (Owen, supra, p. 76.)

Henry Parker Willis in his 1923 book "The Federal Reserve System," confirms Owen's version (p. 250 et seq.). He states flatly that "in the original draft of the bill * * * it had been intended to vest the real management of the Federal Reserve System in the hands of an executive committee representing the Board consisting entirely of bankers."

In "the best sense of the word," Willis says that this executive committee was to constitute a "banking board." For this reason "the idea of turning it into a government body of the conventional type constituted a distinct innovation in the proposed makeup of the system."

The danger was that this change would "alter in no small degree the attitude of the banking community toward the measure," and the thought was that "the proposed change ought not to be introduced except as a matter of the utmost urgency from a political standpoint."

Convinced by Bryan and his associates that the Board was to be "an active government body," Willis said President Wilson "practically ordered" the proposed amendments incorporated in the draft bill, and he quotes from a letter Glass wrote to him at the time in which Glass said he told Wilson—

> * * * his proposition would put the whole scheme into politics and that he could not expect a powerful Republican minority in the Senate to sit quietly by and permit the creation of a banking system, the absolute control of which, to begin with, would be in the hands of men all appointed by a Democratic President. I said to him I considered the proposal both inexpedient and fundamentally wrong; but Owen promptly agreed to it and McAdoo yielded also (p. 251).

Glass was very upset. He thought President Wilson wrong and, whatever else, Carter Glass was a fighter. He conferred that evening at his hotel with Bulkley of his committee who was "for a government note issue and for government control." He wrote Wilson a note asking him "to take Mr. McAdoo's suggestion" and, as President, select the three bankers from "a list proposed by the banks." But Wilson was "adamant." (Glass, supra, pp. 113–115.)

Undaunted, Glass thereafter led a delegation of bankers (Forgan, of First National of Chicago; Wade, of Mercantile Trust, St. Louis; Wexler, of Whitney Central, New Orleans, and Perrin, of Messrs. Perrin, Drake and Riley, Los Angeles) to the White House to protest his decision. It was then that Wilson turned to Forgan and Wade and said quietly:

> Will one of you gentlemen tell me in what civilized country of the Earth there are important government boards of control on which private interests are represented?

After what Glass tells us was a "painful silence,"

President Wilson inquired:

> Which of you gentlemen thinks that railroads should select members of the Interstate Commerce Commission? (Glass, supra, pp. 116–117.)

It was at this conference that President Wilson suggested that "as compensation to the bankers for denial of representation on the central board," Glass "set up a Federal Advisory Council authorized to sit at stated times with the Federal Reserve Board in a purely advisory capacity."

Paradoxically, Glass, who fought so hard for banker representation on the Federal Reserve Board, stated "there could have been no convincing reply to either question" (Glass, supra, p. 116), and Senator Owen says that afterwards "Mr. Glass gave the provision his very cordial support." (Owen, supra, p. 76.)

Willis, in his 1923 study, confirms Owen saying that while Glass accepted the change "with great reluctance," he "subsequently heartily approved," and "in several public addresses he later testified to his change of view expressing in unequivocal language the belief that the original proposal had not been wise."

As a result, the bill was changed to provide for a Board of seven members, two, the Secretary of the Treasury and the Comptroller of the Currency, and five to be appointed by the President with the advice and consent of the Senate.

On June 23 the bill, "in final amended form," made its appearance and "as thus reconstructed, met the approval of Mr. Bryan" who kept his bargain by issuing a statement which the Philadelphia Public Ledger printed on June 26, 1913.

There, Bryan says that:

> When the bill is considered upon its merits, one at once realizes that it is written from the standpoint of the people rather than from the standpoint of the financiers. The latter are quite unanimous in the belief that the issue of money is "a function of the banks" and that "the government ought not to go into the banking business."
>
> The Democratic Party, however, has consistently taken the position that the issue of money is "a function of the government" and should not be delegated to the banks. It all depends upon the point of view from which one considers this question, or for that matter, any public question (p. 253).

Bryan points out that the bill involves "three fundamental principles":

First. The notes issued must be issued by the government and not by the banks.
Second. The issue must be controlled by public servants and not by private institutions or individuals.
Third. The emergency currency issued must be issued through state banks as well as through national banks.

Inasmuch as the bill as amended "observes these three requirements," Mr. Bryan enthusiastically endorsed it. He thought the rights of the general public protected, the needs of the business interests met, State banks put into association with national banks for the first time, and "a life preserver" thrown to the national banks, causing him to ask who could oppose "so wise a measure."

When Glass and the four bankers went to see President Wilson to protest their being left off the Federal Reserve Board, they also protested the President's decision to take out of the bill the provision designed "to retire in time, national bank notes." With the concurrence of Senator Owen, the President had agreed to eliminate it.

Glass, however, after the conference of the bankers with the President issued a statement that he would move to restore the provision the Senate was taking out—he did so, and it went into the final bill.

Once more the fine Italian hand of President Wilson came into play. Though Glass believed that Wilson did not discuss it with him personally, Glass says that Wilson knew that William Jennings Bryan and his large following would not support the currency bill unless the Federal Reserve notes were "obligations of the United States." When Glass argued for his position and pointed out that behind each Reserve note was the liability of the member bank, double liability of its stockholders, and gold and commercial reserves, Wilson replied that Glass was right as to "the substance of the thing."

President Wilson pointed out to Glass, that with all this security for the notes, agreeing to make the notes also obligations of the United States was a mere "shadow," and it was well worth doing to save the bill. (Glass, supra, pp. 123–125.)

One has to admire the way President Wilson, Carter Glass and Robert L. Owen guided the currency bill through the Congress. The banks of the country, one and all, were blindly opposed to the legislation and, in the Senate, Senators Reed, O'Gorman and Hitchcock, all powerful Democrats, were against it.

The opposition's first move was to get President Wilson to bring the bill up in the next Congress. Even Oscar Underwood, the House majority leader, urged this upon him but Wilson adamantly refused. (New York Times, June 17–18, 1913.)

At one point, the President made clear, in a letter to Senator Tillman, that he felt the Congress must pass a currency bill "so that any attempt to create artificial disturbances" after the Underwood tariff bill had become law may be offset by a free system of credit. Such a system would make it possible for men, big and small, to take care of themselves in business. Wilson wisely reasoned that when the tariff bill had passed, the House could work on the currency bill while the Senate debated the tariff. (New York Times, June 1 and 17, 1913.)

President Wilson had made up his mind there would be a currency bill at the special session, and never gave an inch. Moreover, as we have seen, Wilson took the time personally to reconcile the differences between Owen and Glass as to whose obligation the currency bill should be, and as to what body should control the Federal Reserve System. This resulted in Wilson's obtaining 100 percent party support from Bryan to Glass for his currency bill.

In sharp contrast to later Presidents, Wilson's next move was to read the currency bill to his Cabinet and obtain their approval, and calmly spend 2½ hours discussing the bill, section by section, with the Democrats on the House Banking and Currency Committee.

Although there were a few favorable comments, bankers from coast to coast blasted the bill. Senator Hitchcock of Nebraska, next ranking Democrat on Senate Banking, made a long detailed attack to Owen on it. (New York Times, June 17–22, 1913.)

Wilson Calls Joint Session

With the showmanship of P. T. Barnum on June 23, 1913, President Wilson, wearing a frock coat, light-striped trousers, a four-in-hand cravat of some dark material with white figures in it, and accompanied by Mrs. Wilson and his daughters, Jessie and Eleanor, went to the Capitol with his currency bill and addressed a joint session of the Congress over which Speaker Champ Clark and Vice President Thomas Marshall presided.

The 9 minute message President Wilson read is as refreshing to read today in the New York Times of June 24, 1913, as it must have been to hear on the 23d day of June in 1913. He began by acknowledging that by calling a special session to enact the tariff bill and now the currency bill he was subjecting his non-air-conditioned Congress to the excruciating heat of a Washington summer. However, he told them:

> It is under the compulsion of what appears to me a clear and imperative duty that I have a second time this session sought the privilege of addressing you in person. I know, of course, that the heated season of the year is upon us, that work in these chambers and in the committee rooms is likely to become a burden as the season lengthens, and that every consideration of personal convenience and personal comfort, perhaps in the cases of some of us, considerations of personal health even, dictate an early conclusion of the deliberations of the session, but there are occasions of public duty when these things which touch us privately seem very small, when the work to be done is so pressing and so fraught with big consequence that we know that we are not at liberty to weigh against it any point of personal sacrifice. We are now in the presence of such an occasion. It is absolutely imperative that we should give the businessmen of this country a banking and currency system by means of which they can make use of the freedom of enterprise and of individual initiative which we are about to bestow upon them.

As President Wilson said, it is not enough for the Underwood Tariff Act "to strike the shackles from business." One of the chief things business needs now "is the proper means by which to readily vitalize its credit, corporate and individual, and its originative brains."

> What will it profit us to be free if we are not to have the best and most accessible instrumentalities of commerce and enterprise? What will it profit us to be quit of one kind of monopoly if we are to remain in the grip of another and more effective kind? How are we to gain and keep the confidence of the business community unless we show that we know how both to aid and to protect it? What

shall we say if we make fresh enterprise necessary and also make it very difficult by leaving all else except the tariff just as we found it?

The tyrannies of business, big and little, lie within the field of credit. We know that. Shall we not act upon the knowledge? Do we not know how to act upon it? If a man cannot make his assets available at pleasure, his assets of capacity and character and resources, what satisfaction is it to him to see opportunity beckoning to him on every hand when others have the keys of credit in their pockets and treat them as all but their own private possession? It is perfectly clear that it is our duty to supply the new banking and currency system the country needs, and that it will immediately need it more than ever.

The only question is, when shall we supply it now or later after the demands shall have become reproaches that we were so dull and so slow? Shall we hasten to change the tariff laws and then be laggard about making it possible and easy for the country to take advantage of the change? There can be only one answer to that question. We must act now, at whatever sacrifice to ourselves. It is a duty which the circumstances forbid us to postpone. I should be recreant to my deepest convictions of public obligation did I not press it upon you with solemn and urgent instance. (New York Times, June 24, 1913.)

The President saw how his free trade tariff bill might well affect the economy of the country and he wanted a banking system capable of controlling it, boom or bust.

Our banking laws must mobilize reserves; must not permit the concentration anywhere in a few hands of the monetary resources of the country or their use for speculative purposes in such volume as to hinder or impede or stand in the way of either more legitimate more fruitful uses. And the control of the system of banking and of issue which our new laws are to set up must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

The committees of the Congress to which legislation of this character is referred have devoted careful and dispassionate study to the means of accompanying these objects. They have honored me by consulting me. They are ready to suggest action.

Coming specifically to the need for a sound currency, President Wilson said:

We must have a currency, not rigid as now, but readily, elastically responsive to sound credit, the expanding and contracting credits of everyday transactions, the normal ebb and flow of personal and corporate dealings.

Noting there had been objections to the "12 scattered and independent banks" in the proposed Federal Reserve System, Wilson said the criticism went "straight to the mark" as—

We have purposely scattered the regional reserve banks and shall be intensely disappointed if they do not exercise a very large measure of independence.

House Passes Bill

After President Wilson's currency message, the first order of business was for Glass to get the bill through the House. Having held hearings in the 62d Congress, Glass saw no need for more. Moreover, the Monetary Commission had studied the problem for 4 years and was pushing the Aldrich bill.

What Glass did was to mark up the draft bill with the Democrats on his Banking and Currency Committee, have a House Democratic Caucus vote of 168 to 9 to make the bill an administration measure, and then for the first time, consult with the Republican members of his committee. (Glass, supra, pp. 141 and 149.)

The Republicans objected bitterly to their exclusion from Glass' discussions of his draft bill with McAdoo, Owen, President Wilson, and Democrats on the committee. Their argument was that the crushing effect of the caucus made the bill impossible to change in floor debate. That of course was Glass' object in convening the caucus.

Surprisingly, there is no indication that Wilson, our political scientist President (who had written against the caucus, "Congressional Government: A Study In American Politics," pp. 326–332, 1905, reprint 1958, Peter Smith Publishing, Inc., Gloucester, Mass.), raised a hand to stop him as he did later in the Senate with Owen.

The Republican members of the House Banking and Currency Committee proposed "variance minor amendments" which Glass accepted, including "a provision for a savings department for national banks" from Representative Everis A. Hayes of California. However, this provision was "stricken out in the Senate."

The Glass bill when reported promptly passed the House with 48 Republicans joining the Democrats. (Glass, supra, pp. 149–150.)

Glass was very sensitive about charges made against him for driving the currency bill through the House and being so secretive about it. His answer (Glass, supra, p. 150) was that the proposed Federal Reserve Act—

> Had been considered for months in the Committee (from January 7, 1913), discussed ten days in party caucus, debated in general for five days in the House itself, amendments without number offered to its provisions and the freest controversy allowed to persist in the House for three weeks.

As Glass pointed out, this conduct was in sharp contrast to the way the Republicans in 1908 had pushed through the Vreeland-Aldrich emergency currency law by a caucus that discharged the committee before the bill could be printed. In fact, Glass stated, the House debated the bill 1 hour before the bill reached the floor from the printer, then passed it in 5 hours and not 10 Members knew what was in it. Glass said Republicans deserved charges of "King Caucus" and "gag law"; Democrats did not.

Glass declared that "nothing in (President) Jackson's battle against the U.S. Bank Charter" exceeded the intensity of the currency bill fight. (Glass, supra, p. 179.) The New York Times fully corroborates him.

Editorially, the Times damns the Committee on House Banking and Currency as having "rancor toward the rich and considerations of partisanship and territorial sectionalism." In the Times of August 23, 1913, Forgan, president of First National Bank of Chicago, quotes Glass as having admitted, as a country editor, to being incompetent to handle the bank bill, causing Glass to denounce Forgan as violating a confidence and speaking falsely. What Glass claims he said was that he felt "at a great disadvantage." (New York Times, August 23, 1913, p. 8, col. 1.) For this outburst Forgan apologized, and Glass forgave him. (Glass, supra, pp. 179–181.)

To the last, the banks sought changes in the Senate according to the Times of August 24, 1913, page 3, column 1. Editorially, the Times continued to praise Forgan and the bankers, and damn Bryan, Wilson and the administration. (New York Times, August 24, 1913, p. 10.)

After the House Caucus approved the currency bill, the Times on August 29, 1913, continued its editorial lament that "it is not wise, it is not safe to reject contemptuously the advice given in the resolutions adopted by the bankers at Chicago." And on August 30, 1913, the Times said editorially that it was printing "many dispatches from bankers of the small and large towns in many States" as "a contribution to the administration's stock of knowledge."

The House Votes

Minority Leader James Mann of Illinois, and Senator Weeks of Massachusetts, along with Senator Hitchcock, the next ranking Democrat, attacked the bill and demanded Senate hearings. (New York Times, Sept. 2, 1913, p. 1, col. 8.) In the same paper Senator Owen wrote a letter to James Simpson, vice president of the Marshall Field Co. of Chicago, in which he charged that the bankers spent from a quarter to a half-million dollars in propaganda against the bill, falsely representing that Congress had not given the bankers a hearing, and complained that the Democratic Caucus robbed them of any right to propose amendments. Meanwhile, the Republicans prepare to fight the bill on the House floor. (New York Times, Sept. 10, 1913, p. 8, col. 8.)

With Glass and Underwood in new suits of clothes, the floor debate opened. First, Glass pointed out that panics are decennial and another was due in 1917. Then Hayes, the ranking Republican committee member, opposed the bill and, finally, the "Bull Moosers", 20 strong, led by Victor Murdock, supported the bill. (New York Times, September 11, 1913, p. 5, col. 1.)

President Wilson demanded that the House meet every day until the currency bill was passed, and that the Senate hold hearings every day until passage. (New York Times, Sept. 11, 1913, p. 5, col. 1, and Sept. 13, 1913, p. 3, col. 1.)

While the Statist of London thought the provision authorizing the Federal Reserve banks to issue $500 million in notes bordered on state socialism, the Times of London thought that the passage of the tariff bill and the handling of the currency bill a great tribute to Wilson's leadership, and that his leadership "is gradually imparting to the American form of government a smoothness and flexibility it had hitherto lacked." (London Times, Sept. 14, 1913, sec. III, p. 3, col. 2.) And, the London Telegraph viewed with apprehension the clause in the Owen-Glass bill permitting foreign branches. (New York Times, Sept. 22, 1913, p. 1, col. 2, Sept. 23, 1913, p. 1.)

The House passed the bill, and then with Wilson's permission, adjourned to await the Senate bill. (New York Times, Sept. 13, 1913, p. 3, col. 1.)

The Senate Passes the Bill

As the currency bill moved from the House to the Senate, the bankers' attack on the bill grew louder and stronger. As Glass says (Glass, supra, p. 168), and the Times of the period confirms, the day-to-day press reports would have you believe the bankers were right, and the Owen-Glass bill would fail to pass altogether, or certainly go over to the next Congress.

As the Senate hearings began, Senator Owen announced that all the bankers invited testified, except Joseph T. Talbert of the National City Bank. The Chicago bankers thought the New York bankers had made "a serious mistake" in "keeping too far in the background." (New York Times, Sept. 17, 1913, p. 20, col. 3.)

Editorially, the Times urged that the currency bill go over to the next Congress, and blasted Glass for saying the National Monetary Commission study was of no value, pointing out that the Owen-Glass bill adopts whole chunks of the study. Nevertheless, the Times conceded the bill, as amended, had merit. (New York Times, Sept. 18, 1913, p. 10, col. 1.)

Prof. Jeremiah W. Jenks of New York University praised the Owen-Glass bill (New York Times, Sept. 26, 1913, p. 8, col. 2), and Glass said that banks could use their reserve funds to buy stock in the Federal Reserve and won't need new funds. (New York Times, Sept. 27, 1913, p. 3, col. 1.) The Times bitterly criticized Professor Jenks, saying the bill should not be passed merely because it is the best politically obtainable when it is the creation of three-time-loser Bryan, and the money is Government money. (New York Times, Sept. 27, 1913, p. 12, col. 1.)

Praising Owen as a former banker, Professor Jenks answered the Times editorial and said the Owen-Glass bill is "the best law possible now," and that Congress motives, like the bankers, were none but the best and noblest. (New York Times, Sept. 30, 1913, p. 12, col. 7.)

Editorially, the Times lamented that while Wilson knew tariff matters, he did not know banking—it has "not lain at his heart from boyhood." (New York Times, Oct. 5, 1913, p. 16, col. 1.) Wilson became impatient with the Senate delay, blamed the big banks, and planned to see Democratic Senators Reed, O'Gorman, and Hitchcock who opposed the bill. (New York Times, Oct. 7, 1913, p. 2, col. 6.)

The Times continued its editorial attacks on the bill and feared Wilson would make it a party measure. (New York Times, Oct. 8, 1913, p. 10.) The next day 2,000 bankers at Boston denounced the Owen-Glass bill. (New York Times, Oct. 9, 1913, p. 1.)

The Times attacked the Owen-Glass bill again, asking that the composition of the Federal Reserve Board be changed so that "the great banking interests should be represented by membership on the Board." (New York Times, Oct. 10, 1913, p. 10, col. 1.)

Another Times attack pointed out how the banks that supported the National Bank Act of 1863 were opposing the Owen-Glass bill and how the bill was the essence of Bryanism. (New York Times, Oct. 11, 1913, p. 14, col. 2.)

To meet the propaganda attacks on the bill by the banks, Glass said that "at the personal request of the President" (Glass, supra, p. 168), he accepted invitations to defend the House bill "at various large centers." One such meeting was with the New York Chamber of Commerce on October 14, 1913, at Columbia University at which both Owen and Glass were to speak. Glass fell ill and sent his speech which, in part, read:

> The real opposition to this bill is not as to government control upon which we shall never yield. It is not as to compulsory membership which is provided in another way in the Aldrich scheme—a scheme that was unanimously endorsed by the American Bankers Association. It is not in the required capital subscription, nor the 5 percent dividend. It is none of these.

It is in that most vital requirement of the bill that in the future, funds on deposit in other national banks cannot be counted as legal reserve. This means an immediate loss of profits to many bankers—I say immediate, for in the long run the change will benefit bankers as well as the public—and it is the prospect of that loss that explains most of the organized opposition to the bill.

The fight is to drive us from our firm resolution to break down the artificial connection between the banking business of this country *and the stock speculative operations at the money centres.* The Monetary Commission, with more discretion than courage, absolutely evaded the problem; but the Banking and Currency Committee of the House has gone to the very root of this gigantic evil, and in this bill proposes to cut the cancer out. This we propose to do cautiously, graduating the operation to prevalent conditions and extending it over a period of thirty-six months. (*New York Times*, Oct. 15, 1913, p. 8, col. 2; emphasis supplied.)

As you can see, this was straight talk by Carter Glass to bankers who well knew what he meant.

At a dinner of the Academy of Political Science at the Hotel Astor in New York City on October 15, 1913, Senator Nelson Aldrich gave the principal address which occupied 62 printed pages in the record of the proceedings. In that address Aldrich assailed "every essential feature" of the Owen-Glass bill, and concluded in this way:

I have tried to show that the bill has serious defects. It appeals to the populists by adopting their plan of note issues; to the socialists by seeking to place the management of the most important private business of the country in the hands of the government; it seeks the support of bankers in great centres by its unexpected discrimination in their favour, but its dangerous doctrines and unwise methods do not appeal to the judgment of the American people. Its objectional features have neither the support of public opinion nor the approval of the banking fraternity. They are contrary to the teaching of economists and they are not supported by the judgment of practical men. It threatens to upset business and to produce the evil results it was projected to cure. (Glass, supra, pp. 242–249.)

President Wilson conferred with Senators Reed, O'Gorman and Hitchcock, and agreed to cut stock subscriptions to the new banks in half. Glass told the Times that the nomenclature he took from the Aldrich Bill "had been used in 20 bills before Mr. Aldrich and his associates utilized it." (New York Times, Oct. 17, 1913, p. 10, col. 8.)

Bankers raised fears of foreign retaliation for the provision permitting foreign branches. (New York Times, Oct. 19, 1913, p. 9, col. 6.) Although bankers said that it was the Owen-Glass bill, or none at all, Frank A. Vanderlip proposed a brand new bill, and Senator Weeks offered more amendments. (New York Times, Oct. 25, 1913, p. 15, cols. 1, 2.) Vanderlip constituted what Glass calls the "Big Bertha" of the bankers' attack.

Frank Vanderlip rose from baseball reporter to president of the National City Bank. (Glass, supra, p. 166.) As Chicago baseball reporters, Finley Peter Dunne and Frank Vanderlip coined the name "southpaw" for a left-handed pitcher because his left arm in the White Sox park faces South Chicago. ("Mr. Dooley's America: A Life Of Finley Peter Dunne," by Elmer Ellis, Archon Books, England 1969.)

The Chicago Association of Commerce and the Economic Club of New York City held a dinner at the Hotel Astor in New York at which Vanderlip and Professor Joseph French Johnson of New York University debated the Owen-Glass bill with Senator Owen and Congressman Glass. Professor Johnson was a last minute substitute for Sol Wexler of the Whitney-Central National Bank in New Orleans. In discussing this debate in his "Adventures In Constructive Finance," Glass says that "eleven hundred banks and businessmen in evening dress" attended.

Quoting from fan letters he later received from A. Barton Hepburn at Chase and Professor Johnson of New York University, and referring to the favorable comment on his speech by Dr. Abbott in Outlook magazine, Senator Glass Concluded that the "Roman holiday" the bankers had prepared for Owen and himself turned out to be one for themselves. (Glass, supra, pp. 168–176.)

Banker opposition nevertheless continued. Banker W. J. Wollman told how bad London banks thought the Owen-Glass bill was. (New York Times, Oct. 26, 1913, p. 3, col. 2.) Roger W. Babson attacked the Owen-Glass bill in the Sunday Times. (October 26, 1913, p. 8, col. 1.) However, Jacob H. Schiff of Kuhn Loeb & Co. opposed Vanderlip's bill and supported the Owen-Glass bill with reservations. (New York Times, Oct. 27, 1913, p. 1.) But the Times wanted changes along the line of the Vanderlip bill. (November 7, 1913, p. 2, col. 6.)

As we have seen, Owen had a much more difficult time with the currency bill in the Senate than Glass did in the House. In the first place Owen was a gentleman, not a tough fighter like Glass. Glass went to work as a boy, and not to Washington and Lee College as Owen had done. Right or wrong, Glass was prepared to pass the bill, and Owen's approach was to pass it on a nonpartisan basis because it was the right thing to do. Owen, for instance, spoke with Nelson Aldrich before the Academy of Political Science at the Hotel Astor in Manhattan. Glass, unable to attend, sent Bulkley who took warning from the heckling to which the bankers subjected Owen on that occasion. Glass said Bulkley "had on his fighting clothes and did not mince words." You can infer that Glass thought Owen was, to quote Leo Durocher, "a nice guy who finishes last."

As usual, Glass was probably too hard on Owen who, though a Democrat, was a competitor. It was Owen's first term as Senator. Unlike the House, the margin by which the Democrats controlled the Senate was much closer, and three senior Democrats, Reed of Missouri, O'Gorman of New York, and Hitchcock of Nebraska, opposed the bill.

In early October, the Senate was still holding hearings on the currency bill which the Democratic Caucus would not cut off. Wilson then announced he would see Reed, O'Gorman, and Hitchcock. (New York Times, Oct. 7, 1913.)

Wilson, on October 16, 1913 saw the three separately. The Times reported on October 17 (p. 10, col. 8) that "the President got little encouragement from his callers," but that he listened "good humoredly" to their "pessimistic predictions." His purpose in seeing them, the Times said, was—

> A desire on his part to relax the strained relations that have threatened to result from the frequent publication of his intention to stump the states of Senators opposing the currency bill.

President Wilson developed an intense dislike of James Reed when the Senate defeated U.S. membership in the League of Nations on March 20, 1920. Later, whenever asked his opinion, promptly by return mail would come a letter from the former President denouncing Reed as "a party traitor and marplot incapable of sustained allegiance to any man or to any cause." ("Jim Reed Senatorial Immortal," Lee Meriwether, the International Mark Twain Society, Webster Groves, Mo., 1948.) From this, we can see that the intellectual Wilson was also a fighter.

The troubles Owen had with his Banking Committee were evident on October 28, 1913, when five Republican members of the committee, Weeks, McLaren, Nelson, Crawford, and Bristow, joined by Democrat Hitchcock, voted for the single central bank provided by the Aldrich bill. Only six Democrats, Owen, Reed, Pomerene, Shafroth, O'Gorman, and Hollis were for the Owen-Glass bill and its regional banks, leaving the committee tied at 6–6. (New York Times, Oct. 29, 1913, p. 16, col. 1.)

Woodrow Wilson, as usual, came to the rescue. In "two frank talks" Wilson won over Reed "the refractory Missourian" who thereafter "went along with his party associates." (Glass, supra, p. 196.) In addition, O'Gorman switched, and the 6–6 tie became an 8–6 victory for Owen.

Even though the switch of Reed and O'Gorman gave the votes needed, Owen decided not to attempt to have his committee report a bill. Instead, without recommendation, it reported three bills—the Owen-Glass bill as it passed the House, a slightly modified House bill, and a bill sponsored by Senator Hitchcock. (New York Times, Nov. 21, 1913.)

Due to Owen's motion, the Owen-Glass currency bill became the Senate's unfinished business, but the future of the bill was touch and go. This is how Glass pictured the Senate situation:

> The chairman of the Senate Committee was not able to report the bill as agreed on; he reported it without recommendation to the Senate. This resulted in further delay and prolonged confusion, until the President could be won over to a party caucus proposal. On this point Mr. Wilson would not readily yield. At first he was disposed to assert vigorously his established aversion to "rule by caucus" and to put responsibility for failure of currency reform on those who appeared to be conspiring against it. Had he persisted there might have been no reform of the currency for years; and the war which burst eight months later would have caught the country unprepared for the frightful financial strain. "Right of way" is of no value to the autoist who gets killed asserting it; so the practical politicians finally convinced the President that there must be a caucus or an abandonment of all hope for legislation. He agreed to the caucus, which was euphoniously termed "a conference", and did the cleverest kind of work among the Senators in healing differences and imparting a new and militant spirit to the whole movement. (Glass, supra, pp. 194–195.)

As Senator Glass conceded, "the memorable part of the Senate debate on the currency bill was a 3-hour speech by Senator Elihu Root against it. The speech was so good that Minority Leader Senator Gallinger said that unless the Republicans in 1916 nominated Root for President, they would miss the greatest opportunity ever presented to the Party." (New York Times, Dec. 14, 1913, and Glass, supra, p. 200.)

Senator Root began by lamenting that the "caucus," under the guise of a "conference," made the bill a party measure thus depriving the majority party, and the country, of the benefit of the minority's differing views. Though he recognized the futility of the effort, Senator Root concentrated his attack upon section 16 of the bill which read as follows:

> Federal Reserve notes to be isued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal Reserve banks through the Federal Reserve agents as hereinafter set forth, and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable for all taxes, customs, and other public dues. They shall be

redeemed in gold on demand at the Treasury Department of the United States in the City of Washington, D.C., or in gold or lawful money at any Federal Reserve bank.

A slight change had been made in the wording of section 16 (12 U.S.C. 411) that payment would be in "lawful money" instead of gold. Section 16 today reads substantially the same as when Elihu Root in 1913 said this about it:

You will perceive that the provision contains in the terms no limit whatever upon the quantity of notes that may be isued: Federal Reserve notes to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal Reserve banks. The said notes shall be obligations of the United States.

That, Sir, is to my view a plain, simple enlargement of the national currency of the United States. It is authority for the increase, practically, of what we call greenbacks. The notes will be obligations of the Government of the United States pure and simple. They are not credits of anybody else; they are credits of the Government of the United States. (*New York Times*, Dec. 14, 1913, and Congressional Record, Dec. 13, 1913, p. 831.)

What Root said then is as true today. The Owen-Glass bill then, and the Federal Reserve Act today delegate to the Federal Reserve Board the power to issue currency without limit.

What was said by Root on the floor of the Senate on December 14, 1913, others have been saying ever since in successive Presidential administrations, namely, that since the power "to borrow money on the credit of the United States" and "to coin money" are powers conferred upon the Congress by the Constitution (section 8, clauses 2 and 5), they are powers which the Congress cannot constitutionally delegate to any agency. Moreover, the Constitution, in section 9, clause 7, clearly provides that "no money shall be drawn from the Treasury but in consequence of appropriations made by law."

As Elihu Root so eloquently pointed out, the Federal Reserve Act in section 16 delegates to the now Board of Governors of the Federal Reserve System the awesome power to issue currency without limit.

It is by exercise of this unlimited power that the Federal Reserve Board, through its Open Market Committee, buys U.S. bonds in amounts far beyond its needs so that it can draw interest upon them out of which to pay agency expenses.

The net result is that the Board of Governors of the Federal Reserve does not have to apply to the President, the Office of Management and Budget, the Banking or Appropriation Committees of the House and Senate.

The Federal Reserve collects interest on the U.S. Government bonds it buys, deducts its expenses, and yearly returns the excess to the Treasury. So long as it holds, as it does today, upwards of $90 billion of U.S. Government bonds, it can keep the wolf from the door.

Although altered in many respects, the Owen-Glass bill passed the Senate on December 19, 1913, by a vote of 54 to 34, and was immediately sent to conference with the House. (Glass, supra, p. 212.)

In the conference, Glass and Korbly (Democrats), and Hayes (Republican), represented the House; Owens Reed, Pomerene, Shafroth, O'Gorman, and Hollis (Democrats), and Bristow, Nelson and Crawford (Republicans), the Senate. There Glass and Owen won back almost every provision of their bill that the Senate had changed. (Glass, supra, pp. 317–336.)

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At the White House on the evening of December 23, 1913, President Wilson signed the Owen-Glass bill into law to become the Federal Reserve Act of 1913. (Glass, supra, p. 220; New York Times, Dec. 24, 1913.

It was a festive occasion and a Christmas present to the President who was surrounded by his family, his Cabinet, Senator Ham Lewis, the Senate Majority Leader, Champ Clark, the Speaker of the House, Oscar Underwood, the House majority Leader, Senator Owen, Congressman Glass, and members of the Banking Committees.

As so vividly mentioned in the New York Times of December 24, 1913, in signing the bill the President used four gold pens one of which he presented to Senator Chilton of West Virginia, and the other three were presented by the President to Senator Owen, Congressman Glass, and Secretary McAdoo. In addition, the President sent notes of appreciation to both Glass and Owen, and spoke for about 10 minutes to a very happy audience.

The Times, which had been so consistently critical, wrote two favorable editorials for the first time, and the act became law.

The trouble was about to begin.

II. THE FEDERAL RESERVE SYSTEM GOES INTO OPERATION

In July 1914, just as the "Reserve Bank Organization Committee" composed of the Comptroller of the Currency, the Secretary of the Treasury, and the Secretary of Agriculture set about putting the Federal Reserve System into operation, World War I broke out. Individuals and banks hoarded $600 million, the stock market closed, and the banks were in trouble again. ("The Federal Reserve: A Study of the Banking System of the United States," by Henry Parker Willis, published in 1915 by Doubleday-Page and Co. as one of a series called "The American Books". See ch. V, especially 104.)

On April 1, 1913, J. P. Morgan had died in Rome, at the age of 76. On June 28, 1914, Serbian terrorists assassinated Archduke Ferdinand of Austria. On July 28, 1914, Austria declared war on Serbia, and gold reached new highs. On Friday, July 29, 1914, minutes before its scheduled 10 a.m. opening, the stock exchange, which had remained open during the panics of 1893 and 1907, closed. There were those who said it would not have done so had J. P. Morgan been alive and kicking. By another week's end, World War I had started. Within 2 weeks over $80 million was withdrawn from New York banks, and the situation was serious. (Sobel, supra, ch. 10, especially 322, 328, 330, 335.)

As noted earlier, as a young man Senator Robert L. Owen, president and founder of the First National Bank of Muskogee, Okla., had lived as a banker through the panic of 1893. Owen knew, as few men of his time, that when currency is scarce the best and most solvent bank will fail. From his personal experience, and studies abroad, he also knew that this was unnecessary if the country had the proper banking system.

By 1908 Owen was the Senator for newly admitted Oklahoma. He was inspired to shake his finger at Senator Aldrich, say "I told you so," and offer his amendment again to the then Vreeland-Aldrich Act. This time Aldrich accepted the amendment, but he put it into the act, hedged with many restrictions.

The Glass-Owen Act provided for the repeal of the Vreeland-Aldrich Act which was to take place after the Reserve Organization Committee had put the Federal Reserve System into operation. On July 31, 1914, when the European war broke out, Senator Owen rose in the Senate, and amended the emergency banknote provision in the Vreelad-Aldrich Act, removing from the section all the many restrictions Aldrich had tacked onto it.

The emergency notes were limited to national banks, the existence of a national emergency, a total issue of $500 million, and a certain percentage of the bank's capital and surplus. The Owen 1914 amendment removed all restrictions, and left the Secretary of the Treasury free to assist a bank applying to any extent he wished. (Owen, supra, 46–47.)

Professor Henry Parker Willis who had been consultant on the bank bill to Glass in the House, and afterward Secretary to the Federal Reserve Board, tells us that the Aldrich-Owen amendment, as amended by Owen "gave free range" to taking out emergency banknotes.

Before the Federal Reserve System began operating, "more than" $350 million of emergency banknotes were issued. Together with over $200 million of clearing house certificates, Willis estimates that "in all," $575 million "of new media was injected into circulation within a short time." (Willis, supra, 104–105.)

Sobel says the provision extending the emergency provision until June 30, 1915, was "an afterthought, and almost failed to be included in the final draft." Thus, "accident and chance enable the Government to use a huge amount of paper under conditions Wall Street could not have imagined in 1908." (Sobel, supra, 337.)

As American business improved and foreign money came to America instead of leaving it, the emergency bank currency was gradually retired. By June 1915, it "had wholly disappeared." (Willis, 122.)

This is but another example of Senator Owen's farsightedness. It was Owen who convinced Senator Aldrich in 1908 to provide in the Vreeland-Aldrich Act for the issuance of emergency currency, and it was Owen who removed Aldrich's restrictions. This simple provision of Senator Owen prevented hundreds of bank failures in 1914.

One would have thought that Professor Willis would have thought well of the Owen amendment and appreciate how well it enabled the country to meet the 1914 emergency.

Alas, Willis was a banker, and even more conservative than Senator Glass. Along with his brother bankers, Willis firmly believed in the so-called "real bills theory," to wit, that banks must confine themselves strictly to financing "commercial" transactions, and the banking system must only issue currency against such transactions. For instance, a loan to a man who "has sold goods to another and draws on him, at say 90 days sight," and the buyer "accepts the draft by writing the word 'accepted' and his signature across the face," is "a commercial transaction." (Willis, 177–178.)

Also, when B, who buys goods from A, finds it to his advantage to induce his own bankers to accept, the loan becomes a "banker's acceptance" and "commercial paper of the purest type." Seller A often finds it much easier to sell such an acceptance in the open market than to discount it at his bank. Sometimes the banker's acceptance is "so good that it can be sold without any endorsement or undertaking." Of course Professor Willis says that had "the reserve banks been in operation at the beginning of August (1914), they would naturally have supplied the great volume of currency which was called for." (Willis, supra, 180–181, 123.)

This is wishful thinking. Section 13 of the Federal Reserve Act states clearly that "commercial paper" to be eligible for discount must be of a self-liquidating character and mature within 90 days, unless for agricultural purposes when it can mature in 6 months.

Put into the Federal Reserve Act is the monetary real-bills theory that Willis embraces on every page.

You can look from one end to the other of the Federal Reserve Act of 1913, but you will not find in it the provision that the farsighted Owen had in his amendment under which member and nonmember banks could be issued currency in emergencies against government bonds.

Getting the Federal Reserve Started

As one could well imagine, many cities in the United States felt they were entitled to a Federal Reserve bank. Professor Willis states that some 36 applied. (Willis, supra, 85–86.)

During January and February 1914, the committee traveled to as many cities as it could and met with representatives of all.

The act provided that there be not less than 8, nor more than 12 regional Reserve banks. The political pressures were such that 12 were selected, namely, Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. (Willis, supra, 94–95.)

The act of 1913 also provided that membership in the Federal Reserve System was compulsory for national banks, and opponents of the legislation had freely predicted that many national banks would withdraw. But not so. Of the more than 7,600 national banks in the country all except 15 joined. In addition, by April 1914 a dozen State banks pledge to the committee to join. (Willis, supra, 88.)

Each district Reserve bank was to have a board of directors with staggered 3-year terms. Since under the act class A banker directors and class B businessmen directors of the regional Reserve banks were to be selected by member banks in the region—one by large, one by medium, and one by small banks in each bank district—the committee went ahead and conducted these elections.

However, the committee had to leave the appointment of the so-called class C public directors of each regional Reserve bank to the Board. Under the act it was to designate one of these class C directors as "chairman, and Federal Reserve agent", and another vice-chairman. (Willis, supra, 319, and sec. 4 of the 1913 Act.)

Despite the terms of the act, the Board suggested that the chief executive officer of each regional Reserve bank should be designated as "Governor," and another "Vice Governor," both to be elected by each bank board of directors. (Willis, supra, 98.)

Not only was there no statutory authority for the creation of this office of "Governor," but also, the Governor apparently was, in many instances, paid more than the statutorily designated Chairman and Federal Reserve agent. Willis explains the salary difference by saying that the Federal Reserve agents were lower paid Government employees, whereas the "Governors" were "hired on a commercial basis" as if they were "entering the employ of an ordinary commercial bank." (Willis, supra, 164–165.)

As we know the act provided for banker representation through a "Federal Advisory Board." After their election the board of directors of each of the 12 district banks selected one person from its district to be on this board which, by section 12 of the act, was to meet in Washington, D.C., four times a year.

The Federal Reserve Board under the 1913 Act was to have seven members, two of whom would be the Secretary of the Treasury, and the Comptroller of the Currency, ex officio. One Board member was to be designated "Governor" and one "Vice Governor." On August 10, 1914, Board membership was complete, and the Board members took their oath of office. (Willis, supra, 96–97, and sec. 10.)

The members of this first Board were:

John Skelton Williams—Comptroller, February 2, 1914–March 2, 1921.

William G. McAdoo—Secretary of Treasury, December 23, 1913–December 15, 1918.

Charles S. Hamlin—Governor, August 10, 1914; 1916 and 1926 reappointed. Served until February 3, 1936—successor took office.

Frederick A. Delano—Vice Governor, August 10, 1914–July 21, 1918—resigned.

Paul M. Warburg, August 10, 1914–August 9, 1918—tenure expired.

William P. G. Harding, August 19, 1914—August 9, 1922—tenure expired.

Adolph C. Miller, August 10, 1914; 1924—reappointed; 1934—reappointed from Richmond District. Served until February 3, 1936—successor took office.

You can see that the Federal Reserve Board is unusual in its organization. From the beginning, with staggered 2-year terms, a President coming to office cannot make more than two appointments to the Federal Reserve Board during his first term unless an incumbent dies or resigns. The most he can hope is that late in his second term he can make a fourth appointment.

Of course, no one is eligible for an appointment if he is an officer, director, employe or stockholder of a bank, and not more than one can be a resident of any one of the 12 Federal Reserve districts. (Willis, supra, 319–329, and sec. 10 of the 1913 Act.) Two are to be "experienced in banking or finance."

On November 2, 1914, the member banks were asked to subscribe for stock, and on November 16, 1914, the Federal Reserve Board began operations.

Under section 7 of the 1913 act the stock was to pay a 6-percent dividend. The subscriptions were to be equivalent to the member bank's capital and surplus: one-sixth on organization, one-sixth in 3 months, and one-sixth in 6 months. The remaining three-sixths subscription was payable on call of the Board.

Besides buying stock in the Federal Reserve bank of its district, each member bank also had to post reserves upon which no interest would be paid. Under the National Banking Act, these reserves were held, in large part, in New York City banks which loaned the money out on call.

There was, therefore, great opposition to the Federal Reserve Act, particularly by small country banks, which relied for their earnings on 2-percent interest on these city balances. To meet this objection, the Federal Reserve Act, in section 19, reduced required reserves so that banks in large Reserve cities were to keep 18 percent of demand, and 5 percent of time deposits, medium city banks 15 percent of demand, and 5 percent of time deposits, and small country banks only 12 percent of demand, and 5 percent of time deposits. (Federal Reserve Act of 1913, sec. 19.)

Professor Willis very neatly illustrates how this reserve reduction worked. Assuming a country bank has $100,000 of deposits, this required a 15 percent reserve, or $15,000. Under the National Banking Act, three-fifths of this $15,000, or $9,000, might be carried as a bank balance in a large city bank which would pay 2-percent interest, or $180 per year.

Under the new Federal Reserve System, the country bank had to keep its reserves in cash with its regional Federal Reserve bank, which was prohibited from paying it interest. When, however, the reserve requirements for country banks were reduced by the Federal Reserve Act, $3,000 was thereby released for the country bank to use as it pleased. If 6 percent were the prevailing rate of interest, the $3,000 could be loaned and return the same $180 that the $9,000 had earned in New York. But, since our banking system is a fractional reserve one, the $3,000 could be used to sustain new bank loans.

Assuming the country bank could find borrowers, the $3,000 would support $25,000 of new loans. At 6 percent the bank would earn $1,500, as against the $180 it was drawing in interest on its New York balance. (Willis, supra, 203–205.)

As soon as the Federal Reserve System began to operate, it then provided a method to clear checks of member and nonmember banks at par, relieving American business of a burden that cost them from $75 million to $125 million. (Glass, supra, 300.)

Prior to the enactment of the Federal Reserve Act of 1913, the so-called "reasonable collection charge" was a "flimsy" pretense for reasonableness. So successful had Reserve's accomplishments in check collection become that Senator Glass, writing in 1927, could say:

> The reserve system has largely done away with the enormous and hazardous "float" which formerly clogged the mails and prevented banks from knowing exactly where they stood, while it has immensely reduced the exchange charges visited upon the community by "toll-gate" institutions which seized this method of filling an otherwise somewhat depleted exchequer. (Glass, supra, 301–303.)

Federal Reserve banks from the beginning were set up to aid member banks by discounting their paper. However, as indicated, the paper had to be self-liquidating growing out of commerce, industrial, or agricultural transactions. If the latter, the paper should mature in 6 month; otherwise, the paper must mature in 90 days. (Willis, supra, 181, and sec. 13 of the Act.)

Of course, in the open market, Reserve was authorized to buy and sell acceptances and Government securities. In truth, the powers of the Board were sweeping:

To readjust districts created by the Organization Committee and create new ones.

To regulate the establishment of branches of Federal Reserve banks.

To designate three (class C) of the nine members of the board of directors of each Federal Reserve bank, one of these to be chairman of the board with the title of "Federal Reserve Agent."

The Federal Reserve Agent to maintain a local office of the Federal Reserve Board on the premises of the Federal Reserve bank. He shall make regular reports to Federal Reserve Board and be its official representative.

To remove any director of class B (businessmen) if it should appear that he does not fairly represent the commercial, agricultural, or industrial interests of his district.

To remove officers of Federal Reserve bank with due notice.

To establish rules governing applications from State banks and trust companies.

To levy a semiannual assessment upon the Federal Reserve banks for estimated expenses for succeeding 6 months, together with deficit carried forward.

To examine at its discretion the accounts, books, and affairs of each Federal Reserve bank and to require such statements and reports as it may deem necessary.

To require, or on application to permit, a Federal Reserve bank to rediscount the paper of any other Federal Reserve bank.

To suspend for a period not exceeding 30 days (and to renew such suspension for periods not to exceed 15 days) any and every Reserve requirement specified in the act.

To supervise and regulate the issue and retirement of notes by Federal Reserve banks.

To add to the number of cities classified as Reserve and central Reserve cities under existing law in which national banking associations are subject to the Reserve requirements set forth in section 19 of the act, or to reclassify existing Reserve or central Reserve cities and to designate the banks therein situated as country banks, at its discretion.

To require the removal of officials of Federal Reserve banks for incompetency, dereliction of duty, fraud, or deceit.

To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal Reserve banks.

To suspend the further operations of any Federal Reserve bank and appoint a receiver therefor.

To perform the duties, functions, or services specified or implied in the act.

To determine or define (subject to stipulation) the character of paper eligible for discount for member banks.

To prescribe regulations for purchase and sale by Federal Reserve banks of bankers' bills, et cetera.

To review and determine the rate of discount established by Federal Reserve banks.

To authorize establishment of branches of Federal Reserve banks in foreign countries.

To establish rates of interest on notes issued.

To prescribe regulations for substitution of collateral.

To make and promulgate regulations governing the transfer of funds at par among Federal Reserve banks.

To act, if desired, as clearinghouse for Federal Reserve banks.

To require, in its discretion, Federal Reserve banks to act as clearinghouses for shareholding banks.

To require extra examinations of member banks when deemed necessary.

To determine and report annually to Congress fixed salaries of all bank examiners.

To arrange for special or periodical examinations of member banks for account of Federal Reserve banks.

To assess upon banks in proportion to assets or resources the expenses of special examinations.

To receive from Federal Reserve banks information concerning the condition of any national bank in the district.

To receive applications from national banks having $1 million or more capital for the establishment of branches in foreign countries, or reject or accept such applications and to prescribe conditions under which such branches may be opened.

To require examinations of foreign branches as it may deem best.

(Willis, supra, 141–144.)

For instance, Reserve could not only buy and sell Government, State, and municipal securities, but also receive applications from national banks to establish branches abroad, and establish foreign agencies there of its own to buy and sell bills of exchange. (Willis, supra, 323–324 and sec. 14 of the act.)

However, these early American bankers had a very narrow concept of the purpose and effect of these so-called open market operations.

Willis says the purpose of the Federal Reserve System (Willis, supra, 190–191)—

> is to enable persons who have debts to pay to get the funds with which to meet them, and that banking is a process of equalizing the supply of fluid funds among those who require them. The Federal Reserve System is intended to provide just this means of liquefying and equalizing resources. It is not a method of supplying capital to borrowers for investment. Such investments as it makes are made for the purpose of affecting the rate of interest in the market, and of enabling banks to meet their own maturing obligations without difficulty. While this service appears to be directly and primarily for the benefit of the commercial world, it is beneficial indirectly to every member of the community. A bank's suspension effects the whole community, and the same is true of the failure of any commercial enterprise.
>
> Important as is the function of supplying capital to those who need it for long term investment, this is the field of finance and not of banking. Preventing suspension of payment and insuring constant convertibility of demand obligations into cash is quite as great a service to the public at large as it is to those bankers, merchants, and traders generally for whom the service is immediately performed.

You can see from this extract that it never passed Willis' mind that Reserve's buying and selling of Government securities could regulate the money market and protect our economy from extremes of boom and bust.

Of course, perhaps the greatest change effected by the Federal Reserve Act of 1913 was to provide for the gradual withdrawal and cancellation of the national bank notes which had constituted the currency of the Nation since the War between the States. The printing of this currency required a plate for each of the 7,600 national banks in existence in 1913, whereas, since 1913, the Bureau of Engraving has needed but one plate to print our currency since the Reserve System opened on November 16, 1914.

As section 16 of the Federal Reserve Act of 1913 makes clear, Federal Reserve notes are to be issued at the discretion of the Federal Reserve Board to make advances to Federal Reserve banks through the Federal Reserve agents in each of the 12 regional banks subject, of course, to Reserve requirements set forth at some length in section 16. While the currency is issued in the first instance to the Board on application, the Federal Reserve agents are not authorized to give it to the Federal Reserve banks until those banks secure the issue by eligible collateral.

Suffice it to say that the Federal Reserve System began operation on November 16, 1914, possessing the above-mentioned powers. When the banks opened in 1914 these were the "Governors" in each of the district banks:

District 1—Boston, Alfred L. Aiken—Resigned 1918.

District 2—New York, Benjamin Strong, Jr.—Died while in office 1928.
District 3—Philadelphia, Charles J. Rhoads—Resigned 1917.
District 4—Cleveland, E. R. Fancher—Died while in office 1935.
District 5—Richmond, George J. Seay—Retired 1937.
District 6—Atlanta, Joseph A. McCord—Resigned 1918.
District 7—Chicago, James B. McDougal—Retired 1934.
District 8—St. Louis, Rolla Wells—Resigned 1918.
District 9—Minneapolis, Theodore Wold—Retired 1919.
District 10—Kansas City, Charles M. Sawyer—Resigned 1915.
District 11—Dallas, Oscar Wells—Resigned 1918.
District 12—San Francisco, Archibald Kains—Resigned 1917.

Open Market Operations

As we have seen, overcoming even the closing of the stock exchange in the summer of 1914, as World War I broke out in Europe, the Federal Reserve System opened for business on November 16, 1914.

It is right to say that the Federal Reserve System was a big improvement over the banking system that preceded it. There is not much question but that the Federal Reserve banks were of great value in the day-by-day collection of checks. The Federal Reserve was worth the effort for its check collection system alone.

Theoretically, as the drafters hoped, the 12 regional banks could shift money quickly from one end of the country to another to aid a beleaguered bank. But how good the System was to be at that task remained for the future.

Then, the question was open in 1914 as to who would run the Federal Reserve System. Treasury? Congress? The President? The Federal Reserve Board? The Federal Reserve banks? Or, as it turned out, the Federal Reserve Bank of New York of which Benjamin Strong was Governor?

Likewise, problems arise if Reserve is buying or selling acceptances in the open market. Its buying power is so great, that from the beginning, Reserve knew that its transactions could control in large measure the prevailing interest rate in the country.

When the Reserve began in November 1914, member banks were beginning to withdraw the $300 million they had in bank balances with New York City banks. The act gave them 3 years in which to do this. (Willis, supra, 198–199.)

The member banks, at this time, were discounting bills at 4 to 4½ percent, whereas, the Federal Reserve banks were holding to a discount rate of 6 to 6½ percent.

To show how out of line both the member bank and Reserve interest rate was, a brokerage house in Dallas, Tex., offered to buy all the rediscounts at the Federal Reserve Bank of Dallas at 2½ percent.

The situation was discussed by Benjamin Strong, Governor of the Federal Reserve Bank of New York with his counterpart McCord, Governor of the Atlanta bank.

Strong made three points with McCord:

1. Member banks have $7 to $8 million they will not loan at 4 to 4½ percent and if we allow them to rediscount at a lower rate won't the banks loan at a rate less than 4 to 4½ percent. And "force the surplus into use?"

2. But reducing the rediscount rate at this time (1914–1917) would cause a withdrawal of $300 million reserve New York balances that under the Act are to be withdrawn over a 3-year period.

3. It is important that we see to it that the decision as to the interest rate is one for the bankers in the Federal Reserve banks and not one for the politicians on the Federal Reserve Board. (Staff report of Subcommittee on Domestic Finance, Committee on Banking and Currency, 92d Congress, 1st Sess., December 1971 entitled: "Federal Reserve Structure And The Development of Monetary Policy, 1915–1935," pp. 13–14, footnote 6.)

Thus, you see at this very early period there developed a fundamental conflict between the interests of the country and the selfish interests of the commercial banks. Though he was a banker, Benjamin Strong had a brilliant mind, and he saw at once both the country's need and the banker's need.

Of course, this conflict was foreshadowed, when the Federal Reserve Board made the mistake of allowing the Directors of each district bank to elect a chief executive officer and call him a "Governor," when the statute clearly provided that each bank should have a chairman who was also the fiscal agent.

Adding insult to injury, we see that without statutory authority, the Board elevated bankers on the district banks to head the banks, and then paid them better salaries than the Chairman and fiscal agent who were Government employees.

In this early argument, it was the Federal Reserve Board that wanted the interest rate reduced—

The conflict was heightened by the problem of defining the role of the System. The governors tended to view the System as essentially a cooperative enterprise for the mutual assistance of bankers and to favor a conservative interpretation of sound banking policy as a guide for their actions. Seldom was public policy in the broader sense an issue in the Conferences of Governors, and even in the area of open market operations—the development of which was the most important contribution of the Governors during this period—the overall emphasis was less on questions of policy than on bureaucratic procedures.

The Board, on the other hand, reflected the views of the majority of Congress and of the Wilson administration which had seen the establishment of the System as necessary to insure economic growth. To accomplish this end, the legislation had been designed to provide a more elastic currency, to insure governmental control of the banking system, and to guarantee reasonable rates of interest for the commercial borrower. Although the latter objective frequently has been forgotten, it provided the initial policy goal for the System as the Board acted to implement the intent of Congress and pressed for lower and more uniform interest rates. (Staff Study, supra, 12–13.)

When the Board first suggested that the interest rate be lowered Benjamin Strong bristled and remarked:

. their duty is to sit there as a *judicial body* to review what we suggest to them. What we have in fact established at the respective banks is for them to pass upon, and nobody is entitled to go to that board and tell them what they ought to do in suggesting rates to the Federal Reserve banks. (Emphasis supplied.) (Staff Study, supra, 13.)

It seems strange to us today to see Reserve's rediscount rate during the first few months of its operation at 6 to 6½ percent, and 4 to 4½ percent for February 1915 to August 1916, both rates being substantially above market rates. The argument of the bankers, in line with orthodox theories on central banking, was that member banks should not be able to profit by rediscounting with Reserve banks at rates lower than they had received on loans.

Joseph A. McCord of the Atlanta bank was not satisfied. He argued that low interest was good for the country. He withdrew his plea for lower interest after Strong depicted the dire consequences any reduction might have on member bank balances in New York City banks. (December 1971, staff study, supra, 14.)

Thus, we see that the very first question the Federal Reserve System faced is resolved not on its merits, but on the basis of what is good for the commercial banks. In this, the System was breaking faith with its founders.

Just a few months earlier, Oscar Underwood, then chairman of Ways and Means had said to Congressman Glass:

> I congratulate the wisdom of this committee in establishing a Government control of this system that would represent the borrowers of money and enable the people of America to secure the medium of exchange at reasonable rates of interest at all times. I think that is probably the greatest reform that has been worked out in this bill . (and) I believe that this board will carefully and safely manage this, not only in the interest of the American people and low interest rates, but also will have the wisdom to see that the great banking interests of the country are properly safeguarded and proctected. (Congressional Record, 63d Cong., 2d Sess., vol. 51, p. 1459.)

And William Gibbs McAdoo, then Secretary of the Treasury had said:

> Ample credit resources at reasonable rates are an indispensable factor in the development of a country and in the growth and prosperity of its business and productive enterprises. The primary purpose of the Federal Reserve Act was to so alter and strengthen our banking system that the enlarged credit resources demanded by the needs of business and agricultural enterprise will come almost automatically into existence, and at rates of interest low enough to stimulate, protect, and prosper all kinds of legitimate business, and to bring about ultimately a greater equality of interest rates throughout the coutry. ("Annual Report of the Secretary of the Treasury for 1915," p. 12.)

The Federal Reserve System had thus met its first test, and failed. A weak Federal Reserve Board allowed the bankers in the district banks to take over, and the country's interest was ignored.

So much for the first squabble at the new Reserve banks—more were to come.

There is something pathetic about these early days. Ben Strong and the other Governors had fought for the Aldrich bill, and lost, but there they were running the Federal Reserve System and getting away with it. Strong even initiated a discussion among the Governors "of the Board's authority to require one Federal Reserve bank to rediscount for another Federal Reserve bank." This was hardly a point for discussion, because the Congress had insisted on the Board's being able to have one distirct bank help another, and if anything was settled in the legislation, this was.

The matter came up at a second conference of the banks. Strong, pointed out, that the South and West had periods of seasonal pressure, and he felt if at those times those Reserve banks would apply, the Federal Reserve Bank of New York would, on its own initiative, make a fair rate. He argued that it was never the draftsman's intention that "there should be a board of seven men acting as a broker between the Federal Reserve banks." (December 1971, staff study, supra, 15.)

It is readily apparent that the discussions at these early conferences of the Governors bode no good for the System as a whole. To begin with, the Governors were meeting alone, and with each successive meeting they were developing more and more opposition to the Federal Reserve Board whose very creation they had all opposed.

The matter came to a head at the fifth conference of the Governors when they had the audacity, by resolution, to say:

> The function of initiating discount rates of all sorts should be exercised by the Federal Reserve banks without pressure from the Federal Reserve Board.

That did it.

The Federal Reserve Board reprimanded the bank Governors. (Staff study, supra, 14–15.)

Governor W. P. G. Harding of the Federal Reserve Board appearing before the Governors Conference of January 16, 1916, said:

> The Governors should meet only when called together by the Board, all their conferences should be in Washington, D.C., and would adhere to an outline of topics approved by the Board. (Staff study, supra. 15).

Granted that Strong had a point that $300 million should not be precipitately pulled out of the New York banks, Harding declared that the formation of the Governors Conference, as a permanent organization, was "beyond the scope of the powers" of the Governors under the Federal Reserve Act.

He could have added it was also beyond the Board's authority under the act to suggest there be a "Governor" at any Federal Reserve Bank. Under the Glass-Owen Act the title "Governor" and "Vice Governor" was reserved for the heads of the Board.

As its memorandum made clear, the Board told the bank Governors that they wished "to deal with the Reserve banks as individual banks," and the "Board had no intention of permitting the Governors to assume a role in formulating policy." Their role was to be confined to "technical questions of operation." (Staff study, supra, 15–16.)

The next conflict with the Board came when it asked the Reserve banks to buy acceptances, not as a unit, but individually.

The open market operations at this period were very important because the Reserve banks needed the earnings. However, whereas the Board wanted the Reserve banks to purchase individually as the act contemplated, to a man the Governors were opposed because, as Governor Aiken of the Boston bank said, that necessitated their going into the market and bidding against one another.

With the majority of the Governors agreeing with Aiken, the New York bank began buying acceptances for the account of the Boston bank and several others, the New York bank's being allowed for its services "a certain percentage of the interest." (Staff study, supra, 17.)

The Board, which had advocated individual action, suggested an assessment on all the banks to cover the New York bank's expenses. Strong rejected this because it would discourage State banks from joining the System, and it ended by the Board's allowing, by regulation, the Reserve banks to purchase acceptances where the corporation publishes its financial statement and acceptances of member banks. (Staff study, supra, 18–19.)

Once again the Board had been overruled by the Reserve banks, and the intentions of the draftsmen of the act repudiated. Federal Reserve had become a central bank, at least for purchases of acceptances.

It should be added that the way it all worked out, Benjamin Strong, alone at the New York bank was directing these open market operations. His bank was in the "driver's seat" (Staff study, supra, 20), and in no small measure due to him.

Interestingly, when several Reserve banks bought above par the 2-percent Government bonds that held the circulation privilege under the National Bank Act which the Federal Reserve Act compelled the Federal Reserve banks to buy at par and accrued interest, the Federal Reserve Board asked the New York bank to represent all the Reserve banks in the purchase and sale of these bonds.

Once again the Governors were delighted to see the Board support their plan for unit purchases by the Reserve Bank of New York. Vice Governor Treman remarked that the banks "are one unit and we should help each other to make enough to pay expenses." (Staff study, supra, 21.) Of course it was this concern for earnings that caused some Reserve banks to buy the 2-percent bonds above par in defiance of the clear provisions of the act.

III. POSTWAR ADJUSTMENT, 1919–1921

As we have seen, the Federal Reserve System's handling of the financing of World War I left much to be desired.

Its actions, during the postwar period were so inept, that a case could be made for the fact that the Federal Reserve itself caused the 1920–21 depression.

What's Good for Member Banks—Is Good for the Country

World War I ended in November 1918. At the Governors Conference of March 1919, Governor Strong suggested that the discount rate be raised, but member banks had a huge amount of loans outstanding on government bonds at current rates, and an increase in the discount rate would result in their taking a loss on borrowings from the Reserve banks, using the bonds as collateral. For this reason Strong decided not to press the point. (Stenographic Record, hereinafter cited "S.R.", March 1919 Conference, 158, 162, 166, 233–235.)

The Conference agreed that the status quo should be maintained until after the flotation of the Treasury's fifth loan, but to recommend a higher rate on the next Treasury issue so that the discount rate could be raised without disturbing bank profits. (S.R., March 1919 Conference, 353–354.)

Under Secretary Leffingwell and Reserve officials from farm areas saw a need to lower interest rates to stimulate production, but the decision was made on the basis of what was best for the banks, not on what was best for the economy. (S.R., March 1913 Conference, 158, 166, 233–235.)

Built into the Federal Reserve System is a conflict of interest in favor of bankers. This is the inevitable consequence of the fact, that almost all the officials of the Federal Reserve district banks are either bankers, or men selected by bankers.

At no time was this more evident than during this period.

Strong Gives Glass and Leffingwell an Economics Lecture

In September of 1919, Under Secretary Leffingwell purchased $500,000 bonds, naively assuming the funds would be used by the banks to pay off loans on Government bonds.

But as any first year economics student knows, under our fractional reserve banking system, when $500,000 is deposited in the Nation's banks, the banks will, naturally, use it to make loans to their customers.

This is precisely what happened. The banks loaned out the money not only to stockbrokers, but to other borrowers, and there was an expansion of bank credit. (S.R., November 1919 Conference, 89–90, 234–235.)

However, when Glass and Leffingwell discovered that the banks had not used the $500,000 to pay off their loans on Government bonds, Senator Glass charged that Federal Reserve had permitted the banks to use the money for "loans on stocks." (S.R., November 1919 Conference, 89–90, 234–235.)

Strong chided Glass for naivete in thinking that banks would do what Glass thought they ought to do, criticized Treasury for not financing at short intervals, and stated the Treasury should frame its policies so as to accommodate the banking system. (S.R., November 1919 Conference, 73, 261, 277–278, 285.)

Strong warned Glass and Leffingwell that if their December and January 1920 bond issues were to carry a 5-percent interest rate, then they "would have a profoundly inflationary effect unless the preferential and discount rates were raised."

There is, of course, an inconsistency in the Strong position in that higher interest on short-term Government paper and higher discount rates are more inflationary than long-term debts.

His reason for advocating them was to compensate the banks because he wrongly believed that it was an integral aspect of Federal Reserve policy to protect the profits of the member banks. (S.R., November 1919 Conference, 280, 282.)

The Federal Reserve's High Discount Rate Heightens and Worsens the 1920–21 Depression

By September 1919 inflation had escalated and, as soon as the member banks were clear of their last Liberty Loan obligation, the Federal Reserve Board raised the discount rate. ("Banking and Monetary Statistics," Washington, D.C., U.S. Board of Governors of the Federal Reserve System, 1943, 439.)

What happened was both dramatic and traumatic. The yield on 90-day acceptances rose from 4.28 to 4.53 percent. New stock exchange call loans rose from 9.80 to 14.90 percent. (Banking and Monetary Statistics, Federal Reserve System, 1943, 452.)

Strange as it may seem, these increases in market rates seem hardly to have been noticed within the System, and W.P.G. Harding, Governor of the Federal Reserve Bank of Boston, (January 16, 1923 to April 7, 1930), applied pressure for further discount rate increases during the November 1919 Conference. (S.R., November 1919 Conference, 16–17, 234.)

Glass had gone along with the rest of the Board in November 1919 in approving rate increases, but later wrote a letter to Governor Harding urging that System officials use what he called "moral suasion" with the member banks to prevent use of Federal Reserve funds to support "reckless speculation." (S.R., November 1919 Conference, 4–12.)

But his Under Secretary, Leffingwell, had learned the hard way. He announced after Glass' departure to the Senate that the Treasury's intention was to revert, for the time being, to the moderate-size, semimonthly issue of certificates. This acquiescence, plus the rate increase, meant total victory for Strong's position.

In January 1920 the Board had raised the discount rate again to 6 percent. But when the Governors met in April 1920, their Conference ended on a pessimistic note, for which there was ample reason.

The wholesale price index was continuing to rise, and the New York bank indicated another rise in the rediscount rate was needed. (Summary, April 1920 Conference, 2.)

Of course the fundamental fault was that the bankers running the System thought that when a bank discounted paper at a Reserve bank, the discount rate just had to be higher than the market rate. This meant a loss to the member bank.

But even in the face of falling prices and a weakening economy, the Governors kept the interest rate high hoping thereby to force the member banks to liquidate their loans at Reserve.

This high-intrest policy did not work. Loans were not liquidated, and not until the bottom of the depression in December 1920 did the discount rate fall below market rates. (Banking and Monetary Statistics, 283, 439–440, 463.)

The Congress and the 1920 Depression

However contented the Federal Reserve officials were about their credit policies, the U.S. Senate was not. On May 17, 1920, the Senate, by resolution, asked the Board to prepare a statement on how it proposed to meet the current inflationary trend, and mobilize credit to move the 1920 crops.

During the Senate debate on the resolution, the Republican majority made clear it favored an increase in the rediscount rate, while the Democratic minority, consisting of Democrats and Bull Moose Republicans, contended the rate increases already approved had caused the price increases and were ruining the farmer.

Senator Robert L. Owen warned that the current deflationary policy "is going to lead to an industrial depression," and it can only "bring down prices by creating a depression."

Owen contended that the remedies were not to raise interest and deter business expansion but, rather, to "bring down prices by creating a new volume of commodities."

Ignoring the fact that increases in the discount rate would tend to reduce production and increase unemployment, the Republican chairman of Senate Banking and Currency, Senator George P. McLean of Connecticut, contended that when the object is to reduce prices, "the normal way is to raise the discount rate." (Minutes, May 18, 1920 Conference, 2–3.)

On May 18, 1920, the Federal Reserve Board held a conference with the private bankers in the System, namely, the 12-member Federal Advisory Council, and the three class A directors of each of the Federal Reserve banks. (Congressional Record, 66th Cong., 2d sess., vol. 59, 7039, 7145–7146, 7202–7203.)

In addition, Edmund Platt of New York, then chairman of House Banking and Currency, subsequently appointed Vice Governor of the Federal Reserve Board, and a representative of the American Bankers Association also attended.

As a rationale for such a peculiar conference, the then head of the Federal Reserve Board, Governor Harding, said that it seemed "peculiarly appropriate at a time when there is a banking situation to discuss, to have bankers here to discuss it." (Minutes, May 18, 1920 Conference, 2–3.)

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What Harding should have said at this historic meeting at the beginning of the 1920 depression was, as Adolph Casper Miller, former Cornell University professor of Economics, and a member of the Federal Reserve Board (1914 to 1936) was to say subsequently that the Board had no policy, that it was about to make a declaration of operational bankruptcy, and had decided to pass the burden of credit control (by moral suasion) to the member banks. (Sixth Annual Report of the Federal Reserve, 1919, 68–73, 77–90, 99–100.)

"Moral suasion" was to hard headed Ben Strong a poor substitute for the use of open market operations and the discount rate. He pointed out that if one Reserve bank refused to loan money to banks having money on call in New York, then the burden would tend to fall too heavily on the New York bank. To him "moral suasion" was divisive, and a mere palliative which would drive "the infection" from one place to another and undermine the unity of the System.

In November 1919, Governor Strong, hoping to resolve differences of opinion, convened a second session of the November 1919 Conference of Governors as a symposium. Most of the Governors agreed with Strong.

At this symposium there was an extended discussion of the advisability of a penalty discount rate, most System officials agreeing with Glass that the penalty rate at Reserve should be above the market. But Adolph Miller dismissed the concept of penalty rates as irrelevant and antiquated. What was needed, Miller said, was a clear understanding as to what standards you use to determine what rates should be. An analysis of conditions in the district to Miller was the all-important thing.

It was their belief in the so-called penalty rate theory that led the Governors to accept in January a 6 percent rate. That increase led to a further increase in bank rates. Loans were not liquidated, and the discount rate never got above market rates until after the bottom of the depression was reached in December 1920. By that time "the number of bank failures had surpassed the amount recorded for any year since 1893". (Banking and Monetary Statistics, 283, 438–440, 463.)

The Governors who came into the System from positions as private bankers saw its role as essentially passive, and favored rate policies which would act less to control then to stabilize the market indirectly by providing accommodations at a penalty.

Whereas, as Senator Glass pointed out, the Board on the other hand reflects a political climate which sees the control of credit as a public trust and, therefore, a more active role for the System, (S.R., November 1919 Conference, 12.)

The Federal Reserve Ignores Economic Storm Signals

With economic storm signals flying at top mast, New York, Chicago, and Minneapolis banks raised the discount rate to 7 percent on June 1, 1920. Boston followed on June 4, Atlanta on November 1, and the Dallas bank on February 15, 1921. (Banking and Monetary Statistics, 439–440.)

Of course this is incontrovertible proof that a high interest policy in the face of a declining economy, aggravates the difficulty. Yet, bankers in hard times traditionally press for high interest, and as they press, the weakened economy grows weaker. Certainly this was so in the 1920–21 depression.

The Federal Reserve System suffers from officials who have minds of bankers. The country cannot allow bankers to determine interest rates. More especially when, as at the Reserve, the bankers act secretly, and alone, without consultation with the President, his Council of Economic Advisers, and the congressional leadership.

Who runs this country? Reserve?

Dr. Adolph Miller at the April 1920 conference put it this way:

Our Reserve Banking System is the only considerable banking system in the world in which there is no definitely fixed limit of any kind upon the operations of the system"; that reserve requirements, the only factor affecting System operations which is covered by statutory limitation, "can be suspended by vote of the Federal Reserve Board"; that, "when you analyze the thing fundamentally, *the discretion of the Federal Reserve Board ultimately is the regulating principle of our Federal Reserve System*"; *that "it requires virtually parliamentary sanction in England to do what the Federal Reserve Board was set up to do in this country*"; *that "there is no governmental body in the world, certainly none that concerns itself with banking and finance, that begins to have anything like the powers that the Federal Reserve Board has under the Federal Reserve System*"; and that, "in brief, ours is a reserve system by discretion instead of by any fixed principle". Nevertheless, these enormous powers should not be restricted, Dr. Miller added. On the contrary, "I think the Board should exercise its power to restrict. . . ." (Emphasis supplied.) (S.R. April 1920 Conference, 519, 526–528, 535–537.)

Here again we see a decision to be made; namely, to raise or lower the interest rate. It cannot get a fair hearing. The jury is packed with bankers who profit from an increase in interest rates. A depression is in sight and interest rates should be lowered to stimulate production. Instead, rates are raised and held at peak levels until September 1921.

Reserve's catastrophic policy was to "restrict credit and expand production." It was like fiddling while Rome burned.

In less than 8 months, beginning November 1919, the discount rate was increased from 4 to 7 percent at the Federal Reserve Bank of New York. (Banking and Monetary Statistics, 439–440.)

Between May and October 1920 wholesale prices fell 20 percent. Cotton fell 93 percent, oil 50 percent, cottonseed oil 80 percent. Manufacturing was down 42 percent, unemployment was up to 11.9 percent, lumber was stagnant, and agriculture was a disaster. (Seventh Annual Report of the Federal Reserve Board 1920, 7–9; Eighth Annual Report 1921, 10–12; S.R., April 1921 Conference, 53, 65, 75, 90, 610, 616, 635; Benjamin M. Anderson, "The Road To Full Employment: Financing American Prosperity," Paul T. Homan and Fritz Machlup Edition, New York, The Twentieth Century Fund, 1945, 25; "Historical Statistics, Colonial Times to 1957," House Document No. 33, 86th Cong., 1st sess., 73.)

As the Federal Reserve Annual Report for 1921 notes, the economy declined 26 percent in 1921, and 56 percent in the 18-month period from June 1920 through the end of 1921.

The Board had many explanations: Bad transportation, inefficient labor, world-wide lack of capital. (Minutes, May 18, 1920 Conference, 2–3.) But with prices for everything falling, the Board allowed the bank loan rate to remain at 7 percent. It was a unique depression. All prices fell except the price of money.

Even as late as January 1921 when agricultural prices in the southwest were at their lowest, the Board allowed the Federal Reserve Bank of Dallas to raise its rediscount rate to 7 percent, and keep it there until September 1921. The most orthodox monetary theorist would not have suggested an increase in rates during such a sharp deflationary spiral. It was a dreadful error, and one the Federal Reserve Board to its regret was to repeat in 1931, with even worse consequences.

Given the economic disaster which had occurred, it is difficult to understand why the Federal Reserve System persisted in its high interest policy down to September 1921. As early as the May 18, 1920, Conference that Governor Harding convened, Senator Owen had pointed out that the inflationary pressure was directly due to increases in interest rates triggered by the January 1920 increase in discount rates. Owen said what was needed was a rollback in rates to stimulate production, and bring down prices. He suggested a discount rate of 3 percent, coupled with a rigorous policy of moral suasion. (Congressional Record, 66th Cong., 2nd sess. vol. 59, 7039, 7202–7203.)

There are interesting similarities between Senator Owen's position and that of the Council of Economic Advisers during a subsequent period of inflationary pressure.

In November 1950 the Council told the Joint Committee on the Economic Report that "an important inflationary movement should be met by increasing the facilities and volume of production. This process requires cheap and ample credit and, until the volume of output increases, inflationary pressure will increase, and must be curbed by other than monetary measures of the kind which increase the cost of capital." (Statement of John D. Clark, former member of the CEA: "United States Monetary Policy," hearings before the Subcommittee on Economic Stabilization of the Joint Committee on the Economic Report, 83d Cong., 2nd sess., December 1954, 48.)

Governor Harding replied that however desirable, "on general principles," the expansion of trade and industry such as Senator Owen wanted must await "the actual supply of capital and credit available." (Recommendations of Federal Advisory Council, May 10, 1920; Summary, April 1920 Conference, 2, Minutes May 18, 1920 Conference, 3, 5, 14.)

In that reply is the answer to the mystery of the System's inappropriate response.

Reserve officials were looking at financial, rather than economic data. As bankers, this is what they had been taught to do. They were obsessed with the fact that member banks were heavily in debt to the Reserve banks, and were determined to reduce that debt at whatever cost.

The cost was high. And, in fact, the System did not succeed in doing what it set out to do. It did not reduce the level of bank indebtedness to the System by maintaining the 7 percent discount rate. It was not until Benjamin Strong "discovered" open market operations in the early part of 1922 that member banks were taken out of debt (as they are still put into and out of debt to the Reserve banks) by actions of the Reserve banks themselves. The other effect of Governor Strong's purchases of Government bonds in the open market was to lower interest rates. Thus, in the spring of 1922 with the member banks out of debt and able to make new loans, and with interest rates falling, recovery got underway.

When the Federal Reserve Has To Depend on Its Earnings Instead of a Congressionally Approved Budget, Its Judgment as to the Country's Needs Is Warped

It was not only a desire to benefit member banks that made the System favor high interest. At this period it held few Government securities and relied on discounting for its own income. With an increase in the discount rate, its earnings rose. For instance, the New York Times in January 1921 noted that the New York Federal Reserve Bank reported earnings of 217¾ percent for 1920, as against 129½ percent in 1919. (New York Times, Jan. 3, 1921, p. 2 of sec. 2, and January 30, 1921, p. 7.)

The Times figured the New York bank's profits "at the rate of a clear million or more a week," and "total Reserve earnings" at "more than double that." (New York Times, Jan. 2, 1921, p. 2, sec. 2.)

The 12 banks for the first 6 months of 1920 made $68.5 million of which the New York bank alone made over $24 million. (Ibid.)

The profits the Reserve banks were making as a result of their high discount rate were a source of great embarrassment to the System. Well it might be. As the New York Times commented editorially, such profits are "a matter of national, rather than local concern" because "these profits belong to the Nation," and there is "a first lien on them" for "the accommodation of the customers of the Reserve banks through member banks." (Ibid.)

The Times, however, accepted the System's argument that the Treasury pegged rates too low when the Liberty Loan bonds were floated, and that when the national spending stopped at war's end, the Reserve System had no alternative but to raise interest rates.

Naturally, the amount of the Reserve's banks' profits upset the western farmers and southern planters. Their outstanding borrowings climbed from $729.2 million in 1919, to $1,980 billion in 1920. (New York Times, Jan. 2, 1921, p. 2 of sec. 2.)

This led to demands by Senator McLean of Connecticut, then chairman of Sennate Banking, to apply $100 million to reduce the short-term debts of the United States, by Senator Hitchcock of Nebraska to use it as a special deposit to create credit for loans to farmers, and by Senator Sterling of South Dakota to use it to purchase debentures of the farm loan bank. (New York Times, Jan. 5, 1921, p. 23.)

Reserve Ignores Gold Flows

Gold had left the country at the war's end when controls were removed, but started to flow back into the United States with the interest rate increases in November 1920. When it flowed out reserves had to be increased and, correspondingly, when it flowed back, needed reserves were less.

Reserve officials ignored the relationship between the gold inflow, and their high interest policy. They concentrated on how to hide the increase in reserves in order to avoid rate reductions. (S. R., April 1921 Conference, 1089–1090.)

But the surplus reserves did not escape the eagle eye of Henry C. Wallace, father of Henry A. Wallace who was Secretary of Agriculture (1933–1940); Vice President (1941–1945), and Secretary of Commerce (1945–1946).

In his paper "The Farmer," Wallace called for a reduction in the discount rate in view of the rising reserve ratios. (S. R., April 1921 Conference, 5–8, 562–581, 1090.)

It was crystal clear that the pressures for rate reduction would increase, and Reserve would have to take some action.

At both the April and October 1921 Conferences various schemes to hide the reserves were suggested. Strong said the New York Bank had the stock exchange fellows "tamed," but he was scared to death about the farmers. His remedy was to buy all the farm paper he could from other Reserve banks, and keep the reserves to a minimum.

Dr. Miller objected that this method would help New York, but set up reserves in other banks. He suggested a bookkeeping change under which Reserve would put gold into the note reserve.

But the Governor of the San Francisco bank objected to Miller's suggestion as it would be impossible to get the public to look at anything but the high reserves wherever you put them.

Strong offered a second suggestion. Put the gold in cold storage by leaving it abroad on the excuse it would shortly flow back.

This would save transportation costs. Abroad, it could not count in reserves.

Strong came up with another suggestion which, temporarily, won favor. This was to have the Treasury issue gold certificates against the gold, to reduce the reserve percentages of the Reserve banks which might relieve the pressure for lower discount rates. Strong favored this method, even though he regarded it as inflationary. And, when it was put into effect at the end of 1921, it did serve as an inadvertent aid to recovery.

