

William McChesney Martin, Jr., Papers

Box 25/Folder 6

Series V, Subseries D

Hearings, June 1960

H E A R I N G S

(1960, Folder 2,  
Page 1)

- (50) ..... Subcommittee No. 3  
(Wright Patman, Chairman),  
House Banking and Currency  
Committee ..... H.R. 8516 and  
H.R. 8627, providing  
for retirement of  
stock of Federal  
Reserve Banks ..... 6/28/60

(Note: President, Allen, Chicago, testified on  
June 6; President Hayes, New York on  
June 10; and President Mangels, San  
Francisco on June 17, and Governor  
Szymczak, Board, on ~~July 5.~~)

*August 25*

SEE 1961 FOLDER



Subcommittee No. 3

House Banking and Currency Committee

Majority

Wright Patman (Texas) Chairman  
Henry S. Reuss (Wisc.)  
Charles A. Vanek (Ohio)  
James A. Burke (Mass.)  
Clem Miller (Calif.)  
Byron L. Johnson (Colo.)

Minority

Perkins Bass (N. H.)  
Eugene Siler (Ky.)  
William H. Milliken, Jr. (Pa.)

Allen

STATEMENT WITH REFERENCE TO H. R. 8516  
TO  
SUBCOMMITTEE NO. 3 OF THE COMMITTEE ON BANKING AND CURRENCY  
OF THE HOUSE OF REPRESENTATIVES  
BY  
CARL E. ALLEN, PRESIDENT  
OF THE  
FEDERAL RESERVE BANK OF CHICAGO

JUNE 6, 1960

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Mr. Chairman and Members of the Subcommittee:

My name is Carl E. Allen. I am President of the Federal Reserve Bank of Chicago. I am here today at your request to testify on H. R. 8516, and I want to be as helpful as possible.

As you stated, Mr. Chairman, when you announced hearings on H. R. 8516, the bill calls for retirement of the capital stock of the Federal Reserve Banks and thereafter for banks which are members of the Federal Reserve System to hold, in lieu of capital stock, certificates of membership costing \$10.

The bill should not in my judgment be enacted, even though the Federal Reserve Banks have no financial need for the funds represented by their capital stock and the United States Treasury could make good use of the dividends presently paid on that stock.

My reasons for opposing enactment of H. R. 8516  
are:

(1) The subscription to capital stock is an aspect of the institutional concept which the Congress chose to adopt in establishing the Federal Reserve System. A consideration in the mind of the Congress was, I am sure, the desirability of an institutional framework which merged public and private interests, with the Board of Governors exercising general supervision over the activities of the twelve regional banks but with each bank having its own Board of Directors. The Congress devised a combination of centralization and decentralization which is unique among central banks and appropriate to our country's size and variety of economic activity. That framework and combination, including the ownership of capital stock by the member banks, has existed for more than forty-five years and in my judgment has served the public interest. The argument may be made that replacement of capital stock by membership certificates would not destroy the combination of public and private interest which the Congress conceived. Over the years, however, the capital stock ownership has become a traditional aspect of that combination, and the proposed change would diminish its effectiveness, even if it did not destroy it.

(2) The dividends on capital stock paid to member banks provide a partial offset to the cost of membership represented by reserve requirements. I am sure that the obligation to own stock of the Federal Reserve Banks is not unwelcome to the member banks. The six per cent dividend is attractive, particularly because it is so assured. I have never heard of a nonmember bank which considered the stock subscription a burden or bar to membership; on the contrary it is regarded as a desirable aspect of membership. Nor have I heard of a bank which was withdrawing from membership in the System give as a reason that it wished otherwise to employ the funds invested in capital stock. Elimination of the capital stock of Federal Reserve Banks would be more likely to result in withdrawal of members from the System than in additions to membership.

In announcing these hearings your Chairman correctly stated that less than half of the commercial banks operating in this country are members of the Federal Reserve System. It is true, too, that with few exceptions the nonmembers are the smaller banks. I do not believe, however, that enactment of H. R. 8516 would result in a net addition of members because, as I said above, ownership of Federal Reserve Bank stock with its six per cent dividends is an attractive rather than a burdensome feature of membership.

The reserve requirements of the Federal Reserve System, as compared with those required under state laws, provide the principal reason why many banks do not become members. To cite the Seventh Federal Reserve District as an example, our District is comprised of parts or all of five states, and in each of those



states, the reserve requirements which must be observed by nonmember banks are less burdensome than the reserves currently required to be maintained by member banks with the Federal Reserve Bank of Chicago. I have no reason to believe that this does not hold true in the other Federal Reserve districts. The table set forth below shows quite clearly that banks which are members of the Federal Reserve System in effect pay a charge, through the maintenance of reserves at the Federal Reserve Banks, which is many times the dividends received on their holdings of Federal Reserve Bank stock.

Distribution of deposit liabilities and cash assets among all Insured commercial banks according to membership status of banks, December 31, 1959.

(Dollar amounts in millions)

	Deposits	(1) Cash Assets	Per cent to deposits of		
			Total Cash Assets	Reserves at F. R. Banks	Cash and Deposits with Banks
All Member Banks	\$184,707	\$43,509	23.6	9.7	13.9
Insured Nonmember Commercial Banks	33,795	5,651	16.8	-	16.8
All Insured Commercial Banks	\$218,502	\$49,160			

Since reserve requirements differ among banks and are less for time than for demand deposits, the percentages of cash assets to deposits are influenced, but not significantly, by differences in the size and composition of deposits of member and nonmember banks as well as by membership status.

Federal Reserve Bulletin, April 1960, pages 389 and 391.

- (1) Cash assets include: reserves with the Federal Reserve Banks; cash in vault; time and demand balances with banks; cash items in the process of collection.

I have mentioned the relative size of reserve requirements. In the case of the smaller banks I should add that the paper work required of member banks in computing and reporting their reserve positions at frequent intervals is a definite and an added burden as compared with small banks which are not members. I repeat that the dividends received on Federal Reserve Bank stock represent only a partial offset, for smaller banks in particular, to the cost of membership.

Because the point has been made that so many small banks have not seen fit to join the Federal Reserve System, and in the thought that it may be of interest to this Committee, I will state what I know to be another deterrent to membership for many small banks. It is their feeling that rules, regulations, and supervision of member banks are in large part under the control of and subject to change by the Federal Reserve Board in Washington, their dislike of a continuing trend, as they see it, toward more Federal and less State government, and their preference for supervision of their own banks by local officials with whom they are acquainted and who are elected by the voters of the state or otherwise accountable to them. I have said that the Federal Reserve System is a combination of centralization and decentralization. Many owners and operators of small banks believe that centralization has been emphasized at the expense of decentralization. Retirement of the stock of the Federal Reserve Banks would strengthen that belief.

Another aspect of the subject that should be kept in mind is that national banks under the law must be members of the Federal Reserve System. When the National Banking System was originated during the time of the Civil War the banks were given the privilege of issuing their own notes secured by Government bonds. The note issue privilege was a very valuable right and was the basis for the success of the System. Some years after the Federal Reserve System was established this privilege was effectively withdrawn and National Bank notes were redeemed, entailing a loss of earning power to national banks.

If the Congress and the Executive Branch of the Federal Government place a value on the maintenance of the National Banking System and desire to maintain it, it should be their concern to retain advantages that accrue to membership in it, including an attitude of consideration at least equal to that shown by the several states to banks in the state systems.

June 8, 1960

To Chairman Martin

Subject: Summary of points raised during Mr. Allen's appearance on H.R. 8516

From Jerome W. Shay

Copies of the stenographic transcript of the hearings before the Patman Subcommittee on June 6 and 7 are being circulated among the members of the Board for their information. As you know, the witness on those days was Carl E. Allen, whose brief formal statement has been previously distributed.

This memorandum undertakes to relate briefly principal points raised by members of the Subcommittee, and to advise of certain other related matters which may be of interest.

The principal questioners among Subcommittee members were Chairman Patman and Messrs. Reuss (Wis.) and Johnson (Colo.). The hearings were poorly attended by other members of the Subcommittee. Except for the brief presence on June 7 of Mr. Milliken (Pa.), the minority members did not attend the hearings. Members of the full Committee who attended from time to time were Miss Griffiths (Mich.) and Messrs. Barr (Ind.) and Moorhead (Pa.). There was sparse press coverage and virtually no attendance by the public.

At the outset it was related for the first time by Mr. Patman that the hearings covered not only his bill H.R. 8516 but also Mr. Multer's somewhat similar bill H.R. 8627, which, however, was not subsequently mentioned.

Mr. Patman.- Mr. Patman said that his bill was prompted by the "increasing feeling among bankers that they own the Federal Reserve Banks," and that the continuance of stock ownership by member banks, together with the Reserve Bank surplus accounts, "serves no purpose except to perpetuate the erroneous idea of private institutional character."

Repeating an old theme, Mr. Patman sought to emphasize that eleven of the Reserve Banks are financially dependent for their "pea checks" from the Open Market Operations at New York, and that the eleven Banks do little except "clip coupons." He also raised again the question of possible conflict of interest where a Reserve Bank, which enters the securities market through the Open Market Committee, purchases securities for its customers.

Mr. Patman also stressed his much used example of payment of private debt in arguing that it is wrong for a Government debt (security) not to be regarded as paid and cancelled when acquired by a Federal Reserve Bank; e.g., when a mortgagee pays off his mortgage debt, the obligation is ended, but when the Government (a Federal Reserve Bank) buys back its securities, the obligation to pay continues.

Mr. Patman touched relatively lightly the matter of Reserve Bank expenditures. Here again, however, his analogy to the "Postmaster" and "public funds" was emphasized; and he made it clear that it was the "principle of the thing," rather than the small amount of a given expenditure, that he regarded as important. In this connection, Mr. Patman referred to the Board's failure to supply the "supplementary sections" (confidential sections) of the reports of examination of the Federal Reserve Banks when such reports had been sent to the Committee.

The advisability of continuing the law against payment by banks of interest on deposits was again questioned by Mr. Patman, with some feeling that the situation might be somewhat remedied if the prohibition were made inapplicable to deposits of States and political subdivisions and the "free" use of funds in Tax and Loan accounts were ended.

Mr. Patman seemingly found little to quarrel with when Mr. Allen indicated that there seemed to be two alternatives by which membership in the System might be increased: (1) reduce reserve requirements, or (2) change the law to make membership compulsory. In fact, Mr. Patman said that "unless we can deal with this reserve problem, there isn't much we can do about it."

Mr. Johnson.- One line of questioning by Mr. Johnson, in which Mr. Patman joined, sought to bring out that, because of the election of two-thirds of the directors of a Federal Reserve Bank by the member banks, the Reserve Bank president was "selected by," "responsible to," or "a representative of," the member banks.

Mr. Johnson also was interested in the Board's staff memo that was submitted to the Banking and Currency Committees last year in connection with the "vault cash" legislation, the inference being that the memo demonstrated a preoccupation with bank earnings.

The burden of some of Mr. Johnson's remarks were such as to suggest that the Board could make membership in the System more attractive by changes in its regulations.

Mr. Johnson, in effect, seemed to regard recent monetary policy as a restraint on growth, and apparently he would attribute the increase in velocity of money almost entirely to the Board's policy.

In a conversation with Mr. Allen after the hearings ended, it was apparent that Mr. Johnson felt that Denver should be a Federal Reserve Bank city.

Mr. Reuss.- Most of Mr. Reuss' questioning was such as to characterize the dividend on Reserve Bank stock as a "subsidy." He purported to have no "basic objection" to a subsidy, "if one were necessary for a

healthy Federal Reserve System;" but apparently he would prefer to tie it to reserves or some other basis, rather than stock ownership, which he regards as "among the less important aspects of the System." This line of questioning brought up the comparative earnings of large banks as against small banks, and Mr. Patman put figures into the record purporting to show, for some period, that large banks had higher earnings than small banks.

Mr. Reuss also referred to Dr. Goldenweiser's comments in his book negating the basic importance of Federal Reserve Bank stock, in reply to Mr. Allen's reference to the 1952 Report of the Patman Subcommittee, which, in effect, recommended against discontinuance of stock ownership by member banks.

Miss Griffiths.- Most of her questions related to the advantages of membership, the services of correspondent banks as compared to those of Federal Reserve Banks, and the consequence to the System if there were substantial withdrawals from membership.

Mr. Moorhead.- Mr. Moorhead's questioning was almost exclusively for information concerning the tax liability of member banks on dividends from Reserve Bank stock.

Mr. Barr.- Mr. Barr's questioning seemed to carry the inference that retirement of the Reserve Bank stock would tend to impair System independence; and that, unless the stock were retired gradually, it would tend to increase bank reserves unduly.

cc: Each Board Member  
Messrs. Thomas, Young, Molony, Knipe, Fauver,  
Sherman, Hackley, Noyes, Solomon, Hexter,  
Koch, Masters.

June 2, 1960

The Honorable Wright Patman,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Patman:

In accordance with the request contained in your letter of this date, a copy of the report of examination of the Federal Reserve Bank of Chicago made during the year 1959 is being sent this afternoon to the offices of the Committee on Banking and Currency of the House of Representatives. A copy of a self-explanatory letter which is going forward to Chairman Spence with the report is attached.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Attachment

COPY

CONGRESS OF THE UNITED STATES  
House of Representatives  
Washington, D. C.

June 2, 1960

Honorable William McC. Martin, Jr.  
Chairman, Board of Governors  
Federal Reserve System  
Washington 25, D. C.

Dear Mr. Chairman:

Please furnish me as soon as possible a  
copy of the examination report of the Chicago  
Federal Reserve Bank for 1959.

Sincerely yours,

(Signed) Wright Patman

Wright Patman



June 2, 1960

The Honorable Brent Spence,  
Chairman, Committee on Banking  
and Currency,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Chairman:

Pursuant to a request contained in a letter of this date from Mr. Patman, a copy of which is attached, the report of examination of the Federal Reserve Bank of Chicago made during the year 1959 is being sent today to the offices of the Committee on Banking and Currency of the House of Representatives.

For reasons stated on past occasions when such reports have been supplied to your Committee, the report of examination of the Federal Reserve Bank of Chicago made during the year 1959 is being forwarded to the Committee with the understanding that it will be made available in confidence only to members of Congress and their staffs.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.]

Wm. McC. Martin, Jr.

Enclosure

Hayes

*Mr. Tolson*

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK 45, N. Y.

RECTOR 2-5700

*Handwritten initials and a large scribble.*

ALFRED HAYES  
PRESIDENT

June 7, 1960

Dear Bill:

I thought you might like to have this advance copy of the statement I expect to make at the Patman hearings this Friday, which is in substantially final form.

Yours sincerely,

*Handwritten signature of Alfred Hayes.*

Alfred Hayes

Hon. William McC. Martin, Jr.,  
Chairman  
Board of Governors of the  
Federal Reserve System  
Washington 25, D. C.

Enclosure

For release on delivery--  
not before 10 a.m.,  
Friday, June 10, 1960.

Statement  
by  
Alfred Hayes,  
President, Federal Reserve Bank of New York  
before  
Subcommittee No. 3  
of the  
House Banking and Currency Committee

June 10, 1960

Mr. Chairman and Members of the Committee:

You have asked me to comment on H. R. 8516, a bill to provide for the retirement of Federal Reserve bank stock and for other purposes. Before turning to a discussion of the bill itself, I should like to express our appreciation for the opportunity to present the views of the Federal Reserve Bank of New York on this bill which could have such important consequences for the bank and for the Federal Reserve System.

H. R. 8516 would require each member bank to surrender its stock in the Federal Reserve bank of its District to the Reserve bank. The Reserve bank, in turn, would cancel and retire the stock and pay to the member bank the par value of the stock, plus interest from the date of the last dividend, less a membership fee of \$10. Upon cancellation and retirement of the stock the Reserve bank would issue to the member bank a certificate attesting its membership in the Reserve bank and in the Federal Reserve System. The bill, apparently, would also make it possible for any insured bank to become a member of the Federal Reserve System merely upon the payment of a \$10 membership fee.

It is generally agreed that the stock of the Federal Reserve banks is unlike the stock of ordinary commercial or industrial organizations. Ownership of Federal Reserve bank stock does not imply proprietary interest in or control over the policies and operations of Reserve banks. It implies, rather, private provision of capital for, and membership in, one of a federated system of regional banks which administer and help to formulate monetary and credit policies which will contribute to a sound and growing economy.

The amount of Federal Reserve bank stock which a member bank must own is fixed by law in relation to the member bank's own capital and surplus. The stock cannot be sold, transferred or hypothecated but can only be surrendered to the Reserve bank upon termination of membership. Dividends on Federal Reserve bank stock are limited to 6 per cent per year. In the event of the dissolution or liquidation of a Reserve bank, the residual assets, after payment of all obligations and the par value of the stock, are to be payable to, and become the property of, the United States.

Ownership of Federal Reserve bank stock entitles the member banks to no voice in the management of the Reserve bank other than the right to participate in the election of six of the nine directors of the Reserve bank, the other three being appointed by the Board of Governors. As a result of the election procedure

*changed page 2*

prescribed by the Federal Reserve Act, any one member bank can participate in the election of only two directors. Moreover, each member bank has but one vote in the election of directors regardless of the amount of stock it holds.

Under the Federal Reserve Act, the Board of Governors classifies the member banks in each district into three groups, according to their size (capitalization). As just noted, a member bank in any one of these groups is entitled to vote for two of the six elected directors of its Reserve bank. We had, at the end of 1959, 508 member banks in the Second Federal Reserve District, 20 in Group 1, 189 in Group 2, and 299 in Group 3, the member banks in Group 1 having had, at the end of 1959, a combined capital and surplus of slightly more than 80 per cent of the combined capital and surplus of all the member banks in the New York district. There are, of necessity, differences in the sizes of banks within any single group, but subject to this by-product of the present statutory method of classification, the vote of a large bank, within its group, may be said to have a greater weight in the election of the two directors it is entitled to vote for, than does the vote of a bank in one of the groups of smaller banks, when it votes. At the same time there is, as among the three groups, despite the differences in their size and financial importance, an equality of voting power in that each group elects but two directors.

In theory, it is probably true that the Federal Reserve banks could operate without capital stock. The statutory design of member bank ownership of Federal Reserve bank stock has, however, been in existence for 45 years and, we believe, has worked well. In these circumstances, we question the wisdom of abandoning the known for the unknown, of substituting the untried device of a membership certificate for the present system of ownership by member banks of the capital stock of the Federal Reserve banks. The present system of stock ownership is a symbol of the special status of the Federal Reserve in our economy and within our Government; and it has brought into being, and given strength to, a link between the System and the private business community that has enabled the System better to discharge the responsibilities which are vested in it by law.

By describing the Reserve bank stock as a symbol of the System's status within the Government, I mean to refer to what has been called the "independence" of the Federal Reserve System -- independence, that is, from direction by the Executive Branch in the exercise of its monetary authority. The retirement of the Federal Reserve bank stock could give rise to questions, both at home and abroad, as to the future status of the System, and as to its continued ability to maintain its present independence in achieving its goals. Confidence in the dollar is an important goal. It is our impression that, in foreign countries as well as in the financial community in this country, such confidence can be attributed, at least in part, to the existence of an independent monetary authority able to pursue its programs unhampered by political pressures. At present there would seem to be no apprehension that the Federal Reserve System, in performing its central banking function, will be diverted to a pursuit of popular, but unsound, programs. A marked change in the organizational structure of the Federal Reserve System might be viewed as a signal of a basic change in the role or status of the Federal Reserve System and could undermine public confidence in the System and the dollar.

