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Statement of
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Chairman, Board of Governors of the Federal Reserve System

before
Subcommittee No. 3
of the
House Banking and Currency Committee

June 28, 1960

Mr. Chairman and Members of the Subcommittee:

You have asked that I appear before you today in connection with your consideration of the bills H.R. 8516 and H.R. 8627, both of which provide for retirement of the stock of the Federal Reserve Banks. I am glad to be here and give to you such assistance as I can in your study of these proposals.

I should like first to discuss H.R. 8516 and then conclude with some observations concerning the similar bill H.R. 8627.

As you know, the stock of Federal Reserve Banks is non-transferable, and each unit of that stock is an incident of the membership of a commercial bank in the Federal Reserve System. The question raised by these bills, therefore, concerns not only the Reserve Banks, which issue and service the stock, but also the commercial banks that own it.

The Committee has already received the testimony of the Presidents of Reserve Banks in the central, eastern, and western parts of the country, and perhaps proposes to obtain the views also of commercial bankers representing both member banks and nonmember banks. I mention the testimony of Presidents Allen, Hayes, and Mangels because I believe you already have heard from three men well qualified to form reliable judgments regarding the value of the present arrangements regarding Reserve Bank stock and the effects to be anticipated, both at home and abroad, if that stock were to be retired.

The first nine sections of H.R. 8516 relate to "the retirement of Federal Reserve Bank Stock," as stated in its title. It is not necessary to take your time to review the nature, amount, and ownership of that stock, except to mention that about \$400 million is outstanding; all of it is owned by the 6,200 banks that are members of the Federal Reserve System, in proportion to their own capital stock and surplus; it is nontransferable; and it pays a dividend of no more and no less than 6 per cent a year.

Reserve Bank stock of this nature, owned by member banks, has been a feature of the Federal Reserve System from its establishment almost 50 years ago. Such stock has not been a source of difficulty, and does have positive advantages. Unless its elimination or modification either offers a remedy for actual evils or offers new benefits, there would seem to be no justification for changing the provisions of the law with respect to stock ownership.

Neither of these circumstances appears to be present. I would not be understood as claiming that theoretically the operation of the Federal Reserve System could not dispense with member bank ownership of Federal Reserve Bank stock. I simply express the conviction that the existence of such stock has not produced, and does not threaten, any material evils. On the contrary, it has served to integrate the member banks and bankers into the guiding policies of the Federal Reserve System. This is important because the commercial banks are the principal vehicle through which System policy is effectuated and it is desirable that the banks be as conversant as possible with the needs and purposes of policy objectives.

It has been said that a purpose of this bill is to make it easier for small banks to become members of the Federal Reserve System. It is difficult to see how elimination of Reserve Bank stock would have this effect. Far from being a deterrent to Federal Reserve membership, the opportunity to acquire and hold such stock constitutes an incentive to membership, although not a feature of major importance. I cannot conceive of any small bank, otherwise unwilling to become a member of the Federal Reserve System, deciding to apply for membership simply because the stock subscription requirement had been done away with.

Another reason is sometimes advanced for elimination of Reserve Bank stock: The termination of dividends on that stock, it is said, would expand the Treasury's annual receipts by some \$24 million. Calculation of the actual net increase in Treasury receipts would be very difficult because there are factors such as income taxation on the dividends and diminished income from Federal Reserve Bank holdings of Government securities that need to be taken into account. The net cost, after these factors are allowed for, would be considerably less than the figure of Reserve Bank expense.

This is not to say that any avenue of savings should be overlooked, even though relatively small, as governmental expenditure figures go these days. If \$4 million, \$2 million, or even a few thousand dollars could be saved with no loss of benefit, I would advocate the necessary action. But the saving has always to be weighed against the public interest benefits. In my judgment, the payment of dividends by the Reserve Banks to member banks is adequately defensible in these terms.

To me, it seems clear that the reasons advanced in favor of this bill do not provide a substantial affirmative basis for it. But it might be asked whether, even if there is little to be said for the proposal, are there any cogent objections to it?

To my mind, the strongest argument against action in these circumstances is the sound principle that existing institutions, operating well, should not be disturbed except to do away with evils or to gain some new benefits. Whether or not it was true one hundred-odd years ago, it is no longer true that our country is "a land of wonders," as de Tocqueville said, "in which...every change seems an improvement."

In this matter, the proposed change threatens to bring detriment rather than to promise improvement. Without laboring the point, it is sufficient to say that elimination of Federal Reserve Bank stock could, in my judgment and that of the other members of the Board of Governors, be construed, both at home and abroad, as indicating a change in the structure and character of the Federal Reserve System that presaged a weakening of the resolution of the United States to maintain a stable dollar. The change would also adversely affect the extent to which the commercial banking system reinforces, and renders valuable service to, the functioning of the Federal Reserve System.

Some may say that these are merely psychological factors; I can only reply that psychological factors are among the most important in dealing with the monetary and credit streams that are the life blood of our economy.

Up to this point I have discussed only the first nine of the ten sections in H.R. 8516, which deal with the elimination of Federal Reserve Bank stock. The brief tenth section relates to a different subject. Prior to these hearings, the purpose and effect of section 10 were not clear. There was genuine concern that this provision might change for the worse the nature and value of Federal Reserve membership and undermine a stated purpose of the Federal Reserve Act--"to establish a more effective supervision of banking in the United States."

However, it is my understanding now that section 10 is not intended to diminish the authority and duty of the Board of Governors to exercise discretion, within the statutory framework, regarding the admission of commercial banks to Federal Reserve membership, and that you, Mr. Chairman, have indicated that you would be agreeable to clarification of the bill in this respect. In these circumstances, it is not necessary to discuss the significance and possible shortcomings of section 10 in its present form.

To summarize my views on the principal purpose of H.R. 8516--elimination of Federal Reserve Bank stock--it appears to me that the benefits, if any, would be relatively negligible, but that the potential injury to confidence in the American monetary system, as it is now conceived, might be considerable.

The Subcommittee also has under consideration H.R. 8627, which is similar to H.R. 8516. Instead of simply retiring Reserve Bank stock, however, it would provide in effect that member banks should maintain interest-bearing deposits of equivalent amount in the Reserve Banks.

My remarks concerning H.R. 8516 are applicable also to this proposal. The additional feature of H.R. 8627--substitution of interest-bearing deposits for Reserve Bank stock--would not, in my judgment, produce any significant advantage, but would introduce a complicating detail without justifying benefits. Consequently, I do not favor enactment of this proposal.