John U. Calkins, Governor of the Federal Reserve Bank of San Francisco (May 16, 1919 to Feb. 29, 1936), and Strong, warned that any improper use of the gold would leave the System open to hostile criticism. Under Secretary of the Treasury Gilbert also warned against the hoarding of gold by the Reserve banks. (S. R., October 1921 Conference, 90–91, 95–96, 99, 374–377.)

No matter how Reserve attempted to cover it up, it sat in the fall of 1921 as the repository of a majority of the world's gold supply, and it had to reduce its discount rate. The question was how.

Strong privately admitted that the Federal Reserve should intervene in economic events, but he did not want to admit publicly that it could, and did, for fear of political pressure on the Reserve banks. Likewise, he favored using open market operations because that means of control could be used "without too great a red flag." (S.R., November 1925 Conference, 208–209.)

As we have seen, Strong opposed lowering the discount rate, but advocated an increase in open market operations to bring the rate down so that the System could appear to be reacting to market conditions rather than making them. Strong's reason for wanting lower rates had more to do with the international situation than with domestic economic events.

Strong's argument to the Governors was as follows:

> . . we cannot afford in this country to impound all the monetary gold in the world and lock it up and not permit the world to do banking here and borrow money here. In other words, we are shutting down on the world's recovery and closing our markets, if we require gold payments for everything, and then don't use some of that gold as the basis of some extension of credit, and we feel in

New York that the general recovery of trade around the world is going to be brought about by our making New York a good market in which the world can borrow money, and that applies to the world, but New York is where they first come". (S.R., October 1921 Conference, 635–636.)

A large part of the expansion in Federal Reserve credit in 1919 was due to a demand for circulating currency, a fact overlooked by Reserve officials.

The drain did not persist after 1919. If it had, given the System's high discount rate, our banks would have collapsed in 1920, as they did in 1933. In 1920 and 1921 cash flowed back into the banks which, with gold inflows, reduced member bank indebtedness to the Reserve banks to $1,340 million in 1921. (Chandler, supra, 175, 186–187.)

Mellon Reduced the Discount Rate

When President Warren G. Harding took office in March 1921, Andrew Mellon was appointed Secretary of the Treasury, and Ogden Mills, his under secretary. Both wanted lower interest rates in order to market government securities.

In April and May 1921, Andrew Mellon pushed through slight rate reductions that both Adolph C. Miller and Benjamin Strong, Jr. opposed.

Miller and Strong thought that retail prices should decline further, and that despite an alarming increase in unemployment, wages were still too high. (S. R. April 1921 Conference, 674–679; Chandler, supra, 174.)

We had an 11.9 percent unemployment rate. Four million more people were thrown out of work—a five-fold increase. (Benjamin M. Anderson, "The Road to Full Employment; Financing American Prosperity," Paul T. Homan and Fritz Machlup, ed.), New York, The Twentieth Century Fund, 1945, 25, "Historical Statistics, Colonial Times To 1957," House Document No. 33, 86th Cong., 1st sess., 73).

Nevertheless, Mellon prevailed.

In April 1921 the Reserve Bank of Boston agreed to the Treasury's request to reduce its discount rate to 6 percent, and by November 1921 its rate was down to 4½ percent.

The New York and Philadephia banks also adopted a 4½ percent rate, and rates at the other Federal Reserve banks were 5 to 5½ percent. And so in November 1921, for the first time in over a year the overall level of discount rates fell below the average rate charged by banks on customers' loans.

Apparently the System had learned its lesson on that score.

At no time since has it attempted to function with discount rates above the level of market rates as in 1920–1921. (Banking and Monetary Statistics, 283, 261, 356, 440, 443, and 463, Chandler, supra, 175, 186–187.)

The Federal Reserve System Evades Responsibility for the 1920–21 Depression

As one would expect a disaster such as had been experienced in 1920–21 brought forth demands from Congress, and the public at large, that Federal Reserve officials explain what had happened, and justify their actions. Governor Strong told the Agricultural Commission that America's economic problems originated abroad—the result of a postwar depression which was both inevitable and worldwide in scope.

To further suppress any hint that the System itself might have been responsible for events, Reserve officials also deliberately minimized its powers.

In his first appearance before the Congress on June 7, 1921, Andrew Mellon adopted this position, saying:

> The Federal Reserve System is merely the general banking organization of the country . and the private member banks are the banks which do the business, which advance the money. It is not the Government's money; the Government merely has the fiscal organization for the deposit of the reserves of those banks. (Amendment to Farm Loan Act, Hearings before House Committee on Banking and Currency S.1837, 67th Cong. 1st sess., June 7, 1921, 9.)

By minimizing the role of Reserve's open market operations as a policy tool, and perpetuating the idea that Reserve bank investments were primarily a means of covering expenses, it was possible to argue as Governor Harding did that the System's discount rate "had no effect on the market"—that it merely interpreted market conditions. (S.R., April 1921 Conference, 30.)

The Harding-Mellon argument would have you believe that the Federal Reserve System was not a central bank conducted by Federal Reserve New York for the whole System. However, in two respects the System was already centralized by 1922. First, on the administrative level. Second, by the New York Reserve Bank's conducting a systemwide open market account.

Benjamin Strong was of course responsible for this. In his opinion control of the System by the political appointees to the Federal Reserve Board, rather than by experienced bankers, would be dangerous. (S.R., Second Conference 1915, 451–463; S.R., April 1921 Conference, 1094–1906, 1101–1108.)

During the April 1921 Conference, for instance, Strong argued the Reserve banks rather than the Board should have the dominant voice in determining policy. While they may differ as to rates, "in the long run (they) are in a better position to escape the most dangerous kind of pressure, not the pressure of member banks, but the pressure right up here in the Capitol."

As Strong saw it:

> What this System requires is protection against misled public opinion, which will be reflected in Congress, in some foolish act by Congress, and I must say in all frankness that I believe the Federal Reserve Board is very vulnerable, if it exercises that control; much more so than are these twelve reserve banks undoubtedly. If the Federal Reserve Board is in a position to say in response to these demands. "We do not control these reserves, we have not got the power to shovel a hundred or two hundred or give hundred millions of gold into the reserve of the Reserve banks, the question is answered at once, and my experience, through every administration that I have been through, indicates that there is always going to be pressure applied to the Federal Reserve Board." (S.R., October 1921 Conference, 469.)

To paraphrase Strong's comment from another point of view, there is always a threat of legislative action to make the Reserve System more responsive to economic conditions, and this explains the aura of subterfuge which has characterized Federal Reserve policy positions from this period down to the present.

The Bill To Put the Secretary of Agriculture on the Federal Reserve Board

In march 1922 Congress held hearings on a bill to add an eighth member to the Federal Reserve Board to represent agricultural interests.

The Federal Advisory Council petitioned President Harding to oppose the legislation, because the Board should reflect a "judicial point of view uninfluenced by the wishes of parties or classes." ("Amendment to Federal Reserve Act," hearings before the House Committee on Banking and Currency on S. 2263, 67th Cong., 2d sess., March 15–16, 1922, 6, 17–21. S.R., 2d Conference (1915), 458, Summary, 5th Conference (1915), 9, S.R., January 1916 Conference, 2–10.)

Secretary Mellon, as a witness before House Banking and Currency, testified that:

> The Federal Reserve Board does not pass upon paper from agricultural regions and has no latitude as to what may be discounted The Board is just a regulative board, and it is the individual Federal Reserve banks which exercise discretion as the extent of accommodation to the member banks. (Idem.)

When Congressman Eugene Black of Texas questioned Mellon saying he understood that the policies of the Federal Reserve banks "are determined largely by the Federal Reserve Board," and that this was the intent of the law, Secretary Mellon rephrased the law this way:

> The Federal Reserve Board has general supervision of the Federal Reserve banks and has authority to correct anything which it believes to be unsound in policy. (Amendment to Federal Reserve Act, 9.)

Mellon's testimony is important because in March and April 1922 he had striven to repress the open market authority of the Federal Reserve banks, and assert the Board's powers in this area. Their purchases influenced lower rates, though the extent of the downward push was not generally known.

But Andrew Mellon did not fool Henry C. Wallace, Secretary of Agriculture, who told the committee:

> I have not thought of the Federal Reserve Board as a purely administrative body, but rather as an institution which determines the general financial and credit policies of the country, and from that standpoint, I am not able to agree with the suggestion that a larger membership would be inadvisable. On the contrary, it seems to me that the membership of a board, which in time, if not now, will, through the exercise of its administration of the great credit machinery of the country, have a very direct influence upon prices and upon business in general should be a cross section of our industrial life, including agriculture—I am not using the words "industrial life" in a restrictive sense. Such a board might well represent a cross section of the entire business life of the Nation.
>
> The board should be made up of men who have a keen understanding and full appreciation of the effect of every policy of this board on agriculture, industry, commerce, labor, and other large interests, because the administration of this credit machinery can make or break labor as well as agriculture. (Amendment to Federal Reserve Act, supra, 9, 23, and 25.)

When Congressman Brand of Georgia asked whether the Federal Reserve Board could adopt policies which would have "the effect of increasing or decreasing the price of agricultural products," Henry C. Wallace assured him that it certainly could. This caused Governor Harding to tell the committee that:

> The (Reserve) banks are localized. Each federal reserve bank is an independent entity, as you will see if you will read section 4 of the Federal Reserve Act, which describes the powers of the Federal Reserve banks. The duties of the

Federal Reserve Board, as pointed out by the Secretary of the Treasury, are largely supervisory and, in a general way, administrative. But the powers of the Federal Reserve Board have been grossly exaggerated. I do not think the Secretary of Agriculture has a correct conception of the functions of the Federal Reserve Board, with all due respect to him.

The board cannot exercise, under the law, any such influence on prices as he seems to think it can. (Amendments to Federal Reserve Act, supra, 27.)

It is no exaggeration to say that Governor Harding was deliberately attempting to mislead the Congress. The Board had pushed through all the reductions in the discount rate in 1921 and, as we have seen, the reductions in April and May were put through despite Governor Strong's objections because Secretary Mellon insisted.

By one of the ironies of Federal Reserve history, there is nevertheless a great deal of truth in the false testimony Governor Harding and Andrew Mellon gave House Banking and Currency in 1922.

The System was, as we have seen, at that very time moving irrevocably in the direction of centralization through open market operations in Government securities. As a result, because of its location, and the personal and intellectual qualities of its Governor, Benjamin Strong, Jr., the influence of the Federal Reserve Bank of New York was greatly enhanced. Correspondingly, the influence of the Board diminished.

The false witness of Messrs. Harding and Mellon, therefore resembles a classic case of the self-fulfilling prophecy.

Our New International Federal Reserve System

In October 1921 Governor Strong was deeply absorbed in the first of many international ventures, and more concerned with them than domestic policies. At the October 1921 Conference, he proposed, and the Conference accepted, setting up a pool to operate an exchange account with foreign central banks.

Although the 1920 election had soundly repudiated President Wilson's proposal for a League of Nations, and Democratic proposals to lower the tariff, the Federal Reserve Conference enthusiastically backed Strong's suggestion, Governor Norris of the Philadelphia Bank saying:

I am bound to say that I think the three great opportunities that we have had to accomplish the stabilization of foreign exchange were, first, to go into the League of Nations; second, to make a readjustment of our tariff view to opening our doors to export as far as it could be done with the least disturbance to our industries rather than put up barriers. Neither of those things has been done or will be done, and the third was to empower the Secretary of the Treasury to deal in an intelligent way with the refunding of foreign obligations . . . (and) the limitations that have been written into the bill will make it impossible for him to do anything of any real use But because we have lost those three, it does not follow, of course, that we ought to throw aside and discard all others . (and) it seems to me that the proposition you have suggested is one that undoubtedly has merit and may reasonably be expected to accomplish some results. (S.R., October 1921 Conference, 721–741.)

Of course foreign central banks under control of their governments would need approval of their executives. The Federal Reserve was exempt from such control, being an agency of Congress and needing congressional authority in the form of legislation approved for any activity outside the scope of existing law. The System was, however, authorized to maintain accounts in foreign banks, and Strong proposed to operate his foreign exchange pool through this technicality in order to avoid the certainty of a congressional veto of Federal Reserve participation. (S.R., October 1921 Conference, 721–741.)

This was a first and a very significant step toward full participation by the System in international financial arrangements. More important was Strong's modus operandi, since it served as a model for later actions. Not only did he bypass the Congress, but he set up a new relationship between the New York Bank and the Treasury.

This relationship became so congenial that it became habitual for Strong to bypass the Federal Reserve Board altogether, and deal directly with Secretary Mellon and his aides in matters involving international finance.

With the aid of sympathetic Treasury officials, Strong transformed the Federal Reserve Bank of New York into a central bank which could deal with international finance as effectively as its European counterparts.

Regretfully, Strong's action in taking upon himself the interpretation of the act has become a pattern at the Federal Reserve.

Their secret operations of the open market account, and their alleged independence from oversight by either the executive or the Congress, or even the Comptroller General, encourages the bureaucrats at Reserve to interpret the act to fit their purposes.

In making this particular interpretation, Andy Mellon and Strong are no different from "Silver Tim" Sullivan of Tammany Hall who used to say "What's the Constitution among friends?"

In Mellon and Strong's case it was "What's the Federal Reserve Act among efficient and experienced bankers?"

Unfortunately, as we will see, this tendency to so interpret a provision in the act persists to the very day.

Strong's ipse dixit was but the first of many to come. What an operator he was!

IV HOW THE NEW YORK BANK CAME TO TAKE OVER ALL OPEN MARKET OPERATIONS

In the short time the Federal Reserve banks existed before World War I, at the New York Bank, under its able Governor, Benjamin Strong, there had developed a sophisticated mechanism for centralizing there the open market operations of the Federal Reserve System.

Of course the market was quite undeveloped, and limited to bankers' acceptance, municipal warrants, and the one billion of 2-percent Government bonds that prior to the Federal Reserve Act had secured the bank note currency then in use.

And, during World War I, Reserve did not conduct open market operations.

In these early days Strong had endeavored to have his New York bank act as the agent for all the Reserve banks in their open market operations, and he was moderately successful.

However, New York acted on its own and, at the outbreak of World War I, was left with a portfolio of $300 million of acceptances on its hands. (Stenographic Record, hereinafter cited "S.R.", April 1920 Conference, 439–443.)

Strong, at the March 1919 Conference tried once again, and there, for the first time, he proposed that open market operations be used as a tool of policy independent of the question of the need of a Reserve bank to purchase to obtain earnings.

The New York Bank's proposal was contained in a set of guidelines which recommended that transactions in bankers' acceptances of all Reserve banks be coordinated as a means of developing a market for these bills. (S.R., March 1919 Conference, 329.)

It contemplated that the New York Bank would buy but not sell except to other Reserve banks. Selling was to be left to dealers in discount, and specialists with whom the New York Bank felt it should not compete.

But to insure that these dealers could carry bills until marketed, the proposal contemplated the use of repurchase agreements, (S.R., March 1919 Conference, 356–357), much as Reserve's Open Market Committee does today.

In the event a Reserve bank bought or sold acceptances outside its district, the Strong proposal called for this being reported. To this end, the New York Bank inserted into the guidelines at the March 1919 Conference a provision that all sales of bills by one Federal Reserve bank to another "promptly be reported to the Federal Reserve Board." (S.R., March 1919 Conference, 329–330, 356–358.)

The Board sanctioned New York's proposal, and in its comment pointed to the provision in the act under which the Board had power to compel one Reserve bank to rediscount the paper of another, arguing that it had a vital interest in any arrangement shifting investments because of its effect on reserve ratios. (S.R., March 1919 Conference, 359.)

At the March 1919 Conference and at the suggestion of Strong, it was agreed that when one Reserve bank buys acceptances outside its own district, it should be through the Federal Reserve bank of the other district. (S.R., March 1919 Conference, 359.)

Since New York was "the primary market", the potential effect was to return to the New York bank the position of control over the open market transactions of the Reserve banks which it had enjoyed in the period prior to World War I.

At the April 1920 Conference, J. Herbert Case, Vice Governor, Chairman, and Federal Reserve Agent of the New York bank (1930–36), proposed that all Reserve open market operations go through their bank as was the case pre-war. (S.R., April 1920 Conference, 439.)

Currently only three banks (San Francisco, Chicago, and Cleveland) were having the New York bank buy for them.

When some of the Governors stated that their banks had ceased to participate with New York because their reserves were low, Gov. John U. Calkins, Governor of the San Francisco Federal Reserve Bank (1919-36) used this point to argue for allowing New York to buy for all 12 Reserve banks, thereby distributing the acceptances proportionally among them. (S.R., April 1920 Conference, 439–440, 440–443.)

In this, Gov. Elvardore R. Fancher, Governor of the Federal Reserve Bank of Cleveland (1914–35) supported Case and Calkins primarily because of New York's strategic location. (S.R., April 1920 Conference, 440–443.)

But there was opposition. You recall that in the fall of 1919, as a result of its selling $500 million of bonds, Treasury had difficulty thereafter in selling to the member banks its December issue of $400 million, and its fifth Liberty Loan in January 1920.

In November of 1919 in particular, Treasury had to make substantial purchases to stabilize the Government bond market. Under Secretary Leffingwell complained that because of Strong's low buying rates, the market for bankers' acceptances had not been affected by the discount rate increases. His comment was that if Strong were to apply to the Treasury bill market the same doctrine that he seeks to impose on Treasury, the situation would be well met.

Gov. Charles A. Morss, Governor of the Federal Reserve Bank of Boston (1917–22), joined Leffingwell in opposition to the New York bank contending he could not defend in Boston, New York's low buying rate. (S.R., April 1920 Conference, 446–447.)

Manager of the New York bank's open market operations E. R. Kenzel, Deputy Governor of the New York bank (1921–33), then pointed out that New York bought acceptances to stabilize the market, and Gov. James B. McDougal, Governor of the Federal Reserve Bank of Chicago (1914–34), added that if the New York bank did not do so, "there would not be any market." (S.R., April 1920 Conference, 447–449.)

Governor Morss, however, remained unconvinced, and Kenzel had to move that a committee be appointed to study the problem. The motion was carried and Morss, Fancher, and Kenzel became the Committee. (S.R., April 1920 Conference, 451–453, 455.)

The Committee attempted to accommodate different points of view. It recommended each Reserve bank develop its local market, but that the Reserve banks buy bills without regard to the amount created in their own districts and stand behind acceptances unreservedly. The Committee also noted that 5 of the 12 Reserve banks held 90 percent of the total acceptances.

But Governor Morss of the Boston Bank vetoed New York's proposal that each Reserve bank agree to take its portion of bills bought by other Reserve banks under any and all circumstances. When, in an effort to meet Morss' objections, the Committee recommended it be replaced by a "Standing Committee" to suggest buying rates for open market purchases of bankers' bills, Morss refused to allow it. (S.R., October 1920 Conference, 31–39.)

Besides its disagreement with the Boston bank, just before the October 1920 Conference, the New York bank got into a hassle with the Chicago bank which had wired New York to sell $25 million of Chicago's endorsed acceptances. New York, as noted, had a firm policy against the sale of acceptances, leaving sales to specialized dealers. But Governor McDougal of the Chicago bank at once asserted that the acceptances belonged to it, and it had the right to do with them what it pleased. (S.R., October 1920 Conference, 39–46.)

Moreover, McDougal points out that when the New York bank buys bills from its dealers, it requires each bill to be endorsed by a bank which receives a commission for the endorsement. As a result, banks that endorse are liable on acceptances they have never owned, so that New York's real interest in not wanting endorsed bills sold is to prevent their being "hawked around to the embarrassment, if not the detriment, of the endorser."

McDougal concluded his discussion by saying that inasmuch as the New York bank conceded Chicago's right to sell bills in its possession regardless of the contrary policy of the New York bank, Chicago did not regard the Committee recommendation to the contrary in the Kenzel Committee report as binding on it (S.R., October 1920 Conference, 106–111.)

Once more the Conference sought to resolve differences by appointing as a Standing Committee the same three members, but nothing came of it. There was a natural tendency by the twelve Reserve banks to keep to the regionalist cast that the Congress intended for the System. New York's efforts to dominate were met with hostility. Its efforts to centralize open market operations were consistently thwarted by other Reserve banks seeking to maintain functional independence.

Under these circumstances it is not surprising that this attitude of the Reserve banks curtailed the amount of investments purchased. But, of course, 1920 was a depression period, and both the low reserves of the New York bank, and its low buying rates, did not encourage investment.

However, it is quite evident that at this time Strong did not understand open market operations. The New York bank should never have increased the discount rate in November 1919, and January 1920, and kept raising it thereafter into 1921.

But also both its low buying rates, and its restrictions on the free sale of acceptances, were counter productive.

What was wrong was the New York bank's devotion to the so-called "real bills" theory.

By 1921 Benjamin Strong had learned his lesson, and lost his attachment to the real bills theory. He was by then ready to have his bank conduct open market operations to control the economy and avoid depressions.

Strong was to die in 1928, and his successor at the New York bank, George L. Harrison, Governor and President (1928–40), was to repeat Strong's mistake of buying acceptances in volume, while holding the discount levels so high as to force member banks to liquidate their loans.

In addition, in 1928 Roy A. Young became chairman of the board (1927–30), and to his country's deep regret, he revived Strong's 1919–20 policies.

The 1921 Market Operations of the New York Federal Reserve Bank

Despite being able to reach agreement as to open market operations, the Special Committee reported at the April 1921 Conference that it had appointed a Secretary at the New York bank, arranged for weekly reports by telegram to him from the district banks as to operations and conditions, amounts of bills bought, rates, comments of dealers as to supply, price, movement of bills, et al.

Thus the Committee was able to summarize developments between October 1920 and April 1921.

It noted a lack of uniformity in the rates, and recommended, absent extraordinary circumstances, that rates at all Reserve banks be uniform.

The Committee protested the practice of San Francisco, Minneapolis, and New York in holding unendorsed acceptances.

It also complains that Richmond, Atlanta, and Dallas are purchasing acceptances directly, and recommends that sales of bills be in well established markets, such as New York.

It favors the use of repurchase agreements as New York has been doing, and advocates a minimum buying rate. (S.R., October 1921 Conference, 62–70.)

Of course early in 1921, interest rates began to fall so that the Committee could say, as a result of easier market rates, the member banks were depending less and less on Reserve.

It attributed the fall in rates to about $300 million of foreign funds invested in the New York discount market, and the inflow of gold. (S.R., October 1921 Conference, 70–75.)

Until April 1921 we must remember that Benjamin Strong felt that Federal Reserve, as a central bank, should follow high lending principles of Walter Bagehot who was an English economist (1826–77). His work, "Lombard Street," published in 1873, and written to explain the necessity for keeping a greater reserve in the hands of the Bank of England, is regarded as first formulating the modern theory of central banking.

However, Strong's reliance on Bagehot had brought on the 1920–21 depression, and whatever other faults he had, Strong learned from that bitter experience.

In other words, by April of 1921 Strong was prepared to have his New York bank use open market operations to control the economy, lowering interest rates as needed to increase production, and no longer holding the discount rate high to force member banks to liquidate their loans.

Between April and October 1921 the New York bank, under Strong's guidance, undertook to lower rates by means of purchases in the open market.

While Strong's public statements about this time were confusing and misleading (S.R., October 21 Conference, 634–637, and see Chandler, 207–208 for a confusing letter written in October 1921 by Strong to an Ohio manufacturer discussed in "Federal Reserve Structure," Staff Study of House Banking and Currency Committee," December 1971, 92d Cong., 1st sess., at 72–73).

Strong's statements to the Conference, and the actions of the New York bank, indicated quite clearly that Strong was directing New York's open market operations to lower interest rates.

Strong's method was to be in the market to buy Treasury bills, not in volume, but enough to put pressure on the market, and, in the case of Treasury certificates, to buy up every one that was offered so as to keep them at a premium on the assumption that when a thing sells at a discount no one wants it. (S.R., October 1921 Conference, 634–637.)

Of course as the October report of the Committee indicates, both the gold inflow, and increased foreign purchases, were decisive factors in lowering interest rates during 1921.

The New York bank's efforts unilaterally on its own to reduce interest helped, but its allotment proposal had been rejected by its brother banks, and it could not be a decisive factor unless it had power to deal for the entire Federal Reserve System.

However, New York's success in the last half of 1921 was such that Strong could, and did, call it to the attention of the other Governors.

Since a majority of them wanted to reduce interest, he was able, on the basis of New York's 1921 experience, to persuade many of them to adopt a more activist policy.

In 1922 Reserve Establishes the Committees on Centralized Execution of Purchases and Sales of Government Securities

Beginning in 1922 the Federal Reserve banks began acquiring Government securities. Between January and June they bought $365 million, bringing their total holdings to $620 million.

These purchases caused alarm, and led to charges that the Reserve was trying to create easy money. (See "Federal Reserve Policy 1921–30," by Prof. Harold L. Reed of Cornell University, New York, McGraw-Hill 1930 at 28; "minutes," July 12, 1922, Committee on Centralized Control, Federal Reserve file 333a.)

As a result, there was pressure primarily from the Treasury for Reserve to create a committee to centralize Reserve's purchases of government securities.

This caused Secretary Mellon to consult with the General Counsel of the Federal Reserve Board who advised him the Board could take any action it needed. (Memorandum, April 13, 1922, Walter S. Logan, general counsel; letters of April 14, 1922 by Under Secretary of Treasury, S. Parker Gilbert to Board, and April 25, 1922, from Secretary Mellon to Federal Advisory Council, FRB file 333a.)

Mellon also consulted with the Federal Advisory Council which agreed with Mellon that Reserve should hold only acceptances, and not buy Government securities, at least in excessive amounts.

The Council thought Reserve should confine their purchases to short term Government obligations, taking care to schedule their purchases so as not to interfere with Treasury security operations.

As one would expect, both Andrew Mellon, and his 12 apostles on the Federal Advisory Council were wedded to the so-called real bills theory, and viewed with horror the central bank's holding Government bonds to back the national currency.

Mellon was ready. Accordingly, he requested that the Council of Governors at their May 2, 1922 meeting discuss the topic.

Except for Benjamin Strong, all the Governors acted defensively, and insisted they bought Government bonds "for income purposes."

Governor Calkins stated his bank bought them because "acceptances are practically unobtainable at the present time." (S.R., May 1922 Conference, 7–10.) But Strong argued his bank's purchases were for economic reasons. (Summary, May 1922 Conference, 10.)

Strong went so far as to say that one of his bank's chief purposes was to have on hand investments which would enable it to exert control on the money market in case it was necessary to do so.

In his view there is a relationship between these purchases, and the declining interest rate, so that had not the Reserve banks intervened "recovery of business would have been somewhat slower."

Reducing interest, and keeping funds available to the country, said Strong, "has been one of the influences that has hastened and facilitated the recovery of business that has taken place." (S.R., May 1922 Conference, 133–134.)

What a change the depression of 1920–21 had wrought in Strong!

The man who fought the passage of the Reserve Act had been transformed from Capitalist, to Populist!

The open market operations of the Reserve banks in late 1921 and early 1922 had actually been "an advantage and blessing" to the Treasury as Governor George J. Seay, Governor and President of the Federal Reserve Bank of Richmond (1914–36) was quick to tell Mellon. (S.R., May 1922 Conference, 133–134.) The trouble was that Treasury thought it had been harmed.

Even though the Federal Reserve banks, to a man, thought they were within their rights, Ben Strong said the wisest thing to do was not to stand on their rights but to work out a satisfactory arrangement with Treasury so that, henceforth, it would be fully apprised of Reserve's open market operations.

This was sensible as the Treasury did not object to purchases that supported the market. Their displeasure was with purchases that pushed up the price of Treasury issues.

At the suggestion of Governor Strong, the May Conference referred to the Governors of Boston, New York, Philadelphia, and Chicago, how Reserve could work out an orderly method of buying and selling Government securities. It was also asked to come up with a wise investment policy for Reserve, and to consider "to what extent can we afford to pump credit into the market?" (S.R., May 1922 Conference, 537–543.)

Later, at the October 1922 Conference, the Governor of the Federal Reserve Bank of Cleveland was added to the Committee.

This Committee became the "Committee of Governors on Centralized Execution of Purchases and Sales of Government Securities by Federal Reserve Banks." It met for the first time on May 16, 1922, and is the predecesessor of the "Open Market Investment Committee" established in 1923.

Strong became permanent Chairman of the new Committee which was to handle all purchases and sales for the 12 Reserve banks (Minutes, May 16, 1922, FRB File 333a.)

Thereafter, this new Committee set out to sell the Government securities owned by the Reserve banks.

By June 30, 1922 some $55 million was sold.

At a July 12, 1922 Committee meeting it was agreed that certificates maturing August 1, 1922 would be allowed to run off.

As of September 20, 1922 the $629 million held by the Reserve banks on June 14, 1922 was reduced by $168 million, $130 million of this being Treasury certificates allowed to mature. (Minutes, June 12, 1922; Report of Committee, October 10, 1922; FRB File 333a.)

On October 2, 1922 when the Committee met it agreed that during the second half of the year conditions had so changed "that increased attention must be paid by the System to the bearing of the investment operations of the Federal Reserve banks upon the money market."

It asked a free hand, but when its recommendations were presented to the Governors Conference, McDougal of the Chicago Bank objected. (Minutes, October 2, 1922, Meeting and Committee Report of October 10, 1922, FRB File 333a S.R., October 1922 Conference, p. 4.)

With Under Secretary Gilbert present, Strong was very much on the defensive, remarking since the five banks on the Committee were agreed, their purchases were such as to commit the System.

Gilbert praised what the Committee had done, but said that Treasury would continue to impose on the Board and the Committee its own policy objectives. He said a critical time was ahead as Treasury planned heavy operations, and he hoped that the Federal Reserve banks could continue to liquidate their Government securities without giving a false market either way. (S.R., October 1922 Conference, 435–436.)

It was not until the February 5, 1922 meeting of the new Committee that it reviewed the policy directive of the October 1922 meeting. It was then agreed that open market operations should be administered in such a way as to assist the Federal Reserve System in discharging its national responsibility, to prevent credit expansion from developing into credit inflation. It voted to continue its present operations, but not put more Federal Reserve funds into the market by open market operations. (Minutes, February 5, 1923, FRB File 333a.)

This policy of restraint was followed by the Reserve banks selling more Government securities. Of the $629 million the Reserve banks held on June 14, 1922, as we saw, $168 million was sold by September 20. By February 1, 1923 the sales were $276 million, and the total securities then held down to $353 million.

As you might expect, this volume of sales sent the interest rate up. All 12 Reserve banks went to a uniform 4½ percent rate which prevailed until the middle of 1924. (February 5, 1923 Report of Committee, FRB File 333a; Wicker, Banking and Monetary Statistics, 440.)

With the sale of all these Government securities, the income of the Reserve banks was reduced. This led one Reserve bank in February 1923 to bypass the Committee, and purchase two million of Government securities.

This provoked Secretary Mellon, and on March 10, 1923 he wrote the Federal Reserve Board as follows:

> It is hardly necessary to point out that purchases of Government securities by the Federal Reserve Banks put Federal Reserve funds into the market, thereby increasing the supply of available funds, and that it is destructive of any credit policy which the Federal Reserve System may be pursuing to permit the Federal Reserve Banks to expand credit in this way simply for the purpose of increasing their own earnings and putting themselves in a position to pay expenses and dividends. Such an attitude on the part of the Federal Reserve Banks subordinates the major question of credit policy to a purely incidental question of Federal Reserve Bank housekeeping . . It seems to me clearly necessary, therefore, that the Federal Reserve Board, acting under its general powers, should prescribe regulations governing the open market operations of the Federal Reserve Banks, and require in these regulations that the Federal Reserve Banks shall not make any further purchases of Government securities, or bills, for the purpose of increasing their earning assets without first getting the express approval of the Federal Reserve Board, and that generally speaking the Federal Reserve Banks shall not in the future make investments simply for the purpose of increasing earning assets. It should also be definitely understood that under any circumstances all purchases and sales of Government securities for account of the Federal Reserve Banks are to be handled through the Central Committee of Governors which is now functioning.

Coming to the then policy of Reserve, Andrew Mellon added that in his opinion, with rising interest, the Federal Reserve banks should liquidate the Government securities they then held rather than accumulate more. (Letter, March 10, 1923, Mellon to FRB, File 333b.)

This blast by Mellon caused Edmund Platt, Vice Governor of the Board, to appoint a Committee to prepare regulations for open market operations. The outcome was a resolution drafted by Dr. Adolph C Miller dissolving the "Committee on Centralized Execution of Purchases And Sales", and replacing it with a new Committee entitled "Open Market Investment Committee" with the same five bank Governors as members, namely, Boston, New York, Philadelphia, Chicago, and Cleveland.

The new Open Market Committee directed the Board to be guided by these principles:

(1) That the time, manner, character and volume of open market investments purchased by Federal Reserve banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation.

(2) That in making the selection of open market purchases, careful regard be always given to the bearing of purchases of U.S. Government securities, especially the short-dated issues, upon the market for such securities, and that open market purchases by primarily commercial investments, except that Treasury certificates be dealt in as at present,

under so-called "repurchase" agreement. (Resolution, Federal Reserve Board, March 22, 1923, Board Memorandum X–3675, FRB File 333a, S.R. March 1922 Conference, 16–23.)

Interestingly enough, Mellon, in a later letter of March 15, 1923 (FRB File 333b) made clear to the Board he expected the Committee to continue open operations in support of government securities, and in this connection use repurchase agreements with dealers. Later in 1925 when Dr. Adolph C. Miller tried to outlaw these repurchase agreements this letter of Mellon and his support blocked Miller's gallant effort.

When this statement of principles as drafted by the Committee, and approved by the Federal Reserve Board, was presented to the Governors' Conference of March 1933, four Governors (Boston, Philadelphia, Chicago, and San Francisco) questioned the Board's power.

Harding of the Boston Bank said:

I want to stress two points. It is very doubtful, at least in my mind, whether the Federal Reserve Board has specific power to fix a definite limit as to the amount of these legitimate open market transactions that a Federal Reserve bank may engage in. They have the right to regulate it, but nowhere in this Act is the Treasury Department of the United States charged with that responsibility for the credit policy for the Federal Reserve Bank; nowhere in the Act is the Treasury vested with the power to limit arbitrarily the purchase by Federal Banks of notes and bonds of the United States, and nowhere is the Federal Reserve Board given specific power to limit the amount for bonds and notes of the United States that the board or directors of the Federal Reserve banks may wish to buy.

This caused Norris of Philadelphia to raise the even more fundamental objection that if a Committee of the Board were to hold all the powers of the twelve Reserve banks then, instead of a regional banking system, we would have a central bank, and the Federal Reserve Board would be that bank.

Dr. Adolph C. Miller's reaction was instant. He said that if the Board lacks these powers, its first duty was to obtain them.

Dr. Miller said:

I become more and more of the opinion that the open market operations of the System are going to be the most important part of the System, largely because it is through the open market clause of the Act that the reserve banks are in a position to take the initiative; the bank doesn't have to sit back and wait until somebody comes to it, but it is in a position to go ahead and absorb funds for its purposes, when it desires to do so.

In this Miller had the support of Under Secretary Gilbert, who said:

. the Treasury thinks that the Central Committee, which has operated now for about a year has had a most wholesome influence, and that its actions have been most helpful both to the Treasury and to the general situation. There has been a liquidation of something over three hundred million dollars in holdings of Government securities, and regardless of what we may think about the original action of the banks in buying this extraordinarily large volume of Government securities without reference to the Board or to the Treasury, I think there is no disagreement that the subsequent steps which have been taken have been effective and helpful all around.

Implicit in Gilbert's remarks is the assumption that Treasury has the right to intervene in Reserve policy.

It is instructive to note here that the Treasury's position in this episode stands out in sharp contrast to the role which, today, it is widely believed the Treasury would play in monetary policy were the

Federal Reserve deprived of its independence and made subordinate to the Treasury and President.

The prevailing belief is that the Treasury (and presumably therefore the President) desires, above all, low interest rates. Thus, inflationary expansion of money and credit would be certain to follow if monetary policy were formulated by the Treasury or others responsible to the President.

The events of 1923, when the Treasury favored monetary restraint and put pressure on the Federal Reserve to liquidate holdings of Government securities, contradict this so often asserted scenario.

It is interesting to observe that Strong's New York bank did not get into this argument.

Its Deputy Governor Case remarked that New York and the Committee had worked very smoothly, and very satisfactorily with Treasury. He also stated the New York bank held only ten million of Government securities, and after June 15, 1923, the total holdings are now about $230 million.

In other words, the New York bank has been being a good boy, and just loves Andrew Mellon, and the Treasury.

No wonder that the Federal Reserve Bank of New York came into its dominant position.

The October 1922 Symposium On Credit Policy

On notice to bank Governors and Agents, Reserve held on October 10, 1922, a conference to discuss credit policy in various ramifications.

It is embalmed in the "Tenth Annual Report of the Federal Reserve Board."

J. M. Keynes took notice of it ("Monetary Reform," New York, Harcourt, Brace and Co. 1924, pp. 214–215), and the Report has been widely admired for the sophistication of its analysis ever since.

Given the wide divergence of opinion expressed during the Conference, it may be argued that the Report is misleading as an indication of the full spectrum of attitudes in the System and its guides for policy. It necessarily rejects the views of at least half of its officials on any given subject. Most analysts assume that the Report was written by the Board's staff and reflects the views of the Board. The record of the Conference would appear to support this view with the qualification that the Board's position tends to reflect a selection from the Conference material, rather than a unilateral effort by the Board to enunciate an official position for the System.

The Tenth Annual Report states that experience had indicated that the System could not exercise its function of "fixing rates with a view of accommodating commerce and business by the simple expedient of any fixed rule or mechanical principle," and that the System must rely on "judgment" as a guide for credit policy.

The position is based directly on Governor George W. Norris' statement that "changes must always be the expression of a judgment, and no absolute formula can be devised."

This view was, however, highly controversial, and was attacked by Governor Norris' own board chairman, Richard L. Austin, Chairman, Vice Governor, vice president and Federal Reserve agent for the Federal Reserve Bank of Philadelphia (1914–36) who argued that it was an obligation of the System to "remove from our rate making the element of the lack of principle."

The debate over whether to use rules or discretion in formulating monetary policy is still unsettled.

In recent years it has centered on proposals to increase the money supply 2–4 or 2–6 percent per year. But the advocates of discretion prevail today as they did in 1923.

The Conference also reveals the reluctance of a majority of Reserve officials to abandon the framework of the real bills doctrine. On the other hand, there are indications that earlier attitudes had been modified by the recognition of greater responsibility for economic events.

Governor Norris' statement that "the prevention of disaster, and not succor following disaster, is the goal of a successful credit policy," appears to reflect a majority view, as well as the view expressed subsequently in the Report.

But the concern for economic events was not put into specific form. Thus, with Governor Norris concurring, the Report explicitly rejects price levels as a guide for policy.

Meanwhile, the statements of both Pierre Jay Chairman and Federal Reserve agent for the New York bank (1946), and Benjamin Strong stress the significance of the relationship between price levels and credit policy.

In one of the most significant statements on record during the period, Strong said:

> Of the various causes of price changes, none is so potent as changes in the volume of "money", that is of credit and currency". (Tenth Annual Report of the Federal Reserve Board, 1933, 8, 32.)

This last statement indicates a level of sophistication beyond that expressed in the tenth annual report. As Wicker has observed, the Report is concerned with credit, not money.

But, again, the significance of the Conference material lies in its presentation of the full spectrum rather than only the official views of the System, and indicates the extent to which shifts in personnel or influence during the decade which followed were factors in shaping its response to events.

V. MONETARY POLICY, 1923–28

In 1914 before the Federal Reserve System could be organized World War I began in Europe, and the New York Stock Exchange closed.

With the end of the war came the 1920–21 depression, only to be followed by similar trouble in 1923–24 and 1926–28. (Milton Friedman and Anna Jacobson Schwartz, "A Monetary History of the United States," 1867–1960, Princeton, Princeton University Press, 1963, 284, 298. Elmus R. Wicker, "Federal Reserve Monetary Policy," 1917–33, New York, Random House, 1966, 67. "Historical Statistics of the United States, Colonial Times to 1957," House Document No. 33, 86th Cong. 1st sess., 116).

Moreover, as we have seen, Strong had the good will of the then Secretary of the Treasury Andy Mellon and, so far as Reserve was concerned, he was in charge of open market operations.

Mellon favored open market operations that assisted Treasury in selling bonds, and their use, otherwise, to counteract inflation. But he distrusted open market operations designed to produce easy money and counteract depression. Mellon, fortunately, was content to allow Strong to conduct open market operations, and Strong acted contracyclically.

The 1923–24 Trouble

As we have seen, the Federal Reserve System held for its own account $630 million of Government securities on June 14, 1922. On orders from Mellon to the Board, by January 31, 1923 the System had sold $353 million, leaving $277 million on hand.

On May 31, 1923 Mellon insisted that the Board order the Federal Reserve banks to sell their remaining $277 million (Stenographic Report, May 1922 Conference, 520–524.) It did so but it was not a popular decision. The Reserve banks needed the interest on the securities to pay their expenses.

Moreover, it was invitable when the Board forced the banks to sell over $600 million in Government securities between June 1922 and May 1923 that the economy would be adversely affected, and it was.

In September 1923, the Dallas bank reported a large number of bank failures in its district and, because of its low earnings and surplus asked and received permission to buy $10 million of Government securities. (Letter from B. A. McKinney, Governor, Federal Reserve Bank of Dallas to Edmund Platt, Acting Governor of the Federal Reserve Board, September 29, 1923. Proceedings of the Board, October 3, 1923. Letter from Platt to McKinney, October 4, 1923.)

As early as the November 1923 Conference, the Open Market Investment Committee found that steel orders were lower, production in the New England cotton mills and in automobile tires had slowed down, and $532 million of stock exchange loans had been liquidated.

Because of this pessimistic report, the Committee stated that it should resume open market purchases to reduce bank borrowings and ease money rates. (Report of the Chairman of the Open Market Investment Committee to the November 1923 Conference, 29.)

Thereafter, and ostensibly to give the System earnings, the Open Market Committee in January 1924 voted to buy $15 million of Government securities. (Memorandum from Randolph Burgess to J. H. Case, January 12, 1924. Report of the Open Market Committee, February 8, 1924. FRB File 333b.2. Letter from Governor Strong to Governor Crissinger, February 18, 1924. FRB File 333b.1. Recommendation of the Committee on Discount and Open Market Policy of the Federal Reserve Board, February 20, 1924. Letter from Governor Crissinger to Governor Strong, February 21, 1924. FRB File 333b.1.)

However, it was February of 1924 before the Board approved. Economic conditions worsened, and all available indexes for March 1924 showed a considerable decrease in production and business transactions. The Committee, again ostensibly because the System was short $18 million in earning assets, voted to buy first $150 million of Government securities in April. (April 1924 report of the Open Market Committee on "Credit Conditions and the Open Market Program," April 22, 1924 report of the Secretary to the Open Market Investment Committee, May 1924 report of the Open Market Investment Committee. FRB File 333b.2), and $100 million more in July, 1924. (Minutes of the Open Market Investment Committee July 1, 1924, FRB File 333b.2.)

Between the end of April and September 1924 the Open Market Committee bought $500 million of Government securities. (Minutes of the Open Market Investment Committee, November 1924, FRB File 333b.2.)

Moreover, in May 1924 the New York Bank cut its interest rate from 4½ percent to 4 percent, (S. R., November 1923 Conf., 30–32), in June to 3½ percent, and in August to 3 percent, forcing rate reductions at other Reserve banks as well. (S. R., May 1924 Conf., 14.) This action of Strong in reducing interest was in response to conclusive evidence of a business recession.

Nothing succeeds like success. In its November 1924 Conference Report the Committee could confidently say that a "genuine recovery appears to have begun and the bottom of the depression appears to have been passed without serious unemployment."

Strong's use of open market operations contracyclically had saved the day, and the 1923–24 depression never took hold. To the great credit of the Federal Reserve System the recession had ended, and the depression never came.

By the simple expedient of buying Government securities, and lowering interest, the 1923–24 trouble disappeared. By mid-December 1924 the System had begun to sell off its holdings. Government securities were down to $413 million, but the holdings of individual Reserve banks rose $140 million during November and December 1924. Fortunately, there was then a gold outflow so that these purchases by the individual banks did not offset Strong's sales for the System. The discount rate at the New York bank in November 1924 went to 3½ percent.

The 1923–24 recession that began in May 1923 struck bottom in July 1924. Having won its battle to avoid the recession's turning into a full blown depression, the challenge to Strong and his New York bank in the fall of 1924 was to keep the economy stable.

To accomplish this in February 1925, the New York bank raised its interest rate from 3 percent to 3½ percent. This brought it more in line with its sister banks four of which were at 3½, and the remainder at 4 percent.

In January 1926 it went to 4 percent, lowering its discount rate to 3½ percent in April, and going back to 4 percent in August 1926.

The Committee, throughout the period, used open market operations to avoid fluctuation in discount rates and keep the economy stable. Obviously, it did so for financial reasons and, judging by that criterion, was successful. The ratio of net profits to total capital accounts averaged 9 percent for both 1925 and 1926. (Banking and Monetary Statistics, supra, 264–265, 440, 454–455, 463–469.)

England was an important consideration. On April 28, 1925 it went back on the gold standard, and Montagu Norman, Governor of the Bank of England (1920–44), had convinced Ben Strong that to protect England's gold reserve, it was necessary to keep money rates in New York under those in London. (Chandler, supra 303, 319, 322–324.)

Early in 1925 with the economy stabilized, the Committee sold $250 million of Government securities, reducing the System's holdings from $413 million in December 1924, to below $250 million by April 1925.

When the Dallas bank asked permissioin to buy $10 million of Government securities in March 1925, permission was refused. (Minutes of the Open Market Committee, April 1925, FRB File 333b.2. Report of the OMIC November 1925, FRB File 333b.1. Report of the OMIC June 1925, FRB File 333b.2.)

In 1925 and 1926 there were over $100 million of Government securities purchased by individual banks for their own account, as the Dallas bank was quick to advise the Committee.

Ostensibly to protect against England's return to the gold standard in April 1925, the Open Market Investment Committee voted to enlarge its Government securities to $300 million. This had the effect of easing what was then a slight recession probably as the result of the System's sales of Government securities.

In any event 1925 was a stable year and the National Bureau of Economic Research did not record a recession for that year.

1926 was also a good year. The gross national income in constant dollars increased from 4½ percent in 1925 to 5½ percent. The gross national product was at $97.7 billion. Unemployment which was at 5.5 percent in 1924, and 4.0 percent in 1925, went to a staggering low in 1926 of 1.9 percent.

The special investment account which held $270 million of Government securities in September 1926 was reduced to $210 million—a $60 million sale. This was done to moderate what was thought to be an incipient stock market boom. While financial stability was the purpose the operation was contracyclical and kept the 1926 economy stable.

During the last quarter of 1926 industrial production declined 6 percent, and factory employment about 2 percent. But the Federal

Reserve System made no response. It kept the interest at 4 percent, and confined its open market operations to replace maturing issues.

While there was an increase in the Federal Reserve Board's index of industrial production, nevertheless wholesale prices between January and April 1927 dipped 3 percent, and the New York Bank pressed for a reduction in the discount rate.

At year's end in January 1927 the prime commercial paper rate was 4.50 percent. By February it fell to 4 percent. But the Federal Advisory Council did not believe the discount rate should be lowered, and instead of buying, recommended selling Government securities.

How wrong can bankers be?

Accordingly, between March 9 and May 9, 1927, the System sold $100 million of Government securities, reducing its special account to almost $136 million.

Ben Strong warned that $136 million was too little for the System to hold, and in the latter part of May and in June, the New York bank brought the System portfolio up from $136 million to $316 million.

The prime rate on commercial paper which in mid-March was 4.13 percent, went up to 4.25 in June.

Strong refused to raise the discount rate from 4 percent, as the Federal Advisory Council wished, but in June he did sell $60 million, reducing Government securities held by the System to about $250 million.

When, however, the Open Market Investment Committee met in July 1927, it noted that the slackening of business had caused a fall in the commodity market. As a result the Federal Reserve Board accepted its recommendation that the Committee buy $50 million of Government securities. And in August 1927, 8 of the 12 Federal Reserve banks lowered their discount rates from 4 to 3½ percent. In addition the Committee bought another $50 million of Government securities, bringing the System's special account up to $353 million by August 31, 1927. (Minutes Open Market Committee, July 1927, FRB File 333b.2.)

In September three other Reserve banks lowered their interest rates. When the Chicago bank refused to go along, the Federal Reserve Board, by a 4 to 3 vote, forced it to do so.

One of the dissenters, Charles S. Hamlin, a member of the Federal Reserve Board from August 10, 1914 to February 3, 1936, remarked that he doubted the power of the Board to force Chicago to a uniform interest rate "to help New York to help the English situation." (Wicker, supra, 113.)

Two historians of the period (Chandler, supra, 440, and Wicker, supra, 109–110.) Note that Governor Strong initiated this easy money policy in 1927 after Montagu Norman, the Governor of the Bank of England, Hjalmer Schacht, President of the German Reichsbank, and Charles Rist, Deputy Governor of the Bank of France paid him a visit in July 1927 and urged lower rates in New York on him. But Friedman and Schwartz in their work, "A Monetary History of the United States," supra, contend foreign considerations were seldom important. Wicker argues there was a dip between September and December 1926, but in July 1927 the wholesale price index was rising. Wicker contends the easy money policy initiated in July was to establish an international gold standard. He would have you believe that this international policy just happened to coincide with the goal of domestic stability.

Reviewing the steps that the System made to combat the threatened recessions of 1923–24 and 1926–27, one must conclude that the System had made a major conceptual advance and had developed more sophisticated tools to implement its policies.

It had enlarged the limited objective of accommodating business to include responsibility for modifying the business cycle by making credit more easily available during a period of recession, and less easily available during a boom.

Having discovered, in the years 1922–23 the impact of open market purchases and sales on the level of member bank reserves and market rates, it could more effectively control the volume of credit than when in 1920–21, it had relied heavily on the discount rate.

The knowledge which the System gained from the disaster of 1920–21 and its aftermath was set forth at length in its Annual Report for 1923. The report contains a skillful analysis of criteria for policy, but rejects the use of any single criteria—such as reserve ratios, exchange rates or price index numbers—as a guide. It argues that policy "is and must be a matter of judgment," based on careful examination of all available evidence of changes in production, trade, employment, prices and commodity stocks.

As noted above, the behavior of prices between 1923 and 1928 was similar to that of interest rates which is not surprising, since interest rates contain an inflationary component and hence are most likely to be stable when prices are.

The System claimed no influence over prices, however, and there is no indication that any Reserve official, except Governor Strong of the New York bank, saw price stability as a policy objective.

Even Governor Strong rejected the use of a specific level of prices as a target, although such a concept had gained substantial support outside the System, and was embodied in the so-called stabilization bills of the period. Testifying against these measures, he argued that the System could only gain in effectiveness if it were left free of legislative entanglements. (Chandler, supra, 204, 246.)

The behavior of interest rates and prices, and the fact that the System took credit for ending the recessions of 1923–24 and 1926–27 seem to indicate a commitment to countercyclical policy. Nevertheless, only a minority of Reserve officials favored such objectives and, as events after his death in 1928 indicate, Governor Strong was probably the only official who had both the influence and the knowledge necessary to conduct countercyclic operations.

The extent to which a countercyclic policy had been successful in the years 1923–28 is thus perhaps more an indication of Strong's economics and dominant position than it is evidence of an advance in the overall level of understanding within the System, though definitely, as analysis of the October 1922 Symposium shows, there was increasing recognition of Federal Reserve responsibility for economic events, particularly "the prevention of disaster," as put by Governor Norris.

The key to Strong's success was the fact that the New York bank had control over open market operations. Also he virtually represented the United States in international financial matters, and his prestige abroad tended to enhance his position at home.

The implementation of Governor Strong's policies was, however, frequently impeded by pressures and demands from various factions within the System.

Reserve bank governors complained that the amount of assets purchased by the System was inadequate in terms of their needs for earnings, and threatened to ignore or dismantle the Open Market Investment Committee. Secretary Mellon was the Committee's protector but viewed its function with ambivalence. Like many within the System, he valued the deflationary aspects of open market operations—their usefulness in raising money rates—but feared the System's power to create more money. (See letter from Under Secretary of the Treasury S. Parker Gilbert, Jr., to Deputy Governor J. H. Case of the New York Bank, August 3, 1923. FRB File 333b.1.)

Secretary Mellon insisted on the Board's prerogratives in determining the maximum limitation of the System portfolio and saw to it that the amount was kept low.

Only in the latter months of the 1924 and 1927 recessions were the System's holdings permitted to rise to $500 million. As a result, the Committee frequently lacked sufficient assets to pursue a deflationary policy as aggressively as Mellon desired.

However, his conflicting goals were no more self-defeating than those of the Reserve bank governors. They frequently argued that conditions were ripe for an increase in the discount rate while insisting that they must have more earning assets to meet expenses.

While the Committee advocated easy money as a response to recession, it had as little tolerance for low rates as a normal market condition as any other faction in the System. In both 1924 and 1927, it acted prematurely to reduce its portfolio in order to "firm up" rates. As a result, both recoveries were quickly followed by slight slumps.

In 1925, however, the recovery was almost as energetic as it had been in 1923. Gross national income in constant dollars increased 4½ percent in 1925, and 5½ percent in 1926, viewed on an annual basis. Wicker, *supra*, 95).

The figures on unemployment are more revealing. As high as 11.9 percent in 1921, and up to 5.5 percent during the 1924 recession, unemployment dropped to 1.9 percent in 1926, the lowest level for any non-wartime period from 1907 to date. (Historical Statistics of the United States, 73.)

The post-recession period in 1928 was different. It has been suggested that the System maintained rates too high to avoid dampening the overall economy, but too low to control the stock market. Actually, they were attempting to do just the reverse—keep rates low enough to stimulate the economy, but high enough to check the rate at which funds flowed into the market.

As a result of this policy the amount of bank credit supplied, including for speculative purposes, was restricted, thus laying the groundwork for economic weakness.

But the policy did not prevent the 1928–29 stock market boom.

For though bank credit flowing into equities was reduced, there was an even heavier flow of funds into the stock market from nonbank sources.

The market boomed even higher, while the economy slowed significantly in 1928, though there was a temporary recovery in 1929.

Numerous theses have been advanced to explain the 1929 stock market crash, but it has proved easier to indict the Federal Reserve System for its failure to alleviate the depression than to guess what policies it might have pursued to prevent the financial debacle that triggered it.

It would appear, however, that the ability of Reserve officials to control interest rates during the period of prosperity had given them a false sense of security.

After the searching analysis of 1922—prompted, perhaps, by the painful experience which preceded it—no further effort was made to explore the relationship between money and credit and economic performance.

Worse, the successful monetary remedies of the 1920's were a failure when projected into the 1930's. The maintenance of low interest rates alone was not enough to stimulate the economy in the depression.

VI. ANDREW W. MELLON

One of the architects of the monetary policy of the 1920's was Andrew W. Mellon, who served as Secretary of the Treasury from 1921 to 1932. When he entered the office in 1921 the national debt stood at $24 billion, of which $10 billion represented uncollected war and postwar loans to Europe.

Secretary Mellon believed that a liquidation of this debt was essential to cutting taxes and balancing the budget. (William L. Mellon, "Judge Mellon's Sons," private printing, 1948, 409.) And, essential to balancing the budget, was to abolish tax-exempt bonds to reduce the taxes on wealthy taxpayers, and to encourage them to pay their taxes. (Ibid, 429.)

Mellon, on November 20, 1923, sent his plan for tax reform to the House Ways and Means Committee.

In both Houses of Congress, the Democrats attacked Mellon's plan as an aid to the rich, and burden on the poor. Basically, his plan rested on the theory that:

> The history of taxation shows that taxes which are inherently excessive are not paid. The high rates inevitably put pressure upon the taxpayer to withdraw his capital from productive business and invest it in tax-exempt securities, or to find other lawful methods of avoiding the realization of taxable income. (Andrew W. Mellon, "Taxation: The People's Business," Macmillan Co., New York, 1924, 13).

His plan included a 25 percent reduction in tax on earned income; reduction of income surtax (excess profits tax) rates to no more than 25 percent at $100,000; repeal of miscellaneous taxes such as amusement and telegraph taxes, and simplification of tax law by closing loopholes. (Ibid, 54–55.)

The across-the-board earned income reduction was a concession to the hue and cry of the Democrats, but the other points in "Mellon's Plan," as it became known, were points he brought with him in 1924.

Mellon's plan passed the House, only to meet the Democratic-Progressive coalition in the Senate. Senator Robert Marion LaFollette, Republican Progressive from Wisconsin (Representative 1885–1891; Senator 1906–1925), joined with Congressman Nicholas Longworth (Representative 1903–1913, 1915–1931, Majority Leader 1923–1925, and Speaker 1925–1931) cosponsoring an alternate tax bill.

Reelection was coming up, and the 2 percent normal tax rate, as opposed to Mellon's suggested 3 percent and the existing 4 percent, sounded good to the politicians in the House. Mellon's 25 percent surtax was also rejected with a compromise of 37½ taking its place.

Mellon's bill lost, and the LaFollette-Longworth bill passed with a large majority. (Harvey O'Connor, "Mellon's Millions," John Day Co., New York, 1933, 1935.)

In the new act was a provision which raised the inheritance tax on $10,000,000 estates from 25 percent to 40 percent. The Democratic-

Progressives had given the Conservative Republicans and Calvin Coolidge something to think about after the election.

Mellon learned quickly how he had to deal with the Congress which was dominated by Democratic-Progressives.

On October 18, 1925, Mellon submitted a "suggested" tax reform which included reductions for low-income brackets, something his first suggestions did not. (O'Connor, supra, 140.) And, on February 26, 1926, when the new tax measure was signed, he smiled, knowing:

> That the tax load of the rich and prosperous had been cut $700,000,000 in the past 2 years, the equivalent of $2,000,000 a day which was released, as he said, for productive industry * * * The inheritance tax was cut from 40 percent to 20 percent, and the credit on state inheritance taxes was raised from 25 percent to 80 percent. The capital stock tax was repealed. The gift tax was history. The man with the million dollar income who had been paying $663,000 into the Federal Treasury when Mellon assumed charge (in 1921), was (in 1926) asked to pay a trifle under $200,000. (Ibid, 141.)

Up through the crash of 1929 Mellon was idolized by the business public.

Even though Europe was shakily paying its war debt essential to a balanced budget in the United States and the tax cuts allowed by them, Germany began to waiver under the tremendous drain on her economy caused by the reparations exacted from her.

The European Allies were depending on Germany's payments since, for all intents and purposes, Germany's prepayments to them were simply being forwarded to the United States to pay off the Allied debts which came to over $10 billion in 1919.

Since most of the international production was financed by credit, which could only be repaid by profits from consumption, which in turn depended on wage-earner purchases, a flaw at any level would bring the entire house of cards down.

A flaw developed in agriculture.

Many of the food producing regions of Europe had received heavy damage during the First World War.

Germany's industrial production had been damaged, and money that normally would have gone to capital reinvestment was leaving the country as reparation payments or lost in the inflation caused by a shortage of food.

Without this vitally needed capital, Germany had to borrow, usually from the United States, in order to meet her reparation payments. It would only be a matter of time until she either repudiated her debt from anger or collapsed from the inability to pay because her industries were under capitalized. (R. R. Palmer, "A History of the Modern World," Rev. Ed., Alfred Knopf, New York, 1964, 777–778.)

But Mellon and his businessmen supporters refused to anticipate this distinct possibility.

Mellon's plan, as described above, was the final form of the carrot which the Republicans dangled before the American people prior to the election. Davis lost the election, and the Republicans picked up 4 seats in the Senate, more than 20 in the House, and then watched the LaFollette-Longworth team tear their carrot to ribbons on the floor of Congress.

By 1927 opposition to Coolidge-style Republicanism was growing. In the Congressional elections of November 1926 the Republicans suffered setbacks in both Houses which placed them in the same position they had held during the 66th Congress (1919–21).

The Presidential election of 1928 was no less exciting than the Congressional election in 1926. Coolidge was hoping for another term, but was too much the conservative to admit that his ties with Harding politics were wearing thin after 4 years.

The Progressive Republicans were disrupting the "Grand Old Party," and the party leaders felt that a new image was needed.

Certainly, the business interests supported Mellon, but the party leaders were hesitant about placing such a rich American in the Presidential race.

In the end, the Republican party leaders decided upon Secretary of Commerce Hoover over Mellon, and over Coolidge who drifted more and more into the role of "a friend of Mellon's." (Ibid, 301–303.)

Coolidge's "I do not choose to run" allowed the Republicans to abandon him gracefully.

A last minute draft at the Kansas City Convention had been planned, but was quashed by William Vare, the then Republican political boss of Philadelphia who announced that his contingent would support Hoover.

Mellon considered opposing him, but decided that support of Hoover would be in his best interests, since Hoover had agreed to retain him as Secretary of the Treasury to gain the support of big business. (O'Connor, supra, 304.)

The Senate Challenges Hoover's Holdover of Mellon

Apparently the shift from Harding-Coolidge politics to Hoover politics by the Republicans in 1928 was appropriate. Hoover's coattails brought 8 Senate seats and 30 House seats into the Republican fold, thus expanding Republican control of both Houses of Congress—from a mere majority of 1 seat in the Senate to a majority of 17 seats, and an increase in Republican Representatives from 237 to 267.

But even with the majorities, it was not long after Hoover became President that problems began to arise. On March 5, 1929, the day after the inauguration, the Senate passed a resolution challenging:

> 1. Whether the head of any department of the Government may legally hold office as such after the expiration of the term of the President by whom he was appointed.
> 2. Whether in view of the provisions of the laws of the United States Andrew W. Mellon may legally hold the office of Secretary of the Treasury reference being made to Section 243 of title 5 of the Code of Laws of the United States of America. . ." (U.S. Senate, S. Rept. 7, part I, 71st Cong., 1st sess., "Eligibility of Hon. Andrew W. Mellon, Secretary of the Treasury," U.S. Government Printing Office, Washington, D.C., 1.)

Section 243 will be quoted in full when the 1932 Mellon impeachment hearings are discussed. Generally, it precludes anyone "directly or indirectly concerned" with trade, ships, and real property from becoming Secretary of the Treasury.

The Senate Judiciary Committee directed the inquiry, and on May 7, 1929 delivered its printed majority and minority reports.

The majority report submitted by Senator Steiwer, Republican of Oregon, ruled for Mellon on both points.

The other Members of the Senate Judiciary Committee signing the majority report were Senators Overman (D-N.Car.), Deneen (R.-Ill.), Waterman (R-Colo.), Hastings (R-Del.), and Burton (R-Ohio).

Specifically referring to Section 243, the report said:

It is a well-known fact that Mr. Mellon was appointed Secretary of the Treasury by President Harding and was confirmed by the Senate in 1921, and that he has held office for more than eight years. The question asked the Committee is whether he may legally hold the office. This question we have answered in the affirmative.

The question presented requires an interpretatioin of Section 243, the significant language of which is as follows:

No person appointed to the office of Secretary of the Treasury . shall directly or indirectly be concerned or interested in carrying on the business of trade or commerce.

With respect to a corporation this means that the Secretary of the Treasury shall not hold office as a director or as an officer and that he shall not by any means either direct or indirect, participate in any activity in carrying on the business of a corporation if the corporation is engaged in trade or commerce. This, in our opinion, is a reasonable, proper, and correct interpretation of the statute. (U.S. Senate, S. R. 7, part I, supra, 1.)

This interpretation is supported by the fact that numerous Secretaries of the Treasury have owned stock in corporations engaged in trade. It is inconceivable that all these Secretaries willfully violated the law, and equally inconceivable that the Presidents under whom they served would have appointed men of known ineligibility, or that the Senate would have confirmed ineligible appointees. Obviously it has been thought in many official quarters that the section referred to did not apply to mere ownership of corporate stock". (Ibid, 3.)

Significantly, the majority did not end their comments with this flat declaration, but went on to state:

In addition, it is our opinion, upon the facts which the committee has considered, that Mr. Mellon does legally hold the office, and it is also our opinion that no contrary conclusion can properly be reached except through duly instituted criminal proceedings or impeachment proceedings originating in the House of Representatives. (Ibid, 3).

The minority report submitted by Senator Norris, Republican of Nebraska (other signatories were Senators Caraway (D-Ark.), Walsh (D-Mont.), and Blaine (R-Wis.), contains a fascinating, detailed examination of the holdover question, to which it devotes seven pages, and points out that Cabinet officers have been held over without re-confirmation on 110 occasions in our history, and concludes that such practice is proper. (S. Rept. 7, part II, 71st Cong., 1st sess., "Eligibility of Hon. Andrew W. Mellon, Secretary of the Treasury," Minority Report, S. R. 2.)

But unlike the majority, the minority defines the issue of direct or indirect interest in two questions:

(1) Is ownership of a substantial amount of stock by the Secretary of the Treasury, in a corporation engaged in carrying on the business of trade or commerce, a violation of the statute (Section 243)? (2) Is the ownership of a substantial amount of stock by the Secretary of the Treasury in a corporation owning a sea vessel a violation of the statute? (And the minority concludes—both of these questions must be answered in the affirmative). (Ibid, 8.)

Twenty pages of information are included in the Minority Report detailing Secretary Mellon's holdings and interests. Numerous additional submissions fill parts 3 through 7 of the 1929 Senate Report.

Since the majority of the Judiciary Committee found neither Mellon's holdover status nor his stock interests improper, and since impeachment is properly raised initially only in the House, the issues were dropped by the Senate.

Mellon was around 74 years old by the time the reports were filed, and his criticism only lay smoldering, not extinguished as his supporters hoped.

By mid-1929 the stock market speculation was heavy. The false prosperity brought about by the speculation was alarming members of Congress and Government officials.

Rumors floated about that Mellon, as a member of the Federal Reserve Board, had tried to force other members of the Board to allow the discount rate to go up. (Andrew W. Mellon, supra 470.) While he privately may have endorsed this position, publicly he denied it. In March 1929 he reported no such division of opinion. (New York Times, Mar. 17, 1929, 44.)

On Friday, March 15, 1929, the New York Times carried a front page story with the caption "Mellon Advises Buying Of Bonds Now By Investors." (*New York Times*, Mar. 15, 1929 1.) In the story he is quoted as saying by way of qualification:

> This does not mean, said Mr. Mellon, "that many stocks are not good investments. Some, however, are too high in price to be good buys. For prudent investors I would say, if making a suggestion, that now is the time to buy good bonds."

We have the Secretary of the Treasury who happens to be a very wealthy man, who also happens to be a member of the Federal Reserve Board, making a statement which, by itself, can be a little out of the ordinary. Yet speculation went on unchecked.

Mellon's statement was made 1 month after Board warning against heavy stock speculation which had obviously continued after the warning.

Even the New York Times picked it up. On its editorial page on March 16, 1929, it concluded that such a statement shows that the Treasury and Federal Reserve plan to do nothing to quell speculation other than to advise. (*New York Times*, Mar. 16, 1929, 18.) Interest rates, margin rates, and discount rates remained unchanged.

Judging from what occurred in October 1929, the New York Times was unfortunately correct.

The Decline of Mellon

The New York Times for Wednesday, January 1, 1930, carried an article on its front page under the heading, "Mellon Predicts Business Progress," and subheadings, "He Sees 'Ample Credit' Available in New Year and Revival Ahead in the Spring," and (Secretary of Commerce) Lament Concours in Prosperity Forecast * * *"

Mellon made a statement while on vacation off Nassau, Bahamas, in which he predicted, "Sectional unemployment during the Winter, but looked for a revival of activity in the Spring. Government finnances were sound, warranting the tax reduction program * * *" (*New York Times*, Jan. 1, 1930, 1.) He also stated:

> I see nothing, however, in the present situation that is either menacing or warrants pessimism. During the winter months there may be some slackness or unemployment but hardly more than at this season each year.
>
> In the credit situation the trend of the money is down. There is plenty of credit available and we have reason to expect that the rates for new capital in

building construction and expansion will be such as to facilitate the promotion and accomplishment of new undertakings.

Statements from the executives of railroad, public utility and industrial concerns during the President's recent conference were, almost without exception, to the effect that their expenditures for new construction in 1930 will be as much or more than in 1929. (*Ibid*, continued at 4.)

Mellon's remarks quoted in the Times of January 1 were included in full in the Thursday, January 2, 1930 issue under the caption "Chronological Record of the United States for 1929." Nowhere was "Black Thursday" mentioned. (*New York Times*, Jan. 2, 1930, 30.) Perhaps in hindsight we find this a tremendous oversight.

On January 6, 1930, in an interview published in the Daily Princetonian, Mellon stated that a Treasury surplus of $160 million should be applied to tax reduction, rather than to debt reduction. He is quoted as saying:

Debt reduction and tax reduction should, of course, go hand in hand * * *. This has been the case during all the years that I have been at the Treasury and, I may say, it has been the historic policy of the Government since the very early days. No other part of our financial policy has been more steadfastly maintained than that providing for the prompt payment of the public debt.
(*New York Times*, Jan. 7, 1930, 64.)

But the public did not seem placated by such promises and optimism. Mellon, who had emerged unscathed from countless inquiries into his taxes, his businesses, and his fitness to hold office, no longer seemed impervious to these attacks.

Critics who had been ignored before were being listened to in 1930. J. H. Gray, Ph. D., a former President of the American Economic Association assailed Mellon, former President Coolidge, and Prof. Irving Fisher of Yale, at a luncheon of the League for Industrial Democracy, a less than strictly capitalist organization. He said that these three men were most responsible for "continuing and extending the mania" of speculation.

With uncanny accuracy Gray predicted that rate and margin regulation were too little, too late, that President Hoover's public expenditures would be ill-planned, undercapitalized, and insufficient to lesson unemployment which would last for quite awhile.

He argued for a reduction in the "concentrated absentee ownership and control of credit," and the "more equitable proceeds of industry."

While the Republicans in January 1930 criticized Dr. Gray's suggestions for correcting the faults leading to the stock exchange speculation, including the heretical suggestions of higher inheritance taxes, more progressive income taxes, and general wealth redistribution, few men today can say he was not more realistic about the 1930 economic situation than Mellon, Hoover, and Coolidge. (*New York Times*, Jan. 12, 1930, 23.)

February 1930 was also a bad month for Secretary Mellon.

Senator James T. Walsh, Democrat, Montana, a man who could safely be excluded from a list of Mellon's admirers, was joined by Senator Norris of Nebraska in a 41 to 39 Senate vote to reduce the duty on foreign aluminum, crude, and scrap, from 5 cents to 2 cents. Semi-finished aluminum duties were reduced from 9 cents to 3½ cents per pound.

Senator Royal Samuel Copeland, Democrat, New York, also assailed Mellon's Aluminum Co. of America for putting "the people of the country * * * at the mercy of this monster monopoly no matter what we do." (*New York Times*, Feb. 18, 1930, 1 continued 3.)

During that February the House Banking and Currency Committee held hearings on branch and group banking. Fortunately for Mellon, the interest in Congress shifted to banking and left him alone for awhile.

In April 1930 the Times in an editorial said:

"In the Hearts of His Enemies"—Secretary Mellon's admirers have not always erred on the side of moderation. Not content with doing justice to his high qualifications for office and to the excellent use he has made of the pleasant fiscal times in which his lines were cast, they have surrendered occasionally to the temptation of describing him as a miracle worker.

But the feats of well-doing credited to Mr. Mellon by his friends shrink into insignificance beside the prodigies of malevolence ascribed to him by his enemies. In the way of tributes to his personality, it is of his foes that the Secretary of the Treasury should be proudest. Consider, for instance, the compliment involved in the familiar Brookhart theory that the reason for the breakdown of prohibition is Andrew W. Mellon. The manner in which Mr. Mellon dictates our power policies and our waterways policies and our tariff policies is impressive enough. But it is nothing compared to the effectiveness with which he imposes the practice of sabotage upon thousands and thousands of prohibition officers just crazy to enforce the law in countless communities madly clamoring to have the law enforced.

And Mr. Mellon himself—how does he respond when his friends praise him for making the sun shine, and Brookhart excoriates him for making the crops fail? Rumor has it that on such occasions the Secretary of the Treasury sits down as usual to dinner, treats himself to an extra long look at his favorite Rembrandts, and so to bed. (New York Times, Apr. 3, 1930, 28.)

And the congressional election of 1930 showed the trend away from the "Power Trust," "Mellonism," and big business. In Pennsylvania, Gifford Pinchot was elected Governor, signifying that more of the State than just Vare's Philadelphia was rebelling against the Mellon machine. (*New York Times*, Nov. 8, 1930, 3.)

Pinchot had spent years traveling through the rural parts of Pennsylvania claiming that Secretary Mellon was a distiller and as Secretary of the Treasury obviously had a conflict of interest, and by the 1928 election, Mellon forces, weakened by the loss of Philadelphia to Vare, and by the death of Senator Penrose, soon found the anti-Mellon factions even in Pittsburgh.

The result of the hard fought election was a U.S. Senate investigation into Pennsylvania campaign practices which concluded with the U.S. Senate denying Vare a seat in its chambers.

By 1930, the Mellon machine, attacked by Pinchot's Bull Moose Republicans and the Progressive Party, had lost much of its power. (O'Connor, supra, 259–261.)

Perhaps the heaviest blow came in 1931. Secretary Mellon left for England to see his son, Paul, who was studying at Cambridge. When he arrived, Ogden Mills was on the phone and informed him that the Credit-Austalt Bank in Vienna had failed. President Hoover directed Mellon to contact the English leaders. The international debt settlement was at stake with its direct effect on Mellon's domestic funding policies.

The European countries were hoping for a complete war debt cancellation, but Hoover and Mellon concluded that this was unacceptable and suggested a 1-year moratorium. (Ibid, 473–75.)

After a series of conferences the European countries agreed to grant Germany a 1-year grace period to allow her to straighten out her finances. (Ibid, 479.) From history, we know that she failed to do so.

And it is significant to note that Mellon, who spoke optimistically in public about the aftermath of the crash of 1929, believed privately that the panic went beyond Wall Street, and would be as bad as the hard times of 1873. (Ibid, 471.)

The Impeachment of Mellon

On January 6, 1932, Mr. Wright Patman, Representative from Texas, rose on the floor of the House and said:

> Mr. Speaker, I rise to a question of constitutional privilege. On my own responsibility as a Member of this House. I impeach Andrew William Mellon, Secretary of the Treasury of the United States, for high crimes and misdemeanors * * *. (U.S. Congress, Congressional Record, House, Jan. 6, 1932, 1400–1401.)

The specific charges which involved section 1003 of title 31 of the United States Code, were substantially the same as those raised in the Senate several years previous:

> *Restrictions Upon Secretary of Treasury.*—No person appointed to the office of Secretary of the Treasury, or Treasurer, shall directly or indiectly be concerned or interested in carrying on the business of trade or commerce, or be owner in whole or in part of any sea vessel, or purchase by himself, or another in trust for him, any public lands or other public property, or be concerned in the purchase or disposal of any public securities of any State, or of the United States, or take or apply to his own use any emolument or gain for negotiating or transacting any business in the Treasury Department, other than what shall be allowed by law; and every person who offends against any of the prohibitions of this section shall be deemed guilty of a high misdemeanor and forfeit to the United States the penalty of $3,000, and shall upon conviction be removed from office, and forever thereafter be incapable of holding any office under the United States; and if any other person than a public Prosecutor shall give information of any such offense, upon which a prosecution and conviction shall be had, one-half the aforesaid penalty of $3,000, when recovered, shall be for the use of the person giving such information. (31 U.S.C. 1003.)

The section says a Secretary of the Treasury may not directly or indirectly be concerned or interested in a business or trade, own a sea vessel, or use his office to promote his own business.

Mr. Patman in his charge before the House says that Mellon:

> * * * is now and has been since taking the oath of office as Secretary of the Treasury of the United States the owner of a substantial interest in the form of voting stock in more than three hundred corporations with resources aggregating more than three thousand million dollars, being some of the largest corporations on earth, and he and his family and close business associates in many instances own a majority of the stock of said corporations and, in some instances, constitute ownership of practically the entire outstanding capital stock ." (U.S. Congress Congressional Record, House, Jan. 6, 1932, supra.)

Elaborating his charges, Mr. Patman said that in many of these corporations Mellon and his family were either the largest or controlling stockholders. He also charged that some of these corporations owned sea vessels, giving Mellon an indirect interest in over 50 ships, including the oil fleet of Gulf Refining Co.

As Secretary of Treasury, Mr. Patman pointed out, Mellon was in charge of the Coast Guard, and tariff and customs collection, so the possibility of conflict of interest was immense and obvious. (Ibid, 1400–1401.)

The impeachment resolution was referred to the House Committee on the Judiciary for action. The New York Times described Mr. Patman's reading: "Page boys moved like shadows about the chamber, rushing for law and reference books" as Mr. Patman spoke to a silent chamber.

The Times indicated that an "attack" on Mellon had been expected, but the call for impeachment had not. (New York Times, Jan. 7, 1932, 9.)

On January 7, 1932, Representative Sumners, Democrat, Texas, chairman of the House Judiciary Committee, announced that the committee would indeed examine Mr. Patman's charges saying, "It is too serious a matter not to consider." (New York Times, Jan. 8, 1932.)

And while Mr. Patman's charges were quite removed from the front pages, a seemingly unrelated incident was reaching page 1.

The New York Times on its front page for January 13, 1932 carried a column on Secretary of State Henry Lewis Stimson's testimony before the Senate Finance Committee concerning a then recent agreement between Colombia and the National City Co. (New York Times, Jan. 13, 1932, 1.)

Stimson was a remarkable man. A New York lawyer, senior partner in Winthrop, Stimson, Putnam & Roberts, former partner of Elihu Root, Stimson had run for Governor of New York, been Secretary of War under Taft (1911–1912), Governor General of the Philippines (1927–1929), Secretary of State under Hoover (1929–1933), ending his public career as Secretary of War under President Roosevelt (1940–1945). Born 1867, he died in 1950.

The article casually mentioned that National City was extending the Colombian Government a $20 million line of credit. Concurrently, the Barco Oil concession was being extended. The article also mentioned that Gulf Oil Co. and J. P. Morgan Co. had an interest in the Barco concession. (Ibid.)

The article neglected to point out that Mellon had resigned his directorship in Gulf Oil when he became Secretary, that he and his family had owned more than 80 percent of the outstanding stock in Gulf which gave them an aggregate control over $617 million in assets in Gulf Oil alone, and that in 1926 the Mellons had paid the previous holder of the concession $1,500,000 for a 75-percent interest in the concession. (O'Connor, supra, 195, 422.)

It would take a few more days of hearings at both Senate Finance and House Judiciary before an even more critical connection between the credit and the concession renewals would be established.

On January 13, 1932, a Wednesday, Secretary Mellon was telling the House Ways and Means Committee that he now believed a tax increase was necessary to balance the budget and spur the economy.

Mellon recommended that the tax be applied across the board to all tax groups. He even agreed that the time had finally come to increase the estate tax, at least temporarily. (New York Times, Jan. 14, 1932, 10.)

On that same morning, January 13, Mr. Mellon's representatives Mr. A. W. Gregg, and Mr. Walter W Sheppard, were sitting before the House Judiciary Committee as it opened its proceedings.

Gregg had been General Counsel to IRS in 1925, and made a good impression on Mellon. In 1927 he entered law practice in the city of New York. His father had been a Congressman from Texas and Mr.

Mellon asked him to represent him before the House Judiciary Committee on the impeachment hearings.

Sheppard was a lawyer from Georgia who had been secretary to Congressman Lester (1893–1902), judge in the Georgia Superior Court (1911–1927), and U.S. attorney for the southern district of Georgia (1932–1933).

Mr. Patman, "the gentleman from Texas," as the Committee members referred to him, reiterated his charges against Mellon, and began supplying the supporting documentation. (New York Times, Jan. 14, 1932, 8.)

Mr. Patman's exhibits began with a letter dated April 18, 1929, sent by Secretary Mellon to Senator Reed of the Senate Judiciary Committee during the hearings held in 1929, concerning the same charges raised here and the holdover charge.