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By describing the Reserve bank stock as a symbol of the System's status within the Government, I mean to refer to what has been called the "independence" of the Federal Reserve System -- independence, that is, from direction by the Executive Branch in the exercise of its monetary authority. The retirement of the Federal Reserve bank stock could give rise to questions, both at home and abroad, as to the future status of the System, and as to its continued ability to maintain its present independence in achieving its goals. Confidence in the dollar is an important goal. It is our impression that, in foreign countries as well as in the financial community in this country, such confidence can be attributed, at least in part, to the existence of an independent monetary authority able to pursue its programs unhampered by political pressures. At present there would seem to be no apprehension that the Federal Reserve System, in performing its central banking function, will be diverted to a pursuit of popular, but unsound, programs. A marked change in the organizational structure of the Federal Reserve System might be viewed as a signal of a basic change in the role or status of the Federal Reserve System and could undermine public confidence in the System and the dollar. ✓

We must not overlook the fact that the Federal Reserve banks were organized originally in much the same way as ordinary business corporations. Accordingly, the banks had capital accounts. The existence of capital accounts is part and parcel of the use of conventional accounting techniques which impose the discipline of the balance sheet. We believe that these procedures have contributed to the efficient and businesslike conduct of the affairs of the Reserve banks. They have also contributed to public acceptance -- especially among bankers, investors and businessmen at home and abroad -- of the Federal Reserve banks as financially sound institutions capable of bearing the burdens assigned, or likely to be assigned, to them. These accounting techniques are, as I have noted, conventional, but the convention has importance to many people. ✓

In addition, ownership of the Federal Reserve bank stock stimulates and preserves a greater interest in the Federal Reserve System on the part of the member banks than would otherwise be the case. The stock presents a tangible and readily understood link between the member banks and the System which has probably contributed to making the member banks willing, rather than reluctant, participants in the System's monetary programs.

Although H.R. 8516, would not literally affect the method of electing directors, nor change the role of directors of Federal Reserve banks, there exist, we believe, solid grounds for a fear that the substitution of certificates of membership for shares of stock would weaken the link and wipe out many of the advantages that the System now realizes by reason of the presence of that link.

The service on the boards of directors of the Reserve banks of men who are generally well known and highly regarded in their communities and who have backgrounds in banking, business, agriculture and public affairs, has furnished the Reserve banks with valuable sources of information as to the economic conditions within each district and has helped to foster efficiency and businesslike methods in the operations of the Reserve banks. The links provided by stock ownership have also presented an important avenue for disseminating information about the Federal Reserve System and for educating important regional leaders on System objectives and means of attaining these goals. The value of directors' services, in the aggregate, has been heightened as the result of the program, voluntary in nature, under which there is rotation in the directorates of the Reserve banks. At the Federal Reserve Bank of New York, for example, it is the practice that Class A directors, who are bankers, serve only one full term of three years, and Class B directors, who are actively engaged "in commerce, agriculture or some other industrial pursuit," but who are not bankers, serve only two full terms. In some cases, directors in both classes have served, in addition, unexpired portions of the terms of their predecessors.

In 1952, the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report considered the question of the private ownership of the Federal Reserve bank stock. In its report, the Subcommittee said:

"The private ownership of the stock of the Federal Reserve banks also serves as a practical and well-understood link between the System and the private business community, and has been of great help in obtaining the services of able men as directors of the Federal Reserve banks. In theory, an equally effective link might be established by

other means - as by the election of local advisory committees - but a newly-established link would not enjoy the sanction of tradition and it would be difficult to devise one which would conform so well to the mores of the business and financial communities."

We are in full agreement with the Subcommittee's comment.

The Federal Reserve banks are not unique in the respect that their stock is owned by private banks. Many examples could be given of foreign central banks whose stock is owned in whole or in part by private interests. In our view, private ownership of the stock of a central bank is objectionable when such ownership results in the bank serving the private interests of its stockholders or when it prevents the bank from meeting an economy's needs. Where a central bank is serving the public interest, and is contributing to a sound and growing economy, there would seem to be no reason, unless abuses can be shown, for eliminating the private ownership of its stock. We know of no abuses resulting from member bank ownership of the Federal Reserve bank stock, but rather, as I indicated earlier, we find significant advantages to the System by reason of such ownership. ✓

We recognize that the private ownership of the Federal Reserve bank capital stock can give rise to the occasional misconception that the policies of the System are or may be subject to private domination. We see no evidence that the member banks harbor this misconception. The wide publicity given to actions of the Federal Reserve System within the past few years would seem to have produced, in the minds of the general public, an association of the System with the Government. Certainly our own employees view their work as a contribution to the public service, and I know of no more dedicated group anywhere in public life than those I have met during my years in the Federal Reserve System. We are struck by the fact that our directors have readily accepted the established System tradition of service in the public interest, and have not, in fact or appearance, carried out their functions as if they were the instructed delegates of narrow constituencies. ✓

The extent to which any misconception as to private domination exists is, of course, difficult to determine. If it does exist it would seem that the solution is to conduct a continuing program of public information as to the role and functioning of the Federal Reserve System. The Federal Reserve Bank of New York has carried out such a program for many years. We believe it has been effective. We believe such a program, rather than a revision of the organizational structure of the System, is the appropriate method for eliminating whatever misconceptions may exist.

I agree fully with the thoughts expressed in 1952 by Allan Sproul, my predecessor, in replying to a question addressed to the Federal Reserve Bank presidents by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, regarding the status of the Federal Reserve banks, when he said in part:

"I share the belief that it was the original intent of those who created the Federal Reserve System, that the Federal Reserve banks should function somewhere between private enterprise and the Government. I believe that it has been the continuing intent of each succeeding Congress that the Federal Reserve banks should be allied to Government



but not part of Government. I believe that there has been and is wisdom in this segregation. It has generally protected the Federal Reserve banks from partisan political pressure; it has enabled the Federal Reserve banks to repel the pressure of private interests; and it has provided the country with a central banking system staffed by men who have made central banking a career, and operated the Federal Reserve banks according to standards of efficiency and service which compare favorably with the best in Government undertakings and private enterprise. It is significant that there have been no scandals, no charges of influence peddling, no evidence of favors given and received, in connection with the operations of the Federal Reserve banks."

This unique blending of characteristics of private enterprise and of Government has constituted a source of strength to the Federal Reserve banks and, we believe, to the Board of Governors as well, in the discharge of the central banking functions assigned to them by law.

The second major purpose of H. R. 8516 is understood to be that of making it possible for any insured bank to become a member of the Federal Reserve System upon the payment of a \$10 membership fee. We would, of course, like to have as broad a membership in the Federal Reserve System as possible. Broader membership would make the monetary programs of the System more effective, and the new member banks, we believe, would benefit by their membership.

We do not believe, however, that the present requirement that a member bank subscribe to the capital stock of the Federal Reserve bank constitutes a significant deterrent to System membership. The stock, after all, does pay a dividend of 6 per cent. The bulk of the nonmember banks in the country are the smaller country banks. While System membership confers many benefits, it is probably the case that for many of the smaller country banks, membership can constitute a substantial expense. The cost to the smaller country bank of System membership can be traced to the difference in reserves required of a member bank and those required under State laws. Where lower reserves are required under State law than are required of a member bank, the State bank upon becoming a member of the System will be required to immobilize funds which otherwise could be earning income. Where State law permits a bank to hold part of its reserves in income-producing securities, such as United States Government obligations, a further loss of income will result if it joins the Federal Reserve System. These are real and direct items of expense to the smaller bank.

Other deterrents to membership can be mentioned. Nonpar banks, upon becoming members, would be required to clear checks at par. Capital requirements for the establishment of branches by member banks may be more stringent than the capital requirements under State law. Additional restrictions of Federal law, such as the limitations on dealing in investment securities and the prohibitions against interlocking directorates, become applicable to the State member bank and the bank subjects itself to supervision and examination by both Federal and State authorities.

All these factors enter into the decision by a State bank whether to become a member of the Federal Reserve System. In the final analysis, the cost to the State bank of membership in the System is weighed against the benefits of membership, and the decision is made accordingly. The cost of subscribing to Federal Reserve bank stock is, to some degree, balanced by the stock's dividend feature, and is probably not a deterrent to membership.

One other aspect of opening System membership to any insured bank should be considered. Under present law each application for membership in the Federal Reserve System must be approved by the Board of Governors. While the statutory standards which the Board must consider in passing on an application for membership are similar to the standards which the FDIC must consider in respect of an application to become insured, it seems desirable that the final determination as to the qualification of a particular bank for membership be continued in the Board of Governors. There are undoubtedly some insured banks which would not qualify under present standards to be members of the Federal Reserve System. This is so because any bank, as a result of such things as poor management succession, bad investments, or unsound loan programs, can become a problem bank after it has been insured. We recognize that problem status can arise with respect to member banks as well as nonmember banks, whether insured or not. However, it seems to us unwise to provide by legislation for the indiscriminating acceptance of all insured banks as member banks, and thus to increase the System's supervisory responsibilities in this respect. We believe that the Board of Governors should have the authority to point out to a nonmember bank applying for System membership such deficiencies as may exist in the bank's operations and to indicate the action which the bank might take to meet the standards for admission to the System. ✓

I would not like to see any of the standards now used -- standards which may, to be sure, deter some banks from membership -- swept away by a simple conversion of the kind implied by this bill. Whatever Congress decides to do about stock ownership itself, I think it essential that the supervisory decision to accept or reject, based upon detailed study of the full banking record, and a considerable body of precedent developed as the result of years of experience, should still remain with the Board of Governors. In our view the Board of Governors should not be precluded from considering an applicant bank's qualifications at the time such application is made.

Before concluding my statement, I should like to make some general observations which are prompted by the introduction of a bill such as H. R. 8516. H. R. 8516 focuses on two limited aspects of the Federal Reserve System or, for that matter, of our national banking structure. Those aspects are the capital stock of the Reserve banks and admission to the Federal Reserve System. Although these are limited topics they go to the basic organization of the Federal Reserve System. Their consideration prompts the question whether they may be profitably studied of and by themselves.

I am reminded of the story of the man who undertook to fix a chair which had one long leg. When the adjustments were completed, no legs were to be seen.

This suggests to me that the questions raised by H. R. 8516 should be considered in a broader context. A piecemeal approach can create serious problems. For example, if all insured banks were to become member banks, as is contemplated under H. R. 8516, the examination function of the FDIC would all but be eliminated since the Federal Reserve System would presumably then be the responsible examining agency. What would be the appropriate division of other responsibilities then between the FDIC and the Federal Reserve System? What should the continuing scope for independent action by the FDIC be? These questions merely illustrate how a change in one apparently minor aspect of our highly reticulated banking structure could have unintended, but far-reaching and, possibly, adverse, effects ✓

on others. It seems to us that a broad, thorough study should be undertaken of the full range of implications for our entire banking system before even such a seemingly minor change should be made in the structure of the Federal Reserve System.

In conclusion, I should like to restate briefly our position. In view of the positive advantages to the Federal Reserve System resulting from stock ownership by the member banks and in the absence of a showing of any serious disadvantages, we believe that it is desirable to retain the present arrangement. While increased membership is an important goal of the Federal Reserve System, we believe that the Board of Governors should have the authority, as limited by statutory provisions, to make the final determination as to the qualifications of a bank for membership. Finally, it is our view that this bill would actually make a fundamental change in the structure of the Federal Reserve System and could have far-reaching implications for the banking system of the nation; and that such action should be taken, if at all, only after a comprehensive study of the banking system as a whole.

June 13, 1960

To Chairman Martin  
From Jerome W. Shay

Subject: Summary of points raised  
during Mr. Hayes' appearance on  
H.R. 8516 and H.R. 8627

This memorandum undertakes to relate briefly principal points raised by members of the Patman Subcommittee during the appearance on Friday, June 10, of Mr. Hayes, who, as you will recall, was accompanied at the hearing by Mr. Roosa and Mr. Clarke.

A copy of the stenographic transcript of the hearing on June 10 has been put in circulation among members of the Board; and it is understood that Mr. Hayes previously sent a copy of his formal statement to each Board member.

As was true also when Mr. Allen testified on June 6 and 7, there was no significant public attendance, and the press representation was small, at the hearing on June 10.

Majority party members of the Subcommittee present on June 10 were Chairman Patman and Messrs. Reuss (Wis.), Johnson (Colo.), Miller (Calif.), and Burke (Mass.). There were no minority party members present. Mr. Multer from the full Committee was present. Also present was Mr. Oliver (D., Me.). It will be recalled that Mr. Oliver, who is not a member of the Banking and Currency Committee, has shown some interest in Mr. Patman's approach to the Federal Reserve System and monetary policy.

Mr. Patman.- Most of the points raised by Mr. Patman were much the same as those raised by him on June 6 and 7 during the appearance of Mr. Allen, which were covered in my memorandum to you of June 8.

In addition, however, Mr. Patman made it very clear that he had not intended that his bill make any insured bank automatically a member of the System on application and the payment of a \$10 fee. He indicated that admissions to membership should be "subject to standards administered by the Board," and that, if this were not the case under his bill, then the bill should be changed. The foregoing comments by Mr. Patman are almost directly contrary to the impression created by his press release of May 2, announcing hearings on his bill.

Also, at the conclusion of the hearing Mr. Patman asked Mr. Hayes to supply the Subcommittee with studies of (1) loans by correspondent banks to small banks and correspondent bank participation in loans made by small banks, and (2) term loans being made to business borrowers.

As was true also in the case of Mr. Allen, Mr. Patman indicated that he would probably ask Mr. Hayes to supply answers to a list of questions.

Mr. Reuss.- The main point raised by Mr. Reuss was the possibility of reducing quite substantially the rate of dividend on Reserve Bank

stock so as to increase the benefit to the Treasury, while at the same time retaining the feature of private ownership of Reserve Bank stock. This, of course, was suggested as an alternative to the retirement of Reserve Bank stock provided for under both Mr. Patman's bill (H.R. 8516) and Mr. Multer's bill (H.R. 8627).

Mr. Johnson.- After endeavoring to show that ownership of Reserve Bank stock had little financial importance to member banks, Mr. Johnson raised the same point as that raised by Mr. Reuss, above.

As he did during Mr. Allen's appearance, Mr. Johnson again referred to the memorandum of the Board's staff contained in the Committee hearings on the "vault cash" legislation as representative of the Board's "bias towards high bank earnings." Mr. Johnson went on to say that this, together with the "historical record" showing a "Board preference for reducing reserve requirements," substantiated his feeling that the System was "captive of the industry."

An interesting point of Mr. Johnson's was to the effect that, if there is a need to shield Federal Reserve policy from political pressure, it is because politicians are not considered to be adequately informed; and, if politicians, in fact, are not adequately informed, the fault lies with the System because of its "failure to explain" what it is doing.

Mr. Multer.- A principal line of questioning by Mr. Multer sought to show that, of the foreign central banks listed with your recent letter to Mr. Patman, the important ones are wholly owned by their respective governments. While Mr. Multer did not go into the details of his specific proposal (H.R. 8627), he seemed convinced that there were no important reasons justifying retention of the "stock" and "dividend" features of System membership. You may recall that he went into this at length during your 1957 appearance before the Banking and Currency Committee on the "Financial Institutions" bill.

Mr. Miller.- The few questions asked by Mr. Miller suggested that he feels that System policies have not contributed to a "growing economy," and that the Board's policies "reflect political influences," i.e., party politics.

Mr. Burke.- The very brief questioning by Mr. Burke concerned whether the Board denies many applications for System membership.

Mr. Oliver.- Quoting from certain books on money and banking to the effect that the member banks own the Federal Reserve Banks, Mr. Oliver indicated that his interest was in determining whether the Reserve Banks or the public (Government) owns the securities in the Open Market Account and the earnings on those securities.

cc: Each Board Member

Messrs. Thomas, Young, Molony, Knipe, Fauver, Sherman, Hackley,  
Noyes, Solomon, Marget, Farrell, Masters, Hexter, Koch.

Miss Muehlhaus

JUN 9 1960

The Honorable Wright Patman,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Patman:

In accordance with the request contained in your letter of June 8, 1960, a copy of the report of examination of the Federal Reserve Bank of New York made during the year 1959 is being sent this afternoon to the offices of the Committee on Banking and Currency of the House of Representatives. A copy of a self-explanatory letter which is going forward to Chairman Spence with the report is enclosed.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure

MS:me

cc: Miss Muehlhaus  
Mrs. Cotten

Miss Melihan

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CONGRESS OF THE UNITED STATES  
House of Representatives  
Washington, D. C.

June 8, 1960

Honorable William McC. Martin, Jr.  
Chairman, Board of Governors  
Federal Reserve System  
Washington 25, D. C.

Dear Mr. Chairman:

Please furnish me as soon as possible a copy of  
the examination report of the New York Federal Reserve  
Bank for 1959.

Sincerely yours,  
(Signed) Wright Patman  
Wright Patman

Miss Muehlhaus

JUN 9 1960

The Honorable Brent Spence,  
Chairman,  
Committee on Banking and Currency,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Chairman:

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For reasons stated on past occasions when such reports have been supplied to your Committee, the report of examination of the Federal Reserve Bank of New York made during the year 1959 is being forwarded to the Committee with the understanding that it will be made available in confidence only to members of Congress and their staffs.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

cc: Miss Muehlhaus  
Mrs. Cotten

cc: sent to Mr. Patman

MS:me



Mangels

Statement with Reference to H.R. 8516

to

Subcommittee No. 3 of the Committee on Banking and Currency

by

H. N. Mangels, President,  
Federal Reserve Bank of San Francisco

June 17, 1960

Mr. Chairman and Members of the Subcommittee:

My name is Hermann Mangels. I am the President of the Federal Reserve Bank of San Francisco.

I would like, first, to express my appreciation to you, Mr. Chairman, and to your associates, for the consideration you have shown in deferring this part of your hearings until today.

It is a privilege to appear before you this morning to discuss the proposals contained in H.R. 8516, a bill to provide for the retirement of the capital stock of the Federal Reserve Banks, and to make membership in the Federal Reserve System available to any insured bank upon payment of a membership fee of \$10. I should like to discuss each part of that bill separately.

## Capital Stock

The provisions of the Federal Reserve Act with respect to subscriptions to capital stock of the Reserve Banks have been in effect since enactment of the statute in 1913. Those who framed the Act and amended it over the years did so with profound wisdom when they conceived a banking system having a blend of public and private institutions for the common good--the Board of Governors, the Federal Reserve Banks, the member banks, the Federal Open Market Committee, and an advisory group, the Federal Advisory Council. Those authors realized that, if this country was to have a successful system of central banking within a free enterprise system in which there were thousands of private commercial banks, it would be necessary to interest large numbers of banks in supporting the central bank. What better way to obtain this support than through investment in capital stock of the Reserve Banks? To encourage membership, a dividend rate of six per cent per annum was adopted as being a reasonable return on such stock, which did not and does not have many of the usual features found in corporate capital stock. It cannot be sold or pledged, it does not participate in earnings above the statutory rate, it does not have voting rights as such (other than in the election of six of the nine directors of the Federal Reserve Bank), it gives the stockholding members no proprietary interest.

Member banks select six of the nine directors of each Reserve Bank, the remaining three being appointed by the Board of Governors. Over the years, considerable prestige has become attached to these nonsalaried offices and, consequently, men of outstanding public stature have been willing to serve on these Boards. Each member bank has only one vote for a Class A director and one vote for a Class B director, regardless of the amount of Reserve Bank stock owned by the member bank. The three appointed by the Board of Governors are designated as Class C directors, one of whom is appointed as Chairman and another as Deputy Chairman. Through this system, the Federal Reserve System has grown in prestige in the eyes of the public, and, indeed, throughout that part of the world dedicated to preserving

freedom and the dignity of man.

Should the capital stock of the Reserve Banks be retired, there could follow a period of erosion, during which the System would be unable to attract the best-qualified men as directors, and, ultimately, the quality of the staff of the Reserve Banks could deteriorate. Based on my personal experience, I can say that the Reserve Banks are not controlled by the member banks through the directors they elect. Our directors are men of stature and ability--men who are dedicated to the public welfare. Their decisions are made without bias or self-interest of any group. I might mention here that we have had divisions of opinion within each of the three classes of directors. We have had two directors of each group vote as a majority and one director of each group vote in the minority. Moreover, the Board of Governors (the public body) has general supervision over the activities of the Reserve Banks, particularly with regard to their expenditures, and the Board has final authority over many of the actions of the directors. One important authority has to do with action by the Board of Directors to change the discount rate, which is subject to approval and determination of the Board of Governors.

The subscription to the capital stock of a Reserve Bank does not constitute, in any sense, ownership of a Federal Reserve Bank, and, to the best of my knowledge, it is not regarded as ownership by our member banks. Yet the ownership of the stock gives the member banks a real sense of being part of the System, of wanting to make it a vital part of our economic well-being; in short, this is a link to bind together, as one, the public and the private character of the System. To sever the link now would be to cast aside the public-private institution that has grown in esteem during more than 46 years and, possibly, to move in the direction of a new basic concept, that of a wholly nationalized institution.