In pertinent part it read:

> Before I became Secretary of the Treasury I sold every share of stock which I owned in any national bank, trust company, or other banking institution, and I have not since, then owned, nor do I now own any stock in such corporations. I owned then and I now own a substantial amount of stock in the Gulf Oil Corporation, the Aluminum Co. of America, the Standard Steel Car Co., and other business corporations, but in every case my holding is very much less than a majority of the voting stock of such company. (U.S. Congress, Hearings on H. Res. 92, *Charges of Hon. Wright Patman against the Secretary of the Treasury*, January 13, 14, 15, 18, 19, 1932, Govrenment Printing Office (sited infra as *Impeachment Hearings*), 9.)

The questions in the impeachment hearing quickly became defined.

Does the holding of stock merely for investment purposes make Mellon "indirectly concerned" in the carrying on of that business? And, is "control" of a company legally understood to rest with Mellon only if Mellon owns 51 percent or more of the stock? (Ibid, 11.)

Mr. Patman's task was to show beyond a reasonable doubt that Mellon held stock in these corporations and was more than casually interested in their business.

Mr. Patman also had to convince the committee that a minority holding in a company, for example 15 percent, could give that stockholder control of a company if the rest of the company's stock was widely scattered, or if it were owned by relatives and close friends of the stockholder.

To illustrate that Mellon was indeed interested in the conduct of Alcoa while he was Secretary, Mr. Patman next introduced a deposition taken by an attorney named Whipple in connection with a case heard in 1927 and 1928 involving a challenge to the last will and testament of James Buchanan Duke, founder of the Aluminium Co. of Canada, president of the American Tobacco Co., and founder of Duke University. Born in 1856, he died in 1925.

In the deposition, Mellon states that he resigned as a director of Alcoa when he became Secretary, but that his brother, "R.B.," had continued as a director, that he and his brother were very close in their financial relationships, and that each owned more than 15 percent of the outstanding stock of Alcoa.

Mellon said he left the management of Alcoa to Arthur Vining Davis, president of Alcoa (1962–1967), who became very wealthy and powerful in both Alcoal and Aluminium of Canada. Mellon testified that Davis contacted him from time to time on major policy decisions; one such decision was the possibility of a merger with James Duke's Aluminium Co. of Canada. (Ibid. 14–15.)

Mellon, in the deposition, says he met Mr. Duke for the first time in 1922 in Washington, D.C. through Mr. Davis. The next time he saw Mr. Duke was in 1925, a month after Mr. Davis had informed Mellon that a merger was in its final stages.

In Mellon's words, Davis "said that Mr. Duke would like to come to Washington and talk this (merger) business over in Washington." (Ibid, 17.) The committee was so amazed at this bit of deposition that Mr. Patman read it to them four times.

Later in the testimony, Mr. Patman quoted a passage from the deposition in which Mellon fully admitted that he was approached by Davis as the final decisionmaker. (Ibid, 20.)

Although later in the deposition Mellon says he signed the merger agreement, the final agreement lacks his signature. At that point Mr. Patman closed his showing that Mellon was actively engaged in trade or commerce through Alcoa, and moved on to sea vessels. (Ibid, 24.)

The issue raised under the sea vessel question was whether ownership of stock in a corporation owning or leasing ships constituted the carrying on of trade or business under the statute.

Mr. Patman answered it by saying, "For anyone to contend that the owner of one-half of the stock of a company that owns a sea vessel is not an owner, in part, of that sea vessel, it occurs to me would certainly be illogical * * *" (Ibid, 26.)

Some House Judiciary Committee members began to pressure for a resolution of the legal definitions and parameters, and Mr. Patman responded:

> But I thought I would withhold argument on that until these gentlemen (Mellon's representatives) make their legal argument; and after they make their legal argument I think I should be permitted to answer it.

Discussion of the legal arguments was continued:

> Mr. BACHMAN. Mr. Chairman, is it not important to have that question decided before the record is crowded with a lot of matters that have no application?
>
> Mr. LAGUARDIA. I submit, Mr. Chairman, that that is a matter that this committee will have to decide—if stock ownership in a company, which, in turn, owns or operates a ship is an ownership in part by that stockholder in a vessel; that is a question of law that we will have to determine.
>
> Mr. MICHENER. I might suggest this, Mr. Chairman: That we want to get at the facts, after all. That there is not any contention as to the ownership of this stock. I have been hoping that counsel might save the necessity of taking the time of the committee to prove a self-evident fact. Now, I do not want to be put in the position of embarrassing counsel in any way; but if there are facts which can be conceded without prejudice, it is to the best interest of everybody that that be done.
>
> Mr. GREGG. I suggested that in the beginning. We concede that Mr. Mellon owns common stock in the Aluminum Co. of America and the Gulf Oil Corporation. We do not concede that he owns *control* of the Gulf Oil Corporation or the Aluminum Co. of America. (Emphasis added). (Impeachment hearings, supra, 27–28.)

Mr. Gregg then conceded to Mr. LaGuardia of New York that some of the companies mentioned owned ships, but the issue remained whether such stock ownership gave Mellon control. The committee considered deciding the issue before all the facts were presented, but finally allowed Mr. Patman to continue. (Ibid.)

According to Mr. Patman, A. W. and R. B. Mellon, along with two other associates, jointly owned a closed corporation known as the Koppers Co. of America. This company was trading with Russia, while at the same time Mellon, as Secretary of the Treasury, was supervising customs, tariffs, and the Coast Guard. Americans were upset over Communist "convict made goods," but a Mellon company was trading with them.

Again the objection was raised that no criminal action was done.

Mr. Patman again pointed out that no criminal action on the part of Mellon is charged, but only that he is holding office in violation of a statute designed to eliminate such a temptation. (Ibid, 29–30.)

On the second day of the hearings, Thursday, January 14, 1932, the New York Times carried an article on the previous day's hearing. Committee Chairman Sumners was laughingly quoted as saying "only a pauper" could hold Mellon's office and that he might try for it himself if he was "not afraid of being killed in the crush." (New York Times, Jan. 14, 1932, 8.)

The article generally characterized the first day of hearings as a resubmission of old tired charges against Mellon. And the editorial page for the same day criticized Mellon and Hoover for allowing budget deficits to occur but points out that some war debt payments will be coming in shortly to lessen the drain on the tax receipts. (Ibid, 20, col. 2.)

On that second day Mr. Patman spent much of the time explaining the details of the charged indiscretions involving Alcoa, and Mellon directly in his office affairs.

The use of aluminum increased during his term in the construction of public buildings, and an in-house publication was begun at Treasury in the Federal Architect's Office. Many of its pictures contained aluminum-fronted buildings. (Impeachment hearings, supra, 36–39.)

A more serious charge of tampering with his own tax reports and refunds was also entered on the second day, most of this information coming from the Couzens committee's examination of the Bureau of Internal Revenue. (Ibid, 43.)

Then Mr. Patman brought up some very topical material.

Secretary of State Stimson was denying any wrongdoing in the Barco Oil concession in front of the Senate Finance Committee, while Mr. Patman was putting information in the record before the House Judiciary Committee that some Colombians claimed to have been present when Mellon reached a decision with Colombia's President Olaya on the concession contingent upon a loan. (Ibid, 44, New York Times, Jan. 15, 1932, 1.)

For the first time in 2 days the whole House Committee seemed to take the charges seriously.

Mr. Patman's charges were being collaterally supported in a separate committee hearing.

Documents submitted by witnesses in the Senate Finance Committee to refute Stimson's claims of "no wrongdoing" forced Stimson to explain away State Department involvement as a disinterested attempt to solve a difficult situation, yet some of the Colombian press were critical of the move by Olaya, and continued to supply Mr. Patman and the Senate Finance staff with contrary information. (Ibid, O'Connor, supra, 202–206.)

On the third day of the hearing, Friday, January 15, 1932, Mellon' counsel, Mr. A. W. Gregg, gave a statement in answer to the charges. He argued that the statutes involved should be narrowly construed because they had not been used in the past and a narrow reading would be more appropriate since there was no precedent or interpretation available.

By arguing that only Mellon's holdings and not those of his brother, family, or close associates are to be considered, and by arguing that it takes 51 percent of the stock in a company to control it, he maintains that Mellon obviously falls outside the statute. (Impeachment hearings, supra, 53–54.)

While conceding that Mellon had tax refunds of $91,000, Gregg carefully pointed out that the Joint Committee on Taxation was asked to review them to make sure they were proper. (Ibid, 61.)

And as for the architectural magazine, its editor in a memorandum states that it is a private publication, that it is published by an association of Federal architects, that it accepts advertising only from materials of a class and not from contractors, and the Treasury address is only to facilitate the editor's mail delivery. (Ibid, 66.)

The Koppers Co. facts were also modified by Gregg. It seems that technical assistance was being exported in the form of engineers, but that Koppers was not directly involved. (Ibid, 68.)

But when it came to explaining away the Barco concession, Gregg had a little trouble. Mellon made a statement which Gregg quoted at the hearing:

> Mr. Mellon said he met President Olaya at one of the usual social functions, and of course conversed with him, but such conversation was general, and respecting financial and other conditions in Colombia.
>
> Mr. Mellon had no conversation with President Olaya that had to do with the so-called Barco concession, nor the Gulf Oil Corporation, nor with any suggestion whatever, alleged or implied, as to any support or assistance on the part of the Government with respect to Colombia obtaining credit.
>
> Mr. Mellon has never had any conversation with officials of our State Department concerning the Colombia loan, nor has he had any conversation with bankers with respect to this loan. (Ibid, 68–69.)

The Chairman then asked:

> Did Mr. Mellon say whether he had discussed that with any of the officials of the company that procured that concession?
>
> Mr. GREGG. May I ask you to repeat your question, Mr. Chairman?
>
> The CHAIRMAN. I did not catch entirely the statement made by Mr. Mellon. Did he state that he did not discuss with any of the officials of the oil company the procuring of this concession, or that was associated in any degree with the renewal of the loan, or whatever it was?
>
> * * * did Mr. Mellon discuss with some other person the renewing of this concession and this loan? Mr. Mellon may have discussed it with some one else connected with the company, and that other person may have discussed it with the President or someone else connected with the Colombian Government. Does your statement there exclude that possibility?
>
> Mr. GREGG. We discussed the entire matter fully yesterday, and he never mentioned having discussed it with any member of the company. I do not doubt that the Barco concession was mentioned by one of the officers of the company to Mr. Mellon. But any suggestion that Mr. Mellon should see the President of Colombia, or any suggestion by Mr. Mellon that any officer of the company should see the President of Colombia, is what he meant to deny by that statement.
>
> Mr. OLIVER. Do you mean, Mr. Gregg, then, that Mr. Mellon was never consulted by the Gulf Oil Corporation officials with regard to the Barco concession, worth about $2 billion?
>
> Mr. GREGG. No, sir; I did not say that at all. That is what I was very careful not to say. (Ibid, 68–69.)

When asked whether he thought the granting of the loan influenced the granting of the concession, Gregg replied that he had no opinion, and that he did not think the Barco issue was properly before the committee. (Ibid, 70.)

He then went on to discuss the two issues of law: Whether mere ownership of stock disqualified Melon from holding office; and whether Mellon engaged in the operations or business of his companies, regardless of stock ownership.

He explained that as a matter of law a large block of stock, as long as it was less than 50 percent of the outstanding stock, does not give a single holder ownership control.

When pressed by Mr. Celler of New York whether a large block, 30 percent or even 20 percent, might give the holder control if other stockholders were less organized, Gregg responded:

> Mr. GREGG. It would give them control over the election of directors and officers, and over the very few things that have to come before the stockholders, such as a sale of the assets of the corporation, or dissolution, consolidation, or merger. But while the corporation is operating a 99 percent ownership is not any better, as a matter of law, then a 1 percent ownership.
>
> Mr. CELLER. Except that if they have the power to elect directors, and then they have that minority interest which is unified, they have the power to control the operations of the company?
>
> Mr. GREGG. That is very true. They have the power to elect directors. But after the directors are elected they have no power whatever over them, whether they have 99 per cent or 1 per cent of the stock. (Ibid, 71.)

Mr. Gregg then used Senate Report No. 7, 71st Congress, 1st session, discussed above as the May 7, 1929 report, to demonstrate that mere ownership of stock is not disqualifying for Mellon. (Ibid, 147, 149.) Little real argument can be made on that point.

Obviously a narrow construction of section 243 would indicate that stock ownership amounting to less than 51 percent of the outstanding stock would indeed be technically a noncontrolling interest. And, as far as the conflicting charges of decisionmaking and influencing in the Alcoa and Barco areas, technically Mellon's word must be taken as true absent some concrete evidence to the contrary. But some startling facts come to light when the technical is abandoned for the reality of Mellon's affairs.

William Larimer Mellon, nephew of Andrew, was a close business associate and advisor of Andrew during his life. In a privately printed biography, "Judge Mellon's Sons," printed in 1948, William describes Andrew Mellon's life from Andrew's eyes. In a chapter entitled "My Brother and I," William describes the relationship between Andrew W., and brother, Richard Beatty Mellon.

As demonstrated in the book, the brothers were very close. For example, when Richard B.'s adventure in Colorado ended in 1887 and he returned to Pittsburgh, Andrew took

> * * * this brother into the bank as full partner. There was never a scratch of pen to bind this bargain. It was almost as if in business they became a single identity * * *.
>
> As two alloyed metals sometimes combine into a single metal stronger and more useful than either used separately, so these partners seemed to compliment each other and together became something greater than either. (Ibid, 141.)

In referring to a prospective oil lease he was examining, William mentions casually that he met a man he knew at the site who "was a field agent for the Bridgewater Gas Co. which was controlled by A. W. and Dick." (W. L. Mellon, supra, 129.)

From that point on, William Larimer Mellon's book continually refers to "A. W. and Dick" as an inseparable pair.

O'Connor in his 1933 book, "Mellon's Millions," included several appendices showing how interlocked the Mellon family and, especially, Andrew W. and Richard B. were in their business ventures. Appendix 6 contains a partial listing of the Mellon family's holdings, and some of the more interesting ones have been reproduced here:

THE MELLON INDUSTRIAL INTERESTS

	Assets, 1931	Percent controlled	Mellon assets
Pennsylvania Water Co.	$8, 502, 386	100	$8, 502, 380
Monongahela Light & Power	1, 700, 000	100	1, 700, 000
Ligonier Valley Railroad	1, 034, 269	100	1, 034, 209
Brooklyn Borough Gas	10, 313, 277	99	10, 210, 144
Gulf Oil Corp.	743, 871, 135	83	617, 413, 042
Koppers Gas & Coke	177, 933, 881	60	106, 700, 328
ALCOA	247, 341, 625	40	98, 936, 650
Aluminum Ltd. (Canada)	69, 373, 584	40	27, 749, 433
Duke-Price Power Co. (Canada)	63, 557, 721	21	13, 347, 121

[1] Harvey O'Connor, Mellon's Millions, appendix 6, p. 422. (New York: John Day Co., 1933).

Several companies in which the Mellons held substantial stock were omitted so the above list does not include many companies with higher Mellon-controlled percentages.

The financial interests were equally impressive. O'Connor reported on 24 banks, some in the Mellbank Corp. chain whose total resources were $796,120,446 in 1930.

The Mellons controlled $551,760,677 with their stock ownership which in every case but one was over 49 percent. (Ibid, app. 7, 428–429.)

It is small wonder that Mr. Gregg was pushing to a narrow interpretation of "interest" and "control" in section 243.

Gregg tried to leave the discussion of "control," and moved on to give his suggestion for an interpretation of the words "interested directly and indirectly."

He referred to the case of *United States* v. *Delaware & Hudson Co.* (213 U.S. 366) in which the defendant railroad owned stock in a coal mining company and transported that coal to market.

The United States charged that the coal fell under the Hepburn Act which made it illegal for a commercial carrier to be "interested directly or indirectly" in a producer whose commodities it carried.

The Supreme Court ruled in favor of the defendants holding that where ownership of stock by a carrier which does not cause the carrier to discriminate against competitors of the producer does not amount to a "direct or indirect interest." (Ibid, 98.)

The analogy was clear. If railroads can own coal mine stock and ship coal in which they have a small interest, Mellon can own stock in companies in which he has a legal or equitable interest. If it can be shown that he had more, Mellon had to leave office.

Gregg countered the Alcoa charges by submitting affidavits from Arthur Davis, chairman of the board of Alcoa, and Mellon himself, dated May 1929 during the Senate hearings in which both men declared that Mellon had in reality acted the role of disinterested minority stockholder in the transactions discussed by the Senate and later the House committees. (Ibid, 151.)

While Gregg had been discounting Mr. Patman's charges and dismissing the Barco concession, the Senate Judiciary Committee was questioning Francis White, Assistant Secretary of State, on that concession.

White refused to answer any committee questions in which Mellon's name was used, especially after he had admitted that the State Department had only become involved when the concession was transferred to the Gulf Oil Corp. in 1928. (Ibid, 151.)

Colombian President Olaya was quoted as saying in 1928 that a failure to review loans would make further economic dealings difficult. He said also that he and Mellon had only generally talked about Colombia's future. (New York Times, Jan. 16, 1932, 38.)

In retrospect it seems hard to believe that a man whose family owned a substantial amount of stock in a company (Gulf Oil) which had a substantial interest (83 percent) in an oil concession (the Barco) would be able to restrain himself from discussing specifics when meeting socially the President (Olaya) of the country (Colombia) who had the power to grant or deny that concession.

But he must be given the benefit of the doubt in close questions like this one for as Gregg pointed out, his holding office was challenged no fewer than five times in the House and Senate during his service and he was not removed. (Ibid, 72.)

Mr. Gregg resumed his statement to the committee on January 18, 1932, the 4th day of the impeachment hearing. He referred to a prospectus of the Union Gulf Corp. which Mr. Patman had put in evidence by saying that the corporation had been loaned some securities to be used as collateral for a bond issue, that some of these had come from Mr. Mellon, but that such a transaction is simply a personal loan for consideration, and does not amount to "doing business." (Ibid, 153.)

Gregg then dropped the discussion and started to go on to other issues, but Chairman Sumners stopped him.

This exchange followed:

> * * * would you mind addressing yourself, in your discussion of the law, to this point:
>
> This statute to which you refer seems to be an exercise of police power of the Federal Government seeking to protect itself. And while the courts may draw distinctions, as between ownership direct and as stockholders, they would, perhaps, appeal more to the learning of lawyers than to the commonsense of the average person.
>
> Take, for example, 99 percent ownership of stock in a corporation. And a statute that prohibits a person engaged in the business of trade or commerce from holding a certain office. Does it seem to you to be a sensible construction of the statute to say that a man who owns 99 percent of a business can escape the restraint of the statute by incorporating? To make it a little more clear, let us suppose that he is a private owner of a business, that he owns it all; and he sells 10 percent of it; and then he and the person to whom he sells the 10 percent proceed to incorporate: Is there such magic in the act of incorporation as to make him then a proper person to hold office as against the statute?
>
> Mr. GREGG. I think there are two answers, Mr. Chairman, to that: The first is that it would depend upon whether he was active after the incorporation in the business that is being conducted.
>
> The CHAIRMAN. Well, at that point, is it to be assumed that a man who holds 99 percent of a corporation, while he may not be active in managing the corpo-

ration, will not be active in managing those who manage the corporation, will he not?

Mr. GREGG. I would say that with that stock ownership it would be likely, yes * * *. In the ordinary partnership, the partners are active in the business, carrying it on; they really run the business. The corporation may be just a pure investment. It is a question of fact whether it is a pure investment, or whether in a given case the party continues in the business. (Ibid, 156.)

Gregg concluded his argument by reemphasizing that Mellon held the stock purely for investment purposes, was disinterested in the companies—even though he had founded many of them and his family's banks had loans outstanding to some of them—and added that Mellon had not attended a stockholder's meeting since becoming Secretary of the Treasury. Gregg did state, in response to a question, that Mellon's shares were voted by proxy. (Ibid, 159.)

When Mr. Patman resumed his statement he immediately went to the point of law in the *Delaware and Hudson* case, and pointed out that the issue there was the legislative intent of the statute, not conflict of interest under section 243.

The railroad case has the purpose of keeping a railroad from owning and shipping coal from its own mine to the detriment of competitors. It was not for the purpose of preventing an abuse of a public office. (Ibid, 180.) Today the railroad case would fall under the antitrust vertical merger theory enunciated most clearly in *United States* v. *Dupont* (353 U.S. 586) in 1957. But in 1932 the concept was certainly undeveloped, and it is easy to see what the legislature was then intending to do in regard to railroads.

Mr. Patman also pointed out that Alexander Hamilton, the first Secretary of Treasury, did indeed own stock—one and one-half shares in a London, England bank; five shares of a company selling land in the Ohio territory—but that 72 years went by before another Secretary of Treasury owned stock.

Secretary McAdoo owned around $10,000, and ranked among the largest holdings of any Secretary.

As Mr. Patman remarked, "Why. Mr. Mellon's net income from the stocks he owns will amount to as much in 3 hour's time as the total gross amount of all the stocks that were held by all the Secretaries of the Treasury before his time." (Ibid, 182–183.)

The Barco concession was brought up once more by Mr. Patman who drew the inference that the circumstances of Mr. Mellon speaking generally at a dinner party to the President of Colombia who immediately returns to his country and changes a long-standing policy toward a large oil concession is just too much of a coincidence. (Ibid, 187.)

The committee then adjourned until the next day, Tuesday, January 19, 1932, at which time Mr. Patman gave his closing remarks.

After suggesting that the Judiciary Committee press with the Senate Finance Committee to force Stimson's State Department to turn over the documents relative to Barco, Mr. Patman urged that the House Committee report to the House Committee of the Whole that a full impeachment examination be made.

At 11 a.m., January 19, the committee went into executive session.

With the public hearings finished, the committee members began examining the information given them. Although no official report was made, there is a suggestion that the executive session resulted in a decision to pursue the matter further.

Part 2 of the impeachment hearings includes several pieces of correspondence dated subsequent to January 19, 1932.

But the House Judiciary Committee never reached a decision, for on February 3, 1932, President Hoover announced—

> The appointment of Andrew W. Mellon, Secretary of the Treasury to be Ambassador to Great Britain, and Mr. Mellon's acceptance of the post. (New York Times, Feb. 4, 1932, 1.)

The reason given was the economic situation in Europe.

The New York Times in a remarkable piece of objective reporting stated:

> On a number of occasions this old (1789 sec. 243) law has been involved by Mr. Mellon's enemies in Congress to secure his removal. There is even now such a question raised, the matter being before a Congressional committee in impeachment proceedings brought by Representative Patman, Democrat, of Texas.
>
> These attacks never appeared to worry Mr. Mellon, however, and one of his favorite jokes was relative to the reports of his resignation. (Ibid.)

In one of the interviews after his appointment, Mellon was asked about his job in Washington. He replied:

> It is quite interesting. The building program was one of the most interesting part of my work here. All of this centered (sic) in the Treasury. The responsibility is on the Secretary for the determination of plans and *composition* of the buildings and their location. (Emphasis added.) (New York Times, Feb. 5, 1932. 4.)

On February 11, 1932, after several days of running European press quotes praising Mellon and the new possibility of war debt cancellation, the New York Times ran a column stating that the House Judiciary Committee after a 2-hour session had decided to drop the impeachment investigation.

Chairman Sumners summed up the move by saying that an impeachment is an ouster proceeding and there was no longer any one to oust. (New York Times, Feb. 11, 1932, 1.)

Senator Norris, no great admirer of Mellon, on the Senate floor, paid him a backhanded compliment on his—

> Demotion to an ambassadorship * * * Mr. Mellon has had an honor greater than has come to any other man on earth; he has had three different Presidents serve under him. I cannot help but say "Poor Andy" after he has been in command of the political forces of three presidents, to see him pushed off the throne. (Ibid.)

For several months stories rose on both sides of the Atlantic that Mellon's mission would be to rescue Europe from the war debt burden.

It never happened.

When he was sworn in as Ambassador on March 13, 1932, 11 days before his 77th year, he said the words, "I do (accept the post)," and added, "That isn't a marriage ceremony, it's a divorce." (New York Times, Feb. 14, 1932, 24.)

Whether he said it in jest or whether in anger or reflection, the statement truly marked a change in our history.

Whether Mr. Patman's charges forced Hoover to remove him, or whether Hoover wished to make a change on his own, may mean little.

Mellon came into the Treasury touted as the man who would straighten up the country's finances once and for all. He left it when the finances had begun their long slide.

It would take another rich man, Roosevelt, several years to pull us out. An age had definitely come to an end.

VII. THE HISTORY OF PAYMENT OF ADJUSTED-SERVICE CERTIFICATES OF WORLD WAR I

The so-called "bonus" for veterans of World War I was one of the most controversial issues facing the Congress during the 1930's, and, ultimately, one of Wright Patman's greatest achievements.

The problem of payment of adjusted-service certificates first arose when the Selective Service System adopted during World War I led to a reevaluation of the traditional pension plans for veterans. Designed by Julian W. Mack's Commission and approved by President Wilson and Secretary of Treasury McAdoo, a new program was adopted by Congress as the War Risk Insurance Act of 1917.

The Bill provided $15 per month for each soldier, compensation of $30 per month for disabilities, free hospitalization and rehabilitation, and war risk insurance. Each GI was required to purchase this insurance up to $10,000. Premiums averaged $6.60 per month and were deducted from the servicemen's pay.

Four million veterans paid the Government $400 million. Each soldier was required to pay for altering and mending his clothing and shoes, his barber bills, and bills at canteens for tobacco and incidentals. Anything that was left went to payment on a Liberty bond which was required to avoid the appellation of a "slacker."

The 2 million veterans who returned to the United States after the war were given a discharge with 2 months of pay or $60. The Congress, with good reason, felt some obligation out of political self-interest or humanity to compensate the soldiers for dislocations caused by the war. The veteran entered the war and received $1 a day, while the civilian earned $20 a day in the shipyards.

The men who had served their country came home to find their jobs gone, while the rest of the country was prosperous.

Some 7,000 World War I contractors had their pay adjusted including the Du Ponts who made a profit of a quarter of a billion dollars off the war. Billions of dollars were payed to railroad owners and war contractors. Federal employees who received up to $2,500 per year were entitled to adjusted pay of $1,440 each. Foreign countries received $19 billion from the United States.

Despite the obvious economic injustices facing veterans, there was no great movement in the country to compensate the former soldiers after World War I.

In 1921, Harding repulsed efforts by veterans to pass favorable legislation by merely opposing such action.

However, the veterans movement did gain some momentum even during this early period. In 1922, with the election campaign clearly in their minds, Republican leaders of Congress ordered consideration of veterans problems. Congress authorized the issuing of service certificates that could be redeemed immediately or held for 20 years. However, the Congress could not override President Harding's veto of the bill that he characterized as special interest legislation which would increase the national debt by one-sixth.

In 1924 Coolidge vetoed a measure providing veterans with paid-up insurance and allowing borrowing of up to 25 percent of its value. With the help of the American Legion's lobby, Congress was able to override Coolidge's veto.

The World War Adjusted Compensation Act of 1924 provided adjusted compensation at the rate of $1.25 a day for services overseas, and $1 a day for home service rendered from April 5, 1917 to July 1, 1919. Payment was only due in excess of 60 days because each soldier had received $60 at the time of discharge. If the amount due was $50 or less the Government paid the soldier in cash.

In excess of $50 he received from the U.S. Veterans' Bureau an adjusted compensation certificate computed in the manner stated above—$1 or $1.25 a day. Twenty-five percent of the total due was added by the Government, and, in addition, an amount equal to approximately 4 percent interest on the actual amount due for 20 years. This bill clearly made the payment of veterans a contract obligation and not a bonus.

The 1924 bill was inadequate and unfair in compensating the veterans. Instead of dating the adjusted compensation certificates back to the time when the services were rendered, Congress dated the certificates as of 1925. Thus, the veterans lost 7½ years of interest, the entrance of the United States in the war having started in 1917.

At the rate of $1 to $1.25 a day, with a reasonable rate of interest, the ex-soldiers were entitled to 100 percent of the face value of the adjusted-service certificates. The injustice of this situation is illustrated by the examination of tax refunds.

After 10 or 11 years the Treasury Department decided that the refunds were justified. The refunds were not dated 1925, but 1917 and 1918 during the war when the applicants claimed to have overpaid their income taxes and with 6 percent interest from that time which the Government confirmed to be a reasonable rate of interest.

The veteran had to pay an insurance charge. In case he died his dependents would receive the face value of the certificate as of 1945. The cost of carrying the insurance as of 1931 was $76.5 million.

The adjusted-service compensation legislation of 1924 is found to be more unfair by comparison with other countries. In some instances the foreign bonuses and adjusted compensation amounted to $7,209 each.

The reason Congress did not pay the veterans in 1924 was that Andrew Mellon as Secretary of the Treasury convinced Congress that there existed a deficit greater than $300 million. He said in 1924, "We are going to have a deficit around $347 million during this fiscal year." Congress, therefore, believed that payment of the veterans was economically unfeasible. In reality, the Government experienced a surplus of greater than $600 million. The propriety of this billion dollar "error" is questionable to say the least. It is hard to believe that a man of Andrew Mellon's intelligence could have made such a tremendous blunder accidentally.

Instead of immediate payment to veterans, Mellon suggested to the Congress that the veterans wait until 1945 when a large part of the debt owed to the ex-soldiers would be consumed by compound interest. Mellon's suggestion was embodied in the World War Adjusted

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Compensation Act of 1924. Thus, Mellon, as usual, obtained what he desired.

The man who saw through Mellon's shenanigans, and correctly perceived the veterans problems as intolerable, was Congressman Wright Patman of Texas. Patman led the movement for veterans compensation from 1929 when he came to Congress to the resolution of payment to veterans in 1936.

On May 28, 1929, Wright Patman introduced the first bill, H.R. 3493, providing for immediate payment to veterans of the face value of their adjusted-service certificates. When arguing for his bill on the floor of the House of Representatives, Patman pointed out that as of June 1929 nearly 100 percent of the veterans of World War I had borrowed on their certificates. While receiving 4 percent interest on these certificates, the ex-soldiers had to pay 6 percent interest compounded annually for his own money loaned to him.

As Mr. Patman correctly advocates, the 1924 Act prevents veterans from receiving any money in sufficient quantity to be real assistance to them. A veteran who holds approximately the average value of an adjusted-service certificate, that is, $1,014.11, if he borrows to the limit of the law to 1945 would receive $475.72 in loans, while the bank or Government, the one carrying the loan, would receive $478.28. The cash settlement would amount to $46 in 1945. This situation, as Mr. Patman perceived it, was unbearable. The veteran lost nearly half of the money owed him to the banks. The Government would pay the veteran with $475.72 in loans, $478.28 deducted for interest, and $46 in cash. Thus, the total would be $1,000.

Wright Patman in 1929 began his long battle to rectify the 1924 act. He called for the raising of the interest paid to veterans from 4 to 6 percent. The Congressman from Texas reasoned that if a veteran was charged 6 percent on his own money that it was justified to compensate the ex-soldier by compounding annually the value of the certificates by 6 percent.

Another argument utilized by Wright Patman was that the Secretary of Treasury, Andrew Mellon, refunded millions to the steel corporations with interest at 6 percent. Mr. Patman adovocated dating the certificates from January 1, 1918 so the veterans would not lose all that interest. Also, Mr. Patman called for immediate payment of the full face value of the adjusted-service compensation certificates. Mr. Patman recognized the dire financial needs of the veterans which would require payment in a lump sum of money with a reasonable rate of interest dated from the time the services were rendered. Many of the veterans were paying 10 percent interest on their homes if they were fortunate enough to afford a house.

Mr. Patman's bill, H.R. 3493, was sent to the Committee on Ways and Means.

Wright Patman's eloquence in espousing the veterans cause set off heated debates on the floor of the House that lasted until 1936. At this early stage of debate, many in Congress argued that the veterans certificates should not be readjusted along the lines that Mr. Patman advocated, because all other citizens were being hurt by the Depression just as much, if not more, than the veterans of World War I. However, Wright Patman and a few others realized that the veterans were suffering disproportionately due to dislocations caused by the war.

Besides pointing out the various economic disadvantages facing veterans, as compared to the rest of the populace, Patman, the Congressman from Texarkana, made an effective argument before the House in January 1931 by observing that the Secretary of the Department of Agriculture adjusted the pay of veterans who worked on roads during the war according to the difference in pay between civilian and military workers. Also, the pay was made as of 1918.

In 1931 Mr. Patman had his hands full with opponents in the House and from the "Wall Streeters." However, a recurring figure who worked against Patman's proposed adjustment of the 1924 Act was Andrew Mellon. Mellon stated that he did not believe the veterans should be paid in full at that time because it would be "a temporary stimulation of an artificial character." However, Mr. Patman forcefully argued that this was exactly what the country needed so desperately during the Depression.

In order to get consumers to buy more, they must be granted more purchasing power. With consumers buying more, they should, theoretically, stimulate business. With more money in the economy employment would be created. This stimulation must be of an artificial nature since greater purchasing power will not come about naturally in a depression and the Government must intervene.

Therefore, Congressman Patman concludes that Mellon, unknowingly, gave the best argument for payment of the full face value of the adjusted-service certificates, that is, the argument that the veterans "bonus" would be "a temporary stimulation of an artificial character." This artificial stimulation, Mr. Patman reasons, would lead to a natural prosperity. Even if this prosperity is temporary, Mr. Patman points out that it is better than no prosperity at all.

Another of Mr. Mellon's objections to the Patman plan was that it would "divert savings into purchases for consumption." This was at the discretion of the owner of the money and it would have been difficult, if not impossible, for Mr. Mellon to predict accurately how the consumer in aggregate would divide his savings and consumption. Also, it is striking that Mr. Mellon did not worry about the pattern of spending by war creditors.

Congressman Blanton of Texas, a supporter of Mr. Patman's battle for veterans, accentuated the irony of Mellon's opposition to the veterans—that "Billionaire Mellon of the Aluminum Trust and the U.S. Treasury," as Mr. Blanton characterized him before the House, opposed aiding the veterans allegedly because payment would "hurt business" and "unsettle the bond market."

However, Blanton observed, Mellon did not think of those arguments when the railroads got $1.6 billion in backpay, and war contractors received more than $3 billion. Blanton stated that Mellon didn't utilize his argument when the Treasury refunded millions of dollars in taxes to others, including the Aluminum Trust. He pointed out that Mellon was as far out in his prediction that payment to veterans would hurt business as he was in the forecast of the budget of 1929. Thus, Blanton concludes, payment to veterans would stimulate business, rather than hurt it.

Mr. Mellon's lobbying against the Patman proposal made it difficult for the Congressman from Texas to even get a hearing for his bill. In January 1931 Mr. Patman filed a petition asking that the Ways and

Means Committee be instructed to report his bill concerning veterans payments within 15 days. The committee had had before it Mr. Patman's bill since May 28, 1929. Mr. Patman needed 218 Members to sign his petition. In this petition filed with the Clerk of the House on December 9, 1930, Mr. Patman was merely asking for consideration of the matter by the Ways and Means Committee.

In early January the Congressman from Texarkana had half or 109 of the necessary signatures. The chairman of the Ways and Means Committee, Mr. Hawley, called a meeting for consideration of a bill that Mellon wanted passed in January 1931.

On January 17, 1931 Mr. Patman emphasized that no increase in taxes was necessary to pay the veterans. The war debt had been reduced $10 billion in 10 years—$7 billion faster than Congress said it should be reduced. His idea was to divert payment from the war debt to the other war debt—the adjusted service certificates.

Faced with Mr. Patman's persuasive arguments for granting the veterans what was justly due, Mellon became desperate in his attempt to defeat consideration of legislation calling for payment of the adjusted-service certificates of World War I veterans in cash.

Mr. Hawley of Oregon as chairman of Ways and Means had control over consideration of the Patman bill. Being recognized as Mellon's "supporter," Hawley avoided the tremendous demand by veterans to consider the Patman bill by leaving Washington. One of the great mysteries in January 1931 was the location of Chairman Hawley. However, the Mellonite leaders began to fear the voting power of veterans and their sympathizers. Following his return from his secret hiding place, Chairman Hawley called a meeting of the Committee on Ways and Means. The object of the meeting was not to consider veterans benefits, but to succumb to the desires of Andrew Mellon for legislation enabling him to increase the public debt, if he deemed it necessary.

Congressman John Garner of Texas moved at this meeting to consider the several bills calling for cash payment of adjusted certificates held by ex-servicemen. However, Chairman Hawley prevented Garner from making this motion. The ruling of the chairman was sustained. Hawley was able to carry every Mellonite with him—every anti-Mellonite voted with Garner. Thus, Patman's attempts to solve the veterans problems were frustrated by Mellon and his Republican sympathizers in Congress.

Mr. Mellon drew up a bill of his own during January 1931. His bill called for the issuing of $8 billion more of Government bonds.

Mr. Patman revealed on the floor of the House that 4½ million veterans and others had been clamoring for a hearing on payment of adjusted-service certificates. None of them had had a hearing on this bill.

However, with the committee in session only 1 day, the Secretary of the Treasury received a hearing on Mr. Mellon's bill. The reason, Mr. Patman pointed out, that Mellon wanted to issue $8 billion in bonds at his discretion was that the interest rate was cheap at that time, and this was the time to pay off the U.S. debts. However, the debt was being retired too rapidly as Mr. Patman emphasized.

Nearly everyone agreed with the above statement except Mellon and Undersecretary Mills. Mr. Patman called for a diversion for a few years from the war debt to the adjusted-service certificates.

In February 1931, Mr. Garner proposed an alternative bill calling for permitting the veteran to borrow 50 percent of the face value of the certificate at 4-percent interest. Mr. Patman's principal objection to this plan was that it did not provide for real payment, and it also charged interest on the loans which he regarded as too much of a burden for the veteran.

Another alternative was the Connery bill. His bill provided that, if the veteran did not want the money they could have a 4-percent bond, but they should be given a settlement based upon the face value; that would not cause all the bonds to go onto the market at one time.

To this bill Mr. Patman responded more favorably, and appeared in the Congressional Record to completely approve of it.

In February 1931 Mr. Patman came out in favor of H.R. 10574, introduced by Republican Chairman Hawley, calling for an increase of the limitation on borrowing from 25 percent to 50 percent. Though Mr. Patman objected strenuously to the provision of charging interest on loans to veterans, the Congressman from Texarkana apparently believed that this was the best that could realistically be done for the veterans. Mellon, Mills, and numerous bankers, had appeared before the Committee on Ways and Means to urge rejection of any plan to increase the loan value, or cash the certificates.

On February 16, 1931, with many believing this compromise measure to be the only thing feasible at that time, the Hawley bill came up in the House and passed by a vote of 363 to 39. However, on February 26, 1931 President Hoover vetoed the bill. The House and Senate were able to override his veto by votes of 328 for to 79 against, and 76 for to 17 against, respectively.

Mr. Patman announced immediately after the bill became law on February 27, 1931 that he would continue to fight for full payment of certificates without the payment of any interest on loans that veterans obtained.

Mr. Patman introduced H.R. 1, a bill to provide for immediate payment to veterans of the face value of their adjusted-service certificates. He continued his battle for passage of this legislation by debating on the floor of the House—he argued that the 3,600,000 veterans holding these certificates were entitled to payment on October 1, 1931.

Characteristic of Patman, the Congressman from Texarkana argued that the plain people who did not have the resources of newspapers and radio at their disposal were the ones to benefit from this bill. He emphasized again that the plain people were being exploited by the Government's liquidation of its debt to veterans by compound interest.

Another proposal of Mr. Patman's was that payment by foreign nations to the United States on the war debt should be used to retire the adjusted certificates in cash. Mr. Mellon visited Europe in the summer of 1931, and it was evident from subsequent events that he promised foreign debtors that they would never have to pay their debts to the United States.

This had a dual purpose for Mellon, that is, destruction of the argument for cash liquidation of the certificates, and the large contribution to the Treasury deficit—$247 billion a year—which he could utilize to argue against Wright Patman.

In early January 1932 Mr. Patman introduced H.R. 7726 which was also a bill to provide for the immediate payment to veterans of the face value of their adjusted-service certificates. This went to the Committee on Ways and Means.

For H.R. 1 and H.R. 7726, Mr. Patman argued that no bond issue was required for full payment—$2.2 bililon was required to pay the remainder due on all outstanding certificates. Money was being accumulated in the Treasury yearly for the purpose of paying the certificates in 1945. To those who insisted that all currency be backed by 40 percent gold, Mr. Patman assured them that the United States had sufficient idle gold in the Treasury to back the amount of currency proposed to be issued if Congress so desired. Two and one-half billion dollars could be issued on the idle gold.

During the spring of 1932 Mr. Patman repeated many of his previous arguments in favor of full payment, that is, the increase in purchasing power, the justification for dating the certificates as of 1918, the injustice of charging interest on veterans loans, et cetera.

Despite all of Wright Patman's persuasion, H.R. 1 was reported adversely by the Ways and Means Committee. This, however, did not deter Mr. Patman. On May 10, 1932 he introduced House Resolution 220 to make H.R. 1 as amended by H.R. 7726 a special order of business.

On May 19 Mr. Patman filed a motion to discharge the Rules Committee from further consideration of House Resolution 220. On June 14, 1932, H.R. 1 was taken up in the House in accordance with Mr. Patman's petition. This called for payment of ex-servicemen by Treasury notes. Senator Robert L. Owen's plan called for the flotation of a bond issue for the amount of the adjusted-service certificates. This bond would be held by the Federal Reserve System until the dollar had reduced itself to 2 percent below the standard it maintained in 1926.

At that time the Federal Reserve Board would be authorized to to sell or dispose of as many bonds as would keep the dollar at a stabilized price. No interest on the bonds would be paid until they were sold. Both the Patman and the Owen plans were reported unfavorably by the Ways and Means Committee.

While Congress was considering the Patman proposals at a snail's pace, the veterans were getting restless—they were being severely hurt by the depression. Their frustration led them to organize the bonus expeditionary force in May and June of 1932 in order to march on Washington. By the middle of June, 15,000 were camped out in the District of Columbia. The effect of BEF was felt in Congress, Mr. Patman got H.R. 1 passed in the House by a vote of 211 to 176. However, on June 17 the Senators, claiming that they did not want to be intimidated by BEF, defeated the Patman measure by a vote of 18 yeas, to 62 nays.

Despite this setback, most of the BEF stayed in Washington. Some of the demonstrators occupied Federal buildings and tension mounted between the authorities and the veterans. Two veterans were killed. From orders of the President, the Army, under Douglas MacArthur, moved in to completely remove the BEF from the Capital. Their shanties were destroyed, and the men and their families were forced out of the Nation's capital. The people of the United States looked on the treatment of the veterans as a disgrace—this incident would be remembered in the November Presidential election.

On July 13, 1932, Mr. Patman introduced H.R. 12957 to provide for immediate payment to needy veterans of the face value of their adjusted-service certificates. Mr. Patman's reasoning was that the need was so great that the bill had a chance of getting through the Congress quickly. At least, thought Congressman Patman, it was worth a trial before the next session of Congress; however, it failed to get consideration.

In the election of 1932 a Republican President with extremely conservative credentials was defeated by a Democrat who many labeled as radical, namely, Franklin D. Roosevelt. However, Roosevelt was not particularly liberal in his attitude toward veterans. In the early part of his campaign, F. D. R. made himself clear as to his conservatism on this issue.

On April 22, 1932 in Albany, N.Y., the Democratic Presidential candidate stated: "I do not see how, as a matter of practical sense, a government running behind $2 billion annually can consider the anticipation of bonus payments until it has a balanced budget not only on paper, but with a surplus in the Treasury."

Again, on October 19 in an address at Pittsburgh, Roosevelt reiterated, "Last April my views on the subject (bonus) were widely published and have been subsequently quoted. No one for political purposes or otherwise has the right in the absence of explicit statement from me to assume that my views have changed. They have not." Thus, F. D. R. gave forewarnings of his future rejection of veterans legislation.

Despite Roosevelt's proclamations, Wright Patman renewed his battle for the veterans with vigor in the 1933 session of the 73d Congress. Mr. Patman lambasted the press, the radio, screen and stage which the National Economy League had at its disposal, as well as millions of dollars to distribute false information concerning veterans' benefits.

One of the greatest lies employed by the league was the contention that foreign countries paid their veterans less than the United States. With the support of the war contractors, the league helped stifle Patman's efforts over the years to aid the veterans.

On April 27, 1933, Mr. Patman filed a petition to discharge the Ways and Means Committee from consideration of H.R. 1 so as to get immediate consideration by the House. Mr. Patman, however, did not receive the 145 required signatures until February 20, 1934.

On March 12, 1934, Mr. Patman got H.R. 1 passed in the House by a vote of 295 for to 125 against.

Mr. Patman was at pains to explicate the method of paying the veterans. He pointed out that the U.S. Treasury had $8,550 billion in assets—$5.5 billion was in circulation. Therefore, one could earmark $2 billion for veterans and still have $1 billion in untouched gold, not to mention the silver reserve of $720 million. Eight billion dollars in gold is sufficient for a $20 billion issuance on a 40 percent gold reserve basis. Mr. Patman's plan was to issue $2 billion which would have 60 percent more gold behind it than any Federal Reserve note.

Since any of the 12 Federal Reserve banks could order printing of money simply by depositing debt with the U.S. Government, Mr.

Patman saw no reason why the veterans couldn't do the same with their certificates.

Despite Mr. Patman's reiteration of earlier arguments for H.R. 1, the bill came up in the Senate, and was passed over.

In 1935 the main debate centered on the alternative of passing the Patman legislation or the Vinson bill. H.R. 3896, the Vinson bill, called for full payment by bonds, while Patman's bill called for an issuance of currencies.

The American Legion had Congressman Vinson of Kentucky offer H.R. 3896 on January 14, 1935. Henry Morganthau, the Secretary of the Treasury, stated that this bill would not only require more bonds but more taxes. Mr. Vinson, who had labored in the past for two of Mr. Patman's bills H.R. 7726 and H.R. 1, now introduced a bill which one Congressman characterized as the "banker's delight."

In 1935, the showdown between the Vinson and Patman bills occurred. On January 24, 1935, 19 of the 25 members of the Ways and Means Committee favored the Patman bill, and six were opposed to any bill. On that day, as stated previously, the Vinson bill was introduced which took away eight of the Patman bill supporters. The committee then stood 11 for the Patman bill, 8 for the Vinson bill, and 6 against any bill.

Cooperation between the Vinson bill supporters and those opposed to any bill led to a favorable report from the committee—14 to 11. In other words, the opponents of any legislation dictated the favorable report on the Vinson bill by reason of the wedge being driven through the forces of the proponents.

The supporters of the Vinson bill in the House were 120 who favored a full payment bill and 84 who opposed full payment, making a total of 204. Among this number were 82 percent of 102 Republicans—93⅓ percent of all Members of the House opposed to any bill—and 98 percent of the supporters of the Tydings bill that would have given the holder of a $1,000 certificate who had borrowed at every chance the sum of $154 in full payment.

The Vinson bill never received more than 120 votes in the House. The bill did receive nearly total support from the Republican Members of the House and those who opposed any bill at all concerning veterans benefits.

In the Committee on Ways and Means the Patman bill received 61 percent of the support from the committee who favored any bill. Yet, the bill received 39 percent of the support—the Vinson bill—received a favorable report. The Patman bill received 63⅓ percent of all votes in the House of the Members who favored any bill—it prevailed over the Vinson bill by only three votes.

Of the 204 voting for the Vinson bill, in preference to the Patman bill, 84 of them were against any bill and voted against the bill in final passage.

On March 22, 1935, the vote on bill H.R. 3896, as substituted by the Patman bill H.R. 1, carried 319 for to 90 against. On May 1 H.R. 1 was taken up in the Senate and passed May 7 by a vote of 55 yeas to 33 nays.

On May 22, 1935, President Roosevelt vetoed the bill and delivered his veto message in person to a joint session of Congress. Immediately after the President's message, the bill passed in the House over the President's veto by a vote of 322 for and 98 against. The next day.

May 23, the Senate sustained the veto—there were 54 yeas and 40 nays which was nine votes short of two-thirds.

Facing the desperate needs of the veterans, the forces behind the various bills began to collaborate. On January 7, 1936, Mr. Vinson introduced H.R. 9870 to provide for immediate payment of World War I adjusted-service certificates, and for the cancellation of unpaid interest accrued on loans secured by such certificates. This bill became known as the Vinson-Patman-McCormack bill.

On January 10 the House passed the bill 356 for to 59 against.

On January 17 the Senate took up H.R. 9870 and 3 days later passed the bill 74 to 16.

On January 24 the President vetoed the bill. That same day the House overrode the President's veto 326 to 61.

On January 27 the Senate passed the bill over the President's veto 76 to 19—it became Public Law 425.

Thus, the battle ended with Patman victorious. After all those years of frustrations, Congressman Wright Patman never lost hope despite all the power behind his opponents, that is, Andrew Mellon, the Wall Street bankers, and Presidents of the United States.

This fight over the veterans adjusted-service certificates was a foreshadowing of the future challenges to big business and Wall Street in the name of public interest.

In this incident, as in the future, Wright Patman showed himself to be a man of supreme courage with the interests of the people always uppermost in his mind.

VIII. THE BANKING ACT OF 1933

The depression, which began on October 29, 1929, did not reach bottom until the summer of 1933, and as we have seen, the Federal Reserve Board took little or no action to stem the tide either before or after "Black Thursday."

Elected in November 1932, Franklin Delano Roosevelt could not take office until after the lameduck session of the 72d Congress in March 1933. With the inauguration of Roosevelt came the bank holiday. Banks closed from coast to coast, many never to reopen.

Congress, however, did not wait on the new President to investigate the stock market.

As early as June 1932 during the 72d Congress which had begun in 1931, and ended in March 1933, the Senate authorized its Banking Committee to investigate stock exchange practices.

To do so, it retained Ferdinand Pecora of New York City who, for some 17 months from January 1933 until July 1934 during both the 72d and 73d Congresses, conducted one of the most exhaustive and spectacular investigations of Wall Street.

Ferdinand Pecora was born in Italy and came to the United States when he was 5 years old. He studied law at New York Law School and was admitted to the New York Bar in 1911. In the 1912 campaign he was a Bull Mooser and supported Theodore Roosevelt. In 1916 he became a Wilson Democrat. From 1918 to 1930 he was an assistant district attorney in Manhattan, and from 1922, chief assistant.

As indicated, from 1933 to 1934 he was counsel for the Senate Banking Subcommittee on Stock Exchange Practices. In June 1934 President Roosevelt appointed him to the Securities and Exchange Commission, from which he resigned in January 1935 to accept an appointment by Governor Lehman to become a Justice of the Supreme Court of the State of New York. Thereafter, he was nominated by both parties to a 14-year term. He was a political independent, and in 1933 ran for district attorney of New York County on Joseph McKee's anti-Tammany ticket. He died on December 8, 1971.

Judge Pecora wrote an interesting book about his investigation ("Wall Street Under Oath: The Story of Our Money Changers," 1939, Simon and Schuster, New York, reprinted 1968 and 1973 by Augustus M. Kelley, publishers Clifton, N.J.). He dedicated it to the Senators on the subcommittee he represented during the 72d and 73d Congresses, namely: the two chairmen, Duncan H. Fletcher, Democrat, Florida (1909–36), and Peter Norbeck, his successor, Republican, South Dakota (1921–36), Edward P. Costigan, Democrat, Colorado (1931-37), and James Couzens, Republican, Michigan (1922–36).

The Pecora investigation was as revealing as the Pujo investigation of 1912. J. P. Morgan, Jr., was Pecora's star witness, as his father was for Samuel Untermyer, the Pujo committee's counsel. The Pecora hearings will always be remembered because an advertising agent for a circus put a midget on J. P. Morgan, Jr.'s lap. (The New York magazine, Oct. 29, 1973, pp. 38–43, and picture at p. 39: "The Establishment Bank Faces Life" by Andrew Tobias. Hearings Senate Banking and Currency Subcommittee on Stock Exchange Practices on Senate Resolutions 56 and 84, May 23, 24, and 25, 1933, part I.)

In 1912 the Pujo committee discovered that J. P. Morgan and Co., including their Philadelphia house called Drexel and Co., held on November 1, 1912, deposits aggregating $162 million. It also found that Morgan partners held 72 directorships in 47 of the largest corporations.

Commenting on these disclosures of the Pujo committee ("Other People's Money: And How the Bankers Use It," 1913, 1914, McClure publications, and 1914 Frederick A. Stokes Co.), Louis Dembitz Brandeis (then a Boston lawyer), pointed out that Morgan's power came from "other people's money" deposited with the Morgan firm and because of their many interlocking directorates, particularly with banks.

In 1933, over 20 years later, Pecora found (Pecora, supra, 14–15) that J. P. Morgan and Co. held deposits at the end of 1927 of over $½ billion and, even at the end of the depression year 1932, of $340 million. Pecora called it a great reservoir of "other people's money" subject to the will of one man, J. P. Morgan.

Moreover, Pecora found that the Morgan partners held 20 directorships in 15 great banks, and trust companies, with total assets of over $3.8 billion, 12 directorships in 10 great railroads with assets over $3.4 billion, 19 in some 13 public utilities with assets over $6 billion, six in insurance companies with assets over $300 million, and 55 in some 38 industries with assets over $6 billion. A total of 126 directorships in 89 corporations with assets over $20 billion. (Pecora, supra, 36–37.)

In 1929, at the height of what Pecora called "the New Era frenzy," J. P. Morgan and Co. held itself out "for the first time not only (as) commercial bankers and investment bankers, but corporate promoters." (Tobias, supra, 21.)

As such in marketing securities, Morgan had certain preferred lists of 500 names of prominent people to whom he offered shares at cost (John J. Raskob, John W Davis, Charles E. Mitchell, Albert H. Wiggin, Myron C. Taylor, Sosthenes Behn, Calvin Coolidge, Charles Lindberg, Newton D. Baker, William Gibbs McAdoo, and William Woodin, F. D. R.'s Secretary of the Treasury, among others).

Buying at say $20 a share, the friend of Morgan could sell when the issue came out at the issue price of $35 or, as was frequently the case, soon thereafter at, say, $50 if it sold at a premium.

To be on a Morgan preferred list was like receiving manna from heaven.

As Judge Pecora says in his book, the strange thing about all this is that the Morgan partners to a man saw nothing wrong with it though "in effect, it was the offer of a gift of very substantial dimensions." (Pecora, supra, 27.)

For instance, Morgan offered John J. Raskob 2,000 shares of Alleghany Corp. at $20, when it was selling over-the-counter at $35. Raskob immediately sent his check for $40,000 with a note in which he expressed the "hope the future holds opportunities for me to reciprocate." (Pecora, supra, 32–33.)

When Senator Couzens asked (Pecora, supra, 34) George Whitney about this, saying he had never heard of anybody quite so altruistic, Whitney replied:

> It is not a question of altruism, it is a question of doing a legitimate, straight forward security and banking business. (Pecora, supra, 34.)

The bad effect of this testimony on the American people is difficult to exaggerate.

The House of Morgan, a bomb scarred small building at the corner of Wall and Broad Streets (Tobias, supra, 38), across from the Stock Exchange and the Subtreasury where George Washington was inaugurated, looking up to Broadway and the Trinity Church, was the epitome of respectability.

A bomb was thrown at the Morgan building in 1920. It killed 40 people, broke the glass in every window of the Equitable Trust Building at 37 Wall Street, and almost "brought down the glass dome of the New York Stock Exchange."

Today the Morgan empire continues. J. P. Morgan & Co. is a holding company. (Tobias, supra, 38.) Its former security business is done by Morgan Stanley, and its banking business is done by its wholly owned subsidiary, Morgan Guaranty Trust Co., of which we will say more later.

Another star witness for Pecora was Charles E. Mitchell, president of both the National City Bank and its security affiliate, the National City Co.

Perhaps the most damaging testimony of Mitchell related to the sale in 1927 and 1928 by National City Co. of three issues of Peru bonds totaling $90 million.

For a long time National City had considered becoming Peru's banker by consolidating, into one package, all Peru's national debt. The only difficulty was that every time National City looked into the matter it received adverse information about Peru.

For instance, there lay on the shelves of English bankers defaulted Peru bonds. The London Times spoke of Peru's frequent unobservance of her undertakings," her "broken pledges," and her "flagrant disregard of guarantees," which made Treasury obligations "almost impossible to collect." (Pecora, supra, 101.)

For 6 years National City resisted financing Peru, but National City Co.'s salesmen from coast to coast wanted bonds to sell, and in 1927 National City threw caution to the winds and brought out what Pecora describes as "a sort of exploratory Peruvian issue of $15 million" which was "floated with ease." (Pecora, supra, 101.) It followed with two other issues, one for $50 million, the other for $25 million, making $90 million in all. Some of the details of the financing are worth noting.

It should be added that as late as July 1927, vice president Durrell of National City Bank wrote to president Mitchell pointing out that two factors would retard Peru's economic development.

First, its very large Indian population which lives "in primitive conditions and used no manufactured products"; and, second, the ownership of the nation's principal sources of wealth by absentee owners. Nevertheless, National City went ahead with the sale.

The bonds were sold at 91½ and 96½, the bankers receiving a spread of 5 points, or $4.5 million. Interest on the first $15 million issue was at 7 percent, and at 6 percent on the other two. J. & W. Seligman was associated with National City as underwriter of the issues, National City itself making $680,000. In obtaining the $50 million issue the bankers paid Juan Leguia, the son of the then president of Peru, $450,000.

In 1931 the three issues of $90 million Peruvian bonds went into default. Today only about $485,000 of the bonds remain outstanding. In 1944 bondholders were offered 15 percent of principal, and no interest. In desperation in 1947 and 1952 they accepted bonds maturing in 1997 with 3 percent interest.

This was in sharp contrast to the bonds they bought which were to mature in 1959, 1960, and 1961. In 1933 the bonds were selling at 8 and 7, and one time at 4⅝.

The Foreign Bondholders Protective Council, Inc. in its report for the years 1946–49 has this to say about Peru:

> The conduct of Peru in connection with her foreign debt has seemed to our Council so misguided and costly to her credit standing that it should be briefly reviewed here again as an example of what a government which borrows abroad ought not to do. In 1944, almost the whole of the Peruvian foreign debt * * * had remained in complete default for almost fifteen years. Only one issue * * * secured by pledge of guano fertilizer sale receipts in an unusually inescapable form, was being served. The principal of debt in default alone aggregated about $85 million and about 3 million sterling. The interest in default had grown to be nearly as large as the principal. Peru has always exported large amounts of sugar, cotton and copper and her foreign debt was not especially large as measured against her foreign trade, her national budget or debt owed abroad by such neighbors as Colombia or Chile. Peru's continued neglect of it was willful, and not forced upon her. P. VI.

Despite this sordid financial record, American commercial banks are continuing to invest in Peru, lured by 13 percent interest.

The Wells Fargo Bank of San Francisco had recently led a group of 67 banks to loan Peru $100 million, and its unsecured loans to Peru today are said to be over $49 million. Like the defaulted issues of 1927 and 1928, this loan was oversubscribed.

Chase Manhattan contemplated a $200 million loan to Peru by a syndicate of banks the world over. Of this amount Chase had expected to take $30 million. Chase, besides this, had given Peru a line of credit of about $25 million. Chase has over $49 million of unsecured loans to Peru, Citibank, over $188 million.

These loans may all be paid at 13 percent interest, but we can only judge the future by the past. The 1927 and 1928 issues are not paid yet and, meanwhile, Peru has confiscated properties of Exxon, H. J. Heinz, Cargill, General Mills, W. R. Grace, Cerro, and I.T. & T.

An agreement has recently been negotiated by a vice president of Manufacturers Trust Co. under which all the American companies (except Exxon), whose properties have been confiscated, will receive some payment.

Peru was able to make payment with a loan from First National of Boston.

Franklin National Bank, now in the hands of the Federal Deposit Insurance Corporation, held over $500 million of foreign loans which FDIC has been unable to sell except at large discount.

Franklin's $500 million consists of loans to some 45 different foreign countries. Its loans to Peru total $14.5 million: $1 million in the above-mentioned Wells Fargo $100 million loan; $8½ million in a similar $76 million loan by a syndicate of banks led by Morgan-Guaranty; and, $5 million in a similar $130 million loan by a bank syndicate led by Manufacturers Hanover.

Are these loans that commercial banks should make? Are trust and pension funds used?

One would have thought that the exposure by Pecora in 1933 would have warned our commercial banks against being lured by high interest into making speculative loans in Peru. But alas, despite a congressional policy (Gonzalez amendment, 22 U.S.C. 283R, Public Law 92-246, Mar. 10, 1972) against investing in Peru so long as our dispute about their claiming a 200-mile limit and arresting our tuna fishermen remains unsettled, our American banks continue to invest in Peru.

The Congress in 1916 and 1919 passed laws permitting our banks to conduct foreign financial operations abroad by wholly owned subsidiaries incorporated under state or national law. Until recently, there were very few such subsidiaries.

On the false assumption that the Glass-Steagall Act of 1933 does not forbid it, the Federal Reserve Board has permitted American banks to engage in the securities business overseas through subsidiary corporations.

Thus, we have American banks with security affiliates overseas that the Glass-Steagall Act prohibits their having anywhere.

Today, while there are only 6 so-called State agreement corporations, there are over 100 national, or Edge Act subsidiaries, and their numbers are increasing.

Moreover, the banks, ignoring Glass-Steagall, are flagrantly loaning foreign countries directly, and under the guise of "a loan," underwriting and bringing out syndicate bank loans such as the $100 million loan to Peru by Wells Fargo.

As a loan in the Eurodollar market, neither the SEC nor the banking agencies regulate it.

These loans are dangerous and undesirable and convert our commercial bankers into investment bankers—the very thing Glass-Steagall was passed to prevent.

Moreover, it is bound to involve the use not only of deposits, but pension and trust funds. It is commercial banks using other people's money as investment bankers.

In 1933 the above testimony of Charles E. Mitchell, together with that of Hugh B. Baker and Victor Schopperte (hearings, Senate Banking Subcommittee on Stock Exchange Practices, S. Res. 84 and 239, Feb. 21, 22, 23, 24, 27, 28, and March 1, 2, 1933, 72d Cong. 2d sess.) with respect to the sale of $90 million of Peru bonds, sent shock waves through Wall Street, and had as devastating effect on the country then, as the Watergate testimony has today. And, for the same reason, lack of confidence.

National City was then, and is now, one of the Nation's largest and best banks. It shocked the conscience of every American to see such a leading financial institution unloading on an unsuspecting public these Peru bonds.

What is equally incomprehensible is that commercial bankers today continue to do in Peru a speculative investment banking business which yesterday Congress forbade even for banks at home.

Still another colorful witness, called by Pecora, was the famous Otto H. Kahn of Messrs. Kuhn, Loeb & Co., Morgan's principal competitor.

He and others from Kuhn, Loeb (County, Larsen, Lee, Taplin, and Buttenwieser) testified on June 27, 28, 29 and 30, and July 5, 1933. (Hearings, Senate Banking Subcommittee on Stock Exchange Practices, S. Res. 56, 84, and 97, 73d Cong., 1st sess.)

Kahn's testimony before Pecora, as his later testimony before U.S. District Judge Harold Medina in the Investment Bankers antitrust case, is notable for his description of Kuhn, Loeb's "show window" policy.

Indeed, as Pecora tells it, Otto Kahn was the "principal apologist" for the investment banking business and "no suaver, more fluent, and more diplomatic advocate could be conceived." (Pecora, supra, 45.)

He assured the committee that a firm such as Kuhn, Loeb would never descend to bidding competitively for an issue. Whatever saving to the company would be at the expense of losing the invaluable advice of a private investment banker, such as Kuhn, Loeb.

Mr. Kahn explained it's the difference between buying an expensive and inexpensive suit of clothes. The one from the cheap tailor keeps you warm, but "the other tailor puts the experience and the reputation of making good suits into it, and you go to him." (Pecora, supra, 46.)

And Otto Kahn assured Pecora that Kuhn, Loeb had high moral standards. He would never any more underbid Morgan to get an issue "than Paul D. Gravath would attempt to get a law case away from John W Davis by going to the latter's client and offering his services at a lesser fee."

As for large profits, Kahn states that the investment banker takes the risk of selling the issue he buys. Although dire catastrophies are rare, when the investment banker buys an issue he must sell it, or keep it.

In sharp contrast to Richard E. Whitney and other stock exchange officials, Otto H. Kahn condemned short selling, and he was even sympathetic to the ideals of Franklin Roosevelt's New Deal. He was refreshing as a witness.

But like Morgan, Kuhn Loeb was a powerful firm. Whereas Morgan had $1½ billion of deposits, Kuhn Loeb had only $89 million. Its capital was $25 million against Morgan's $118 million. Its 11 partners held 65 directorships in 48 corporations, whereas Morgan partners held many more. But between 1927 and 1931, Kuhn, Loeb as "merchants of securities" originated over $1.6 billion of bonds—according to Pecora "a stupendous total for a single house in half a decade." (Pecora, supra, 54–55.)

In the fall the Pecora investigation kept going. Dillon Read was fortunately called to testify during the world's series, a great achievement of its counsel, John Cahill.

But after the series was over came Albert Wiggin, and other Chase Bank officers. Their testimony was not good. In loans to the Fox Film Co., Chase stood to lose $50 million at one time. Even though in the end Chase gained, Albert Wiggin paid $2 million to settle stockholders claims, and certain of his colleagues had to pay an additional $500,000.

Albert H. Wiggin was a self-made man. Born in Medfield, Mass. on February 21, 1868, he died at the age of 83 on May 21, 1951. The Chase Bank which he came to in 1904 was his life. He became president and chairman of the board (1904–1933). He saw it grow from a capital of $1 million, a surplus of $1 million, and deposits of $54 million in 1904, to a capital of $148 million, a surplus of $148 million, and deposits of over $2 billion in 1930 after its merger with the Equitable Trust Co. of New York.

Chase was then one of the largest banks in the world. Wiggin was a powerful figure in Wall Street, and a director of Armour, American Express Co., American Woolen, American Locomotive, BRT, IRT International Paper, Lawyers' Title, Mack Trucks, Underwood, Otis Elevator, Western Union, and Westinghouse, to mention just a few—some 59 corporations in all.

Even the national bank examiners remarked that in Chase "the national banking system has a great standard bearer," and they added that Wiggin was "the most popular banker in Wall Street." (Pecora, supra, 133–34.)

Needless to say, Pecora's investigation of Chase made "a shocking disclosure of low standards in high places." (Pecora, supra, 135.)

In 1928 Wiggin had a salary of $175,000; in 1929, $218,750; and in 1931, $250,000. In 1932 he took a cut to $220,300. At the same time he was denouncing high wages and asking labor to accept moderate salary reductions. (Pecora, supra, 142–43.)

But these figures only cover Wiggin's "regular" salary. Chase gave him and other top officers bonuses. In 1928 Wiggin's bonus was $100,000, in 1929 another $100,000, and in 1930, $75,000. Besides this Chase Securities gave Wiggin an annual bonus which some years went up to $75,000.

Also, his 59 corporate directorships paid him handsomely. Armour paid him $40,000, Brooklyn Rapid Transit $20,000, American Express $2,000. Every little bit from his 59 corporations added up to a tidy sum of its own. Needless to say, many of these corporations received large loans from Chase.

These salaries, as lucrative as they were, were just a drop in the bucket to his total income from salaries and his personal family corporations. For instance, in 1928 Wiggin had an income of $6.8 million on which he paid only $962,000 in taxes.

In 1929 Wiggin's total income was $3.8 million. Even in the depression years 1928–32 Wiggin had a net income of $8.6 million.

But his income from his family corporations was disgraceful. In all he had six corporations, three were hopeful tax dodges and Canadian; the other three were Shermar, Murlyn, & Clingstone. The name Shermar was compounded from the first syllables of "Sherburne" and "Marjorie," Mr. Wiggin's daughter and son-in-law. "Murlyn" and "Clingstone," came in a similar way from the name of another daughter. (Pecora, supra, 147–48).

Through these six corporations Wiggin speculated in the stock market, especially in Chase Bank stock. He saw no impropriety in so doing. His efforts he said were to stabilize or make a market for the stock. But actually Chase stock rose from 575 on September 21, 1927, the day these stock pools were started, to 1,415 when the stock was split 5 to 1.

Shortly before the bubble burst the new stock was at 283. In 1933 it was 17¾, or 89 for the old stock. (Pecora, supra, 150–51.)

Curiously, the bank's own corporation, Metpotan, made only $159,000 for the whole 5 years. But Wiggin's personal corporations, over the same period, made $10,425,000, 65 times as much. (Pecora, supra, 152.)

Some profit of Wiggin's personal corporations came from being "cut in" by Metpotan, but "the vast bulk of the money came * * * from transactions in which neither the bank nor any of its affiliates shared a penny of profit." (Pecora, supra, 152.)

Of this profit $4,008,538 was reaped between September 19, 1929 and December 11, 1929 "in the very midst of the great Wall Street crash." Pecora tells it in one line:

> Mr. Wiggin made all that money by selling Chase National Bank stock short." (Pecora, supra, 153.)

While a leading member of the famous bankers consortium organized to stabilize the market after the crash, Wiggin was selling his own bank's stock short. When he covered his short sales on December 11, 1929 he made a profit of over $4 million. (Pecora, supra, 154.)

Prior to its merger with the Equitable Trust Co. of New York, Wiggin had been the controlling stockholder of Chase. After the merger with Equitable, however, control passed to John D. Rockefeller, Jr., and Chase became a Rockefeller bank.

With Rockefeller control, Mr. Rockefeller, Jr.'s brother-in-law, Winthrop W. Aldrich (Harvard AB 1907 and L.L.B. 1910, born in Providence, R.I., on November 1885, died Feb. 24, 1974), then a leading practicing lawyer representing the Equitable Trust Co., became president of Chase.

In 1933 Pecora tells us that Aldrich "fairly out-Heroded Herod." (Hamlet, act III, scene 2, line 4, Hamlet's speech to the players.) His whole attitude was "as severely high-minded and as militantly imbued with the necessity for correcting banking abuses, as Mr. Wiggin's was skeptical and unbending." (Pecora, supra, 137.)

Apparently the creation by National City of National City Co., and by Chase of Chase Securities was illegal, and a violation of the National Banking Act. In 1911 at the request of then Attorney General George W. Wickersham, and President William Howard Taft, the Solicitor General, Frederick W Lehmann, so ruled in an opinion never made public, or acted upon. (Pecora, supra, 80.)

Under the National City arrangement, three trustees held the stock of National City Co. in trust for stockholders of National City Bank. In Chase's case, the voting trust was held superfluous, and each stockholder of the Chase National Bank was simultaneously an equal shareholder in Chase Securities.

Chase's attorneys who organized the company in 1917 never heard of Lehmann's opinion. Pecora says that since National City "had gotten away with it," Chase decided it "would not be left behind." (Pecora, supra, 137–39.)

You can see from what is detailed above that the country was outraged at the disclosures of the Pecora investigation, and that legislation to correct the abuses was in order.

Reform came when Chase, under its new president, Winthrop W. Aldrich, liquidated its security affiliates and repudiated Wiggin's policies. From November 23 to December 7, 1933, Chase and its officials testified, the star witness being Winthrop W. Aldrich. (Hearings, Senate Banking on S. Res. 56 and 84, part 8, before Subcommittee on Stock Exchange Practices, 3975–97.)

Aldrich began by spotting the problem—how to legislate to prevent a repetition of the mistakes and abuses incident to the conduct "of both commercial and investment banking." And he added that no one who is familiar with the testimony can fail "to be impressed by the necessity of change." (Hearings, supra, 3975.)

In Aldrich's mind, many of the abuses revealed by Pecora's investigation "had arisen from failure to discern that commercial and investment banking are two fields essentially different in nature." (Hearings, supra, 3977.)

Aldrich was merely repeating what Brandeis said after the Pujo investigation, namely, that the temptation of large profits was so great that commercial banks designed to make temporary loans to business concerns were invading the realm of the investment banker, and by interlocking directorates subjecting corporations to their will. (Brandeis, supra, 26–27.)

In a public statement on March 8, 1933 as chairman of the board and executive head of the Chase National Bank, Aldrich had called for five reforms:

1. Any corporation or partnership that takes deposits should be subject to the same regulations as commercial banks.
2. No business dealing with securities should be permitted to take deposits even under regulation.
3. No one should be an officer or director of a commercial bank if he deals in securities and *vice versa*, no commercial banker should be an officer or director of a securities firm.
4. Boards of directors of commercial banks "should be limited in number so as to be sufficiently small to enable the members to be actually cognizant of the affairs of their banks."
5. Commercial banks should not be permitted to underwrite securities except securities of the United States Government and of states, territories, municipalities and certain other public bodies in the United States. (Hearings, supra, 3977.)

In accordance with these principles Aldrich was able to tell the Senators that on May 16, 1933 the stockholders of the bank had authorized the discontinuance of the securities business by the bank's affiliates. Chase Securities was in the process of liquidation.

The bond department of its affiliate Chase Harris Forbes, Inc. the bank took over. This part deals with Federal, State and municipal bonds, securities proper for national banks. The stockholders also voted to reduce the board of directors from 72 to 36 members. (Hearings, supra, 3978.)

Aldrich freely acknowledged that there are "sincere differences of opinion as to the wisdom of these changes." But he pointed out that "the overlapping of interest as between commercial banking and investment banking was not a new one," and that the Pujo committee report on February 28, 1913 "had pointed out the desirability for such changes." (Hearings, supra, 3978.)

In Aldrich's view, investment banking is "a self-contained enterprise" which should not be destroyed or superseded by any governmental agency but which should be allowed "to operate with as little restriction as is commensurate with due protection of the investing public."

Likewise, separating investment banking from any direct interest in commercial banking ought to improve normal investment banking. (Hearings, supra, 3978.)

The system itself, Aldrich testified, which permitted "overlapping of function and interlocking of interests" is responsible "for much that the public now condemns." Both commercial and investment banks had been taking deposits and doing an investment business so that "it was not unnatural that officers of commercial banks should at times fail to appreciate the distinction."

Aldrich then takes pains to point out to the subcommittee that commercial banks, as "an essential and integral part of the monetary and credit machinery of the Nation" are in a different category from the unregulated investment banker. While it has an obligation to make a fair return on capital, the commercial bank must be able "to meet its deposit liabilities on demand." (Hearings, supra, 3978–79.)

Therefore:

> It must not seek excessive profits by taking undue credit risks and it cannot wisely tie up its funds in long-term credits however safe they may be. Its primary credit function is performed by lending money for short periods to finance self-liquidating commercial transactions largely in the movement of goods and crops through the various stages of production and distribution; and in the making of short-term loans against good collateral. The commercial bank cannot safely make loans to a borrower who lacks capital of his own or who cannot in the normal course of his business repay the loan within a reasonable period of time. It is within this framework that the commercial bank renders sound and constructive service to the industry, trade and agriculture of the country." (Hearings, supra, 3979.)

The investment banker also renders a valuable service to industry, trade and agriculture but he does it "by meeting long-term needs, providing funds for plant and equipment or for permanent working capital." This involves his taking "speculative risks of a sort unsuitable to the commercial bank." Moreover, Aldrich points out that with every new issue "he takes the risk that the public may not readily absorb the new securities which he brings out and that his own capital may be tied up for a long period of time."

It is this last distinction which in Aldrich's mind—

> Emphasizes the wisdom of the legislation (Glass-Steagall) forbidding investment bankers from taking deposits." (Hearings, supra, 3979.)

Despite its different character, Aldrich acknowledged there were points of contact between the commercial and investment bankers. For instance, Aldrich said it was proper for a commercial bank to lend to investment bankers, on short term, funds necessary to carry a new issue of securities while it is in the process of being marketed.

But he warns that such a loan should be secured by collateral, carefully scrutinized and, in making such a loan which performs an essential service, the commercial bank "should be absolutely free from interest in the issue, and immunized from possible influence arising from interlocking interests with the investment bankers participating in it." (Hearings, supra, 3979.)

Likewise, when the commercial banker has a customer who needs long-term working capital, it is quite proper for him to refer that party to an investment banker. However, in so doing, it is critical that the investment banker be able to use his own good judgment "as to the wisdom of issuing the credit" and the "conditions" of it. There should not be pressure by the commercial bank arising out of any dual financial interest. (Hearings, supra, 3980.)

At this point in reading his statement, Senator Couzens asked Mr. Aldrich what he thought about the Federal Reserve Board.

Aldrich answered as follows:

Well, Senator Couzens, that question is a very difficult one, too. I should like to make my answer to that in the form of a general answer. I think the manner in which the Federal Reserve System functioned during the period of 10 years prior to 1930 was most unfortunate, because of the fact that a money market situation was created which, I think, is very largely responsible for the difficulties of bankers that occurred. (Hearings, supra, 3981.)

In a second section of his statement Aldrich discussed changes needed in the Glass-Steagall legislation which had been passed in June 1933.

Although the Glass-Steagall bill quite rightly recognizes the need to separate commercial from investment banking and "the public is likewise under the impression that the act effectively accomplished that purpose", Aldrich states that both careful analysis of the act and observation of its operation shows the need for its amendment.

Glass-Steagall or the Banking Act of 1933, to Aldrich, when read with Clayton 8, establishes this congressional policy:

1. Divorcement of commercial from investment banking;
2. No interlocking between commercial and investment banking;
3. No interlocking among commercial banks in the same community; and
4. Enforcement of the legislation is not to affect adversely national banks or member banks of the Federal Reserve.

It is true, says Aldrich, that the Banking Act of 1933 requires: (1) divorcement of commercial from investment banking; (2) prohibits firms in the securities business from taking deposits; and (3) forbids any firm but one subject to Federal or State regulation from receiving deposits.

But Aldrich points out that the Glass-Steagall legislation, (sec. 8 of the Clayton Act and provisions of secs. 32 and 33 of the Banking Act of 1933) in its present form, leaves wide open the opportunity for an interlocking of management on the one hand between investment bankers and commercial banks, both national and State, and between commercial banks themselves, so long as they are not national banks; and, for an individual who may actually be engaged in the securities business through a corporation (so long as he is not a director or officer of the corporation doing such business but employs other people for those offices) to act as a director of a commercial bank without even the necessity of obtaining a permit from the Federal Reserve Board. (Hearings, supra, 3982.)

Stated another way, Aldrich testified that as then drawn regulations L and R, series 1933, and Clayton 8:

1. Allows any individual—investment banker or otherwise—to act as a director, officer, or employee of any number of commercial banks, so long as no one of them is a national bank.

2. It allows any individual to act as a director, officer, or employee of a national bank as well as of two other banks—if the Federal Reserve Board issues a permit therefor.

3. It allows a member of a partnership engaged in the investment banking business or an officer or director of a corporation engaged in such business to act as a director, officer, or employee of any member bank, provided only that he obtains a permit therefor from the Federal Reserve Board.

4. It allows anyone engaged in the securities business as a controlling stockholder in an investment banking corporation—so long as he does not act as a director or officer of such corporation—to act as a director, officer, or employee of any bank without the necessity of a permit from the Federal Reserve Board. (Hearings, supra, 3983.)

Then Mr. Aldrich points out that the Federal Reserve Board has ruled that member banks can avoid certain prohibitions in Clayton 8 against interlocking directorates by obtaining permision from the Federal Reserve Board. (Hearings, supra, 3983.)

Attacking the wisdom of allowing the Federal Reserve Board to dispense with the protections of Clayton 8, Aldrich said:

The fact is that under the present law any of the prohibitions contained in section 32 of the Banking Act and sections 8 and 8–A of the Clayton Act, can actually within certain limitations be avoided with the permission of the Federal Reserve Board. The Federal Reserve Board must only determine that such exceptions as it makes are in its judgment "compatible with the public interest."

To state the situation in another relation: The Banking Act of 1933 in section 21(a)(1) prohibits unconditionally an investment banker from at the same time engaging in commercial banking. No provision is contained in this section of the act even permitting the Federal Reserve Board to authorize an avoidance of this prohibition, and yet section 32 of the same act, as indicated above, permits the Federal Reserve Board to authorize indirectly an evasion of this prohibition by permitting an interlocking directorate between an investment banker and a commercial bank.