The dividends which the Federal Reserve Act requires be paid at the rate of six per cent per annum presently aggregate approximately \$24 million a year. Such an amount cannot be considered inconsequential. The original text of the Act

provided that such dividends would be exempt from taxation. On March 28, 1942, the law was amended to provide that dividends on capital stock subscribed for after that date would not carry such exemption. At about that date, March, 1942, the capital stock of the Federal Reserve Banks was approximately \$143 million. Although some of that stock has been retired, let us assume that approximately that amount carries tax exemption on dividends. Therefore, there is about \$250 million in Reserve Bank stock on which dividends are subject to tax when received by the stockholding banks. At the six per cent rate, the dividends received by the holders of that \$250 million in stock would be about \$15 million. Assuming further that most banks are in the 52 per cent tax bracket, about \$7,800,000 of the almost \$24 million paid annually as dividends would be paid into the Treasury. Therefore, the change proposed by H.R. 8516 would increase Treasury receipts by about \$16.2 million instead of \$24 million.

In the light of the disadvantages which I believe would flow from the movement away from voluntary private participation, I cannot persuade myself that we should eliminate the payment of dividends. It is accepted business practice to pay a return to investors for invested capital. It seems to me that, rather than to repay the present stock to eliminate the payment of dividends, it would be more desirable to consider again the question of whether dividends on the stock issued prior to 1942 should continue to enjoy tax exemption.

The concept of each Federal Reserve Bank having a capital stock account was adopted in 1913, when the original Federal Reserve Act was passed. Many changes have come into our economy since 1913, but it is of interest to note that, some 19 years later, the Federal Home Loan Bank Act was enacted to provide a Home Loan Bank System which, in many respects, follows quite closely the concepts of the Federal Reserve Act-- in the way of stock subscriptions in the regional Home Loan Bank, the nominating and electing of directors, the receipt of dividends on the stock holdings, and the privilege of borrowing, in case of need, from the Federal Home Loan Bank. The Home Loan Banks

also have certain supervisory powers over their member savings and loan associations.

As another item of possible interest: at times since 1914 the capital stock holdings in the Federal Reserve Banks have provided receivers of insolvent banks with an additional liquid asset with which to pay off creditors.

If the stock of the Federal Reserve Banks were to be repaid, it probably would not have any material adverse effect on the ability of the System to perform its statutory functions as a central bank other than the possible erosion in staff quality referred to above, as the System does not need its present capital of almost \$400 million. I recall a comment made some time ago by another Reserve Bank President, who referred to our capital accounts as being symbolic--the Reserve Banks could operate without them, just as our country could operate without a flag. I cannot help believing that the retirement of the capital stock of the Federal Reserve Banks would have an adverse effect on, and perhaps diminish the confidence of, not only the financial interests of this country, but the general public as well.

I am concerned too about the effect such action might have on other countries, and on our relationships with the central banks of those countries. It is true that central banks of most other countries have a different capital structure than do the Federal Reserve Banks of this country, but we are operating under a form of government and a banking system which also differ from those of other countries. But, regardless of the differences in the capital structure of central banks in other countries, those banks and their governments have come to accept our Federal Reserve System as a capitalized institution not free from government control in the ultimate sense, but one exercising a degree of independence within the established limitations of the law.

This brings up the question of whether it would be possible convincingly to deny that the elimination of capital of the Federal Reserve Banks would be a step toward putting the System under direct and detailed government domination. Whether justified or not, would not our own citizens tend to believe that this would be the case? Even though

the question might exist only in minor degree, would the benefits of the proposed change justify assuming such risks of loss of confidence, and the elimination of participation in policy formulation of some of our most highly respected community leaders?

In the light of all the factors, I arrive at the conclusion that the advantages of the proposed elimination of Federal Reserve Bank capital stock would be fewer than the disadvantages, and therefore I cannot favor such a change.

### Membership

The second part of H.R. 8516 would provide for membership in the Federal Reserve System by any insured bank upon payment of a membership fee of \$10. A little less than half the commercial banks in this country are members of the Federal Reserve System, although they hold nearly three fourths of all banking assets, and the purpose of this section of the bill would be to encourage membership by the remaining banks, to permit them to avail themselves of the services which the System provides.

There are several important reasons, in my thinking, why some banks have elected not to become members of the System. First, there are still a large number of banks (almost 1,700) in certain areas which obtain part of their earnings through the collection of charges for paying checks drawn on them--exchange charges. By the terms of the Federal Reserve Act, member banks may not charge exchange on checks presented to them for payment by a Federal Reserve Bank. I have considerable doubt whether the substitution of a \$10 membership fee in lieu of a capital stock subscription would be sufficient inducement to membership for any bank which would, of necessity, upon becoming a member of the Federal Reserve System, have to sacrifice income now derived from exchange charges on checks drawn on it.

Second, an important reason for not becoming a member is the question of other earnings. In the past five years, in the Twelfth District, five member banks have elected to withdraw from membership. Four of those withdrawals resulted from

the bank's analysis of its earnings and the reaching of a conclusion that earnings could be increased as a result of the freeing of the reserve funds carried on the books of the Reserve Bank, and the carrying of required reserves as a nonmember bank with correspondent banks, as cash in vault, or, in some states, in Government securities.

With few exceptions, most of the banks in the Twelfth District which are not now members are the smaller banks. Average figures per bank follow:

<u>Class of bank</u>	<u>Capital</u>	<u>Deposits</u>	<u>Loans</u>
National member banks	\$4,900,000	\$230,000,000	\$130,000,000
State member banks	1,900,000	88,000,000	46,000,000
State nonmember banks	450,000	17,000,000	9,000,000

Smaller banks in our area generally look to their larger city correspondent banks to provide services for them. Some of such services go beyond the free services extended to the public through the member banks by the Federal Reserve Banks. Larger correspondent banks provide services relating to check collections, coin and currency, and loans and discounts; they provide investment advice and credit analysis; they hold themselves available to provide advice on operating procedures, even to the extent at times of temporarily furnishing supplementary and expert help and, possibly, even equipment; they are available to participate in overline loans; and they provide other services which extend much beyond the services available from the Reserve Banks. For reasons of their own, smaller banks prefer to handle their affairs directly with their larger correspondents.

I would have considerable doubt that, in the Twelfth District, the substitution of a \$10 membership fee in lieu of a capital stock subscription would be any inducement to smaller nonmember banks to join the Federal Reserve System, particularly in the light of their very satisfactory relationship with correspondent banks, a relationship I do not think should be disturbed.



Also, I believe that in considering this part of the bill thought should be given to what effect membership, which would be available virtually for the asking, would have on existing membership, which now is a privilege carrying with it a certain prestige. Membership now is an indication that certain minimum standards have been met, such as those providing for capital structure, for general asset condition, and for proper administration of operations and policies. Further, I believe that it would be most unfortunate to have a program under which banks could withdraw from or rejoin the System at will--to take advantage of whatever benefits might be more to their liking at any given time--one time as members and another time as nonmembers.

For example, if the Board of Governors should increase reserve requirements, there could result an exodus of state member banks from the System to obtain the advantages of lower requirements under state law. On the other hand, when System advantages exceed those available to state nonmember banks, an influx of new members could be expected.

We now have in the Twelfth Federal Reserve District a well-coordinated, efficient, sound, and effective banking structure. This system has been instrumental in providing for substantial growth of the area, and from my point of view, representing the Twelfth District, there would seem to be no need for requiring a change in that structure.

#### H. R. 8627

After my departure from San Francisco, I learned that the Subcommittee also desires comments on H. R. 8627. H. R. 8627 differs from H. R. 8516 in that it would retain the existing investment of the member banks in the System, but would designate those investments as deposits. In addition, H. R. 8627 would abolish the present six per cent statutory dividend rate and substitute therefor an interest payment equal to the lowest current rate of discount charged by the Federal Reserve Bank at which such deposit is made, plus one-half of one percentum.

Here again, as I have indicated in my comments on H. R. 8516, I do not believe that the benefits that might be gained from such a change would be sufficient to warrant disturbing a mechanism that has proven its ability, over the years, to blend public and private interests in accomplishing the delicate and complex purposes for which the System was fashioned. As to the rate to be paid, with no minimum and no maximum, the range could be considerable. In 1921, under H. R. 8627, the interest rate would have been 6-1/2 per cent at San Francisco; from 1942 to 1946, it would have been 1 per cent. Furthermore, it is my feeling that it would be improper to tie the interest rate to the discount rate. The discount rate is an instrument of monetary policy and use of such an instrument should be confined to monetary policy considerations and not be related to the rate of return on the funds of the member banks in the interest-bearing deposits.

If the purpose of H. R. 8627 is to lower the rate of return on the contributed capital of the Reserve Banks, it would be preferable to do so by direct amendment of the existing dividend rate, retaining the present stock ownership scheme of the System.

June 20, 1960

To Chairman Martin  
From Jerome W. Shay

Subject: Summary of points raised  
during Mr. Mangels' appearance on  
H.R. 8516 and H.R. 8627

Set forth briefly herein are principal points raised by members of the Patman Subcommittee during the appearance of Mr. Mangels on Friday, June 17. Mr. Mangels was the last of the three Federal Reserve Bank presidents scheduled thus far to testify on the above bills.

A copy of the stenographic transcript of the hearing on June 17 has been put in circulation among members of the Board; and it is understood that Mr. Mangels, previously, sent a copy of his formal statement to each Board member.

There was no significant public attendance, and press representation was small, at the hearing on June 17. This was the situation also on June 6 and 7 and on June 10, when Mr. Allen and Mr. Hayes testified.

Majority party members of the Subcommittee present on June 17 were Chairman Patman and Messrs. Reuss (Wis.), Johnson (Colo.), and Miller (Calif.). Mr. Multer (N. Y.) and Mr. Barr (Ind.) from the full Committee were present also. Except for the brief presence of Mr. Milliken (Pa.), no minority party members were present.

Mr. Patman.— Mr. Patman raised most of the same points on June 17 covered previously by him during the appearances of Messrs. Allen and Hayes and set out in my memoranda to you of June 8 and June 13. Omitted from those memoranda is one point raised by Mr. Patman with each of the three Reserve Bank presidents, as follows:

Referring to the "Federal Open Market Committee Report of the Ad Hoc Subcommittee on the Government Securities Market, November 12, 1952," Mr. Patman inquired whether that report's characterization of the FOMC as a "completely independent organization" (Report, para. 134) gave rise to conflicts of interests on the part of Board members and Reserve Bank presidents, as such, and as members of the FOMC. The purport of Mr. Patman's questions suggested that FOMC members would be expected to act in ways contrary to their duties in their other capacities, and that the FOMC was thought to be outside the Government and not a part of the Federal Reserve System.

Other but related lines of questioning by Mr. Patman on June 17 were, in effect, (1) whether the Reserve Bank presidents on the FOMC voted as a group or as individuals; and (2) whether the presence of all Reserve Bank presidents at FOMC meetings might influence how the twelve members of the Committee might vote.

In connection with membership in the System, Mr. Patman was interested in what the System might be able to do to make membership more attractive. He asked, for example, whether the System might be able to perform for member banks all of the services performed for commercial banks by their correspondent banks,

Mr. Patman seemed fairly certain that, in calculating the income to the Treasury from that portion of the dividends on Reserve Bank stock that is taxable (i.e., on stock issued since 1942), the member banks should be regarded as in the 30 per cent rather than the 52 per cent bracket.

While recognizing that the question was one for the Bureau of Internal Revenue, Mr. Patman seemed to think it wrong for a new member bank, resulting from a merger since 1942, to have any Reserve Bank stock exempt from taxation merely because either one or both of the merging banks had some Reserve Bank stock issued prior to 1942 and, therefore, exempt from taxation. (We have had this question from Mr. Patman before.)

As in the case of the two previous Reserve Bank witnesses, Mr. Patman indicated that Mr. Mangels also would receive for answering a list of further questions.

Mr. Reuss.- Mr. Reuss seemed to think that whether membership in the System was evidenced by Reserve Bank stock or a \$10 certificate of membership, the main feature was the power of the Board to approve or disapprove applications for membership on the basis of certain standards. In this connection, Mr. Mangels was asked to supply to the Subcommittee the standards now followed by the Board in deciding whether or not to approve a membership application.

As an alternative to retirement of the stock of the Reserve Banks, Mr. Reuss suggested a reduction in the percentage of the member banks' subscriptions to such stock that is actually called, so as to reduce dividends and increase the amount of payments to the Treasury. Throughout the hearings, Mr. Reuss' principal interest has been, in effect, to reduce somehow the "subsidy" to the banks and help the taxpayers.

Messrs. Johnson and Miller.- The questioning of these Subcommittee members on June 17 seemed to involve virtually nothing essentially different from their questioning of Messrs. Allen and Hayes, which is covered in my memoranda to you of June 8 and 13. The one possible exception was the question whether ownership of Reserve Bank stock by member banks plays a significant role in the quality of the boards of directors of the Reserve Banks.

Mr. Multer.- A line of questioning by Mr. Multer seemed to suggest that a director of a Federal Reserve Bank who was also a director of a member bank would be faced with conflicts of interest.

cc: Each Board Member

Messrs. Thomas, Young, Molony, Knipe, Fauver, Sherman, Hackley,  
Noyes, Solomon, Marget, Farrell, Masters, Hexter, Koch.

June 16, 1960

The Honorable Wright Patman,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Patman:

In accordance with the request contained in your letter of June 16, 1960, a copy of the report of examination of the Federal Reserve Bank of San Francisco made during the year 1959 is being sent today to the offices of the Committee on Banking and Currency of the House of Representatives. A copy of a self-explanatory letter which is going forward to Chairman Spence with the report is enclosed.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure

cc: Chairman Spence  
Miss Muehlhaus  
Mrs. Cotten

me

Miss Muehlhaus

June 16, 1960

The Honorable Brent Spence,  
Chairman,  
Committee on Banking and Currency,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Chairman:

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Sincerely yours,

(Signed) Wm. McC. Martin, Jr.  
Wm. McC. Martin, Jr.

Enclosures

cc: The Hon. Wright Patman

cc: Miss Muehlhaus  
Mrs. Cotten

COPY

Congress of the United States  
House of Representatives  
Washington, D. C.

June 16, 1960.

The Honorable William McC. Martin, Jr.

Dear Mr. Chairman:

Please furnish me as soon as possible a copy  
of the examination report of the San Francisco Federal  
Reserve Bank for 1959.

Sincerely yours,

(Signed) Wright Patman

Wright Patman

Received by messenger 11:40 a. m., June 16, 1960.

Szymczak



Miss Muckhaus



September 6, 1960.

The Honorable Wright Patman,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Patman:

During my appearance before your Subcommittee on August 25 in connection with the bills H.R. 8516 and H.R. 8627, you referred to and quoted from the Annual Report of the Board for 1935. In that connection you commented that the report is scarce and expressed the hope that the Board would consider reprinting the report.

You will, of course, be advised if the Board has the 1935 Report reprinted. In the meanwhile, I am sending to you under separate cover five copies of the 1935 Report. These are used copies, but appear to be in good condition.

Sincerely yours,

(Signed) M. S. Szymczak

M. S. Szymczak.

JWS:mcc

Margaret:

Governor Szymczak asked that this copy be sent to Chairman Martin for his information.

gls

EIGHTY-SIXTH CONGRESS

HOUSE OF REPRESENTATIVES

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**HOUSE OF REPRESENTATIVES  
COMMITTEE ON BANKING AND CURRENCY  
WASHINGTON**

August 9, 1960

ROBERT L. GARDON, CLERK AND GENERAL COUNSEL

Honorable M. S. Skymczak  
The Board of Governors  
The Federal Reserve System  
Washington 25, D. C.

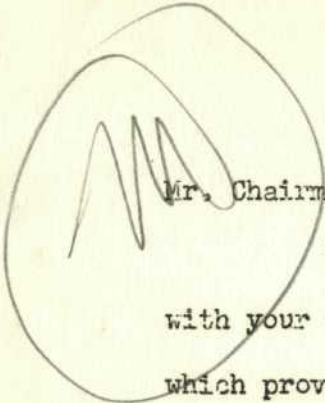
Dear Governor Skymczak:

This is to confirm arrangements made yesterday concerning your appearance before Subcommittee No. 3 on H.R. 8516 and H.R. 8627. Due to the fact that many of the Members will not return until the week of August 22, the hearing originally scheduled for August 18 has been postponed to August 25.

Sincerely,

*Robert L. Gardon*  
Robert L. Gardon  
Clerk and General Counsel

Martin



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.

July 5

Mr. Martin

Mr. Molony brought over the attached draft of reply to Congressman Reuss -- together with the transcript of your testimony (with the Reuss information included) which is to be returned today.

Mr. Molony said that Bob Cardon of the Committee staff said that Mr. Patman asked if he had gotten your testimony back because he wants to go right ahead and make up a committee print without waiting for any further hearings.

mnm

July 5, 1960

The Honorable Henry S. Reuss,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Reuss:

In the course of the Hearings on June 28 on H.R. 8516 and H.R. 8627 before Subcommittee No. 3 of the House Committee on Banking and Currency, you requested me to have the Board's legal staff prepare and file with the Subcommittee an amendment to existing law that would reduce the amount of Federal Reserve Bank stock held by each member bank from 3 per cent of the member bank's capital stock and surplus to three-tenths of one per cent. There is enclosed a draft of a brief bill to amend the Federal Reserve Act along the lines you described.

The provisions of the Act with respect to Federal Reserve Bank stock are especially intricate. However, in view of your request for a simple amendment, no attempt has been made to modify the many provisions of the Act that relate, in one manner or another, to the amount of outstanding capital stock of Federal Reserve Banks.

I am sure you will understand that the enclosure should not be regarded as a proposal by the Board or by me personally, but is simply in response to your request.

A copy of this letter and the enclosure are being sent to the Staff of the Subcommittee for inclusion in the record of the Hearings.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, JR.

Wm. McC. Martin, Jr.

DBH/JWS:ac

Enclosure

cc: Mr. Robert L. Cardon,  
Clerk & General Counsel,  
Committee on Banking and Currency,  
House of Representatives,  
Washington 25, D. C.

A BILL

To amend the Federal Reserve Act with respect to the stock of Federal reserve banks

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 5 of the Federal Reserve Act (12 U.S.C. 287) is amended by adding at the end thereof the following paragraph:

"Notwithstanding any other provision of law,

- (1) after the date of this amendment, stock of Federal reserve banks shall be issued only to the extent of one-tenth of the amount that otherwise would have been issued pursuant to the provisions of this Act, and
- (2) the Federal reserve banks shall retire, as nearly as practicable, nine-tenths of the Federal reserve bank stock held on the date of this amendment by each member bank of the Federal Reserve System, such retirement to take place at the time or times and in the manner to be prescribed by the Board of Governors of the Federal Reserve System."

DBH:ac

**This article is protected by copyright and has been removed.**

**Article Title:** Martin Opposes Change In FRB Stock Ownership Says Private Bank Holdings Play More Than Symbolic Role in Policymaking

**Journal Title:** American Banker

**Date:** June 29, 1960

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

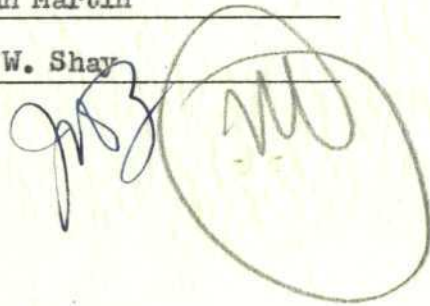
Date June 30, 1960

To Chairman Martin

Subject: Patman's request for examiners'

From Jerome W. Shay

supplementary memoranda



This will confirm that Congressman Patman advised me this morning by phone that he was unable today to look at the supplementary memoranda of the Board's examiners requested by his letter to you of June 21 and about which you talked with Congressman Patman at his office on June 27. However, he said he continued in his desire to accept your offer (made during the visit on June 27) to let him see the memoranda, and asked me to phone him for an appropriate time to do so after I return from my leave around the first of August.

cc: Each Board Member  
Mr. Sherman

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date September 9, 1960

To Chairman Martin

Subject: Patman request for

From Jerome W. Shay 

examiners' supplemental memoranda.

This will bring you up to date concerning Congressman Patman's letter to you of June 21 asking that he be supplied with the supplemental memoranda of the Board's examiners relative to their examinations of the Federal Reserve Banks of New York, Chicago, and San Francisco, for 1957-58-59.