The foregoing observations are not to be interpreted as criticism of the Federal Reserve Board; nor to imply that the Federal Reserve Board will not proceed conscientiously in discharging the duties imposed upon it by law. The point here made is that the necessities of so vital a situation should not be subject, once Congress has determined public policy, to the discretion of the Federal Reserve Board or of any other authority. It is only natural—as was pointed out when the Kern amendment was first added to section 8 of the Clayton Act whereby the Federal Reserve Board was given power by permit to excuse from the prohibitions against certain interlocking directorates—that if the Federal Reserve Board is given such power the Federal Reserve Board will interpret this as a mandate from the Congress to exercise such power. The fact is that Congress having acted to prohibit certain relationships, presumably because in its judgment they were contrary to the public interest, has apparently delegated the power to the Federal Reserve Board to determine whether Congress was itself right. I submit that Congress was wise in its legislative purpose, and that its wisdom in that regard should be expressed in mandatory rather than permissive terms.

To accomplish the purpose and intent of the Congress to effect a complete termination of interlocking directorates between commercial banks and investment bankers, I urge that the Banking Act of 1933 should be amended by incorporating in the National Bank Act a provision expressly disqualifying anyone engaged, directly or indirectly, in the investment banking business from acting as a director or officer of a national bank. (Hearings, supra, 3984.)

All of this caused Aldrich to recommend that the entire subject of the qualification of directors, officers, and employees of both State and national banks be comprehensively covered by the elimination of the provisions in sections 31, 32, and 33 of the Banking Act of 1933, and revision of Clayton 8.

Aldrich also pointed out, that while a director of a national bank may, with permission of the Federal Reserve Board, act as a director of two banks which make loans secured by collateral, the director of a national bank may not, even with Federal Reserve permission, serve as a director of a corporation which, as an incidental matter, "makes loans secured by stock and bond collateral" (Hearings, supra, 3985.)

To do this adequately, Aldrich cautioned there are many definitions of investment banking, and the legislation should be drawn with care.

In a third section of his statetment, Aldrich pleaded with the committee for legislation blocking these loopholes:

A. All loans above a certain minimum by an executive officer of a State or Federal bank should be reported to the board of directors. As then drawn, an executive officer has to report his loan to the chairman, but there is no indication what the chairman should do with the information or what he is to do if he himself needs a loan.

B. Because banking experienee has conclusively demonstrated the undesirability of participation by bank officers in transactions of this kind, the act should specifically prohibit executive officers of member banks from participating directly or indirectly in syndicates offering securities or trading accounts, or pools of any kind.

C. Above all, the legislation should prohibit executive officers and directors of the Federal Reserve banks from participating directly or indirectly in syndicates offering securities, or in trading accounts or pools, because banking experience has conclusively demonstrated its undesirability.

D. The act should require an executive officer of a member bank to report to his board of directors every case where he has an outside interest and what pay he receives. Directors should know his outside interests.

E. Because banks sometimes make policy loans to officers of depositor banks and corporations or to financial agents of important people or firms, the Congress should require that such loans made for policy reasons should be reported to the board of directors. Such a provision might have the effect of discouraging applications of this sort and force the borrower to go to another bank where his loan can stand on its own merits.

In a fourth section of his statement, Aldrich suggested a redefinition of "affiliates" which have to file reports in view of the many corporations then controlled by banks because of bad loans and in the process of liquidation. Along the same line he asked the subcommittee to remove from Glass-Steagall the provision requiring divorce of securities affiliates within 1 year. More time was said to be needed.

In the fifth and last section of his statement to the subcommittee, Mr. Aldrich made certain general remarks:

First, he warned that in legislating the Congress should remember that "the whole mechanism of trade is as delicate as it is complicated." (Hearings, supra, 3990.)

Second, granted banks and bankers "were responsible for specific acts and for certain abuses," in Aldrich's opinion they were not responsible for "the great excess of member bank reserves"—1922–28 when deposits of commercial banks increased by \$13.5 billion, while loans and investments increased by \$14.5 billion.

Naturally this great increase in commercial bank credit, unneeded by commerce, flowed into capital uses generating an immense speculation in real estate and securities. While the bankers took improperly secured mortgages, unseasoned high yield, narrow-market bonds or loans against securities inadequately margined and diversified, they "did not create the general money-market situation." (Hearings, supra, 3991).

The fair inference from the Aldrich statement is that the principal culprit for the 1929–32 Great Depression was, as we have said, the Federal Reserve System.

As he finished, Pecora asked Aldrich about an investment banker who has a controlling stock interest in a commercial bank. Mr. Aldrich conceded he had overlooked that case, and the legislation should prohibit it. (Hearings, supra, 3992–3993.)

Pecora next asked Aldrich "whether or not a commercial bank should be permitted to act in a trust capacity." (Hearings, supra, 3993.)

Aldrich replied that he had given it serious thought. His information was that it is impossible to support a trust company standing alone in a small community, so State banks were given trust powers and, then in larger communities, national banks were given trust powers to meet the competition of State trust companies. (Hearings, supra, 3993–3994.)

At this point Senator Couzens interjected that he objected to a commercial bank acting as a trustee in other than small communities. His point was that with the elimination of bank affiliates the use of trust companies should grow. (Hearings, supra, 3995–3996.)

Rather than divorce the trust business from commercial banking, Aldrich suggested there might be other ways. The only embarrassment Chase has experienced he said, was making bank loans when the bank was trustee for the debtor company, and the indenture of trust contained negative pledge covenants the loan conceivably might violate. (Hearings, supra, 3996.)

Though he does not identify the issue, the loans about which he spoke were loans to the Insull companies in Chicago.

Reading this brilliant Aldrich statement, one goes back to the Bible. Solomon said he had seen all the things that were done under the Sun, and all was vanity and vexation of spirit.

Allowing commercial banks to act as trustees asks for trouble. Yet, this is the way we have allowed the banking business to develop.

Senator Couzens in 1933 was as right as rain that the trust business should be divorced from the commercial banking business. The only mistake Couzens made was thinking such an inherent conflict of interest should be allowed to exist in either large or small communities.

Despite all Aldrich said in this great statement, when Penn Central recently failed, what did we find?

As of December 31, 1969, Morgan Guaranty Trust Co. shared with Penn Central two interlocked directors. These interlocked directors sat on the Morgan Guaranty board of directors even though Penn Central owed Morgan Guaranty $91 million, and Morgan Guaranty owned a great deal of Penn Central stock. What happened?

The very thing Winthrop W Aldrich had pointed out in 1933 came to pass.

By the end of 1969, Morgan Guaranty held $1.1 million shares of Penn Central stock, 200,000 for its own account, 850,000 in pension trusts administered by its trust department.

In 1970, prior to May 28, 1970, Morgan Guaranty sold all its own 200,000 shares and, thereafter, between May 29, 1970, and the date of bankruptcy, June 21, 1970, sold 371,000 shares from its pension trust holdings.

Likewise, as of December 31, 1969, the chairman of the board of directors of the Penn Central was on the Chase Manhattan board, even though Penn Central owed Chase $7.8 million, and it owned 436,000 shares of Penn Central stock.

In the final 2 months before bankruptcy in 1970, Chase sold 554,715 of its 630,000 shares of Penn Central stock.

In addition, the chief financial officer of Penn Central was a director of the Provident National Bank of Philadelphia even though it held $57 million in conditional sales agreements on the railroad.

Furthermore, as Senator Lloyd M. Bentsen's Senate Finance Subcommittee on Financial Markets in the 93d Congress, first session, recently disclosed, Morgan Guaranty, at the end of 1972, held the following: $2 billion IBM, $1.1 billion Kodak, $651 million Avon, $605 million Sears, $596 million Xerox, $370 million Disney, $242 million Polaroid, and $20 million Procter & Gamble.

While Samuel R. Callaway, Morgan Guaranty's executive vice president said he did not really know. Senator Bentsen said it was his understanding that Morgan Guaranty is "the largest stockholder in the world" (subcommittee, 93d Cong., 1st sess., hearings July 24, 25, and 26, 1973, part I, 76, and see Tobias, supra, 41), almost as powerful as a "government" (Hearings, supra, 67.)

As Senator Bentsen pointed out in an address to the U.S. Senate on December 20, 1973 (Congressional Record No. 201, vol. 119), this gives an institutional investor, such as Morgan Guaranty, a tremendous leverage in the stock market.

In 1963 Senator Bentsen stated that 35 percent of the trading was done by institutional investors, whereas, today, the figure is 70 percent. For instance, Morgan Guaranty's eight-man investment committee manages $21 billion worth of common stock.

Individual investors have declined by 800,000, and one large bank's trust department has invested more than 60 percent of its total common stocks in just 20 issues, another 20 percent of its discretionary stock market investments in just two issues, and still another 15 percent in just two issues.

It is the thought of Senator Bentsen that when one institution owns more than 10 percent of a company, it no longer is just an investor—it is an owner. (Congressional Record, supra, 119.) He, therefore, would limit the amount of stock one bank trust company could hold in one company.

One can agree with Senator Bentsen's position but one might ask, in view of Penn Central, whether the time has not come to divorce trust departments completely from State and Federal banks?

In fairness, it must be said that if Morgan Guaranty from 1961 to June 30, 1973, earned 9.5 percent on its "Commingled Pension Trust Fund," it did pretty well. (Tobias, supra, 42.)

But the fact remains its large portfolio is confined to so-called premium stocks, and only 8 to 15 percent turnover in a year. This means that 85 or 90 percent of Morgan's $26 billion trust investments are frozen as a matter of policy. (Tobias, supra, 43.)

It is not good, and it is dangerous. Senator Bentsen is right to want to do something to correct it.

However, Senator Bentsen's study of Morgan Guaranty broke out even more fundamental errors in our banking system.

Consider in the light of the Aldrich statement what Morgan Guaranty does and ask yourself whether, regardless of its technical validity, it is in the public interest that a great bank such as Morgan Guaranty should be allowed to act as it does?

1. Its corporate research department gives financial advice on capital structures and mergers.

2. Its financial services department is said to have completed more acquisitions in 1973 than any firm except Lazard Freres and Goldman Sachs.

3. It is underwriting public bonds.

4. It has established "J. P. Morgan Interfunding" to make loans up to 20 years instead of the 6- or 7-term commercial bank loans.

5. Nor is Morgan Guaranty as separate from Morgan Stanley as one would think.

(*a*) Morgan Stanley is underwriter on a $150 million debenture issue of Morgan Guaranty;

(*b*) Morgan Guaranty manages Morgan Stanley's pension and profit-sharing plans; and

(*c*) Jointly with Morgan Guaranty, Morgan Stanley owned Morgan and Cie, International, S.A. based in Paris; for some years even though it recently decided to sell its interest to Morgan Stanley;

(*d*) When Morgan Guaranty acquired a foreign company in 1973 for Consolidated Foods, naturally it put the long-term financing through Morgan and Cie; and,

(*e*) Significantly, Morgan Stanley, between 1968 and 1972 acted as underwriter in at least 21 of the 30 industrial companies in which Morgan Guaranty has positions; and

6. In England, a Morgan Guaranty Edge Act Corporation is in a joint venture with Household Finance. (Tobias, supra, 40–41.)

Consider also, that in 1972—10 American banks made a substantial part of their 1972 income from foreign financial operations:

	Percent
Bank of America N.T. and S.A., S.F.	52
First National City Bank, N.Y.	63
Chase Manhattan Bank N.A., N.Y.	28
Morgan Guaranty Trust Co., N.Y.	27
Bankers Trust Co., N.Y.	37
Continental Illinois N.B. and Tr. Co., Chicago	15
First National Bank of Chicago, Chicago	22
Marine-Midland Bank, N.Y.	58
First National Bank, Boston	31

More particularly, consider how these banks made their foreign income.

For instance, among the many foreign holdings of the Chase Manhattan Bank, the Bank of America, and First National City are stock interests in foreign banks the world over.

Does not this recital take you back to both the Pujo and Pecora investigations? Is it not history repeating itself?

It is no small wonder then that a Morgan Guaranty financial man remarked that Morgan Guaranty was getting into "all the things an investment banker gets into" except "domestic corporate underwriting." (Tobias, supra, 40.)

As mentioned earlier, this is a violation of the spirit, if not the letter of the Glass-Steagall Act, that ordered our commercial banks to divest themselves of their security affiliates.

So we have lived to see Morgan Stanley and Morgan Guaranty divorced at home by Glass-Steagall, together again at Paris in Morgan and Cie despite all the excesses brought out in both the Pujo and Pecora investigations.

And, in England, we see Morgan Guaranty in business with Household Finance.

None of these activities would have taken place if the Federal Reserve Board had done its duty.

It was a tragedy, of course, that Aldrich testified when he did in the late fall of 1933. Congress passed, and the President signed, the Glass-Steagall Act on June 16, 1933.

Neither the Senate nor the House, nor the President, had the benefit of Aldrich's suggestions. Aldrich was ahead of his time, as were Untermyer and Pujo. And, as Pecora said, this great Wall Street banker "advocated more radical proposals than Congress itself adopted."

However, Glass-Steagall did accomplish certain reforms.

First, and foremost, the reform so long urged from the 61st Congress (1909–11) to the 72d (1931–33), governmental insurance of bank deposits finally came to pass in the Glass-Steagall Act of the 73d Congress on June 16, 1933, as section 12B of the Federal Reserve Act. This was of course temporary legislation which did not become permanent until the Banking Act of 1935. (Chapter 335, 49 Stat. 435. Public Law 66, 73d Cong. (H.R. 5661). Approved June 16, 1933.)

The management of the Federal Deposit Insurance Corporation created by Glass-Steagall is vested in a board of directors consisting of the Comptroller of the Currency, and two civilians appointed by the President from different political parties for 6-year terms.

As Senator Lister Hill, of Alabama, so wisely said, there had been no banking legislation comparable in importance to it since the passage of the Federal Reserve Act in 1913. Hill called it "the shadow of a great rock in a weary land." (LXXV Political Science Quarterly 181, No. 2, June 1960.)

Second, hopefully, as a result of the awful disclosures during Pecora's investigation of the banks, Glass-Steagall had forever forbidden national and member banks to have security affiliates such as National City Co. and Chase Securities, and American banks that accept deposits from engaging in the securities business any place. Sections 20 and 21.)

Third, for the first time the Open Market Committee was given statutory recognition and was told to meet in Washington, D.C., at least four times a year, and to have as many members as there are Federal Reserve districts, each Reserve bank to select its own member. (Section 8.)

Fourth, it contained provisions with respect to loans by bank officers, and a provision prohibiting directors of national and member banks from being officers, or directors, of any concern engaged in the securities business. (Sections 12, 32, and 33.)

Fifth, member banks were prohibited, henceforth from paying interest "on any deposits payable on demand." (Section 11(b).)

There were flaws in the Banking Law of 1933, as Winthrop W. Aldrich took great pains to point out in his statement to the subcommittee later in the year. But whether one agrees with the policy of each, these five so-called reforms are significant.

As Aldrich said, the act represents policy decisions by the Congress, and should be followed meticulously by the Federal Reserve.

IX. THE BANKING ACT OF 1935

When Franklin Delano Roosevelt looked around for a man to head the Federal Reserve Board, he selected Marriner Stoddard Eccles.

At about the time of the Battle of Gettysburg, the Eccles family immigrated to the United States from Scotland. There they had become Mormons, and the Perpetual Immigration Fund of the Mormon Church paid for their passage to Great Salt Lake City, Utah.

In 1885, 5 years before the prohibition of plural marriages by the Mormon Church, Marriner Eccles' father, David, married Ellen Stoddard who bore him nine children. However, David, at 28 had previously married Bertha Jensen by whom he had 12 children. ("Beckoning Frontiers: Public and Personal Recollections," by Marriner S. Eccles, edited by Sidney Hyman, Alfred A. Knopf, New York, N.Y 1951, 7, 8, and 20–21.)

Marriner Eccles had grown up in Utah, and became a successful banker. At the invitation of Stuart Chase when he came to lecture at the University of Utah, Marriner Eccles had agreed to visit Professor Rex Tugwell at Columbia University when he went east to testify before the Senate Finance Committee, along with some 200 others during February 1933.

Tugwell recommended Eccles to Henry Morgenthau when he became Secretary of the Treasury, and in January 1934 Eccles came to Washington as Morgenthau's advisor on monetary matters planning to remain until June 1935. (Eccles, supra, 113–114, 165.)

When Eugene Black resigned in June 1934 as Governor of the Federal Reserve Board, Roosevelt, on the recommendation of Morgenthau, selected Marriner Eccles as his successor announcing the appointment on November 10, 1934. (Eccles, supra, 165, 175.)

Before agreeing to take the job, Eccles, who was a millionaire and did not need the salary, outlined in a memorandum—memo given to President Roosevelt on November 3, 1934, which is on file at the National Archives Library at Hyde Park, N.Y.—to President Roosevelt the following fundamental changes he wanted to see at Federal Reserve:

First, because the available supply of money determined fluctuations in production, employment, and the national income, there must be at Reserve a conscious control and management of the monetary mechanism. The depression was intensified during 1929–34 because Reserve contracted, instead of expanding, the money supply.

Second, to recover from the depression we must rely on increased governmental and private expenditures, but Federal Reserve, by monetary control, must assure support for such emergency financing as is involved in the recovery program.

Third, monetary control is a critical need for the future: (a) to assure that recovery does not bring inflation; and (b) that it is not followed by another depression.

Fourth, to do the needed job: (1) the Federal Reserve Board should have complete control of all open-market operations; and (2) the Governors of the Federal Reserve banks should be appointed annually by the Board of Directors of each district Reserve bank but "subject to the approval of the Federal Reserve Board."

Fifth, in the past, banker interest, as represented by the individual Reserve bank Governors, has prevailed over the public interest as represented by the Board due to the higher salaries paid the bank Governors, and the failure of the Board to play an effective role. As a result, the Board has not commanded the respect and prestige to which it is entitled, and membership has not been as highly desired as it should be to attract the necessary talent.

Its lack of authority to initiate open-market policy, and the complete independence of the district bank Governors, combine to give the Board a minor role.

Sixth, the party that can buy and sell securities in the open-market controls both the banking system and the money supply. At present the district Federal Reserve banks have this power. All the Board can do is approve or disapprove. From 1930 to 1933 this power has been in the 12 bank Governors. At present these 12 have this power. They are the ones responsible for the policy Reserve pursued during the depression. These Governors have "a narrow banking rather than a broad social point of view." They are a cumbersome body that functioned badly in the past and we need in the future to concentrate control in "a small policy formulating body."

Seventh, the "Governors," not even mentioned in the Federal Reserve Act control its policies, and to give the Board the power to approve the appointment by the district banks of the Governors would lessen the possibility of friction and enhance Board prestige.

Eighth, adoption of these suggestions would make Federal Reserve "a real central bank capable of energetic and positive action without calling for a drastic revision of the whole Federal Reserve Act."

As mentioned previously, the Banking Act of 1933, for the first time, created by statute a Federal Open Market Committee consisting of one member from each Federal Reserve district designated annually by the Board of Directors of the particular Federal Reserve district bank. The committee was to meet in Washington, D.C.

Under this arrangement there was no place for the Federal Reserve Board. It was responsible for the open-market operations but could not initiate them. It could only approve or disapprove. And any Federal Reserve district bank that refused to participate in open-market operations was free to do so.

In other words, as Eccles says, before decision on open-market operations "there had to be a complete meeting of minds between the Governors of the 12 Reserve banks, and the 108 directors of all those banks, plus the Federal Reserve Board in Washington." (Eccles, supra, 170.)

In Eccles' view there was dire need "to broaden the types of paper eligible for discount at the Federal Reserve banks." Restricting the paper to "short-term commercial loans and investments," in Eccles' opinion "hamstrung the operation of the Federal Reserve System" and the banking system "would die of atrophy." In October 1934 eligible paper "amounted to only slightly more than $2 billion" and banks could not live on that little interest. (Eccles, supra 171.)

Back of the ideas presented to President Roosevelt by Eccles was his desire to allow banks to discount both short- and long-term paper "making all sound assets liquid by permitting them to be rediscounted at the Reserve banks."

To carry out this reform, Eccles wanted the explicit definition of "eligible paper" removed from the act, and "sound assets" substituted. (Eccles, supra, 173–174.)

Eccles also wanted the separate office of Chairman of the Board of each district Federal Reserve bank abolished and its functions merged with that of the Governor. But in addition he wanted the Governor approved by the Federal Reserve Board. (Eccles, supra, 174.)

Eccles, needless to say, was enthusiastic for his reforms. However, President Roosevelt in appointing him either purposely or indvertently neglected to clear it with Senator Glass. This put Carter Glass in opposition not only to Eccles personally, but also to his hoped-for reforms. In this opposition Glass was joined by George L. Harrison, successor to Ben Strong as Governor of the powerful New York district Reserve bank. (Eccles, supra, 178–179.)

Glass was chairman of Appropriations. He took that post at the request of the leadership to prevent its going to Senator Kenneth D. McKellar, Democrat of Tennessee (Representative (1911–17) and Senator, (1917–53)), as the Democrats organized the 1933 Congress.

Logically, Glass should have taken Senate Banking, but the leadership permitted him to name Senator Duncan U. Fletcher of Florida as chairman.

Eccles says this meant that Glass surrendered the chairmanship of Senate Banking "in name only."

Actual power in important banking matters remained with Glass to whose subcommittee Fletcher referred all vital banking matters.

The Glass subcommittee was a strong one. Robert J. Bulkley of Ohio (who had been on House Banking and Currency with Glass when the Federal Reserve Act was enacted), William Gibbs McAdoo (Woodrow Wilson's son-in-law who, like Glass, had been Secretary of the Treasury in the Wilson administration), James F. Byrnes, Democrat of South Carolina (1930–41), John Hollis Bankhead II, of Alabama (father of Tallulah and brother of William Brockman Bankhead), Speaker of the House (1930–46), Peter Norbeck of South Dakota, John G. Townsend, Jr., Republican of Delaware (1928–41), and James Couzens of Michigan.

Nevertheless, Eccles says that "Glass rode herd over them all, and came very close to binding the subcommittee to the service of his personal pique." (Eccles, supra, 180–181.)

Fortunately, insofar as his proposed amendments were concerned, Eccles was in a much better position in the House where Henry B. Steagall, Democrat of Alabama, was chairman of House Banking. The ranking Democratic member was T. Alan Goldsborough of Maryland. Steagall referred the banking bill of 1935 to his full committee, whereas Fletcher referred it to the Glass subcommittee of Senate Banking. (Eccles, supra, 181.)

Besides, Governor Harrison of the New York district Federal Reserve bank (who had married Mrs. Cary Grayson on the death of Admiral Grayson, Woodrow Wilson's personal physician) the Democratic national committeeman from Utah, contacted Senator Glass giving Eccles a bad press.

It seems one of Eccles Utah banks had refused the committeeman a loan. The loan was refused because the bank thought him "an unreliable character." (Eccles, supra, 179–180.)

Their judgment was apparently confirmed because Eccles states that at a later date this fellow was convicted of rape. (Eccles, supra, 179-180.)

For 3 months Glass pigeonholed Eccles' nomination in his subcommittee. It was not until April 15, 1935, that Glass called up the Eccles nomination. His excuse was the pressure of his duties on Senate Appropriations. The first meeting on his nomination lasted an hour and produced 15 pages of testimony; the second lasted 10 minutes, adding two letters to the record.

As Eccles saw it, Glass' scheme to get rid of him was merely to recite his business connections and then "in short, sharp shock," cut his head off. (Eccles, supra, 202–203.)

It was said that three Senators on the subcommittee were in favor of the Eccles nomination; two opposed.

The deciding votes were those of McAdoo and Couzens. George Creel, a friend of Eccles, assured him that McAdoo would vote for Eccles, but as luck would have it, McAdoo missed the meeting and left his proxy with Glass who voted it against the confirmation of Eccles.

The 3–3 deadlock was broken when Couzens voted for Eccles. It seems Couzens was a close friend of Senator Charles L. McNary, Republican of Oregon (1917–42). McNary knew the Eccles family well from their logging operations in Oregon, and he assured Couzens that Eccles "was neither the dangerous radical nor the knave he had been made out to be." (Eccles, supra, 204.)

The full Senate Banking Committee unanimously confirmed the Eccles nomination, and on April 25, 1935, the Senate confirmed him with but one dissenting vote, that of Carter Glass. (Eccles, supra, 204.)

Unfortunately, long before his nomination was called up, Eccles had to worry about amending the Federal Reserve Act to enable him to do a job for President Roosevelt if and when he was confirmed. Roosevelt was to launch a $4 billion work relief program. Federal Reserve, as then constituted might block it, so Eccles was forced to go before House Banking to press his Federal Reserve amendments before his confirmation. This did not endear him to Glass. (Eccles, supra, 187.)

In this critical period, F.D.R. was a great help to Marriner S. Eccles. At lunch on the south portico of the White House, Roosevelt said to him when his spirits were at their lowest: "You know Marriner, when I appointed you a member of the Federal Reserve Board, it never occurred to me that a Mormon had to be confirmed." (Eccles, supra, 188.)

As early as September 28, 1934, just as the fall congressional campaign opened, the Advisory Council of the Federal Reserve System consisting of one member from each of the 12 Federal Reserve districts, "issued a public statement demanding, among other things, a prompt balancing of the budget." (Eccles, supra, 188.) Needless to say this was the last thing either F.D.R. or Eccles wanted said.

Few peonle of course knew that the Federal Advisory Council was merely a group of private bankers who, under the Federal Reserve

Act, were privileged to advise with the Federal Reserve Board. People thought they were an organ of Government free to speak for the Board.

Eccles took the position he would deny the Advisory Council access to the Federal Reserve staff until the Council first showed statements to the Board so that in the event of a disagreement two statements could be released, one for the Council, the other for the Board. (Eccles, supra, 188–190.)

After a stormy session, the Council accepted the Eccles position with face-saving verbal changes. (Eccles, supra, 188–190.)

Another obstacle Eccles faced at Reserve was a so-called Committee on Legislative Program for the Federal Reserve System. It was responsible for initiating legislation affecting the Federal Reserve System. Yet, except for one Board member, all the committee represented the viewpoint of the private banker. It was not the vehicle for Eccles to use to promote the program he and F.D.R. had in mind. George L. Harrison, Governor of the New York Federal Reserve Bank headed this committee, and Eccles promptly told him his first task would be to liquidate it. (Eccles, supra, 191–192.)

When Eccles told his Board about his legislative program, blessed by F.D.R., the Board accepted the report of Harrison's committee and discharged it.

In its place a new legislative committee was created to work with Eccles consisting of E. A. Goldenweiser, Director of the Division of Research and Statistics of the Federal Reserve Board, Chester Morrill, Secretary of the Board (1931–51), Walter Wyatt, General Counsel (1922–46), and Lauchlin Currie, Assistant Director of Research and Statistics (1934–44). (Eccles, supra, 193.)

However, it never rains but it pours and, once again, both the administration and Eccles made a mistake in dealing with Senator Carter Glass.

Early in 1934 Eccles went to see Glass, and promised him that as soon as the proposed banking bill of 1935 was cleared with the administration's Interdepartmental Banking Committee, of which Henry Morgenthau, Jr., as Secretary of the Treasury (1934–45) was chairman, he would "discuss the bill with him before personally discussing it with anyone else." (Eccles, supra, 195.)

As luck would have it, the Federal Reserve portions of the bill were not completed and approved by the Interdepartmental Committee until a day before the bill was sent to the House and Senate.

Before Eccles personally received a copy, the bill was at the Capitol. (Eccles, supra, 195.)

Eccles at once phoned Glass and explained what happened. Needless to say Glass was offended and "intimated" that Eccles was lying to him. It was a bad way to begin, and Eccles then knew it. He says at that time he did not register on how important Glass was, and how important it was to work with him. Eccles puts it this way—"I was still a stranger in Europe." (Eccles, supra, 195–196.)

On February 5, 1935, Steagall introduced the banking bill in the House, and the next day Senator Fletcher introduced it in the Senate. Like Gaul, the bill was divided in three parts: Title I related to the Federal Deposit Insurance Corporation; title II covered the amendments to the Federal Reserve Act upon which Eccles and Roosevelt had agreed: and, title III were needed technical amendments to the banking laws.

Obviously to President Roosevelt and Eccles, title II of the bill was a must.

On the other hand, the banks very much wanted title I and title III. Title I "liberalized" the rate and nature of FDIC assessments to the advantage of the banks, and buried among the technical changes in title III was a provision giving bankers who had not paid their loans to their banks until July 1935 to do so. The 1933 act provided that if they did not pay by July 1, 1933 they were to be fired. (Eccles, supra, 196.)

Eccles doesn't say so, but one infers it was his and Roosevelt's strategy to tie title I and III of the bill which the bankers so much desired to title II which they bitterly opposed.

Once again Eccles was a greenhorn Mormon on the Potomac. While he did discuss the proposed bill, and give his Federal Reserve Board a memorandum to study which he discussed with them a week later, he neglected to give each member a copy of the bill before it was introduced.

It was impossible to do so as Morgenthau sent it to Congress before even Eccles saw it. (Eccles, supra, 197.)

To make matters worse, Leo T Crowley, head of FDIC and J. F T O'Connor, the then Comptroller of the Currency, both resented having their matters in title I and title III tied to the Federal Reserve amendments in title II. Accordingly, when testifying before Glass' subcommittee both men "disassociated themselves from title II in very opening remarks."

As Eccles confesses, "coming in the wake of his failure to send him a copy of the banking bill in its final form, Glass saw in the Crowley and O'Connor statements further proof of a foul conspiracy of which Eccles was the chief architect." (Eccles, supra, 198.)

To help matters along, Joseph H. Frost, a class A Director of the Federal Reserve Bank of Dallas (1931–36), and a member of the advisory council testified that it was his information that "no member of the Federal Reserve Board saw the bill until it was introduced in the House and Senate, and printed." (Eccles, supra, 198.)

While none of the members of the Federal Reserve Board objected to the proposed amendments in title II when the Board discussed them, two, namely, George R. James, and Adolph C Miller, said they had reservations, and both testified before the Senate subcommittee "where in some respects they opposed the measure." On the other hand, Charles S. Hamlin of the Board defended title II. (Eccles, supra, 198–199.)

There was great pressure to break out title II from titles I and III, but Eccles resisted.

At one point the bankers sent word to E. G. Bennett, Eccles' close friend, a fellow Mormon from Utah and the Republican member of the FDIC Board, that if Eccles would take title II out of the bill he would be quickly confirmed as head of the Federal Reserve Board.

Eccles' reply to Bennett was to tell his "banker friends to go to hell" as the proposed changes in title II had to be made with or without Eccles as Governor. (Eccles, supra, 199.)

No one could have had a more difficult time beginning his job than Eccles. Before confirmation he had to guide his bill through House Banking and Currency hearings that began February 21, 1935, and ran until April 8, 1935. The Glass subcommittee began hearings on April 19. (Eccles, supra, 200.)

However, prior to that, on April 5, 1935, after a 3-month delay, Glass called for hearings on Eccles' confirmation, and it was not until April 25, 1935, that Senate Banking and Currency reported the nomination favorably, and the Senate confirmed the appointment. (Eccles, supra, 204.)

In comparison with the Senate, the House hearings on the bill were a breeze, Steagall, and Goldsborough of the House committee worked closely with Eccles, and while they had a number of changes, Eccles was able to accept them all enthusiastically. (Eccles, supra, 200.)

A New York University economics professor, Walter E. Spahr, who was Secretary of the Economists National Committee on Monetary Policy, submitted a statement signed by 67 economics professors in opposition to title II.

Unfortunately for Professor Spahr, Congressman Goldsborough "was committed to the principle of a central bank" and "in dealing with Spahr's testimony, riddled him in a manner as embarrassing as it was remorseless." (Eccles, supra, 200.) In all, 23 witnesses testified before House Banking, but very few opposed title II. (Eccles, supra, 200.)

On February 12, 1935, a few days before title II went to the Hill, Eccles spoke before the American Bankers Association in convention assembled at Pass Christian, Mississippi. There the bankers created a five-man committee to be located in Washington, D.C., and act as liaison between the bankers and the administration while the banking bill was before the Congress. Its members were: Rudolph S. Hecht, ABA president; Robert V. Fleming, Riggs National Bank in Washington, D.C., first vice president of ABA; Tom K. Smith, Boatmen's National Bank, St. Louis, second vice president of ABA, and Winthrop W. Aldrich of the Chase National Bank in New York. (Eccles, supra, 201.)

At Pass Christian Eccles was much encouraged from his discussions with this five-man committee. They seemed to him to go "a long way in endorsing the changes in the Reserve System that were being proposed." Their only reservation was to the draft formula in the bill for the Open Market Committee. Later at a meeting in Augusta, Ga., the recommendations of this five-man committee were approved by the executive council of ABA.

However, Eccles found out that these five bankers were "generals without troops." Moreover, the five split into two groups when "Aldrich, who had signed the statement of recommendations, placed himself in the van of the banker-attack on title II during the Senate hearings."

Eccles said he was "dumbfounded" by the contradiction in Aldrich's views.

Individually, Eccles could convince the bankers of the need for changes in the Federal Reserve System "but when they returned to their own camp they went native again, and accepted the party line." (Eccles, supra, 201–202.)

Aldrich, so great before Pecora, had feet of clay in 1935.

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But, despite Aldrich et al., the House Banking and Currency Committee reported out the banking bill with title II unscathed on April 19, 1935, and, by a vote of 271 to 110, the bill won the approval of the House of Representatives on May 9, 1935. (Eccles, supra, 202.)

The House bill was then at the mercy of the Glass subcommittee in the Senate.

There some 60 witnesses testified, among them, Winthrop W. Aldrich of Chase National; James P. Warburg of Kuhn, Loeb; Professors Edwin W. Kemmerer of Princeton, Henry Parker Wills of Columbia, and Oliver M. W. Sprague of Harvard; James A. Perkins of National City; Owen D. Young of General Electric; Frank A. Vanderlip, a former president of National City Bank; John B. Byrne of the Connecticut Bankers Association; Elwyn Evans of the clearinghouse banks in Wilmington, Del.; William L. Sweet of the U.S. Chamber of Commerce; Edward Eagle Brown, president of First National, Chicago, and H. Grady Langford, president of the Georgia Bankers Association.

The common thread in the testimony of all of them was that title II was not needed, and the existing Federal Reserve System "was working quite well." (Eccles, supra, 205–206.)

As Eccles repeatedly notes in his memoirs, this whole thing was history repeating itself.

Aldrich's father, Nelson Aldrich, Frank Vanderlip, and Paul Warburg had fought Glass, Owen, and Wilson in 1913. Then they did everything they could to delay and defeat the Federal Reserve Act.

Here they were in 1935 doing their best to delay and defeat Eccles' and Roosevelt's amendments to the Federal Reserve Act! But this time Carter Glass was in the camp of the bankers. Woodrow Wilson was Glass' President. Franklin Delano Roosevelt was not.

It was May 10, the day after the House of Representatives passed the bill that Eccles was finally called as witness by the Glass subcommittee. (Eccles, supra, 207.)

By the time Eccles was called, Warburg, Young, and the others were saying over and over again that there was no need for the legislation, that it would convert Reserve from a system of regional banks to one central bank and subject it to political control. (Eccles, supra, 207–210.)

While waiting for Glass to call him as a witness (which he did on May 10, 1935), Eccles received an invitation to speak before the annual convention of the Pennsylvania Bankers Association on May 5, 1935. Eccles accepted. His speech there is a good introduction to his Senate testimony. (Eccles, supra, 210.)

With that directness for which he became noted, Eccles told the Pennsylvania bankers that since they made their living investing money left with them by their customers, their function was "a private business function" and they have "no power individually to influence the volume of money that is created." (Eccles, supra, 210–211.)

On the other hand Eccles said that "the regulation of changes in the total volume of money is a public function."

Continuing, Eccles said:

> You are told that since the Reserve banks deal with your money you should have some say in its investments. But this argument will not stand examination. When the Reserve banks buy securities they do not do so with existing money;

they create new money for the purpose, and this increases your reserves and your deposits. When they sell securities you lose deposits and reserve funds. The Reserve banks, in other words, are not agencies for the investment of member-bank funds; they actually create and destroy money. Neither are open-market operations a regional or local matter. Their effect cannot be confined to a single district, but is nationwide and affects all classes. (Eccles, supra, 211.)

Really, Eccles said, what the bankers would like is to put the banking system so firmly under their control that the Government will have to terminate its spending for social welfare. Then the bankers would balance the budget. But a moment's reflection ought to convince any self-respecting banker that "this is the most dangerous and irresponsible argument that any group of bankers could present."

Congress has power not only to appropriate money but to raise it.

To attempt to hinder the Government in raising funds to carry out the programs passed by the Congress "is to invite disaster for the banking system."

For those who disapprove governmental policies, the only avenue open is the ballot. (Eccles, supra, 211.)

What Eccles said he wanted in the 1935 Banking Act was a specific direction by the Congress to Reserve to use its powers over the country's monetary system "to promote conditions conducive to business stability." (Eccles, supra, 212.)

Moreover, Eccles told the Senate subcommittee that when the Federal Reserve Act was enacted in 1913, the House Banking and Currency Committee declared that supervising the banking system was "a governmental function" and Woodrow Wilson agreed, saying that the control "must be public, not private" so that banks are "the instruments, not the masters of individual enterprise and initiative." (Eccles, supra, 212–213.)

Marriner S. Eccles, however, conceded that monetary policy alone was insufficient to prevent "booms and depression." It was, he said, dependent upon "a properly managed plan of Government expenditures," and "a system of taxation conducive to a more equitable distribution of income." Then monetary policy can "regulate the volume of money" efficiently. It becomes the machinery that carries out the legislative purposes. (Eccles, supra, 214.)

Early in his testimony Eccles dealt with the Warburg-Aldrich argument that would delay passage of title II "until a committee of experts had a chance to study the whole question."

Eccles met the argument head on. The differences of opinion, he said, could not be resolved by study because they "represent fundamental differences of approach to economic problems." (Eccles, supra, 216.)

What it amounts to, said Eccles, is that the proponents of the bill "are irrevocably convinced of the necessity of public control of national monetary and credit policies." Divergent points of view cannot be reconciled by argument, nor can they be clarified by future study. Believing, as they do, that control should be left with the private banks that own the Federal Reserve System leaves the opponents of the bill in deadly opposition to the proponents who will not settle for less than public control. The Congress has to decide one way or the other. (Eccles, supra, 216.)

Unfortunately, action by the Senate subcommittee was delayed. It was graduation time. Carter Glass was on the road collecting honorary degrees from universities. Trustees of these universities wanted to see title II defeated. This led Eccles to observe they were trying "to kill the banking bill by degrees." (Eccles, supra, 217.)

But Eccles says one thing caused the bankers who were university trustees to pause "in their eulogies of Glass' statesmanship" and take "a look at the calendar." July 1 was fast approaching and, if bank officer loans were to be extended, Congress had to act before July 1.

Efforts to split title II from titles I and III had failed, and the bankers had to have title III, but to get it they had to take titles I and II. A final effort for the bankers to divorce title II from titles I and III was made by Jesse Jones, joined by Leo Crowley of FIDC, and J. F. T. O'Connor, the Comptroller of the Currency. (Eccles, supra, 217.)

Glass was, of course, willing to accommodate the bankers but he was not in a position to do so as the House had passed Eccles' bill virtually intact. As long as the House demanded title II, Glass was powerless.

As a compromise, the bankers proposed at the end of June 1935 that the whole Banking Act go over to the next Congress, and in the meantime they should be relieved of all the burdensome provisions in the existing banking laws from which titles II and III would relieve them.

Eccles would have no part of this compromise as he and the proponents would be in a much worse position to achieve their reforms if the bill went over to the Congress of 1936. (Eccles, supra, 218.)

Steagall knew the heat was on him so he refused any phone calls, but Eccles contacted Goldsborough who was as firm against the bankers' compromise as Eccles.

Goldsborough and Eccles then sat down together and proposed a compromise of their own. Under it the present banking laws were extended 60 days. This would give the Congress the time it needed to complete action on the banking bill of 1935.

Eccles carried the compromise to President Roosevelt at the White House. F.D.R. leaned over, picked up the phone and called Steagall who, of course, accepted the call. Roosevelt then told Steagall that under no circumstances was he to consent to split title II from the bill. Rather, President Roosevelt said, he was to make a counterproposal along the lines of the Goldsborough-Eccles compromise. Needless to say. Steagall went along, and the Senate bowed to the House. (Eccles, supra, 218–219.)

The Senate gave the bankers the 60-day extension for which the Eccles-Goldsborough compromise provided before the July 1 deadline, but thereafter it passed the Senate subcommittee's version of title II which the Senate Banking Committee had reported out on July 2, 1935. This shifted the battle arena to the Conference Committee.

Conference committees usually bring agency representatives with them.

Glass had Judge L. E. Birdzell of the FDIC and Gloyd Awalt, Deputy Comptroller of the Currency with him but refused to allow Walter Wyatt, General Counsel of the Federal Reserve Board to attend. Wyatt became persona non grata to Glass when he wrote an opinion letter to the effect that Eccles' connection with the Eccles

Investment Co., did not disqualify him from becoming a member of the Federal Reserve Board. (Eccles, supra, 220.)

This forced Eccles and Wyatt to work through Awalt, the Deputy Comptroller. In retrospect Eccles counted this a blessing as it caused Representative Goldsborough "to assume personal responsibility" and to enter into even closer working relations with him. (Eccles, supra, 220.)

Eccles' battle plan with Alan Goldsborough was to give Glass as many points as they safely could but to stick fast "to the first five basic provisions in the House bill."

They hoped Glass would be happy if he won "a majority of individual points" and think he had won "a decisive victory," little realizing that "the fewer points on which Goldsborough had his way had a combined importance that was at least equal to the sum of Glass' individual gains." (Eccles, supra, 220–221.)

At one point Alan Goldsborough fell out with Glass who maintained that Goldsborough had insulted him and demanded an apology that Goldsborough declined to give. Eccles saw title II go up in smoke, and urged Alan Goldsborough to apologize.

The next day, to save the legislation, Goldsborough made a public apology to Glass on the House floor in such a "back-handed" way that few people understood it. Goldsborough thought he had not apologized at all but Glass accepted it as adequate and the conference went on. (Eccles, supra, 221.)

As predicted, Glass claimed his Senate committee "rewrote the whole of title II" so that Eccles believes their battle plan succeeded. In this Eccles saw no purpose in disenchanting Glass as in his opinion the bill was "workable," set up a far more effective central banking mechanism and, what is most important, "established the authority of the Federal Reserve Board as the central source of direction for the Reserve System." (Eccles, supra, 221–222.)

First, the bill changed a lot of names. Instead of the "Federal Reserve Board" as in the 1913 act, the Board became the "Board of Governors of the Federal Reserve System."

Effective February 1, 1936, the Board was reduced from eight to seven members, each to be appointed by the President and confirmed by the Senate.

Eccles, you will recall, had wanted the Board reduced to five, and the House bill had left the Board unchanged with six appointive members and the Secretary of the Treasury and the Comptroller of the Currency as ex officio members. (Eccles, supra, 222.)

In the Senate, Carter Glass told his subcommittee that while he "would not say in an offensive way that I dominated the Board. * * * I, at least had a considerable influence with the action of the Board." (Eccles, supra, 216.)

Furthermore, as we have seen, whatever Glass did, Andrew Mellon did dominate the Federal Reserve Board.

The Senate subcommittee agreed with Glass that "the Secretary of the Treasury has had too much influence upon the Board" and they voted to reduce the Board to seven and eliminate his ex officio membership. (Eccles, supra, 222.)

But when Morgenthau heard that he was to lose his job but that the Comptroller of the Currency, ranking as a mere bureau chief in Treasury was to hold his, Morgenthau demanded that the Comptroller be removed also. Glass complied making Eccles very happy. (Eccles, supra, 222.)

The House version of the bill struck out the requirement that in selecting Federal Reserve members, the President should have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests and the geographical divisions of the country. It substituted a requirement that members should be well qualified by education and experience to participate in the formation of national economic and monetary policies.

The House change failed to survive the conference.

Another House change that lost in the Conference Committee was a provision raising the salaries of Board members to those paid the Cabinet. This involved a raise from the $12,000 salary specified in the 1913 act to $15,000.

Under the final bill appointments were to be scheduled for periods of from 2 to 14 years so that not more than one would expire in any 2-year period. And, after the first group of appointees had run their cycle, each member would hold office for 14 years unless removed by the President for cause. (Eccles, supra, 223.)

The President was directed to name one member of the Board of Governors as chairman and another as vice chairman, each for 4-year terms. The chairman was to be the Board's active executive officer. (Eccles, supra, 223.)

Second, the 1935 act provided that in each of the 12 Reserve district banks there should be a president and a first vice president. Heretofore these officers had been known as Governors. While appointed for terms of 5 years by the Boards of Directors of the banks, henceforth appointments were to be subject to the approval of the Federal Reserve Board.

In this connection Eccles lost a fight to separate the functions of Reserve bank chairman from Federal Reserve agent, but Eccles achieved the same result and a saving of $300,000 by appointing chairmen on an honorary basis.

"In each district bank there continued to be a governmental employee who acted as Federal Reserve agent." (Eccles, supra, 224.)

Third, by the banking bill of 1935, effective March 1, 1936, the old Federal Open Market Committee given statutory recognition in the banking bill of 1933 and composed of the 12 Governors of the Federal Reserve district banks, was changed in membership to consist of the 7 members of the Federal Reserve Board, and 5 representatives of the Federal Reserve district banks selected annually by the Boards of Directors of the Federal Reserve district banks, one by Boston and New York, one by Philadelphia and Cleveland, one by Richmond, Atlanta, and Dallas, one by Chicago and St. Louis, and one by Minneapolis, Kansas City and San Francisco.

Meetings were to be held in Washington, D.C. at least four times a year on the call of the Chairman of the Federal Reserve Board or any three committee members. (Eccles, supra, 224–225.)

Eccles fought this provision. He wanted the Open Market Committee to consist of Federal Reserve Board members only. In the

House bill the committee consisted of Federal Reserve members alone. There was a provision, however, under which the Federal Reserve Board would consult with five representatives annually selected by the Federal Reserve banks, but after consultation the Open Market Committee was free to do what it pleased. Its policy was to be binding on all the Federal Reserve banks. (Eccles, supra, 225.)

Nevertheless, Eccles was reasonably happy with the provision as it was written into the banking bill of 1935. Under it, "no Federal Reserve bank would be permitted to decline to engage in open-market operations." Authority and responsibility was centralized in the committee.

Records were to be taken of every vote and annually reported to the Congress. And there were seven Federal Reserve Board members, as against five from the banks. (Eccles, supra, 225.)

Fourth, by the Banking Act of 1935 the Federal Reserve Board was authorized to increase or decrease demand and time requirements for balances member banks are required to keep. A vote of four of the seven Board members was needed.

However, despite Eccles' plea to put no limit on the Board's right to change reserve requirements, Glass put in a provision that no change in reserve requirements could decrease reserves then required by law to be kept, nor increase them more than twice the present rate.

Of course this was a considerable improvement as the old act, while it permitted the Board to raise or lower reserve requirements, prevented the Board from doing so except "during an emergency," on a vote of five members and with the President's approval. (Eccles, supra, 226.)

Fifth, by the Banking Act of 1935 Reserve was required every 14 days with the approval of the Board of Governors to establish the discount rate. Eccles comments the provision stems from "Senator Glass' skimpy knowledge of what the procedure entailed in practical terms." (Eccles, supra, 226.)

Sixth, in the banking bill of 1935, Eccles succeeded, over Glass' opposition, in inserting a provision permitting loans by any Federal Resrerve bank pursuant to regulations of the Board of Governors of the Federal Reserve Board "on any satisfactory as well as eligible paper to any member bank."

The House bill had used the phrase "sound assets" but under the old act loans were restricted to "eligible paper," and member bank loans were difficult, if not impossible to make otherwise. (Eccles, supra, 227.)

Seventh, another provision in the banking bill of 1935 liberalized loans by commercial banks for longer terms. This permitted easier real estate loans, removing the restriction that the real estate had to be in the area where a national bank is located, and removing other restrictions as to the kind of loan that could be made. (Eccles, supra, 227.)

Eighth, the new banking bill of 1935 provided that the Federal Reserve could admit to membership "a State bank with impaired capital." The Board could waive admission requirements of State banks with deposits of $1 million before July 1, 1942, so as to allow them to gain admission into the FDIC.

Likewise, admission of other banks with impaired capital was waived when part of their capital was in preferred stock or when they had outstanding capital notes or debentures eligible for purchase by the Reconstruction Finance Corporation. (Eccles, supra, 227–228.)

Finally, Eccles maintains the Banking Act of 1935 "introduced technical changes" which "relieved the new Board of Governors of much administrative detail and enabled it to concentrate more readily on important policy questions." (Eccles, supra, 228.)

However, Eccles weeps for his loss of the statement in the House bill requiring the Federal Reserve Board:

> To exercise such powers as it possesses in such manner as to promote conditions conductive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment so far as may be possible within the scope of monetary action and credit administration. (Eccles, supra, 228.)

As Eccles says, if Glass had allowed this statement to stand, it would "let the people of the country know what to expect of monetary management" and yet leave "the Federal Reserve Board discretion as to the choice of means." What Eccles asked for in 1935 was but a preview of what ultimately became the declaration of national policy that Congress in the Employment Act of 1946 set down for the Government as a whole. (Eccles, supra, 228.)

On August 23, 1935, President Roosevelt approved the Banking Act of 1935 (H.R. 7617 as amended by the Conference Committee) presenting pens to the men who played a major part in getting the new legislation enacted.

Eccles comments that a wag remarked that F.D.R. should have given Glass, one of the authors of the Banking Act of 1913 creating the Federal Reserve System "an eraser instead." (Eccles, supra, 228–229.)

So the banking bill of 1935 was enacted.

You can see that like the two acts that preceded it, the banking bill of 1933 and the banking bill of 1913, the 1935 act was a good one.

By and large there was nothing wrong in any of this legislation that competent administration would not cure.

But, as we saw with the 1913 act, it was improperly administered. The same has also been true of both the 1933 and 1935 acts.

Suffice it to say that as we have seen the banking bill of 1938 required completely new appointments of the Federal Reserve Board. This meant, in Eccles' case, another Senate confirmation. But this time he did not make the mistakes he had made when first nominated.

Hearing rumors that Glass would seek to block his nomination, early in September Eccles saw Roosevelt at Hyde Park who at once released a statement that on February 1, 1936, he would appoint Marriner S. Eccles for a term commencing that date. This silenced the rumors but, of course, confirmation lay ahead. (Eccles, supra, 231–232.)

Eccles could not go to Glass who continued hostile to him. Yet not only Eccles but all his Board had to run the gauntlet of the Glass Subcommittee of Senate Banking.

The resourceful Eccles was equal to the task. What he did was to prepare a list of names of men acceptable to Roosevelt and him, but also acceptable to Glass. He gave this list to F.D.R. and persuaded him to show it to Glass and tell him that he, Roosevelt, would first pick the first four names from it, and then Glass could pick three.

Eccles' gamble was that Glass would choose the three men Roosevelt and he hoped he would. It worked out just as Eccles thought. Carter Glass selected Joseph A. Broderick who had been superintendent of banks for the State of New York, and Ronald Ransom of the Atlanta Federal Reserve Bank. (Eccles, supra, 238–239.)

Roosevelt, however, had a dreadful time.

Vice President Garner came to him and asked him to appoint a man neither he nor Eccles wanted, namely, Ralph Morrison. Reluctantly, Roosevelt appointed Morrison, but, fortunately, he left in 2 months. (Eccles, supra, 245–246.)

Roosevelt wanted to appoint to the Board his two old friends who were on the old Board, namely, Charles S. Hamlin, age 74, and Adolph C. Miller, age 70.

While Eccles was understanding about F.D.R.'s having to appoint Garner's protege Morrison, even though he believed him not to be qualified for the job, he felt both Hamlin and Miller were too old for the job and, to appoint one, would hurt the other.

On the other hand Eccles was prepared to hire both for the Board, and did, Hamlin as special counsel, and Miller as chairman of the Building Committee, so that he could be on hand for advice on Reserve matters.

Roosevelt was still determined to appoint one or both. Eccles, as only he could, talked Roosevelt out of it. (Eccles, supra, 236–238.)

There was one younger member of the old Board, M. S. Szymczak of Chicago who was with the Chicago Federal Reserve Bank of whom Eccles thought highly. Roosevelt appointed him. (Eccles, supra, 245–247.)

A little later, Roosevelt appointed Chester Davis who had been head of the triple A (Agricultural Adjustment Association). With Eccles, Davis made the seventh member.

The new Federal Reserve Board of Marriner S. Eccles was off and running.

X. MARRINER S. ECCLES BEFORE AND AFTER F. D. R.

During the Roosevelt administration Marriner S. Eccles was a most eloquent, and influential spokesman for the coordination of Reserve and administration policies. He strongly felt, and often stated, that the monetary power of the Nation must not be wielded by bankers, but by men representing the public interest.

As Chairman of the Federal Reserve Board during the Roosevelt administration, Eccles greatly influenced the monetary policy of the Nation. However, when on the death of Roosevelt, Truman became President, Eccles no longer wielded such influence at the White House.

In disagreement with practically all the major policy decisions of the Truman administration, Eccles began to back off from his position that Reserve was never meant to be independent of the administration.

Faced with the unfortunate choice of following the policies of Treasury and doing what he believed was harmful to the Nation, or claiming the independence of Reserve so that he might carry out the policy he believed best for the Nation, Eccles was forced to choose the latter.

Eccles' influence during the Truman administration declined. He lost the chairmanship at Reserve, and Treasury/Reserve relations deteriorated.

When he resigned from the Board in July of 1951, Treasury and Reserve had reached an "accord." If this was a victory for Eccles in his new posture as defender of Reserve's independence, it was, at best, a pyrrhic victory.

In 1950 Eccles wrote of Roosevelt:

> Throughout his Presidency I usually found myself in agreement with Roosevelt's social objectives, although I often disagreed with his ideas as to the way they could be achieved. But whether I agreed or disagreed, whether I had moderate, slight, or no influence whatsoever on his particular decisions, I always felt we were working on the same team. (Eccles, Ibid, 401.)

Written after 5 years of service under the Truman administration, this is as much a statement of Eccles' feelings about Truman, as about Roosevelt.

The years Eccles spent on the Board during the Truman administration were, in his words, "years of frustration and failure, as I tried, in my limited capacity, to influence public thought and governmental policy." (Ibid, 397.)

The Truman Years

A front page story headline in the New York Times, of January 28, 1948, read as follows:

> Eccles is demoted in Federal Reserve by Truman's order—is reduced from Chairman to Vice Chairman of Governors' Board in unexpected shift—T. B. McCabe is new head—change held a victory for conservatives led by Snyder.

According to the article, the "shuffle" surprised the banking fraternity and official Washington.

The shuffle was a surprise to Mr. Eccles as well.

President Roosevelt in 1944 had designated Marriner S. Eccles Chairman of the Board of Governors of the Federal Reserve for a 4-year term expiring in February of 1948.

Several months after Roosevelt's death in 1945, Eccles went to see President Truman. Restating his belief that the Chairman of the Federal Reserve should serve at the pleasure of the President, Eccles volunteered to step down although there were 3 years remaining to his term if Truman desired to designate someone of his own choice. Truman, in response, indicated he totally approved of Eccles' work. He had no one else in mind, and expected Eccles to stay on as Chairman of the Board.

According to Eccles, as late as December 1947 Truman received him cordially. Although they had had disagreements over policy in the past, Eccles hadn't the slightest notion of what was about to occur.

On January 22, 1948, 9 days before his term was to expire, John Steelman, special asistant to President Truman, called Eccles to his office. The meeting was short. "The President has given me a very unpleasant assignment," Steelman said. "I am to inform you that he is not going to redesignate you as Chairman of the Board of Governors. But he told me to be sure that you understand that he wants you to stay on as a member of the Board." (Eccles, "Beckoning Frontiers," 435.)

Eccles was incredulous. No reasons were given.

Eccles requested to see the President, and at a meeting the following day, learned no more about this decision. When asked why he had not made his decision earlier so that Eccles could have announced his noncandidacy for redesignation, and saved much embarrassment and the implication that he was being asked to resign because of his failure, the President responded that he simply had not thought about it earlier.

To avoid just such embarrassment and implication of failure, Truman complied with Eccles' request, and released the following exchange of letters in announcing the change:

Dear Mr. Eccles:

Shortly after I became President you offered to resign as Chairman of the Board of Governors of the Federal Reserve System and said it was your feeling that the Chairman, who is designated by the President, should serve at his pleasure. I told you then and on other occasions that there was no one I desired to appoint in your place.

You will have completed your present term as Chairman on February 1, your appointment as a member of the Board continuing until 1958. As I explained to you last week, it is now my preference to appoint a new member of the Board to fill the vacancy created by the death of Vice Chairman Ransom and, when confirmed by the Senate, to designate him as Chairman.

This decision, as I assured you, reflects no lack of complete confidence in you, or dissatisfaction in any respect with your public service, or disagreement on monetary or debt-management policies, or with official actions taken by the Board under your chairmanship. All who are familiar with your record recognize your devotion to the public welfare and the constructiveness that has characterized your leadership in the Federal Reserve System.

Therefore, I urged you to remain as a member of the Board and to accept the Vice Chairmanship so that the benefit of your long experience and judgment will continue to be available and so that you may carry forward legislative proposals now pending in Congress dealing with the important problems of bank credit as outlined in the President's economic report to Congress, as well as with other matters in the interest of a sound banking system and a sound economy.

Sincerely yours,

HARRY S TRUMAN.

The response:

My dear Mr. President:

You have stated in your complimentary letter the substance of our conversation of last week. As I advised you then, I desired to have time to consider fully your decision and request. I have not altered my conviction that the Chairman of this Board should serve at the pleasure of the President, and I sought to have such a provision included in the Banking Act of 1935.

I have carefully considered your request. After consultation with close friends and associates on the Board and because of the reasons mentioned in your letter, I have decided to remain with the Board in the capacity as you suggest.

Respectfully yours,

M. S. ECCLES, *Chairman.*

The complimentary language did not satisfy the curiosity of the press. At a press conference following the announcement and release of the correspondence, the President was sharply questioned about the changes. Truman's response was simply that the demotion of Eccles was his own business, and he need not and would not explain it. ("New York Times," Jan. 30, 1948.)

No explanation was in fact forthcoming. There were reports that the conflict in the outlook between Treasury Secretary Snyder and Eccles over controls on bank credit and other anti-inflation steps was a factor in the change. ("New York Times," Jan. 29, 1948.) Snyder denied these reports, although the New York Times' article reporting the demotion of Eccles called the change "a triumph for orthodoxy and conservatism in fiscal policy as represented by John W Snyder, Secretary of the Treasury" (Ibid.) The article continued, "Mr. Snyder and Mr. Eccles have long been at odds." The differences between Snyder and Eccles predated Snyder's appointment as Secretary of the Treasury in the summer of 1946.

As long as the United States was at war, the primary objective of Treasury and Reserve was the expeditious financing of military operations. The Treasury had decided early in 1942 to finance the war through the expansion of the national debt, and, as much as possible at the abnormally low interests rates then prevailing. Reserve had agreed to take all steps necessary to implement Treasury's decision to finance a "2 Percent War."

When the war ended in August 1945, the Federal debt was over five times what it had been in December 1941 at the outbreak of the fighting. This debt expansion involved considerable sales of Government securities to the banking system, and a considerable rise in bank deposits. The increase in commercial bank holdings during this period—$60 billion—was the equivalent of one-third of the increase in the national debt. Total deposits and currency increased by approximately $85 billion. The Federal Reserve bought over $20 billion of Government securities. (Fforde, "The Federal Reserve System 1945–49," Oxford University Press, 1954, 21–22.)

During the wartime "cooperation" between the two financial agencies, Reserve followed Treasury policy on interest rates and availability of credit. Reserve banks created reserves at the direction of the Treasury Department through its debt management policies.

The end of the war saw the beginning of the great conflict between Treasury, led by Snyder, and Reserve, led by Eccles. Eccles believed two things had to be done for the postwar adjustment to come about with a minimum of inflation: (1) The controls on the economy had to be maintained until levels of peacetime production could be restored, and (2) the money supply had to be reduced. (Eccles, Ibid, 409.) Truman, however, supported by the then head of the war mobilization and reconversion program, Snyder, urged the early removal of all controls.

When in August of 1945 all manpower controls and almost all commodity controls were removed, and most rationing was abandoned, Eccles felt the most prudent course for curbing inflation would have been to defer tax reductions until the time when supply more nearly balanced demand. Again, with Snyder's support, Truman proposed to the Congress that the excess profits tax be repealed.

With the end of the war Eccles took the position that fixed patterns of rates on securities used to finance the hugh war expenditures were no longer justified. Specifically, that the rate on Treasury short-term securities should be allowed to rise instead of being "pegged" at exceedingly low wartime levels by Federal Reserve support.

The preferential rate had been established in 1942 when banks were being called on to do an increasing amount of war financing by buying and holding Treasury bills and certificates. A preferential discount rate on loans secured by Treasury bills and certificates was established as an inducement to the banks to do this. Since the problem in the postwar years was to retard the growth of bank holding of securities, Eccles felt this was no longer justified.

Thus, the Federal Reserve suggested that Reserve banks discontinue the preferential discount rate of one-half percent on loans secured by Treasury bills and certificates. Treasury opposed, on the grounds that it would be interpreted by the market as an indication the Government had abandoned its low interest rate policy. The Federal Reserve backed off.

A few months later, Reserve proposed the abolition of the preferential rate. Treasury opposed on the grounds that the action would increase the already large interest charge on the public debt. Reserve again backed off. However, after a year of resistance, the Board exercised its discretion, and, against the will of Treasury, independently ended the preferenial rate. (Eccles, ibid, 422.)

According to Eccles, the rate changes on Treasury bills accomplished the desired purpose but, alone, could not stop bank credit expansion. Reserve felt it had to act.

Inflationary pressures had become so great that President Truman called a special session of Congress in November of 1947 to present a 10-point inflation control program. Restraint of bank credit was one of the primary items on the program.

When asked for the Federal Reserve's suggested plan to deal with this matter, Eccles, on behalf of the Board, submitted the secondary Reserve plan:

> As a more basic means of restricting excessive growth of bank credit. I recommend that Congress give to the Open Market Committee of the Federal Reserve System a temporary authority under which all banks engaged in receiving and paying out demand deposits may be required to hold in addition to present required reserves, some specific proportion of their deposits in the form of cash and balances with the Federal Reserve banks or other banks or in Treasury bills, certificates or notes. At present the banking system has access, without effective limitation, to reserves upon which a multiple expansion of bank credit can be built. The proposed measure would serve to retard expansion of bank credit beyond the requirements of full and sustained production. (Eccles, supra 430.)

To Eccles' surprise and chagrin, on the advice of Secretary Snyder, Reserve's program was not included in the President's message.

Eccles' program was not dead yet. The Joint Committee on the Economic Report was to hold hearings shortly thereafter. Eccles discussed his proposal with Snyder prior to the hearings. Snyder indicated that although he could not support the proposal, he would raise no objections to it. Congress would have to determine the merits of Reserve's case.

Eccles thus outlined his proposal for a secondary reserve as a means for restraining bank credit before the committee. Snyder, however, when he appeared before the same committee, flatly stated that he thought the secondary reserve plan wouldn't work.

With formidable opposition from bankers, including Allan Sproul, president of the New York Federal Reserve bank, and lack of administrative support, Congress did not give the Board the power to authorize a special reserve. It was shortly after this controversy that Eccles was notified that his chairmanship of the Board of Governors would not be renewed.

Eccles desperately wanted to stop inflation. He was on record as being totally opposed to the policy the administration was following. Confronted with public disagreement between the money managers of the country, Truman evidently decided that Eccles would have to go.

The Eccles Theory

His disagreements with Treasury and administration policies, notwithstanding, Eccles offers a different theory to explain his demotion. He attributes his fall to pressures brought on President Truman by the Giannini banking interests.

Since the early 1920's the expansion of the Giannini banking empire on the west coast had been a subject of concern by Reserve, the Comptroller of the Currency, and later, by the FDIC. As Transamerica Corp., the holding company for the Giannini interests, acquired more and more banks in California, Oregon, Arizona, Nevada, and Washington, it became evident that only their joint resistance could prevent Transamerica from monopolizing the banking business in the West.

In February 1942, Transamerica was informed that the Government's three banking agencies would decline permission for its acquisition, directly, or indirectly, of any additional banking offices. Undeterred, Transamerica continued to buy control of existing banks. Bank of America, part of the Transamerica group, applied to the Comptroller for permission to take over these newly acquired banks from Transamerica, and convert them into branches. The Comptroller consistently refused.

In 1943 the Antitrust Division of the Department of Justice commenced an investigation to determine whether Transamerica's domination of commercial banking was in violation of the Sherman Antitrust Act. The conclusions of that investigation, led by the then Attorney General, Thomas Clark, were that evidence of abuse of its dominant position, essential to make a case under the Sherman Act, could not be found.

Representatives of the Department of Justice, the Comptroller of the Currency, the Federal Reserve, and the FDIC, agreed that some means had to be devised to halt the further expansion of the Transamerica group. The result was a bank holding company bill drafted by the Board of Governors, and introduced in Congress in 1947. Due to the opposition of the new Secretary of the Treasury Snyder, however, the bill died before coming to a vote in the Senate.

In the meanwhile, the Supreme Court had decided the American Tobacco Co. case which indicated that an antitrust case was actionable if it could be shown that a corporation was merely in a position to assert monopolistic power. Eccles brought this to the attention of Attorney General Clark in a letter which was never answered. Evidently Secretary of the Treasury Snyder had requested that he be advised of any matters pertaining to Transamerica, so Clark had sent the letter to Snyder, and there the matter had died.

In April 1947 Eccles addressed a letter to Snyder asking him to give the subject of Transamerica his "early consideration" in that the Board was anxious to know what justice planned to do so that it could decide its own future course of action. (The Board, under the Clayton Act, was empowered to take action against Transamerica but had deferred to justice since they had initiated the investigation.) This letter was never acknowledged.

When in November it was reported to the Board that the Comptroller was being pressured by Treasury to permit the branching of the banks that Transamerica had been buying over the years, the Board initiated its own investigation into whether the facts concerning Transamerica justified proceedings under the Clayton Act.

It was less than 2 months later when Eccles was informed that he would not be redesignated as Chairman of the Board of Governors of the Federal Reserve.

Eccles' theory that west coast pressure brought about his firing, is supported by an article appearing in the St. Louis Post-Dispatch on February 3, 1949, with the headline:

> **Biffle discloses Downey urged demotion of Eccles—Senator's action indicates link between Reserve Board shift and bank trust case. (Eccles, Ibid, 451–452.)**

When the Post-Dispatch interviewed Leslie L. Biffle (Secretary to the Senate, and the "Colonel House" of the Truman administration), he stated that Senator Sheridan Downey of California (1938–50) had urged President Truman to fire Eccles.

Since Senator Downey was a good friend of the Giannini family, and Federal Reserve, under Eccles, was trying to prevent the Bank of America from acquiring so many western banks, the Post-Dispatch concluded that it was really the Bank of America that got to Truman to fire Eccles.

Two days after Eccles was fired, an attempt was made by Senator Charles Tober (R.–N.H.), in a congressional hearing, to link Treasury Secretary Snyder and the Giannini banking interests with Truman's decision to reshape the Federal Reserve Board. ("New York Times," Mar. 31, 1938). Snyder, who had previously pressured the Comptroller of the Currency to permit the branching of the banks that Transamerica had been buying, denied allegations that he had been offered a job by the Gianninis.

Senator Tobey asked Snyder whether or not he had met with the Gianninis in a Florida hotel room, or had entertained the California bankers in Washington in the fall of 1947. Snyder replied that he did not meet with the Gianninis in Florida, but that he did entertain them in Washington.

Senator Tobey's attempts to associate Snyder and the Gianninis with the Eccles demotion, however, were inconclusive.

Interestingly enough, Snyder, during his directorship of the RFC, was closely associated with Samuel Husbands, who, in the summer of 1946, "accepted a high position with a flattering salary with the Transamerica interest." (Eccles, supra, 447–448.)

Significantly, the day before the Transamerica hearings opened at the Federal Reserve, President Truman was visited by Samuel B. Stewart, Jr., of San Francisco, then counsel for the Gianninis. Stewart had previously been counsel for Truman's War Investigating Committee. When interviewed by the Post-Dispatch, Stewart conceded it was his "third trip to the White House in recent months," but said "his latest call was 'personal.' " (Eccles, Ibid, 452.)

Under all these circumstances one must conclude that Eccles was not "stretching the laws of probability to any large extent" when he concluded that Biffle, carried to Truman, Downey's complaint and, that was, that if Harry Truman was to carry California he needed the Gianninis and their price was Eccles' head. (Eccles, Ibid, 452–453.)

Considering that the Transamerica hearings opened in June 1948, and the feeling between Eccles and the Gianninis was very bitter, and his relations with Snyder not much better, you can see that Truman was hearing a lot against Eccles from his close friends. He was also running for President.

After the Firing

After the firing of Eccles, the postwar inflation that commenced immediately after V–J Day continued through 1950. In June, with the outbreak of the Korean war, it threatened to increase even more, and, as the war raged, so did the conflict between the Treasury and the Reserve.

The conflict centering around the management of the public debt was not a new one—Treasury was issuing securities at a low rate of interest pattern, and Reserve was being forced to defend them unless it was prepared to see the financing fail. Yet, Reserve believed such financing was just stoking the "engine of inflation."

Even with Thomas McCabe, Truman's new appointee as Chairman of the Board, the struggle between Treasury and Reserve continued. The Federal had, for the most part, continued its pegging of the Government securities market. According to Eccles, the Reserve Board was gearing up to stop the pegging, although it had neither taken any action in that direction, nor made a formal presentation of its views to the President by January of 1951.

Truman and his council of economic advisors were opposed to the Fed's stopping its support of the government bond market. They felt that cheap and ample credit was necessary to counter the inflation.

Truman felt the continued pegging of government securities necessary for another reason—the success of the defense program.

In his memoirs, Mr. Truman writes that:

> * * * It was my position that until we could determine the extent of the defence requirements that might result we should maintain a stable position in reference to money rates that affected the management of the public debt. * * * It did not

seem appropriate to me that we should enter into a period of deficit financing on a rising money-rate pattern. I also felt strongly that in the moment of impending crisis we should not take deliberate steps that could possibly disturb public confidence in the nation's financing. (*Memoirs* by Harry S. Truman. Doubleday & Co., Inc., Garden City, N.Y., 1956; vol. II, p. 44.)

According to Truman, it was to assure the success of the defense program that he invited the members of the Federal Reserve Board to meet with him at the White House on January 31, 1951. He described the results of the meeting in his memoirs: (Truman, Ibid, 44–45.)

I was given assurance at this meeting that the Federal Reserve Board would support the Treasury's plans for the financing of the action in Korea. This assurance was given entirely voluntarily. At no time during the conference did I attempt to dictate to the Board or tell them what specific steps they ought to take. I explained to them the problems that faced me as Chief Executive, and when they left I firmly believed that I had their agreement to cooperate in our financing program. I was taken by surprise when subsequently they failed to support the program. (Eccles, supra, 484.)

Eccles disagreed with this position, and felt that a majority of the members of the federal open market committee concurred in his views. On his own initiative (as he writes), he brought the matter out into the open by releasing the memorandum of the meeting with the President which the Board had prepared.

Focusing on the fact that the President had not tried to "dictate to the Board, or tell them what specific steps they ought to take", Eccles denied that the Board had agreed to continue to support the government bond market, or maintain the 2½ percent long term rate.

He interpreted the Board's offer of support as just a vague commitment "to protect the government credit". He emphasized the fact that Chairman McCabe had suggested to the President that the Board "consult frequently with the Secretary of the Treasury, giving him our views at all times, and presenting our point of view strongly, and that by every means possible we try to reach an agreement." (Eccles, supra, 489.)

The conflict was out in the open. Throughout the month of February there were consultations between the Board and the Treasury, but there was no answer to the question of whether Reserve would support the securities market as the demanded.

Secretary Snyder became ill during this period of consultations, and William McChesney Martin took his place as spokesman for the Treasury at the meetings which Chairman McCabe had suggested. Describing his role during the subsequent hearings on his nomination as a member of the Board on March 19, 1951, Mr. Martin said:

I plead with the Federal Reserve Board and with the Open Market Committee to go along with us on this operation; that both of us jointly agree to keep within the family what our policies and programs were, and that I wanted to have a working relationship between the Treasury and the Federal Reserve that would make it possible for us to combine our judgment as to what proper pricing of securities should be. (*Nominations of William McChesney Martin, Jr.*, Hearings before the Senate Committee on Banking and Currency, 82nd Cong. 1st sess., March 19, 1951, p. 10).

During the course of these negotiations, Chairman McCabe submitted his resignation effective March 31, 1951, and President Truman nominated Mr. Martin the Treasury's spokesman to succeed him. Subsequently, Mr. Eccles implied that McCabe resigned in protest over the terms of the accord—possibly because he was unaware that in the end, the Fed would win.

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During the hearings on his nomination, Mr. Martin gave his view of the projected relationship between the Fed and the Treasury:

> * * * I don't see any way that we can move forward, regardless of how the arrangements that currently exist were arrived at, to refinance in the balance of this year $39 billion in addition to some $13 billion of bills, plus any new money demands that may be faced by the Treasury—I don't see how we can move forward to face that sort of a situation unless the Treasury and the Federal Reserve are working hand in glove. (Ibid, p. 6.)

Elsewhere, during the course of these hearings, Mr. Martin defined the so-called "accord" in a colloquy with Senator Bricker:

> Senator Bricker. What further commitments, if any, are there on the part of the Treasury or the Federal Reserve under this so-called understanding, which of course was never reduced to writing in any way, shape, or form, or any definite promise, but what is the understanding as to the future?
>
> Mr. Martin. Well, the understanding as to the future is that the Treasury and the Federal Reserve work very, very closely together.
>
> Senator Bricker. That is what I was getting at, whether there was any definite understanding of any kind or character or whether there was just an understanding that would be a definite working arrangement.
>
> Mr. Martin. There is a working arrangement, yes sir. (Ibid, p. 13.)

The "accord", then, announced on March 4, appears to have been an arrangement for consultation between the Federal Reserve and the Treasury as to policy.

The agreement, reached in March of 1951, reflected President Truman's position that the policies of the Fed should be coordinated with those of the administration.

Far from seizing its independence, it seems the Federal Reserve agreed to cooperate with the administration. Independence came in 1953 when the Eisenhower administration granted it without a struggle.

XI. THE DISAGREEMENT BETWEEN PRESIDENT JOHNSON AND WILLIAM McCHESNEY MARTIN ON THE RESERVE BOARD'S DECEMBER 1965 DECISION TO RAISE INTEREST RATES

Interest rates in the 20th century are probably as much a subject of political and economic controversy as they were in antiquity. American political parties are as divided on interest rates as were the patricians and plebeans of republican Rome. Some like them high, and others prefer them low. The issue has plagued man from time immemorial. (See "The History of Interest Rates," by Sidney Homer, Rutgers University Press, 1963.)

The dispute which materialized between President Johnson and William McChesney Martin during the midsixties evolved from the "plebean" Johnson attitude, and the "patrician" Martin attitude toward the issue of bank interest rates.

The resulting controversy served to illuminate the significance of Federal policies, and their effects on the economy.

As early as January 1964, Chairman Martin indicated, in a veiled fashion, that a rise in interest rates could be forthcoming. (New York Times, January 23, 1954, 43.) This discreet admission was clearly incompatible with the publicly stated wishes of President Johnson, who believed that a higher interest rate would not be necessary to counter his newly-proposed tax cut.

Needless to say, a rise in interest rates at that time would have affected the 5-percent-plus unemployment figure unfavorably. Higher interest rates would render greater difficulties to business dependent on borrowed money, thus stifling production and increasing unemployment.

In view of its undesirable influence on unemployment and inflation, the President was opposed to any rise in interest rates. Being an election year, the issue became even more of a critical consideration to the President.

A higher interest rate would, on the other hand, have favorable consequences within the banking community; a fact which raised quite a bit of suspicion as to Mr. Martin's real economic loyalties. These suspicions were often voiced by Congressman Patman, who had maintained for some time that the Federal Reserve was serving the interests of the American Bankers' Association. (Ibid., sec. III, 1.)

On April 28, 1964, in a speech to American business leaders, President Johnson expressed his opposition to high interest rates and made clear his hope that the Federal Reserve would support his policy. ("Public Papers of Lyndon B. Johnson (1963–1964)," U.S. Government Printing Office, Washington, D.C., 1965, 295.)

> But let me assure you: If the balance of payments turns sour, of if inflation starts rolling, I will look to the independent Federal Reserve as our second line of defense. I would have said "first" but you in this room are the first line But right behind you is Bill Martin.

On November 24, 1964, the discount rate was increased from 3½ percent to 4 percent. The action was clearly contradictory to the President's program to keep interest rates down. The Reserve Board's decision to increase the discount rate was a response to a similar move exercised by the British Government, which raised its interest rate from 5 to 7 percent earlier that same day. Mr. Martin stated that the Federal Reserve action was an attempt to prevent an outflow of dollars abroad, and not an attempt to raise the rates at which banks lend to businesses and individual borrowers. Nevertheless, creditmen and Wall Street observers predicted that a rise in interest rates would, in all likelihood, increase borrowing costs for businessmen. ("New York Times," November 24, 1964.)

The long-debated issue of whether the Federal Reserve System should be making their decisions independently was intensified by the Board's unwelcome decision to raise interest rates. On the 20th of December, 1964, Congressman Patman announced that he would introduce legislation to dilute the Federal Reserve Board's independence and to encourage closer cooperation with the administration and Congress on matters of monetary policy. ("New York Times," December 21, 1964.)

The rise in interest rates on November 24, 1964, though, did not seem to be an arbitrary decision on the part of the Board but rather a necessary action to protect the dollar. An editorial appearing in the November 29, 1964 issue of the "New York Times" praised the Federal Reserve for its swift and "unfortunately necessary" response to the British interest rate increase. The editorial also said that the consequences of a rise in American rates would not be as drastic as expected because it would create a tighter credit policy which in turn would prevent an outbreak of domestic inflation.

A real conflict, according to a majority of press reports, was to arise in the following December when the Board voted four to three in favor of raising the discount rate again; this time from 4 percent to 4½ percent.

On December 5, 1965, the Federal Reserve Board, "defying the President," announced the increase. The Board also raised from 4½ to 5½ percent, the ceiling on interest rates that banks could pay to interest-earning deposits of large corporations, but maintained the 4-percent ceiling on personal savings accounts. Chairman Martin said he acted, despite Secretary of the Treasury Henry Fowler's public warning against an increase in interest rates, because of "compelling financial and monetary reasons." ("New York Times," December 14, 1965.)

President Johnson who was at his Texas ranch on the day of the announcement, remorsefully stated that the decision was made by an "independent agency" and would result in the higher cost of credit for homes, schools, hospitals, and factories. Furthermore, the President regarded the decision as premature, having been made without the knowledge of the following year's budget, Vietnam costs, and other significant economic data. Johnson believed that the decision would have been more responsible if the Board had consulted the Treasury and the Council of Economic Advisers. The Reserve Board's measure was the result of a narrow majority and constituted a unilateral, uncoordinated effort. Yet its policies were implemented, and began to take their effects on the economy.

One member of the Board who voted in the minority, Sherman J. Maisel, when testifying before the Joint Economic Committee, 2 weeks after the decision, said that he found the reasons for the action less "compelling" than Mr. Martin did. Maisel expressed shock at the Board decision which he believed to be an irresponsible use of independence. ("New York Times," December 14, 1965.)

The Reserve Board's decision elicited similar response from Congressman Patman, who stated that the Board had become a "second government" whose action was both unnecessary and harmful to the consumer and borrower. ("New York Times," December 14, 1965.)

Three months after the decision, President Johnson, in an address to a national mayors' conference said that he was disappointed by the Board's December decision. Johnson said that he "did not agree with Bill Martin and the other three members of the seven-man Board that it was either the time or the means to take action, but they did take it . and it's beginning to bite." ("Public Papers of Lyndon B. Johnson 1966," U.S. Government Printing Office, Washington, D.C., 1967, 155.)