Briefly, you will recall that we visited Mr. Patman at his office concerning this matter on June 27, at which time he readily accepted your offer that he be given the opportunity to examine the supplemental memoranda to determine whether he might wish to subpoena them; and it was agreed at that time that I would visit his office with the memoranda on Thursday morning, June 30, for that purpose. You will recall also that early on June 30, Mr. Patman 'phoned and advised me that he would be unable to examine the supplemental memoranda because of the rush for recess of Congress; and it was arranged between Mr. Patman and me that I would 'phone him for an appointment after I returned from my leave early in August.

On August 4, I stopped by Mr. Patman's office and learned from his secretary, Mrs. Spain, that he was away and not expected back until around August 14. I asked her to let Mr. Patman know that I had called. Having heard nothing further from Mr. Patman, I stopped by to see him early on August 19. He said he was too busy to examine the supplemental memoranda himself, but asked that I arrange with a member of his staff, Mr. William S. Johnson, for the latter to examine them at his office in my presence so that he might flag anything which he thought would be of interest to Mr. Patman. This arrangement was carried out during the afternoon of August 19. At the conclusion of his examination of the memoranda, Mr. Johnson advised me that he would recommend to Mr. Patman that there was nothing in the memoranda seeming to warrant Mr. Patman's attention. Mr. Johnson said he would try to see Mr. Patman concerning the matter promptly and advise me of the result of his talk with Mr. Patman. Thus far, all I have heard concerning the matter was a 'phone call from Mr. Johnson on August 22 during which he asked and I answered certain general questions which he said Mr. Patman had raised concerning the duties and responsibilities of the Federal Reserve Bank auditing departments.

I am not proposing to do anything further about the matter until we have some word on this matter from Mr. Patman or Mr. Johnson.

cc: Board members, Mr. Solomon and Mr. Sherman.



CONGRESS OF THE UNITED STATES

House of Representatives

Washington, D. C.

June 21, 1960

Honorable William McC. Martin,  
Chairman, Board of Governors,  
Federal Reserve System,  
Washington 25, D. C.

Dear Chairman Martin:

It would be appreciated if you would supply Subcommittee No. 3 of the House Committee on Banking and Currency with those portions of the audit reports for the Federal Reserve Banks of New York, Chicago, and San Francisco which are, in accordance with the Board's instructions to its auditors, reserved and set out in supplemental memorandums.

These so-called supplemental memorandums contain, of course, the auditors' findings and comments concerning the conduct of the management, and concerning the conduct of the directors, of the Federal Reserve Banks. It would be appreciated if you would supply those for the three banks in question resulting from the audits for the years 1957-59, inclusive.

Sincerely,

(signed) Wright Patman

Wright Patman

Note: Mr. Martin and Mr. Shay visited with Mr. Patman at 9:30, Monday, 6/27, re this matter.

June 24, 1960

CONFIDENTIAL (F.R.)

TO: Board of Governors  
FROM: Division of Examinations

SUBJECT: Confidential memoranda supplementing reports of examination of Federal Reserve Banks

*jes*  
*[Handwritten signature]*

CONFIDENTIAL (F.R.)

The following comments are offered for whatever assistance they may be to the Board in its consideration of Representative Patman's letter of June 21, 1960, requesting that Subcommittee No. 3 of the House Committee on Banking and Currency be furnished certain confidential memoranda submitted by the Chief Federal Reserve Examiner in supplement of the reports of examination of Federal Reserve Banks.

There are two confidential memoranda, each addressed to the Director of the Division of Examinations; one is a memorandum commenting on management and other matters not covered in the report of examination, and the other presents fairly detailed information respecting the organization and functioning of the Auditing Departments of Reserve Banks.

It may be helpful first to review the contents of the memorandum on management according to the topical arrangement usually followed in the memorandum.

Management- General comments

In this section the Chief Federal Reserve Examiner undertakes to inform the Board concerning the changes in the composition of the official staff of the Reserve Bank that have occurred since the previous examination. In addition to naming the officers involved in the changes, an endeavor is made to include sufficient identifying information so that the Board may have an intelligent understanding of the fitness and eligibility of the men for the places to which they have been assigned in the Reserve Bank's organization. If there was any reason for criticizing any officer because of his work performance or personal habits (occasions for which fortunately have been very rare), such criticisms would appear in this section also.

One of the more important subjects covered in this section is the vacancies that are anticipated, arising either from service retirements or for other reasons, and the tentative plans of the management for filling these vacancies. This information is usually based on information given in confidence to the Chief Examiner by the President of the Reserve Bank.

This section of the memorandum also may include comments on the Reserve Bank's planning for management training and development, and other matters regarding the official staff that are thought to be of possible interest to the Board. There is usually a concluding statement in which the Chief Examiner gives his general impression of the management.

Management- Comments on newly appointed  
members of the official staff

This section contains biographical information concerning those who have been appointed to the official staff since the previous examination, together with some personal characterization of the individuals by the examiners, if their acquaintance with them is sufficient to form a basis for an appraisal.

Office of the Federal Reserve Agent-- Newly appointed  
members of the Federal Reserve Agent's staff

This section includes biographical data concerning those employees who have been given appointments to the Federal Reserve Agent's staff since the previous examination, together with the examiners' comment whether the employee's work in the Federal Reserve Agent's function would be in conflict with his duties for the Bank. It would also contain any information coming to the attention of the examiner that would bear on the individual's suitability for handling large sums of currency.

Inattendance of directors

In this section there are reported the names of any directors who have failed to attend at least half of the scheduled Board meetings, with a statement of the reason for such failure.

Indebtedness, stock ownership in member  
banks, and outside business connections  
of officers and employees

It is the policy of each Reserve Bank to request information on the above subjects annually from all officers and from a selected number of employees, usually including the staffs of the Auditing and Bank Examination functions, all those handling cash and securities, and others occupying positions of key responsibility. These reports are reviewed by the Board's examiners each year to ascertain whether any officers or employees have become financially involved beyond prudent limits, the extent to which any of the personnel owns stock in member banks, and whether the holding of public office or outside business connections impose such demands on the holders as to present a probability of hampering them in the performance of their Reserve Bank duties and whether the public offices or outside business connections were of such nature as to be incompatible with Reserve Bank employment.

Any cases that present question are usually listed in the memorandum with a statement as to what action, if any, the Reserve Bank has taken or proposes to take.

Whether questionable or not, the outside business connections of members of the official staff are listed in the memorandum as a matter of information. There is regularly attached to the memorandum, also, a detailed list of the indebtedness and other information reported by the individual members of the Bank Examination Department.

Apparent or possible violations of the  
criminal provisions of the banking laws  
of the United States involving officers  
or employees of State member banks

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Part of the Board's examination procedure is to ascertain that all cases of the captioned nature have been reported by the Reserve Bank, as required, to the United States Attorney, the Federal Bureau of Investigation, and the Board of Governors. If there are any that have not been so reported, the memorandum usually includes a summarization pertaining to the facts of these cases, usually including the name of the member bank and the names of the officers or employees of that bank who may have been involved in the incident reported, with a statement of the reason why the Reserve Bank had not reported the matter to the authorities mentioned.

#### Auditing Department

As previously noted, there is also a separate memorandum which goes into considerable detail concerning the activities and personnel of the Auditing Department of each Reserve Bank.

Among the information included is a list of the departmental staff, showing the names of the staff members, their ages and salaries, and their ratings by the General Auditor according to his judgment as to their performance and competence.

#### Reasons for not divulging the contents of confidential memoranda to persons outside Board's organization

1. The use of a confidential section of an examination report has been fundamental to the examination procedure as a medium for the examiner to inform the supervisory authority on the management of the Bank and some of the personalities in the management, as well as on other matters concerning the Bank's affairs that would be useful for the supervisory authority to know as an aid to the proper discharge of its function. This information is of a kind that need not and should not be a part of the open section of the report. Examiners have been encouraged to comment freely and informally in their confidential reporting and have been willing to do so because of the long tradition that the confidential sections would be treated as sacrosanct. A departure from this tradition would,

if it became generally known, inhibit the examiners from expressing their frank opinions and to that extent would vitiate the value to the supervisory authority of this medium of information.

2. The release of the confidential memoranda to outside parties could cause embarrassment both to the examiners and to people in the Reserve Banks, and could thereby result in a lessening of the effectiveness of the examining procedure.

3. The presidents and other officials of the Reserve Banks would be inhibited from freely discussing management affairs with the examiners.

4. Disclosure of tentative future changes in the Reserve Bank's official staff and the reasons therefor could be disruptive of the morale of those organizations.

5. If information in the confidential memoranda concerning officers' and employees' indebtedness and outside connections, although innocent of any stigma, became a matter of public knowledge, it could cause embarrassment to the individuals concerned and would be an unnecessary interference with their privacy.

6. Although there is nothing in the confidential memoranda included in Representative Patman's present request that should cause embarrassment to the Board or the Reserve Banks, the few cases of the maintenance of stock brokerage accounts that are mentioned therein and such items as the holding of public office and outside employment might lend themselves to misinterpretation if lifted out of the context of the memoranda.

#### Conclusion

It is realized that because of overriding considerations, the Board may be disinclined not to comply with the request of a member of Congress or a Committee thereof for submission of the confidential memoranda related to examinations of Federal Reserve Banks. If it elects to make the memoranda available, the Board may wish to consider an arrangement whereby they would be retained in the custody of a member of the Board's staff, while at the same time affording Representative Patman or designated members of the Committee's staff the opportunity to satisfy themselves as to the contents of the memoranda.

COPY

HOUSE OF REPRESENTATIVES  
Committee on Banking and Currency  
Washington

June 20, 1960.

Honorable William McChesney Martin  
Chairman  
Federal Reserve Board  
Washington 25, D.C.

Dear Chairman Martin:

This will confirm arrangements made today for your appearance on Tuesday, June 28th before Subcommittee No. 3, to testify on H.R. 8516 and H.R. 8627, bills providing for the retirement of Federal Reserve bank stock.

The hearings will be held in Room 1301 New House Office Building and will begin at 10 A.M. I would appreciate your sending fifteen copies of your prepared statement to Robert L. Cardon, Clerk and General Counsel of the Committee on Banking and Currency, by Friday, June 24. I suggest that you have seventy-five copies of your statement delivered to the Committee on the morning of your appearance. These copies will be for Members and the press.

I am looking forward with pleasure to hearing your views on this legislation and discussing it with you.

Sincerely,

(Signed) Wright Patman

Wright Patman, Chairman  
Subcommittee No. 3

## Retirement of Federal Reserve Bank Stock: Detrimental Effects

Obviously, it cannot be demonstrated--or even asserted categorically--that the national economy or the international "image" of the United States would be adversely affected by the retirement of all outstanding stock of the Federal Reserve Banks. The potential detriment would arise, if at all, because such action by Congress might give rise to widespread doubts and suspicions and to the weakening of beneficial relationships, interests, and loyalties. Necessarily, the extent to which these adverse effects would result is a matter of judgment regarding intangibles, not subject to mechanical enumeration or weighing.

In my own thinking on this matter, the following are some of the important considerations.

1. The basic concept of the Federal Reserve System has always involved a blending of governmental control with cooperation and assistance from the privately-owned commercial banking system. In a sense, this blending has been embodied and expressed in the institution of Federal Reserve Bank stock, a security with unique and deliberately designed characteristics. The characteristic American device for evidencing an interest in an enterprise is corporate stock. Although the member banks, which own Reserve Bank stock, are aware that it is not an instrument of ownership and control in the sense of ordinary corporate stock, its issuance, ownership, voting rights, and dividend payments do serve to associate member banks with the System, in the minds of member bank officers, more intimately than would be the case if Reserve Bank stock were abolished.

To a substantial extent, successful performance of many Federal Reserve responsibilities can be advanced by member bank cooperation or impeded by lack of such cooperation. Examples of this involve the voluntary furnishing of considerable information and--even more important--conformity with the spirit and purpose (not merely the letter) of laws and regulations administered by the System. Banks, like governmental entities, actually operate through the agency of human beings. The people who manage commercial banks are men accustomed to corporate structure, and ownership of Reserve Bank stock has a real psychological significance to them. This is true also of the recurrent receipt of dividends on Reserve Bank stock, even though the amount is not an important element of the members' various income.

I am satisfied that withdrawal of Reserve Bank stock would in some measure weaken the loyalty of the commercial banking system to the Federal Reserve and its willingness to continue to participate as

wholeheartedly in the work of a unique institution that has rested, for almost a half century, on a combination of public and private effort and support.

2. As the Committee knows, the Federal Reserve System is strongly identified in the public mind with the continuing struggle against inflation and in favor of monetary stability--an objective with which the commercial banking system is also identified, to a considerable extent. The American public is aware that other elements of our Federal governmental structure, both legislative and executive, at times have criticized and opposed the policies and actions of the Federal Reserve that were aimed at restricting the availability of credit. As a result, the Federal Reserve System, with its present structure, is widely regarded as a bulwark against excessive expansion of credit with inflationary consequences.

The great majority of people are not acquainted with the detailed operations of the Reserve System. To them, the retirement of all Reserve Bank stock might appear to be a first step toward bringing the American central banking system more into the political orbit and this inference might well be drawn, also, by more informed and sophisticated observers, both at home and abroad, since the reasons advanced for the proposal do not appear, upon analysis, to justify this action. In such circumstances, it might be natural for observers, well-informed or ill-informed, to wonder whether there must not be an unmentioned but substantial purpose in the legislative proposal--some effort to change materially the status, powers, or effectiveness of the Federal Reserve System.

In brief, we are dealing in this situation with the structure created by the basic legislation dealing with the integrity of the American monetary system. Particularly in view of the events of recent years, the stability and prestige of our currency system--the standing of the dollar both at home and abroad--is a matter of widespread interest as well as a matter of great economic importance. In this area, psychological factors are exceptionally significant, and it is unwise, in my judgment, to jeopardize national and international confidence in the future of the dollar by enactment of legislation that, at best, promises little or nothing beneficial but could, on the contrary, produce serious economic injury.

D. B. Hexter

June 23, 1960



~~Confidential~~ 4/20/60

Re H.R. 8516

Background Definition (You probably would not need--or want--to use)

Member banks of the Federal Reserve System are of two classes-- national banks which are chartered by the Comptroller of the Currency and as an incident thereto become member banks, and State chartered banks that join the System voluntarily and retain their charter privileges while agreeing to be subject to applicable requirements of the Federal Reserve Act.

Federal Reserve membership carries various privileges among which is access to all the facilities of the System. In return, member banks take on several obligations including the obligation to comply with requirements of membership imposed by law or regulation promulgated in the public interest.

Criteria for Admission

In passing upon applications from State chartered banks for membership in the Federal Reserve System, the Board of Governors gives special consideration to all features of importance relative to the affairs of the applicant bank and approves the application if, in the Board's judgment, such considerations are resolved favorably. Among those matters to which special consideration is given by the Board are the financial history and condition of the applying bank; the general character of its management; the adequacy of its capital structure in relation to the character and condition of its assets and to its existing and prospective deposit liabilities and other corporate responsibilities; its earnings

prospects; the convenience and needs of the community to be served by the bank; and whether its corporate powers are consistent with the purposes of the Federal Reserve Act.

Conditions of Membership

Each State bank which is admitted to membership in the Federal Reserve System is subject to a condition of membership which requires that at all times the bank shall conduct its business and exercise its powers with due regard to the safety of its depositors and shall not cause any change to be made in the character of its business or in the scope of its corporate powers without first obtaining the permission of the Board. In addition, and when circumstances warrant, special conditions of membership may be imposed by the Board to prohibit, limit or correct particular situations in individual cases.

Withdrawal or Disapproval of Applications

Applications for membership in the Federal Reserve System by State banks are filed with the Federal Reserve Bank of the District in which the applying bank is located. If it is determined at that level that the bank is not qualified for membership, the applications are usually withdrawn and do not, therefore, come to the Board of Governors. When, in the opinion of the Board of Governors, an application for membership is not worthy of approval, it is customary to suggest to the bank that its application be withdrawn rather than take action formally disapproving. In recent years there have been very few cases in which formal action has been taken disapproving an application for membership, the most recent case being a small uninsured bank in the State of Texas which was disapproved in January 1958.

*There have been 4 formal disapprovals since 1934.*



How Would Net Receipts of Treasury Department be  
Affected by Retirement of Reserve Bank Stock?

It has been stated that dividends on Federal Reserve Bank stock constitute a "yearly Federal expense" of \$24,000,000, implying that the Treasury would be better off to the extent of \$24,000,000 annually if that stock were retired, so that there would be no more such dividends paid.

¶1. However, of the \$24,000,000 paid as dividends annually, the Treasury recaptures, through taxes, approximately \$8,000,000.

¶2. The Board of Governors recommends termination of the existing tax exemption of dividends on FR Bank stock issued prior to March 28, 1942. If Congress took this step, the Treasury would recapture an additional \$4,000,000.

¶3. If FR Bank stock were retired, monetary policy probably would require the System to sell an equivalent amount of Government securities. In view of the System practice of turning over most of its net earnings to the Treasury the Treasury's gain through termination of dividends would be largely offset by its consequent failure to receive from the FR any earnings on the securities thus sold. After allowing for applicable tax factors, this offsetting loss to the Treasury would be in the neighborhood of \$8,000,000.

¶4. It has been suggested that the present statutory 6% dividend rate on FR Bank stock should be reduced. If Congress reduced that rate to 4%, for example, the net earnings of the FR Banks, available for payment to the Treasury, would be increased by approximately \$4,000,000, after allowing for applicable tax factor.

Recapitulation: The present net "cost" of FR Bank stock dividends to the Treasury is certainly not more than \$16,000,000 (see ¶1). If the tax exemption presently attaching to some of those dividends were terminated, the net "cost" would be further reduced to \$12,000,000 (see ¶2). Retirement of FR Bank stock probably would involve monetary-policy actions that would offset to some extent the "saving" due to termination of dividend payments; taking this into consideration the net "cost" of the dividends would be down to \$4,000,000 (see ¶3). Finally, even this element of cost would be off-set, wholly or in large part, by reducing the dividend rate from 6% to 4% (¶4).

June 27



Mr. Martin--

Governor Balderston thought that in case Mr. Patman opens up on the Desk and its relations to the 17 dealers, as well as to the income the latter derive from the \$500 billion of Governments they handle annually, you might like to have in mind the following from the Radcliffe Report--

"How far, and by what means, is it known in the gilt-edge market, what are the day-to-day operations of Her Majesty's Government?

"11,921. Mr. Mullens: There are about 20 jobbing firms in the market. When there are certain stocks which I have had instructions from the Chief-Cashier to sell, the price at which we are prepared to be approached for these stocks is known to my representative, who in turn keeps the market advised of the prices, and also of any change there may ~~have~~ be, not only in the day-to-day policy but hour-to-hour as the market progresses.

"11,923. Professor Sayres: ... the jobbers would ascertain that you are prepared to buy such and such stock at such and such price? ---They would.

"11,924. Chairman: How is it known whether these are sales and purchases on behalf of the Government or on behalf of other clients? By the nature of the stock? --  
Yes, we would never disclose who are client is: but it is, as you say, guessed by the nature of the stock."

# Office Correspondence

Date August 13, 1959

To Chairman Martin

Subject: Multer bill (H.R. 8627) for  
replacement of Reserve Bank stock with  
member bank deposits.

From Jerome W. Shay

On August 11, 1959, Congressman Multer introduced a bill (H.R. 8627), "To amend the Federal Reserve Act to provide for the retirement of Federal Reserve bank stock and the substitution of interest-bearing deposits in lieu thereof."

Like Mr. Patman's recent bill (H.R. 8516), which was summarized in my memorandum of August 7 to you, the Multer bill would require each Federal Reserve Bank to cancel and retire its capital stock at par value, plus interest at the rate of 1/2 of 1 per cent per month from the date of the last dividend thereon, and to issue certificates of System membership in lieu of the retired stock. Both bills also would prohibit Reserve Banks thereafter from having any capital stock; and future applications for System membership would be for certificates of membership, rather than Reserve Bank stock.

Unlike the Patman bill, however, Mr. Multer's bill would require a member bank to maintain on deposit with its Federal Reserve Bank a sum equal to 3 per cent of the member bank's paid-up capital stock and surplus and, if deemed necessary by the Board, to double the amount of such deposit. These deposits--which would be in addition to the section 19 reserve balances of member banks--would bear interest at a rate equal to the lowest current rate of discount at the local Reserve Bank, plus 1/2 of 1 per cent.

Other differences include the absence from the Multer bill of the Patman-bill provisions establishing a \$10 fee for a certificate of System membership and repealing the present capital requirements for membership. Nor does the Multer bill contain the Patman-bill provision that any bank having Federal Deposit Insurance shall be eligible for System membership.