The December 3, 1965, Federal Reserve Board action had been timed rather conveniently to fall after the Presidential election, which was also the case in the November 24, 1964, rate increase. This fact caused some individuals to see President Johnson's disapproval of the rate increase as a token reaction intended to assuage certain block votes to which the Chief Executive had committed himself in the 1964 election. "New York Times" columnist Arthur Krock said the Reserve Board had actually done Johnson "a very great favor" by imposing inflation restraints that would have been embarrassing for the President himself to invoke. ("New York Times," December 12, 1965.) Mr. Krock added that in view of the "Florentine atmosphere" of the Johnson administration, it would be no great surprise to learn that the President was not really displeased with the Federal Reserve Board's measures.

As the quadriad (Chairman of the Federal Reserve, Chairman of the Council of Economic Advisers, Secretary of the Treasury, and Director of the Budget) met at the LBJ ranch on December 6, 1965, President Johnson was asked if discussions with Martin had made the interest rate increase any easier to swallow. The President indicated that his previous statement expressing regret at the Federal Reserve Board decision still stood firm. But he added he was not concerned with "post mortems." "Your (the Press) job" said the President, "is to provoke a fight. Mine is to prevent one." ("Public Papers of Lyndon B. Johnson 1965," U.S. Government Printing Office, Washington, D.C., 1966, vol. II, 641.)

Mr. Martin made reference to his widely publicized dispute with the administration over the 1965 interest rate increase during a farewell speech he gave shortly before his retirement. He told the audience (members of the business council) that President Johnson had told him that he came from a "part of the country that liked interest rates to be low—all the time." (Speech by Mr. Martin at Hot Springs, Va., October 17, 1969, 7.) The soon-departing Chairman said he told the President that the "only way" interest rates could be low was by cutting down on Government spending and tax cut policies. "If you will see to that," said Martin, "you can have moderate interest rates—

maybe not as low as Mr. Patman likes, but you can have them low." (Ibid, 7.)

In the same speech, Martin criticizes nations in which the welfare of the people is subordinated to the self-serving policies of a totalitarian regime.

Other countries have staked their destiny upon systems whereby an all-powerful few decide what's best for the many, and then use the whip of governing authority to drive their people to sacrifice their labor and lives in service to a government whose welfare is considered to stand separate from that of the people themselves.

For many, this criticism also applied to the Federal Reserve Board itself, which was viewed as an "all-powerful few using the whip of governing authority" to enhance the profits of the banking community.

The pro-banking bias alleged to the Board was given credibility by an obscure measure implemented in conjunction with the discount rate increase. Under its regulation Q, the Federal Reserve Board raised, from 4 to 5 percent, the ceiling interest rate that member banks could pay on time deposits. The subtle change in regulation Q quickly shifted the balance in market power, giving large commercial banks the advantage over savings and loan associations. Soon, savings and loan associations became hard pressed for funds. Interest rate competition forced their costs up rapidly while income from outstanding mortgages—issued earlier at lower interest—could not be proportionally increased. To worsen matters, the housing market was suffering because of overbuilding, particularly in California. (G. L. Bach, "Making Monetary and Fiscal Policy," The Brookings Institution, Washington, D.C., 1971, 127.)

During the first half of 1966, savings and loan associations sustained a net loss of $3 billion in customer savings. The subsequent credit crunch was largely due to the Federal Reserve Board's action which raised the discount rate and its change of regulation Q. The Federal Home Loan Bank Board (FHLBB), the supervisory authority for federally insured savings and loan associations, was extremely limited, in terms of funds, in its power to aid the weakening savings and loans. They could not expect, and certainly did not receive, any help from the Federal Reserve System. Policy coordination between the Federal Reserve and the FHLBB, a seemingly prudent idea, apparently was not an objective of Chairman Martin. Congressional testimony revealed that the Reserve Board's action of raising regulation Q ceilings for commercial banks did not have the benefit of prior consultation with either the FHLBB or the Comptroller of the Currency. When asked if he was given advance notice of the December 1965 Reserve Board action, FHLBB Chairman John E. Horne replied in the negative. The same answer came from James J. Saxon, Comptroller of the Currency, who stated that he had first learned of the Board's measures from the "Monday morning newspapers." (Ibid., 131.)

The Federal Reserve Board's December decision to increase interest rates and alter regulation Q had grave consequences on the Nation's economic health. For the savings and loans, the Federal Reserve Board action nearly sounded a death knell. The permutation of regulation Q, raising the amount of interest commercial banks could pay on time deposits drained the lifeblood out of the already weakening savings and loans. Commercial bank credit increased, but the savings and loans suffered a devastating aggregate loss of $3 billion within 6 months of the Board's decision. Fierce competition among financial institutions for funds resulted in a dizzying upward spiral of interest rates. The savings and loans became ineffective as a vehicle to promote the building industry, and prospective homeowners and sellers alike suffered for lack of credit.

To help heal these wounds, Congress enacted the interest rate control bill. This law was designed to reduce exorbitant interest rates, thereby aiding citizens in building, purchasing, or selling their homes. The bill would also serve to strengthen financial institutions like savings and loan associations. It became a law on September 21, 1966, less than 1 year after the fateful Federal Reserve Board vote.

The dispute between President Johnson and Chairman Martin was, in one respect, another episode in the continuing "tug of war" over monetary policy. On one side was the administration pulling for low interest rates and a supportive electorate. On the other was the chairman of the central bank of the United States, convinced that what was good for the banking community, was good for the Nation. In another respect the conflict was an illustration of the tremendous power wielded by the Federal Reserve, and the ofttimes tragic consequences of its use.

The interest rate increase in 1965 was a clear example of the Federal Reserve's abuse of power which, unfortunately, led to an economic crisis of widespread proportions.

The Chairman of the Federal Reserve Board had actively guarded what can be described as a self-imposed mandate to manage the country's monetary policy without interference from the President or anyone else.

History has revealed that, frequently, Federal Reserve policy has gone against the grain of administration and congressional thinking. And, if the Federal Reserve System pursues contradictory policies then the Government has, in effect, no policy at all.

Appendix I. LAW REVIEW ARTICLES OF WRIGHT PATMAN

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The Federal Reserve System: A Brief for Legal Reform

By Wright Patman*

The Constitution vests the monetary powers of the nation in the Congress. Article I, Section 8, Clause 2, of the Constitution provides that: "The Congress shall have Power. To borrow money on the credit of the United States. . . " Clauses 5 and 6 empower the Congress "To coin Money, regulate the Value thereof, and of foreign Coin " and "To provide for the Punishment of counterfeiting the Securities and current Coin of the United States. ." Clause 18, embodying the so-called "Incidental Powers," provides that the Congress shall have power "To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." Article II, Section 1, Clause 1, states: "The executive Power shall be vested in a President of the United States of America." Thus it is eminently clear that Congress has the responsibility of establishing the laws for carrying out the monetary powers and that the President, vested with the executive powers, has the responsibility of carrying out the laws established by Congress.

The founding fathers realized the power inherent in these monetary functions. They were keenly aware from their study of history that the power to regulate and control money, like the power to declare war and to levy taxes, is fundamental to the public welfare. Their study of history had taught them that these great powers must be kept subject to the will and vigilance of a free and alert citizenry; for, otherwise, that citizenry stood in imminent peril of domination by a powerful oligarchic minority, a phenomenon that has recurred countless times throughout human history.

The landmark decision of *McCullough* v. *Maryland*,[1] clearly affirmed the principle that Congress holds the monetary powers under our Constitution, and this doctrine has been reaffirmed and elaborated in a number of cases since that decision, one of the more recent being *Norman* v. *Baltimore & O.R.R.*[2] Furthermore, the federal government argued successfully in the *Legal Tender Cases* that Congress was "under no express restrictions on the subject of money."[3] There is no equivocation in legal precedent, therefore, about the principle that the monetary powers belong to the people and reside in the Congress.

In spite of this indisputable clarity, however, we find that Congress has in fact handed this sovereign power to create and control money to the Federal Reserve System, an institution more responsible to itself than to the federal government, and one which has shockingly close ties to the commercial banks. As an illustration of this self-accountability, William McChesney Martin, Jr., Chairman of the Federal Reserve Board, told the Joint Economic Committee on February 6, 1964, that the Board has "the authority to act independently of the President" and even "despite the President."[4]

On December 5, 1965, by a four-to-three vote, the Board raised the discount rate in flagrant disregard of the President's statement a few days earlier that

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*United States Congressman, Chairman of the House Banking and Currency Committee and the Joint Economic Committee of Congress.

[1] 17 U.S. (4 Wheat.) 316 (1819).

[2] 294 U.S. 240 (1935).

[3] 79 U.S. (12 Wall.) 457, 518 (1871).

[4] *Hearings Before the Joint Economic Committee on the January 1965 Economic Report of the President*, 89th Cong., 1st Sess., pt. 3, at 46 (1965).

tightening money would be harmful. This action prompted Professor Tobin of Yale University to say in a letter to the *New York Times* that, "Because of the paranoiac mania for Federal Reserve independence, the Federal Open Market Committee, the real hard core on policy in this country, does not even let the Secretary of the Treasury or the Council of Economic Advisers inside the door to explain the Administration's fiscal outlook for strategy." [5] When the Board was brought before the Joint Economic Committee to answer questions about its precipitate action, Chairman Martin admitted, in response to a question from Senator Sparkman, that prior to raising the interest rate the Federal Reserve Board did not consult the Federal Home Loan Bank Board, which represents the Savings and Loan industry and which was destined to be adversely affected by the action.[6] In the previous year, the Board refused outright to furnish the Banking and Currency Committee of the House of Representatives with minutes of the recent meetings of the Open Market Committee.

It should be stressed that the Open Market Committee is a creature of the Federal Reserve System that possesses tremendous power over the money supply of the nation through the purchase and sale of billions of dollars of United States securities each year. But even the congressional committees, charged with the responsibility of supervising our banking laws, have no access to its activities and decisions. It is unfortunate that the operation of our monetary system is shrouded in obscurity and is not as well known to the people as it should be. This situation has been fostered by the Federal Reserve Board and by some of the banking community who have made a mystique of the subject. They carefully cultivate the illusion that they are the only ones who can understand the money market and the mysterious breezes and occasional hurricanes that blow through it.

The principles of our money system can be clearly understood if people are given a chance to see the facts. We have a fractional reserve system under which the commercial banks are permitted to lend out money approximately ten times in excess of their reserves. These loans by the commercial banks constitute demand deposits which bankers can create, literally, by a stroke of the pen. The Federal Reserve System, by regulation, sets the reserve requirements which the private commercial banks must by law maintain against their demand deposits. In other words, it is the Federal Reserve System which has the power under the law to determine the percentage ratio between reserves and demand deposits. In actual practice, the Federal Reserve System controls the supply of money or, more specifically, the amount of commercial bank reserves through the purchase and sale of government bonds in the open market. By selling bonds, the Federal Reserve Board withdraws reserve funds from the banking system. Conversely, by purchasing bonds in the open market, it adds to the reserves of the banking system. In short, the power to create money, which the Constitution vested in the elected representatives of the people, and the power to fix its volume and its cost have been given to the Federal Reserve System and its Open Market Committee, consisting largely of representatives of private banks.

The limit on the lending power of the commercial banks is the supply of reserves which is determined by the Federal Reserve System. It is the Open Market Committee, made up of the seven members of the Federal Reserve Board and the twelve presidents of the regional Federal Reserve banks, who are selected by representatives of private commercial banks, which actually determines the purchase and sale of securities and, thereby, controls the reserves of the banking system. This is the most important power in the Federal Reserve System. This committee has the power to issue notes of the federal government which are interest free in exchange for United States bonds which bear interest. The Committee also has the power to do the reverse: Issue United States bonds bearing interest in exchange for interest-free notes.

The Federal Reserve System is a quasi-private exercise of public power which is completely improper in a modern democracy. Even though the Employment Act [7] gives the President extensive responsibilities for the prosperity and growth of our economy, neither the President nor the Congress controls the monetary powers which are among the most important and fundamental for our well being. The Employment Act cannot be carried out effectively unless the Government has the power to control and coordinate all of its economic activities, including the all-

[5] Letter to the Editor, N.Y. Times, Dec. 15, 1965, p. 46.
[6] *Hearings Before the Joint Economic Committee on the recent Federal Reserve Action and Economic Policy Coordination*, 89th Cong., 1st Sess., pt. 1, at 120 (1965) [hereinafter cited as *Hearings on recent Federal Reserve Action*].
[7] 60 Stat. 23 (1946), 15 U.S.C. § 1021 (1964).

important monetary powers which include the control of the money supply, the available credit, and the interest rates charged to borrowers—the fundamentals of economic stability. The policies of the United States Government for full employment, international stability, equitable taxation, and domestic prosperity can never be sound or dependable while the most important part of the nation's economic powers is in the hands of a private group which exists as a separate government. The result is that there are two governments in Washington—the elected Government of the people and the autocracy that controls our financial destiny.[8]

It is tremendously important to the public welfare that lawyers understand the nature, origin, and development of our present monetary situation. This article will analyze in detail the present structure of the system that manages the public money, explore the turning points of history that brought about the present system, examine some of its results, and, finally, suggest what can be done about it.

THE PRESENT STRUCTURE OF THE FEDERAL RESERVE SYSTEM

As presently constituted, the Federal Reserve System[9] consists of twelve regional banks governed by directorates and supervised by a board of seven members appointed by the United States President for terms of fourteen years. Each of the twelve Federal Reserve banks has nine directors. One of the vital insights into an understanding of the Federal Reserve System is the method of selecting these directors. Three of them are called Class A, three, Class B, and three, Class C. The Class A and Class B directors are elected by member banks. Class A directors are chosen from officers of banks in the area; and Class B directors are chosen by the commercial banks from the fields of commerce, industry, or agriculture, and may be stockholders in banks. Class C directors are appointed by the Board of Governors, and they must not be officers, directors, employees, or stockholders of any bank.

It should be noted that the 7,000 commercial banks who are members and who hold "stock" in the Federal Reserve System, do not vote according to the size of their stock-holdings. Rather, each exercises one vote. It should also be noted that the word "stock" is a misnomer since the relationship it denotes lacks the true attributes and power of stock in a corporation. The president of each of the twelve Federal Reserve banks is elected by the nine directors of the bank; and significantly, no oath of office is taken by these presidents or by the directors.

Studies have revealed a preponderance of banking background among directors.[10] Early in 1964 the House Banking and Currency Committee, in connection with the comprehensive review of the Federal Reserve System, sent to all Class B and C directors a questionnaire regarding bank affiliation and bank stock ownership. Since Class A directors are chosen from officers of banks, they would be expected to have banking connections. But the study showed that of the thirty-six Class B directors, all of whom responded, seventeen had been directors of banks

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8 The Committee on Administrative Management characterized the problem in this manner:

> They (Administrative Agencies) are, in reality miniature independent governments set up to deal with the railroad problem, the banking problem, or the radio problem. They constitute a headless "fourth branch" of the Government, a haphazard deposit of irresponsible agencies and uncoordinated powers. They do violence to the basic theory of the American Constitution that there should be three major branches of the Government and only three. The Congress has found no effective way of supervising them, they cannot be controlled by the President, and they are answerable to the courts only in respect to the legality of their activities. . . .
>
> They suffer from an internal inconsistency, and unsoundness of basic theory. This is because they are vested with duties of administration and policy determination with respect to which they ought to be clearly and effectively responsible to the President (or to the Congress) and at the same time they are given important judicial work in the doing of which they ought to be wholly independent of Executive control. . . . [T]he independent commission is obliged to carry on judicial functions under conditions which threaten the impartial performance of that judicial work. The discretionary work of the administrator is merged with that of the judge. . . . Any program to restore our constitutional ideal if a fully coordinated Executive Branch responsible to the President must bring within the reach of that responsible control all work done by these independent commissions which is not judicial in nature.

Report of President's Committee on Administrative Management 36–7 (1937). For a current summary of these problems see also, Staff of Senate Comm. on Administrative Practice and Procedure, 86th Cong., 2d Sess. Report on Regulatory Agencies (Comm. Print 1960).

9 38 Stat. 251 (1913), 12 U.S.C. § 221 (1964).

10 The results of the House Banking and Currency Committee survey are published for the first time in this article.

before becoming Federal Reserve directors and four had held other positions or offices in banks. Of this total of twenty-one, there were only three who did not own some bank stock. Of the remaining fifteen who had never been directors or officers of commercial banks, nine owned bank stock. Thus, out of thirty-six Class B directors, thirty had some connection with banking.

Of the thirty-six Class C directors, all of whom responded, eighteen had formerly been bank directors and two had held other bank positions. Of this group of twenty, there were only three who had never owned bank stock. Out of the remaining sixteen who had never been directors or officers, five had owned bank stock at one time. Thus, out of the total of 108 directors in the twelve banks, ninety-one are or have been connected with the private banking industry which they have the responsibility to regulate.

The present Chairman, Mr. William McChesney Martin, Jr., is widely regarded as sympathetic to the banking interests and is much respected by them. Mr. Martin has won great respect as a man of ability and integrity; but there is a very serious question whether he has the balanced view that should be the *sine qua non* of public service with broad national responsibilities. He belongs to the money world of New York and was, at one time, the president of the New York Stock Exchange. In his testimony before the Joint Economic Committee on December 13, 1965, Mr. Martin stated that, in his conversation with President Kennedy concerning the idea of making the Chairman of the Federal Reserve Board "*persona grata*" to the President, he [Martin] "would undertake to take that up with the American Bankers Association . . ." to see if he could ". get their support for it." [11] The presence of Chairman Martin and of Alfred Hayes, president of the New York Federal Reserve Bank, on the Open Market Committee, along with the additional support received from the presence of the presidents of the Chicago, Boston, and Philadelphia banks, guarantees the powerful New York banks ample protection.

It is important to recognize that the fundamental monetary powers of the nation are exercised by the Open Market Committee which is made up, on the record, of five Federal Reserve bank presidents and the seven members of the Board. But, in actual fact, all twelve bank presidents participate in the deliberations which, of course, are conducted in secrecy every three weeks. In this way, the fundamental power for economic good and economic ill in our country is exercised by a group currently identified with the banking community and operating willfully and deliberately outside the ambit of the United States Government.

HISTORICAL DEVELOPMENT

Throughout the fifty-three years of its existence, there has been a struggle over the control of the Federal Reserve System between the advocates of a public-spirited, impartial, able administration dedicated to the public interest and the advocates of the special interests of the banks. There is no doubt that the bankers have been winning the struggle and that the open market function has been the basis of their control. This extra-legal power is so great that its exercise can literally create prosperity or depression. The Open Market Committee maintains a forty billion dollar portfolio of bonds, over which there is no outside control and upon which the people of the United States are required to pay full interest, in spite of the fact that the Federal Reserve Board has already paid for these bonds with the people's money.

Contrary to notions disseminated by spokesmen for the banking interests, this state of affairs was never sanctioned by the Congress. It was deliberately engineered by the banking interests and was aided by the inactivity of the Congress which failed to take action as, step by step, the people's control of their own monetary powers was whittled away. Furthermore, the Federal Reserve System has never been subjected to public audit or budgetary control like the other agencies of government. Although it controls exclusively the forty billion dollar portfolio which belongs to the Government, handles hundreds of billions of dollars of the Government's money, and exercises the Government's power to destroy soiled and damaged bills, the Federal Reserve System has become a power unto itself. It decides its own budget without any congressional scrutiny and it audits itself.

As passed in 1913, the Federal Reserve Act [12] was never intended to set up anything like the system that exists today. What the Act did was establish twelve

[11] *Hearings on recent Federal Reserve Action, supra* note 6, pt. 1, at 167.
[12] 38 Stat. 251 (1913).

regional banks, each with autonomy in its own region and designed to operate more or less automatically to provide a flexible supply of money and credit under general supervision of a Board appointed by the United States President. There was no central bank; President Wilson was opposed to the very concept of a central bank. He also stressed the need for public control. When the Act was under consideration in 1913, President Wilson said:

> The control of the system of banking and of issue which our new laws are to set up must be public, not private. It must be vested in the Government itself so that the banks may be the instruments, not the masters, of business and of individual initiative and enterprise.[13]

President Wilson was once approached by a group of bankers who desired to assure themselves of control of the System while in its formulative stage. In a circumspect way, they proposed the subject to him in his office. "Which of you gentlemen would condone putting a Railroad President on the I.C.C.?," [14] asked the President. There was an embarrassed silence, after which the delegation walked out. They did not convince Woodrow Wilson, but they did achieve certain compromises in the final legislation. One of them was the provision that six out of the nine directors of each regional bank be chosen by the banking community. It is this provision, more than any other, which has weakened the Federal Reserve System and has allowed banking interests to dominate it, in spite of the fact that its original legislative character contemplated twelve autonomous regional banks.

When the Federal Reserve legislation was considered in 1913, the question whether it should be a central bank or a system made up of twelve independent regional banks was basic. The Aldrich Commission had proposed a system of branch Reserve banks operating under the control of a central board of directors.[15] Under this system, the branch banks would have carried out mechanical operations without any control over policy. Nelson Aldrich, the maternal grandfather of Governor Rockefeller of New York, was a prominent New York banker. The plan developed by him and his commission was a big-bankers' dream and, thus, it was opposed strenuously by President Wilson. Due to the vigorous efforts of the President and of many legislators mindful of the public interest, the Aldrich plan was rejected in favor of a system of semi-autonomous regional banks which had the power to buy and sell bonds and notes of the United States and of States and counties, to purchase and sell bills of exchange, and to establish discount rates. The Board, which was appointed by the President, had certain supervisory powers such as the right to review discount rates. The clear aim of the legislation's sponsors was to "get the money market out of New York," and that is one reason the Aldrich plan was rejected.

At the time of its enactment and for a number of years thereafter, there was no general awareness of the great power inherent in the open market function. Gradually, several astute eastern bankers began to see the tremendous possibility for power and control in exercising the open market function and, more important to them, in centralizing it under the control of the New York bank. Andrew Mellon, the Secretary of the Treasury from 1921 to 1932, Benjamin Strong, the governor of the Federal Reserve Bank of New York from the time it was established in 1914 until his death in 1928, and a number of others began a long quest for power. It should also be pointed out that in 1921 the banks began to purchase bonds in the open market, mainly to provide themselves with earning assets. They paid for these bonds by simply increasing the reserves of banks. In other words, they simply created the purchasing power. Although this had not been intended by the Act, neither the Board nor the Congress recognized this usurpation and the practice expanded. Each of the Reserve banks determined the amount of its own purchases and bought as much as it felt it needed.

In the vital period between 1921 and 1932, the Federal Reserve System was dominated by Andrew Mellon, Secretary of the Treasury. For, in those days, the Treasury Secretary and the Comptroller of the Currency were members of the Board and the former was the ex-officio chairman. Mellon was a representative

[13] 50 Cong. Rec. 4643 (1923) (Representative Carter Glass of Virginia quoting President Wilson).

[14] *Hearings on recent Federal Reserve Action, supra* note 6, pt. 1, at 167.

[15] In 1910 Congress created a National Monetary Commission to conduct a searching examination into the nation's monetary and banking structure. Senator Aldrich was Chairman of the Commission, and submitted the first report to Congress, S. Doc. No. 784, 61st Cong., 3d Sess. (1911). Senator Aldrich retired from the Senate on March 3, 1911, but the proposed plan was later submitted by Senator Burton. Although Senator Aldrich had retired from the Senate, he continued as Chairman of the Commission, and the final report was submitted by him, S. Doc. No. 243, 62d Cong., 2d Sess. (1912).

of big banking interests; and, in various ways, he and his associates saw to it that the Board remained weak and under banker domination. He established a pattern that has proved hard to change. Mellon took an immediate and violent dislike to the regional autonomy in the purchase of bonds. He took the position that it interfered with Treasury efforts to purchase securities for government accounts, and he claimed that they were bidding against each other for Treasury securities,[16] a situation which one might expect to redound to the advantage of the Treasury. Unfortunately, the Treasury Department does not have such a delightful option today. Mellon, along with Benjamin Strong and a number of stalwart allies, took the first step away from public control in a 1922 palace revolution which ended in the formation of an *ad hoc* committee of the presidents of the five eastern-district Reserve banks. The function of this "committee of governors" was to coordinate open markket operations. As Governor Strong of the New York bank stated, "Nobody watches this market as closely as we do . if we do not do something they [the Federal Reserve Board] will. The Federal Reserve Board has power to regulate this matter."[17]

Strong was able to convince the other banks to go along with this proposal, which clearly put the open market function in the hands of eastern bankers, by arguing that, if they did not do what he said, the Federal Reserve Board would take control. Obviously, this was anathema to the banking community and was sufficient to frighten the regional banks into acquiescence. It is also a revealing indication that the Federal Reserve Board had failed at a vital juncture to assert the power that the Congress gave it. This deficiency in initiative furthered the success of the eastern bankers toward their objective of constituting themselves a central bank with the vital monetary powers of the nation in their hands.

When in 1923 the Federal Reserve Board, dominated by Andrew Mellon, failed to take any action, the Committee of Governors started at once on a policy of tightening money and raising interest rates. Already it had become an extension of Benjamin Strong's ego. In the short space of a year he prevailed against most of the other participants in monopolizing the power not only to recommend purchases and sales but actually to control them and thus to dominate the monetary policy. Even Carter Glass, then Chairman of the House Banking and Currency Committee, who often showed great tolerance for the ambitions and powers of the banking community, observed that "Strong is trying to dominate the Treasury and the Federal Reserve Board."[18] Strong and his associates beat down every feeble effort of the Board to reassert its authority except for the relatively minor accomplishment in 1923 of changing the name of the committee and requiring that it submit its actions to the Board for approval. However, the committee retained the power of initiating policy and therefore preserved its control. Meanwhile, Mellon muddied the waters by thundering against the confusion engendered by local bank purchases. Although ostensibly speaking for a stronger Board, he was really strengthening the hand of Benjamin Strong, the president of the New York bank.

Mellon and Strong were the successful architects of the transformation of the Federal Reserve System. It is clear that Congress intended to establish public control over the System through the appointive Board and that the decentralization in the form of regional banks was designed to nullify the monopolistic powers of the New York money managers. Mellon and Strong, however, transformed the nature of the institution through assuring "safe" control of the open market function. They shrewdly left the discount provisions of the law, under which regional banks discount debt paper for commercial banks to provide flexibility for the credit system and to meet local needs, in the hands of the local banks. They realized that the discounting function, which was paramount in the minds of the founders, would decline steadily in importance as the scope of the open market powers became more obvious.

As a matter of fact, the arrogant domination by New York was not readily accepted in the other sections of the country, and there was counter agitation from time to time. Moreover, the Board, stimulated by this grass roots discontent, occasionally made feeble efforts to assert itself. Due to this periodic ferment there was another revision in March 1930, resulting in the informal formation of the open market policy conference to replace the open market

[16] Chandler, Benjamin Strong, Central Banker 209–10 (1958).
[17] *Id.* at 213.
[18] *Hearings Before the Subcommittee on Domestic Finance of the House Committee on Banking and Currency*, 88th Cong., 2d Sess., vol. 3, at 1986 (1964).

investment committee. This was done without any legal sanction.[19] The conference was made up of the heads of all twelve banks and, on the surface, gave more weight to the various regions of the country. But in actuality, the functions continued to be dominated by the New York bank. In the 1933 legislation, this provision was enacted into law,[20] thus giving legal sanction to the idea of complete control of the sovereign monetary powers of the people of the United States by the banking interests. This legislation was reported by the House Banking and Currency Committee without any hearings, and it slipped through without a record vote after an intensive campaign by the American Bankers Association. Representative Lemke of North Dakota summarized it as follows:

> I can well understand why this bill was considered in executive sessions by the committee, because, if my friends and colleagues, the gentleman from Texas (Mr. Patman), the gentleman from Pennsylvania (Mr. McFadden), and others had been permitted to take part in the considerations, the bill would never have appeared on the floor of this House in its present form—A bill of this kind could never have been born in the bright sunlight of day. It had to be born in executive session. And now we are asked to vote for it without knowing its contents and without having had time to digest its far-reaching results.[21]

Actually, the 1933 Act was a step toward a central bank, but not a complete one, because it was still possible for regional banks to refuse cooperation with New York. It was the 1935 Act, discussed below, that converted the Federal Reserve System from a twelve-bank regional system to a central bank, Marriner Eccles, who became Chairman of the Federal Reserve Board in 1934, in discussing the 1933 Federal Reserve Act Amendments, said:

> Under existing law open-market operations must be initiated by a committee consisting of representatives of the 12 Federal Reserve Banks, that is, persons representing primarily local interests. They must be submitted for approval or disapproval to the Federal Reserve Board, and after they have been approved by the Federal Reserve Board, the boards of directors of the Federal Reserve banks have the power to decide whether or not they wish to participate in the operations. We have, therefore, on this vital matter a setup by which the body which initiates the policies is not in a position to ratify them; and the body which ratifies them is not in a position to initiate them or to insist on their being carried out after they are ratified; and still a third group has the power to nullify policies that have been initiated and ratified by the other two bodies. In this matter, therefore, which requires prompt attention and immediate action and the responsibility for which should be centralized so as to be inescapable, the existing law requires the participation of 12 governors, 8 members of the Federal Reserve Board, and 108 directors scattered all over the country before a policy can be put into operation.[22]

The struggle by the dominant eastern banking elements to set up a central bank controlled by them in New York continued. As indicated above, a major objective of the founders of the Federal Reserve System and most of the bankers who participated in it was avoidance of the domination of the eastern

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[19] The Federal Reserve Board became particularly concerned with the easy money policy initiated in 1927 by Governor (President) Strong of the New York Federal Reserve Bank. Because of his close connections with the European central banks, Strong became convinced that this policy was necessary to stop the continuous gold flow to the U.S. Consequently, the Open Market Investment Committee, under his domination, undertook a large purchase of government securities in 1927. The disastrous consequences of this policy led the Federal Reserve Board to attempt to assert its authority over the regulation of open market operations. As a result it established the Open Market Policy Conference in March 1930 to replace the Open Market Investment Committee. The main purpose was to reduce the power of the New York Bank by making the Board Chairman, Chairman of the Conference and by giving all 12 banks representation.

The Conference still remained "extra-legal," as there had never been any legislative provision for an open market committee, and this change took place without any legal action. (Emphasis supplied.)

[20] 48 Stat. 168 (1933), 12 U.S.C. § 263 (1964).

[21] *Hearings Before the Subcommittee on Domestic Finance of the House Committee on Banking and Currency, supra* note 18, vol. 3, at 1992.

[22] *Hearings Before the House Committee on H.R. 5357,* 74th Cong., 1st Sess., at 181–82 (1935).

bankers—the so-called New York Money Trust. But in spite of the fact that the regional bankers and their representatives in Congress battled valiantly over the years and put up strong resistance to the New York forces, they slowly lost the fight. By the early 1930's the trend of the struggle was apparent, and, by the end of the World War II period, the battle was over. At the present time, there is no doubt that the New York money market dominates the Federal Reserve System. As was brought out in the December 1965 hearings of the Joint Economic Committee in a colloquy between the author and Chairman Martin, the President of the New York Federal Reserve bank dominates the open market function, controls its employees, and has exclusive possession of the forty billion dollar portfolio.[23]

One aspect of this situation that should command the attention of students of public law is the existence of an exclusive and limited group of bond dealers who have a monopoly on the huge purchases and sales of government securities conducted by the Open Market Committee. In this way, the twenty authorized dealers are in possession of a double tollgate that permits them to collect commissions on every bond transaction of the Open Market Committee—both purchases and sales. They get them coming in and going out, and neither the Congress nor the people have the slightest idea how much profit these dealers make from this exclusive franchise. The legality of channelling all of this public business through an exclusive and restricted handful of large-scale operators is open to serious question.

The dominance of the New York bank became obvious to all informed observers. Carter Glass once reported that the English press regards the Federal Reserve bank of New York as the central bank of the Federal Reserve System, with the other eleven banks mere branches.[24]

At the time of the 1933 legislation, advocates of bank domination began to express concern about "political" control of the System. It was first raised in connection with the feeble and partly successful efforts to give the Board some role in the open market function by requiring its approval. This power was exercised in a very timid fashion and had virtually no effect. This theme has been repeated constantly and can be heard daily from the lips of Federal Reserve officials and commercial bankers. The originally intended public role of the Federal Reserve System has been reversed and replaced by the spurious doctrine of nonpolitical control of the monetary powers. By this is meant banker control as opposed to public control in the public interest. This is like having the geese guard the shelled corn. Thus it has never failed to amaze this observer to see how many people can ge duped by the notion that somehow the Government would not run the Federal Reserve System properly and that the commercial bankers would. The 1933 legislation also extended the terms of the six appointed governors to twelve years and put them on a staggered basis, thus placing the Board beyond the reach of the President and the administration. It was a great victory for the banking interests.

Riding the crest of his overwhelming mandate in 1932, President Roosevelt had determined that a substantial work-relief program was necessary to increase employment and purchasing power and to help get the country back on its feet. He was well aware that the Federal Reserve System would play a key role in deciding what kind of reception would be accorded the government bond issues that would be necessary to finance it. With good reason he was afraid that the Federal Reserve banks might block his program by failing to take appropriate action in the open market. In particular, he was afraid that they would try to offset the stimulative effects of large-scale government spending by dumping government bonds and shrinking the money supply. This situation was documented by Marriner Eccles, who for many years was Chairman of the Federal Reserve Board.[25]

To avoid this prospect President Roosevelt sent a reform bill to the Congress which would have given authority for open market operations to an eight man Federal Reserve Board, including the Secretary of the Treasury and the Comptroller of the Currency serving as ex-officio members. The Board members were to be appointed by the President to fourteen year terms and were to consult with a five-man advisory committee appointed by the Federal Reserve banks. The committee would not have any vote in the final determination of policy. Thus the

[23] *Hearings on recent Federal Reserve Action*, *supra* note 6, pt. 1, at 166.
[24] Clifford, The Independence of the Federal Reserve System 120 (1965).
[25] Eccles, Beckoning Frontiers 186 (1951).

proposals were designed to place full authority for open market operations in a central board which represented the national interest.

The bill, as introduced in the House by Congressman Steagall of Alabama, differed from the Administration proposal in the composition of the committee. Steagall's bill provided for a Committee made up of the Chairman of the Board, two members of the Board to be selected by the entire Board, and two Federal Reserve Bank presidents selected by all the presidents of the Reserve banks.[26]

In the hearings before the House Banking and Currency Committee, Marriner Eccles stressed the desirability of placing final authority in the Board. He told the Committee:

> Open-market operations are the most important single instrument of control over the volume and cost of credit in this country. Authority over these operations, which affect the welfare of the people as a whole, must be vested in a body representing the national interest.[27]

He critized the Steagall bill as follows:

> The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of the monetary policies, would have to delegate its principal function to a committee, on which members of the Board would have a bare majority.[28]

Eccles also quoted from President Wilson and other founders of the Federal Reserve Act, clearly indicating the intention of the framers to assure Government control of the System. After Eccles' testimony, Congressman Steagall introduced an amended bill which would have placed full responsibility for open market operations in the Federal Reserve Board. In the debates that followed on the floor of the House, there was very clear indication that the basic issue was who would wield the monetary power—private banks or the elected government of the United States. Symptomatic of the opinions of the proponents was the following statement by Congressman Sisson:

> I am heartily in favor of the main provisions of title II, which carry out nearly in whole the recommendations made by Governor Eccles to the Banking and Currency Committee, and in accordance with the program initiated by the great leader of the American people, Franklin D. Roosevelt, to give us a sound and adequate currency and to place the control of the issue of money and the control of credit, which is at least nine-tenths of our money, in the Government of the United States rather than in the private bankers.[29]

Another comment, from Representative Hancock, is of interest:

> [T]he heart of this bill, as I have just said, revolves around the operations of the open market committee. . Every power provided for in this bill exists today in the present law; but there is a transfer of power to take the control of the volume and the cost of money from private hands and place it in Government hands, where, in my opinion, it should have been for the past 20 years.[30]

And finally, Representative Steagall himself made clear his own considered judgment on the Act, saying:

> After the Federal Reserve Board outlines policies, every Federal Reserve bank will be required to carry out in full faith the plans and policies declared by the Federal Reserve Board, as the servants of the Government of the United States, speaking for all the people and not for any private interest.[31]

Unfortunately for the national welfare, the bill was badly weakened in the Senate—partly, I regret to say, because of efforts of an old friend, the late Senator Glass.

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[26] The bill was introduced by Representative Steagall and referred to the Committee on Banking and Currency. H.R. 5357, 79th Cong. Rec. 1501 (1935).
[27] *Hearnigs Before the House Committee on H.R. 5357, supra* note 22, at 101.
[28] *Id.* at 181–82.
[29] 79 Cong. Rec. 6964 (1935).
[30] *Id.* at 6734.
[31] *Id.* at 6720.

Carter Glass had been annoyed at President Roosevelt for ignoring him when the President chose Eccles to be the new Chairman of the Federal Reserve Board. As Chairman of the Subcommittee on Monetary Policy, Banking and Deposit Insurance in the Senate at that time, Senator Glass challenged the philosophy underlying the bill and solicited support from sympathetic economists and bankers as witnesses before the Subcommittee. As a result of his efforts and aided by the testimony of witnesses he produced, the Subcommittee amended the provisions affecting the open market committee to include five Federal Reserve bank representatives and seven members of the Board. This, of course, greatly changed the original bill. It was passed by the Senate in the form proposed by Glass and, in conference, the Senators were able to prevail. The conference bill passed both Houses on August 19, 1935.[32]

As a result, appointments to the Board were staggered over periods of from two to fourteen years so that not more than one would expire in any two-year period. The fourteen-year term remains in the present law. Moreover, the Chairman was selected from the members of the Board. When Chairman Martin's term expired during the administration of President Kennedy, the President found his hands tied. He had no freedom of choice, being limited to the seven members of the existing Board. A President who serves two full terms will not have, under present law, the opportunity to appoint more than two members in his first four years in office. The third would come in the first half of his second term. Inasmuch as a recent amendment to the Constitution limits a President to two terms, the law virtually denies him any opportunity to control the Board through appointments. The net result is that he is controlled by his predecessors' choices and his selections control his successor.

To sum up the history of deliberations on the vital question of control of the open market committee, the original bill would have drastically revised the open market committee which, because of its control of the monetary system, is one of the most powerful economic forces in the world. The House bill would have placed this important function exclusively in the Federal Reserve Board, which is appointed by the President and confirmed by the Senate, and it would have relegated the committee of bank presidents to a supervisory role. This House bill passed, 262 to 110, on a record vote. However, the Senate-passed bill favored the bankers' position, and it was this substitute measure that passed in House and Senate without a record vote.

In addition to diluting the possibility of Board control of the open market activities, the bill eliminated any possibility of day-to-day Administration contact with the Board by eliminating the Secretary of the Treasury and the Comptroller of the Currency from its membership. Moreover, it was not long before all twelve Reserve Bank presidents began to attend the open market committee meetings. While only five could vote, all could participate freely in the discussion and in shaping the consensus of the meeting which was generally summed up for the record, in any case, by the Chairman. In this way, the Reserve Bank presidents, under the leadership of the New York Federal Reserve Bank, are able to exercise a dominance on the committee.

The Administration's efforts to strengthen the public control of the Board suffered a defeat in 1935 and, as a result, the Board and the open market function were further removed from Administration control and influence. In addition to the 1935 legislation, subsequent developments have strengthened the control of the System by the banking community.[33] The president of the New York bank, for example, was made a permanent member of the Open Market Committee in 1942. This appointment became effective on March 1, 1943. Thus, the New York bank now conducts the open market operation in its entirety. The

[32] H.R. 7617 was reported from the House Banking and Currency Committee on April 19, 1935, H.R. Rep. No. 742. It passed the House May 9, 1935, by a record vote of 271 yeas to 110 nays. On May 10, 1935, the bill was introduced in the Senate and referred to the Senate Committee on Banking and Currency. 79 Cong. Rec. 7281 (1935). It was reported favorably by Chairman Glass on July 2, 1935, with an amendment. 79 Cong. Rec. 10588 (1935). The amendment changed the Open Market Committee provisions of the bill to include not only the Board of Governors, but also five representatives of the Federal Reserve banks which in the House bill were to act in an advisory capacity only. On July 26, 1935, the bill, with the Federal Open Market Committee amendment intact, was passed by a voice vote. 79 Cong. Rec. 11935 (1935). On August 19, 1935, the Conference Report, which included the Senate provision, was agreed to by a voice vote in both Houses. 79 Cong. Rec. 13711, 13655 (1935).

[33] The Voting Record. On September 18, 1913, the Federal Reserve Act was passed by the House with only two Democrats voting against it while 248 voted for it. On the other hand, eighty-one Republicans voted against it with only twenty-five voting for it. 50 Cong. Rec. 5129 (1913). In the Senate, forty-seven Democrats voted for it with none voting against it; thirty-four Republicans voted against it with only six voting for it. 51 Cong. Rec. 1230 (1913). It will be recalled that Aldrich, a leading New York banker, and other representatives of the large banks had proposed a system that was completely independent of the

eleven other banks conduct no open market activities; they are mere service centers for check-clearing and similar functions. They do not even know their condition until the New York bank sends them a telegram to advise them: It is the New York bank which assigns to the other eleven banks their shares of the portfolio of government bonds held by the Committee. These bonds, of course, are the basis for the earnings of the various banks. Detailed questioning of the bank presidents during the 1964 hearings held by the Banking and Currency Committee revealed that most of the bank presidents did not even know how the allocation of the portfolio or its income is determined. For this function is handled completely in New York, and the other eleven banks are merely passive recipients.[34] This practice is particularly indicative inasmuch as the original Federal Reserve Act did not mention the New York bank. Instead, it contemplated taking the money market out of New York and decentralizing it to the twelve regional banks, the sole overall coordination coming from Washington.

These developments in the history of the Federal Reserve System, all of which were made possible by the inaction or indifference of the Congress, placed the Federal Reserve System well beyond the reach of the people and their elected Representatives. It became an autocracy and it has so remained. This transformation to autocracy was accomplished through a number of steps which looked small or harmless to most people at the time. But each step led eventually to the control of the central bank by private commercial banks. As indicated above, it was the clear intention of the founders that the System be run by public officials and completely in the public interest.[35] But the banking com-

Government. Consequently, there was fear that the final version of the Act, moderate as it was, might be too effective in reducing banker control. In the vote on the Conference report in the House 248 Democrats voted for the bill with only two against it while forty Republicans voted for it with fifty-eight against it. 51 Cong. Rec. 1464 (1913). In the Senate, thirty-eight Democrats voted for the Conference Report with none voting against it. On the other hand, twenty-five Republicans voted against the bill with only three voting for it. 51 Con. Rec. 1488 (1913).

The 1935 legislation evidenced a similar voting pattern. House bill, H.R. 7617, which would have vested the open market function in the Board and therefore kept it more closely under public control, was passed by a vote of 271 to 110. Two hundred and sixty-two Democrats voted for it, and eleven against it. Only three Republicans voted for it, and ninety-six were against it. 79 Cong. Rec. 7270 (1935). However, the bill was changed in the Senate in order to bring the Reserve bank presidents back into the open market picture, and this version stayed in the Conference report. With these added assurances of continued banker influence in the system, the Republicans no longer opposed the bill and, when the Conference report came before the Senate, only three voted against it. 79 Cong. Rec. 13655 (1935). It is also of interest to note that the House Joint Resolution, H.J. Res. 27, passed by the Eightieth Congress and which later became the Twenty-Second Amendment to the Constitution had overwhelming Republican support. One of the effects of this legislation was to further insulate the Board members from presidential control. As indicated elsewhere in this article, a President must stay in office for two terms before his influence will be felt by the Board. The vote on this resolution in the House on February 6, 1947, showed 238 Republicans as opposed to forty-seven Democrats for the bill. One hundred and twenty-one Democrats voted against it without a single Republican dissent. 79 Cong. Rec. 872 (1947). A month later in the Senate, forty-six Republicans and thirteen Democrats voted for the bill. Twenty-three Democrats voted against it, and, again, not one Republican voted against it. 93 Cong. Rec. 1978 (1947). The proposals suggested in this article will probably arouse similar opposition from the Republicans in the Congress.

[34] The strength of the New York Bank president's position is further indicated by the powers granted to him by the Federal Reserve Act.

[A] Federal Reserve bank shall have power . . . to appoint by its board of directors a president, vice presidents, and such officers and employees as are not otherwise provided for in this Chapter. . . . The president shall be the chief executive officer of the bank and shall be appointed by the board of directors, with the approval of the Board of Governors of the Federal Reserve System, for a term of five years; and all other executive officers and *all employees of the bank shall be directly responsible to him.* (Emphasis supplied.)

12 U.S.C. § 341 (1964). Thus, the president of the New York Bank maintains a commanding position in the Federal Reserve System.

[35] The following quotations from the House and Senate debates on the original Federal Reserve Act provide further documentation of the intention of Congress in establishing the System:

Mr. Glass (Dem., Va.) quoting President Wilson:

> And the control of the system of banking and of issue which our new laws are to set up must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative. 50 Cong. Rec. 4643 (1913).

Mr. Glass (Dem., Va.):

> The danger which the banking community professes to see is not the real danger which I apprehend. The bankers seem to fear that men of their craft will be excluded; but the real peril of the provision is the possibility of too many bankers being included. 50 Cong. Rec. 4645 (1913).

Mr. Korbly (Dem., Ind.):

> We have created these 12 banks, partly in control of bankers, in conjunction with Government officers, and then we have practically put these 12 banks under the control of the Federal reserve board, which is altogether a Government office, and we propose that this board shall see to it that the prescriptions of Congress shall be obeyed. 50 Cong. Rec. 4663 (1913).

Mr. Murdock (Progressive, Kansas):

> The measure places the central conventional control of reserve banks in the hands of the Government, a proposition which the bankers themselves very strenuously op-

(Continued)

munity has never accepted this principle and, today, while the tide of battle has varied, the private banking community clearly has the upper hand.

Throughout the 1920's, these differences were acute. In the course of the 1935 revisions, there were a number of eloquent exhortations by Senator Borah,

(Continued)
posed until a guardian advisory committee of bankers was added to the central governmental board.

This addition weakened the original proposition, but as the amended governmental control stands, even though it prove feebly formal, it carries the promise of the ultimate actual control by the Government, and this promise alone warrants a supporting vote of the whole measure. 50 Cong. Rec. 4664 (1913).

Mr. Phelan (Dem., Mass.) :

The supreme oversight and control of the whole system, however, is vested in a board representing the public. Thus the bill renders unto the bankers what is the bankers', but positively and definitely secures to the public what belongs to the public. 50 Cong Rec. 4673–4 (1913).

Mr. Borland (Dem., Mo.) :

Either the control of credits and money must be turned over to the banker or it must be retained in the hands of the people of the United States and their representatives. The Glass bill does not make the national reserve board a corporation. It is simply a board of public officials similar to the Interstate Commerce Commission or any other governmental agency through which the people exercise administrative control. 50 Cong. Rec. 4731 (1913).

Mr. Quin (Dem., Miss.) :

I want to say to you, gentlemen, that the people want the Government to control the banks under this bill, but the special-privilege crowd are all exceedingly anxious that the banking fraternity should control the board. I stand for the rights of the people of this country, and I am voting for them to control through the President and the Senate, for the people in the final analysis are financially responsible for every dollar of this currency. 50 Cong. Rec. 4763 (1913).

Mr. Seldomridge (Dem., Colo.) :

We have reached the parting of the ways in this legislation. We must either give the power to regulate our financial system to private and special interests or else we must confine it exclusively to governmental supervision and discretion. The Democratic Party will never permit this great function to be exercised through other than governmental agencies. On this declaration it stands fearless and unafraid. 50 Cong. Rec. 4708 (1913).

Mr. Barkley (Dem., Ky.) :

Mr. Chairman, we hear much criticism from the Republican side of this House and from some of the larger bankers of the country because it provides for a Federal reserve board, to be appointed by the President of the United States. Those who have criticized this provision of the bill upon this floor and elsewhere claim to fear that by reason of the fact that this board shall be appointed by the President, it will therefore be a political board and may use its great powers for political purposes.

There is not a governmental function with which we have to do today that is not a political function. There is not an act of Congress, nor an order of the executive department, nor a decision of the courts, from the smallest to the highest, that is not a political function, for the real definition of "politics" itself is "the science of government," and the definition of the word "political" is simply "pertaining to or having to do with the science of government." It is therefore impossible for any function of the Government to be performed that is not a political function.

Mr. Hayes. "Mr. Chairman, will the gentleman yield?"

The Chairman. "Does the gentleman yield?"

Mr. Barkley. "Yes."

Mr. Hayes. "I would like to ask the gentleman if he claims that all of the powers of the Government are exercised as a matter of partisan politics?"

Mr. Barkley: "No, sir; I do not. And that is where the gentleman fails to distinguish between the terms 'political' and 'partisan.'"

Mr. Hayes. "I would like for the gentleman to distinguish between 'partisan' and 'political.'"

Mr. Barkley: "I appreciate that difference. That is where the critics make their mistake. They take it for granted they are the same, which is largely true of the so-called Republican Party."

"The President does not control the action if the reserve board after they are appointed any more than he controls the action of the Interstate Commerce Commission after he appoints its members." 50 Cong. Rec. 4789 (1913).

Mr. Helvering (Dem., Kansas) :

The issue and control of money is too intimately connected with the welfare of every inhabitant of the United States to leave it in private hands, and while the banker is a most important cog in the economic life of the Nation, yet his powers are so great and his opportunities for good or evil so many that it is absolutely necessary that he should be the servant of the Government in dealing with the people instead of a separate and independent entity. 50 Cong. Rec. 4800 (1913).

Mr. Collier (Dem., Miss.) :

One of the most serious objections to the Aldrich plan of currency reform was that it contemplated placing this control in the hands of the bankers themselves. I would never agree to support such a proposition. I would never be willing to place this power, this control, in the hands of the bankers or the lawyers or the merchants or any other set of men. Human nature is too strong in the best of us to permit such power to be vested in private hands. This power should properly be placed under the control of the Government itself—under the control of a Government placed into power by the ballots of the American people and responsive to the will of that people. 50 Cong. Rec. 4805 (1913).

Mr. Gray (Dem., Ind.) : "I believe that the issue of money and its control and distribution is a vital public function which should be exercised only by the people themselves through the instrumentality of government." 50 Cong. Rec. 4821 (1913).

Mr. Graham (Dem., Ill.) :

The ordinary banker devotes very little of his time to a study of financial system. He devotes himself rather to the immediate management of his bank, such as deter-

Senator LaFollette, Senator Thomas, Representative Goldsborough, and a host of other prominent public figures, pleading for public control of our monetary system.[36] These men were concerned basically with one thing Congress had not

mining the soundness of the paper he discounts, the character of the loans and investments made for the bank, and all that. In fact, he is so close to this part of the field that it is quite difficult for him to have a clear and disinterested view of the entire field. 50 Cong. Rec. 4843 (1913).

Mr. Neeley (Dem., Kans.):

The failure of this plan would be directly charged to the administration in power, and justly so. Therefore in installing it and in its future ministrations, no matter what political party may be in power, it should be directed by those who are in sympathy with the administration charged with the responsibility of its proper conduct. 50 Cong. Rec. 4845 (1913).

Mr. Wilson (Dem., Fla.):

Objection is made by the opposition to this bill, claiming it would give the President too much power in appointing the Federal reserve board. The bill provides these appointments shall be made with the advice and consent of the Senate. They also claim this board would be under political control. Political control is governmental control. Who constitutes the Government in this country? The People. Do you want to deny the people the right to govern themselves? 50 Cong. Rec. 4855 (1913).

Mr. Gray (Dem., Ind.):

Money is the most vital of all public agencies, and as such vital public agency it should be held in the full and complete control of the public, all the people—its issue, volume, and its distribution, to insure its availability to all the people equally and impartially for their use. Such a public function should never rest in the control of private or selfish interests, to be made the subject of monopoly and concentration into the hands of a few. The provisions of the Glass bill place such control where it properly belongs—in the Government—to be administered by the sworn and chosen representatives of the people.

The unrestricted power to issue money carries with it the power to control the volume of currency, and thereby the power to fix prices of all products, commodities, services, and property, and of all values as measured in money. To surrender this power to private control would be to surrender the most potent and vital authority of the Government—the control of money and the virtual control of the welfare of the people.

Give me the absolute power to control the volume of money and I will control the destinies of this Nation more fully and completely than the exercise of arbitrary power by a czar. . . .

This House is under political control, the Senate is under political control, the Executive is under political control. . . .

Political control means the rule of the people, and it has terrors only for those who are afraid of and recoil from the rule of the people. 50 Con. Rec. 5038 (1913).

Mr. Brown (Dem., W. Va.): "Under the proposed system, however, the appointees on the Federal reserve board must be confirmed by the Senate, and the majority of the board must retire when a new President is elected. In this way the people have the power to ratify or reverse the policy of any administration at the end of every four years." 50 Cong. Rec. 5107 (1913).

Mr. Underwood (Dem., Ala.).

The rock on which our friends on the Republican side have broken when they attempted to pass their monetary legislation through this House in the last 16 years has been the fact that they have attempted to put the control of the system that they advocated in the hands of the men who loan the money and not in the hands of the representatives of the people who borrow the money. 50 Cong. Rec. 1459 (1913).

Mr. Reed (Dem., Mo.):

The banks have contended that they are entitled to be represented upon the Federal reserve board. I utterly deny it. They are on one side of the table; the Government of the United States, representing the people of the country, is upon the other. The bankers represent those who demand, who ask, rights from the Government. They come to the Federal reserve board making their demands and proffering their requests. No man should sit upon that board unless he represents the people of the United States—the people of the United States alone—for it is their money and their credit which is to be granted. 51 Cong. Rec. 179 (1914).

Mr. Weeks (Repub., Mass.): "And the control of the system of banking and of issue which our new laws are to set up must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative." 51 Cong. Rec. 538 (1914).

Mr. Hollis (Dem., N.H.): "But the Federal reserve board should represent the Government solely. They should control broad questions of policy concerning which individual interests might tend to favoritism and abuse." 51 Cong. Rec. 783 (1914).

Mr. Borah (Repub., Idaho):

It cannot adjust itself to an industrial life grounded in inequality; it cannot be fitted to monopoly; though strong enough to destroy, it can never be powerful enough to regulate monopoly. These things we ought to realize and cease our efforts to adjust our Government to the centralizing, monopolizing tendencies of business and compel business to adjust itself to the fundamental principles of democracy. This Government should assert its power and exert its prerogatives, and nowhere is it more essential and vital that it do so, than in the complete regulation and control of the money and currency of its people. Everything that performs the functions of money, whether technically money or not, should come under this control. 51 Cong. Rec. 1071–2 (1914).

Mr. Norris (Repub., Nebr.): "I did believe, and do believe, that the banking and currency system and the banks organized under the system ought to be under Government control." 51 Cong. Rec. 1136 (1914).

[36] Mr. Borah (Repub., Idaho): "To regulate the value of money is the function of the Government by the express terms of the Constitution. It ought not to be delegated to private interests." 79 Cong. Rec. 11909 (1935).

Mr. LaFollette (Progressive, Wisc.)

[T]itle II does not go as far as I believe it should. It is my firm conviction that we must have a complete control of credit and monetary policies in the public inter-

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realized in 1913, the immense potential of the monetary power. They did not realize a central bank could control the money supply and influence the entire spectrum of interest rates through its absolute control of the reserves of the banking system. This was not realized until long after 1913. Eventually, however, it became apparent that the central banking function was the most concentrated, single economic power in modern society; and that, in a democracy, it must be employed for the social good, kept under complete public control, and completely coordinated with the other broad economic policies of the Government. Nevertheless, the 1935 Act made a central bank out of the Federal Reserve System, further removing the System from public direction and control.

It is ridiculous for the President of the United States to be overruled by the Federal Reserve Board without any preliminary advice and to be forced to resort to the forum of public opinion to try to keep an arrogant central bank in line. It is an absurd and dangerous situation. The proponents of private control have cynically distorted the basic reasoning behind the Act. They persist in arguing, as Mr. Martin has done even before the Banking Committees of the Congress, that the Federal Reserve System must be protected from political control.[37] In effect, the System must be left in private hands, beyond the reach of the elected representatives of the people. It is perfectly legitimate, they argue, that the vital powers of taxation and the issues of war and peace remain in the hands of the elected representatives, but not the monetary powers. And this they argue in spite of the clear constitutional mandate vesting the monetary powers in the Congress.

It is inevitable that the Federal Reserve System will necessarily reflect the bias of the people who control and dominate it. Interest rates are the bankers' income; and the higher the interest rates, the more the lender receives. Bankers live

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(Continued)

est. . . . I find myself in complete disagreement, therefore, with the recommendation of the Senate committee that the banker representation upon the open market committee should have full and equal power, so far as their individual votes are concerned, with the members of the newly constituted board. 79 Cong. Rec. 11914 (1935).

Mr. Thomas (Dem., Okla.)

I suggest the advisability of congressional legislation fixing a definite tribunal, and it should be, in my judgment, the Federal Reserve Board to regulate the value of the dollar. Today it is being regulated by influences outside of the public service. In my judgment the value of the dollar is being regulated by the Federal Reserve Bank of New York City. It is my purpose to get that power out of the Federal Reserve Bank of New York City and into some federally owned and controlled institution. 79 Cong. Rec. 11925 (1935).

Mr. Goldsborough (Dem., Md.)

At this time the banks themselves practically control the monetary policy of the country, and this [the open market provisions] changes all that. That is what this racket is about, that is why the subsidized press tells us that there is something wrong with the bill. They call it a political bill. They say that we are setting up a political board.

It is exactly the opposite. . . . Now it is the Governors of the Federal Reserve Banks who control the open market policies of the Federal Reserve Banks. This bill places their open market policies under the control of an independent board, the Federal Reserve Board, which is not dependent at all upon the banks. 79 Cong. Rec. 6653 (1935).

Mr. Martin (Dem., Colo.)

That the monetary system of the country has been privately controlled for the benefit of the banking system of the country and not in the interest of the people generally. I believe the time has come to curb that system and that it would be nothing less than a hollow gesture to pass a law here that would still leave the same control in the banks over the money and the credit of the country that has existed up to this time and that exists now. 79 Cong. Rec. 6733 (1935).

Mr. Ford (Dem., Cal.)

What this bill aims to accomplish is to give back to Congress its constitutional function to "coin money and regulate the value thereof." This function was long ago surrendered to the privately owned banks and has been tenaciously held by them to the detriment of the people.

Prior to the creation of the Federal Reserve System, the responsibility for the monetary and credit policies of the Nation was in the hands of a powerful group of New York banks. The reserves of the entire Nation, through the correspondent system then in vogue, were in the hands of this powerful group.

It was this Money Trust which made apparent the necessity for the Federal Reserve System.

One of the shortcomings of the act was that it left in the hands of the Federal Reserve banks the control of open-market operations, one of the most powerful of the levers for the control of monetary and credit policy. The bill before us seeks to remedy this defect by placing the control of open-market operations in the hands of the Federal Reserve Board. 79 Cong. Rec. 6802 (1935).

[37] See generally, *Hearings Before the Subcommittee on General Credit Control and Debt Management of the Joint Economic Committee*, 79th Cong., 2d Sess., Vol. 1, 86–87 (1952); *Hearings Before the Subcommittee on Domestic Finance of the House Committee on Banking and Currency*, *supra* note 18, vol. 1, at 536–37, 693; *Hearings Before the Joint Economic Committee on the January 1965 Economic Report of the President*, *supra* note 4, pt. 3, at 46.

on debt. If there is no debt, there is no money, no interest, and no income. Bankers want only high-grade, low-risk debt paper, especially government bonds. In fact, the one thing they do not want is Government reduction of the public debt.

Professor John Kenneth Galbraith, testifying before the Joint Economic Committee on February 24, 1965, stated that "it is hard to recall any occasion when the Federal Reserve was known to be agitating for lower interest. . We have come to envisage the Open Market Committee as a group of men of excellent character and reassuring demeanor who meet to consider whether there is good reason for tighter money."[38] Professor Emeritus Seymour Harris, testifying on the same day, stated:

> Financial groups seem to believe that the higher the price of their product, the more profits. They exercised excessive influence in th 1950's when long-term rates rose by two-thirds. But, in my opinion, they will do better with lower rates. Their attitude toward restrictive monetary policy since 1961 only strengthens the case for the exclusion of the Federal Reserve bank presidents from the Open Market Committee. .[39]

Both of these eminent economists again testified publicly in December 1965 on the issue of the Federal Reserve Board's raising the discount rate.[40]

The type of quasi-private exercise of public power manifested in the Federal Reserve System is completely improper in a modern democracy. History indicates the control of monetary power by private groups has had adverse consequences for mankind. It is most unsound and actually dangerous for us in the United States to permit the volume of money and the level of interest rates—the two

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[38] *Hearings Before the Joint Economic Committee on the January 1965 Economic Report of the President, supra* note 4, pt. 2, at 11.

[39] *Ibid.*

[40] Prof. John Kenneth Galbraith, December 15, 1965:

And this problem [coirdination of economic policy] can be solved very simply by giving the ultimate authority to the President of the United States, where it belongs. The point I am making is that . . the ultimate responsibility—lies with the Secretary of the Treasury, Council of Economic Advisers, Bureau of the Budget, and, also, with the Federal Reserve. If the system of economic management which we have then allows six members of the Federal Reserve who have not attended these meetings, have not participated in this discussion to exercise arbitrary independent power to overthrow the decisions reached by the previous group, this is a very poor form if coordination. It is indefensible. *Hearings on recent Federal Reserve Action, supra* note 6, pt. II at 331.

The world in which the Federal Reserve System was born, apart from some romantic echoes in the rescripts of the modern conservatives as they are called, is now gone and forever. . . . The Government now acts to insure expanding output and stable prices. The central bank plays a subordinate but integral role in this policy. To such coordinated management . . . we owe the steady expansion and the steady prices of the last five years. . . The imperatives of coordinated economic administration have required all countries to bring their central banks fully under government control. . . Most Americans regard successful management of the economy as an imperative. They do not react well to unemployment, depression or stagnation. The right of the Federal Reserve to independent action has survived only because it has not interfered with that management—because it has not been used. *Hearings on recent Federal Reserve Action, supra* note 6, pt. II at 308–09.

I do not wish to be unfair to these excellent and indispensable gentlemen [the bankers]. Perhaps they have persuaded themselves that the money is, in their case, unimportant. But it should be observed that an increase in interest rates is the only form of inflation control that ever appeals to the financial spokesman. Increased taxation is not urged. The wage and price guideposts evoke no applause. And also, alas, one must notice that the stock market did not misunderstand the recent increase in interest rates. It prompted mark ups of banks' stocks on the over the counter market. If I am wrong, if the banks are only interested in higher interest rates for their public benefit, these capital gains must be most embarrassing. *Hearings on recent Federal Reserve Action, supra* note 6, pt. II at 313.

Prof. Seymour Harris, December 16, 1965:

Federal Reserve independence is an insane idea. Even in less troubled times, it is folly to allow the Federal Reserve to run in one direction and the Executive in another. I have never had much sympathy with the theory of independence. Particularly in these troubled times the Government certainly should not move in one direction and the monetary authority in another. The latter has every right to push its views before Government decides on a policy. But once the decision is made monetary policy must be an instrument of Government policy, not a barrier to its achievement.

Who wants higher rates here? Primarily European bankers because they are unwilling or unable to control their inflation; and American bankers who want higher prices for their product, and more profits. But the banking system and the Fed should serve the public not the banks *Hearings on recent Federal Reserve Action, supra* note 6, pt. II at 356-57.

As for the American bankers, they are simply interested in raising the price of the pr[illegible] they sell. Their profits are high and rising; but they want market forces, with [illegible] from the Fed. to raise their profits even more. Somehow they do not seem to realize that a high money rate will reduce the national product and hence even at higher prices cut into banker's profits. *Hearings on recent Federal Reserve Action, supra* note 6, pt. II at 359.

basic determinants of our economic destiny—to remain under the control of an institution which is independent from the executive branch and from the Congress, and which is oriented toward the banking community. The welfare of the nation is at the mercy of a group which is beyond public control and which openly boasts of it. In fact, it asserts that the people, through their elected representatives, cannot be trusted to exercise their own monetary powers, in spite of the fact that the Constitution vests these money powers in the Congress of the United States.[41] This is not simply a question of proper government structure. The country has paid a high economic price for permitting the Federal Reserve System to control our money supply independently of the United States Government. It is a fact of economic life that the creation and the management of money are prime determinants of employment, wages, prices, indeed, of the prosperity and well being of the entire nation. Indirectly, these powers affect the deficits, the debt, and the interest burden of the federal government, as well as those of every governmental unit in the nation.

It was the Employment Act of 1946, with which the author was intimately acquainted, that set forth the basic economic objectives of our society—maximum production, purchasing power, and employment. The present Chairman, Mr. Martin, recognizes the mandate of this Act. It was his interpretation that the Employment Act gives him the power to take such action as he thinks desirable to promote maximum production or stability, as the case may be. The following colloquy from the 1957 Hearings of the House Banking and Currency Committee on the Financial Institutions Act of 1957 is very interesting in this regard:

> The Chairman: When we delegate power to an agency, without any standards or limitations or definitions or restrictions, it is a legislative power that we delegate.
>
> Mr. Martin: That is what I conceive..
>
> The Chairman: We have delegated that to the Federal Reserve.
>
> Mr. Martin: That is correct, sir.
>
> The Chairman: Without restrictions or standards.
>
> Mr. Martin: Oh, yes, indeed.
>
> The Chairman: We might delegate power with standards, and within the scope of the power delegated to the Board, it would have great freedom of action.
>
> Do you think it would be feasible and practical to legislate for the Federal Reserve Board certain objectives which they are to attain?
>
> Mr. Martin: Well, I think they have said to us that we are to attain certain objectives. I think the Employment Act of 1946, to which I subscribe, gives us certain objectives—maximum production, maximum purchasing power. I think we have got to do everything we can, use the resources of the Government to attain those ends.
>
> The Chairman: Do you think you could attain a uniform price level, a stable interest rate?
>
> Mr. Martin: I don't think you can do it precisely, but yes, sir, I think that it is possible to have price stability if you have competition in the economy and you have reasonable restraint on the part of businesses and individuals, and you reduce spending and increase saving, when it is in imbalance that way, or the reverse—when it is in imbalance the other way—I believe it is quite possible to attain those objectives. I accept the objectives that we are trying to reach, and the point I have constantly made is that under present conditions the only way we can hope to attain the objectives of the Employment Act is by resisting inflation, and by resisting inflation, I mean dealing with this problem of the cost of living, which for eight successive months has risen, and I think it is something that has to concern all of us.[42]

Chairman Martin has chosen to intrepret the Act as empowering him to take whatever monetary action he judges desirable to obtain the objectives of the Act as he interprets them. But this is not the proper interpretation. As indicated above, monetary policy has been coordinated with the general economic policy of the nation.

Tight money is closely related to a high interest rate; and, when money gets too tight, the economy slumps. This nation suffered three recessions in the decade

[41] U.S. Const. art. I, § 8.
[42] *Hearings Before the House Committee on Banking and Currency,* 85th Cong., 1st Sess., pt. I, 68–69 (1957).

of the 1950's, each of which was preceded by a deliberate tightening of money and raising of interest rates. It is important to note that under our system, the final stage in the creation of money is performed by commercial banks when they lend to borrowers. In this way, the money supply is tied to the creation of debt. Obviously, when people have to pay too high a price to borrow, they reduce their business operations and forego previously planned expansion. This results in lower spending and lower production; employment falls and deficits rise at all levels of government. The overall result is that economic growth is stunted. The only people who benefit from tighter money and higher interest rates are bankers. Interest rates, after all, represent their income, and it is not strange that they wish to take in as much income as possible.

Unfortunately, we have permitted the banking community to control our basic monetary policies. When we consider that banking is not as competitive as other industries and that it is, moreover, threatened by a virulent merger movement, it becomes clear that the oversights of the Congress have permitted an autocracy to develop and flourish.

It is striking to examine the rise in interest rates in the past fifteen years since the Federal Reserve Board asserted its independence by refusing to cooperate with the Treasury in supporting the government bond market. In this period, interest rates on long-term government bonds have more than doubled and the annual burden of the national debt to the taxpayers has risen from about six billion dollars to twelve billion dollars. Interest rates on short-term obligations of the United States have sky-rocketed from one-eighth of one percent during the height of World War II to four percent today, practically as high as the interest on long-term bonds. As a result of this increase, the Government now has to pay thirty-two dollars in interest for every one dollar it would have paid under World War II rates. The yield on long-term United States bonds at the time of writing is four and forty-five hundredths percent, dangerously beyond the statutory ceiling [43] which has been in effect for almost fifty years.

RECENT DEVELOPMENTS

On December 5, 1965, the Chairman and a majority of the Federal Reserve Board openly defied the President of the United States and raised the discount rate, thereby triggering a general rise in interest rates. This occurred at the very time when the President and the Secretary of the Treasury were taking great pains to make it clear that they were pursuing a policy of price and interest rate stability in order to keep the economy on the prosperous course that had prevailed for the preceding five years. This event illustrates the manner in which the Federal Reserve Board can force the hand of the President and of the Congress, and shape the structure of our economy to suit itself. If there were, in fact, any danger of inflation, it could have been countered in any one of several ways: by raising taxes, by reducing government expenditures, or by tightening money. When the Board tightened the money supply, it cut down the options available to the elected Government of the United States. Many observers overlooked the extensive nature of the Board's action. The increase, however, from four percent to five and one-half percent on thirty to ninety day paper is a rise of thirty-seven and one-half percent. These increases result in millions of unbalanced famiy budgets. This distressing situation is the fault of the Congress. It is the failure of Congress to exercise its responsibilities in the field of money that has permitted the bankers to control the fundamentals of our money system.

CORRECTIVE LEGISLATION

At the beginning of the 89th Congress, the Omnibus Federal Reserve bill, H.R. 11, was introduced by the author. It was preceded by very extensive hearings in the previous Congress during which expert testimony was received from economists, lawyers, bankers, political scientists, and others. The bill is designed to correct the principal defects in the Federal Reserve System and restore it to its proper position. The bill would accomplish this in a number of ways.

First, it would emphasize the public character of the Federal Reserve System by providing for the retirement of the existing Federal Reserve stock which, for many years, has given rise to the spurious impression that the member commercial banks own the Federal Reserve System. Actually, the stock, which is

[43] The Second Liberty Loan Act of 1917 set the statutory ceiling for long-term Government bonds, maturities of five years or more, at 4¼%.

owned by the member banks, cannot be transferred or sold and is clearly a fixed-income, nonproprietary asset. Retirement of the stock will remove any doubts about the System's belonging to the Government and eliminate the notion that it is only "allied to Government," a phrase used by one of the Federal Reserve officials during a Banking Committee hearing.[44]

Second, it would place the open market powers in the Federal Reserve Board. The independent status of the Open Market Committee and its continued performance of crucial monetary functions are untenable in a modern democracy. As indicated in the first part of this article, there is no basis in law or in fact for having the open market function performed by a mixed body of Federal Reserve Governors and Federal Reserve bank presidents. Moreover, the correction of this situation would go a long way toward ridding the Federal Reserve System of its chronic tight money bias and inflation psychosis.

Third, it would make the Federal Reserve System more responsive to the President by reducing the membership of the Board to five, by reducing the terms of office of the Governors to five years, and by making the term of the Chairman of the Board of Governors coterminous with that of the President. Under the present arrangements, a President does not have an opportunity to appoint a majority of the Federal Reserve Board until his eighth year in office. He is, therefore, unable to count on a Board that is sympathetic and responsive to him. President Johnson will have to retain the seven present Governors until January of 1967. At that time one term expires; the next term expires in January, 1968. Mr. Martin will continue as Chairman until 1967. And, significantly, the President, under existing law and regulation, will have to pick his Chairman from among the seven Governors then on the Board.

Fourth, it would insure public control over the expenditure of public money by requiring the Federal Reserve System to pay into the Treasury as miscellaneous receipts all the revenues which it receives, by providing a public audit by the Comptroller General of all expenditures by the Board and the banks, and by requiring that Congress authorize appropriations to defray the expenses of the Federal Reserve Board and the banks.

Fifth, it would assure coordination of governmental economic policies by requiring the President to set forth in his periodic economic reports the monetary policies to be followed by his Administration and by providing that the Federal Reserve Board report regularly to the Congress on its activities implementing the President's economic politics.

As members of the legal profession will readily discern, this legislation is aimed at the so-called "independence" of the Federal Reserve System. It is designed expressly to return control of our monetary policy to the President of the United States and to the Congressmen who are responsible to the will of the people. The people can remove a Congressman or a President if they disapprove of his actions; but they cannot dislodge the members of the Board of Governors of the Federal Reserve from office, regardless of the mistakes they make.

In theory, the Federal Reserve Board should be an agency of the United States government. Readers will recall, however, that the law requires that an agent assume a special relationship toward his principal:

> It is the duty of an agent in all transactions concerning or affecting the subject mater of the agency, to act with the utmost good faith and loyalty to further the principal's interests.
>
> It is an agent's duty to adhere faithfully to all instructions given him by his principal, and a failure or neglect to do so will serve to make the agent liable for any loss or damage which may result therefrom.
>
> Agency presumes subordination on the part of an agent to the principal.[45]

Needless to say, no such relationship exists between the Federal Reserve Board and the federal government at the present time.

In summary, I would like to make it clear that the Federal Reserve System, as it presently operates, is harmful to the best interests of the people of this country. As has been shown, the Federal Reserve System was not designed to be independent. It merely assumed and seized its present position. Furthermore, this situation has continued because Congress has not retained supervision over its delegated monetary powers, not even to the extent of clearing the annual

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[44] *Hearings Before the Subcommittee on Domestic Finance of the House Banking and Currency Committee, supra* note 18, vol. 1.

[45] 3 C.J.S. Agency §§ 138, 147 (1936).

budget for the Federal Reserve System, appropriating its funds or auditing its transactions.

As indicated above, for the first twenty-two years of its life, the Federal Reserve System did not really have control over the money supply, nor was it designed to have such control. This was made clear in the Report of the House Committee on Banking and Currency on the Federal Reserve Act. In speaking of the Act as reported to the House, Chairman Carter Glass said:

> It it proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no way attempt to carry on through its own mechanism the routine operations of banking which require detailed knowledge of local and individual credit and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine.[46]

It is now time to remedy the present situation by appropriate legislation placing the Federal Reserve System into the position envisioned by the Congress when it first enacted the Federal Reserve Act.[47]

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WHAT'S WRONG WITH THE FEDERAL RESERVE AND WHAT TO DO ABOUT IT

By Wright Patman*

> The Federal Reserve System got off on the wrong track when private banks were permitted to own stock in the district Fed banks, letting the tail wag the dog. Now the Fed's Open Market Committee has control of the banking system but operates in secrecy, while the Fed itself operates cavalierly, even with private auditors. It's time to curb the abuses of the Fed and reform the system.

As Chief Justice Charles Evans Hughes so well said, the Constitution means what the Supreme Court of the United States says it means. In our economy, how we fare depends crucially on what the Open Market Committee of the Federal Reserve System says. We have as much or as little money to spend as that committee dictates. Banks have an abundance or scarcity of reserves to lend depending on what it decides. The committee determines the volume of bank reserves and the nation's money supply, primarily by instructing the New York Federal Reserve Bank to buy or sell securities in the open market. When the New York bank buys, it adds to reserves and increases the money supply. When it sells, reserves and money supply fall.

The Federal Reserve also affects how much money banks can lend by fixing reserve requirements, specifying what fraction of deposits banks must keep in reserve. Lowering the requirement increases reserves available for loans. Raising it decreases availability of reserves.

In its exercise of these awesome powers the Fed has made serious mistakes, and the time has come for basic changes.

In 1912 a commission, headed by Nelson Rockefeller's maternal grandfather, Sen. Nelson Aldrich of Rhode Island, proposed a central bank controlled by the private banks, but Woodrow Wilson would have none of it. Putting on his best

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[46] House Committee on Banking and Currency, 85th Cong., 1st Sess., Report to accompany H.R. 7873. 18–19 (Comm. Print 1958).

[47] Lawyers must interest themselves in this important public policy question. For this reason, I wish to recommend to the legal profession the Report of the December 1965 Hearings on the Federal Reserve and a recent study of the $49 billion Federal Reserve portfolio, both of which were prepared by the Joint Economic Committee. These documents and those referred to in this article can be obtained from your Congressman or either of your Senators. I am sure they would be happy to supply you with any of the documents you may need.

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frock coat and breaking precedent by appearing in person before a joint session of Congress, President Wilson, along with Carter Glass and Robert L. Owen, then chairmen of the House and Senate banking committees, proposed a presidentially appointed Federal Reserve Board. Under this board there were to be independent regional banks, but bank lobbying forced him to compromise and allow private banks to hold the stock of the twelve district banks in the Federal Reserve System and to elect six of the nine directors of each.

To this day these bank-elected directors select the executive heads of each Federal Reserve district bank, formerly called "governors" but since 1935 "presidents," the title "governors" being reserved today for members of the Federal Reserve Board.

Although board members receive $40,000 and the chairman $42,500, these banker directors, without consulting with the president or the Congress, pay the president of the New York bank $90,000, Chicago $76,000, San Francisco $75,000, Kansas City $65,000. Saint Louis $64,000, Boston $60,250, Atlanta $60,000, Dallas $59,000, Cleveland $58,650, Minneapolis $56,500, Philadelphia $55,000, and Richmond $50,000. Paying these district bankers at the bottom of the system more than board members at the top has made board membership less attractive and, worse, robbed it of prestige.

Believing that the open market operations were for "bankers," not "politicians," Benjamin Strong, then "governor" of the New York bank, created the Open Market Committee in 1915 exclusively from the then district governors and persuaded them to allow the New York bank to buy and sell for all the banks. This ended Woodrow Wilson's dream of twelve independent regional banks. Ever since, the New York bankers have dominated Federal Reserve policy—a case of the tail wagging the dog.

Marriner S. Eccles, chairman of the Fed from 1934 to 1948 and himself a banker, blames Federal Reserve inaction during the depression in 1929–32 on "a narrow banking rather than a broad social point of view."

By statute in 1935, President Roosevelt and Eccles were able to put the seven board members on the Open Market Committee and compel it to meet in Washington, but they had to make the New York bank a permanent voting member, allow the presidents of all twelve banks to attend, and give them five votes.

In his recent book, *Managing the Dollar*, Sherman J. Maisel, professor of business administration at the University of California at Berkeley and a former board member, states that these district bank presidents, "twice removed from the democratic process" are "not strictly government officials." While they know bank operations, they are not qualified to pass on monetary policy, increase the size of committee meetings by twelve, delay board action for their arrival, or postpone it because of an early departure.

CONFLICT OF INTEREST OUTWEIGHS VALUE

Professor Maisel says that giving area member banks a stock interest in Federal Reserve district banks "makes no sense" and is "a vestigial and sentimental remnant of the system's beginning." In his opinion, whatever value the bank presidents have on the Open Market Committee is "more than outweighed by their conflict of interest." Because district bank presidents depend for the jobs and salaries on the commercial bankers of their areas, their presence on the committee violates the spirit, if not the letter, of 18 U.S.C. § 208. As Chief Justice Warren said so eloquently in the Dixon-Yates case, *United States* v. *Mississippi Valley Generating Company*, 364 U.S. 520 (1961), a conflict of interest arises "by the logic of circumstances" when a person must serve two masters.

The time has come to redeem the stock area banks own in the Federal Reserve district banks and allow the Federal Reserve Board, appointed by the president of the United States with the advice and consent of the Senate, to manage the nation's money.

While the Federal Reserve promptly announces changes in the discount rate and reserve requirements, it keeps secret the discussions as to why the Open Market Committee makes or does not make monetary changes and the orders it issues to sell or buy to the manager of the Federal Reserve's securities portfolio, who is an employee of the New York Reserve Bank.

Ninety days after a meeting the Fed publishes an enigmatic summary of its instructions, and five years later the minutes. Both come at a time when they are not much good to anybody. It is just now publishing the 1969 minutes. What we need is immediate release of the instructions and a transcript of the discussions telling us the reasons for and against the policy instruction.

In short, the procedure is all wrong. Bankers and bond dealers who have the most to gain find out from analysis of the buy and sell orders. It is only the public and the Congress who are kept in the dark.

Federal Reserve officials know that secrecy serves insiders. Governor Sheehan told Robert Weintraub, staff economist of the House Banking and Currency Committee, that "It's very difficult to find out really what the Fed is doing if you're not on the inside."

President Mayo of the Chicago district bank put it this way:

> . the market indeed does have a fairly full understanding as to what the factors are in monetary policy that are going to lead to specific steps by the Federal Reserve. This happens to be a product, in part, of the fact that many of these people who are in the market, and in the position of making markets, have at one time either worked in the Treasury or in the Federal Reserve. Indeed, there is also cross-fertilization the other way. So it is no great secret as to how you interpret what the Fed is doing and indeed is trying to do. A number of the leading writers in New York—the Lehman Letter, Lanston's Letter and so forth—are written by former Treasury, former Federal Reserve people, and they're very good in interpreting these things.

Professor Maisel states that the Fed pursues a policy of secrecy from "fear of political attack and public criticism." It is fundamentally wrong, he adds, because the more you publish about monetary policy at the time you make it, the better that policy is likely to be.

Over the years the Federal Reserve Open Market Committee has been buying United States bonds with currency it asks the Bureau of Engraving and Printing to print. It now holds more than $82 billions' worth of these bonds. It collects the interest, deducts its expenses, and gives the balance to the Treasury.

Down to the first Eisenhower administration these purchases only totaled about $26 billion, but purchases between December 31, 1952, and August 7, 1974, came to $56,481,660,000. During the chairmanship of Arthur F. Burns and from January 1, 1970, to August 7, 1974, the Open Market Committee bought $24,620,660,000.

The real vice is that as a result of its ownership of government bonds the Fed can spend as much as it pleases. If these bonds were cancelled, as they should be, it would have to bring its budget to the president and the Congress as every other agency does.

From the little information available to the congressional banking committees, I have come to believe that the Federal Reserve annually spends hundreds of thousands of dollars in a questionable way. This is one of the reasons why the House Banking and Currency Committee voted during the Ninety-third Congress when I was chairman of the committee to subject the Federal Reserve System to a limited audit by the comptroller general and the General Accounting Office.

Whether the purchase is table tennis balls for the Dallas district bank or an annex to its building in Washington, the Fed spends lavishly. Washington's new Mormon Temple cost $15 million, but the William McChesney Martin Building for six hundred employees not only wastes thousands of square feet but to date has cost more than $46 million. Compare its cost with the Dirksen and Rayburn buildings, which thousands use:

Martin:	
Square foot	$57.67
Cubic foot	4.52
Dirksen:	
Square foot	36.06
Cubic foot	2.52
Rayburn:	
Square foot	36.56
Cubic foot	2.45

What Federal Reserve did was to build, at taxpayers' expense, a marble monument to a former chairman who does not deserve the honor.

With this kind of extravagance you can appreciate why the Fed hires Touche Ross and Company as its private auditor and opposes an audit by the General Accounting Office. Yet, the need for audit is there. The Board itself spends more than $25 million a year, the twelve regional banks more than $400 million, and

Professor Maisel says open market foreign exchange transactions go into billions and sometimes result in large losses. The comptroller general audits much more sensitive matters at the Atomic Energy Commission and the Department of Defense, but no one has suggested that either of these should use a private auditor.

NONPOLITICAL FED MANIPULATES POWER

The ultimate irony is that the alleged nonopolitical Fed is one of the most astute manipulators of political power in Washington. Nowhere was this more evident than during the debate on the audit bill. Although Dr. Burns personally lobbied against it among members of Congress and Manhattan bankers, the House of Representatives approved the bill by a vote of 290 to 58. But the Senate, sad to say, did not act on the bill.

The American people cannot afford to allow an agency so important to our economy to operate in the dark as it pleases. The time has come to allow the comptroller general to audit all Federal Reserve operations.

In 1933, when the banks closed, we attributed their troubles primarily to their having security affiliates that were selling stock. When the financial history of recent times is written, the ills that now afflict banks will be attributed in no small measure to our allowing banks to be owned by holding companies.

The late Winthrop Aldrich wrote to me in 1969 that he was "horrified" that banks were becoming "conglomerates" and holding "completely unrelated" businesses. He saw it as a return to the evils of 1933. Then the only danger was that banking affiliates did not sell securities they brought; today the banks hold entire big businesses, many abroad, all requiring high-priced, competent personnel and millions in capital.

As in the 1920s, the banks today have become too deeply involved in businesses other than commercial banking. Worse, particularly overseas, they are making speculative long-term loans that only investment bankers should make.

In October of 1974 at the convention of the American Bankers Association in Hawaii, Dr. Burns pointed out that the Federal Reserve System "regulates all bank holding companies." What he does not say is that though this is the way the legislation reads, there has been no regulation of any consequence. Until recently the Fed has approved routinely the creation of bank holding companies and their applications for mergers or acquisitions. Lately a few have been disapproved. There has been no regulation worthy of the name.

The problems with bank holding companies are many and serious.

Theoretically, a bank holding company is a separate corporation, and the holding company's failure should not affect the bank. But, alas, for theory. When the holding company fails, as was the case with the Beverly Hills National Bank, there is a run on the bank that ends with its sale. This is for good reason. The management is the same, so that a lack of confidence in the holding company causes a lack of confidence in the bank.

Some owe as much as twenty dollars of debt for every dollar of capital. This is not all ordinary debt but commercial paper running into millions of dollars, sometimes with an average maturity of thirty days. The best holding company is in serious trouble the day it cannot roll over this debt.

There is also a great temptation for bank holding companies to go into the banking business by buying from their banks high interest loans, many of which are made abroad in countries as unstable and militaristic as Peru. Likewise, when they need to borrow money, there is a temptation for bank holding companies to sell their commercial paper to a bank owned by another bank holding company.

The difficulty is that the bank holding company is not a bank, and there are few restrictions on what it can borrow or lend and to whom. It does banking business without regulations or safeguards. Take a decision as to payment of dividends. While a bank holding company needs dividends from its bank to show a profit, it is sometimes cheaper to leave the dividends with the bank to loan out at high interest even though it obliges the bank holding company to borrow to pay its own dividends. The legality of that is open to question, but the Fed has not forbidden bank holding companies from paying dividends when not earned. It has simply done nothing about their regulation.

The tendency of bank holding companies is to think of themselves as corporate conglomerates, which they are not. And it is dangerous and misleading to consolidate the bank's balance sheet with that of the holding company. Worse, the directors, officers, attorneys, and accountants who act for both the holding company and the bank usually are the same. Yet there is a fundamental conflict of interest between the two that makes every transaction between them suspect. Because banks hold and invest other people's monies, their officers, directors, attorneys, and accountants should be independent.

RETURN COMMERCIAL BANKS TO COMMERCIAL BANKING

When Congress passed legislation regulating bank holding companies, these serious problems were not brought to its attention. Perhaps the time has come again to limit all commercial banking institutions, regardless of corporate form, to traditional commercial banking services. The truth is that we have not thought these problems through. In any event, the time has come to return commercial banks to banking and divorce them completely from holding companies.

Unfortunately, this is not simply a holding company problem. As Dr. Burns told the bankers in Hawaii, "some carelessness" has "also crept into our banking system." The good doctor is a master of understatement. Presumably he had in mind "the two largest bank failures in the nation's history"—the United States National at San Diego and the Franklin National in New York.

What is most disturbing in the failure of the United States National is that the Federal Deposit Insurance Corporation in an action against bank directors charges that more than $400 million of loans were made in contravention of sound, safe, and prudent banking practices; that loan officers were not supervised; that the records were inaccurate; and that the directors had no audit committee and illegally distributed dividends when there were no profits.

In an attempt to save Franklin, it now appears the Fed advanced $1.750 billion of the peoples' monies at 8 per cent interest against collateral of doubtful value. Some creditors of Franklin were paid who would not have been otherwise: for instance, banks which had advanced federal funds to Franklin in amounts upwards of $500 million, and some six thousand of its six hundred and twenty thousand depositors whose deposits were not insured by the Federal Deposit Insurance Corporation.

By what right, without consultation with the president and the Congress, do Dr. Burns and the Fed secretly dispense $1.750 billion of the people's money?

In sharp contrast, when in June of 1974 the largest private bank in Germany, Bankhaus I.D. Herstatt of Cologne, had foreign exchange losses and failed, the West Germans let it happen, causing the *Wall Street Journal* to remark editorially

> The Bundesbank believes that the public will have confidence in banks when banking is sound, and that banking diverges from "soundness" when those who run banks know there is a net under them The banking community here and abroad would now be in a more promising condition if the Fed had followed the lead of those West German Socialists. The Franklin National Bank should have been permitted to sink. victim of its excesses in "unauthorized currency trading." Its loan portfolio would have been peddled and its depositors paid off, and if there were anything left over, the shareholders would have divided that up.

The very morning this editorial appeared (August 8, 1974), Dr. Burns was testifying before the House Banking and Currency Committee, and in response to a question regarding the editorial from Rep. John H. Rousselot of California, said:

> In the case of Herstatt, the Germans had an insolvent bank; in the case of Franklin National, we had a solvent bank faced with a serious liquidity problem. That distinction is not made by the *Wall Street Journal* in its editorial. It is a very basic distinction.

Dr. Burns was mistaken. The comptroller of the currency, on whom he relied, also was mistaken. When the Fed, acting in recret on its own, decides to advance $1.750 billion, is it too much to ask that it be sure that the bank is solvent?

The Federal Reserve Board, led by Dr. Burns, once acted on its own to bail out banks that held Penn Central commercial paper. Now the newspapers tell us that the Fed is pressuring hundreds of banks to pick up a $600 million debt of W. T. Grant Company and a $130 million debt of Pan Am—acting again in secret without consultation with the president or the Congress.

As *Barron's* said editorially on December 9, this is "easy to credit" because "of the Fed's unbridled interventionism" but there are "issues of principle involved" because by "becoming Grant's partner" the banks "are diverting scarce credit from worthier borrowers." The editor, Robert M. Bleiberg, found it "extravagant" to claim that W. T. Grant Company as a going concern "is vital to the nation's commerce and the national interest."

While *Barron's* doesn't want to see Grant's flashy skyscraper at One Astor Place in Manhattan "turn into Grant's Tomb," it suggests that a "lasting monument to failure" there "would be worse." Its point is that, "Keeping Grant open may force competitors which are more efficient—but less visible, hence with less political or financial clout—to shut their doors." Mr. Bleiberg adds that this is "no way to run a candy store, let alone a country." I could not agree more.

There is more at stake here than meets the eye. It is an assertion of a right of complete independence from political accountability by Dr. Burns and the Fed to use the people's money in any way they see fit. It is arrogance we must not tolerate. No one man or institution should have this unbridled power. The people did not elect Dr. Burns, and he is not our king.

It is clear that Dr. Burns did not exaggerate when he told the bankers in Hawaii that "some carelessness" has "crept into our banking system." As he points out, the comptroller has jurisdiction over national banks and the F.D.I.C. over state-chartered banks that are not members of Federal Reserve. This leaves the Fed with jurisdiction over state-chartered member banks, holding companies, and so-called federally chartered Edge Act corporations that are supposed to do only an international business.

Dr. Burns sees these "overlapping regulatory powers" as "a jurisdictional tangle that boggles the mind" and fosters a "competition in laxity," allowing bankers to play one agency off against another.

I am sure that Dr. Burns wants to centralize all banking powers in the Fed. This he must not be allowed to do. As the *Wall Street Journal* said editorially last November 25: "If regulatory authority is centralized, it had better be centralized somewhere else than in the Fed. Combining the money creation power with regulatory authority creates a conflict of interest."

Granted something must be done, my suggestion of long standing is the creation of a single National Banking Commission combining existing regulatory authority over all banking institutions in one agency. Then, at least, we will have one agency in charge of examination of banks, Edge Act corporations, and holding companies. A single agency will be more competent than the comptroller, the Fed, and the F.D.I.C. have been in the United States National and Franklin bank failures. It could not do worse.

In Honolulu Dr. Burns said that during the last three years "the assets of foreign branches and subsidiaries of American banks nearly tripled, reaching $117 billion" and accounting "for more than one fifth of the growth in total assets of the U.S. commercial banking system." We also know that in 1973 the American banks listed below received the following percentages of their operating income from abroad:

Bankers Trust Company (New York)	80.0
First National City Bank (New York)	61.0
Bank of America (San Francisco)	56.5
Chase Manhattan Bank, N.A. (New York)	43.0
Morgan Guaranty Trust (New York)	32.0
First National Bank of Chicago	21.0
Continental Illinois (Chicago)	18.0

We also know from former Governor Maisel that while he devoted 20 percent of his time to international matters, neither Chairman Martin nor Chairman Burns brought important international matters to the board for resolution, although these chairmen were more in accord with administration policy than the board. This is a serious indictment, because Professor Maisel says that in August 1971, the Federal Reserve System "was in debt for $3 billion" on foreign currency "swaps" and lost close to $400 million.

EDGE ACT CIRCUMSTANCES HAVE CHANGED

In 1919 Sen. Walter E. Edge of New Jersey proposed that member banks of the Fed be allowed to organize federal corporations to engage in international banking and other foreign financial operations.

When his act was passed, the United States was a creditor nation, and Europe was broke. Senator Edge proposed that these corporations be set up to finance European imports from the United States by buying European bills, rolling them over, and redeeming them as the economies of Europe began recovering. When the Glass-Steagall Act was passed in 1933, Congress forgot about providing that Edge Act banks be confined to commercial banking. Perhaps this was because Edge Act banks were then so few in number.

Now, more than twenty banks or bank organizations are operating more than thirty Edge Act corporations in states other than their home state. For instance, Bank of America National Trust and Savings Association has Edge Act corporations not only at its head office in San Francisco but also in New York, Chicago, and Miami.

Although the Fed assures us that these domestic Edge Act corporations only do business incidental to the banks' foreign business, we see advertisements in the *Wall Street Journal*, *Business Week*, and *Fortune* describing how throughout the United States they finance off-shore drilling, a grain deal, a London sterling market problem, international medium-term financing, international leasing, and an Export-Import Bank project.

When we do not permit interstate banking, and the Edge Act specifically provides that no Edge Act corportation can "carry on any part of its business in the United States" except as "incidental to its international or foreign business" (12 U.S.C. § 616), I question the right of the Federal Reserve Board to allow any of these Edge Act corporations to exist within the continental United States in any other state than the head office of the parent bank. As has happened so frequently, the board has read into the phrase "incidental to its international or foreign business" a power to authorize the Edge Act corporations of large banks to do an interstate banking business, soliciting customers who do business abroad, something Congress never intended,

In addiiton, the banks make questionable high-risk foreign loans at home but by subterfuge execute them abroad through their Edge Act corporations so as to avoid Securities and Exchange Commission regulation. They are marketed without the protection of adequate disclosure on which the S.E.C. insists for domestic securities. At the least, the S.E.C. should require registration of these loans before they are sold.

In briefing the Federal Reserve Open Market Committee on the state of the economy, the board's staff in nineteen consecutive meetings from November 1971, to June 1973, stressed that the economy was expanding at a rapid rate of growth. There was, therefore, no reason to increase the money supply rapidly at that time. Nonetheless, it was done. The result was reaccelerated inflation.

HOW TO WIN AN ELECTION

In the course of warning against giving the Fed too much power, on November 25, 1974, the *Wall Street Journal* editorially stated that, "The money supply grew far too rapidly in 1971–1973. In blunt words, the erosion of bank capital ratios were fundamentally caused by the inflational policies pursued by Chairman Burns." Professor Maisel, who was then a member of the board, states that George Schultz, then director of the Office of Management and Budget, in 1971 passed the word to the board that, "If an election were to be won, the Federal Reserve would have to increase the money supply at far more than the 4.2 percent average of 1969–70."

The fact is that the Fed increased the money supply beyond what the economic indicators required, and President Nixon was re-elected. In no small measure, Dr. Burns is personally responsible for our inflation.

It is not so much that Dr. Burns as chairman of the Federal Reserve Board in 1971–72 used his position to flood the country with money, it is that the regulation of banks and bank holding companies by the Fed under his chairmanship has been poor.

In his Hawaii speech Dr. Burns said there are five things wrong with our banks: (1) an "attenuation of the banking system's base of equity capital"; (2) "reliance on funds of a potentially volatile character"; (3) "heavy loan commitments in relation to resources"; (4) "deterioration in the quality of assets": and (5) "increased exposure of the larger banks to risks entailed in foreign exchange transactions and other foreign operations." Translated, this means that under Dr. Burns's stewardship at the Fed the banks are in a mess.

As in previous Congresses, I intend to reintroduce in the Ninety-fourth Congress a bill for a comprehensive reform of the Federal Reserve System.

Whatever the doubts about the wisdom of this reform or that, the time has come to effect at least these:

1. Have the United States redeem the stock held by member banks in the twelve Federal Reserve district banks, removing bank presidents with their conflicts of interest from the Open Market Committee and allowing the Federal Reserve Board to operate the system as Woodrow Wilson intended.

2. Compel the Fed's Open Market Committee to publish a transcript of its proceedings on the day it meets, thereby disclosing to the people and the Congress what the country's monetary policy is that day, not five years ago.

3. Except to the extent necessary to operate the open market account, cancel the $82 billion of bonds held by the Fed, thereby preventing it from building any more marble palaces to departed chairmen and requiring it to operate on appropriated funds.

4. Subject the Fed to audit by the comptroller general in the same way he audits other agencies.

5. Regardless of their corporate form, limit all commercial banking institutions to traditional banking services, divorce commercial banks from bank holding companies, insist that commercial bank officers, directors, attorneys, and accountants be independent, and to the extent they are allowed to exist, subject bank holding companies to the same regulation as commercial banks.

6. Forbid the Fed from continuing to bail out banks and large corporations secretly without the permission of the president and Congress.

7. Vest one federal agency with all the federal bank examination powers now held by the Fed, the F.D.I.C., and the comptroller.

8. To ensure that the Federal Reserve Board and its chairman are accountable to the president of the United States and the Congress, as duly elected representatives of the people, reduce the present staggered fourteen-year terms of board members to five years and make the four-year term of the chairman coterminus with that of the president of the United States.

AND CREATE A DEPRESSION

The high interest policy of the Fed under Dr. Burns bears a marked resemblance to what Andrew Mellon did in the depression of the thirties. Both have inflicted hardships on the lower and middle classes. The Burns polices at the Fed have increased unemployment, liquidated the real estate industry, emptied the savings banks, taxed the little fellow, proved ruinous to the housing industry and thrift institutions, and brought on depression. This is power that no one man or no one agency of government should have. There is no need for me to recall the evils of Watergate, except to point out that they came from individuals operating in secret with excessive governmental power.

The Fed's claim of independence masquerades its desire to use the people's money secretly in any way it chooses. Before its wrong policies bankrupt this nation, the Fed should be made to account to the elected representatives of the people--the president and the Congress.

Appendix II. LETTERS OF WRIGHT PATMAN

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., February 24, 1975.

Hon. RAY GARRETT, Jr.
Chairman, Securities and Exchange Commission,
Washington, D.C.

DEAR MR. GARRETT: On July 24, 1974, with your approval, Citicorp, the holding company for the First National City Bank, issued a prospectus for the sale of $650 million so-called floating notes. I am very concerned about the scope of disclosure in this prospectus. It was a "first" and has become a model for offerings of this type.

As I understand it, corporations may use in their prospectuses unaudited quarterly figures subject to the condition that such figures fully and fairly describe the company's quarterly position. In my opinion, Citicorp's quarterly figures for 1973 and 1974 showing actual loan loss chargeoffs in Citibank, do not accurately reflect losses sustained at those times. Citicorp represents that on June 30, 1974 Citibank may legally declare a dividend in the amount of the bond issue, $650 million. Presumably, this figure is obtained by plugging actual loan loss figures for the first and second quarters (see table below) into the statutory formula of Section 60 of Title 12 of the United States Code:

Actual loan loss minus tax benefit

Quarter:	
1973:	
First	6,836
Second	6,814
Third	14,628
Fouth	48,254
1974:	
First	6,880
Second	8,523
Third	14,000
Fourth	59,780

You will note that in both years approximately 83% of the Bank's total losses are deferred to the third and fourth quarters. The statements in the prospectus do not contain any explanatory footnote, but it is extremely unlikely in a Bank the size of Citibank that any seasonal factor could cause such large fluctuations in revenue.

Of course by manipulating the actual charge-off figure a bank may arbitrarily increase the amount of legally available profits from which dividends may be declared under 12 U.S.C. 60(b). There is no evidence in the prospectus that Citibank has employed an objective accounting method—or any method at all—in choosing to write its loans off in this manner. Both the S.E.C. and the Comptroller have the authority to prevent illegal manipulation of 12 U.S.C. 60 by promulgating guidelines for reporting unaudited quarterly figures which represent loan loss charge-offs. As this same pattern of loss activity has been observed in the prospectuses of other banks offering floating rate notes, it is time that authority were exercised. The S.E.C. might consider insisting on audited figures.

I am also concerned by the fact that while the prospectus is careful to highlight the Bank's *legal* ability to declare a dividend, any discussion of the Bank's *actual* ability to make such a payment is conspicuously absent. Citibank did not pay dividends to Citicorp in 1972 or 1973. Nor did it declare a dividend in 1974.

However, Citicorp has paid dividends of $75 million in 1972, $86 million in 1973, and $98 million in 1974. The logical inference is that Citicorp is paying these dividends with money borrowed in the commercial paper market. In addition to being a practice of doubtful legality, it is one which should certainly be disclosed to the potential investor and discusssed in the holding company's prospectus.

While I appreciate the values served by the equity method of accounting, it is singularly inappropriate as a method of disclosing the cash position of a bank vis-a-vis its holding company. The Bank's assets are not the holding company's assets.

When Citicorp is allowed to represent—

> In the determination of the dividend policies of Citicorp its Board of Directors considers the earnings of Citibank available for the payment of dividends to Citicorp. Citicorp would anticipate that a portion of such earnings would be paid to it as dividends if such payment were required as a source of funds to pay Citicorp dividends in the future.

a consolidated statement is irrelevant. It is the liquidity of Citibank which is in issue, and the Commission ought to require that a statement providing this particular information be included in the prospectus.

The prospectus, moreover, neatly sidesteps disclosure of the nature and extent of Citibank's foreign investments—another factor affecting the Bank's actual ability to pay dividends. A geographic break-down of domestic and international net income is qualified by the statement—

> It is not practicable to make a precise separation of the domestically oriented business from the part of the business resulting from operations in foreign countries and derived from customers in foreign countries; accordingly, the separation set forth below is based upon internal allocations which necessarily involve certain assumptions. (P. 13, Citicorp prospectus.)

Such assumptions are never defined. The investor has no facts on which to base a judgment as to the soundness of the Bank's loans in foreign countries.

While you or the banking agencies may lack the statutory power to do so, don't you think that the directors, officers, attorneys, and accountants who represent a bank holding company should be completely independent and different from those of the bank? After all the Bank directors as trustees owe their first duty to the Bank's depositors. Here the holding company's need for the dividends may clash with the obligation of the Bank's directors to retain the dividends. If necessary, should we not pass legislation to effect this?

I would appreciate hearing from you what you can do to correct this situation.

Sincerely,

WRIGHT PATMAN, *Vice Chairman.*

[Reprinted from the Congressional Record of Feb. 24, 1975, pp. H1117–H1118]

FLOATING NOTES OF CITICORP

(Mr. Patman asked and was given permission to extend his remarks at this point in the Record and to include extraneous matter.)

Mr. PATMAN. Mr. Speaker, I would like to bring to the attention of the Members a copy of a letter I have forwarded to Chairman Ray Garrett, Jr., of the Securities and Exchange Commission with respect to the $650 million floating note issue which Citicorp marketed in July 1974. I have presumed to send a copy to Congressman John E. Moss, chairman of the Subcommitte on Oversight and Investigations of the House Commerce Committee.

Inasmuch as this matter involves the Nation's second largest bank, First National City Bank—"Citibank"—it should be of equal or greater interest to our three banking agencies so I have also sent copies to the Comptroller of the Currency, James E. Smith, the Chairman of the Board of Governors of the Federal Reserve System, Dr. Arthur F. Burns, and the chairman of the Federal Insurance Deposit Corporation, Frank Willie.

In this connection, I also call the Members' attention to the complaint, dated July 5, 1974, filed in the United States District Court for the Southern District of New York, against the Board of Governors of the Federal Reserve System by the Bowery Savings Bank, and the National Association of Mutual Savings Banks, in which it is alleged that these floating notes should be subject to Federal Reserve regulations D and Q.

[IN THE U.S. DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK]

Complaint

The Bowery Savings Bank, National Association of Mutual Savings Banks, by its President Kenneth L. Birchby and Savings Bank Association of New York State, by its President Joseph C. Brennan, Plaintiffs, v. Board of Governors of the Federal Reserve System, Defendant.

The plaintiffs The Bowery Savings Bank ("Bowery"), the National Association of Mutual Savings Banks and Savings Banks Association of New York State, by their attorneys, Cadalader, Wickersham & Taft, for their complaint allege:

1. This action for declaratory judgment arises out of the provisions of Section 19 of the Federal Reserve Act, as amended, 12 U.S.C. § 461 and Regulations D and Q of the Federal Reserve Board, 12 C.F.R. §§ 204 and 217 respectively, issued pursuant to said act.

2. Jurisdiction of this Court is based upon Sections 1331 and 2201 of Title 28 of the United States Code.

3. The amount in controversy exceeds $10,000 exclusive of interest and costs.

4. Venne properly lies in the Southern District of New York pursuant to Section 1391 (c) of Title 28 of the United States Code. The plaintiffs have their principal places of business in the Southern District of New York.

5. Plaintiff Bowery is a New York State mutual savings bank organized and existing by virtue of the laws of the State of New York and maintaining its principal place of business at 110 East 42nd Street, New York, New York.

6. Plaintiff National Association of Mutual Savings Banks is an unincorporated association existing under the laws of the State of New York, and has its principal place of business at 200 Park Avenue, New York, New York. Its 475 members, representing $108 billion in assets, are mutual savings banks conducting and authorized to conduct the business of savings banking under and by virtue of the laws of various states throughout the United Sttaes. Kenneth L. Birchby is the President of this association. This association brings this action on behalf of itself and in the interest of its members.

7. Plaintiff Savings Banks Association of New York State is an unincorporated association existing under the laws of the State of New York, whose members are 118 mutual savings banks chartered under the laws of the State of New York. Its principal place of business is in the City of New York, State of New York. Its members conduct the business of savings banking in various counties of the State of New York, including the County of New York. Joseph C. Brennan is the President of this association. This association brings this action on behalf of itself and in the interest of its members.

8. The defendant Board of Governors of the Federal Reserve System is an agency of the United States empowered and authorized by the Federal Reserve Act to regulate the business of members of the Federal Reserve System and their affiliates for purposes germane to this action, including all National Banking Associations ("National Banks").

9. On information and belief certain registered bank holding companies registered under the Bank Holding Company Act of 1956 which are affiliates of National Banks subject to the provisions of the Federal Reserve Act are about to and have expressed their intention to issue or their interest in issuing unsecured small denomination notes ("Notes"). These issuers include the holding company affiliates of Chase Manhatten Bank, N.A., Bank of America., N.A. and First National City Bank ("Citibank"). The Notes will yield interest in excess of the rates prescribed by Federal Reserve Board Regulation Q; and the requirements for reserves prescribed by the Federal Reserve Board pursuant to Regulation D are to have no certain application to the proceeds of such Notes.

10. Bowery and the member of plaintiffs National Association of Mutual Savings Banks and Savings Banks Association of New York State (collectively referred to as "Associations"), are within the group sought to be protected by authority granted to defendant to expand the scope of Regulations D and Q.

11. One such bank holding company, Citicorp, which owns all of the capital stock of Citibank, has presently pending before the United States Securities and Exchange Commission a certain preliminary prospectus dated June 27, 1974 with respect to the issuance, offer and sale to the public of $850,000,000 of such Notes ("Citicorp Notes") and is seeking registration for such an offering to the public.

12. The funds, or a portion of such funds, so obtained by such bank holding companies will be used directly or indirectly in the banking business of their affiliate National Banks or to maintain the availability of funds for the benefit of such banks.

13. Issu[illegible] of such Notes [illegible] to attract and [illegible] whi[illegible] would be inve[illegible]ed in time [illegible] deposits [illegible] savings institutions which are members of the As[illegible]

14. Bowery has requested that the Federal Reser[illegible] [illegible] with the Securities and Exchange Commission on the [illegible]plicable di[illegible] regar[illegible] the application of Regulations D and Q [illegible] the issuances of the Notes. The plaintiffs have requested that the defendant regulate the issuance of the Notes by subject[illegible] this issuance (and proceeds [illegible] Regulations D and Q

15. Unless the defendant so regulates the issuance of the Notes, Bow[illegible] and the members of the plaintiffs Associations will suffer irreparable competitive injury.

16. In a certain letter dated July 2, 1971 from [illegible] Ray Garrett, Jr. Chairm[illegible] the [illegible] Exchange C[illegible] concerning the Citicorp Notes, the defe[illegible] recognized that:

"[illegible] the result of the large offering- a[illegible] any othe[illegible] offering like [illegible] other issued by bank holding companies or othe[illegible] corporations can well se[illegible] to divert the flow of savings from the residential mortgage market and to deprive home buyers of needed mortgage financing. It is not clear, therefore, that an offering of this type is in the public interest at this time."

17. In disclaiming authority to apply Regulation D to the entire offering of the Citicorp Notes, and apparently disclaiming any power to apply Regulation Q or to amend Regulation Q to apply to interest payable on any part thereof the Board states that it lacks the necessary statutory powers.

"The Board's present statutory powers do not authorize it either to prevent or to regulate the terms of the Citicorp lease. The legislative history of the 1969 amendments to the Federal Reserve Act, which authorized the Board to determine what types of obligations issued by affiliates of member banks may be deemed to be deposits for purposes of the Board's regulations, makes it clear that such authority applies only to the extent that the proceeds of such affiliate obligations are used for the purpose of supplying funds to a member bank. To the extent that the proceeds of the Citicorp Notes may be *used for supplying funds to member banks*, they would be subject to reserve requirements but not otherwise." (Emphasis supplied.)

17. With specific reference to the Citicorp Notes the issuer describes the proposed "Use of Proceeds" on page 3 in its preliminary prospectus as follows:

"The net proceeds from the sale of the Notes offered hereby are expected to be applied to the repayment at maturity of commercial paper issued by Citicorp. See Capitalization" Citicorp has issued commercial paper principally to finance the activities of its subsidiaries other than Citibank, including Advance Mortgage Corporation, Nationwide Financial Services Corporation, and Citicorp Credit Services, Inc. See "Business—Related Services and Activities" Citicorp expects to continue to issue commercial paper to repay outstanding commercial paper as it matures and to finance expansion of the activities of its subsidiaries, including Citibank. With the anticipated continued growth of Citibank and other Citicorp subsidiaries, Citicorp also expects that it will, on a regular basis in the future, engage in additional financings in character and amount to be determined as the need arises."

18. Defendant has the statutory power to apply Regulations D and Q to the Citicorp Notes and proceeds thereof, and any similar issuances by other bank holding companies, for the following reasons, among others:

(a) On information and belief Citibank has been able to avoid paying any dividends to Citicorp, thereby retaining for its own capital base its entire net income for two and one-quarter years—amounting to approximately $550 million. Citicorp dividends during this period, in the amount of $186.2 million (to meet the expectations of Citicorp shareholders—formerly shareholders of Citibank) have been paid through funds supported by intricate borrowings by Citicorp and by decreases in loans financed from previous borrowings (largely through commercial paper). These previous borrowings are now "expected" to be refinanced from the sale of Citicorp Notes. The defendant has the statutory power to characterize the proceeds from the Citicorp Notes as "deposits" for purposes of Regulations D and Q by reason of the use of previously borrowed funds, intended to be refinanced by the Citicorp Notes, to benefit Citibank by enabling it to retain earnings otherwise payable as dividends to its shareholders.

(b) On information and belief, pending application of the proceeds to the repayment at maturity of commercial paper issued by Citicorp, the proceeds "may be used for supplying funds" to Citibank. The defendant has the statutory power to apply Regulations D and Q at the very least pending such application of proceeds.

(c) The defendant has the statutory power to treat debt issuances of Citicorp on a "first-in-first-out" ("FIFO") method of tracing funds used by for the benefit of Citibank. Hence, even if the present "expected" use of proceeds is not deemed for the benefit of Citibank, funds resulting from a subsequent debt issuance (and benefiting Citibank directly or indirectly) may be attributed *pro tanto* to the proceeds of the instant Citicorp issue. Defendant has the statutory power to apply Regulation D to such proceeds on a FIFO basis, and Regulation Q as then applicable to all of the Citicorp Notes.

(d) Accordingly, the defendant has the statutory power to apply Regulations D and Q to the Citicorp Notes by reason of past Citicorp uses of funds to be refinanced (as described in (a) above), of current proposed Citicorp uses of proceeds described in (b), and/or by reason of future uses of proceeds from the Citicorp Notes under tracing described in (c).

20. Pursuant to Section 19 of the Federal Reserve Act, the defendant has the statutory power to apply the reserve requirements of Regulation D to the proceeds of the entire offering of the Citicorp Notes or similar obligations. Similarly, the defendant has the statutory power to regulate certain of the terms of the Citicorp Notes or similar obligations by the application to them or requirements of Regulation Q. The exercise of such statutory powers is plenary whether or not the proceeds are traceable to the direct use of banks which are members of th Federal Reserve System.

21. In the event that Section 19 of the Federal Reserve Act is construed so as to apply "only to the extent that the proceeds of such issuance are used for the purpose of supplying funds to banks which are members of the Federal Reserve System," then:

(a) In those circumstances where the issuer identifies the Notes, proceeds of which are to be so used, the defendant has the statutory power to subject to Regulations D and Q such proceeds and Notes as so identified:

(b) in thise circumstances in which the issuer does not so segregate the Notes and proceeds to be so used, thereby rendering identification not feasible, the defendant has the statutory power to subject the entire issuance to the terms of Regulations D and Q; and

(c) failure by the issuer to facilitate the determination of whether Notes and proceeds therefrom serve the purpose of supplying funds directly or indirectly to or for the benefit of banks which are members of the Federal Reserve System shall in no way disable the defendant's full use of its statutory power to determine that interest payable on all or any part of a Note. Issuance is subject to Regulation Q, and that all or any portion of the proceeds are subject to Regulation D.

Wherefore, plaintiffs pray for judgment in their favor declaring that the Board of Governors of the Federal Reserve System has the statutory power under Section 19 of the Federal Reserve Act to regulate the terms of Note issuances by bank holding companies as described herein for purposes of determining whether and to what extent, proceeds shall be deemed "deposits" for Regulations D and Q, and for such other relief as the Court deems just and proper.

Dated: New York, N.Y., July 5, 1974.

CADWALADER, WICKERSHAM & TAFT,
By ——— ———,
A Member of the Firm

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE OF DOMESTIC MONETARY POLICY,
COMMITTEE ON BANKING, CURRENCY AND HOUSING,
Washington, D.C., April 24, 1975.

Hon. ARTHUR F. BURNS,
Chairman, Federal Reserve Board,
Federal Reserve System,
Washington, D.C.

DEAR DR. BURNS: I have been concerned for some time by the problems inherent in the control of American banks through foreign holding companies which also control substantial nonbanking interests in the United States. These problems become even more complex when the controlled American bank is owned by an international joint venture. As I am sure you are aware, the parent/shareholders of the European-American Bank and Trust Co., which recently purchased the insolvent Franklin National Bank, include six of the largest banks in Europe:

Parent	Assets in billions	Percent of stock in EAB and EAC
Deutsche Bank, Germany's largest	$24.5	+20
Societe Generale, one of Franc's three largest	20.4	+20
Midland Bank Group, a major London clearing bank	19.0	+20
Societe Generale de Banque, Belgium's largest	9.1	+20
Amsterdam-Rotterdam Bank, largest in the Netherlands	9.6	+17
Creditanstalt-Bankverein, Austria's largest	4.2	+2

Under the statute and your own Regulation Y there is a rebuttable presumption of control from ownership of so little as 5 percent of the stock, and, if need be, you are authorized to hold a hearing. Accordingly, there seems reason to believe that the four largest stockholders of the European-American Bank and Trust Company, and probably the fifth, should be adjudged to be bank holding companies and subject to Federal Reserve regulations.

I would also like to suggest that in making the factual findings necessary to determine "control", the individual influence of each stockholder *not* be measured by standards applicable to "control" in a large publicly held corporation. Different standards of "control" govern the conduct of a joint venture which, by definition, is a cooperative undertaking. While in a publicly held corporation with majority and minority shareholders and a whole range of interests in between it is reasonable to assume the existence of adverse interests, such an assumption is inappropriate in the case of a joint venture where the stock is not widely held, and each mmber holds approximately the same interest.

These same banks control also a sister institution called the European-American Banking Corporation which is organized under the New York Investment Company Act. That Act gives companies organized under it wide powers to buy and sell stock even though I understand they do not accept deposits nor underwrite.

Moreover, the American Banker in June 1974 reports that the Deutsche Bank has a 50% interest in an investment banking firm in New York called UBS–DB, and that Societe Generale, Societe Generale de Banque, and Amsterdam-Rotterdam have interests in undisclosed amounts in another New York investment banking firm called SoGen-Swiss International Corporation.

As you know the Glass-Steagall Act (12 USC 377) prohibits an American bank from being affiliated (12 USC 221(a)(b)(2)) "with any corporation, association, business trust or other similar organization engaged principally in the issue, flotation, underwriting, public sale or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities".

"Affiliate" is broadly defined by Glass-Steagall, and it would seem to me that your Agency should look into the business that European-American Banking Corporation actually does, and is empowered to do. Of course the ownership by four of these banks of investment banking firms seems to be a violation of, if not the letter, certainly the intentions of Glass-Steagall.

I am sure you will agree that we must not permit foreign banks, under the guise of a joint venture, to do what we forbid to our domestic banks.

Accordingly, I should be much obliged if you would tell me:

1. Whether the ownership, by way of a joint venture of European-American Bank and Trust Company, at least by the four banks with the 20%, and the one with a 17% interest, does not subject these banks to the Bank Holding Company Act?

2. Whether the European-American Banking Corporation is an "affiliate" within the meaning of the Glass-Steagall Act?

3. Whether the European-American Banking Corporation is authorized under its state charter to engage in any of the activities forbidden to banks under Glass-Steagall?

4. Whether the European-American Banking Corporation, while not accepting deposits, or acting as an underwriter, is principally engaged in any of the other activities forbidden by Glass-Steagall?

5. Whether these six banks each have interests in investment banking firms, what the firms are, what they do, and whether such ownership does not make these firms "affiliates" under Glass-Steagall and in violation thereof?

Of course, if the present statutes are inadequate to meet this problem, please be assured I stand ready to consider such new legislation as may be necessary.

Sincerely,

WRIGHT PATMAN.

MAY 14, 1975.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: I woud like to request that your Department conduct an investigation to determine whether the European-American Bank and Trust Co. is being operated in the United States in violation of our antitrust laws. As you may know European-American Bank, a member of the Federal Reserve System is a joint venture, and its parent companies are:

Parent	Assets in billions	Percent of stock in EAB and EAC
Deutsche Bank, Germany's largest	$24.5	+20
Societe Generale, one of France's 3 largest	20.4	+20
Midland Bank Group, a major London clearing bank	19.0	+20
Societe Generala de Banque, Belgium's largest	9.1	+20
Amstardam-Rotterdam Bank, largest in the Netherlands	9.6	+17
Creditanstalt-Bankverein, Austria's largest	4.2	+ 2

I was dismayed to learn that the Department did not conduct a bank merger study in 1968 when this company was formed. Nor can I understand why such perfunctory consideration was given to the purchase of the insolvent Franklin National Bank by European-American in October of 1974.

Your so-called "Railroad Letter" of October 4, 1976 did not contain any discussion of the effect of this acquisition on the national and international wholesale banking markets, nor did it undertake to explain why the liaison of six competing banks for the purpose of dividing the American wholesale banking market between them is not a pare se antitrust offense.

I am enclosing a short report which lays out these issues in greater detail, and a copy of a letter I addressed to Dr. Arthur F. Burns on April 24, 1975 which is self-explanatory.

I would appreciate your advising me whether your Department will look into the matter.

With kindest regards and best wishes, I am,

Sincerely,

WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee.

Enclosure.

MEMORANDUM OF LAW

European-American Bank and Trust Co. (EAB) and European-American Banking Corporation (EABC) form part of a world-wide banking empire commanding resources in excess of $96 billion. The shareholder/parents of the EAB and EABC joint ventures include six of Europe's largest banks; Deutsche Bank, Germany's largest, with $24.5 billion in assets, holds approximately 20% of the stock, as does Societe Generale, one of the three largest banks in France, with assets of $20.4 billion. Midland Bank Group, a major London Clearing Bank, with $19 billion in assets and Amsterdam-Rotterdam Bank, largest in the Netherlands with assets of $9.6 billion, also have stock interests of approximately 20%. Societe Generale de Banque, Belgium's largest bank, with assets of $9.1 billion holds approximately 17% and the remaining 2% is held by Creditanstalt-Bankverein, Austria's largest bank, with assets of $4.2 billion.

The predecessor of EAB began its United States operations in New York City in 1921, as an affiliate of Societe Generale de Banque of Belgium, doing business under the name of "Banque Belge pour L'Etranger." In 1950, it became a New

York-chartered bank and a member of the FDIC. At this time its name was changed to Belgian-American Bank and Trust Co., and a sister subsidiary, Belgian-American Banking Corp., a state-chartered international investment company, was organized.

In 1968, Societe Generale de Banque began to sell interests in its American subsidiaries, and the Dutch, German, and English banks became partners in that year. The names of the subsidiaries were changed to EAB and EABC to reflect this change in ownership, and in 1971, the French and Austrian banks were admitted to the consortium.

At the time of the stock acquisitions, Midland Bank and Societe Generale (Paris) had full branches operating in New York City. The licenses of both were surrendered in January 1971, and June 1972, respectively, and their offices were consolidated in the European-American headquarters.

Prior to its purchase of the insolvent Franklin National Bank in October of 1974, EAB had four Manhattan offices, with headquarters at 10 Hanover Square, in the heart of the financial district, and a Eurodollar office in the Cayman Islands. Its operations were concentrated primarily in the area of "wholesale" banking—serving mainly business customers with direct business loans, revolving credit, and foreign exchange, as well as custody accounts and trust operations. With assets of $580 million, EAB was the 190th largest bank in the United States in terms of deposits.

EAB and EABC as "Reverse Edge Act Corporations"

The Federal Reserve has determined that as a joint venture, the EAB is outside the terms of the Bank Holding Company Act, as amended in 1970. It is interesting, therefore, to explore the possible similarities the EAB and EABC bear to corporations which are regulated by the Edge Act.

Viewed from a functional, rather than from a regulatory perspective, the EAB and EABC are operated in the United States by their European parents in much the same way that Edge Act Corporations subsidiaries of American parents are operated abroad.

The Edge Act, passed in 1919, was added to the Federal Reserve Act in the form of Section 25(a). It authorized the Federal Reserve Board to charter corporations:

> For the purpose of engaging in international and foreign banking, either directly, or through the agency, ownership, or control of local institutions in foreign countries.

Edge Act Corporations can indulge in all aspects of international banking—they may accept drafts generated by foreign trade transactions, and foreign demand and time deposits; they may provide advances to finance overseas trade and deal in foreign exchange. In addition, they may also take part in other foreign financing activities such as the buying and selling of foreign securities, and investment in foreign non-banking concerns.

The Federal Reserve Board regulates Edge Act Corporations through Regulation D, which details those operations which Edge Acts may undertake within the United States. Section 211.7 which describes activities specifically allowed, states in its preamble:

> It is the Board's general policy to permit corporations to transact such limited business in the United States as is usual in financing international commerce.

To a large extent, the activities of Edge Acts duplicate those of their parent banks' overseas branch and correspondent networks, and their international departments within the United States. American banks, however, are not allowed to invest directly in foreign nonbanking concerns. The Edge Act is a convenient device for avoiding this restriction, and also allows, theoretically at least, a limitation on liability for such investments to the amount of the Edge Act's capital. However, despite the advantages of a separate legal identity, American Edge Acts often retain close ties to their parent banks. Many work closely with the interna-

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This section goes on to state that demand and time, (but not savings) deposits may be accepted, but only when they relate to international business, and that funds not currently tied up in international business can only be held in the form of cash, deposits with banks, or obligations of "the U.S., any state thereof, or any department, agency or [illegible] of or corporation wholly owned by the U.S."

tional departments of their affiliates, paying a fee for the use of general services and the advice of officers experienced in particular countries. That such a relationship is enjoyed by EAB and its European parents is evidenced by EAB's absorption of the operations of Midland's and Societe Generale's New York branches, including personnel.

The activities of European-American in the United States, (especially those of EABC) are not subject to the same restrictions placed on the operation of American Edge Acts overseas. Investment in foreign banking and non-banking concerns by American Edge Acts, for example, must be approved by the Federal Reserve Board. Under the provisions of Regulation K, a general consent is given for investments which do not exceed a total of $500,000 in any one corporation, and which do not amount to a holding of more than 25% of the voting shares of any one corporation. Investments in limited partnerships and other similar organizations are excluded from this general consent and any investment beyond the stated levels must be specifically approved.

In addition, the total investment in any one company by an Edge Act Corporation is restricted to 50% of the Edge Act's capital and surplus if it is also engaged in banking. Aggregate outstanding liabilities at any one time may not exceed ten times an Edge Act's capital and surplus without prior approval of the Federal Reserve Board.

Moreover, the permissible activities of Edge Act Corporations abroad can be sharply contrasted with those activities in which their American parents may engage. Under the Glass-Steagall Act, American banks may not be affiliates of any security or investment company. With the exception of one brief period (1957-1963) the same blanket prohibition has been spared Edge Act Corporations abroad--a concession granted in recognition of the scope of activities commonly pursued by foreign banking interests in their own countries. It was felt, too, that regulation of parent bank activities provided a sufficient safeguard against the abuses at which Glass-Steagall was aimed. Thus, under the present law, the banking agencies have no authority to monitor—or even inquire into—the holdings of EAB and EABC's foreign parents.

THE QUESTION OF EDGE ACT RECIPROCITY

It seems clear that foreign banks operating in the United States (branches of foreign banks as well as fully chartered domestic banks owned in whole or in part by foreign individuals, corporations or banks) are at least as important a component of a sound American banking system as the Edge Act subsidiaries of American banks operating abroad. Indeed, the failure of a foreign "reverse Edge Act" operating in New York City, would probably have a greater adverse impact on the American economy than would the failure of a Chase Manhattan Edge Act Corporation's subsidiary in London, Paris, or Rome. Would an American Edge Act Corporation structured as a joint venture with participants similar to the six banks which hold EAB and EABC be authorized by the Federal Reserve Board.

At the present time, only one American joint venture Edge Act Corporation has been authorized by the Federal Reserve Board-Allied Bank International. Allied's banking business is not dissimilar to that conducted by EAB and EABC prior to EAB's acquisition of Franklin National Bank. Their corporate structure and ownership, however, differ in several important respects.

In contrast to the parents of EAB and EABC, which are in competition throughout Europe and the rest of the world, the parents of Allied, in the judgment of the Federal Reserve, do not compete with each other either locally, in New York City (where the Edge Act Corporation is located), or in national or international banking markets. In contrast to the size of the owners of EAB nad EABC, original participation in Allied was limited by the Federal Reserve Board to banks with less than $1 billion in deposits. Although several exceptions to this figure have been made,[2] it is still felt to mark that point at which a bank possess sufficient strength to enter the international market on its own.[3] This standard was adopted by the Federal Reserve in order to reduce the possibility that such joint ventures would be in violation of the Clayton or Sherman Acts.

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[2] Both the Valley National Bank and United States Bank of Oregon exceeded this limit. The Federal Reserve Board determined, however, that, despite the size of their deposits, neither bank was capable of individual market entry.

[3] The factors considered by the Federal Reserve Board in approving joint venture participation are discussed in a 1972 letter to Cleveland Trust Company, the largest bank in Ohio, in which the Board denied Cleveland Trust's request to enter Allied Bank International.

Another difference between the two joint ventures is with respect to their ownership. ABI's is broadly-based, divided among 18 banks of varying size. The ownership of EAB and EABC, on the other hand, is confined to six banks, all European giants.

THE ANTITRUST IMPLICATIONS OF THE EAB AND EABC JOINT VENTURES

The questions raised by the operation of banking and investment institutions such as EAB and EABC—especially the antitrust aspects of those problems—are many and complex. The do not, however, appear to have been considered in great depth by the regulatory authorities involved.[4]

Under the Bank Merger Act of 1966, the Justice Department has the responsibility to scrutinize the formation of joint venture subsidiaries for compliance with the requirements of the Sherman and Clayton Acts. If anticompetitive effects are found, the Bank Merger Act allows as a defense to the merger, proof that such effects are outweighed by the convenience and needs of the community which the bank will serve. Unfortunately, such a study was not done when Societe General offered five other banks participation in Belgian-American in 1968.

The Supreme Court specifically held in *Penn-Olin v. United States*, [378 U.S. 158 (1964)] that joint ventures were within the contemplation of Section 7 of the Clayton Act, noting that:

> . the progeny was organized to further the business of its parents, already in commerce, and the fact that it was organized specifically to engage in commerce should bring it within the coverage of Section 7.

Moreover, the applicability of Section 1 of the Sherman Act to joint venture subsidiaries was determined by the Supreme Court in 1951, in *Timken v. United States*, [341 U.S. 593 (1951)].

The cases considered by the Supreme Court as well as the approach of the Justice Department in non-banking areas, have identified two separate lines of inquiry in the joint venture area: first, whether the creation of the joint venture itself is in restraint of trade or tends to substantially lessen competition; and second, if the joint venture passes this initial test, whether the venture is subject to impermissible collateral conditions restricting the activities of the venture or its member.

Preliminarily, two types of parent-subsidiary relationship may be distinguished:

A. Where one or more of the parents continue to engage in direct competition with the joint venture after its formation; and

B. Where the parents transfer a given operation to a newly created joint venture, and cease engaging (or determine never to engage) in the line of commerce involved, except indirectly, through the joint venture.

The Type A joint venture was dealt with by the Supreme Court in *Timken* v. *United States*. The Government's complaint alleged that Timken, an American firm which manufactured and sold roller bearings, had combined and conspired with British and French subsidiaries to eliminate competition in world markets. The Court held that "agreements between legally separate persons and companies to suppress competition among themselves and others" cannot be justified "by labelling the project a 'joint venture.' " Justice Black was careful to define exactly what he meant by suppression of competition in the joint venture context:

> What may not be done by two companies who decide to divide a market, surely cannot be done by the convenient creation of a legal umbrella—whether joint venture or common ownership and control—under which they achieve the same objective by in unison.

Thus, where competition in a relevant market still exists between a joint venture and a parent, every decision by the joint venture as to prices, production, customers, or territory necessarily involves price-fixing and divisions of markets, and runs the risk of being illegal per se.

The Court also refused to accept Timken's contention that its agreements were "reasonable" restraints of trade in view of current foreign trade conditions:

> The argument in this regard seems to be that tariffs, quota restrictions and the like are now such that the export and import of antifriction

[4] One Federal Reserve official was of the opinion that the anticompetitive impact of such joint ventures was simply not a pressing problem at this time—while American banks control approximately 7% of the total banking assets abroad, foreign banking interests in the United States account for only 3% of our total.

> bearings can no longer be expected as a practical matter; that appellant cannot successfully sell its American-made goods abroad; and that the only way it can profit from business in England, France and other countries is through the ownership of stock in companies organized and manufacturing there.

It seems clear that the creation of a common subsidiary by six European banks already competing in the wholesale international banking market, is a Type A joint venture, at least with respect to the five largest participants. It embodies a de facto agreement to divide the American wholesale market between competitors who have the demonstrated ability to enter that market individually.

However, it is also possible that the EAB–EABC combination could be considered a Type B joint venture with respect to those of its parents—if any—which do not compete in the international banking market, and, but for the joint venture, would be incapable of individual market entry. The legality of a Type B joint venture will depend on factors very similar to those which govern the legality of a merger:

(1) The shares of the market held by the leading companies in the line of commerce involved;

(2) The parent's share of the market prior to the joint venture; and,

(3) The competitive capabilities of the parents prior to the joint venture.

These factors necessitate a consideration of the possibility that the merger might tend to eliminate or lessen potential, as well as actual, competition in a given area. *Penn-Olin* v. *United States* dealt with an action brought under Section 7 of the Clayton Act to challenge a joint venture between two leading chemical corporations. The puropse of the venture was to produce and market a particular product in a regional chemical market dominated by two other firms. The Supreme Court agreed with the Government that the joint venture eliminated the possibility that one or both firms might enter the market independently.

> The existence of an agressive, well-equipped and well-financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated.

The court went on to state that:

> The test of the section [Section 7, Clayton] is the effect of the acquisition. Certainly the formation of a joint venture, and the purchase by the organizers of its stock would substantially lessen competition—indeed foreclose it—as between them. . . Realistically, the parents would not compete with their progeny. . . Inevitably, the operations of the joint venture will be frozen to those lines of commerce which will not bring it into competition with the parents and the latter will be foreclosed from the joint venture's market.

The Court also noted that while a merger was not perfectly analagous to a joint venture, the merger intent—seeking to protect a market by acquiring a potential competitor was equally illegal in the context of a joint venture. It is also interesting to note that at least two members of the Court, Douglas and Black, would have found a per se violation of Section 1 of Sherman, under the standards announced in *Timken.*

The creation of EAB eiminated not only potential, but actual competition in the New York wholesale—national and international—banking markets. As noted above, in 1968, both Midland Bank and Societe Generale de France operated full branches in New York City. Their licenses were surrendered in 1971 and 1972 in order that their operations might be consolidated in the European-American headquarters. The other European banks involved (while not having an established New York presence) were certainly potential competitors, exercising some influence on the behavior of those European banks participating more directly in the New York international market. [United States v. Falstaff Brewing Co., *410* U.S. *526*, 93 S.Ct.1096 (1973)]. It is inconceivable that these large central banks, already participating in the international market did not intend to establish a presence in so important a center as New York City.

While the absence of Justice Department comment on EAB and EABC in 1968 is puzzling, it is even more difficult to understand the Department's perfunctory approval of EAB's acquisition of Franklin National Bank. The Department's "Railroad Letter" (6 November 1974) was limited to a discussion of possible anti-competitive effects in the Long Island retail banking market. Again, the antitrust implications of joint venture competition in the wholesale banking market were ignored. Wholesale banking was, and continues to be, EAB's primary field of endeavor. The Chairman of the Board of Directors and President of the EAB, Harry Eckblom, is quoted by the Wall Street Journal and New York Times as saying that EAB's management plans to combine only the "strongest" aspects of Franklin's business with its own wholesale banking orientation.

Banking analysts estimate that, despite Franklin's image as a retail bank, only 16% of its loans were retail by the end of 1973. The FDIC's first report on the Franklin National Receivership (2 February 1975) indicates that EAB selected from Franklin's assets approximately $250 million in cash and due from banks, $371 million in securities (the bulk of which are United States treasuries and Government agencies) and $761 million in loans at Franklin National's book value. (These loans include real estate mortgages and commercial and installment loans.) EAB is now the 48th largest American bank, having acquired from Franklin National an additional 74 branches on Long Isalnd and 26 in New York City. Moreover, EAB elected to retain Franklin's London branch (which raises, again, the possibility of antitrust violations). EAB controls deposits of approximately $1.88 billion and has $2.3 billion in total assets. In conjunction with the EABC, which has offices in New York, San Francisco, Los Angeles, and Nassau, this joint venture commands assets in excess of $4 billion.

The Justice Department excuses the inadequacy of the "Railroad Letter" on the basis of the emergency situation created by the failure of Franklin National. It was under intense pressure from both the Federal Reserve Board and the FDIC to approve a purchaser. Now that the emergency is over, it would be well for the Justice Department to consider the implications of its approval, and formulate some guidelines for dealing with the problems which are certain to arise in the future.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., May 27, 1975.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: The New York Times of May 19, 1975 and the American Banker of May 20, 1975 report that an application is to be made to the Superintendent of Banks of the State of New York by the banks listed below to form a new bank named *United Bank, Arab and French* (UBAF-N.Y.), and to operate it as a joint venture similar to the European-American Bank of which I wrote you under date of May 14, 1975.

Name	Assets in billions	Ranking USA [1]	Ranking World [2]
Credit Lyannais, Paris, France	$28.2		10
Bankers Trust, New York	17.5	7	28
Security Pacific Bank of California, San Diego	13.4	11	44
First National Bank, Chicago, Ill	14.8	9	36
Banque Francaise du Commerce Exterieur, Paris, France	3.6		129
Union de Banques Arabs et Francaises, UBAF, Paris, France	[3] .982		328
Texas Commerce Bancshares, Houston, Tex	2.2	31	204

[1] Business Week, April 21, 1975.
[2] American Banker, July 1974.
[3] Deposits only. The American Banker states that UBAF "is 31.95 percent owned by the $23.6 billion deposit Credit Lyannais, 8 percent by the $2.6 billion deposit Banque Francaise du Commerce Exterior, Paris, with the remaining shares held by about 24 Arab banks."

As I pointed out to you in my letter of May 14th with respect to the European-American Bank, there are fundamental antitrust objection to joint ventures of this type. Such a bank would doubtlessly do a retail as well as a wholesale banking business, an intrastate as well as an interstate business, and a naional as well as an international business. If so, this would put the joint venture bank in direct competition with its parent banks and consitute a *per se* antitrust offense (*Timken* v. *United States*, 341 U.S. 593 (1951); *Penn-Olin* v. *United States*, 378 U.S. 158 (1964), and *Topco* v. *United States*, 405 U.S. 596 (1971)).

Moreover, once the Superintendent approves this joint venture there is no chance that any one of the many foreign banks will ever enter the New York market on its own.

As the Supreme Court held in *Penn-Olin, supra,* a joint venture is a merger subject to Clayton Seven and the Bank Holding Company Act compels you and the banking agencies, state and federal, to scrutinize its formation so as to avoid antitrust offenses.

In addition, because foreign banks are involved, Section 14(g) of the Federal Reserve Act (Title 12 USC 348(a)) gives the Board of Govenors of the Federal Reserve System "special supervision" over "transactions of any kind" that Federal Reserve members have with foreign banks. Indeed, under the statute, officers of member banks are forbidden to negotiate with forign banks "without first obtaining the permission of the Board of Governors" and, if permission be granted, "a full report" must be given the Federal Reserve Board.

There are of course solid reasons why the Federal Reserve Board should disapprove the organization of such a bank. In the first place, participation by any one of these four American banks in ownership of such a New York chartered bank would be interstate banking in violation of the *McFaddin Act* (12 U.S.C. 36), and the Bank Holding Company Act (12 U.S.C. 1842(d)).

Even if the foreign banks were to own the bank alone it is a joint venture, and a holding of five percent should raise a rebuttable presumption of control subjecting the foreign bank parents to the Bank Holding Company Act. It is unrealistic in joint ventures to measure control by percentage of stock ownership.

Investigation of the foreign banks may well reveal that they have interests in investment companies not permitted to our own banks under Glass-Steagall. The Superintendent of Banks of the State of New York should not issue a charter to such an organization not only because the foreign *parent banks* have real competitive advantages over our domestic banks in that they are not subject to the reserve and loan requirements of member banks of the Federal Reserve System, but also because under the above cited decisions of the Supreme Court of the United States the joint ventaure itself is a *per se* antitrust offense.

My information is that to date no notification has been filed of an intention to apply for a charter for this proposed bank, and if such notification be filed within four weeks, a plan of organization of the bank must be filed.

I trust you will promptly investigate the matter. If you conclude with me that the granting of such charter be unwise and unlawful I trust that you will promptly communicate your conclusions to the Superintendent of Banks of the State of New York and, if necessary, take whatever legal action be appropriate to stop this bank before it begins.

With kindest regards and best iwshes, I am,

Sincerely,

WRIGHT PATMAN, *Vice Chairman.*

BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., June 26, 1975.

Hon. WRIGHT PATMAN,
Chairman, Subcommittee on Domestic Monetary Policy, Committee on Banking, Currency and Housing, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I am responding to your letter of April 24, 1975, in which you ask certain questions about the status of the foreign bank shareholders of European-American Bank and Trust Company (EABTC), New York, New York, under the provisions of the Bank Holding Company Act of 1956 and the Banking Act of 1933 (the so-called Glass-Steagall Act). I have asked the staff to prepare a memorandum commenting on the questions raised and I am enclosing a copy. I hope you will find it helpful to your concerns.

As indicated in the staff memorandum, the statutory provisions of the Bank Holding Company Act and the Glass-Steagall Act presently limit the Board's jurisdiction over the foreign bank shareholders of EABTC and their banking and nonbanking operations in the United States. A consortia bank, such as EABTC, is a frequent form of banking organization in many foreign countries but is relatively unique in U.S. banking markets. The question of how the individual shareholding banks of such an entity should be treated under U.S. banking laws poses many difficult problems and it occupied a great deal of my attention and that of my colleagues on the System Steering Committee on International Banking Regulation in preparing the Board's legislative proposals to regulate foreign banks in the United States. As you know, the proposal that has been submitted to Congress would not extend coverage of the Bank Holding Company Act to the foreign bank shareholders of EABTC. The Board concluded that it was not possible to do so without either singling out foreign bank shareholders of consortia banks in a discriminatory fashion or changing the general definitions of control in the Bank Holding Company Act. The former would have been contrary to the principle of national treatment underlying the proposal and could possibly cause retaliation abroad. The latter could have domestic repercussions and would reopen difficult questions concerning definitions of "control" that required considerable time and effort in Congress' consideration of the 1970 Amendments to the Bank Holding Company Act. Because of these difficulties and because of the present limited number of domestic consortia banks, the Board decided not to recommend specific amendments to cover the case of the foreign bank shareholders of consortia banks such as EABTC.

At the present time, to my knowledge, there are only two other consortium banks, The Japan California Bank and The Chicago-Tokyo Bank each of which is owned by a large number of corporate shareholders none of whom own more than 5 per cent of the outstanding voting shares of the bank. The shareholders are mainly Japanese industrial or trading companies with only two shareholders of Japan California Bank and one shareholder of Chicago-Tokyo Bank being Japanese banks.

In addition to these existing joint ventures, as you know, a group of Arab banks along with a French bank and four U.S. bank holding companies have indicated an intention to establish a consortium bank in New York to be known as UBAF Arab-American Bank.

In connection with your letter of May 27, 1975, to Attorney General Levi concerning the proposed establishment of this new consortium bank, I would like to note that the domestic participants in the proposed bank have kept myself and the Board's staff advised of this proposed venture. In this regard, I have asked the staff to analyze several of the legal questions you raised concerning this venture based on information which has been made available to date. A staff memorandum on these issues is also enclosed. It is my understanding that, if chartered, the bank will apply both for FDIC insurance and membership in the Federal Reserve System.

A joint venture bank which is a member of the Federal Reserve System, such as EABTC, is supervised and examined to the same extent as any other member bank, and is, of course, subject to the same monetary and regulatory restrictions imposed on other member banks. In this regard, I believe EABTC to be a sound and well-managed banking institution.

One aspect of a joint venture form of banking organization that does present a unique problem for bank regulators is, however, the extent to which the various shareholders of a joint venture bank are prepared or obligated to provide financial support for the venture in the event of financial difficulties. This matter has emerged recently in relation to joint venture banks abroad and is a matter of concern and study for bank supervisors in all countries.

The status and activities of foreign banks in this country, including those that invest in consortia banks such as EABTC, raise important issues of public policy. I would hope that hearings on the Board's proposed legislation might be scheduled for the near future so that these issues might be aired and that Federal legislation covering foreign bank activities in the United States might be enacted this year.

Cordially,

GEORGE W. MITCHELL.

Enclosures.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JUNE 23, 1975, STAFF MEMORANDUM ON PROPOSED UBAF ARAB-AMERICAN BANK, NEW YORK, N.Y.

In his letter of May 27, 1975, to Attorney General Levi, Chairman Patman notes three possible legal impediments to the organization of UBAF Arab-American Bank: (1) antitrust objections under section 7 of the Clayton Antitrust Act (15 U.S.C. 18); (2) possible legal objections under section 14(g) of the Federal Reserve Act (12 U.S.C. 348(a)); and (3) possible violations of the multi-State banking prohibitions of the McFadden Act (12 U.S.C. 36), and the Bank Holding Company Act (12 U.S.C. 1842(d)). Chairman Patman also indicates that he feels Board approval of the organization of UBAF is necessary under the Bank

Holding Company Act, and that UBAF will have an advantage over other U.S. banks since it will not be a member of the Federal Reserve System.

It is understood that at the present time, the organizers of UBAF have not as yet made a formal filing with the Superintendent of Banks of the State of New York, although certain draft documents have apparently been filed for review by the staff of the New York Banking Department.

The purpose of this memorandum is to give a preliminary evaluation of Chairman Patman's legal or other objections to the formation of UBAF based on the staff's knowledge of this situation to date. In this regard, this memorandum is intended as an outline of the possible legal issues involved in the formation of UBAF, and is not intended as an exhaustive review of or formal staff determination on any such issues.

For analytical purposes, this memorandum is subdivided into four areas of legal inquiry: (1) New York State Banking Law—Summary of Statutory Provisions Relating to the Organization of a State Bank; (2) Legal Issues under the Federal Reserve Act; (3) Legal Issues under the Bank Holding Company Act; and (4) Legal Issues under Section 7 of the Clayton Antitrust Act.

I. NEW YORK STATE BANKING LAW—SUMMARY OF STATUTORY PROVISIONS RELATING TO THE ORGANIZATION OF A STATE BANK

Under § 4002 of the New York Banking Law, the proposed incorporators of a New York bank or trust company such as UBAF, must first sign a notice of intention to organize such corporation which must specify their names, the name of the proposed corporation, the amount of the capital stock, and the place where its office is to be located as set forth in the organization certificate. The original of such notice must be filed in the Superintendent of Banks' office within sixty days after its date of execution, and a copy thereof must be published at least once a week for four successive weeks in a newspaper designated by the Superintendent. At least fifteen days before an organization certificate is filed with the Superintendent, a copy of such notice must be served upon each State bank and trust company doing business in the village, borough or city, if in a city not divided into boroughs, specified as the location of the office of the proposed corporation. To the staff's knowledge, the incorporators of UBAF have not as yet filed such notice, although a draft notice has apparently been filed for review and comment by the staff of the New York Banking Department.

After the lapse of at least twenty-eight days from the date of the first due publication of the notice of intention to organize a bank and within ten days after the date of the last publication thereof, an organization certificate must be submitted to the Superintendent, together with affidavits or other satisfactory evidence of publication of the required notice.[1] The contents of the organization certificate are specified in § 4001 of the New York Banking Law.

Within twenty days after the receipt by the Superintendent of an organization certificate for a proposed bank, the Superintendent must file such certificate for examination, if the certificate and accompanying documents comply with the statutory requirements.[2] If a certificate or other documents do not comply, they are returned to the incorporators within the twenty-day period.[3]

If the Superintendent shall find after investigation and examination (1) that the character, responsibility, and general fitness of the person or persons named in such certificate are such as to command confidence and warrant belief that the business of the proposed bank will be honestly and efficiently conducted in accordance with the intent of the New York State banking laws, and (2) that the public convenience and advantage will be promoted by allowing such proposed bank to engage in business, he must, within 90 days after a certificate has been filed for examination, submit the organization certificate, all relevant documents, the results of his investigation and his recommendation to the banking board, which is composed of the Superintendent as its Chairman, and twelve other members appointed by the Governor by and with the advice and consent of the State Senate.[4]

The ninety-day period may, however, be extended by a written consent executed by a majority of the persons filing the organization certificate, for such reasonable period of time as may be required for the applicants to comply with

[1] N.Y. Banking Law § 4003 (McKinney 1971).
[2] *Id.*, § 23.
[3] *Id.*
[4] *Id.*, § 24.

conditions precedent stipulated by the Superintendent as being a prerequisite to his recommendation to the banking board.[5]

If three-fifths of the banking board vote for approval and the Superintendent remains satisfied that the bank should be permitted to engage in business, he approves and dates the certificate.[6] The corporate existence of the bank thereupon begins and it may elect officers and take other steps relating to its organization.[7] The bank may not begin any other business, however, until all of its capital stock has been paid in cash and a list of its shareholders shall have been delivered to and filed by the Superintendent.[8]

If three-fifths of the banking board do not vote for approval, or if the Superintendent, either prior or subsequent to the submission of the certificate, is not satisfied that the bank should be permitted to engage in business, the Superintendent refuses the certificate.[9]

II. FEDERAL RESERVE ACT

Chairman Patman avers in his letter that section 14(g) of the Federal Reserve Act (12 U.S.C. 348(a)) gives the Board "special supervision" over "transactions of any kind" that "Federal Reserve member banks" have with foreign banks.

Section 14(g) of the Federal Reserve Act provides that the Board "shall exercise supervision over all relationships and transactions of any kind entered into by any *Federal reserve bank* with any foreign bank or banker. . ." (emphasis added). It is thus clear from the plain words of the statute that such special supervision applies only to the twelve Federal Reserve Banks and not to each of the member commercial banks. Such construction is also conclusively supported by the legislative history of the provision in question.

If chartered, UBAF, of course, need not become a member of the System. The organizers of the bank have, however, apparently agreed that if UBAF is chartered, it will apply both for System membership and FDIC insurance.

In passing upon any application by UBAF for membership in the System, the Board must by statute consider the financial condition of the applying bank, the character of its management, and whether or not the corporate powers exercised are consistent with the purposes of the Act.[10] In addition, the Board must by statute determine that the bank possesses capital stock and surplus, which in the Board's judgment, are adequate to the character and condition of its assets and to its existing and prospective deposit liabilities and other corporate responsibilities.[11]

If it became a member, UBAF would, of course, be subject to examination and supervision by the Board,[12] and would be subject to the Board's monetary controls over reserves and interest rate limitations.[13] In addition, it would become subject to the provisions of the Glass-Steagall Act,[14] and the McFadden Act,[15] and would have to abide by the restrictions of section 23A of the Act on loans to and investments in affiliates (12 U.S.C. 371c), the restrictions of section 22(g) of the Act on loans to executive officers (12 U.S.C. 375a), as well as other financial and other restrictions contained in the Federal Reserve Act.[16]

If it became a member bank, UBAF would also be under the Board's jurisdiction with respect to the administration and enforcement of certain provisions of the Federal Deposit Insurance Act, including the Bank Merger Act[17] and the Financial Institutions Supervisory Act of 1966.[18]

As a member bank, UBAF would also be under the Board's jurisdiction with respect to the administration and enforcement of certain federal consumer credit

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[5] *Id.*
[6] *Id.*
[7] *Id.*, § 4004.
[8] *Id.*
[9] *Id.*, § 24.
[10] 12 U.S.C. 322 (1970).
[11] 12 U.S.C. 329 (1970).
[12] 12 U.S.C. 325 (1970).
[13] 12 U.S.C. 371a, 371b, and 461 (1970).
[14] Glass-Steagall Act restrictions on a national bank's dealing in investment securities and stock apply to State member banks under ¶ 20 of section 9 of the Federal Reserve Act (12 U.S.C. 335). Prohibitions against affiliation and interlocking personnel relationships with securities companies apply under 12 U.S.C. 377 and 78 respectively.
[15] See paragraph 3 of section 9 of the Act (12 U.S.C. 321) which applies the McFadden Act restrictions on branching to State member banks.
[16] See paragraph 6 of section 9 of the Federal Reserve Act which applies certain provisions of the National Bank Act to a State member bank and certain provisions of the United States Criminal Code to its officers, agents, and employees. See also restrictions on acceptances of member banks in 12 U.S.C. 372.
[17] 12 U.S.C. 1828(c) (1970).
[18] 12 U.S.C. 1818(b) (1970).

protection laws, such as the Trust-in-Lending Act,[19] the Fair Credit Reporting Act,[20] and the Equal Credit Opportunity Act.[21]

While the above is not intended to be exhaustive, it does indicate that if it became a member bank, UBAF would, in its banking operations, be subject to a substantial amount of federal control over its activities.

III. BOARD JURISDICTION UNDER THE BANK HOLDING COMPANY ACT

Under the Bank Holding Company Act, any company, as defined in section 2(b) of the Bank Holding Company Act (12 U.S.C. 1841(b)), must obtain the Board's approval to become a bank holding company.[22] As defined in section 2(a)(1) of the Act, a bank holding company means any company which has "control" over any bank or over any company that is or becomes a bank holding company by virtue of the Act.[23] Under the Act, any company is deemed to have control over a bank or over any company if (a) the company directly or indirectly or acting through one or more other persons, owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company; (b) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or (c) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.[24]

In any case in which there is a proposal to organize a new bank, whether national or State, and a company is to acquire control of such new bank and become a bank holding company, it has been the Board's practice not to accept the filing of an application by the proposed bank holding company unless it is reasonably likely that the new bank will be chartered. Accordingly, applications in such situations are generally not accepted until receipt of information that the chartering authority has given preliminary or tentative approval to the proposed charter. The Board has therefore not yet received any bank holding company application in connection with the organization of UBAF, nor has there been any determination by the Board or staff as to whether any application will be required in the case of UBAF. The organizers of UBAF have, however, agreed to furnish the Board's staff with copies of all final documents filed with the New York banking authorities, for analysis and comments by the Board's staff.

With respect to the four domestic bank holding companies that plan to participate in the organization of UBAF—Bankers Trust New York Corporation, First Chicago Corporation, Security Pacific Corporation and Texas Commerce Bancshares—it is provided in section 3(a)(3) of the Bank Holding Company Act (12 U.S.C. 1842(a)(3)) that a bank holding company needs the Board's approval to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank. From information available to date, it appears that each of the four bank holding companies proposes to acquire only 5 percent of the voting shares of UBAF and thus each of such bank holding companies would not have to obtain prior Board approval under section 3 of the Act to acquire those shares. The exemption from prior Board approval under section 3 of the Act also exempts such shareholdings from the multi-State prohibitions of section 3(d) of the Act, since, by its terms, section 3(d) only prohibits the Board from approving "any application under this section (i.e., under section 3 of the Act)" which will permit a bank holding company to acquire voting shares of an out-of-State bank. In the case of a 5 percent or less acquisition, no application is required under section 3 of the Act, and thus section 3(d) by its terms is not applicable. At present the staff knows of three other bank holding companies which own or control 5 percent or less of the voting shares of a bank outside their principal State of business—The Bank of Tokyo, Ltd., which owns 5 percent of The Chicago-Tokyo Bank, Chicago, Illinois; the Dai-Ichi Kangyo Bank, Ltd., which owns less than 5 percent of the shares of The Japan California Bank; and The Mitsui Bank, Ltd., which owns less than 5 percent of the shares of City National Bank of Honolulu, Hawaii.

While dealing with the issue of multi-State banking, it should be noted that Congressman Patman also indicated that he thought the proposed investments

[19] 15 U.S.C. 1601 *et seq.* (1970).
[20] 15 U.S.C. 1681 *et seq.* (1970).
[21] Title III of the Act of October 28, 1974 (P.L. 93–495; 88 Stat. 1512) eff. 12/28/75. Codified to 15 U.S.C. 1666.
[22] 12 U.S.C. 1842(a) (1970).
[23] 12 U.S.C. 1841(a)(1) (1970).
[24] 12 U.S.C. 1841(a)(2) (1970).

in UBAF by domestic bank holding companies might violate the provisions of the McFadden Act (12 U.S.C. 36). Under that Act, a national bank does not have the power to establish a branch office in a State outside of the State where it is situated. State member banks are subject to these same restrictions under section 9 of the Federal Reserve Act. Since UBAF is to be a separately incorporated State bank, and the proposed investment is to be made by domestic bank holding companies and not their subsidiary banks, the restrictions of the McFadden Act would not apply unless the facts indicated that UBAF was, in fact, to be staffed, organized and run as a branch office of a subsidiary national or State member bank of one of the holding companies involved.

IV. ANTITRUST OBJECTIONS UNDER SECTION 7 OF THE CLAYTON ANTITRUST ACT

In *United States* v. *Penn-Olin Chemical Co.*,[25] the U.S. Supreme Court held for the first time that Section 7 of the Clayton Antitrust Act applies to joint ventures. While recognizing that "a joint venture creates a new competitive force" whereas mergers eliminate one of the participating corporations from the market, the Court nevertheless concluded that "[o]verall, the same considerations apply to joint ventures as to mergers. . ."[26]

Any action by the Justice Department against UBAF would thus, of course, depend on its evaluation of the anticompetitive effects of the proposed joint venture under the standards of Section 7 of the Act which, in general, prohibits, acquisitions, "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

The type of inquiry required in considering the legality of a joint venture under Section 7 is indicated by the Supreme Court's instruction in Penn-Olin that the trial court on remand take account of the following criteria:

> [T]he number and power of the competitors in the relevant market; the background of their growth; the power of the joint venturers; the relationship of their lines of commerce; the competition existing between them and the power of each in dealing with the competitors of each other; the setting in which the joint venture was created; the reasons and necessities for its existence; the joint venture's line of commerce and the relationship thereof of that of its parents; the adaptability of its line of commerce to non-competitive practices; the potential power of the joint venture in the relevant market; and appraisal of what the competition in the relevant market would have been if one of the joint ventures had entered it alone instead of through Penn-Olin; the effect, in the event of this occurrence, of the other joint venturer's potential competition; and such other factors as might indicate potential risk to competition in the relevant market.[27]

All of these criteria, of course, involve questions of fact, and thus until all of the relevant facts are obtained and analyzed, it would be premature to express any competitive judgment on the joint venture.

Any Justice Department action would also depend on whether a bank holding company application will be required under the Bank Holding Company Act, for if such an application is required, the Board, under section 3(c) of the Act (12 U.S.C. 1842(c)), must deny any bank holding company application involving the acquisition of a bank or bank holding company that violates the standards of Section 7 of the Clayton Act, unless it finds "that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." Should the Board approve any such formation, the Justice Department would, under section 11(b) of the Bank Holding Company Act (12 U.S.C. 1849(b)), still have thirty calendar days to bring suit to prevent the acquisition. Under section 11(b) of the Bank Holding Company Act, any Board approval order would automatically be stayed by a Justice Department suit, unless the court specifically ordered otherwise. If Bank Holding Company Act approval is not required, the Justice Department could, of course, still bring suit to prevent the formation of UBAF under Section 7 of the Clayton Act. The

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[25] 378 U.S. 158, 167–68 (1964).
[26] *Id.*, at 169–170.
[27] *Id.*, at 177. On remand, the district court again upheld the joint venture. *United States* v. *Penn-Olin Chemical Co.*, 246 F. Supp. 917 (D. Del. 1965), *aff'd by an equally divided Court*, 389 U.S. 308 (1967).

formation would not, however, be automatically stayed if such suit were brought; rather, it appears that in such case the Justice Department would have to show a reasonable probability that it would ultimately prevail on the merits in order to obtain a temporary restraining order or other prohibition.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JUNE 23, 1975, STAFF MEMORANDUM ON EUROPEAN-AMERICAN BANK AND TRUST CO., NEW YORK, N.Y.

European-American Bank and Trust Company (EABTC), a New York State-chartered bank, assumed certain assets and liabilities of Franklin National Bank on October 9, 1974. Shortly thereafter, on October 25, 1974, the Board approved EABTC's application for membership in the Federal Reserve System and EABTC became a State member bank on October 31, 1974. The Board's files indicate that the stockholders of EABTC are as follows (as of October 31, 1974):

Stockholder	Total shares	Percent
Amsterdam-Rotterdam Bank, N.V., Amsterdam, The Netherlands	17,830	15.50
Creditanstalt Bankverein, Vienna, Austria	2,616	2.27
German-American Capital Corp., a subsidiary of Deutsche Bank, A.G., West Germany	21,111	18.36
Midland Bank, Ltd., Longon, England	21,111	18.36
Societe Generele de Banque S.A., Brussels, Belgium	20,996	18.26
Societe Generele, Paris, France	21,111	18.36
European-American Banking Corp., New York, N.Y.	9,990	8.68
Total, percent		[1] 99.79

[1] The remaining shares are qualifying shares held by directors.