Another difference is that under the Multer bill the Board's semi-annual assessments on the Reserve Banks for payment of Board expenses would be levied on the Reserve Banks in proportion to their surplus and interest-bearing deposits of member banks, rather than in proportion to their net earnings for the immediately preceding half-year period, as provided by the Patman bill.

Most of the other provisions of the Multer bill are in nature of conforming changes and, therefore, merely technical.

cc: Each Board Member  
Mr. Riefler  
Mr. Thomas  
Mr. Molony  
Mr. Sherman  
Mr. Hackley  
Mr. Solomon  
Mr. Farrell



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

OFFICE OF THE CHAIRMAN

JUN 3 1960

The Honorable Wright Patman,  
House of Representatives,  
Washington 25, D. C.

Dear Mr. Patman:

In response to your letter of May 20, 1960,  
I enclose tables showing the ownership of capital stock  
and the selection of the management of all foreign  
central banks (excluding banks in Communist countries)  
for which information is available to the Board's staff.

You will note that the heads of the banks are  
called "Governors" in the tables, for the sake of sim-  
plicity, regardless of their official titles.

Central banks in Communist countries have been  
excluded because all financial institutions in these  
countries are so completely dominated by their govern-  
ments that the details of their legal provisions concern-  
ing capital and selection of management are immaterial.

Sincerely yours,

A handwritten signature in cursive script that reads "Wm. McC. Martin, Jr." with a flourish at the end.

Wm. McC. Martin, Jr.

Enclosures

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
		(Millions of currency units)					
<u>Western Hemisphere</u>							
Canada (Canadian dollar)	Bank of Canada	5.0	--	--	--	By Board of Directors with approval of Governor General.	By Minister of Finance with approval of Governor General.
Argentina (Peso)	Banco de la Republica Argentina	1,000	--	--	--	By President of the Republic with approval of Senate.	5 by President of the Republic (4 upon nomination by the Ministry of the Treasury), and 1 <u>ex officio</u> from public credit institution.
Bolivia (Boliviano)	Banco Central de Bolivia	5,000	--	--	--	By Government	7 appointed by Government, and 1 each by mining industry, banks, Chambers of Industries, and Chambers of Commerce.
Chile (Escudo)	Banco Central de Chile	.02	2.1	n.a.	n.a.	By Board of Directors.	4 by the Government, 2 each by Senate and Chamber of Deputies, 3 by banks, 1 by non-bank stockholders, 1 by Labor organizations, 1 jointly by National Farmers Association and National Assoc. of Manufacturers, and 1 jointly by Nitrate Sales Corp. and Central Chamber of Commerce.

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
		(Millions of currency units)					
			Total	Banks	Other		
Colombia (Peso)	Banco de la Republica	--	53.8	36.6	17.2	By board of directors.	3 by government, 3 by private banks, 1 by state banks, 1 by National Federation of Coffee Planters, 1 jointly by Chambers of Commerce, Assoc. of Industries, and Federation of Merchants, and 1 jointly by Farmers' Society and Cattlemen's Association.
Costa Rica (Colon)	Banco Central de Costa Rica	5.0	--	--	--	By board of directors from among its members.	7 directors, including the Minister of Economy and Finance, all by the Government.
Cuba (Peso)	Banco Nacional de Cuba	2.5+	2.5-	2.5-	--	By President of the Republic with approval of Council of Ministers.	2 Government officials <u>ex officio</u> , 1 each by private domestic banks and by foreign banks operating in Cuba.
Dominican Republic (Peso)	Banco Central de la Republica Dominicana	.3	--	--	--	By "Executive Power"	By "Executive Power", including three Cabinet Ministers.
Ecuador (Sucre)	Banco Central del Ecuador	2.1	15.4	15.4	--	By Monetary Board.	"Monetary Board" of 9 members, including Minister of Economy, 1 by Congress, 2 by banks, 2 by Chambers of Agriculture, Commerce and Industry, 1 each by National Economic Council and National Institute of Social Security, and 1 selected by the other 8.



FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
			Total	Banks	Other		
El Salvador (Colon)	Banco Central de Reserva de El Salvador	--	1.8	n.a.	n.a.	By stockholders upon nomination of board of directors, subject to approval by president of the Republic.	2 by the shareholders, 1 by private banks, and President of Coffee Planters' Association <i>ex officio</i> .
Guatemala (Quetzal)	Banco de Guatemala	.5	--	--	--	By President of the Re- public from a list sub- mitted by Board of Directors.	1 by State University of San Carlos, 1 by private banks, 2 cabinet minis- ters, <i>ex officio</i> , and 1 by President of the Re- public from a list sub- mitted by other Directors.
Haiti (Gourde)	Banque Nationale d'Haiti	12.0	--	--	--	By Board of Directors from among its members.	By President of the Republic.
Honduras (Lempira)	Banco Central de Honduras	1.2	--	--	--	By President of the Republic.	1 by State Development Bank, 1 by private banks, 1 jointly by agricultural, industrial and commercial associations. 1 cabinet minister, <i>ex officio</i> .
Mexico (Peso)	Banco de Mexico	102.0	43.0	n.a.	n.a.	By Board of Directors.	5 by Government, 4 by non-Government shareho- lders.
Netherlands Antilles (Guilder)	Curacaosche Bank	.45	--	--	--	Finance Minister, <i>ex officio</i>	4 by Prime Minister

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
		(Millions of currency units)					
			Total	Banks	Other		
Nicaragua (Cordoba)	Banco Nacional de Nicaragua	9.5	--	--	--	By Administrative Board, which is appointed by Council of Ministers, 4 freely and 3 from lists submitted by pri- vate economic groups.	1 by President of the Republic, 1 by private banks.
Paraguay (Guarani)	Banco Central del Paraguay	3.5	--	--	--	By "Executive Power"	By "Executive Power"
Peru (Sol)	Banco Central de Reserva del Peru	--	4.0	1.6	2.4	By Board of Directors	3 by President of the Repub- lic, 2 by domestic banks, 1 by non-bank shareholders, 1 by National Agricultural Society, 1 by National Soci- ety of Industries, and 1 by local Chambers of Commerce.
Surinam (Surinam guilder)	Centrale Bank van Suriname	3.0	--	--	--	By Government	By Government
Uruguay (Peso)	Banco de la Repub- lica Oriental del Uruguay	123.4	--	--	--	By "Executive Power"	By "Executive Power"
Venezuela (Bolivar)	Banco Central de Venezuela	2.54	2.5-	n.a.	n.a.	By shareholders from list submitted by President of the Repub- lic	4 by the Government, 3 non-Government sharehol- ds, 1 by National Banking Council.

## FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
		Total	Banks	Other			
		(Millions of currency units)					
Europe and Oceania							
Austria (Schilling)	Oesterreichische Nationalbank	75.0	75.0	n.a.	n.a.	By President of Republic	5 by Federal Government, 6 by stockholders
Belgium (Belgian franc)	Banque Nationale de Belgique	200.0	200.0	n.a.	n.a.	By Crown	By Crown; 10 regents by stockholders
Denmark (Krona)	Danmarks Nationalbank	50.0	--	--	--	By Crown. 2 other mem- bers of Board of Gov- ernors by Board of Di- rectors	25 directors -- 8 by and from Parliament, 2 from Parliament by Minister of Trade, Industry, and Ship- ping; 15 by existing Board of Directors
Finland (Finnish mark)	Finlands Bank	10,000	--	--	--	By President of Republic	By President of Republic; 9 Bank Supervisors by Diet
France (New French franc)	Banque de France	150.0	--	--	--	By President of Republic	4 <u>ex officio</u> , 7 by Finance Minister, 1 by Bank employees
Germany (Deutsche mark)	Deutsche Bundes- bank	290.0	--	--	--	By President of Federal Republic	By President of Federal Republic, 9 upon nomina- tion of Federal Council, 7-9 upon nomination of Federal Government
Greece (Drachma)	Bank of Greece	--	168.0	n.a.	n.a.	By Cabinet, upon propos- al of Board of Directors	By shareholders

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
		(Millions of currency units)					
		Total	Banks	Other			
Iceland (Krona)	The National Bank of Iceland	4.8	--	--	--	By President	Chairman by Government, 4 members by Parliament
Ireland (Irish pound)	Central Bank of Ireland	0.04	--	--	--	By President on advice of the Government	By Minister of Finance
Italy (Lira)	Banca d'Italia	--	300.0	253.5	46.5	By Superior Council of the Bank, with approval of President of Republic	By stockholders, with approval of President of Republic
Netherlands (Guilder)	De Nederlandsche Bank	20.0	--	--	--	By Crown	By Minister of Finance
Norway (Krone)	Norges Bank	35.0	--	--	--	By Crown	By Parliament
Portugal (Escudo)	Banco de Portugal	0.2	99.8	13.6	86.2	By Minister of Finance	By shareholders
Spain (Peseta)	Banco de España	--	177.0	n.a.	n.a.	By government	12 by shareholders and 15 by government
Sweden (Krona)	Sveriges Riksbank	50.0	--	--	--	By Board of Directors	Chairman by Crown, other 6 by Parliament
Switzerland (Swiss franc)	Schweizerische Nationalbank	9.7 (Cantons)	15.3 (Canton banks)	4.2	11.1	By Federal Government	15 by General Assembly of stockholders and 23 by Federal Government
Turkey (Turkish pound)	Central Bank of the Republic of Turkey	3.7	11.3	6.8	4.5	By Government	1 by government, 3 by banking institutions, 1 by Chamber of Commerce and Industry, 2 by agri- cultural cooperatives

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
		Total	Banks	Other			
		(Millions of currency units)					
United Kingdom (pound)	Bank of England	14.6	--	--	--	By Crown	Court of Directors by Crown
Australia (Australian pound)	Reserve Bank of Australia	4.0	--	--	--	By Governor General	Aside from Governor, Deputy Governor, and Secretary of Treasury, 7 other members appointed by Governor General
New Zealand (New Zealand pound)	Reserve Bank of New Zealand	1.5	--	--	--	By Minister of Finance on recommendation of Board of Directors	By Minister of Finance

## FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
		(Millions of currency units)					
Africa							
Belgian Congo and Ruanda - Urundi (Congoese franc)	Banque Centrale du Congo Belge et du Ruanda - Urundi	90.0	60.0	30.0 (National Bank of Bel- gium)	30.0	By Crown.	4 directors by Crown; Council of Regency by Minister of Colonies.
Ethiopia (Ethiopian dollar)	State Bank of Ethiopia	10.0	--	--	--	By Crown.	By Crown.
Ghana (Ghana pound)	Bank of Ghana	1.0	--	--	--	By Governor General on recommendation of Prime Minister.	By Prime Minister.
Guinea (Guinean franc)	La Banque de la Republique de Guinee	500.0 (author- ized)	--	--	--	By President.	By President.
Libya (Pound)	National Bank of Libya	0.7	--	--	--	By Royal decree on recom- mendation of Minister of Finance with approval of Council of Ministers.	By Council of Ministers on recommendation of Minister of Finance.
Morocco (Dirham)	La Banque du Maroc	n.a.	n.a.	n.a.	n.a.	By crown.	By Crown.
Nigeria (Nigerian pound)	Central Bank of Nigeria	1.5	--	--	--	By Governor General.	By Prime Minister of Federation.
Rhodesia and Nyasaland (Pound)	Bank of Rhodesia and Nyasaland	1.0	--	--	--	By Governor General.	By Governor General.

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor (s)	Directors
		(Millions of currency units)					
Sudan (Sudanese pound)	Bank of Sudan	1.5	--	--	--	By Council of Ministers on recommendation of Minister of Finance and Economy.	1 by Minister of Finance and Economy and 4 by Council of Ministers on recommendation of Minister of Finance and Economy.
Tunisia (Tunisian franc)	Banque Centrale de Tunisie	1,200	--	--	--	By President.	By President.
Union of South Africa (South African pound)	South African Reserve Bank	--	1.0	n.a.	n.a.	By Governor General.	Four by Governor General, six by stockholders.
United Arab Republic, Egyptian Sector (Egyptian pound)	National Bank of Egypt	3.0	--	--	--	By President.	By President.

## FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
		(Millions of currency units)					
		Total	Banks	Other			
<u>Asia</u>							
Afghanistan (Afghani)	Da Afghanistan Bank	240.0	--	--	--	By Finance Minister with approval of the Cabinet.	By Government.
Burma (Kyat)	Union Bank of Burma	10.0	--	--	--	By President of Union.	6 by President of Union, and Secretary to Ministry of Finance and Revenue, ex officio.
Cambodia (Riel)	National Bank of Cambodia	100.0	--	--	--	By Government.	5 by Government, 1 by owners of Series B shares.
Ceylon (Rupee)	Central Bank of Ceylon	15.0	--	--	--	By Governor General on recommendation of Prime Minister.	1 by Governor General on recommendation of Prime Minister, 1 <u>ex officio</u> (Permanent Secretary to the Minister of Finance).
China (Taiwan) (new Taiwan dollars)	Bank of Taiwan	100.0	--	--	--	By Minister of Finance	By Minister of Finance
India (Rupee)	Reserve Bank of India	50.0	--	--	--	By Cabinet.	By Cabinet.
Indonesia (Rupiah)	Bank Indonesia	100.0	--	--	--	By Cabinet.	Ministers of Finance, Distribution, Development and Construction, and Pro- duction, all ex officio.
Iran (Rial)	Bank Melli Iran	2,000.0	--	--	--	By Imperial Decree.	By Council of Ministers upon nomination of Governor.
Iraq (Dinar)	Central Bank of Iraq	6.0	--	--	--	By Council of Ministers.	By Council of Ministers.
Israel (Pound)	Bank of Israel	10.0	--	--	--	By President on recom- mendation of Government.	By Government.



FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
		(Millions of currency units)					
			Total	Banks	Other		
Japan (Yen)	Bank of Japan	55.2	44.8	3.9	40.9	By Cabinet.	2 non-voting members from Ministry of Finance and Economic Planning Agency; 4 voting members by Cabinet with approval of Diet.
Korea (Hwan)	Bank of Korea	15.0	--	--	--	By President of Republic with concurrence of State Council.	Minister of Finance, <i>ex officio</i> ; 5 by President of Republic with approval of State Council.
Laos (Kip)	National Bank of Laos	100.0	--	--	--	By Royal decree.	3 by Minister of Finance, 1 representative of Minister of Finance, 1 representative of Minister of Commerce and Industry, 1 <i>ex officio</i> (Inspector-General of the Kingdom).
Malaya, Federation of (Malayan dollar)	Central Bank of Malaya	20.0	--	--	--	By Head of State.	By Head of State.
Nepal (Rupee)	Nepal Rastra Bank	10.0	--	--	--	By Government.	By Government.
Pakistan (Rupee)	State Bank of Pakistan	15.3	14.7	n.a.	n.a.	By Central Government.	6 by Minister of Finance, 3 by shareholders.
Philippines (Peso)	Central Bank of the Philippines	10.0	--	--	--	By President of Republic with consent of Commission on Appointments.	Secretary of Finance, President of the Philippine National Bank, and Chairman of the Development Bank of the Philippines, all <i>ex officio</i> ; 3 public members by President of the Republic with consent of Commission on Appointments.

FOREIGN CENTRAL BANKS: CAPITAL OWNERSHIP AND MANAGEMENT

Country (currency)	Bank	Ownership of paid-up capital				Appointment (election) of	
		Gov't. owned	Privately owned			Governor(s)	Directors
			Total	Banks	Other		
		(Millions of currency units)					
Thailand (Baht)	Bank of Thailand	20.0	--	--	--	By Crown upon recommenda- tion of the Government.	By Council of Ministers upon recommendation of Minister of Finance.
United Arab Republic, Syrian Sector (Syrian pound)	Banque Centrale de Syrie	10.0	--	--	--	By Council of Ministers on recommendation of Council of Money and Credit.	By Council of Ministers
Viet-Nam (Piastre)	National Bank of Viet-Nam	66.7	--	--	--	By President of the Government.	By President of the Government.

WRIGHT PATMAN  
FIRST DISTRICT  
STATE OF TEXAS


WASHINGTON ADDRESS:  
1201 HOUSE OFFICE BUILDING

HOME ADDRESS:  
P. O. BOX 868, TEXARKANA, TEXAS

Congress of the United States  
House of Representatives  
Washington, D. C.

COMMITTEES:  
BANKING AND CURRENCY  
CHAIRMAN, SMALL BUSINESS OF THE HOUSE  
VICE CHAIRMAN, JOINT ECONOMIC  
COMMITTEE  
JOINT COMMITTEE ON DEFENSE PRODUCTION

SECRETARY:  
MRS. LUCILLE SPAIN



May 20, 1960

Honorable William McChesney Martin  
Chairman, Federal Reserve Board  
Washington 25, D. C.

Dear Mr. Martin:

The House Banking and Currency Committee Subcommittee of which I am Chairman will begin hearings on H. R. 8516, to provide for the retirement of Federal Reserve Bank stock, on June 6.

It would be greatly appreciated, therefore, if you would supply the subcommittee with a list of the central banks of the other nations of the world, indicating for each whether or not the bank has capital stock, and where such is the case, what the ownership of the stock is. In other words, where there is private ownership, either by private banks or other persons, in the stock of a central bank, I would like to know the extent, or percentage, of ownership in the hands of such private banks or other persons.

Further, if you have the information available, I would like to know also for each of these banks who selects the management of the bank and by what means.

If you do not have this information available for all of the foreign central banks, I would appreciate it if you would supply such information as you have by June 6 and then supply the remaining information at a later time.

It was my thought that for the sake of variety, the hearings this time would begin with the presidents of the Federal Reserve Banks, rather than with yourself or other members of the Board. Accordingly, Messrs. Allen, Hayes, and Mangels have been invited for the hearings presently scheduled to

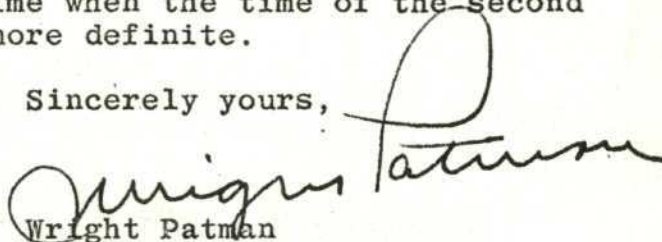
Hon. Wm. McC. Martin

- 2 -

May 20, 1960

begin June 6. The invitation list of other witnesses will be decided upon at a later time when the time of the second session of hearings becomes more definite.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Wright Patman". The signature is written in dark ink and is positioned to the right of the typed name "Wright Patman".

Wright Patman

May 18, 1960

To Chairman Martin  
From Jerome W. Shay

Subject: Hearings on the  
bill H.R. 8516

Confirming our conversation after lunch today, I have been advised by Mr. Robert L. Cardon, Clerk and General Counsel, House Committee on Banking and Currency, that hearings on Mr. Patman's bill H.R. 8516 will begin on June 6.

Mr. Allen, President of the Federal Reserve Bank of Chicago, who is the first witness, will testify that day (June 6). The next witness scheduled to testify is Mr. Hayes, President of the Federal Reserve Bank of New York, who will appear on June 10, followed by the third scheduled witness on June 13, who will be Mr. Mangels, President of the Federal Reserve Bank of San Francisco.

Mr. Cardon indicated that Mr. Patman, at this time, apparently has made no plans for further hearings this year, but it was also clear from my conversation with Mr. Cardon that whether further witnesses might be called and who they might be would be a matter of pure speculation at the present time.

As you also know, Mr. Allen talked with Mr. Molony following Mr. Allen's telephone call from Mr. Cardon regarding this matter.

cc: Each Board Member

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date August 7, 1959

To Chairman Martin

Subject: Patman bill (H. R. 8516) for

From Jerome W. Shay

retirement of Reserve Bank stock

Mr. Patman's bill "To provide for the retirement of Federal Reserve bank stock, and for other purposes," (H.R. 8516) introduced August 4, 1959, may be summarized as follows:

Each Federal Reserve Bank would be required to cancel and retire its capital stock at par value, plus interest at the rate of 1/2 of 1 per cent per month from the date of the last dividend on such stock, and thereupon to issue, in lieu of the retired stock, certificates of membership in the System. Thereafter, Reserve Banks would be prohibited from having any capital stock. There would be a \$10 fee for a certificate of membership.