As noted by Chairman Patman, EABTC's shareholders are among the largest banks in Europe. Amsterdam-Rotterdam Bank is the largest bank in the Netherlands with assets in excess of $9.6 billion; Creditanstalt Bankverein is the largest bank in Austria with assets in excess of $4.2 billion; Deutsche Bank is the largest German commercial bank, with consolidated assets of approximately $24.5 billion; Midland Bank, a major English clearing bank, has consolidated assets of nearly $20 billion; Societe Generale de Banque (Belgium) is the largest bank in Belgium with assets of approximately $9.1 billion; and Societe Generale of France is one of the three largest banks in France with consolidated assets of $20.4 billion.

STATUS UNDER THE BANK HOLDING COMPANY ACT ("ACT")

Since no one of the foreign bank sharehloders of EABTC owns or controls 25 per cent or more of the shares of EABTC, or itself controls in any manner the election of a majority of the directors of EABTC, none of the foreign banks has ever been under a duty to apply to become a bank holding company. While the Board could require any of the foreign bank shareholders to apply to become a bank holding company, it could only do so if it found, after notice and opportunity for hearing, that any such foreign bank directly or indirectly exercises a controlling influence over the management or policies of EABTC. In this regard, there does not appear to be any basis for instituting a controlling influence proceeding against any of the foreign bank shareholders of EABTC at this time, since none of the foreign bank shareholders is presumed to control EABTC under the Board's rebuttable presumptions of control (§ 225.2(b) of Regulation Y, a copy of which is enclosed) and no information has otherwise been obtained which would indicate that any one of the foreign bank shareholders of EABTC exercises a controlling influence over the management or policies of EABTC.

At the time the Congress was considering the 1970 Amendments to the Bank Holding Company Act, the House originally passed H.R. 6778 which amended the definition of "control" in section 2(a)(2)(A) of the Act, such that any "person" would have "control" over a bank or a company for purposes of the Act "if the person directly or indirectly or acting in concert with one or more other persons, . . . has power to vote 25 per cent or more of any class of voting securities" of the bank or company. However, as finally enacted by the Congress, the phrase "any person" was deleted and replaced by the phrase "any company", and the phrase "acting in concert with one or more other persons" was deleted and replaced by the phrase "acting through one or more other persons".[1] Had the "in

[1] The statutory phrase first appeared in H.R. 6778 when it was reported out by the Senate Banking Committee.

"concert" language been adopted by the Congress, it is possible that *each* of the foreign banks with significant shareholdings in EABTC could have been required to apply to become a bank holding company under the Act. Under the statutory language as adopted, however, a company cannot be deemed to be a bank holding company merely by showing that it acts in concert with other shareholders to control the bank; rather, it appears that it must be shown that the company acts "through" one or more other persons to control the bank. On the basis of available facts, it does not appear that any of the foreign bank shareholders acts through the other shareholders to control EABTC. Thus, no foreign bank shareholder of EABTC has ever been required to become a bank holding company.

Under the present definition of "company" in the Act, if a corporation, partnership, business trust, long-term trust, association, or similar organization controlled EABTC, that entity would have to apply to become a bank holding company. If the shareholders of EABTC had themselves formed a partnership, association or similar organization and that separate organization acted through the foreign bank shareholders to control EABTC, that entity would be a bank holding company. To date, the staff has been unable to obtain any factual evidence which would support a finding that such an independent entity exists, or that the foreign bank shareholders of EABTC are subject to the central controlling influence of any "company" as defined in the Act.

STATUS UNDER THE GLASS-STEAGALL ACT

As a member bank, EABTC is subject to the provisions of the Glass-Steagall Act. Under section 20 of the Glass-Steagall Act (12 U.S.C. 377), EABTC may not be affiliated, in any manner described in section 2(b) of the Glass-Steagall Act (12 U.S.C. 221a), with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities. A copy of the statutory definitions of "affiliate" under section 2(b) of the Glass-Steagall Act is attached.

It is clear that European American Banking Corporation (EABC), New York, New York, an Investment Company chartered under Article XII of the New York State Banking Law, is an "affiliate" of EABTC within the meaning of section 2(b) (2) and (3) of the Glass-Steagall Act, as EABC shares common management with and has the same owners as EABTC.[2] While EABC has the authority under its charter powers to deal in securities,[3] EABC does not in fact principally engage in any of the securities activities included within the proscriptions of section 20 of the Glass-Steagall Act referred to above. Due to its being affiliated with EABTC, a member bank, EABC is also now prohibited from principally engaging in any such securities activities in the future notwithstanding its charter powers.

Deutsche Bank, one of the six major foreign bank shareholders of EABTC, has a 50 percent share interest in UBS–DB Corporation, New York, New York, a securities company with membership on the Pacific and PBW stock exchanges. This ownership does not ake UBS–DB Corporation an affiliate of EABTC, however, since there is no common control of EABTC and UBS–DB, as Deutsche Bank does not control EABTC within the meaning of section 2(b) of the Glass-Steagall Act (it only has an indirect 18.36 percent share interest in EABTC). The maining shares of UBS–DB Corporation are owned by the Union Bank of Switzerland, Geneva, Switzerland, which is not a shareholder of EABTC.

Amsterdam-Rotterdam Bank, Societe Generale de Banque of Belgium, and Societe Generale of France, whose shareholdings aggregate 52.02 percent of the shares of EABTC, also each own substantial voting share interests in So-Gen Swiss International Corporation ("So-Gen Swiss"), New York New York, a securities company which is a member of the Midwest and PBW stock exchanges. Amsterdam-Rotterdam Bank directly owns 16.4 percent of So-Gen Swiss, Societe

[2] Midland Bank, Societe Generale (France), Deutsche Bank, and Societe Generale de Banque (Belgium) each own 20.125 per cent of EABC. Amsterdam-Rotterdam Bank owns 17.54 per cent of EABC and Creditanstalt Bankverein owns 2.0 per cent of EABC.

[3] Paragraph 5 of § 508, Article XII of the New York State Banking Law, authorizes investment companies to "purchase, acquire, invest in, and hold all or any of the stocks of any corporation domestic or foreign, and to sell and dispose of all or any stocks owned by it. . . ." An investment company may not, however, invest more than 10 per cent of its capital and surplus in any one corporation, nor more than 30 per cent of its capital and surplus in the aggregate in all such corporations.

Generale de Banque of Belgium owns 10.0 percent of So-Gen Swiss, and Societe Generale of France owns 13.1 percent of So-Gen Swiss. In addition, it appears that Societe Generale de Banque may indirectly control an additional 6.4 per cent of the voting stock of So-Gen Swiss through Sofina S.A., Brussels, Belgium, a Belgian holding company, in which it is understood that Societe Generale de Banque has a minority, but perhaps controlling, interest. Similiarly, it is understood that Societe Generale of France may indirectly control an additional 3.3 per cent of the voting shares of So-Gen Swiss through its minority, but perhaps controlling, interest in Societe Generale Alsacienne de-Banque. Thus, it is understood that, in the aggregate, three foreign bank shareholders of EABTC may directly or indirectly own or control a maximum of 49,2 per cent of the voting shares of So-Gen Swiss. It appears, however, that So-Gen Swiss is controlled by Credit Suisse, a Swiss bank, which is not a shareholder fo EABTC. Credit Suisse owns 50.8 per cent of the outstanding voting stock of So-Gen Swiss, and eight of So-Gen Swiss' 13 directors appear to represent Credit Suisse. The chief executive and chief operating officers of So-Gen Swiss also appear to represent Credit Suisse.

Under setcion 2(b))(2) of the Glass-Steagall Act, So-Gen Swiss would be an affiliate of EABTC if Amsterdam-Rotterdam Bank, Societe Generale de Banque of Belgium and Societe Generale of France controlled So-Gen Swiss, directly or indirectly, through stock ownership or in any other manner. On the basis of the Articles of Incorporation and By-Laws of So-Gen Swiss, the three foreign bank shareholders of EABTC do not appear to have the power to control So-Gen Swiss through their direct or indirect stock holdings. It also appears that the three foreign bank shareholders of EABTC do not control a majority of the board of directors of So-Gen Swiss, since only 5 of the 13 directors of So-Gen Swiss appear to represent, directly or indirectly, the shareholders of EABTC.[4] Counsel to EABTC has also informed staff of the Federal Reserve Bank of New York that he knows of no side agreements relating to the voting shares of So-Gen Swiss by the shareholders thereof which would otherwise give them control of So-Gen Swiss. Staff is awaiting further information regarding the ownership and control of So-Gen Swiss; that information is being furnished from abroad and has been delayed.

With reference to these common shareholdings, it should be noted that Congress did not include within the proscriptions of section 20 of the Glass-Steagall Act substantial common holdings of stock in commercial and investment banks; rather, it drew the line at majority ownership or control apparently because it felt abuses were most likely to occur when a commercial bank and investment bank were controlled by the same persons. Thus, whatever inconsistency there may now be between the spirit of section 20 of the Glass-Steagall Act and the substantial common shareholdings in EABTC and So-Gen Swiss, on the basis of information gathered to date, it appears that such shareholdings would not be prohibited law.

Enclosure.

Definition of Affiliate in Section 2(b) of the Banking Act of 1933

Sec. 2. As used in this Act and in any provision of law amended by this Act—

(b) Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization—

(1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of it directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preced-

[4] Amsterdam-Rotterdam Bank, Societe General de Banque of Belgium, Societe Generale of France, Sofina S.A. of Belgium, and Societe Generale Alsacienne de Banque each appear to have one representative on the board of directors of So-Gen Swiss. As indicated previously, Credit Suisse appears to have eight representatives.

ing election, or by trustees for the benefit of the shareholders of any such bank; or

(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

(12 U.S.C. 221a)

JULY 2, 1975.

Hon. GEORGE W. MITCHELL,
Vice Chairman, Board of Governors,
Federal Reserve System, Washington, D.C.

DEAR GOVERNOR MITCHELL: Thank you for forwarding a copy of your letter dated June 26, 1975, to Chairman Patman concerning the status of foreign bank shareholders of European-American Bank and Trust Company, New York, New York, under the Bank Holding Company Act of 1956 ("the Act").

The Act defines a bank holding company to mean any company which has "control" over any bank. One of the tests of the existence of "control" is whether or not the company "directly" or "indirectly" exercises a controlling influence" over the management or policies of a bank. It may be reasonably concluded that one or more companies could each separately exercise a "controlling influence" over a particular bank within the meaning of that term in the Act by virtue of the holding and exercising of rights with respect to any class of voting securities of the bank (albeit less than 25 percent of any class thereof) together with the real impact which the company may have on the management or policies of the bank.

I realize that the resolution of the question of whether a company exercises a "direct" or "indirect" controlling influence over the management or policies of a bank may vary on a case by case basis depending upon the facts which are developed. Because of this the Act provides that the Board of Governors may determine the existence of a "controlling influence" only after notice and opportunity for hearing.

Section 2(a)(2)(C) of the Act does not circumscribe the requirement for a hearing on the "controlling influence" question by placing a threshhold burden on the Board to adduce facts which indicate some probability of success in determining "control." Indeed, imposition of such a requirement might pose a question of fairness to the company in question in the sense that it might be considered as a prejudgment of the issues, such a requirement might well be contrary to the public interest in any case where a "controlling influence" is present but no threshhold probability of success is sufficiently apparent to the Board.

While the Board should not schedule hearings under 2(a)(2)(C) of the Act for frivolous purposes, it appears clear that certain complex situations involving matters of first impression that may have a strong precedential value would be best served by holding a hearing on the record before an Administrative Law Judge in preference to a purely administrative resolution of the question without a detailed factual inquiry and a clear resolution of the "control" question.

The hearing procedure appears especially desirable in the European-American case where significant collaterial issues under the Act turn on a resolution of the question of "control", the consortium mode may portend a significant breach of the coverage afforded by the Act and no legislative recommendation is being made to impact upon the situatino. The matter of "control" should not be resolved by default at this early stage of the European-American case when there is an opportunity to develop a record to determine the extent to which the present provisions of the Act cover the situation and whether they are adequate to protect the public interest.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

DEPARTMENT OF JUSTICE,
Washington, D.C., July 18, 1975.

Hon. WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee,
U.S. Congress,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: This is in response to your letters of May 14 and May 27, 1975, concerning, respectively, the operation of European-American Bank and Trust Co., New York, New York and the possible formation of United Bank, Arab and French, New York.

With respect to European-American Bank and Trust Co. ("EABTC"), you note that this state-chartered member bank is jointly owned by six large European Banks and recently purchased the insolvent Franklin National Bank. You also note that a report submitted by the Department dated October 4, 1974 to the Federal Deposit Insurance Corporation on the competitive factors presented by this acquisition did not contain any discussion of its effect on the national and international wholesale banking markets, nor did it udertake to explain "why the liaison of six competing banks for the purpose of dividing the American wholesale banking market between them is not a *per se* antitrust offense." You request that the Department of Justice conduct an investigation to determine whether the operation of EABTC is a violation of antitrust law.

The Department's October 4, 1974 report on the possible acquisition of Franklin by EABTC focused on possible competitive effects of the transaction in retail banking in the New York Metropolitan Area, particularly on Long Island. Our competitive analysis was limited to retail banking because we considered the possibility of anticompetitive effects arising out of any possible acquisition of Franklin to be most serious in retail markets, which are limited in geographic scope by the strong customer convenience factor. *See*, e.g., *United States* v. *Marine Bancorporation*, 94 S. Ct. 2856, 2868 (1974); *United States* v. *Phillipsburg National Bank*, 399 U.S. 350, 362–65 (1970). Our competitive report did not discuss the potential effect of the acquisition on national or international wholesale banking markets because we concluded that the overall size of those markets was so great, and the relative market positions of Franklin and EABTC therein so small, in fact, as to make any increase in concentration in those markets resulting from the acquisition *de minimus*. In short, antitrust case law on mergers and acquisitions, and the legal and economic theories which support these cases, did not indicate that any anticompetitive effects in wholesale banking markets would be likely to result from EABTC's acquisition of Franklin.

Your question as to why our letter did not discuss a division of the American wholesale banking market by six competing banks as a *per se* antitrust violation appears to reflect a view that the joint ownership of EABTC by six large European banks is, in and of itself, illegal under the antitrust laws. Of course, this question may be considered essentially apart from the Franklin acquisition, which did not affect the basic nature of EABTC as a joint venture, but rather increased its size. In any case, we do not share the view that joint ventures generally, or more particularly among banks, are illegal *per se.*

In *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158 (1964), the Supreme Court considered a joint venture between two chemical companies to produce sodium chlorate in the Southeast. The Court held that the record in that case did not disclose a violation of the Sherman Act, but remanded the case for further consideration of the possibility that the joint venture might violate Section 7 of the Clayton Act. Recognizing that the formation of a joint venture could have an effect on competition between the venture and its organizers, the Court adopted a legal analysis similar to that used for mergers and acquisitions generally, *i.e.*, whether "a reasonable likelihood of a substantial lessening of competition in the relevant market is shown", 378 U.S. at 171. Such a test, of course, does not constitute a *per se* rule of illegality. An analysis of the *Penn-Olin* joint venture as an illegal agreement among competitors to divide the market involved, based on such cases as *Addyston Pipe and Steel Co.* v. *United States*, 175 U.S. 211, and *Timken Co.* v. *United States*, 341 U.S. 593, was presented by two dissenting Justices, but not adopted by the Court. Thus, we view the *Penn-Olin* case as establishing that a joint venture formed by two or more companies for the purpose of competing in a new market is not a *per se* antitrust violation; rather its legality must be tested by an analysis of its actual or potential competitive effects in view of the specific economic circumstances in which it occurs. We are aware of no evidence which would indicate that the EABTC venture is part of a more comprehensive illegal arrangement affecting the domestic or foreign commerce of the United States. Nor does it appear that the joint venture, when viewed in the context of a very large market containing numerous powerful domestic and foreign competitors, may substantially lessen competition as defined by the courts under Section 7 of the Clayton Act. Consequently, on the basis of information presently available to us, we do not believe that a full scale antitrust investigation would be fruitful.

With respect to United Bank, Arab and French ("UBAF–NY"), you note that according to press reports, application may be made to the Superintendent of Banks of the State of New York to form said bank and operate it as a joint venture along the lines of EABTC. Prospective applicants, according to your letter, include four United States banks (one of which is located in New York), and three French banks (one of which is partially owned by the other two, and partially owned by about 24 Arab banks). You reiterated the view expressed in your earlier letter that the formation of this type of joint venture would constitute a *per se* antitrust violation under *Timken Co.* v. *United States*, 341 U.S. 593, *Penn Olin Co.* v. *United States*, 378 U.S. 158, and *Topco* v. *United States*, 405 U.S. 596. As I noted above with respect to EABTC, we do not share the view that the joint venture, alone and of itself, would constitute a *per se* antitrust violation. Rather, the question is whether the venture may substantially lessen competition, a prospect that seems unlikely, taking into consideration the nature of the market involved, which contains numerous powerful domestic and foreign competitors.

We appreciate your continuing interest in antitrust enforcement.

Sincerely yours,

THOMAS E. KAUPER,
Assistant Attorney General, Antitrust Division.

AUGUST 1, 1975.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: On May 14, 1975 I wrote you with respect to the purchase of the Franklin National Bank on Long Island by six large European banks, and on May 27, 1975 with respect to the possible formation of the United Bank, Arab and French in Manhattan by four American holding companies, 26 Arab financial institutions, 11 Arab and 3 French banks.

Presumably, at your request, under date of July 18th Professor Thomas E. Kauper, Assistant Attorney General in charge of the Antitrust Division answered both letters.

Because of the respect I have always had for your approval to antitrust matters I write to inquire whether Professor Kauper's answer of July 18th to my two letters has your approval as, in my judgment, his decision is very much against the public interest.

Frankly, I was shocked to see your antitrust division approve the acquisition by six of Europe's largest banks of Franklin "the leading commercial bank in Nassau", and "the second leading bank in Suffolk County" with 72 offices in both counties.

Prior to the Franklin Application, the then Superintendent of Banks for the State of New York, Harry W. Albright, Jr., denied the application of Barclays Bank, a $24 billion bank, to acquire Long Island Trust Company, a $500 million bank, fourth largest on Long Island with 32 offices.

The Superintendent found that approval of the application would "result in a significant lessening of potential competition between Barclays and Long Island Trust Company in the Nassau-Suffolk market, and in other banking markets around the State".

At the time of purchase Franklin was a bank of $1.37 billion. The Deutsche Bank alone is a $24 billion bank, and the assets of the six banks total $86.8 billion.

Obviously, you are allowing six large banks to divide up among themselves the business of Long Island's leading commercial bank-a division of business and a horizontal restraint.

Speaking for six of the present Supreme Court Justices in *United States* v. *Topco, Inc.* (1972) 405 U.S. 596, Mr. Justice Marshall says that when the restraint is horizontal, as it is here, it is a *per se* antitrust offense under Sherman One and, since it involves a forbidden "business relationship", the rule of reason is no defense. This *per se* view is the one to which the Court returns in *Topco.*

What disturbs me most about Professor Kauper's letter of July 18th is his statement that you do not share my view "that joint ventures generally, or more particularly among banks, are illegal *per se*".

So far as the antitrust laws are concerned, this gives the green light to combinations of banks, domestic and foreign, to join together in the operation of one of our American banks. Conceivably, Professor Kauper would approve our six largest banks, Bank of America, Citibank, Chase Manufacturers Hanover, Morgan Guaranty, and Chemical's combining together in owership of Riggs here in Washington.

Of course Professor Kauper is right that all *United States* v. *Penn-Olin Chemical Co.* (1964) 378 U.S. 1958 decided is that a joint venture like a merger must be judged under Clayton Seven. However, it is of great significance that Mr. Justice Douglas, with the concurrence of Mr. Justice Black, repeated what Mr. Justice Black said for the Court in *Timken Roller Bearing Co.* v. *United States* (1951) 341 U.S. 593, namely, "Agreements among competitors to divide markets are *per se* violations of the Sherman Act", so that "an actual division of the market through the device of joint venture has . . the effect substantially to lessen competition within the meaning of Section 7 of the Clayton Act".

Under the circumstances, I assume that we cannot expect any move by Professor Kauper to block the proposed United Bank, Arab and French, nor any action against the European-American Bank and Trust Company.

It disturbs me to see any weakening of the antitrust laws in their application to big banks, foreign or domestic, and I would like to think you do not share Professor Kauper's views, If you don't, who is to present the opposite side? Are these illegal mergers to take effect by default?

With kindest regards and best wishes, I am.

Sincerely,

WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., August 4, 1975.

Hon. GEORGE W. MITCHELL,
Vice Chairman, Federal Reserve System,
Washington, D.C.

DEAR MR. MITCHELL: You were very kind to write me as you did on June 26, 1975, in answer to my letter of April 24, 1975 to Dr. Burns, and you may be sure I very much appreciate your courtesy in sending to me your two staff memoranda.

I am afraid you do not view the Sherman Act and the other antitrust laws as an American Charter of Economic Freedom as I do. There was a time when we doubted we could sell the principles of our antitrust laws to the world, but since the Treaty of Rome, and the coming of the Common Market, there is hope today that our European cousins will see the light.

But whether the rest of the world agrees with us or not, the Sherman Act and the other antitrust laws are the law of the land, and they are binding on American corporations not only in the United States, but in foreign commerce as well.

We have every right to expect that foreign banks who do business here will respect all our laws, including our antitrust laws. Accordingly, it seems quite immaterial whether "a consortia" or "joint venture" is "a frequent form of banking organization in many foreign countries". Under our law, as I read it, a joint venture by its very nature is a restraint of trade on its members horizontally, and, therefore, a *per se* antitrust offense for which the rule of reason is no defense.

Feeling as I do, I am appalled at your inserting a grandfather clause in your proposed foreign bank legislation to give Congressional blessing to the European-American Bank in which six of Europe's largest banks with assets of $86.8 billion divide the business of Franklin, Long Island's leading commercial bank.

What disturbs me equally is your permitting three bank holding companies (The

Bank of Tokyo, Ltd., Dai-Ichi Kangyo Bank, Ltd., and Mitsui Bank, Ltd.) to dodge the McFadden Act by having interests of 5 percent or less in respectively, The Chicago-Tokyo Bank, Japan California Bank, and City National Bank of Honolulu, all banks in a different state.

Section 3(d) of the Bank Holding Company Act cannot be read as your staff attempts to do. It specifically prohibits the acquisition by a bank holding company of stock in an out-of-state bank, "unless the acquisition of such shares or assets of a state bank, by an out-of-state bank holding company, is specifically authorized by the statute laws of the state in which such bank is located, by language to that effect, and not merely by implication".

It is this bad precedent upon which the proposed United Bank, Arab and French apparently relies in including in its ownership four American bank holding companies, 26 Arab financial institutions, 11 Arab and 3 French banks, everything but a partridge and a pear tree.

You are the sole regulator of bank holding companies, and the policy of the McFadden Act is not to permit interstate banking. Accordingly, I should expect the Federal Reserve to disapprove such an acquisition by three of these bank holding companies (First Chicago, Security Pacific, and Texas Commerce) regardless of the amount of their stock interests so long as McFadden represents Congressional policy, and regardless of whether the bank in question be a state nonmember bank.

In the case of the fourth bank holding company, Bankers Trust New York Corporation, I would expect you, as regulator, to deny the application because it is an antitrust offense for it to join the proposed joint venture.

Your troubles with holding companies stem primarily from your ignoring them unless the statute compels them to apply to you. As you point out, the McFadden Act prohibits interstate banking, and the Federal Reserve Act carries the same prohibition against member banks. Under these circumstances to say that the Fed can stand idly by and allow bank holding companies to take any interest in out-of-state banks is dead wrong. Merely because bank holding companies do not have to apply to you for approval of an acquisition of 5 percent or less does not authorize you to ignore such minor acquisitions when they flagrantly violate the policy of the McFadden Act. Nor does the fact that the out-of-state bank is a state nonmember bank authorized you, as the sole regulator of bank holding companies, to ignore their violating the policy laid down by McFadden.

In thinking that with respect to either the United Bank, Arab and French or European-American that you are powerless to subject the owners to the Bank Holding Company Act unless they own 25 percent of the stock, you are making, once again, the same costly mistake Dr. Burns made in July 1972 with the Franklin New York Corporation when he refused my request to hold a hearing to determine what everyone knew, but you, that Michele Sindona controlled the bank with 18 percent of the voting shares.

In his letter to you of July 2, 1975, Senator Proxmire asks you to hold a hearing to determine if the six banks that own European-American each have a controlling interest. This, unquestionably, is what you should have done in Franklin, and what you must do here. Have you acted on Senator Proxmire's letter?

When enacting the Bank Holding Company Act the Senate Banking Committee in its Report Number 1084 says—

> The committe is cognizant of the fact that under modern conditions, it is entirely possible to control the affairs of a company without owning 25 percent or more of its outstanding voting stock.

and, in the next paragraph of its Report, the Committee "approved a provision which would allow the Federal Reserve Board to make a finding of control after notice and opportunity for hearing where the company directly or indirectly exercise a controlling influence over the management or policies of the bank."

Moreover, the Committee on Banking and Currency of the House in its Report (91–1747) says the Act, as agreed to in conference "authorizes the Federal Reserve Board to find actual control of a bank where a company holds less than 25 percent of its stock."

As Senator Proxmire says, you should schedule hearings before an Administrative Law Judge, and determine the question of who controls European-American, and in the event it applies, do likewise in the case of the United Bank, Arab and French.

Turning now to the Glass-Steagall Act, I am sure we both can agree that this prohibits a commercial bank from having an investment bank as an affiliate. My complaint is that permitting Deutsche Bank to have a fifty percent interest in the investment banking firm of UBS–DB Corporation and Amsterdam-Rotterdam, Societe Generale de Banque of Belgium, and Societe Generale of France, over a fifty percent interest in the investment banking firm of So Gen-Swiss International Corporation, violates Glass-Steagall in principle, and gives these foreign banks a competitive advantage over our American banks.

Accordingly, you have no right to admit a bank owned by these foreign banks as a member bank in the Federal Reserve System unless these foreign bank stockholders divest themselves of their investment banking interests.

Your foreign bank bill should also make the same provision with respect to foreign banks who do an investment banking business directly or indirectly.

I am also informed that you have allowed Morgan Guaranty Trust Company, through its French Edge Act Corporation, to hold a one-third stock interest in Morgan and Cie International, S.A., a Paris investment banking firm in which Morgan Stanley, the well known American investment banking firm, owns the other two-thirds.

As I am sure you know, Glass-Steagall was enacted primarily to prevent the House of Morgan from being, at one and the same time, a commercial and investment banker. Today, Morgan does in Paris, with your approval, the business Glass-Steagall forbids it to do at home.

Moreover, I am also informed that the following subsidiaries of American commercial banks are principally engaged in selling securities abroad:

Bank of America International, Ltd., London
Banque de Commerce, S.A., Brussells (owned by Chase Manhattan)
Bankers Trust International, Ltd., London
Chase Manhattan, Ltd., London
Citicorp International Bank, Ltd., London
Continental Bank, S.A., Brussels
Continental Illinois, Ltd., London
Deutsche Unionbank, Frankfurt (owned by Bankers Trust Co.)
First Chicago, Ltd., London
International Marine Banking Company, Ltd., London
Manufacturers Hanover, Ltd., London
Trinkaus and Burkhardt, Dusseldorf (owned by First National City Bank)
Wells Fargo, Ltd., London

As I understand it, all these are either Edge Acts or subsidiaries thereof which offer their securities abroad, principally in the Eurodollar market, to evade registration with the Securities and Exchange Commission. However, I might add that there is reason to believe that these banks actually handle these issues at their home offices and merely formalize them abroad.

Because Glass-Steagall applies to corporations that receive deposits, Edge Act Corporations, which are under your sole control, have apparently been regarded by you as exempt from Glass-Steagall. Though I have my doubts, in this you may be technically and legally correct, but does it not make nonsense out of Glass-Steagall to say that while it applies in the United States, American banks are free to avoid it abroad?

More important, should you not, as the sole regulator of Edge Act Corporations, forbid these American banks from engaging any longer in the investment banking business either abroad or anywhere else unless authorized by the Congress, and placed under Securities and Exchange Commission supervision?

Once more I thank you for the careful consideration you have given to my letter of April 24th.

With kindest regards and best wishes, I am,

Sincerely,

WRIGHT PATMAN, *Vice Chairman.*

BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., November 20, 1975.

Hon. WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee, U.S. House of Representatives, Washington, D.C.

DEAR VICE CHAIRMAN PATMAN: This is in further response to your letter of August 4, 1975, in which you raised several questions pertaining to the underwriting activities abroad of Edge Corporation and their subsidiaries. In my earlier letter to you, I indicated that a staff memorandum dealing with the legal and regulatory aspects of such activities would be prepared. Enclosed for your information is a staff memorandum that I believe deals extensively with the issues you have raised.

I hope that the enclosed memorandum is responsive to the concerns addressed in your letter. I regret any inconvenience which the delay in transmitting this memorandum may have caused you or your staff. The Board will, of course, be glad to provide any additional information which you might request.

Cordially,

GEORGE W. MITCHELL.

Enclosure.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, NOVEMBER 14, 1975, STAFF MEMORANDUM ON INVESTMENT BANKING ACTIVITIES ABROAD OF EDGE CORPORATIONS AND THEIR FOREIGN SUBSIDIARIES

In a letter dated August 4, 1975 to Vice Chairman Mitchell. The Honorable Wright Patman, Vice Chairman of the Joint Economic Committee ("JEC"). raised several questions pertaining to the investment banking activities abroad of Edge Act Corporations [1] and their foreign subsidiaries. In particular, Vice Chairman Patman was concerned that such activities might be in contravention of the policies of the Glass-Steagall Act.

It is understood from the questions raised by Vice Chairman Patman and from conversations with Dr. Arthur J. Keeffe of the staff of the JEC that Vice Chairman Patman would like an explanation of the legal authority under which Edge Act Corporations and their foreign subsidiaries engage in investment banking activities abroad that are not permissible for member banks in the United States.

GENERAL STATEMENT AND SUMMARY

Edge Act Corporations are chartered, examined, regulated and supervised by the Board under section 25(a) of the Federal Reserve Act (the "Edge Act") (12 U.S.C. 611–631 (1970)). The Board has implemented its regulatory authority over Edge Act Corporations by adopting its Regulation K (12 CFR Part 211 (1975)), which contains provisions regulating the organization, banking and financial operations, and investments of Edge Act Corporations.

A principal purpose of the Edge Act was to facilitate the international and foreign banking and financial operations of U.S. banks and to promote thereby the foreign trade and commerce of the United States. Through the creation of subsidiary corporations endowed with greater banking and financing powers than those possessed by national banks, it was intended by the Congress that U.S. banks would be able to compete more effectively with foreign banking institutions in U.S. trade financing and in international and foreign banking.

It was recognized by the Congress that if Edge Act Corporations were bound by domestic banking rules in their operations abroad they would be placed at a severe competitive disadvantage with foreign banks and the foreign trade and commerce of the United States would not be promoted. Accordingly, in addition to giving Edge Act Corporations broader banking powers than those permitted domestic banks e.g., the power to purchase and sell debt securities and make investments in virtually any type of corporation, the Congress further gave Edge Act Corporations the right ". . . generally to exercise such powers . . . as may be usual, in the determination of the Board of Governors of the Federal Reserve System, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. . . ." Two statements made during consideration by the Senate of this "usual in connection with the business of banking" clause are particularly illustrative of Congress' intention to free Edge Act Corporations from domestic banking rules in their operations abroad: Senator McLean, "Unless these institutions are permitted to exercise any rights now exercised by foreign institutions doing the same business, in the opinion of the Federal Reserve Board it [a proposal to delete the 'usual in connection' clause] is practically destroying the value of the bill"; and Senator Edge, ". . . surely we want to give them [Edge

[1] Corporations organized and operating under section 25(a) of the Federal Reserve Act (12 U.S.C. 611–631 (1970)).

Corporations] the same privileges that competitors have in those countries when they will inure to their benefit." 58 *Cong. Rec.* 4970 (1919).

The Glass-Steagall Act was landmark banking legislation providing fundamental reforms of the nation's banking system; key among its provisions were four sections designed to separate commercial and investment banking in the United States banking system. A review of the legislative history of those latter sections does not reveal any clear intent on the part of Congress to extend the wall separating commercial and investment banking to the foreign operations of Edge Act Corporations and their subsidiaries.

In order to accomplish the purposes of both the Edge Act and the Glass-Steagall Act, the Board has considered carefully the policies and provisions of both statutes and has interpreted the Edge Act as permitting Edge Act Corporations and their subsidiaries to engage in investment banking activities abroad but not in the United States. The Glass-Steagall wall separating commercial and investment banking in the United States is firmly reinforced in the Board's regulation of Edge Act Corporations and their subsidiaries; the Edge Act purposes of making U.S. banks competitive abroad and promoting thereby the foreign trade and commerce of the United States have been accomplished by permitting Edge Act Corporations and their subsidiaries to engage in investment banking activities aboard, when the Board has found either specific statutory authority granting Edge Act Corporations such powers or it has determined that such activities are usual in connection with the transaction of the business of banking or financial operations abroad. The remainder of this memorandum discusses the particular statutory provisions of the Edge Act and Glass-Steagall Act in more detail.

RELEVANT STATUTORY PROVISIONS

The Glass-Steagall Act

The Banking Act of 1933 was omnibus legislation, which not only dealt with the securities activities of banks but, in addition, introduced such major banking reforms as federal deposit insurance and full branching parity between State and national banks. The securities sections of this legislation—§§ 16, 20, 21, 32 (12 U.S.C. §§ 24, 78, 377, 378 (1970))—have, however, become customarily referred to as the "Glass-Steagall Act" in recognition of the efforts of Senator Glass of Virginia and Representative Steagall of Alabama.

Section 16 (12 U.S.C. 24 ¶ 7)

Section 16 provides that national banks (as well as State-chartered member banks)[2] cannot generally deal in securities and stock for their own account, nor "underwrite any issue of securities or stock" Notwithstanding these general prohibitions, section 16 does, however, permit member banks to purchase certain approved investment securities for their own account, and generally to underwrite, deal in, and purchase for their own account obligations of the United States or general obligations of any State or of any political subdivision thereof.

Section 20 (12 U.S.C. 377)

Section 20 proscribes a member bank from being affiliated with any firm "engaged principally" in the issue, flotation, underwriting, public sale, or distribution of securities. Section 2(b) of the Glass-Steagall Act defines "affiliate" for the purpose of section 20 as essentially forms of "majority control".

Section 21 (12 U.S.C. 378)

Section 21 makes it a felony for individuals or firms "engaged in the business of issuing, underwriting, selling or distributing " securities to willfully engage, at the same time, in deposit banking.

Section 32 (12 U.S.C. 78)

Section 32 generally prohibits personnel interlocks between firms "primarily engaged" in the issue, flotation, underwriting, public sale, or distribution of securities and member banks. The Board is given the authority to permit interlocks by general regulations when in the Board's judgment it would not unduly influence the investment policies of such member bank or the advice it gives its customers.

[2] Section 16 is made applicable to State member banks under § 9 of the Federal Reserve Act (12 U.S.C. 335 (1970)).

Federal Reserve Act

Section 25(a) (the "Edge" Act)

Edge Act Corporations are chartered by the Board under section 25(a) of the Federal Reserve Act to engage in international and foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions (12 U.S.C. 611 (1970)). The charter powers of Edge Act Corporations are set forth in paragraphs 5 through 8 of Section 25(a) of the Act (12 U.S.C. 615), which provide in pertinent part, as follows:

> Each [Edge] corporation so organized shall have power under such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe: (*a*) *to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided;* and generally to exercise such powers as are incidental to the powers conferred by this Act *or as may be usual, in the determination of the Board of Governors of the Federal Reserve System, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein*
>
> (*c*) with the consent of the Board of Governors of the Federal Reserve System to purchase and hold stock or other certificates of ownership in any other corporation organized under the provisions of this section, or under the laws of any foreign country or a colony or dependency thereof, or under the laws of any State, dependency or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Board of Governors of the Federal Reserve System may be incidental to its international or foreign business. (Emphasis added.)

As hereinafter discussed, the Board has interpreted these foregoing provisions in section 25(a) of the Act to permit Edge Act Corporations and their subsidiaries to engage in investment banking activities outside the United States.

DIRECT ACTIVITIES OF EDGE ACT CORPORATION

As quoted above, Section 25(a) of the Federal Reserve Act empowers an Edge Act Corporation "to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or any State thereof but not including shares of stock in any corporation except as herein provided. " This language has been held by the Board to permit Edge Act Corporations to underwrite, sell and distribute *debt securities abroad.* Such a construction is clearly supported both from the "plain" or "commonly accepted" meanings of the terms "purchase and sell" and the context in which they are used, namely, the authorization to "purchase and sell" is contained in the same paragraph which grants various other banking and financial powers to Edge Act Corporations. This power to engage directly in such activities should be contrasted with the specific prohibitions contained in section 16 of the Glass-Steagall Act, which section does not apply to Edge Act Corporations.

The authority granted by section 25(a) for Edge Act Corporations to underwrite and deal in securities is restricted by the requirement that Edge Corporations not purchase and sell "shares of stock in any corporation except as herein provided." It is specifically provided, however, in the same paragraph of section 25(a) that an Edge Act Corporation may generally exercise such additional powers ". as may be usual, in the determination of the Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or posessions in which it shall transact business. . ". Construing these provisions together and in light of the purposes of section 25(a) of the Act to give Edge Act Corporations additional powers to make them competitive abroad, the Board has determined that since such powers are usual in connection with the transaction of the business of banking or other financial operations abroad, Edge Act Corporations may also purchase and sell i.e., underwrite and deal in, *equity securities outside the United States.*

While the Board has permitted Edge Act Corporations to engage in investment banking activities abroad, it has in § 211.5(a) of Regulation K specifically limited the direct investment banking activities of an Edge Act Corporation "engaged in banking" that is, an Edge Act Corporation which has aggregate demand deposits and acceptance liabilities exceeding its capital and surplus (§ 211.2(d) of Regulation K), to those permissible under section 16 of the Glass-Steagall Act and to the underwriting, selling, or distributing of obligations of the national government of a foreign country in which it has a branch or agency.[8] The Board has thus, by regulation, applied the direct prohibitions of section 16 of the Glass-Steagall Act to the foreign operations of those Edge Corporations engaged substantially in a deposit-taking business, even though section 16 does not by its terms apply to Edge Corporations.

The Board has also prohibited by general regulation (§ 211.5(b) of Regulation K) *all* Edge Act Corporations from engaging in the business of selling or distributing securities in the United States (except private placements of participations in their investments or extensions of credit) or underwrting any portion thereof so sold or distributed.

INDIRECT ACTIVITIES THROUGH FOREIGN SUBSIDIARIES

Under section 25(a), an Edge Act Corporation may, with the Board's consent, acquire and hold stock of any company so long as it is not engaged in the general business of buying or selling goods or commodities in the United States and does not transact any business in the United States except such as may be incidental to such company's international or foreign business (12 U.S.C. 615). In granting its consent for an Edge Act Corporation to acquire a controlling interest in a foreign company, however, the Board, as a condition to its consent, limits the activities of the foreign subsidiary to those permissible for an Edge Act Corporation under the Edge Act and Regulation K.

Thus, foreign subsidiaries of Edge Act Corporations have been permitted to engage in investment banking activities outside the United States to the same extent that these actvities are directly permissible for an Edge Act Corporation. It should be noted that a foreign subsidiary of an Edge Act Corporation "engaged in banking" may also engage in investment banking activities abroad, even though, as previously discussed, its parent Edge Act Corporation is more strictly limited in its direct activities. Consistent with the policies of the Glass-Steagall Act, the Board has provided in § 211.8(c)(2) of Regulation K that shares of stock in a company must be disposed of by an Edge Act Corporation as promptly as practicable if such company should engage in the business of underwriting, selling, or distributing securities in the United States. A foreign subsidiary of an Edge Act Corporation, or indeed a company in which an Edge Act Corporation has only a minority share interest, may thus not engage in investment banking activities in the United States.

[8] The power to underwrite and deal in foreign government securities parallels that given foreign branches of member banks under section 25 of the Federal Reserve Act and the Board's Regulation M. Under section 25, Congress gave the Board the authority to issue regulations giving foreign branches of member banks the right to exercise such further powers as may be usual in connection with the transaction of the business of banking in the places where such foreign branches shall transact business. Congress, however, also specifically provided in section 25 that, except to such limited extent as the Board may deem necessary with respect to securities issued by a "foreign State" as defined in section 25(b) of the Federal Reserve Act, any such regulations *may not* authorize a foreign branch of a member bank "to engage or participate, directly or indirectly, in the business of underwriting, selling or distributing securities" (12 U.S.C. 604a (1970)). The Board has implemented the foregoing provisions by permitting a foreign branch of a member bank to underwrite, distribute, buy, and sell obligations of the national government of the country in which it is located, subject to a specific prohibition that no member bank may hold, or be under commitment with respect to, obligations of such a government as a result of underwriting, dealing in, or purchasing for its own account in an aggregate amount exceeding 10 per cent of its capital and surplus (§ 213.3(b)(4) of Regulation M). In conformity with the explicit statutory prohibition previously quoted, the Board has also provided in its Regulation M that nothing in that regulation shall authorize a foreign branch, except as permitted for obligations of a national government, to engage or participate, directly or indirectly, in the business of underwriting, selling, or distributing securities (§ 213.3(c) of Regulation M). Foreign branches of member banks thus may only engage in investment banking activities with respect to certain foreign government securities as contemplated by the Congress in section 25 of the Act.

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INTERRELATION OF THE EDGE ACT AND GLASS-STEAGALL ACT

As previously discussed, the direct prohibitions of section 16 of the Glass-Steagall Act apply only to member banks and do not apply to Edge Act Corporations or their subsidiaries, although the Board has by regulation applied its direct prohibitions to Edge Act Corporations engaged in a deposit-taking business. This failure to include Edge Act Corporations within section 16 is consistent with Congress' view that Edge Act Corporations should have greater banking powers abroad in order to be competitive with foreign banks.

The Board has long followed the policy of not purporting to interpret section 21 because of its general applicability and the penal nature of its provisions. However, as noted above, the Board has implemented its policies by prohibiting Edge Act Corporations from engaging in any of the proscribed investment banking activities in the United States.

With respect to sections 20 and 32 of the Glass-Steagall Act, it has been the Board's view that the prohibitions of neither of these sections are applicable so long as the entire underwriting, selling, or distribution of securities by a foreign company takes place wholly outside the United States. This accords with the traditional judicial principle that the legislation of Congress will not extend beyond the boundaries of the United States unless a contrary legislative intent appears. A review of those statutes and their legislative histories does not reveal any clear intent on the part of Congress that sections 20 and 32 should have extraterritorial effect and thus should be applied to include the foreign operations of Edge Act Corporation affiliates of member banks. Absent specific Congressional intent to apply the Glass-Steagall Act extraterritorially, the Board has reviewed the question of whether such provisions should be applied to the foreign operations of Edge Act Corporations and their subsidiaries as a policy decision. In light of Congress' clear intent not to apply domestic banking rules to the foreign operations of Edge Act Corporations and their subsidiaries in order to promote the foreign trade and commerce of the United States by making U.S. banks competitive abroad with foreign banks, Congress' specific granting to Edge Act Corporations of the power to purchase and sell debt securities, Congress' specific granting to Edge Act Corporations of the power to exercise additional powers which the Board determines to be usual in connection with the transaction of the business of banking or financial operations abroad, and Congress' failure to specify an extraterritorial effect in the Glass-Steagall Act or proscribe Edge Act Corporations and their subsidiaries from engaging in investment banking activities abroad, it seems clear that the Board's policy of permitting Edge Act Corporations and their subsidiaries to engage in investment banking activities abroad but not in the United States is consistent with both the Edge Act and Glass-Steagall Act and fulfills Congress' intent in enacting both such statutes.

NOVEMBER 26, 1975.

GEORGE W. MITCHELLA, Esq.,
Vice Chairman, Board of Governors,
Federal Reserve System,
Washington, D.C.

DEAR MR. MITCHELL: I have your good letter of 20 November enclosing to me your staff memorandum of 14 November and I am very grateful to you for having it prepared.

As you doubtless know Senator Harrison A. Williams has announced that he intends to hold hearings as the Glass-Steagall Act. In that connection I am sure you will be interested in the letter I have written to him under the date of 25 November, a copy of which I enclose together with all its enclosures except those you already have.

With kindest regards, I am,

Sincerely,

WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee.

Enclosures.

NOVEMBER 25, 1975.

Hon. HARRISON A. WILLIAMS, Jr.,
U.S. Senate,
Washington, D.C.

DEAR SENATOR WILLIAMS: I am delighted that your Securities Subcommittee of Senate Banking is to look at the Glass-Steagall Act, and in accordance with your invitation, I presume to suggest certain directions your study might take.

First, as you know Glass-Steagall was enacted in June 1933, and in the fall of that year the late Winthrop W. Aldrich suggested amendments to plug loopholes in the Act. The Congress never enacted them, but they are as necessary today as in 1933, and I enclose a short, clear summary of the loopholes which appeared in Business Week, December 9, 1933.

Second, Federal Reserve states that a number of our leading banks, Bank of America, Bankers Trust, Chase Manhattan, Continental Illinois, First Chicago, First National City, Marine Midland, Manufacturers Hanover, and Wells Fargo with its permission engaged in the securities business overseas. The Fed apparently takes the position that the Edge Act enacted in 1919 authorizes this, and the Glass-Steagall Act enacted in 1933 does not forbid it.

I enclose a copy of a letter dated November 20, 1975 from Vice Chairman George W. Mitchell, and a copy of a staff memorandum dated November 14, 1975 of the Fed making this point, together with a memorandum prepared by a member of my staff reaching the opposite conclusion.

Third, until recently through an Edge Act Corporation Morgan-Guaranty held a one-third interest, and Morgan-Stanley a two-thirds interest in the investment banking firm of Morgan Cie in Paris. I wrote Vice Chairman Mitchell at the Federal Reserve about this matter on August 4, 1975 and, since that time, J. P. Morgan Company has announced that Morgan-Guaranty is to sell its one-third interest in Morgan Cie to Morgan Stanley.

I suggest you inquire why and whether the other banks are also divesting themselves of their foreign securities affiliates.

Fourth, I enclose the tombstone notice of the sale of a $100 million loan to the central bank of Peru by Wells Fargo, Ltd., a so-called London merchant bank owned by Wells Fargo through an Edge Act subsidiary. As you can see participations in this loan were sold by Wells Fargo to over 60 banks, many American.

Your Committee would do a great service if it would investigate how these so-called Eurodollar loans are made and underwritten as my information is that the commitment to make the loan is made here at the head office of each bank in the United States, and executed abroad to evade Securities and Exchange Commission regulations.

Franklin National Bank went down with $500 million of foreign loans that FDIC cannot sell except at a large discount--$14.5 million in Peru loans, $1 million from Wells Fargo, $8 and one-half million in a similar $76 million loan led by Morgan-Guaranty, and $5 million in a similar $130 million loan led by Manufacturers Hanover.

Query whether American banks should be permitted to make foreign loans of this character?

The New York Magazine for December 1, 1975 states that our American banks may have an exposure of as much as $25 billion in loans to less-developed countries. Zaire, with over $1 billion in foreign loans, is said to have defaulted on about $8 million of interest payments. I enclose a copy of the article.

This history repeating itself. In 1933 when Judge Ferdinand Pecora investigated the banks for the Senate Banking Committee and the midget sat on J. P. Morgan's lap, perhaps the worst testimony of all was the sale in 1928 by First National City and Seligman of Peru bonds which defaulted in 1931 and are not paid yet.

Fifth, when the Federal Deposit Insurance Corporation sold the principal assets of the Franklin National Bank to six of the largest banks in Europe, it came to my attention that the Deutsche Bank has a 50 percent interest in UBS–DB Corporation, and that Amsterdam Rotterdam, Sociate Generale de Banque of Belgium, and Societe Generale of France, have over a 50 percent interest in So Gen-Swiss International Corporation.

Despite the fact that UBS–DB and So Gen-Swiss are active security dealers, these four banks were allowed, by the Superintendent of Banks of the State of New York, to retain their stock interests in European-American Bank and Trust Company and, in October 1974, that concern was allowed to purchase the cream of Franklin National's assets and become a member of the Federal Reserve System.

Ignoring the fact that this purchase of the leading bank on Long Island by six of Europe's largest banks is as flagrant an antitrust offense as one can imagine, at least four of these large European banks, through UBS–DB and So Gen-Swiss, are also allowed to do business in America in flagrant violation of Glass-Steagall.

Of course this raises the question whether foreign banks should be allowed to do an unregulated banking business in the United States when billions of dollars are involved.

For your information I enclose copies of my correspondence with both the Department of Justice and the Federal Reserve on this subject.

Sixth, I am delighted to observe from the enclosed article in Forbes for September 15, 1975, that your Committee is to look into the complaints of our investment bankers that here in the United States our commercial banks, under the guise of sections specializing in corporate finance, are acting as investment bankers in violation of Glass-Steagall.

I know full well from your colloquy in the Senate with Senator John Sparkman on December 18, 1970 (Vol. 77 Cong. Record, Part 42430) that you are as convinced as I am of the need for the Glass-Steagall Act.

I trust these suggestions will be of value to you, and at the appropriate time I shall be glad to make myself available as a witness for you if you need me.

With kindest regards and best wishes, I am,

Sincerely,

WRIGHT PATMAN,
Vice Chairman, Joint Ecomonic Committee.

Enclosures.

MEMORANDUM OF LAW

Question. Does the Glass-Steagall Act forbid our American banks directly or indirectly through affiliates to underwrite securities or buy and sell them for their own account either at home and abroad?

Answer. Yes.

LEGISLATIVE HISTORY

Discussion

The purpose of the Glass-Steagall Act can clearly be seen by an analysis of two distinct areas:

1. Legislative history of the Act.
2. Analysis of the important sections of the Act.

The Pujo (money trust) investigation of 1912–13 was, in a measure, aimed at the use by the banks of other peoples' monies.

The investigation of 1912–13 covered much of the same area as the investigation of the commercial banks by a Subcommittee of the Senate Banking Committee in 1933 which led to the passage of the Glass-Steagall Act.

The banks feared that direct involvement in the securities business would run afoul of the National Banking Act and, in order to avoid this, set up affiliates.

Their growth was phenomenal. Whereas, in 1927 these affiliates had been responsible for only 12.8% of all investment-banking organizations, by 1930 they accounted for over 40% of these organizations. If banks and trust companies were included, the 1930 figures show these affiliates accounted for over 60%.

As early as November 6, 1911, Frederick W. Lehman, then Solicitor General of the United States, advised then Attorney General George W. Wickersham, in an unpublished Opinion, that National City Bank had no power under the national banking laws to set up the National City Company and authorize it to deal in securities.

When the 1929 crash came, it was clear to many, particularly to Senate Banking that the relationship between banks and the securities business had played a significant part in the debacle.

Senate banking investigations

A Senate Banking Subcommittee investigation was conducted from February 1931 to June 1934 by Judge Ferdinand Pecora of New York, which extended through the 71st, 72nd, and 73rd Congressional Sessions, occupying over 15 volumes of hearings. At one point the press agent for a circus put a midget on J. P. Morgan's lap.

Two conclusions came from these hearings:

1. Banks are to get out of the securities business; and,
2. Their affiliates are also to get out.

In the Glass-Steagall Act Committee Report the aims of the Committee are said to be–

> To provide for the safer and more effective use of the assets of Federal Reserve Banks and of national banking associations to regulate interbank control: *to prevent the undue diversion of funds into speculative*

operations, and for other purposes. (Report 584, 72nd Cong., 1st Sess.. p. 1.) (Emphasis added.)

In 1932 on the Senate floor, Senator Bulkley said:

> If we want banking service to be strictly banking service, without expectation of addittional profits in selling something to customers, we must keep banks out of the investment security business. (75th Cong. Record 9912.)

And, with respect to affiliates:

> The important and underlying question is whether banking institutions receiving commercial and savings deposits ought to be permitted at all to engage in the investment security business. The existence of security affiliates is a mere incident to this question. (75th Cong. Record 9910.)

The affiliate problem

The Committee recognized that the affiliate had become the major device by which commercial banks entered the investment banking business. In its Report, for instance, the Committee says that,

> machinery has been created which tends toward danger in several directions. The greatest of such dangers is seen in the growth of 'bank affiliates' which devote themselves in many cases to perilous underwriting operations, stock speculation, and maintaining a market for the bank's own stock often largely with the resources of the parent bank it would therefore appear that the affiliate system calls for the establishment of some legislative provisions designed to deal with the institution. The Committee has determined to . . *separate as far as possible national and member banks from affiliates of all kinds.* (Emphasis added.) (Report 584, p. 14, 72nd Cong., 1st Sess.)

Congressional floor debates

Once on the Senate floor Glass and his fellow Committee members clearly emphasized those matters which had been emphasized before the Subcommittee. Senators Bulkley makes clear that their intention was to draw from the experience in England, and separate commercial banks from the securities business:

> The English banks of deposit have kept themselves strictly clear of the investment security business whatever we may learn from comparison of English and German banking should lead us to prefer the English practice under which *commercial banking is strictly segregated from the origination and underwriting of capital issues.* (Emphasis added.) (Cong. Rec., 72nd Cong., 2nd Sess., p. 9911.)

In this speech Senator Bulkley read a letter of Bank of Manhattan in which it promised to confine its then security affiliate, International Manhattan Co., to the trust business:

> After mature deliberation the conclusion has been reached that it is to the best interests of the group to follow the trend of opinion strongly expressed in some quarters to the effect that deposit banks should not have affiliated securities companies. . Accordingly, the Bank of Manhattan Trust Co. will carry on such of the activities of the International Manhattan Co. as are consistent with the most conservative trust company practice. (Cong. Rec., 72nd Cong., 2nd Sess., p. 9913.)

Significantly, International Manhattan Company was a so-called "Agreement Corporation" doing primarily an overseas business. It is quite evident from this that Senate Banking meant Glass-Steagall to outlaw both Agreement and Edge Act Corporations from the securities business.

Analysis

In determining whether the Act prohibits member and national banks from engaging in the securities business, either directly or through affiliates, there are at least four sections of Glass-Steagall that are very much in point, namely, Sections 16, 20, 21, and 32, each of which so far as material reads the same today.

Section 16 (now Section 24 of Title 12 U.S. Code) provides specifically that the—

> Business of dealing in investment securities shall be limited to purchasing and selling such securities without recourse solely upon the order, and for the account of customers, and in no case for its own account, and the association shall not underwrite any issue of securities.

How could anything be more concisely and clearly stated?

While prior to Glass-Steagall member banks bought and sold securities for their own accounts, more frequently they acted through affiliates such as National City Company, Chase Harris-Forbes, et al.

For this reason, as pointed out by the Supreme Court in *Investment Company Institute* v. *Camp*, 401 U.S. 630 (1971), the Act takes specific aim at "affiliates"

Section 20 of Glass-Steagall (12 U.S.C. 377) forbids a member bank to "be affiliated in any manner described in Section 2(b) hereof" (12 U.S.C. 221(a) subsection (b))

> With any corporation, association, business trust or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

It is, however, difficult to read 2(b) of Glass-Steagall (12 U.S.C. 221(a), subsection (b)) with sections 16, 20, 21, and 32 of Glass-Steagall (12 U.S.C 24, 377 and 78).

For instance, 2(b) of Glass-Steagall begins by saying that "except where otherwise specifically provided" the term "affiliate" shall "include" corporate bodies of certain kinds.

As noted above, Section 16 of Glass-Steagall (12 U.S.C 24) specifically forbids a member bank from buying or selling securities for its own account, or as an underwriter, and has no exception for "affiliates"

Section 2(b), (now subsection (b) of 221(a) of 12 U.S.C.), then goes on to say that *included* in the term "affiliate" is an outfit—

> (1) In which a member bank "directly or indirectly" either "owns or controls" fifty per cent of the voting stock, and.
>
> (2) Whether it holds that control directly or indirectly "through stock ownership or in any other manner".

In 1966 the section as presently written (12 U.S.C. 221(a) subsection (b)) was amended to apply to a bank holding company which directly or indirectly "controls in any manner the election of a majority of the directors of a member bank".

In the hearings themselves a security affiliate was defined as a corporation-

> 1. A part or all the stock of which is deposited in trust for the benefit of stockholders in the bank; or
>
> 2. The shares of which are sold in units in combination with shares of the bank; or
>
> 3. A *controlling* interest in which is held by the same interests which control the bank; or,
>
> 4. A *controlling* interest in which is held by the bank; or,
>
> 5. A *controlling* interest in which is held by some other security affiliate of the bank. (U.S. Senate, 71st Cong., 3rd Sess., S. Res. 71, p. 1054.)

The emphasis on the term "*control*" is clearly reflected in the amended definition of "affiliate" which is quoted above (221(b) of Title 12 U.S. Code). The words "and controls in any manner" were added to this section, and this phrase clearly reflects Congressional intent.

This much, therefore, is crystal clear. No member bank can control an "affiliate" that buys and sells securities for its own account or underwrites.

This clearly makes illegal the operation by the Wells Fargo National Bank of Wells Fargo, Ltd. All the stock of that English bank is held by Wells Fargo International Investment Corporation, all the stock of which is held by Wells Fargo International New York, the wholly-owned Edge Act Corporation of Wells Fargo Bank, N.A.

Mutatis mutandis, the same applies to—

Manufacturers Hanover, Ltd., London
Bankers Trust International, Ltd., London
Deutsche Unionbank, Frankfurt
(owned by an Edge Act Corporation of Bankers Trust)
Bank of America International, Ltd., London
Citicorp International Bank, Ltd., London
Trinkhaus and Burkhardt, Dusseldorf, Germany
(owned by First National City Bank ("Citibank")
Continental Bank, S.A., Brussels
Continental Illinois, Ltd., London
International Marine Banking Company, Ltd., London
Chase Manhattan, Ltd., London
Banque de Commerce, S.A. Brussels
(owned approximately 50 percent each by Chase Manhattan National Bank and Banque de Bruxxelles)
First Chicago, Ltd., London
Morgan and Cie, Paris
(the one-third interest of Morgan-Guaranty in this French corporation is to be sold to Morgan Stanley which now owns a two-thirds interest)

There can, of course, be no question that all these corporations are "affiliates" of their parent banks. Nor is there any question that each is controlled by the parent bank, or, in some case, by its bank holding company.

However, some of these affiliates, as Wells Fargo, Ltd., say they do not engage in so-called "equity" financing as Morgan-Stanley does, but confine their activities to making Eurodollar loans and syndicating participations in such loans to other banks.

Is selling a participation in such a loan or underwriting, say a loan of $100 million to the central bank of Peru, engaging in the "business of dealing in investment securities" in violation of Glass-Steagall?

Such transactions may or may not be private placements executed abroad and exempt from regulation by the Securities and Exchange Commission, but on any common sense basis the banks who do this are engaging in the securities business in violation of Glass-Steagall.

As lead bank or underwriter of the loan, Wells Fargo presumedly receives a commission. In this it is not acting much differently from a bank that sells mutual funds which the Supreme Court so roundly condemned in *Investment Company Institute* v. *Camp* (1971) 401 U.S. 617.

Granted, however, that an affiliate be doing a securities business and that affiliate being one a member bank "controls", there seems no question but that Glass-Steagall forbids such a bank to operate such an outfit.

Significantly, the statute says nothing about a member bank's being empowered to engage in the securities business through an Edge Act or an Edge Act subsidiary.

Moreover, the Edge Act was enacted in 1919 and Agreement Corporations were permitted by an amendment to the Federal Reserve Act in 1916. Thus, there is no reason for any one to believe that in enacting Glass-Steagall the Congress meant to authorize either Edge Act or Agreement Corporations to engage in the securities business.

In this connection, the promise of the Bank of Manhattan Trust Co. to the Senate Banking Committee in 1933 to confine the business of its affiliate International Manhattan Co. to the trust business is quite significant. If the Committee condemned investments in foreign securities done at home, is there any doubt that they would also condemn the same thing being done by an affiliate abroad?

The most one can say is that it is open to question whether a member bank can operate a securities affiliate in which it does not have a controlling interest, or one which it operates along with other banks in a joint venture.

A somewhat similar problem came before the Supreme Court in *Board of Governors of The Federal Reserve System* v. *Agnew* (1947) 329 U.S. 441. There the question was whether John Agnew could be a Director of the Patterson National Bank while an employee of Eastman Dillon, a brokerage firm that earns 47 percent of its income as a broker, and 32 percent as an investment banker from underwriting.

Section 32 of Glass-Steagall (12 U.S.C 78) forbids any employee of a firm "primarily" engaged in underwriting from serving at the same time as a director of a member bank.

The argument was, that since Eastman Dillon made more money as a stock broker, it was no "primarily" engaged in underwriting. This argument was bolstered by pointing out that under 2(b) of Glass-Steagall (12 U.S.C. 221(a)), subsection (b) for the Act to apply a member bank had to have fifty percent voting control.

While this very technical argument was accepted by two of the C.C.A. panel, it was flatly rejected by the District Court (274 F.Supp. 624) and the Supreme Court of the United States.

In dissent at the Circuit, Judge Edgerton said:

> I think Congress used the word 'primarily' in a sense which includes "essentially" or "fundamentally" and is not limited to "chiefly" or "principally." These are all recognized senses of the word. The Oxford Dictionary includes "essentially," Webster's New International Dictionary includes "fundamentally," and Funk & Wagnalls' Standard Dictionary includes both "essentially" and "fundamentally," among the meanings of "primarily." (153 F.2d 785, p. 795).
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> * * * * * * *
>
> The Board says, and its statement is not disputed, that restricting the application of Sec. 32 to firms whose underwriting business is first in volume would make this section "apply to no one." The court does not suggest that this result, which is no result at all, is the one which Congress intended. If the court's position is correct, the Act of Congress requires us to defeat the purposes of Congress. This seems to me another paradox. (153 F.2d 785, p. 796.)

In reversing for an unanimous Supreme Court, Mr. Justice Douglas said:

> If the underwriting business of a firm is substantial, the firm is engaged in the underwriting business in a primary way, though by any quantitative test underwriting may not be its chief or principal activity. On the facts in this record we would find it hard to say that underwriting was not one primary activity of the firm and brokerage another. If "primarily" is not used in the sense we suggest, then the firm is not "primarily engaged" in any line of business though it specializes in at least two and dones a substantial amount of each. One might as well say that a professional man is not "primarily engaged" in his profession though he holds himself out to serve all comers and devotes substantial time to the practice but makes the greater share of his income on the stock market.
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> * * * * * * *
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> Moreover, the evil at which the section was aimed is not one likely to emerge only when the firm with which a bank director is connected has an underwriting business which exceeds 50 percent of its total business. Section 32 is directed to the probability or likelihood, based on the experience of the 1920's, that a bank director interested in the underwriting business may use his influence in the bank to involve it or its customers in securities which his underwriting house has in its portfolio or has committed itself to take. That likelihood or probability does not depend on whether the firm's underwriting business exceeds 50 percent of its total business. It might, of course, exist whatever the proportion of the underwriting business. But Congress did not go the whole way; it drew the line where the need was thought to be the greatest. And the line between substantial and unsubstantial seems to us to be the one indicated by the words "primarily engaged." (329 U.S. 441, pp. 446–447).

From all of which one must conclude that there is grave doubt that any member bank can have an affiliate engage in the security business even if it does not control it. Glass-Steagall expresses a policy against allowing member banks to be affiliated in any way with investment bankers. It was a conclusion the Congress reached after long hearings.

Perhaps the strange wording of Section 2(b) (12 U.S.C. 221(a), subsection (b)) in defining what is an "affiliate" was a Committee oversight.

As one of the draftsmen of the Federal Reserve Act who was then on the scene and close to Senator Carter Glass puts it:

> The Senate Banking Committee, in preparing the draft of the Banking Act of 1933, first considered the idea of regulating them (affiliates); then thought of recognizing them and providing for their incorporation under federal charters, but finally under the influence of public demand swung to the idea of complete eradication of these affiliates, by requiring the banks absolutely to separate them within a year's time after the passage of the Act.
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> * * * * * * *
>
> That the banks were at first bitterly opposed to this kind of surgical operation was natural. It is an excellent symptom of returning health in the banking community that not a few of the wiser bankers have openly recognized the harmfulness of the affiliate system, have repudiated it, and have devoted themselves since the passage of the Banking Act of 1933 to effecting a genuine and thorough separation between the parent institutions and their dependents. (Professor H. Parker Willis, *The Banking Act of 1933 In Operation*, 34 Columbia Law Review, at pp. 701–704).

At best, this is a situation in which Federal Reserve as the regulator should heed the advice Mr. Justice Stewart gave its colleague, the Comptroller of the Currency in *Investment Company Institute* v. *Camp*, *supra*, namely, not grant any authority to a member bank to engage in any way directly or indirectly by affiliate in the securities business—

> Until he is satisfied that the exercise of this new authority will not violate the intent of the banking laws,

because—

> There is substantial danger that the momentum generated by initial approval may seriously impair the enforcement of the banking laws that Congress enacted. (401 U.S. 617 at p. 628.)

Moreover, it is of some significance that in drawing Glass-Steagall, the Congress drew it both ways, to wit, against member banks and also against investment bankers. (See particularly Section 21 of Glass-Steagall, now 12 U.S.C. 378, and 32 of Glass-Steagall, now 12 U.S.C. 78).

Congress also in Section 19 of Glass-Steagall (12 U.S.C. 61) provided that before a bank holding company can obtain a permit to vote its bank stock, it must:

> (e) (1) Show that it does not own, control, or have any interest in and is not participating in the management or direction of any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort (hereinafter referred to as "securities company").

The section goes on to compel a bank holding company holding a permit to agree (19(e)(2) now 12 U.S.C. 61(e)(2)) neither to acquire a securities company nor participate in its management, and also to agree (19(e)(3) now 12 U.S.C. 61 (e)(3)) that if at the time it applied for its permit it held a securities company to divest it within five years.

Study of these statutes and their legislative history ought to convince the most doubting Thomas that the Congress of 1933 made up its mind to take banks out of the securities business in every way shape or form and that no Congress since the 73rd has in any way relaxed the stringent statutory prohibitions that Congress wrote in the dark days of 1933.

It must, therefore, be concluded that the Glass-Steagall Act on its face prohibits:

(*a*) Banks from dealing in any way in "investment securities" except "solely upon the order and for the account of customers" or for the banks' own account under limitations described by the Comptroller of the Currency. (16 of Glass-Steagall, now 12 U.S.C. 24.)

(*b*) Banks from being affiliated with any organization dealing principally in the securities business. (20 of Glass-Steagall, now 12 U.S.C. 377 read with 2(b) of Glass-Steagall, now 12 U.S.C. 221(a), subsection (b).)

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(c) Persons, individual firms, corporations, trusts, or similar organizations from dealing in the business of receiving deposits, and at the same time dealing in the securities business. (21 of Glass-Steagall, now 12 U.S.C. 378.)

(d) Interconnections between banks and any securities company. (32 of Glass-Steagall, now 12 U.S.C. 78.)

It must be further stated that as written, these statutory prohibitions apply across the board to all commercial banks and all investment bankers at home and abroad.

FEDERAL RESERVE JUSTIFICATION

In a staff memorandum of November 14, 1975, Federal Reserve frankly admits that, despite Glass-Steagall, it has authorized member banks to do a securities business overseas.

It says it did so under the authority of the Edge Act of 1919 (25(a) of the Federal Reserve Act, 12 U.S.C. 611–631), and, presumedly, the similar Agreement Act legislation of 1916 (Section 25 of the Federal Reserve Act, 12 U.S.C. 601–604).

There are three difficulties with this argument:

First, so far as we can ascertain, in 1933 there was no problem about banks selling securities overseas.

In his June 1968 graduate study at Rutgers of Edge and Agreement Corporations, Allen F. Goodfellow, presently Senior Foreign Banking Analyst at the Federal Reserve, states that there were 18 corporations that came under Board jurisdiction from 1913 to 1933 only 3 of which were Edge Act Corporations, the other 15 being Agreement Corporations. Goodfellow says that by the early thirties only three had survived; all were Agreement Corporations. One of these dropped its Agreement in 1947, and another converted to an Edge Act Corporation in 1957.

Second, it is clear that banks have extensively gone into the securities business abroad only in recent days. The staff memo of the Fed gives the false impression that the practice antedates Glass-Steagall whereas, in truth, it is a development of the last fifteen years.

Mr. Goodfellow states that down to 1954 there were very few Agreement or Edge Act Corporations in existence, and he charts the growth since 1954 as follows:

Year	Number	Edge Act corporations	Agreement corporations
1954	6	2	4
1955	7	3	4
1956	7	3	4
1957	7	4	3
1958	7	4	3
1959	9	6	3
1960	15	10	5
1961	16	11	5
1962	26	21	4
1963	35	30	5
1964	37	33	4
1965	41	37	4
1966	45	40	4
1967	51	46	5
1968	61	56	5
1969	68	63	5
1970	74	69	5
1971	85	80	5
1972	93	87	6
1973	103	98	5
1974	112	107	5

In other words, down to roughly 1954 there were only 6 Agreement and Edge Act Corporations. As late as 1960 there were only 15. Thereafter, there was a steady increase of approximately 10 a year, until by the end of 1974 we have 103.

Under these circumstances, it ill-behooves Federal Reserve to rely on either the 1916 Agreement Corporation Act or the 1919 Edge Act to justify their authorizing these corporations to do a securities business.

In 1933 the Glass-Steagall Act prohibited American banks from doing a securities business, and there is no reason to read that Act as exempting banks with either Edg or Agreement Corporations. The prohibition is on banks and their affiliates.

Third, as it has done so frequently before, the Federal Reserve Board reads into 25(a) of the Edge Act of 1919 (12 U.S.C 615) authority to permit banks to buy and sell securities from this general language which authorizes Edge Act Corporations:

> Generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Board of Governors of the Federal Reserve System, in connection with the transactions of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein.

Vague, general language of this sort enacted in 1919 can be of no avail when, as we have seen, the Glass-Steagall Act enacted in 1933 so clearly prohibits commercial banks from engaging in the securities business.

The Federal Reserve staff memo of November 14, 1975 concedes that the Fed lacked statutory authority except for this vague phrase in the 1919 Edge Act.

What the Fed should have done was to come to the Congress in the sixties and ask for the authority it lacked, not read into the Edge Act of 1919 powers taken away from American banks by the Glass-Steagall Act of 1933.

The prohibitions, as we have seen of Glass-Steagall, are broad and all inclusive of affiliates.

Moreover, as we have seen the Senate Banking Committee in 1933 made clear in discussing an affiliate of the Bank of Manhattan named International Manhattan Company that it did not want American banks abroad to be any more in the securities business than banks at home.

Bank of Manhattan promised the Committee that henceforth International Manhattan would stick to the trust business and get out of the securities business.

In forbidding our American banks to do a security business the Congress as we have seen was also influenced by what they then understood to be the practice of English banks. It would have been news to them to be told that this was not the practice.

Moreover, in writing the Act the Committee defined "affiliate" in such broad terms that the Attorney General in a letter to the Fed felt obligated to say that:

> It is nevertheless worthy of note that the Senate Committee which reported the Bill stated a purpose to discourage "affiliates of all kinds." I am familiar with the statements of Members of Congress made to your department (the Department of the Treasury) and to mine, that Congress did not intend to go so far as apparently it has in the definition of "affiliates." However, this may be, the executive department must accept the law as Congress has written it, leaving it to Congress to correct by amendment any inequities which may appear. (Federal Reserve Bulletin, September 1933, pp. 570–571.)

In this the Attorney General is as correct today as in 1933. Glass-Steagall prohibits all affiliates of member banks from engaging in the securities business at home or abroad.

[Reprinted from Business Week of Dec. 9, 1933]

Aldrich Plan

Chase National head not only tells Senate Committee that Bank Act needs plugging up but offers a detailed program on how it can be done.

Two decades ago Senator Nelson W. Aldrich (R.I.) attempted to write a Magna Carta for American banking by proposing the organization of "monetary associations," a scheme that closely paralleled the subsequent set-up of the Federal Reserve Banks. The "monetary associations" foundered because of public distrust of the plan's backers.

Today, extraordinary significance is being attached to another Aldrich proposal, largely because of the high esteem which the Senator's son commands in the face of a general collapse of public trust in banking officials.

"NECESSITY OF CHANGE"

The program for eliminating speculation from American banking put out by Winthrop W. Aldrich, president of Chase National Bank, is being read in the light of his favorable impression on the Senate investigating committee to which it is submitted, and in connection with his statement that "no one who has observed events, or is familiar with the testimony presented to your committee, can have failed to be impressed with the necessity of change."

Mr. Aldrich's proposals start from the contention that the Glass-Steagall Banking Act of 1933, which so many bankers so bitterly opposed, left large loopholes for the entry of the "spirit of speculation" into the management of commercial banks, despite its work in separating the interests of commercial and investment banking. Criticisms:

(1) It allows any individual (investment banker or otherwise) to act as a director, officer, or employee of any number of commercial banks, so long as no one of them is a national bank, thus voids the provision on interlocking directorates;

(2) It allows any individual to act as a director, officer, or employee of a national bank as well as of two other banks—if the Federal Reserve Board issues a permit therefor (a hazardous exception if divorcement from affiliates is to be complete and lasting);

(3) It allows a member of a partnership engaged in the investment banking business, or an officer or director of a corporation engaged in such business to act as a director, officer or employee of any member bank, provided only that he obtain a permit from the Federal Reserve Board—again a hazardous exception;

(4) It allows anyone engaged in the securities business as a controlling stockholder in an investment corporation (so long as he does not act as a director or officer of such organization) to act as a director, officer, or employee of any bank, without the necessity of permit from the Federal Reserve Board—an opportunity for indirect affiliation of investment and commercial banking.

TO CLOSE LOOPHOLES

Having inside information on how the Banking Act of 1933 can be legally evaded, Chase's president has very clear ideas on how its loopholes can be legally closed. Aldrich amendments would: (1) Expressly disqualify anyone engaged, directly or indirectly, in the investment banking business from acting as director or officer of a national bank; (2) "disqualify any director, officer, or employee of a national bank from acting as director, officer, or employee of any other bank in the same community"; (3) "make appropriate provision applying the same canons of eligibility with regard to officers, directors, and employees of state member banks, so that there shall be no unfair discrimination against national banks."

However, Mr. Aldrich wouldn't stop at that point. There is "a practice out of which much embarrassment and, at times, abuse has arisen," which is, of course, the banking practice of making loans to bank officers and to officers of depositing corporations. The Glass-Steagall Act provides that any executive officer of a member bank must report such borrowings to the chairman of the bank board. The president of Chase, who speaks from the heart of this subject, points out that it says nothing about what the chairman is to do with this information, or what he is to do if he is an executive officer of the bank and wants to do a little borrowing on his own, or what happens if there is no chairman. And he adds that the act doesn't prevent a bank officer from getting "embarrassing" loans from brokers or private bankers, or other sources, without making any report.

If the committee hasn't figured out controls for borrowing bank officers and corporation officers who use their corporation influence as a club for private loans, Mr. Aldrich has. Like this:

(1) Prohibit executive officers of member banks from participating, directly or indirectly, in syndicates offering securities to the public, or in trading accounts or pool operations in securities dealt in publicly;

(2) Impose similar prohibitions on executive officers and directors of the 12 Federal Reserve Banks;

(3) Compel all executive officers of member banks to report to their boards all their borrowings above some nominal sums related to the size of their salaries;

CHECK ON OUTSIDE JOBS

(4) Compel executive officers of member banks to report to their boards of directors all jobs they undertaken for outside interests;

(5) Put controls on loans made for "reasons of policy," so as to keep American banks competitive and prevent them from doing "unsound" things in their efforts to get business.

Point 5 gets special emphasis. Loans to borrowers who are in a position to influence other importance business of the lending bank, or to bring important business to the bank, may be all right in some cases, but, says Mr. Aldrich, "the situation would be less subject to abuse if there were added to the Banking Act a provision that in every case where a loan is made by a member bank to individuals in relations such as those specified above, a report should be made by the lending bank to the board of directors of the customer bank or corporation of which the borrower is an officer, or to the individual depositor or partnership for whom the borrower acts as financial agent."

Finally, he recommends a more exact definition of an investment affiliate and an investment banker, and, for purposes of sound liquidation, suggests that the existing affiliates be permitted to continue beyond June 16, 1934.

All of which sets forth in an orderly and detailed way the kind of banking reform that Senator Glass has been advocating for years.

However, even the carefully studied Aldrich plan will require for effectiveness the corporation of the clearing houses and the exchanges. Unless they help it out by self-imposed regulations, the chiselers will still find ways. If self-regulation can be provided by those who know the game and if the spirit of the Aldrich proposals can be put across, much of the public concern over the moral state and the mechanics of commercial banking will be allayed. The problem of reestablishing the commercial banks as manufacturers of credit and reducing the proportions of the pawnshop business of making loans on securities is something else again.

[From Euromoney, June 1973]

Republic of Peru—$100,000,000—Eight-Year Loan with BANCO DE LA NACION as Financial Agent, arranged by WELLS FARGO LT. and provided by:

American Express International Banking Corporation; Associated Japanese Bank (International) Limited; Atlantic International Banks Limited; Banco de Santander; Banco do Brasil S.A. London Branch; Bankers Trust Company; The Bank of California N.A., Nassau; The Bank of Kobe, Limited; The Bank of Tokyo, Ltd.; Banque Commerciale pour l'Europe du Nord (Eurobank); Banque de l'Union Europeenne S.A.; Banque de Suez et de l'Union des Mines; Banque Europeenne de Tokyo S.A.; Banque Francaise du Commerce Exterieur; Central National Bank of Cleveland, Nassau; Cisalpine Overseas Bank Limited; Citicorp International Bank Limited; Commerce Union Bank, Nassau; The Commercial Bank of Kuwait S.A.K.; Credit du Nord; The Fidelity Bank; First National City Bank; The First Pennsylvania Banking & Trust Company; Franklin National Bank; The Fuji Bank, Limited; Fuji Bank (Schweiz) A.G.; Girard Trust Bank; Handelfinanz Bank; Hartford National Bank, Nassau The Hokkaido Takushoku Bank Limited; The Industrial Bank of Japan, Limited; The Industrial National Bank of Rhode Island, Grand Cayman Branch; International Commercial Bank Limited; Italian International Bank Limited; Japan International Bank Limited; Kredietbank S.A. Luxembourgeoise; The Kyowa Bank, Limited; La Salle National Bank; Libra Bank Limited; Lloyds & Bolsa International Bank Limited; The Long-Term Credit Bank of Japan, Limited; Marine Midland Bank—New York; Marine Midland Bank—Western, Nassau; Midland Bank Limited; The Mitsubishi Bank, Limited; The Mitsubishi Trust & Banking Corporation; The Mitsui Bank, Limited The Mitsui Trust & Banking Company Limited; National Bank of North America, Nassau; The National Shawmut Bank of Boston, Nassau; The Nippon Fudosan Bank, Limited; Orion Termbank Limited; Republic National Bank of Dallas; Rothschild Intercontinental Bank Limited; The Royal Bank of Canada International Ltd.; The Royal Bank of Canada; The Saitama Bank Limited; The Sumitomo Bank, Ltd.; The Tokai Bank Limited; Toronto Dominion Bank; Ultrafin A.G.; Union Planters National Bank of Memphis; United California Bank; United International Bank Limited; Wells Fargo Bank N.A., Nassau; Wells Fargo Limited; and The Yasuda Trust & Banking Company Limited.

The Bottom Line—The Banks' Biggest Worry

By Dan Dorfman

A PROBLEM, NOT A CRISIS

The number-one danger confronting United States banks today, according to some knowledgeable people I spoke to recently, is neither their real-estate loans, their holdings in municipal bonds, nor their loans to the likes of troubled W. T. Grant. Rather, it is the viability of about $25 billion in loans to less-developed countries—a problem that's potentially more serious to U.S. banks than to all the others combined.