The present capital requirements for System membership would be replaced by a provision that any bank having Federal Deposit Insurance "shall be eligible" for Federal Reserve membership. The bill, however, seems to leave intact the provisions of present law for Board approval of applications for membership, subject to conditions that the Board may prescribe; and apparently membership of national banks would continue to be compulsory and membership of State chartered banks voluntary. But, under the bill, any applicant bank would apply for a certificate of membership rather than for Federal Reserve Bank stock.

The bill would specify that the Board's semiannual assessments on the Reserve Banks for payment of Board expenses would be levied on the Reserve Banks in proportion to their "net earnings for the immediately preceding half year period," rather than in proportion to their "capital stock and surplus", as at present.

cc: Governors Balderston  
Robertson  
Mills  
Szymczak  
King  
Shepardson  
Messrs. Sherman  
Hackley  
Solomon  
Farrell  
Molony

May 13, 1960

TO: Board of Governors  
FROM: Ralph A. Young and Jerome W. Shay

SUBJECT: Reference material in  
connection with Mr. Patman's  
bill, H.R.8516--re ownership  
of Reserve Bank stock

On the subject of member bank ownership of the capital stock of the Federal Reserve Banks, a number of reference materials have been collected and put on a reserve shelf in the Board's library. The items might best be read in the order in which they are listed below:

Warburg, Paul M.

The Federal Reserve System: its origins and growth.  
1930. vol.2, pp.301-302.

Mortimer, Frank C.

Address at the Annual Convention in San Francisco of the American Institute of Banking, August 19, 1915. In: Commercial and Financial Chronicle, vol.101, page 888, September 18, 1915.

Kisch, Cecil and W. A. Elkin

Central banks. 1932 ed. pp.7-8, 45-47.

Clark, Laurence E.

Central banking under the Federal Reserve System.  
1935. pp.135-136.

Chamber of Commerce of the United States

The Federal Reserve System. Report of the Banking and  
Currency Committee. 1929. pp.121-122.

Goldenweiser, E. A.

American monetary policy. 1951. pp.79-81, 290-306.

"Public nature of the Reserve Banks" in Banking Studies.  
1941. pp.233-234, 239.

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BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

Chairman Martin

# Office Correspondence

Date May 4, 1960

To Board of Governors

Subject: Bills to retire Federal Reserve

From Jerome W. Shay

Bank stock

Attached is a copy of my memorandum of August 7, 1959, summarizing Mr. Patman's bill H.R. 8516, on which he has announced that he will begin hearings on or about June 1. As of possible interest in this connection, I attach also a copy of my memorandum of August 13, 1959, summarizing Mr. Multer's bill H.R. 8627, which, as will be noted, would also require retirement and cancellation of stock of Federal Reserve Banks but on a different basis than that provided for in Mr. Patman's bill. Mr. Patman's bill also provides that any insured bank shall be eligible for Federal Reserve membership.

It does not appear that either the Patman or the Multer bill would materially disturb the present scheme for the selection of directors of Federal Reserve Banks.

The most recent material bearing on the subject of Federal Reserve Bank stock will be found in the hearings on February 2, 1960, before the Joint Economic Committee on the President's Economic Report. Colloquy between Mr. Patman and Chairman Martin, at that time, may be found at pages 196-198, 200, 201, 206, and 207 of those Hearings, copies of which have been previously distributed.

Attachments



COPY

August 7, 1959

Chairman Martin

Patman bill (H.R. 8516) for

Jerome W. Shay

retirement of Reserve Bank stock

Mr. Patman's bill "To provide for the retirement of Federal Reserve bank stock, and for other purposes", (H.R. 8516) introduced August 4, 1959, may be summarized as follows:

Each Federal Reserve Bank would be required to cancel and retire its capital stock at par value, plus interest at the rate of 1/2 of 1 per cent per month from the date of the last dividend on such stock, and thereupon to issue, in lieu of the retired stock, certificates of membership in the System. Thereafter, Reserve Banks would be prohibited from having any capital stock. There would be a \$10 fee for a certificate of membership.

The present capital requirements for System membership would be replaced by a provision that any bank having Federal Deposit Insurance "shall be eligible" for Federal Reserve membership. The bill, however, seems to leave intact the provisions of present law for Board approval of applications for membership, subject to conditions that the Board may prescribe; and apparently membership of national banks would continue to be compulsory and membership of State chartered banks voluntary. But, under the bill, any applicant bank would apply for a certificate of membership rather than for Federal Reserve Bank stock.

The bill would specify that the Board's semiannual assessments on the Reserve Banks for payment of Board expenses would be levied on the Reserve Banks in proportion to their "net earnings for the immediately preceding half year period," rather than in proportion to their "capital stock and surplus", as at present.

cc: Governors Balderston  
Robertson  
Mills  
Szymczak  
King  
Shepardson  
Messrs. Sherman  
Hackley  
Solomon  
Farrell  
Molony

COPY

August 13, 1959

Chairman Martin

Jerome W. Shay

Multer bill (H.R. 8627) for  
replacement of Reserve Bank stock with  
member bank deposits.

On August 11, 1959, Congressman Multer introduced a bill (H.R. 8627), "To amend the Federal Reserve Act to provide for the retirement of Federal Reserve bank stock and the substitution of interest-bearing deposits in lieu thereof."

Like Mr. Patman's recent bill (H.R. 8516), which was summarized in my memorandum of August 7 to you, the Multer bill would require each Federal Reserve Bank to cancel and retire its capital stock at par value, plus interest at the rate of 1/2 of 1 per cent per month from the date of the last dividend thereon, and to issue certificates of System membership in lieu of the retired stock. Both bills also would prohibit Reserve Banks thereafter from having any capital stock; and future applications for System membership would be for certificates of membership, rather than Reserve Bank stock.

Unlike the Patman bill, however, Mr. Multer's bill would require a member bank to maintain on deposit with its Federal Reserve Bank a sum equal to 3 per cent of the member bank's paid-up capital stock and surplus and, if deemed necessary by the Board, to double the amount of such deposit. These deposits--which would be in addition to the section 19 reserve balances of member banks--would bear interest at a rate equal to the lowest current rate of discount at the local Reserve Bank, plus 1/2 of 1 per cent.

Other differences include the absence from the Multer bill of the Patman-bill provisions establishing a \$10 fee for a certificate of System membership and repealing the present capital requirements for membership. Nor does the Multer bill contain the Patman-bill provision that any bank having Federal Deposit Insurance shall be eligible for System membership.

Another difference is that under the Multer bill the Board's semi-annual assessments on the Reserve Banks for payment of Board expenses would be levied on the Reserve Banks in proportion to their surplus and interest-bearing deposits of member banks, rather than in proportion to their net earnings for the immediately preceding half-year period, as provided by the Patman bill.

Most of the other provisions of the Multer bill are in nature of conforming changes and, therefore, merely technical.

cc: Each Board Member  
Mr. Riefler  
Mr. Thomas  
Mr. Molony  
Mr. Sherman  
Mr. Hackley  
Mr. Solomon  
Mr. Farrell

EXCERPTS FROM EARLIER CONGRESSIONAL COMMITTEE HEARINGS  
RELEVANT TO CONSIDERATION OF PATMAN BILL H. R. 8516

see pp. 3 v  
to 36,  
repeated

To assist preliminarily in the consideration of Congressman Patman's bill H.R. 8516, on which hearings are scheduled to begin on or about June 1, 1960, certain recent hearings before Congressional Committees have been examined for any relevant Board or System testimony that might be helpful.

Set forth below are excerpts from the Joint Economic Committee's hearings last February, the hearings before Mr. Patman's Select Committee on Small Business in November 1957 and April 1958, and the House Banking and Currency Committee's hearings on the Financial Institutions Act in July and August 1957.

Following these excerpts are references to certain other earlier materials to which access might be made in this connection.

This memorandum does not represent an exhaustive search for materials bearing on the various aspects of either H.R. 8516 or Congressman Multer's somewhat similar bill H.R. 8627.

Hearings before Joint Economic Committee on Economic Report of the President, 86th Congress, 2d Session, February 2, 1960, pp. 196-198, 200-201, 206-207. During questioning by Congressman Patman, Chairman Martin replied that he had testified "many times" that the member banks "do not have a proprietary interest" in the Federal Reserve Banks. Briefly, Chairman Martin emphasized that the capital stock of the Federal Reserve Banks was part of the System's "institutional framework," that it was a basis for member bank "participation that is in accord with business practice," and that "some capital and surplus is needed unless we come back under a different system than we have now...." More specifically, the Chairman's testimony includes the following:

"Representative Patman. If someone were to ask you the question: Who owns the Federal Reserve Banks? What would be your answer?

"Mr. Martin. Mr. Patman, we have been over this many times. The Federal Reserve System was a unique political contribution in my judgment by Woodrow Wilson in his administration. Senator Glass took a part in it. It provided for a merger of public and private interest to safeguard the currency. The Federal Reserve Board in Washington is clearly Government. The Federal Reserve Banks are quasi-government, or quasi-private, depending on where you want the emphasis.

"I have repeated this a great many times.

"A distinguished professor in Oxford University, when I was attending some lectures there a good many years ago, said that, in his judgment, the United States had only made two real

contributions in political science. One was the Northwest Ordinance. I will not go into his reasons for that. The other was the Federal Reserve Act because in the Federal Reserve Act you had a merger of public and private interest without nationalizing the bank system but bringing the currency into consonance with the public interest through the Government.

"There is certainly no question at all that if we want to review the entire institutional framework of the Federal Reserve System we can do it any time we want. You certainly have taken the lead in raising points on it. I remember discussing this at great length with you in 1952 when you were chairman of a committee that worked on this, and I do not think there has been any change in substance in this institutional relationship since that time.

"The way the banks participate in the Federal Reserve System is that we have accounting procedures that are in accord with business practice and we have participation that is in accord with business practice. The way that it is arrived at is that the member bank becomes a part of the system. Banks do not have to be members except that all national banks have to be members. If a bank is a national bank it must subscribe up to 6 percent of its capital and surplus to stock of a Federal Reserve Bank; other banks who choose to be member banks are subject to a similar statutory requirement.

"Representative Patman. Mr. Martin, as you said, we have gone over that a lot. For the sake of brevity, may I ask you this question on which I think we will both agree. The commercial member banks in the Federal Reserve System do not own a proprietary interest in the Federal Reserve System?

"Mr. Martin. I have testified to that many times.

"Representative Patman. That is correct, is it not?

"Mr. Martin. They do not have a proprietary interest.

"Representative Patman. And you cannot have ownership unless you have a proprietary interest. That is correct, too, is it not?

"Mr. Martin. They have a sense of participation in it.

"Representative Patman. I am not disputing that. I am talking about proprietorship now.

"Mr. Martin. On proprietorship, you and I have agreed repeatedly." (pp. 196-197)

"Representative Patman. I have one other question.

"When you delivered \$266 million to the Treasury, you had about \$750 million left, did you not?

"Mr. Martin. Yes.

"Representative Patman. Why did you not deliver it all? Why did you just deliver \$266 million? Why did you not say to the Treasury, 'We are not using that money. It is idle and unused. We are not investing it. It serves no purpose'? And I could show that by your own statements. Why did you not give it all over to the Treasury and save the people that much interest?

"Mr. Martin. You cannot say from statements that I have made that it serves no purpose when this comes to the institutional framework of the Federal Reserve System. If you want to change it so that we don't have any capital, any surplus, we do not have any participation by the banks through stock ownership of securities, you will have an entirely different institutional concept than we have today. The change that we made at the end of the year, which came in part out of hearings that you and I have participated in for some time, we started working on in June and finally decided that we would not, particularly in a period of relatively high interest rates, want to be in the position of keeping from the Treasury anything, so that we now are paying 100 percent. You say we ought to give everything.

"Representative Patman. That is right.

"Mr. Martin. I say that you are then basically changing the institutional concept of the System and the business accounting procedures.

"Representative Patman. Let me quote your exact language on November 21, 1957, when I was interrogating you and I stated,

'Surplus funds are not at present used in the Federal Reserve System corporations,'

and other members of the Board, at least three other ones, say that these funds are not needed, are not used, are not invested, serve no purpose.

"Mr. Martin. No, Mr. Patman. That is not right.

"Representative Patman. I have the testimony here. I can read it.

"Mr. Martin. That testimony says at present they are not being used but we have uses in Government securities. We have contingencies to work against and all of this is a part of this institutional concept and also the accounting procedures of the System.

"The Chairman. Congressman Curtis.

"Representative Curtis. In other words, what you are saying is that there is a purpose.

"Mr. Martin. Of course, there is a purpose." (pp. 200-201)

"Mr. Martin. I have already pointed out to you that this goes to the heart of the institutional framework of the Federal Reserve System whether it is to be a business procedure and follow business accounting procedures and that some capital and surplus is needed unless we come back under a different system than we have and Congress gives us our appropriations for our operating procedures. That is the heart of the matter.

"Representative Patman. Mr. Martin, are you not mistaken in saying that this is the heart of the System when you know the heart of the System is your power to create money on the credit of the U.S. Government? That is the heart of the System, is it not?

"Mr. Martin. I do not conceive it to be such because the power to create money which came into the System was put in the institutional framework of merging public and private interests. Now, that is why we have this present framework. The capital and surplus is for that purpose. There may be a time when we would need it.

"With due respect to those quotations, it was the judgment of the Board that this was a reasonable relationship which was followed out in the history of the act, because the franchise tax was in existence until 1933, as you know.

"We have tried to get the franchise tax reimposed. It was part of the Financial Institutions Act which died in the House Banking and Currency Committee.

"I think we would have preferred to have had the franchise tax but that is a matter of judgment, but we think that it is important that this framework be retained or at least that we know what is happening when you make a basic change.

"Representative Patman. Mr. Martin, I wish you and your Board would study a plan to deliver to the Treasury the remainder of about \$700 million of surplus funds, just as you did the \$266 million. Then plan also to pay these private banks their \$400 some-odd million in so-called stock, because they are misinterpreting that, Mr. Martin. They think they own the Federal Reserve System, and some of them are becoming what is tantamount to being squatters on Government property. We do not need their money. We are out about \$24 million a year paying them interest or dividends on it for no purpose on earth.

"You have not invested it. If you invest it in 4-percent or 3-percent bonds you would at least salvage half of it, but you do not do that. It is not used for any purpose.

"There is no reason to have it and you ought to pay them back and save that \$24 million a year and pay that surplus fund over into the Treasury." (p. 207)

Hearings before House Select Committee on Small Business on "Problems of Small-Business Financing," 85th Congress, 1st Session, Part I, November 19, 1957, pp. 32-35. With respect to his idea to use some of the surplus of the Federal Reserve Banks to finance a small business capital bank system, Congressman Patman sought the views of Reserve Bank Presidents Hayes, Bryan, Johns, and Leach, whose testimony included the following:

Mr. Hayes agreed that the Reserve Banks' "capital" and "reserves" are not used and are "relatively unimportant," but he added that "personally we should have some cushion somewhere to take up unforeseen expenses."

Mr. Bryan agreed that a Reserve Bank does "not depend" on its "reserves and ... capital stock." While he added that "there is some reason, however, to allow the Federal Reserve Bank to show a conventional statement that people understand," he doubted that he "ever got ... explained to anybody's satisfaction" how the Reserve Banks "could do \$50 billion worth of business on \$332 million worth of capital."

Mr. Johns commented that he had "not observed that the Federal Reserve Banks' presidents spend a great deal of time worrying about their capital funds."

Mr. Leach said "I would not feel like I was busted" if Mr. Patman's ideas were adopted.

Ibid., November 21, 1957, pp. 335-399. With respect to the Patman proposal to use some of the surplus of the Reserve Banks, Chairman Martin also testified before the House Select Committee on Small Business. He indicated that "the world would not come to an end" if a "very small amount" of the surplus were to be appropriated. At first he indicated that the surplus was an "important safety valve," but later he described it as a "cushion." Chairman Martin said: "Let me just emphasize that by setting it out this way: Capital and surplus facilitates the operations of the banks and in this way is an element in the confidence factor of our currency. We should never overlook this factor. The minute you start tampering with this type of thing, you are changing the pattern, with possible adverse effects on confidence. That is one of the things we have to consider." In particular reference to the capital stock of the Reserve Banks, the following colloquy may be noted:

"The Chairman. Now, Mr. Martin, the Federal Reserve System is paying 6 percent interest on that money. Now as you have stated to me in answer to the question as Mr. Eccles and the other chairmen have, the banks have no proprietary interest by reason of that investment. In other words, it does not give them any right except give them a feeling that they have got something invested thereupon which they get 6 percent, and about half of that is tax exempt. They do not pay any taxes at all. They have that feeling that they have that investment there, but they cannot vote by reason of their investment. If it is a million dollars or a thousand dollars, it is still the

same vote they have. They cannot hypothecate the so-called stock. They cannot sell the so-called stock. It is not stock. It is a misnomer. It is just a convenience with no proprietary ownership; is it not?

"Mr. Martin. It is a device which I think was very properly used, again in consonance with business practice, in order to give a means of getting direct participation through the directorates. It is a voting device that is used in the System, and I think very effectively and very properly.

"Now it is not, and I am glad it is not, proprietary interest on the part of the banks.

"The Chairman. Mr. Martin, I am afraid your answer there is a little bit misleading that it is a voting device.

"Mr. Martin. The device by which we determine what the votes of the individual banks are with respect to the six directors that they elect. I do not know what is misleading in that.

"The Chairman. What I mean is, Mr. Martin, you are not inferring that by reason of a high investment they have more votes than one with a low investment?

"Mr. Martin. Well, these procedures are worked out. I could get someone up here, Mr. Patman. It is worked out on an equitable basis. I cannot give you the precise details with respect to it, but we have small banks, medium-sized banks, and large banks.

"The Chairman. That is right, and they all have equal votes in those categories.

"Mr. Martin. Yes; and this device of dividing it into small, medium and large was a means of trying to get proration of directors in accord with a recognition of size.

"The Chairman. Yes.

"Mr. Martin. And at the same time the capital procedure, the voting procedure, was related to capital and surplus.

"The Chairman. But Mr. Martin, is it not a fact that you do not use this stock for any purpose in your operations?

"Mr. Martin. That is correct. We do not.

"The Chairman. You do not use it for any purpose in your operations. Now is it not a fact that you do not use any of this \$750 million or these surplus funds, you do not use them in any part of your operations?

"Mr. Martin. Not at the present time." (p. 338)



Ibid., 85th Cong., 2d Sess., Part II, April 16, 17, 28, 1958.  
On these dates Governors Szymczak, Mills, Robertson, Shepardson, Vardaman, and Balderston testified before Mr. Patman's Select Committee on Small Business concerning, among other things, Mr. Patman's proposal to use some of the Reserve Bank surplus to initiate a small business capital bank system.

Governor Szymczak's testimony includes the following (pp. 416, 421-422):

"The CHAIRMAN. Do you agree with Mr. Martin that the member banks do not own the Federal Reserve banks, and have no claim to their assets or income other than the interest payment on the so-called stock which the member banks are required to subscribe to the Federal Reserve banks?

"Mr. SZYMCZAK. That is correct. They are also entitled to the 3 percent of their capital and surplus that they paid in to purchase the stocks and the 6 percent dividend. It is a sort of preferred stock; it is not a common stock.

"The CHAIRMAN. Governor--Mr. Martin uses a phrase which I think is a correct one when he says commercial banks own the nonproprietary interest in the Federal Reserve System?

"Mr. SZYMCZAK. That is right." (p.416)

"Mr. SZYMCZAK. On the other hand, people are accustomed to private business accounting. They are accustomed to banks and businesses and so forth keeping books in a certain way and these books show a surplus. A John Jones therefore looks at the Federal Reserve with a power to issue currency and power to buy Government securities and so forth, and looking at the statement and not finding a surplus there, might figure--and that question came up not so long ago when it arose in connection with other countries' currencies and whether the System could lend the money. Legal questions arose, and other questions arose, but the immediate question was why should the Federal Reserve use its funds for the purpose of aiding currencies of other countries and the loss of confidence in the Federal Reserve System in case it did so.

"That is the thing that the average bank is accustomed to, which is different from the philosophy of central banks.

"The CHAIRMAN. The fact is that the central bank having the power to create money doesn't need any surplus funds and doesn't need any capital stock.

"Mr. SZYMCZAK. That is right.

"The CHAIRMAN. It doesn't need either one.

"The truth is, Governor Szymczak, that the capital stock, that \$300-some-odd million, is not used for any purpose, is it?

"Mr. SZYMCZAK. It was used to start with.

"The CHAIRMAN. That was for operating expenses.

"Mr. SZYMCZAK. That is right.

"The CHAIRMAN. But has not been used since, and is not now used is it?

"Mr. SZYMCZAK. That is correct.

"The CHAIRMAN. And that capital stock has never been invested in Government bonds or anything else?

"Mr. SZYMCZAK. You are technically correct. It would be hard to say what money is used for what purpose.

"The CHAIRMAN. But your transactions are paid for by created money?

"Mr. SZYMCZAK. The essence of our existence is the power to issue currency.

"The CHAIRMAN. Your surplus funds are not used for any purpose now, are they?

"Mr. SZYMCZAK. No.

"The CHAIRMAN. And they have never been invested?

"Mr. SZYMCZAK. No.

"The CHAIRMAN. So they are idle for all practical purposes?

"Mr. SZYMCZAK. Yes." (pp. 421-422)

Governor Mills' testimony includes the following (pp. 448-450, 452, 460, 461):

"The CHAIRMAN. Governor Mills, do you share the views of Chairman Martin and Chairman Eccles at the time, and others, that the banks own a nonproprietary interest in the Federal Reserve System? That phrase, I think, was gotten up after Mr. Eccles left, but I think it is such an apt phrase.

"Mr. Mills. An offshoot of that phrase that to me is as apt as the expression you use is that the member banks have what amounts to preferred stock in the Federal Reserve System.

"The CHAIRMAN. And preferred stock?

"Mr. Mills. Yes.

"The CHAIRMAN. That is, they don't have any proprietary interest.

"Mr. MILLS. A proprietary interest, historically and in a very real sense, in that the capital which the member banks subscribe is, of course, drawn from their own private funds, but not a proprietary interest in the sense that the ownership or the representation of stock ownership in the Federal Reserve banks entitle the member banks to the type of ownership and the control of resources that is associated with stock ownership in private enterprise.

"The CHAIRMAN. Of course, you agree, too, I'm sure, that the Federal Reserve banks operate on the Government's capital. That is their source of power and strength?

"In other words, the credit of the Nation?

"Mr. MILLS. That is a very broad term to apply to the operations of the Federal Reserve banks. Their operations are prescribed by the Federal Reserve Act with responsibility placed in the boards of directors of the Federal Reserve banks who are drawn from private life and with general supervision in the Federal Reserve Board who are Federal officials. It would be difficult for me to persuade myself that the Federal Reserve System was operating on Government capital where the administrative responsibility for the System is vested in a blend of private and public officials. It is, of course, a fundamental fact that the System's operations in conducting monetary and credit policy operate through the mechanical means of market transactions in United States Government securities. The use of these mechanical means, of course, gives color to a statement that the Federal Reserve banks operate on Government capital.

"But if it was a fact that the System truly operated on Government capital, a concept would exist so radically different, in my estimation, from the philosophy followed by the authors of the Federal Reserve Act as it is passed in 1913, and as it has since been administered, that the acceptance of that principle, if carried into its complete ramifications, could lead to a complete change and--again in my opinion--an inadvisable change in the structure of the Federal Reserve System, in that it would set in motion a slow progress toward nationalization.

\* \* \* \* \*

"The CHAIRMAN. Now, the stock that is held by the Federal Reserve banks--do you consider that invested?

"Mr. MILLS. Oh, very definitely.

"The CHAIRMAN. What do they invest in?

"Mr. MILLS. Their stock is represented in a proportionate share of all of the assets held by a Federal Reserve bank that range from their holdings of cash to gold certificates to loans and discounts of the member banks and their overriding investment in the United States Government securities, through which open market transactions are carried out.

"The CHAIRMAN. What about the surplus funds? Now the banks have about \$750 million or \$800 million in surplus funds under section 7. Do you consider that they are invested?

"Mr. MILLS. Yes, through the same range of assets and through the process of the retention of the earnings of the Federal Reserve banks beyond the 90 percent of those net earnings that are transferred to the United States Treasury.

"The CHAIRMAN. Don't you feel your testimony is in conflict with Mr. Eccles' and Mr. Martin's, in that they claim that every transaction that the Federal Reserve makes is an individual transaction upon which they operate on the credit of the Nation. In other words, they use Federal Reserve credit, Federal Reserve notes, where necessary, and this money is not invested in fact.

"Mr. MILLS. I'm not completely sure that I get the import of your question, and I don't recall the positions of either Mr. Eccles or Mr. Martin, but there is a distinction between the United States Government securities that are held in the portfolio of the Federal Reserve banks and the Federal Reserve notes that are issued by the Federal Reserve banks on the liability side of the ledger and which make up the most important part of the currency of the land and which come into being as demand for the use of the currency is expressed by the people of the country when they draw deposits from the banks in the form of Federal Reserve notes." (pp. 448-450)

"The CHAIRMAN. That is a question, of course.

"You knew Dr. E. A. Goldenweiser, didn't you?

"Mr. MILLS. I knew him best by reputation. I had the pleasure of meeting him on only one or two occasions.

"The CHAIRMAN. Do you recognize him as an outstanding authority on the Federal Reserve System?

"Mr. MILLS. Yes, sir, but as in all things, authorities change as time changes, and we change with them. If I had been in constant contact with Dr. Goldenweiser, I'm sure there would have been occasions when I would have chosen to differ with him.

"The CHAIRMAN. I recall his opinion about capital stock in banks. He said capital stock was an unnecessary appendage, and one of these days when Congress takes another look at the Federal Reserve System, they'll wipe it out. They'll pay off the capital stock, because it serves no purpose at all.

"Do you recall that?

"Mr. MILLS. I don't recall that particular statement, but it is an opinion that has had currency over the years. It is, if I might say so, an academic principle by which, it could be proven that a central bank could operate without the use of privately subscribed capital, or, in fact, capitals subscribed by the National Government itself. But as a matter of tradition and as a matter of experience, it could prove-- that scheme of things could prove to be a great error." (p. 452)

"Mr. MULTER. Yes, you are talking now about the practical operation of the system. I am talking about the situation as to the rights of stockholders.

"No matter what class of bank is getting the stock, stock in the Federal Reserve bank as such carries with it no right to vote as stock usually does. In every corporation, every bank, you have voting rights that go along with the stock certificate, isn't that so?

"Mr. MILLS. The stock in the Federal Reserve bank carries a voting right, but it isn't like--

"Mr. MULTER. Only by virtue of the statute, though, not because of the issuance of stock.

"Mr. MILLS. Yes, but I mean the statute is akin to the bylaws and the charters of a private corporation.

"Mr. MULTER. That is precisely the point I make.

"Mr. MILLS. It would prescribe what the voting rights would be. In this case, it is the Federal Reserve Act.

"Mr. MULTER. And in the Federal Reserve Act, which is the charter and bylaws of Federal Reserve banks, there is no provision that stock ownership gives you a right to vote. It is membership in the System that gives you the right to vote in accordance with all the standards written into the act.

"Mr. MILLS. Except that the privilege of membership is dependent on the acquisition of stock." (p. 460)

"Mr. MULTER. Now, as a matter of fact, the law specifically says, does it not, that the stock issued by the Federal Reserve bank to its member banks is neither salable nor pledgeable; when the bank gets out of the System it must surrender--it can't sell it to anybody--it must surrender it to the System or to the bank from which it got it, and it has none of the attributes of stock certificates as we know them in banks and other corporations. Isn't that so?

"Mr. MILLS. Except for the rights that it gives for the nomination and election of these two classes of directors, and the service rights that come with qualification as a member.

"Mr. MULTER. If the section in the Federal Reserve Act which calls for the issuance of certificates of stock were changed to read that the banks--Federal Reserve banks--shall issue to the member banks a receipt for the amount deposited by the private banks with the Federal Reserve bank, it would accomplish the identical purpose that the stock certificate does?

"Mr. MILLS. Except again in the realm of tradition and principle, it would destroy the philosophic rationalization of what the Federal Reserve banks should be, destroy that rationalization and impair that tradition and unsettle confidence in the--

"Mr. MULTER. Again I want to ask you, sir, is the tradition that the private banks shall own the central bank, or that the United States Government shall own the central bank? I'm talking now about the Federal Reserve bank.

"Mr. MILLS. It isn't to be regarded as ownership by the private banks because the Federal Government has the ultimate authority and the overriding responsibility for the conduct of the Federal Reserve banks, but the private banks who have been admitted to membership in the Federal Reserve System enjoy the right to participate in the direction of the Federal Reserve banks through their authority to choose directors." (p. 461)

Governor Robertson's testimony includes the following (pp. 466-467, 468-469, 470):

"The CHAIRMAN. Do you agree with Chairman Martin that the banks have a nonproprietary interest in the Federal Reserve banks, and not an ownership?

"Mr. ROBERTSON. I think the commercial banks hold stock in the Federal Reserve banks, but all that represents, as far as I can see, is membership in the Federal Reserve System, for which they are compensated on a very good basis, as a matter of fact. They have no proprietary interest in the Federal System as such.

"The CHAIRMAN. The capital stock--Dr. E. A. Goldenweiser--you knew him?

"Mr. ROBERTSON. Yes, sir.

"The CHAIRMAN. He said that when Congress takes another look at the Federal Reserve System, we should consider that capital stock an unnecessary appendage, and that we should eliminate it like we would an unnecessary appendix.

"Do you agree with that?

"Mr. ROBERTSON. I think you could operate the Federal Reserve System without the member banks having stock in Federal Reserve banks.

"The CHAIRMAN. It doesn't serve any purpose to the Government?

"Mr. ROBERTSON. Not unless it stimulates interest in the Federal Reserve System, and I have my doubts about that.

"The CHAIRMAN. The surplus funds--you don't use those for any purposes?

"Mr. ROBERTSON. No, it has been used in the past, but it is purely an accounting matter.

\* \* \* \* \*

"Mr. MULTER. Very briefly, Governor.

"The 6 percent that is payable now on the stock by statute to the private banks because of their membership in the Federal Reserve System is a rather high return, is it not?

"Mr. ROBERTSON. It is a very good return, in my opinion.

"The CHAIRMAN. Don't you think we should do something about it? It is there by statute. The only way to change it is to have Congress legislate.

"Mr. ROBERTSON. That would be up to Congress to change it, and I think before changing it, Congress ought to make a careful study of the entire Federal System to see whether or not that particular feature of the Federal Reserve System is worth its salt, whether or not you need stock ownership and dividends on that stock in order to encourage interest on the part of the commercial banks in the Federal Reserve System. If Congress should determine that it was a useless appendage and were to remove it, I'm sure the Federal Reserve System could operate just as well without it as with it.

"Mr. MULTER. Don't you think that the Federal Reserve Board should come forward to us with a recommendation in the first instance?

"Mr. ROBERTSON. I did not hear you.

"Mr. MULTER. Don't you think that the Federal Reserve Board should come to the Congress with a recommendation on this subject?

"Mr. ROBERTSON. I am not sure that is the way to approach it, Mr. Multer. It seems to me it ought to be a part of a thorough study by Congress of the whole Federal Reserve System before you tamper with one little phase of it. Therefore, I doubt that the board of governors should come forward with a proposal dealing solely with that." (pp. 466-467)

"Mr. MULTER. And it is also true that if every bank that had a right to get out of the Federal Reserve System should get out at one time, they could do it and it wouldn't affect you?

"Mr. ROBERTSON. It would not affect a single earning asset of the Federal Reserve System.

"Mr. MULTER. It would not affect the economy of the country, would it?

"Mr. ROBERTSON. It wouldn't affect the economy, if the increase in bank reserve was offset, but it would not be good if all the banks got out, of course.

"Mr. MULTER. I appreciate that." (pp. 468-469)

"The CHAIRMAN. Now, concerning the stock, we have agreed that the stock really served no purpose. You don't operate on stock at all, and don't operate on surplus, and don't operate on reserves of the commercial banks.

"Mr. ROBERTSON. Not at all.

"The CHAIRMAN. You operate on the credit of the Nation?

"Mr. ROBERTSON. Completely so." (p. 470)

Governor Shepardson's testimony includes the following (pp. 473-474):

"The CHAIRMAN. The truth is, Governor Shepardson, and I believe you would agree, that if the Congress just said that you must deliver over \$120 million to the Treasury tomorrow, it would not affect your operations at all, would it?

"Mr. SHEPARDSON. That is right.



"The CHAIRMAN. And you could really give up the whole surplus fund and not affect your operations?"

"Mr. SHEPARDSON. On that I would raise a question, Mr. Chairman. So far as the financial operations, I think you would be correct. So far as affecting our operations--when you consider the effect on public relations, on the attitude of the people about what is considered a sound structural organization--it would have a psychological effect on the reaction of people to the condition of the central bank, if we consider the system as our organization of a central bank; and the doing away with or impairing seriously the surplus of the bank, would be more psychological than real as far as any effect on operations--"

"The CHAIRMAN. I can see where it could conceivably have a psychological effect, but of course it could not be real, because you don't operate on the surplus. You don't operate on the capital stock, either."

"Mr. SHEPARDSON. I recognize that."

"The CHAIRMAN. You have never invested either one, have you, the capital stock or the surplus?"

"Mr. SHEPARDSON. No."

"The CHAIRMAN. For all practical purposes, the surplus funds are idle and unused, aren't they?"

"Mr. SHEPARDSON. Let me say right here, as you already know, I am not a professional banker. I find some of these money problems very difficult."

"But as I understand it, when this money comes into the Federal Reserve, whether it be stock, the capital funds, or whether it be surplus, the money drawn out of the commercial stream, so to speak, into the Federal Reserve banks to all intents and purposes is nullified completely."

"In other words, it is only a bookkeeping entry of what has been turned in. To say that we have that money on the shelf, if I understand anything about this money system--it is my understanding that funds drawn into the Federal Reserve System are expunged, that those funds or credits are recreated when they go out of the System."

"The CHAIRMAN. Of course, that is what you operate on, the creation of credit."

"Mr. SHEPARDSON. That is right."

"The CHAIRMAN. Rather than any funds."

"Mr. SHEPARDSON. That is right." (pp. 473-474)

"Mr. MULTER. There is another thing that I don't quite understand, and that is what appears to be the attitude of your Board that since this is the law, when you come before us and other committees, that you ought not to come forward and make some recommendation to us.

"Each time we suggest some of these things to you, you say, well, that is the statute, if you want to change the statute, it is up to the Congress.

"Yes, it is, but we look to you for guidance, and I think you ought to come forward and give us that guidance.

"Mr. SHEPARDSON. Are you referring to what I had to say about the surplus and the capital?

"Mr. MULTER. Yes.

"Mr. SHEPARDSON. If you want my opinion, I think the Congress did an excellent job in the creation of the Federal Reserve System as it is, that it was a very happy compromise between the typical central bank of other countries and the straight commercial banks with no government bank, that we have developed something here that is unique in the history of world finance, that it is sound, and that there is an advantage in maintaining the semblance of the typical corporate structure. Even though I admit that we don't have to have that capital and surplus to operate, that does present a picture to the public that lends confidence and strength, and something that they are familiar with in other organizations and operations that they seek.

"So if you want my opinion, I would not want you to change it. I think it is good, as it is.

"Mr. MULTER. Let me ask you this, along that same line:

"While most other countries, ignoring now the totalitarian countries, have called upon your Board and have received guidance from them in setting up their own central banks, most of the free countries of the world that have set up central banks-- am I not right that in almost every instance, I can't think of a single instance in any country, outside of the totalitarian states, that has a central bank, where the central bank is not absolutely and completely owned by the government, and there is no pretense that the private banks own or operate the central bank.

"Mr. SHEPARDSON. Yes, I think that is correct. I still think that the compromise that has developed in this country in the development of this system was a wise one that, in our circumstances, has given strength to our total monetary and credit system.

"Mr. MULTER. In the main, I agree with you, but I am sorry to find that you won't go along with me that while we have taught the other countries to set up a central bank as a government institution, we continue here our original thinking of 1913, that this is really a banker's bank and not a Government bank.

"Mr. SHEPARDSON. I think that on that particular point, Mr. Congressman, there is some difference of opinion. I think we have never contended that the central bank, the Federal Reserve System, is owned by the commercial banks. On the contrary, we have taken every occasion in my knowledge to disabuse that idea. I don't contend that at all.

"The Federal Reserve System is a type of organization that was set up to give a picture of a typical corporate organization that the rest of the country would recognize. To say that it is owned by the private banks, I don't know of anyone in the System who has ever said that, and I know of many, including myself, that have tried to disabuse that idea whenever we encounter it.

\* \* \* \* \*

"Mr. SHEPARDSON. If I might describe my understanding of this stock, it is flexible membership fee, or a sliding scale membership fee.

"Mr. MULTER. Yes.

"Mr. SHEPARDSON. It is not stock in the actual sense of the word 'stock.'

"Mr. MULTER. Yes. That is a good definition. That is the way I have always looked upon it.

"And of course we have had some of the members of the American Bankers Association come before the Banking and Currency Committee and take the same view as Mr. Mills: 'Why, this is our bank. The Federal Reserve bank belongs to us, the private bankers.'

"Mr. SHEPARDSON: I have heard that and I would disagree with it." (pp. 479-480)

Hearings before House Committee on Banking and Currency on Banking on the "Financial Institutions Act of 1957", 85th Cong., 1st Sess., Part 1, July and August 1957, pp. 76, 383-384, 387, 388-390, 392-396, 451-454, 459-460. During Chairman Martin's testimony during these hearings there was considerable discussion of Federal Reserve Bank capital stock, eligibility of banks for System membership, and related matters to which page references are set out above. Chairman Martin's testimony in these respects includes the following:

"Mr. PATMAN. Mr. Martin, in view of the fact that this so-called stock, which is not stock, which the member banks claim to own, but do not own, but for which they make an involuntary investment of 6 percent of their capital and surplus but really pay in only 3 percent, since these funds from the member banks are not used for any purpose on earth, don't you think that they should be paid back to the banks in order to save the \$20 million a year interest payments on these funds? Why keep them? They are not used. They are not needed. And the amount is so insignificant in comparison to the business done by the Federal Reserve banks, it would be ridiculous to think that you would ever have to depend on that little money. Don't you think you should repay that and save that 6 percent interest charge which amounts to \$20 million a year?

"Mr. MARTIN. No, I think that it is desirable to have it as a business transaction.

"Mr. PATMAN. To make the banks feel that they have an investment in the Federal Reserve?

"Mr. MARTIN. I think it is a little bit like that gold at Fort Knox, Mr. Patman. You and I might disagree. But I think if we found that gold at Fort Knox had disappeared entirely, it would have an effect on our currency.

"Mr. PATMAN. It would shock us for 2 or 3 hours. But when we awakened we would find that our money was still just as good to pay debts and taxes, and we have enough debts and taxes to assure the money's value." (p. 76)

"Mr. PATMAN. . . .

"In all these banks most of their earnings are from Government bonds, as you have admitted, but the 12 Federal Reserve banks and the 24 branches don't touch them at all; they are in New York City handled by this one person, whom I have talked about. The money involved in these transactions is sent to the banks, or is credited to their accounts. In addition to the earnings on Government securities, the banks have some other earnings, but they are relatively insignificant.

"Now, where a bank like, we will say, Minneapolis, is making loans on Government securities entirely, you wouldn't consider that a duty that a clerk couldn't perform, would you, Mr. Martin? You wouldn't consider that a matter requiring such diligence and discretion that you should have some highly paid official doing it? Couldn't a clerk perform a duty like that, extending loans on United States Government securities?

"Mr. MARTIN. No, Mr. Patman, that is not the function of the discount window. The discount committee of each of the

Federal Reserve banks, taking Minneapolis for example, has to decide not what the security of the loan is going to be, but whether it is desirable to make the advance to the member bank.

"These are not automatic advances. There is no automatic right of the banks to get this money.

"Mr. PATMAN. I understand that.

"Mr. MARTIN. Now the Government securities, as collateral, is merely a means of procedural operation.

"There was a time when this was all commercial paper. We didn't originally contemplate having Government securities at all.

"Mr. PATMAN. That is back in the time which you were discussing a while ago.

"Mr. MARTIN. That is back in the early days of the system.

"Mr. PATMAN. That is right. They did it that way and I think it was a fine way.

"Mr. MARTIN. And they can still do it that way. In the case of some of the cotton areas, in recent years we have had cotton paper, not Government securities, as collateral for advances through the discount window.