These countries include Brazil, Mexico, South Korea, Kenya, Taiwan, and Zambia. And they're heavily in hock to some of this country's biggest banks, including First National City, Chase Manhattan, Morgan Guaranty, Chemical, Manufacturers Hanover, Bank of America, and the First National Bank of Chicago.

"The 'LDCs,' as the less-developed countries are called, are top heavy in debt, and sizable defaults could trigger a major banking crisis," one Chicago banker told me last week. "I'm not saying it's going to happen, but it's worrisome as hell."

One LDC, Zaire, a major African borrower on the international money markets with over $1 billion in foreign loans, has already defaulted on some interest payments. According to some estimates, it skipped about $8 million in interest payments dating back to last June. Among the banks which have reportedly lent money to Zaire are Citibank, Chase, Bankers Trust, and Morgan Guaranty.

"The budding LDC crisis," as one banker characterizes it, has not gone unnoticed in Washington. Last June, the Senate Foreign Relations Subcommittee on Multinational Corporations, headed by Senator Frank Church, fired off a questionnaire on their foreign operations to 35 of the country's largest banks as a preliminary step in an investigation of U.S. banks' overseas activities. About half the banks—principally the large ones—refused to answer. The committee does have subpoena power, but for the moment, at least, it's trying to obtain the information from the Federal Reserve Board. "There's enough evidence to be concerned," I was told, and so the Church committee will now likely call for hearings on the whole overseas operations of U.S. banks early next year.

For an insight into the LDC problem, I sought the thinking of Arnold Safer, a vice-president and economist for Irving Trust Company and an expert on the subject. My timing was pretty good. Safer, a former economics professor at Long Island University and one-time economic consultant to Westinghouse and the New York Stock Exchange, is currently in the midst of wrapping up a bimonthly report to the bank's clients in which the LDC problem will be thoroughly aired.

His comments—which the bank's clients will be reading in about two weeks—are not encouraging. A growing number of LDCs, Safer said, face mounting problems meeting their debt service, largely because of skyrocketing oil prices. He sees such countries as Brazil and South Korea, and even Greece, "facing difficulty rolling over their credits." And he believes prospects have heightened for defaults in Zambia, Tanzania, and Kenya.

The problem, Safer said, isn't rising oil pricees alone. Other factors include:

Higher prices for manufactured goods purchased from the industrialized nations. (These prices are up about 20 per cent in the last eighteen months.)

Recent declines in the prices of the LDC's chief commodity exports, such as copper, coffee, and phosphates. (The United Nations index of non-oil-commodity prices is off about 25 per cent from the highs of late 1974.)

Declining commodity purchases from LDC countries owing to the world-wide recession.

Unfortunately, Safer said, the countries suffering most are those that are at the take-off stages of economic growth. He pointed, in particular, to Brazil, Mexico, Taiwan, South Korea, and the Philippines.

Mounting problems for LDCs have been accompanied by mounting—and record—debt. And that's got a number of bankers scared.

For example, between 1967 and 1973, according to Safer, the LDCs borrowed about $15 billion. On top of that, some $16 billion was borrowed by the LDCs in just the eighteen months from December of 1973 through July of 1975. Last year, the balance-of-payments deficit for the LDCs was $20 billion. At the end of 1974, the LDCs had accumulated a debt of $120 billion. Safer's estimate by year-end 1975: a jump to $160 billion.

Of an estimated $25 billion in U.S. bank loans to LDCs, Safer figures two-thirds—some $17 billion—is directly related to New York City banks and their overseas branches.

Obviously, LDCs will continue to require enormous capital needs to finance their growth and to ensure orderly repayment of interest and principal to lenders. But that's easier said than done.

One bank leader, Morgan Guaranty, in a recent report on world financial markets, pointed to the strain on the capital resources of U.S. banks. Moreover, Morgan warned that some slowing of U.S. credit to LDCs can be expected because "the total-risk exposure of individual banks to certain countries has grown so rapidly in relation to bank capital. . . ."

Most bankers I know are optimists at heart. And Safer is no different. "I think LDCs are a problem, but not a crisis," he said. Safer points out that debt expansion—in line with a country's economic growth—is a normal process. And he believes an expanding economy in 1976 and 1977 should make it easier for the LDCs to meet their debt obligations.

Maybe so. But what happens, I asked, if the economy turns out not to be expanding over the next couple of years?

"Then you'll probably have defaults," replied Safer, "which could well be the forerunner of a further erosion of bank earnings from heavy write-downs that would likely ensue."

Safer told me a bank—like a corporation or a government—doesn't hang out its dirty laundry. "And I'm not going to do it either," he said. But then, moments later he admitted: "I guess things could become very uncomfortable for the banks. It really could get serious."

[From Forbes, Sept. 15, 1975]

Cracks In Glass-Steagall?—Do the Banks Want to Gobble Up Wall Street?—Their Ambitions Are Probably More Modest

As if cut-rate commissions on the brokerage side of their business weren't bad enough, the investment bankers are gloomy about a new threat. The commercial banks, they whisper darkly, are nibbling away at the Glass-Steagall Act, the Chinese Wall that separates the two worlds of investment and commercial banking.

The Act, passed in 1933 in the wake of the Crash and several banking scandals, forbade commercial banks from selling, underwriting or distributing corporate securities. The idea was to halt conflicts of interest that could result from a bank selling the securities of companies to which it had lent money. They could, however, deal in government and municipal securities and provide corporate advisory services.

Now, both the Administration and Congress, hearing the cries of the investment bankers, are Studying The Question. Senator Harrison Williams (Dem., N.J.) has announced that his Banking & Currency Committee will hold hearings on Glass-Steagall's adequacy this fall.

For their part, the commercial bankers protest—to quote W. J. Tozer Jr., head of Citicorp's Merchant (read investment) Banking Group—they're doing nothing very different: "It's a natural aspect of the broad-gauge banking we are doing today."

Morgan Guaranty, for example, has a mergers and acquisitions (or "financial services") staff that has arranged deals like the purchase of Gimbels by Brown & Williamson Tobacco, or Quaker Oats' takeover of Fisher-Price Toys. Citicorp's investment bankers advised White Consolidated on the purchase of Westinghouse's appliance business, while its private-placement specialists arranged $180 million worth of financing in the year ended June 30. Now other banks are rushing to set up investment banking departments. What's going on?

One thing they're doing, of course, is adding to earnings with little extra risk. Mank bank diversifications of recent years—mortgage banking, leasing, factoring—required hard capital. They looked great on the way up, but could cost a lot on the way down.

By contrast, corporate finance consulting demands little more commitment than some employment contract office space, phone lines and stationery. If things don't work out, you terminate the contracts and unplug the phones.

What can the commercial banks do better than the investment banks? Some investment bankers argue that the commercial banks' deal-makers wouldn't have the talent to make it on Wall Street. Says one: "I'm not worried about the straightforward competition; the people they've got aren't what you'd call outstanding."

But William Comfort, who runs the corporate finance section of Citicorp's Merchant Banking Group, counters that the banks (and Citibank in particular) have upgraded their staffs until they now have an edge, especially in the international deal-making area. "We're the best channel possible to steer overseas direct investors into the U.S. market. We have not only extensive contacts in the States, but have merchant banks in places like Thailand and Brazil. Companies have confidence in us because they know that we're always going to be here."

The investment bankers most likely to be hurt, if the banks do go into the merger, acquisition and private-placement business, are not the big underwriting houses like Salomon Bros., Goldman Sachs or First Boston. Comments one partner in a big underwriter: "They're competing for maybe 5% or 10% of our total business—but you're certainly not talking about losing that much."

Most worried are the partners in the small houses whose reputation and business come from their skill as imaginative deal-makers. Says one: "We're really a custom-tailoring shop. Arranging mergers, acquisitions and private placements accounts for maybe 40% of our business. Simple competition doesn't bother me. What does is the banks using their power as lenders to take away business."

The bankers FORBES talked with seem to be aware of the dangers and improprieties involved in mixing the lending and advisory functions. However, one investment banker told of a corporate client who banked at a big New York bank. "The bank said to my client, 'You should get some long-term financing in the form of a private placement with an insurance company.' The treasurer told me, 'Gee, they've lent us all this money, so we should use their department to do it.' So what do they do? They use them, these guys aren't the top pros in the field, they miss the market, and the company never gets its money."

UNDERWRITING AT HOME?

But do the banks really *want* to get back into underwriting corporate securities domestically? The investment bankers insist that they do, and point to the banks' interest in getting permission to underwrite state and local government revenue bonds.

That's hardly a foot in the door. True, some eager beavers in the banks' corporate finance departments would like to take over the whole financial world, but most commercial bankers see commonsense objections to underwriting corporate securities. As Manufacturers Hanover Vice President George Armiger says, "It's not just Glass-Steagall; there are too many risk elements. Banks have a hard enough time keeping people's confidence these days, and if you underwrite and get hurt doing it, you can have a hard time, say, rolling over your certificates of deposit."

Besides, some major U.S. banks have had sobering experiences abroad, where they are not subject to U.S. limitations. A number of them set up London-based merchant banking affiliates in the late Sixties. Some, like Bank of America, Manufacturers Hanover and Wells Fargo, stuck mainly to managing big Eurodollar loans. But others, to their sorrow, jumped headlong into corporate financing, underwriting and speculative real estate.

Look at last year's results—spelled out in detail not in domestic annual reports but in hard-to-get-at British filings. Officially, merchant banks owned by Bankers Trust and Continental Illinois just broke even. Actually, BT kept $100 million on deposit with its subsidiary at below-market interest rates to boost the subsidiary's earnings by $3.5 million, and also made an $8-million capital infusion to beef up sagging ratios. Continental helped out its merchant bank by buying a $5,000 debenture from it for $15 million. Marine Midland's merchant bank reported a $1.4-million loss and would probably have reported more had it not upstreamed nearly $300 million in loans, to spread the impact of its bad debts over its parent's much larger portfolio.

In short, more freedom provides both opportunity and risk. The London experience drove that home to some U.S. banks the costly way.

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., December 29, 1975.

HON. WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR CONGRESSMAN PATMAN: Please accept my apology for this delayed response to your August 1st letter which expressed your concern over the purchase of the insolvent Franklin National Bank by European-American Bank and Trust Company and the possible formation of United Bank, Arab and French, New York.

You take issue with Assistant Attorney General Kauper's July 18 letter both as to his understanding of applicable law and as to his analysis of the relevant banking markets.

Concerning the former point, Mr. Kauper's discussion in his July 18 letter comports with my own understanding of the law. In light of the Supreme Court's decision in *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158 (1964), I share Mr. Kauper's opinion that a joint venture formed for the purpose of competing in a new market is not illegal *per se*. In *Penn-Olin*, the Court adopted an analysis comparable to that used for mergers and acquisitions generally, which requires consideration of the actual or potential competitive effects of the venture in the context of the specific markets and economic circumstances in which it occurs. A characterization of the *Penn-Olin* joint venture as an illegal agreement to divide markets, ably presented by Mr. Justice Douglas in a dissent joined in by Mr. Justice Black, was not adopted by the Court.

Concerning the latter point, absent an independent and detailed analysis of the pertinent markets, I am of course not in a position to gainsay the specific conclusions reached by the Antitrust Division. The market analysis as outlined by Mr. Kauper, however, strikes me as being fully in accord with the requirements of a case of this nature. I specifically concur in the judgment that the asset size of the joint venture is insufficient, without more, to create an unlawful restraint of trade.

Sincerely,

EDWARD H. LEVI,
Attorney General.

FEBRUARY 24, 1976.

Hon. EDWARD H. LEVI,
Attorney General, Department of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: (1) I wrote to inquire whether in your opinion an Article 12 New York investment company such as European-American Corporation is, as a matter of law a bank, and, as such, subject to the limitations which the Glass-Steagall Act and our other banking laws impose on commercial banks?

To aid you, I enclose a study prepared by my staff on this subject from which you can see that an Article 12 New York investment company is identical in operation to a commercial bank, except that it does not have ordinary checking accounts but holds so-called "credit balances" withdrawable on notice. Yet New York permits this "bank", called an "investment company" to:

(*a*) buy and sell securities for its own account;

(*b*) be the owner and creditor of the same business firm laying itself open to dangerous conflicts of interest;

(*c*) loan free of loan and reserve limits, regardless of who is the borrower or the amount of his loan;

(*d*) affiliate with a firm that underwrites securities and trades in the stock market;

(*e*) be owned by foreign banks and individuals; and,

(*f*) branch anyhere in the United States without securing approval from anyone.

Though they hold other peoples' money just like a commercial bank, New York allows these investment companies to buy equities, affiliate with underwriters and stock brokers and lend unrestrictedly to a single borrower owned by them.

(2) Moreover, in July 1972 when Michele Sindona bought an 18 percent stock interest in Franklin National Bank through two foreign corporations, I asked Dr. Burns to rule that his companies were subject to the Bank Holding Company Act. He refused because the interest was not 25 percent, even though both the statute and Regulation Y provide that any stock interest over 5 percent raises a rebuttable presumption of control. Four of these foreign banks each own 20 percent of the stock of European-American Bank and Trust Company and the other two hold, respectively, 17 and 2 percent.

Both Senator Proxmire and I have asked the Fed at least to hold a hearing on the question of control before an Administrative Law Judge. To date it has not done so. In your opinion in this proper?

(3) I need not tell you that I was very unhappy with your letter to me of December 29th in which you say that six of Europe's largest banks are permitted under our antitrust laws to acquire the billion dollar Franklin National Bank, even though not long ago the Superintendent of Banks of the State of New York thought it an antitrust offense for Barclay's Bank to acquire the much smaller Long Island Trust Company.

(4) I am, therefore, conditioned to receiving from you a letter saying that Article 12 New York investment companies are not banks, and any stock interest less than 25 percent does not constitute control subjecting the owner to the Bank Holding Company Act.

(5) However, even though you may disagree with me, I respect you and know you to be fair. You will, I am sure, concede that I am raising three important points of law upon which I may be right and you wrong. Accordingly in answering this letter would you consider how these three important points of law can be presented to an appropriate court for decision?

(6) If your answer be that there is now no such method available, should not our Judiciary Committees provide one? Or is your ruling, right or wrong, to prevail?

With kindest regards and best wishes, I am.

Sincerely,

WRIGHT PATMAN.
Vice Chairman, Joint Economic Committee.

Enclosure.

MEMORANDUM OF LAW—NEW YORK INVESTMENT COMPANIES CHARTERED UNDER ARTICLE 12 OF THE NEW YORK BANKING LAWS

Question. Do New York Investment Companies, chartered under Article 12 of the New York Banking Law, violate federal banking law by engaging in an essentially banking business?

Answer. Yes.

Just as the State of Delaware encourages corporations to incorporate there by permitting them to draw their charters about as they please, so New York State has built itself up as the world's financial center by permitting certain foreign banks to operate there virtually without regulation.

Besides allowing foreign banks to operate so-called agency offices in New York without any loan limits or reserve requirements, New York also allows foreign banks to charter so-called investment companies pursuant to Article 12 of the New York Banking Law.

When we add together financial transactions of foreign banks directly, their agencies, and New York Article 12 investment companies, there is as much as $250 billion going into and out of our banking system, for the most part, unregulated. This makes very difficult, if not impossible, monetary control by the Open Market Committee of the Federal Reserve System.

For the protection of the dollar and the financial strength of the country, steps must be taken to subject foreign banks who do business in this country to proper controls whether they choose to come here directly, through agencies, or under the guise of New York Article 12 investment companies.

It does not make sense to allow foreign interests to do a banking business in the United States that is either unregulated altogether, or partially immune to any of the traditional bank controls—especially the loan and reserve limits to which our domestic banks are subject.

I. FOREIGN-OWNED NEW YORK INVESTMENT COMPANIES ARE ENGAGED IN A BANKING BUSINESS

Article 12 investment companies are empowered to perform any and all functions of "commercial" banks chartered in New York State, except that Section 509 of New York's banking law forbids them to "engage in the business of receiving deposits." However, Section 509 explicitly authorizes maintenance "for the account of others, credit balances incidental to, or arising out of the exercise of its lawful powers. " Also, as mentioned above, unlike commercial banks, Article 12 investment companies have the power to buy and sell securities for their own account.

Although Article 12s call themselves "investment companies," they are, in truth, the equivalent of an international wholesale bank and compete on a parity with the foreign departments of our commercial banks.

Counsel for Belgium-American Banking Corporation, an Article 12 investment corporation, before the Senate Subcommittee on Financial Institutions in 1966 let the cat out of the bag when he testified:

> Article 12 refers to Article 12 corporations as investment companies. and therefore we are an investment company. We do not do the kind of business that a company regulated under the Investment Company Act of 1940 does. We do much more banking buisness. (*Hearings on Bills to Amend the Bank Holding Company Act of 1956:* S.2353, S.2418, and H.R. 7371, Senate Committee on Banking and Currency, 89th Cong., 2nd Session, p.261).

The history of foreign ownership of Article 12 banks has not been spectacular. Until 1975 no more than three Article 12 New York investment companies had been chartered by foreign banks. In fact, this low profile seems to have been the primary reason for the lack of attention paid to the Article 12 investment companies by federal banking regulators.

In a letter dated August 13. 1975 from the Federal Reserve Board to Mr. James Gargan, Acting Deputy Superintendent of Banks of New York, cmmenting on the application of "Baer American Banking Corporation" to become the fourth foreign-owned Article 12 investment company, the Board clearly indicated that the "limited number of 'banking' investment companies", and the fact that the policy of New York as understood by the Board was to deny charters to future Article 12 applicants, were prinlipal reasons why the Board had recommended that foreign-owned Article 12 investment companies not be included under proposed legislation regulating foreign banking in the United States.

The Baer application has now been granted. New York, in the interim, has chartered a fifth Article 12 investment company, the Nordic Banking Corporation, wholly owned by Sweden's third largest commercial bank, Svenska Handelsbaken. Indications are that it will be New York's policy to invite further applications from foreign interests.

II. NEW YORK INVESTMENT COMPANIES ENJOY SUBSTANTIAL COMPETITIVE ADVANTAGES BECAUSE OF THEIR UNREGULATED STATUS OVER DOMESTIC COMPETITORS

Foreign-owned Article 12 investment companies are almoset exclusively engaged in international wholesale banking. They compete with the international banking departments of domestic commercial banks, other foreign banks' agencies and branches, and most of all, with the so-called Agreement and or Edge Act Corporations of our domestic banks.

The fact that an Article 12 investment company cannot have ordinary checking accounts is no disadvantage because they hold credit balances upon which their customers can draw. In this respect also they are on a parity with agencies, Agreement and Edge Act Corporations, none of which have ordinary checking accounts.

However, unlike Agreement or Edge Act Corporations there are no statutes requiring Article 12 investment companies to maintain adequate reserves and observe loan limits. Regulation K restricts Edge and Agreement Corporations engaging in international banking business whose total demand deposits and acceptance liabilities exceed its capital and surplus from creating liabilities to any one customer of more than 10% of such capital and surplus.

Moreover, aggregate outstanding liabilities at any one time must not exceed ten times a corporation's capital and surplus without prior permission from the Federal Reserve Board.

Furthermore, under Regulation K (12 C.F.R. Sec. 211.7), Edge Act Corporations doing business in the United States may only do "such limited business as is usual in financing international commerce". Subparagraph (d) (1) to Sec. 211.7 specifies that "such limited business" does not include financing import-export transactions to the extent of advancing "expenses in the United States of an office or representative therein". Article 12 investment companies, on the other hand, are not restricted from making such working capital loans.

III. FOREIGN OWNERS OF NEW YORK INVESTMENT COMPANIES EVADE REGULATION UNDER THE BANK HOLDING COMPANY ACT OF 1956 AND THE PROHIBITIONS IMPOSED BY THE GLASS-STEAGALL ACT

When Bank Nationale de Paris the largest bank in France decided to expand its United States business to California in 1971, it had to apply for permission from the Federal Reserve Board to become a bank holding company pursuant to Sec. 3(a) of the Bank Holding Company Act of 1956, 12 U.S.C. Sec. 1841, *et seq.*

Bank Nationale de Paris already completely owned French-American Banking Corporation (FABC), a New York investment company chartered in 1919 as an Article 12 investment company. The Board ruled that under the 1970 amendments to the Act, Article 12 investment companies were not "banks" as defined by Sec. 2(c) because FABC could not, under New York law, "accept deposits that the depositor has a legal right to withdraw on demand".

When the Bank Holding Company Act was amended in 1970 the Congress added a special exemption for "any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States". (Sec. 4(c) (9).

To accommodate this change, the Board in 1971 amended Regulation Y (Sec. 225.4(g)), which in part permitted domestic activity by a foreign bank holding company if it was found to "finance and facilitate" foreign commerce. This standard is much broader than that for Edge and Agreement Corporations given content in Regulation K (Sec. 211.7).

New York Article 12 banks, therefore, are allowed to make loans under the facilitating foreign commerce standard which their competitors the Edge and Agreement Corporations are prohibited from making—witness their ability to advance to United States corporations working capital loans.

In addition, New York investment companies are subsidiaries of foreign bank holding companies under Section 225.4(g) (2) (iv), need not exclusivley engage in business related to foreign and international commerce, whereas *all* the domestic business of Edge and Agreement Corporations under Regulation K must be related to its foreign business.

By confining their banking business to Article 12, New York investment companies, foreign banks can thereby evade the Glass-Steagall Act which confines banks to the business of banking.

For instance, FABC organized French-American Capital Corporation (FACC) in 1970 to invest for its own account in the securities market to make venture capital investments and temporary short-term investments, including participations in the syndication of foreign and domestic loans. Also included in FACC's functions are investment advisory services, and merger and acquisition assistance.

Although the Board required that FACC meet the requirements imposed upon domestic bank holding companies when engaging in like activity, it allowed it to do a securities business our commercial banks cannot do.

Section 225.4(9) (2) (iv) is a loophole for foreign banks that ought to be closed. They should not be allowed to do what our banks are forbidden to do under the guise of an Article 12 New York investment company.

The parent corporation of another New York Article 12 investment company, J. Henry Schroder Banking Corporation, likewise owns subsidiaries engaged in investment counseling, real estate, and leasing.

Because of their false "non-bank" status under the Bank Holding Company Act these New York Article 12 investment companies permit their foreign parents enjoy in the United States an interstate banking presence which, as we have seen, is denied to American banks' Edge and Agreement Corporations, and under the McFadden Act to our commercial banks.

IV. FOREIGN-OWNED NEW YORK INVESTMENT COMPANIES THAT ARE AFFILIATED WITH COMMERCIAL BANKS INVITE REGULATORY ABUSES

European-American Bank and Trust Company (EABTC) is owned by six of Europe's largest banks. (Deutsche Bank, Germany's largest, 20% ownership; Societe Generale, one of France's three largest, 20% ownership; Midland Bank Group, a major London clearing house, 20% ownership; Societe Generale de Banque, Belgium's largest, 20% ownership; Amsterdam-Rotterdam Bank, Netherlands' largest, 17%+ ownership; Creditanstalt-Bankverein, Austria's largest, 2%+ ownership).

As a member of our Federal Reserve System, EABTC is subject to the loan limits and reserve requirements of other member banks. But over a long period these self-same six European giants have owned European-American Banking Corporation (EABC) organized as a New York Article 12 investment company. Indeed, EABTC and EABC share common management staff and, to a large extent, common directors.

If EABTC cannot make a loan because of its loan limits, the management refers customers to EABC which has no loan limits. Likewise, EABTC, as a bank, cannot buy and sell securities for its own account, but of course EABC can do so, even though it cannot underwrite securities.

The six European banks that own both EABTC and its Article 12 investment company EABC, are also allowed ot deal as they please in our financial markets without any regulation, and are also allowed to have subsidiary companies that underwrite, buy, and sell securities in the American market.

V. NEW YORK INVESTMENT COMPANIES DOING A BANKING BUSINESS SHOULD BE SUPERVISED AND REGULATED LIKE OTHER FOREIGN BANKS IN THE UNITED STATES

A. Grandfathering would unjustifiably exempt the largest foreign interests from regulation and supervision

Governor Mitchell, in his recent statement before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance, stated the view of the Fed as follows:

> The Board believes that there is a potential for evasion of its proposed legislation if foreign banks can readily obtain investment company charters in lieu of agency or branch licenses. The Congress may thus wish to consider subjecting all *future* investment companies that would be chartered to engage principally in a commercial banking business to the same scope of federal regulations that have been suggested for agencies and branches in order to close this potential loophole. (Emphasis supplied.)

This is a half step towards reform. If there be "a potential for evasion" of needed legislation, why would any bank regulator worth his salt want to preserve "a potential for evasion" in J. Henry Schroder, French-American Banking Corporation, European-American Banking Corporation, or any previously incorporated New York Article 12 investment company?

Although this position is a step in the right direction, there is no justifiable reason for "grandfathering" those New York investment companies already in existence. This would allow European-American, the largest European-owned banking group in the United States, to continue its unregulated and illegal activities.

In the last two years the foreign New York investment company presence has almost doubled, with no indication that this proliferation will cease. Indeed, given the New York authorities' receptive policy for granting new Article 12 investment company charters "grandfathering" would encourage many other foreign banks to establish New York investment companies before the Congress acts.

This would be clearly contrary to all efforts of the federal government to end the impermissible advantages enjoyed by foreign banks in this country.

B. The inability to offer checking account services is irrelevant to an institution's status as a bank

A survey of the balance sheets of United States banking institutions owned by foreign banks located in New York for 1975 (figures provided by Governor Mitchell with his statement) clearly indicates that although investment companies are incapable of offering checking accounts, their liabilities to corporations and other non-bank customers, are of levels comparable to those of other commercial banks and branches which do receive demand deposits in the form of checks.

For agencies and New York Article 12 investment companies, these liabilities are entirely in the form of credit balances, time and savings deposits, and other borrowings.

In view of the kind of business New York Article 12 investment companies actually do, and the credit balance of their customers that they hold, there can be no valid argument that they are not "banks" subject to Federal Reserve regulation merely because they do not offer ordinary checking accounts.

Section 2(c) of the Bank Holding Company Act defines "bank" as "any institution which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans". Despite the highly technical arguments advanced to show that credit balances are not such deposits, they are subject to withdrawal.

Although it is difficult to understand why they would do so, the United States maintains Treasury tax and loan accounts in these New York Article 12 investment companies, and agrees to give a week's notice before withdrawal.

It is an outrage for the United States to deposit a cent in institutions of this kind. It must be the United States thinks they are banks even if they are pretending not to be, and it would be far better were the United States to play out the charade and not deposit in them on the grounds they are not banks.

European-American Banking Corporation, in its promotional literature, describes itself as "an investment company *with commercial banking powers* organized under the banking laws of the State of New York" Why then, should it not be regulated as such?

It is a fundamental misunderstanding of the function of traditional banking safeguards which leads one to the conclusion, that merely because an institution does not offer checking accounts, its failure would have no effect on the American banking system.

The 1975 balance sheets of four Article 12 New York investment companies indicate a net liability to other banks of 23.2% of their total assets/liability ratio; these liabilities are ultimately depositor's funds. Little protection is afforded depositors in the United States banking system if they are prohibited from making deposits in unregulated banking institutions, but their banks are permitted to sell their deposits to these institutions.

It is also significant to note that when Congress amended the Bank Holding Company Act in 1966 a list was prepared by the Fed and introduced by Senate Banking and Currency Committee Chairman Senator A. Willis Robertson of organizations that would be covered by proposed amendments, including New York Article 12 investment companies. (*Hearing on Bills to Amend the Bank Holding Company Act of 1956:* S. 2353, S. 2418, and H.R. 7371, Senate Committee on Banking and Currency, 89th Cong. 2nd Sess., p. 330).

C. Unregulated New York investment companies subvert Federal monetary policy

New York investment companies (as do other unregulated foreign banks doing business in the U.S.A.) make it difficult for the Federal Reserve to control monetary policy. Since their principal business is wholesale banking, the majority of these investment companies deal in the interbank market. The Fed's figures bear this out. (See Tables 4a and 4b of Appendix to statement by George W. Mitchell before the Subcommittee on Financial Institutions of the House Committee on Banking, Currency and Housing, December 12, 1975).

Absent the standard regulatory mechanisms, New York Article 12 investment companies are able to ignore United States monetary policy through Eurodollar borrowings and deposits (the latter in the form of credit balances and time deposits). Presumably, then, the only safeguard for this activity is the willingness of the central bank in the parent organization's country to come to the aid of a failing investment company.

Finally, it is apparent that New York banking officials are not prepared to halt further growth in the number of Article 12 investment companies.

The time has come for the Congress to subject these New York Article 12 investment companies to regulation by Federal Reserve. However, the Congress should not accept any so-called "grandfather" clauses that extend the lift of these unregulated banks beyond a reasonable period of a year or so.

CONCLUSION

The regulation of foreign banks operating in the United States has become an issue of considerable importance and the subject of many legislative proposals in this 94th Congress. In the past several years we have seen a proliferation of quasi-banking institutions that totally ignore the principles and practices of sound banking for which so many have worked so long to establish.

It is claimed by those who would have these foreign-owned banks continue their unregulated presence that any meaningful attempts to bring them under proper control would endanger the profits of our banking concerns abroad. Nothing could be further from the truth. Nowhere in the world do United States banks enjoy anywhere near the competitive advantages of the subsidiaries, branches, agencies or investment companies of foreign interests operating in our domestic banking markets.

In this context, focus should be placed on New York investment companies chartered under Article 12 of the New York State Banking Laws. Although by law these investment companies are unable to offer standard checking account services, the fact that they do a banking business, cannot be disputed.

The largest of these companies with over $1.5 billion in assets is the European-American Banking Corporation. In its promotional literature this New York Article 12 bank announces itself as "an investment company *with commercial banking powers* organized under the banking laws of the State of New York."

Why then should Congress or the various bank regulatory agencies allow such institutions to be free from all legal restraints?

Fundamentally, it is a misunderstanding of the function of traditional banking safeguards which leads one to believe, that merely because Article 12 investment companies do not hold demand deposits derived from checking accounts, they therefore need not observe reserve requirements.

Moreover, New York investment companies which are foreign-owned are heavily involved in the inter-bank money exchange markets. Little protection is afforded depositors in the United States banking system if they are prohibited from making ordinary checking deposits in unregulated banking institutions when their banks are permitted to sell their deposits to these institutions.

Subject to no loan limits or reserve requirements, investment companies organized under Article 12 of the New York Banking Laws are able to make loans to customers that commercial banks cannot. Moreover, they are able to buy and sell securities for their own account. In principle, this violates the Glass-Steagall Act and permits these investment companies to combine a banking and a securities business—something no domestic bank is allowed to do.

Although New York investment companies are empowered to engage in all the regular activities of a commercial bank, save checking accounts, they are not legally considered "banks" by the Federal Reserve Board and, threfore, do not subject their foreign owners to bank holding company regulations.

What is most significant is that these New York Article 12 investment companies are not subject to regulation by the Federal Reserve. They, just like foreign-owned bank "agencies", which likewise refuse checking facilities, can act as they please to channel any moneys to and from the United States through their loans to corporations and their heavy activity in the inter-bank markets, irregardless of the policies of the Board's Open Market Committee.

Governor Mitchell of the Federal Reserve Board has already urged that New York Article 12 investment companies be brought under the supervision of the federal banking regulatory agencies. However, he would grandfather all New York investment companies now in existence.

I think this unwise. Besides allowing European-American the largest European-owned banking group in the United States to continue its unregulated and illegal activities, "grandfathering" would encourage many other foreign banks to apply for Article 12 charters before Congress could act. This trend is already clearly noticeable with the chartering of the 4th and 5th foreign-owned investment companies in the past six months.

In the proposed "Financial Institutions Act of 1976" there is a provision which would bring all foreign-owned branches and agencies operating in the United States under the regulation of the proposed Federal Banking Commission. I would like to urge that like treatment be afforded to all Article 12 New York investment companies. It is only in contravention of the purposes, policies, and good sense of this legislation to allow this potential loophole to exist.

JANUARY 29, 1976.

Hon. EDWARD H. LEVI,
Attorney General, Deparment of Justice,
Washington, D.C.

DEAR MR. ATTORNEY GENERAL: On November 19, 1974 at a private dedication ceremony to which only present and former Federal Reserve people and no Members of Congress were invited, the Board of Governors of the Federal Reserve System has presumed to name the new $50 million dollar Federal Reserve building in this City in honor of William McChesney Martin, Jr.

Section 298d. of Title 40, United States Code, reads as follows:

"The Administrator of General Services is authorized, notwithstanding any other provision of law, to name, rename, or otherwise designate any building under the custody and control of the General Services Administration, regardless of whether it was previously named by statute".

As I read this Section, in the absence of a naming by the Congress, the Administrator of the General Services Administration has authority to name a government building. My further information is that the Congress acted in Public Law 92–520 to name the new FBI building in honor of J. Edgar Hoover.

So far as I know there has been no naming of the new Federal Reserve Building by either the Congress or the Administrator of the General Services Administration, and I cannot locate any provision in the Federal Reserve Act empowering the Board of Governors of the Federal Reserve System to name the government building they occupy. That seems clearly to be a job for the Congress and G.S.A.

In my opinion the main Federal Reserve building on Constitution Avenue should be named in honor of Woodrow Wilson who created the Agency, and the new annex, the Glass-Owen building, in honor of Carter Glass and Robert Owen who handled the legislation.

Accordingly, I would very much appreciate your looking into this question and advising me whether the Board of Governors of the Federal Reserve System in thus attempting to name their new building have acted legally or illegally. If the latter, I wish to assure you that this will not be the first instance in which the Federal Reserve has assumed powers that the Congress has not conferred upon it.

Sincerely,

WRIGHT PATMAN,
Vice Chairman, Joint Economic Committee.

Appendix III. SPEECHES OF WRIGHT PATMAN IN THE CONGRESSIONAL RECORD

[Reprinted from the Congressional Record, July 8, 1975]

THREE BANK FAILURES—WORST IN NATION'S HISTORY

The Speaker pro tempore (Mr. McFall). Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 30 minutes.

Mr. PATMAN. Mr. Speaker, we have just experienced the three worst bank failures in the Nation's history, namely, the closing on October 18, 1973, of the Nation's 86th largest bank, the $1 billion United States National at San Diego; the closing on October 8, 1974, of our 20th largest bank, the $5 billion Franklin National Bank in New York, and the closing on January 19, 1975, of our 68th largest bank, the $1.7 billion Security National in Hempstead, Long Island, N.Y.

Mr. Speaker, there is good reason to believe that if our banking agencies had been on the ball none of these failures would have occurred.

Without going into detail at this time, let me say that the trouble at the United States National in San Diego was due to President Nixon's friend, C. Arnholt Smith, who has just pleaded nolo contendere to a 25-count indictment that accuses him of misapplying $27.5 million and falsifying the bank records.

As long ago as 1962 a conscientious bank examiner accused Smith of similar acts and asked that his charges be referred to the U.S. attorney. Indeed, in 1969 the Wall Street Journal in a front page article detailed many transactions between the bank and Smith's companies, suggesting there might be insider profits in violation of the Federal securities laws.

It is hard to believe, Mr. Speaker, but neither the Comptroller, nor the Federal Deposit Insurance Corporation, nor the Federal Reserve took any action. Even when on May 31, 1973, the SEC filed a civil complaint against C. Arnholt Smith the three banking agencies did nothing.

Three successive Comptrollers of the Currency—Saxon 1961–66; Camp 1966–73, and Smith 1973 to date—either ignored or sidetracked the bank's problems. And, of course, Frank Wille at FDIC and Dr. Arthur F. Burns at the Federal Reserve, did nothing.

In the case of the Franklin National Bank, its troubles began when it opened offices in Manhattan and became worse when in July 1972 control of the bank passed to Michele Sindona. On July 19, 1972, when Sindona bought Franklin I wrote Dr. Arthur F. Burns at the Federal Reserve and suggested to him that the Board consider subjecting Sindona's companies to the Bank Holding Company Act. Burns refused and said that because Sindona held only 18 percent of the stock instead of 25 percent that he was powerless.

Dr. Burns and his Board were the only ones in the United States that did not know that Sindona controlled Franklin. If he had acted on my letter instead of ignoring it there might never have been a Franklin failure.

The downfall of Franklin began when on May 1, 1974, after almost a year's study, the Federal Reserve said that Franklin could not afford to buy the Talcott National Corp., a factoring outfit. From its Talcott study the Fed either knew or should have known that Franklin, under Sindona, had produced—or more correctly manufactured—foreign exchange profits to meet its September 30, 1973, and March 31, 1974, dividends, and as sources have indicated, the bank examiner assigned to Franklin was saying, according to my interpretation, the bank was insolvent.

Many knowledgeable banking experts feel that the bank should have been closed by the supervisory authorities, but instead the three banking agencies approved an optimistic press release, which the SEC charges was false, and in which Sindona loosely promised to increase Franklin's capital by $50 million.

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Although on May 12, 1974, trading in the stock of the Franklin New York Corp., the bank's holding company was suspended at its own request, in the press release the Federal Reserve assured the world that it would provide whatever funds Franklin needed, and it did to the tune of over $1.7 billion.

Needless to say this allowed Franklin to pay off in full uninsured advances by large banks of Federal funds, and over $1 billion in uninsured deposits in Franklin's overseas branches. Dr. Burns saw that all the big fellows here and abroad were paid in full at the expense of little fellows who bought stock and debentures in the holding company thinking it was as secure as the bank.

What was precisely the trouble at Security National I do not know, but with what I do know about what the three banking agencies did not do at the United States National and Franklin I fear the worst.

Bad as these failures were, the trouble was compounded when on October 18, 1973, the Federal Deposit Insurance Corporation sold United States National to the $10 billion asset Crocker National Bank, our 15th largest, and it sold Franklin on October 8, 1974, to the $2.4 billion European-American Bank & Trust Co., our 51st largest, operated as a joint venture by the Deutsche Bank, Germany's largest, and five other large European banks.

Under threat by the Comptroller of the Currency to appoint a conservator, the board of directors of Security National on January 19, 1975, sold itself to Chemical New York Corp., the holding company for the $22 billion Chemical Bank, our Nation's 6th largest bank.

Only 50 banks today own over half the deposits in our 14,500 banks. Selling these three banks to such large banks intensifies our already too great concentration.

But, Mr. Speaker, this is not all. Before Frank Wille at the FDIC sold either United States National or Franklin he met, in utmost secrecy, in a smoke filled room with his cronies James E. Smith, Comptroller of the Currency, and Dr. Arthur F. Burns, Chairman of the Federal Reserve Board, and decided upon the buyer. Thereafter they presented the buyer to the Justice Department on an emergency basis, assuring that no matter how flagrant the antitrust offense, Justice would go along on grounds akin to national security.

The candidates of Frank Willie at the FDIC to buy United States National were the following:

	Assets in billions	Rank, U.S.A.
Bank of America	$60.37	1
United California (Part of Western Bancorp)	18.7	10
Security Pacific	15.48	11
Wells Fargo	12.67	14
Crocker	10.29	15
Union	4.08	28
Bank of California (Part of BanCal Tri-State Corporation)	3.05	45

NOTE.—Values and ranks as of December 31, 1974 and as reported in Business Week, April 21, 1975.

To its credit the Antitrust Division at Justice advised against Bank of America, Security Pacific, and United California, so that only the others bid. The one FDIC selected was Crocker, the Nation's 15th largest bank with assets of $10 billion.

In the case of Franklin, Frank Wille of FDIC made an effort to interest some 17 banks, but in the end only these banks bid:

	Assets in billions	Rank U.S.A.
Citibank	$44.7	2
Manufacturers	21.0	4
Chemical	17.0	6
European-American	2.5	51

NOTE.—Values and ranks as of December 31, 1974 and as reported in Business Week, April 21, 1975.

The three banking agencies agreed on European-American and this acquisition raises some extremely serious questions. It is a joint venture of these six European banks:

PARENT, ASSETS, AND STOCK IN EAB AND EAC

Deutsche Bank, Germany's largest, $24.5 billion, 20%+.
Societe Generale, one of France's 3 largest, $20.4 billion, 20+.
Midland Bank Group, a major London clearing bank, $19.0 billion, 20%+.
Societe Generale de Banque, Belgium's largest, $9.1 billion, 20%+.
Amsterdam-Rotterdam Bank, 3rd largest in the Netherlands, $9.6 billion %+.
Creditanstalt-Bankverein, Austria's largest, $4.2 billion, 2%+.

NOTE.—Assets and Ranks as of December 31, 1973, American Banker, July 31, 1974.

Under the statutes and Federal Reserve Regulation Y there is a rebuttable presumption of control from so little as ownership of 5 percent of the stock of a bank and, if need be, the Federal Reserve Board can hold a hearing and determine the question of control.

Accordingly, I wrote Dr. Arthur F. Burns on April 24, 1975, there was reason to believe that these joint ventures controlled European-American, suggesting to him that you measure control of a joint venture in a different day from control of the ordinary stock corporation. There is little chance that an interest adverse to that of a joint adventurer can find expression. In this the joint venture is quite distinct from the stock corporation.

Moreover, to the knowledge of the banking agencies at least four of these banks own interests in American investment banking firms, a practice outlawed for American banks by the passage in 1933 of the Glass-Steagall Act. In addition, these six banks also own the European-American Banking Corp. which, except for underwriting and taking commercial bank deposits, does a banking business.

Neither European-American Banking Corp. nor any of the six foreign banks are subject to reserve requirements. All do an unregulated banking business, not only in the State of New York, but throughout the United States in competition with our domestic banks which are subject to reserve requirements, and forbidden to do an interstate banking business.

Of course, Mr. Speaker, if our six largest American banks were to open a bank in the city of New York, or elsewhere in the United States as a joint venture, we would expect the Department of Justice to call it a per se antitrust offense in violation of the Sherman and Clayton Acts. Certainly that is the teaching of *Timken* v. *United States*, 378 U.S. 158 (1964), and *Topco* v. *United States*, 405 U.S. 596 (1971).

So much for the sale of Franklin to European-American.

You would not believe it, Mr. Speaker, but the Comptroller dictated the sale of Security National to Chemical which had been endeavoring to expand further on Long Island for some time. Acquisition of Security gave it 86 additional branches making Chemical, from the point of view of branches, the second largest bank in the State of New York.

Furthermore, as of December 31, 1974, Security National had assets of $1.7 billion and, in point of size, was our 68th largest bank. Chemical acquires it for $40 million. With approximately 5 million shares outstanding this comes to $7.50 per share. While the stock sold up to $33.50 in 1973, it sold down to $4 bid, $4.75 asked on January 14, 1975.

In sharp contrast, Crocker paid $89 million for United States National, a bank with only $1 billion of assets as of December 31, 1972, and European-American paid $125 million for the cream of Franklin's assets amounting to $1.37 billion at the time of purchase October 8, 1974.

It is no wonder, Mr. Speaker, that stockholders of Security National allege that the Comptroller gave their bank to Chemical at such a bargain price that it stands to make a quick $30 million.

It is interesting, Mr. Speaker, to observe how Security National was sold. It sold itself through action of its board of directors, with the Comptroller of the Currency certifying pursuant to section 181 of title 12 that an emergency existed, justifying his waiving the required statutory approval by two-thirds of Security's stockholders. On May 9, 1975, the stockholders did approve 4,004,111 to 221,233. A group of Security stockholders recently failed in an attempt in the courts to void the deal.

Coming to them as a completed transaction the stockholders had no alternative. Neither did the directors. The Comptroller told them either to approve a sale to Chemical or he would take over the bank and put in a conservator. He held a pistol at their heads.

In effect, Mr. Speaker, what the three banking agencies have been doing is rejecting our traditional methods of liquidating insolvent banks. Instead, they go together in a back room and decide to what bank they will give the troubled one.

Moreover, to induce bidding the FDIC offered to loan the purchasers—Crocker borrowed $50 million for 5 years at 7½ percent—European-American borrowed $100 million for 10 years at floating rates that average 10.03 percent and has a right to borrow $50 million more on the same terms for 8 years.

What is most disturbing, Mr. Speaker, is that the banking agencies are at liberty to act in secret without any supervision. The purchase, as we have seen, is a fait accompli and the Justice Department is asked to approve in an emergency situation. The court is in even a worse position. It is asked to approve what both the banking agencies and the Department of Justice have done.

It is very disturbing to me to have large banks handled in secret this way by the three banking agencies. In equity receivership, and now in chapters 10 and 11 proceedings in bankruptcy, we have modern methods by which to test plans of reorganization to make cerain they are fair and equitable. The court in these traditional proceedings decides before the plan takes effect, not afterwards and on notice to the parties concerned.

For instance, because of the way the Comptroller handled the sale of Security National, there was no opportunity for the stockholders to question the price Chemical paid. It may well be that Chemical will make an unconscionable profit from this sale.

In the case of the Franklin sale, a very important consideration is whether FDIC has the right to reimburse the Federal Reserve for its advance, and obtain a priority over unsecured creditors and stockholders of the Franklin New York Corporation. A court might well have deep-rocked the $1.7 advance by Federal Reserve to Franklin (*Taylor* v. *Standard Gas and Electric Company, Claim of Deep Rock Oil Corporation*, 306 U.S. 307 (1939)) before it approved the FDIC sale to European-American.

In truth, for the reasons stated above, the Court might well have judged the sale to European-American improper, and the $1.7 billion advance to Franklin as beyond the powers of the Federal Reserve.

Mr. Speaker, the Congress needs to study how the three banking agencies handled the sale of United States National, Franklin, and Security National. Otherwise, we will see repeated the evils that at the turn of the century existed in equity receivership when the railroads were full of watered stock and in the hands of the investment bankers.

It may be we should recreate the Reconstruction Finance Corporation, or develop new legislation to meet this problem. What we need at the moment, however, is to ascertain whether what the three banking agencies did to dispose of United States National, Franklin, and Security National was proper. There is every indication it was not.

[Reprinted from the Congressional Record, Mar. 14, 1975]

Let Us Compel Publication of Transcripts of Fed's Open Market Committee on the Day of the Meeting, Thereby Stopping Secrecy in Fed and Prevent Conditions Like We Endured in the Early Thirties Because of Andrew Mellon and That We Are in Today Because of Dr. Arthur Burns

The Speaker pro tempore. Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 30 minutes.

Mr. Patman. Mr. Speaker, while there are many matters upon which this House divides, I would like to think that there is not one Member present who does not agree with me that this Congress is entitled to receive from the Board of Governors of the Federal Reserve System uncensored transcripts of the meetings of its Open Market Committee on the day the committee meets. What that committee does, or does not do, brings this country good or hard times.

At the present time we receive an enigmatic summary 90 days after the committee meets—not even Dr. Einstein could understand that summary. At the end of 5 years we receive a censored transcript. Sometime this year we will receive the 1970 transcript.

Certainly, you can all agree with me that this is wrong as to the meetings of the Open Market Committee from 1970 through 1974. Dr. Arthur F. Burns became Chairman of the Fed in 1970. There is agreement by everyone that in the 1971–73 period the Open Market Committee, under Dr. Burns' direction, increased the money supply when the economic indicators said the economy should be held steady.

This is not a personal prejudice of mine. Economists from Friedman to Samuelson, newspapers from the New York Times to the Wall Street Journal, magazines from Fortune to Playboy, all say this is true. Moreover, Sanford Rose, writing in the July 1974 issue of Fortune specifically charges that Dr. Arthur F. Burns forced the inflationary policy on a reluctant Open Market Committee by threatening to bring the White House down upon them.

Let us not forget that former President Nixon believes that a downturn in the economy cost him the election of 1960. Burns warned Nixon in March 1960 that an "economic dip" was just around the corner and would reach its lowest point in October, just before the election. He advises that two steps be taken immediately to head off the slump—a loosening of credit, and increased spending for national security.

At Nixon's insistence, Eisenhower referred the matter to his Cabinet, and the Federal Reserve, both of which declined to act on Burns' recommendation. In "Six Crises" Nixon says:

> Unfortunately, Arthur Burns turned out to be a good prophet. The bottom of the 1960 dip did come in October and the economy started to move up again in November—after it was too late to affect the election returns. In October, usually a month of rising employment, the jobless rolls increased by 452,000. All the speeches, television broadcasts, and precinct work could not counteract that one hard fact.

Thereafter, the economy was No. 1 on Nixon's "enemies list," Sherman J. Maisel, a member of the Federal Reserve Board from 1965–1972, states in his recent book, "Managing the Dollar," that the Director of the Office of Management and Budget, George Shultz, informed the Board in 1971 that—

> If an election were to be won the Federal Reserve would have to increase the money supply at fare more than the 4.2 percent average of 1969–70.

Granted that Mr. Dooley is right and that there are lies, damn lies, and then statistics, still it is very interesting to compare the discount rate, the prime rate, and the growth of the money supply under Dr. Burns with previous Chairmen:

Year	Money supply percent change	Federal discount rate		Prime		Federal funds rate	
		Low	High	Low	High	Low	High
1959	1.6	2½	4	4½	5	[1]	----------
1960	.6	3	4	4½	4½	----------	----------
1961	3.1	3	3	4½	4½	----------	----------
1962	1.5	3	3	4½	4½	2.68	2.68
1963	3.7	3	3½	4½	4½	3.38	3.38
1964	4.6	3½	4	4½	4½	3.42	4.00
1965	4.6	4	4½	5	5	3.57	4.63
1966	2.4	4½	4½	5½	6	3.86	5.96
1967	6.6	4	4½	5½	6	3.50	5.39
1968	7.9	4½	5½	6	6¾	4.54	6.25
1969	3.5	5½	6	7	8½	5.95	9.68
1970	6.1	5½	6	6¾	8	4.84	9.39
1971	6.3	4½	5½	5¼	6	3.59	5.73
1972	8.7	4½	4½	4½	6	3.18	5.38
1973	6.1	5	7½	6	10	5.61	10.84
1974	4.7	7¾	8	8½	12¼	8.45	13.55

[1] Federal funds rate was not available prior to 1962. Years 1970 to 1974 denote Dr. Burns chairmanship.

Exactly what do these dry statistics show? In 1972 when Nixon was running for President the Fed held the discount rate to 4½ percent, the prime rate to under 6 percent, increasing the money supply to 8.7 percent. After election it raised the discount rate to 8, the prime rate to 12¼, and decreased the growth of the money supply to 4.7 percent.

You can judge how much this upset our economy by the changes in the prime rate. From 1929 to 1969 there were 38 changes, never more than five changes in a single year. With Dr. Burns at the helm from 1971 to 1974 there were 151 changes, over 37 a year, and in 1974—61.

Is it any wonder that on November 25, 1974 the Wall Street Journal was forced to say editorially:

> The money supply grew far too rapidly in 1971–1973. In blunt words the erosion of bank capital ratios was fundamentally caused by the inflational policies pursued by Chairman Burns.

While it is unreasonable to expect that the Fed will never make mistakes, it is not unreasonable to require that its mistakes be based on poor business—not poor political—judgment. It was never intended that the Fed play "step-and-fetch it" for an incumbent Presidential candidate, and Congress should not tolerate a situation in which it cannot satisfy itself that this has not occurred.

As I recently stated in the February issue of the American Bar Association Journal, a copy of which I include in the Record, Dr. Arthur F. Burns has used his position as Chairman of the Board of Governors of the Federal Reserve System to flood the country with money to elect Richard Nixon. This was a dishonest thing to do when the economic indicators indicated he should have left the economy alone.

Worse, the election over, he caused the Open Market Committee to put the brakes on the economy too sharply, allowing unemployment to increase—liquidating the real estate industry—emptying the savings banks, taxing the little fellow, and transforming recession into depression.

Under these circumstances, do you not agree that the Congress is entitled to see uncensored transcripts of the Open Market Committee meetings the day the committee meets?

Keeping the transcripts of this critical 1971–73 period from the people amounts to a coverup comparable with Watergate. We need to see an uncensored transcript of what was said by the Open Market Committee members.

Lest you have reservations about our rights to receive daily transcripts, let me remind you that another election is coming in 1976. Is there any reason to suppose that Dr. Burns will not act then at the Open Market Committee meetings as he wanted to in 1960, and as he did in 1972?

As you all know since I was elected to this House in 1928, I have been a voice crying in the wilderness for the accountability of the Federal Reserve System to both the President and the Congress.

As all economists will tell you, it was not the stock market, but the stupid refusal of the Federal Reserve System under Andrew Mellon to increase the money supply that brought on the depression of 1929–33. Here we are again in 1975 with an unnecessary depression facing us because of the bad policies of the Board of Governors of the Federal Reserve System under Dr. Arthur F. Burns.

The time has come to bring Dr. Burns and his Board to book. At least, let us require disclosure to the Congress and the people of the proceeding of the Open Market Committee on the day the Committee meets.

Former Board member Maisel tells us that the proceedings of the Open Market Committee are kept secret out of "fear of political attack and public criticism." As he says, this is fundamentally wrong, because the more you publish about monetary policy at the time you make it, the better that policy is likely to be.

Moreover, the doings of the Open Market Committee are well known to those who have the most to gain—the bankers. It is only the Congress and the people who are kept in ignorance.

Let us compel publication of uncensored transcripts of the Open Market Committee on the day of the meetings so that our country will never again be in the situation we were in during the thirties because of Andrew Mellon, and the condition we are in today because of Dr. Burns.

[Reprinted from the Congressional Record, Oct. 31, 1975]

Dr. Burns Sabotages Congress Tax Cut

The Speaker pro tempore. Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 20 minutes.

Mr. Patman. Mr. Speaker, the Congress has spent a great deal of time and effort to turn our economy around and put this Nation back on the road to prosperity. On March 26 of this year, it passed H.R. 2166, the Tax Reduction Act of 1975 which was signed into law on March 29, providing for both a reduction in 1975 income taxes, and a $22 billion cash rebate on 1974 taxes.

The Internal Revenue Service immediately set about figuring new withholdings and mailing rebate checks to taxpayers around the country, completing its monumental task in June 1975.

In passing its tax program, the Congress underestimated the arrogance of Dr. Arthur F. Burns. During the period when the Congress naively thought it was stimulating the Nation's economy, Dr. Burns, at the Federal Reserve in the secrecy of Federal Reserve's Open Market Committee, was sabotaging the congressional program.

Apparently, Mr. Speaker, in Dr. Burns judgment the economy did not need the stimulation the elected representatives in the Congress decided it did.

Of course we do not know what the members of the Open Market Committee said, because Dr. Burns, despite my repeated requests, has refused to make available a transcript of remarks made at the Open Market Committee meeting.

What they did is quite evident. At the meeting of June 17, 1975, the Open Market Committee voted to keep the Federal funds rate between 5 and 6 percent. According to the minutes of this meeting:

> Messrs. Bucher and Coldwell dissented from this action because they believed that a tightening in money market conditions and the associated increase in short-term interest rates would be premature at this time, and they preferred to specify a lower range for the Federal funds rate than that adopted by the Committee. Mr. Bucher, in addition, thought that primary emphasis should be given to promoting recovery in economic activity.

Later, in June, when the stimulation of the congressional action was taking effect and the monetary aggregates were growing, Dr. Burns recommended, and the Open Market Committee approved, his raising the Federal funds rate to 6¼ percent.

To this action, Vice Chairman Mitchell and Governors Bucher and Holland dissented. Governor Coldwell, who had dissented on June 17, concurred with Dr. Burns.

Needless to say, Mr. Speaker, the effect of this increase was to reduce the growth of the money supply—M–1—in July to 2.05 percent.

At the July 15, 1975 meeting, the Open Market Committee voted that the Federal funds rate be fixed at between 5½ and 6¾ percent, authorizing an increase of half a point above the previous rate.

Governor Holland dissented again, stating that in his opinion this increase was not warranted.

As a result of the rate increase in July, the Fed reports that the money supply—M–1—grew at a rate of only 2.86 percent, despite the stimulus that the tax action had given to the economy.

The preliminary figures for the September money supply—M–1—show even a greater decline—down to 2.04 percent—and there are indications that the October figures will be even lower.

Clayton Fritchey, in an article entitled "Reforming The Federal Reserve," which appears in the October 18, 1975, edition of the Washington Star, says that Dr. Burns caused the Open Market Committee to take the action it did, because he felt that the economy was recovering well enough without either the tax cut, or the cash rebate.

His charge is substantiated not only by the above figures on the money supply, but also by fragmentary reports of what was said at the Open Market Committee meeting of June 17, 1975:

> Some members favored a modest tightening in the period immediately ahead in order to restrain growth in monetary aggregate.

What else was said, we do not know, and can only imagine.

But it is quite clear, as Clayton Fritchey says in his interesting article:

Reforming the Federal Reserve

By Clayton Fritchey

For years, actually for decades, Congress has been talking about reining in the autonomous and often arrogant Federal Reserve Board (FRB), at least enough to prevent it from pursuing policies that are not acceptable to the administration, to Congress and ultimately the public. Yet little has come of it.

Nevertheless, the belief has now become so widespread on Capitol Hill and elsewhere that the Fed has sabotaged economic recovery by its policy of tight money and high interest rates, that the climate for FRB reform is presently propitious enough to inspire corrective legislation.

Sen. Hubert Humphrey (D-Minn.), the influential chairman of the Joint Economic Committee, says the time has come to shake up the FRB and make it more responsive to Congress and the people. Next week he will introduce legislation that would require one of the seven board members to represent labor, with another for agriculture, a third for consumers and a fourth for small business.

The terms of the members would also be cut from 14 to seven years, thus enabling the President to appoint a majority in his first term of office. Humphrey's intention is to "make the board more responsive to the will of the people and less likely to act as the high priest of finance."

The long-simmering conflict between the Fed and Congress has been brought to a head by what the board did after Congress voted a tax rebate of $22 billion earlier this year to stimulate economic recovery through increasing public purchasing power. There has been little recovery, however, because, in the eyes of many economists, the FRB, led by Chairman Arthur Burns, initiated a money squeeze that offset the tax cut.

Conservatives as well as liberals share this view. Sen. Henry Bellmon (R-Okla.), who like Dr. Burns opposed the $22 billion tax rebate, recently said to the chairman of the Fed, "If the Federal Reserve is going to cancel out what we in Congress do, then we'd better know about it."

Sen. Edmund Muskie (D-Me.), chairman of the Senate Budget Committee, went further. His message to Dr. Burns was that if the FRB "won't provide the stimulus the economy needs, then the temptation is for us (in Congress) to provide more" through increased spending or tax reduction.

That reaction is not confined to the Senate, for over in the House the respected chairman of the Banking Committee, Rep. Henry Reuss (D-Wis.), is also raising the question of whether the Fed should be allowed to undermine national policy on economic recovery, no matter how sure it is that "Papa knows best."

What about the board of the Fed itself? The members generally act in secrecy, but it is known that several oppose the Burns policy of higher interest rates. Philip Coldwell, a former president of the Dallas Federal Reserve Bank and now a member of the Fed's board, told Hobart Rowen of The Washington Post, "I thought philosophically the Federal Reserve shouldn't be in the position of negating what Congress wants to do."

Even in the business community itself there are doubts. An authoritative spokesman, Business Week, said, "The first faint signs of economic recovery seems to have thrown the Federal Reserve into another fit of anxiety about future inflation.

"It is not even certain yet that an upturn has begun," Business Week added, "but the money managers are swinging back toward tight credit as though they are dealing with a roaring boom."

Dr. Burns feels justified in his course because he thinks recovery from the recession is "proceeding satisfactorily." That, of course, is not the view of Congress or the American people, especially the 8–10 million unemployed, and their families.

In fact, it is not the view either of our main foreign trading partners, such as West Germany, for instance. The chancellor of that country, Helmut Schmidt, frankly says that the Burns high-interest policy "gives us some pain." It is, he adds, "too restrictive."

It isn't that Dr. Burns is above politics or lives in an ivory tower. He was made chairman of the FRB by Richard Nixon, and when Nixon wanted a boom in 1972 to insure his reelection, the Fed poured money into the system with no-holds barred. It produced a boom, all right, but what of the collapse that followed when the money spigot was turned off after the election?

Despite his monetary rigidities. Dr. Burns is a giant compared to most of President Ford's economic advisers. His views on guaranteed employment and controlling wages and prices are surprisingly flexible and broad-minded. Unfortunately, the White House listens to him only on money.

[Reprinted from the Congressional Record, Nov. 4, 1975]

Dr. Burns, and Dr. Jekyll and Mr. Hyde

The Speaker pro tempore. Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 20 minutes.

Mr. Patman. Mr. Speaker, I appear today to relate to the House another chapter in the life and times of Dr. Arthur Burns, Chairman of the Federal Reserve System.

You will recall that on October 15, 1971, by Executive Order 11627, President Nixon created the Committee on Interest and Dividends, and charged it with formulating and administering "a program for obtaining voluntary restraints on interest rates."

The President named his old friend and adviser Dr. Burns as Chairman, even though he was then, and had been since 1970, Chairman of the Board of Governors of the Federal Reserve System. In this capacity he also presided over the Federal Reserve Open Market Committee. This dual role involved Dr. Burns in what can only be described as a classic case of conflict of interest, with Dr. Burns as a kind of Dr. Jekyll and Mr. Hyde turned loose on our American economy.

As the annexed charts clearly establish, during the life of the Committee on Interest and Dividends, October 15, 1971 to April 30, 1974, the prime rate nearly doubled from 5¾ percent at birth, to 10¾ percent at death.

Mr. Speaker, I do not call an 87 percent increase restraining interest rates. Significantly, the only restraint was to hold the discount rate at 4½ percent and the prime rate at 5¾ percent until after the 1972 Presidential election—thereafter, the sky was the limit.

Who was responsible for this modest and temporary restraint? Dr. Burns, of course, since he was playing both ends against the middle.

Our story begins on February 2, 1973, safely after the election, as the Girard Bank of Philadelphia raises its prime rate from 6 to 6½ percent, and Dr. Burns, as Dr. Jekyll of the Committee on Interest and Dividends, demands that Girard justify the increase.

What the Girard Bank told Dr. Burns, was simply that to obtain Federal funds to loan would cost over 5½ percent—with the prime rate at 6 percent there was not sufficient spread for Girard to cover its overhead expense.

This made sense to Dr. Burns since, in his alter ego, Mr. Hyde of the Federal Reserve, he had 1 month earlier raised those very rates. Indeed, he was getting ready to push the Federal funds rate to over 10 percent in a few months. Thus, as Dr. Jekyll, Dr. Burns had no difficulty in approving what the Girard Bank had done, and in a February 23 letter allowed the increase. Naturally, the rest of the banks followed Girard's lead.

As you will note in chart I, Mr. Speaker, the Federal funds interests rate began increasing in December 1972. This interest rate is controlled by the Federal Reserve, operating through the Federal Reserve, operating through the Federal Reserve Open Market Committee which sets a range of interest rates, and proceeds to expand, or contract bank reserves, to keep the Federal funds rate within that range.

It should be noted, Mr. Speaker, that the Open Market Committee kept conditions tight against the advice of their staff of advisers. As early as February 1973, the staff advised that reserves available to support nonbank deposits should be allowed to grow from 0.5 to 2.5 percent.

However, the Open Market Committee decided to let these reserves shrink, dictating that no active reserve supplying should take place unless reserves were decreasing by more than 2.5 percent. Again, in Jnue 1973, the staff recommended that reserves be allowed to grow from 9.5 to 11.5 percent, but once again the committee lowered the goal, this time to 8 percent.

The minutes of the June 19, 1973 meeting of the Open Market Committee contains the following highly revealing information:

> On May 24 and again on June 8, a majority of the Committee members concurred in recommendations by the Chairman that money market conditions should be permitted to tighten still further. . .

It is crystal clear from this that Dr. Burns, as Mr. Hyde of the Federal Reserve, was working to raise interest rates, and keep them prohibitively high. Yet, at the same time he was masquerading as chairman of the committee to restrain increases in the rates of interest.

There was one other bit of deception, Mr. Speaker, that Dr. Burns used to hide his dual role in this affair—the so-called dual prime rate. Dr. Burns knew that Congress and the people were most concerned about the effect of rising interest rates on small businesses and consumers, and he therefore created on April 16, 1973, the diversion of a "small business prime rate."

While in an April 16, 1973, press release it was said that if increases in the small business price rates occur, "they are to be decidedly smaller, and are also to be made less frequently than changes in rates on loans to large firms." This turned out to be a smokescreen as can be seen in chart II which shows an annual rate of interest of over 31.5 percent from July 1973 to May 1974.

Another press release issued April 26, 1973 admitted as much:

> It is not likely that rates to small business in general will be lower than rates to large business. However, the rate to a particular small business borrower of high credit standing may be below rates to some large business borrowers.

The "dual prime rate," Mr. Speaker, was a sham created to hide the failure of the Committee on Interest and Dividends to control interest rates, a failure which can only be attributed to the use of voluntary, instead of mandatory, control.

It is clear that Dr. Burns as Mr. Hyde at the Fed was actively opposing Dr. Burns as Dr. Jekyll at the committee. It is also clear that Mr. Hyde won, and all of us lost.

CHART I.—*Weekly Federal funds rates*

[In percent]

1971:		1972—Continued	
August 7	5.75	June 3	4.38
August 14	5.59	June 10	4.48
August 21	5.59	June 17	4.46
August 28	5.48	June 24	4.39
September 4	5.59	July 1	4.49
September 11	5.73	July 8	4.61
September 18	5.59	July 15	4.62
September 25	5.46	July 22	4.46
October 2	5.43	July 29	4.54
October 9	5.32	August 5	4.56
October 16	5.29	August 12	4.69
October 23	5.14	August 19	4.87
October 30	5.11	August 26	4.75
November 6	5.16	September 2	4.90
November 13	4.98	September 9	4.89
November 20	4.88	September 16	4.69
November 27	4.86	September 23	4.93
December 4	4.68	September 30	4.99
December 11	4.59	October 7	5.15
December 18	4.20	October 14	5.09
December 25	3.89	October 21	4.91
1972:		October 28	5.01
January 1	4.05	November 4	5.06
January 8	3.57	November 11	5.25
January 15	3.71	November 18	4.89
January 22	3.54	November 25	4.97
January 29	3.43	December 2	5.03
February 5	3.23	December 9	5.17
February 12	3.25	December 16	5.29
February 19	3.43	December 23	5.38
February 26	3.34	December 30	5.34
March 4	3.18	1973:	
March 11	3.43	January 6	5.61
March 18	3.88	January 13	5.66
March 25	3.91	January 20	5.86
April 1	4.09	January 27	6.03
April 8	4.16	February 3	6.35
April 15	4.18	February 10	6.21
April 22	4.05	February 17	6.58
April 29	4.20	February 24	6.79
May 6	4.25	March 3	6.75
May 13	4.20	March 19	7.02
May 20	4.32	March 17	7.13
May 27	4.24	March 24	6.95

CHART I.—*Weekly Federal funds rates*—Continued

[In percent]

1973—Continued		1973—Continued	
March 31	7.11	December 1	10.09
April 7	7.18	December 8	10.17
April 14	6.84	December 15	10.04
April 21	7.23	December 22	10.18
April 28	7.14	December 29	9.52
May 5	7.43	1974:	
May 12	7.60	January 5	9.87
May 19	7.81	January 12	9.76
May 26	8.06	January 19	9.77
June 2	7.95	January 26	9.60
June 9	8.43	February 2	9.47
June 16	8.17	February 9	9.13
June 23	8.55	February 16	8.93
June 30	8.59	February 23	9.07
July 7	10.21	March 2	8.81
July 14	9.52	March 9	8.98
July 21	10.22	March 16	9.03
July 28	10.58	March 23	9.33
August 4	10.57	March 30	9.61
August 11	10.39	April 6	9.93
August 18	10.39	April 13	10.02
August 25	10.52	April 20	10.36
September 1	10.79	April 27	10.78
September 8	10.79	May 4	[1] 11.17
September 15	10.74	May 11	11.29
September 22	10.80	May 18	11.46
September 29	10.84	May 25	10.95
October 6	10.72	June 1	11.54
October 13	9.87	June 8	11.45
October 20	10.07	June 18	11.46
October 27	9.98	June 25	10.95
November 3	9.90	July 6	13.55
November 10	9.71	July 13	13.34
November 17	10.03	July 20	13.04
November 24	10.23	July 27	12.60

[1] The Committee on Interest and Dividends expired April 30, 1974.

CHART II.—*Changes in the prime rate*

[In percent]

PRIME RATE

1971:		1972—Continued	
July 7	6	June 26	5¼
October 20	5¾	August 29	5½
November 4	5½	October 4	5¾
December 31	5¼	December 27	6
1972:		1973:	
January 24	5	February 27	6¼
January 31	4¾	March 26	6½
April 5	5		

CHART II.—*Changes in the prime rate*—Continued

[In percent]

LARGE BUSINESS PRIME RATE

1973:[1]	
April 18	6¾
May 7	7
May 25	7¼
June 8	7½
June 25	7¾
June 3	8
July 9	8¼
July 18	8½
July 30	8¾
August 6	9
August 13	9¼
August 22	9½
August 28	9¾
September 18	10
October 24	9¾
November —	9¾
December —	9¾
1974:	
January 29	9½
1974—Continued	
February 11	9¼
February 19	9
February 25	8¾
March 22	9
March 29	9¼
April 3	9½
April 5	9¾
April 11	10
April 19	10¼
April 25	10½
May 2	10¾
May 6	11
May 10	11¼
May 17	11½
June 26	11¾
July 5	12
August —	12
September —	12

SMALL BUSINESS PRIME RATE

1973:[1]	
July 3	7.27
August 6	7.83
September 18	8.17
October 24	8.31
November —	8.30
December —	8.33
1974:	
January 29	8.37
1974—Continued	
February 11	8.38
March 9	8.30
April 3	8.57
May 2	9.18
June 26	9.27
July 5	9.82
August —	9.97
September —	10.22

[1] Beginning on April 16, 1973, the Prime Rate was split into a Large Business Prime Rate and a Small Business Prime Rate. Figures for the Small Business Prime Rate from April to July 1973 are unavailable.
Figures for the Small Business Prime Rate are average rates in effect on the last business day of the first full calendar week of the month.
Large Business Prime Rate figures are shown as of the date of change.

CHART III.—*Discount rate changes*

[In percent]

1971:	
July 23	5
November 11	4¾–5
November 19	4¾
December 13	4½–4¾
December 24	4½
1972:	
No changes	
1973:	
January 15	5
February 26	5–5½
March 2	5½
April 23	5½–5¾
1973—Continued	
May 4	5¾
May 11	5¾–6
May 18	6
June 11	6–6½
June 15	6½
July 2	7
August 14	7–7½
August 23	7½
1974:	
April 25	7½–8
April 30	8

[Reprinted from the Congressional Record, Dec. 18, 1975]

STOP BANK CONCENTRATION

The Speaker pro tempore. Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 15 minutes.

Mr. PATMAN. Mr. Speaker, it is with a great feeling of unease that I note changes in the banking laws of the State of New York will allow statewide bank branching as of January 1, 1976.

Surely our Nation deserves a better 200th birthday present than the inevitable further concentration of money and power that will result from this change.

It means that the large banks in Manhattan—Citibank, Chase, Morgan Guaranty, Chemical, Irving, Manufacturers Hanover, and Marine Midland—can inundate the State of New York with branches from Niagara Falls to Montauk Point, Long Island. What chance does a small bank in Niagara Falls or Montauk have to compete with these giants? The local bankers in these towns who own small banks will shortly be liquidated as the owners of small corner grocery stores were by the A. & P., Safeway, Acme, and Kroger.

The most recent figures on bank concentration are now nearly 1 year old and they present a very grim picture. Nationally, this concentration is demonstated by the fact that 47.95 percent of the country's total bank deposits, or nearly $1 out of every $2, is deposited in 1 of 5 States, specifically New York, California, Illinois, Pennsylvania, and Texas.

The 10 largest banks in New York now control 87.7 percent of the deposits in the State. What will they control tomorrow? Inasmuch as deposits in New York total 17.87 percent of the national total, these 10 banks control over 15 percent of the deposits in the Nation's 12,410 banks.

Moreover, as of December 31, 1974, the largest bank organization in each of the following States controls over 20 percent of the deposits:

State:	Percent of deposits held	State:	Percent of deposits held
Nevada	56.6	Delaware	32.2
Rhode Island	44.0	Utah	28.5
Arizona	42.2	Minnesota	28.2
Oregon	39.0	Massachusetts	28.0
California	38.7	Montana	26.8
Hawaii	35.9	New Mexico	25.2
Idaho	35.7	South Dakota	23.1
Washington	35.4	Connecticut	22.2
District of Columbia	34.4	North Carolina	20.9
Alaska	33.4	South Carolina	20.8

At the beginning of this year 10 largest banks in each State held deposits of $478 billion—64.5 percent of the Nation's total. In Illinois, which has 1,180 banking organizations, the 10 largest hold 49.7 percent of deposits. In Minnesota the four largest of 616 banking organizations control 56.6 percent of the State's $13.4 billion deposits.

Far from being alarmed by this increase in bank concentration, the Comptroller of the Currency is asking Congress to permit interstate banking. This would permit Bank of America, Citibank, Chase, Morgan Guaranty, so forth, to branch from Manhattan to San Francisco, and from St. Paul to New Orleans.

As Ralph Nader points out, major bank holding companies already have a network of nonbanking offices:

	Amount (billions)	Offices	States
Bank:			
Bank of America	$62.4	336	32
Citicorp	56.9	284	34
Manufacturers Hanover	28.3	151	15
Chemical	24.1	121	15
First National of Boston	8.1	33	12

Moreover, the Comptroller recently ruled that a bank can use Customer Bank Communication Terminals—CBCTS—free from the McFadden Act, both intrastate and interstate. To date four U.S. district courts have ruled that the Comptroller is wrong, but he persists in his opinion, and it will take a decision by the Supreme Court of the United States to stop him.

Were the Comptroller to have his way by turning a switch these big banks could sweep the country, in the words of Ralph Nader, "like McDonald's golden arches."

About the only small business we have left in this country is the small independent bank. The rest of the economy has gone the way of the roses—three companies make our cars, two our cans, one our computers, and one our copying machines.

Mr. Speaker, let us keep our small independent locally owned banks and not allow chain banks to liquidate them in the same way chain stores did yesterday.

[Reprinted from the Congressional Record, Feb. 16, 1976]

Why Can't Dr. Burns Hit His Monetary Targets

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Texas (Mr. Patman) is recognized for 30 minutes.

Mr. PATMAN. Mr. Speaker, this Nation is struggling to emerge from the worst recession since the Great Depression of the 1930's. The one thing necessary for our continued recovery and growth is confidence in the economy.

To create an atmosphere of confidence we need a moderate and steady growth in money supply—a sensible monetary policy. Steady growth is vital. Wild swings in the growth rate, and rapidly changing policies only lead to confusion and, understandably, overcaution.

Mr. Speaker, Dr. Burns has set what he describes as moderate monetary growth targets for our Bicentennial year of 4.5–7.5 percent for M_1 and 7.5–10 percent for M_2. Naturally, I would prefer that the bottom limits of these target ranges be set higher, but I am much more concerned about Dr. Burns' ability to hit any announced targets.

Of course, the Congress would be in a much better position to judge these money supply projections if it had more timely data on the deliberations of the Open Market Committee. We need to know—in specifics—what these targets mean in terms of employment, prices, and economic growth. The Open Market Committee receives detailed projections in these areas from its staff, but it refuses to share this information with the Congress.

We can only judge the future, Mr. Speaker, by the past. In the last two years, Dr. Burns has not come close to hitting the growth targets he established. In 1974 the narrowly defined money supply (M_1) grew by 4.66 percent. This growth rate, already too low, fell in 1975 to 4.17 percent. This is below the level of growth generally accepted as necessary for a healthy economy.

In view of this past performance it is interesting to note that Dr. Burns is lowering from 5 to 4.5 percent the lower range of the growth target for the narrowly defined money supply (M_1).

My own suspicions that this is a ploy to make Dr. Burns' failures look better was echoed by Mr. Alan Abelson who observed in the February 9, 1976 issue of Barron's:

> What occasions our present awe of Dr. Burns' capacity for contrivance is the Fed's latest action on the monetary front. You may recall that a while back after due and sober deliberation, it set a target for growth of the money supply of 5% to 7½% a year. For reasons not entirely clear, but probably numbering among them sheer ineptitude, it has failed to come anywhere near even the lower limit of that range. So, what do you do? Well, what Dr. Burns did is simple and simply beautiful: unable to reach the target, he lowered the target!

What is perhaps even worse is the wild fluctuations in the money supply on a month-to-month basis. In January 1975, M_1 shrank at a frightening 5.09 percent annual rate. Just two months later it was growing at the rate of 13.24 percent per year. This growth rate was reduced in April, but rocketed to 14.19 percent in June, only to plummet to 3.71 percent the following month. Nor has more recent history seen any improvement. The growth rate for M_1 in October, November and December of last year was −0.82, 9.41 and −3.25 percent, respectively.

The following table shows the actual money supply and its growth rate for the last 2 years—it is a bleak picture:

Date	Amount (billions)	M_1 growth target	Actual growth	Amount (billions)	M_2 growth target	Actual growth
1974						
January	$271.3	(1)	3.55	$575.5	(1)	8.61
February	272.6	3 –6	5.75	580.5	6 – 9	10.43
March	274.1	6½–9½	6.60	584.3	9½–12½	7.86
April	2/5.5	6½–7½	6.13	588.2	7¾– 9¾	8.01
May	276.2	3 –7	3.05	590.2	5½– 8½	4.08
June	277.7	3 –7	6.52	594.4	4½– 7½	8.54
July	278.9	3½–7½	5.19	597.9	5½– 8½	7.07
August	279.5	2 –6	2.58	600.7	4½– 7½	5.62
September	279.8	4¾–6¾	1.29	602.5	5½– 7½	3.60
October	281.1	3 –6	5.58	607.2	5 – 7½	9.36
November	282.5	4¾–7¼	5.98	610.5	8 –10½	6.52
December	283.1	6½–9½	2.55	612.4	8 –10½	3.73
Total 1974			4.66			7.18

[1] Not available.

Date	Amount (billions)	M_1 growth target	Actual growth	Amount (billions)	M_2 growth target	Actual growth
1975						
January	$281.9	5 - 7	−5.09	$614.5	7½–10	4.11
February	281.9	3½– 6½	0	618.2	7 –10	7.23
March	284.1	5½– 7½	13.24	623.0	6½– 8½	9.32
April	284.9	5 - 7½	3.38	626.7	8 –10	7.13
May	287.6	6½– 9	11.37	633.7	9½–11¾	13.40
June	291.0	7 - 9½	14.19	642.4	9 –11½	16.47
July	291.9	6½– 9½	3.71	647.5	9 –12	9.53
August	293.2	3 - 5½	5.34	650.6	8 –10½	5.75
September	293.6	4½– 7	1.64	652.9	8¼–10¾	4.24
October	293.4	3 - 7	−.82	655.7	5½– 8½	5.15
November	295.7	6 –10	9.41	661.6	7½–10½	10.80
December	294.9	4 - 7	−3.25	663.3	7 –10	3.08
Total 1975			4.17			8.31

Now the Fed, Mr. Speaker, is attempting to dismiss the M_1 measurement as being of little consequence. Dr. Burns observes that there are "profound uncertainties" in the behavior of the narrowly defined money supply and that the Fed is giving more weight to the broader measurements of the money supply such as M_2.

Unfortunately, Dr. Burns' record in achieving his established goals for M_2 growth has been as poor as for M_1. In the past twenty-three monthes Dr. Burns has missed his goal for M_2 growth eighteen times, and only achieved his goal five times. Of the five times he achieved his goal twice, and did so by barely reaching the bottom of the range.

This poor performance, Mr. Speaker, on both M_1 and M_2 leads to one of two possible conclusions. One conclusion for this failure is that Dr. Burns and the Open Market Committee are incompetent and unable to attain the established goals. The other conclusion is that Dr. Burns is setting false goals, one that he has no intention of trying to attain in order to placate the Congress, and the people, while he secretly operates as he pleases.

Regardless of which conclusion you believe, there is only one course of action available—the removal of Dr. Arthur Burns from his position on the Board of Governors. The problem lies not in the choice of targets so much as Dr. Burns' failure to come close to hitting them.

In a period that required confidence in our leaders charged with responsibility for our economic growth only the foolhardy can maintain faith in Dr. Burns.

O