"Mr. PATMAN. But Mr. Martin, isn't it a fact that the earnings of all the banks, the 12 banks and the 24 branches-- outside of their interest on Government securities which comes to them from the New York bank--last year amounted to about \$20 million for all the banks.

"That is what your report shows here, between \$20 million and \$23 million, I believe.

"Mr. MARTIN. If that is what the report shows, that is right."  
(pp. 383-384)

"Mr. PATMAN. Mr. Martin, according to your report, isn't it a fact that last year only  $8\frac{1}{2}$  percent of all the banks in the Dallas Federal Reserve district asked for or received any accommodation of any kind whatsoever; that is, any loan discount, or advance?

"Mr. MARTIN. I don't know what the percentages are.

"Mr. PATMAN. Well, that figures out from the information that you have supplied.

"So that leads me to this point: wouldn't it be a good thing for the Government, and in the public interest, Mr. Martin, since the public, the taxpayer, is out about \$125 million a year, to clear checks for commercial banks--to which I am not objecting, I am willing for it to be done, although it is a subsidy--I am willing for it to be done, and it is in the public interest, I believe, but why should we do it for a few banks? Why shouldn't we pay back that \$330 million worth of stock, which is called stock, and which you have already said is not stock, because there is no proprietary interest--pay that back, and then let all banks that are insured by the FDIC have the benefit and the privileges and the opportunities of using the Federal Reserve banks and their branches?

"Don't you think there is something to that Mr. Martin, that you could agree to?

"Mr. MARTIN. No; I don't think so, Mr. Patman. I think it is desirable to have a business system, and to have the ordinary checks of business methods and procedures. I don't think you can just operate in a vacuum." (p. 387)

"Mr. PATMAN. Now, of course, the Dallas bank is the lowest bank. That is the reason I picked it out, to show that in that whole big area down there, only  $8\frac{1}{2}$  percent of the banks took advantage of any accommodation they could get from the Federal Reserve in the way of loans or discounts.

"Now, up in Boston, 58.9 percent of the banks received accommodations; in Cleveland, 23 percent; St. Louis, 10 percent. I will put the whole list in.

"But the point I am trying to make, Mr. Martin, is that since the taxpayers are out this money, and it is done on the theory of a public interest--which it is--and so few of the banks, in proportion, are actually using the accommodations of the Federal Reserve System, we should use this public money in such a way that all the banks would get the benefit of it, and in that way, more of the people would be benefited by it.

"That is the point I was trying to make.

"Mr. MARTIN. I want to answer that point, Mr. Patman, as I have repeatedly.

"The name, the title of this, is the Federal Reserve System. We are not in here to solicit business. We are available at all times as a reserve institution.

"Mr. PATMAN. That is right.

"Mr. MARTIN. And I think the  $8\frac{1}{2}$  percent of the people that called on us in Dallas, we didn't solicit them calling on us.

"Mr. PATMAN: That is right.

"Mr. MARTIN. We didn't go out and actively try to get them to come in for business. But we are there for all 100 percent.

"Mr. PATMAN. You are available?

"Mr. MARTIN. We are available at all times, and that is why we have in our title, 'Reserve.'

"Mr. BROWN. Don't you treat all banks alike?

"Mr. MARTIN. We do, indeed.

"Mr. PATMAN. All member banks. Some of them you won't deal with at all. You won't even let them in the door, because they are not members. You don't accommodate the nonmember banks, do you?

"Mr. MARTIN. They can all become members.

"Mr. PATMAN. Well, in effect they get the benefit of the checking privilege through correspondents, don't they?

"Mr. MARTIN. They do, indeed.

"Mr. MULTER. Do they pay for that privilege?

"Mr. MARTIN. No, they don't.

\* \* \* \* \*

"The CHAIRMAN. What qualifications are required of a bank to become a member of the Federal Reserve System?

"Mr. MARTIN. If they have passed their State qualifications and are willing to subscribe to the capital of the Reserve bank, they are eligible and admitted almost automatically. We review them, and they have to agree to our examining them, and they have to agree to become a part of the System and then they are eligible for the services that anyone else is eligible for.

"The CHAIRMAN. Very few banks would not be eligible if they desired to become members?

"Mr. MARTIN. Practically none. In some instances, State banks find it costly to become members because the Reserve requirements are a little more stringent with us than the State requirements.

"Mr. Hexter will comment on that in detail.

"Mr. HEXTER. Mr. Chairman, formerly there were specific requirements of law specifying the amount of capital that a bank had to possess in order to become a member of the Federal Reserve System.

"In recent years that provision of law, in section 9 of the Federal Reserve Act, was changed so that at the present time a bank may be admitted to membership if, in the judgment of the Board of Governors of the Federal Reserve System, its capital structure is adequate in relation to the nature of its business and the amount of its responsibilities, deposits, and so on.

"Mr. MULTER. Isn't there one additional requirement as to capital, that it must have the same capital as required of a national bank in that community?

"Mr. HEXTER (reading):

PROVIDED, That no bank engaged in the business of receiving deposits \* \* \* which does not possess capital stock and surplus in an amount equal to that which would be required for the establishment of a national banking association in the place in which it is located, shall be admitted to membership unless it is, or has been, approved for deposit insurance under the Federal Deposit Insurance Act.

"So that if it has been approved for insurance, the requirement that the amount of capital shall equal that required for a national bank in the same situation is not applicable.

"Mr. MULTER. As a matter of practice, the Federal Deposit Insurance Corporation will not insure that bank unless it brings its capital and surplus up to the requirements of a national bank in the same community, isn't that so?

"Mr. HEXTER. I believe that in very few cases, if any, has the capital been less than that. Because ordinarily the minimum statutory requirements for national banks' capital are lower than the requirements actually imposed by the Comptroller of the Currency in chartering national banks. The statutory minimums are rather low in these cases. So the question does not arise." (pp. 388-390)

"Mr. BROWN. Mr. Martin, I think it would be very helpful if you describe the present arrangements with respect to the ownership of the stock of the Federal Reserve banks. What are the advantages of this ownership, as compared with ownership by the Federal Government?



"Mr. Martin. Well, I think the advantages are in that it provides a means for the election of class A and B directors. The stock is a business transaction. Each Federal Reserve bank is organized as a corporation. We pay 6 percent dividends on that stock, and we could call--we have only called 3 percent of it, but we could call the entire amount.

"But it is now set up as the organization of any corporation, and this is a means--and I think a very useful and effective means--of providing for the participation through A and B directors, which are elected by the stockholding banks. Private participation to that extent, but without control.

"I think we have tried to do just what Senator Glass was talking about in that passage that you read to me earlier.

"Mr. Multer. Will you yield?

"Mr. Brown. I yield.

"Mr. Multer. In further clarification of this point, actually the stock which is issued by the Federal Reserve bank to its member banks, is not negotiable, it is not transferable, it is not salable, it is not--it can't be hypotheticated, am I right?

"Mr. Martin. That is right.

"Mr. Multer. It is a certificate that merely certifies to the member bank that it has on deposit with the Federal Reserve bank a certain amount of dollars.

"Mr. Martin. That is right.

"Mr. Multer. Now, I think you said that only part of that-- I am wrong when I say it certifies that it has a certain amount on deposit. It certifies that it can be required to pay into the Federal Reserve bank a certain sum of money which is subject to call by the Federal Reserve bank.

"Mr. Martin. That is right.

"Mr. Multer. And you said only half of that has been called.

"Mr. Martin. That is right.

"Mr. Multer. And half of that is still outstanding.

"Mr. Martin. That is right, and could be called.

"Mr. Multer. And the dividend is payable on what, the total amount of subscription or only on the part that is paid in?

"Mr. Martin. Only on the part actually in existence.

"Mr. Multer. And if the State member bank is under the restrictions of State laws against subscribing to or owning such stock, instead of buying that stock or subscribing for it, it deposits with you the equivalent amount of what it would be required to subscribe for as stock, and instead of getting a dividend on stock, it gets interest on its deposits, is that right?

"Mr. Martin. I don't know the State laws.

"Mr. Multer. No, this is the Federal Reserve Act I am talking about. There are some States that say that a State bank cannot buy stock in another bank, even in the Federal Reserve bank. In those instances the law permits you to, and you have, I believe--and correct me if I am wrong--you have actually taken deposits in lieu of stock subscription and paid interest instead of dividends.

"Mr. Martin. I don't know. I would have to look it up. But it has been worked out in every instance so that they can participate.

"Mr. Multer. Yes, sir, so they either get a dividend or they get interest.

"Mr. Martin. Right.

"Mr. Multer. And in every instance it is the same. If the bank wants to get out, or the Federal Reserve Board puts the bank out, the stock, if it is stock, is canceled, and the money paid back or the deposit is returned.

"Mr. Martin. That is right.

"Mr. Multer. And the membership ends.

"Mr. Martin. That is right.

"Mr. Multer. Now, as to the voting of the stock, the member who has no stock but has a deposit in lieu of stock, has the same voting rights as a member who owns stock, isn't that so? The statute requires it. I assume you follow the statute?

"Mr. Martin. I don't know how we worked out the technicality of it, but it amounts to the same thing.

"Mr. Multer. Yes, sir, so that the member bank, whether it has a deposit or stock, has the same voting right, so they all have the same voting right?"

"Mr. Martin. Yes, sir."

"Mr. Multer. Now, the voting right, however, is not dependent upon the amount of deposit or stock, so that the bank that owns a million dollars worth of stock has no more vote in electing members of the Board of that particular Federal Reserve bank than a member that has \$100,000 worth of stock. Am I right on that?"

"Mr. Martin. Well, your A and B directors, you see, are divided into 1 representative of the large banks, 1 of the medium-sized banks, and 1 of the small banks."

"Mr. Multer. The point I am making is each bank has only one vote in any category."

"Mr. Martin. In that category, that is right."

"Mr. Multer. All the banks in class A have only one vote for class A directors, and so forth."

"Mr. Martin. That is right."

"Mr. Multer. And all the banks in class C have only one vote."

"Mr. Martin. Class C directors we appoint."

"Mr. Multer. You are right. I am wrong. That is correct."

"So that as to class A and class B directors, that would apply, whereas, if this were a private bank or corporation, for every share of stock I owned, I would have a vote, so that I could attain, if I had enough stock, control the election of the Board, unless there was cumulative voting."

"Mr. Brown. That is very helpful to the little banks, Mr. Multer."

"Mr. Multer. I agree. I am not finding fault with it. I just want the record to show what is being done."

"So that if, instead of selling stock to all of your member banks, you simply required them all to carry these reserves, and called as much of it as you needed, of the 50 percent, now, with the right to call more, and paid interest on what you got, and gave them the right to vote, you would accomplish the same thing as with this paper you call a stock certificate, which is really not a stock certificate. You could accomplish the same thing by giving them the right to vote, apart from any stock ownership."

"Mr. Martin. I think you could. But I still think that this procedure is a good one.

"Mr. Multer. I am not saying it is not a good procedure. But I am trying to indicate clearly on the record that you don't need this stock arrangement in order to give every bank the right to vote, which they have today, and you don't need this arrangement in order to give them either their dividend or their interest on whatever amount they deposit with the Federal Reserve bank.

"Mr. Martin. I agree. You could set up an entirely different system and do the same thing. But I happen to be a little bit prejudiced in favor of this way of doing it.

"Mr. Multer. Because of its traditional use.

"Mr. Martin. Mr. Hexter would like to comment.

"Mr. Hexter. Mr. Multer. I believe the provision you had in mind with respect to a deposit in lieu of stock is one with respect to mutual savings banks in certain circumstances.

"Mr. Multer. That is correct." (pp. 392-394)

"Mr. Patman. Mr. Martin, isn't it a fact that on this so-called stock that each member bank deposits with the Federal Reserve System an amount equal to 3 percent of the member banks' capital and surplus?

"Mr. Martin. That is right.

"Mr. Patman. Now, the amount goes up or down with changes in the capital stock and the surplus of the banks, doesn't it?

"Mr. Martin. That is right.

"Mr. Patman. There is no certain amount. It just goes up or down?

"Mr. Martin. That is right.

"Mr. Patman. And that stock cannot be sold, as Mr. Multer brought out, and cannot be hypothecated?

"Mr. Martin. That is right.

"Mr. Patman. And it cannot be voted except according to the rules that you explained to him.

"For what purpose is that money used, Mr. Martin? Can you name one purpose for which that money is needed, except as you

said, that it creates a good relationship with the banks and makes them feel they are part of the System. Outside of that, what purpose does that capital stock serve?

"Mr. Martin. I don't think it has any purpose at the moment. I think originally it was part of the organization capital of the Federal Reserve banks.

"Mr. Patman. To set up the Reserve banks?

"Mr. Martin. Certainly.

"Mr. Patman. But now it is not needed at all, is it?

"Mr. Martin. I think we could get along without it today.

"Mr. Patman. All right." (p. 396)

"Mr. Multer. The moneys that are deposited by the members of the Federal Reserve System, with the Federal Reserve banks, which are the moneys paid on their subscriptions to the stock, are immobilized almost to the same extent as their reserves, are they not? That money is held by the Federal Reserve bank, and it is immobilized the same as you immobilize the reserves. Am I right?

"Mr. Martin. Yes, sir, that is right.

"I think the point was made here in discussing those stock subscriptions--Mr. Patman made the point--that in the early days those stock subscriptions were part of the organization, the corporate organization of the banks, and they could have been used for operating expenses or anything else at that particular time, by the System.

"As time has gone on, they have become an insignificant amount of money against the general operations.

"I don't think that is any justification for eliminating them.

"Mr. Multer. I am not suggesting that we eliminate them.

"Mr. Martin. I know you are not, but I am just making that point. To me, that has nothing to do with their elimination.

"Mr. Multer. Well now, the reserves that are carried by the banks with the Federal Reserve System carry what interest or compensation to the banks which deposit those reserves?

"Mr. Martin. No interest.

"Mr. Multer. No interest at all?

"Mr. Martin. No interest at all.

"Mr. Multer. Then why should they get any interest or dividends on the moneys which are deposited as part of their stock subscriptions?

"Mr. Martin. Well, that was just an ordinary business transaction. Originally, they purchased this stock just as you could buy stock on the exchange, and this stock, you must remember, was also to be available to the public. In the original Federal Reserve Act, if there had not been sufficient, it could have been sold to the public. There never was, and I am glad it wasn't. But it was an ordinary transaction, and the business procedure--you can discount business procedures and practices and say they shouldn't be followed when you are engaged in Federal public practice, but I think they serve a very real purpose, and I think that it should be followed.

"Mr. Multer. Can this stock be sold to the public today?

"Mr. Martin. I don't believe the law has ever been changed on that, has it, Mr. Hexter?

"Mr. Hexter. The provision with respect to public sale is still in the act, but the conditions under which it could be exercised do not exist at the present time. I believe that provision, which I have not had occasion to review, since there has been no use for it, provided for sale to the public in the event that the necessary capital could not be obtained from member banks, and of course the Federal Reserve banks' capital is far in excess of the required minimum.

"Mr. Multer. What if any change is recommended in this bill as to that?

"Mr. Martin. I don't think there is any recommendation made on that point.

"Mr. Patman. I think there is a recommendation to leave it out, as something that should be left out in the recodification as obsolete. I think that is what is in the bill.

"Mr. Martin. That it is an obsolete provision?

"Mr. Patman. I think it is construed as an obsolete provision.

"Mr. Martin. Construed as an obsolete provision.

"Mr. Patman. That is my understanding

"Mr. Martin. That is right.

"Mr. Multer. If existing law is continued in the proposed bill, will you go along with the suggestion that an amendment should be made to the law so as to eliminate the possibility of the stock being sold to the general public?

"Mr. Martin. I think we could, yes. I wouldn't have any objection to that.

"Mr. Multer. Now with further reference to this stock which is presently owned by the member banks, if we don't eliminate completely the provision for payment of dividends on that stock, would it not be much fairer to limit the payment of dividends on that stock to the amount of the average earnings on Government bonds during each dividend period? In other words, if the average being paid by the United States Government on bonds is 3 percent during the dividend period, to pay them 3 percent; if it is 4 percent, pay them 4 percent; if it drops back to 2 percent, which we hope it will sometime, pay them 2 percent.

"Mr. Martin. I would see no reason for changing the original contract that they enter into. The money would be just a drop in the bucket, Mr. Multer.

"Not that any money is a drop in the bucket, but the amount would be negligible. It would just add to the necessity of having bookkeeping adjustments made periodically, and I wouldn't see any purpose being served by it." (pp. 451-452)

"Mr. Multer. Nonmember banks do get the services of the Federal Reserve System as to clearing their checks, at least, by clearing through member banks; do they not?

"Mr. Martin. That is right, through the correspondent banking system.

"Mr. Multer. Is there any charge made to the nonmember bank by the member bank for that service?

"Mr. Martin. I don't know. Mr. Leonard is the head of our Department of Operations.

"Do the nonmember banks made any charge for that service?

"Mr. Leonard. It is my understanding, Mr. Multer, that no direct charge as such is made; that the city correspondent banks, or the correspondent banks in the other areas provide that service for their customers, their correspondent banks who maintain accounts with them, and that the account they maintain with the correspondent bank serves as compensation for that service.

"Mr. Multer. Are there any banks in the country today that are charging for the clearing of checks?

"Mr. Martin. Yes, sir; there are some nonpar banks.

"Mr. Leonard. I think, Mr. Multer, there are two points there.

"One is the clearing of checks, and the other is an exchange charge.

"In general, banks analyze the deposit accounts that are carried with them and see that the account is large enough to justify the business for them, and in their analysis they would figure that it costs them so much to handle checks for this depositor, and that he should maintain with them a corresponding account, or that they might, in some cases, make a service charge for that to large companies as well as individuals.

"On the other side of the picture, there are, as you know, some 2,000 banks in the country that charge exchange on checks drawn on that bank when they remit for them to the bank that sent the check.

"Mr. Multer. There is no control over those charges by the Federal Reserve Board, as to either member or nonmember banks?

"Mr. Leonard. No, sir.

"Mr. Multer. Shouldn't something be put in the statute to give you the right to regulate those charges, at least as to member banks?

"Mr. Martin. Well, if they violate any sound practice or anything of that sort, we could interfere at any time.

"Mr. Multer. You mean, make a recommendation?

"Mr. Martin. No; we would talk to them about it. I don't think we would have any problem with that.

"Mr. Multer. Well, when you talk to them about it, if you think the charge is an improper charge, you would make a recommendation that they change the charge, would you not?

"Mr. Leonard. Mr. Multer, Mr. Hexter has a copy of the law there, and I think that there is a provision in the law that limits the charge that a bank can make.

"Mr. Multer. May we have the citation, Mr. Hexter?" (pp. 453-454)



"Mr. Hexter. You asked earlier for the provision in the Federal Reserve Act relating to fixing of maximum charges for collection or payment of checks. That is contained in the first paragraph of section 13, Federal Reserve Act, and reads as follows--

\* \* \* \* \*

"Mr. Hexter. It is the proviso at the end of that first paragraph, which reads:

PROVIDED FURTHER, That nothing in this or any other section of this Act shall be construed as prohibiting a member or nonmember bank from making reasonable charges to be determined and regulated by the Board of Governors of the Federal Reserve System, but in no case to exceed ten cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise, but no such charges shall be made against the Federal Reserve banks.

"Mr. Multer. With reference to that section, there isn't any doubt, Mr. Martin, but that these banks that are carrying the demand accounts that do not earn enough for the bank to warrant the service deposits and honoring those checks, that in those cases they charge the depositor for the service, as this provision permits the bank to do.

"Mr. Martin. They are not very good bankers if they don't.

"Mr. Multer. So there isn't a bank in the country, if it is a good bank, that doesn't have a net return to them from the use of the demand accounts." (pp. 459-460)

CERTAIN OTHER MATTERS

Hearings before House Committee on Banking and Currency on H. R. 7230, "Government Ownership of the Twelve Federal Reserve Banks," 75th Congress, 3d Session, March and April 1938. In testifying on this bill, which, among other things, would have required the sale of all Federal Reserve Bank stock to the Treasury, Chairman Eccles said that "Ownership of stock by member banks does not enable the bankers to control the Federal Reserve System. It is more nearly in the nature of a compulsory capital contribution than stock ownership." (p. 446)

As to another feature of the bill, Chairman Eccles said that "The proposal ... to offer all the privileges of membership to nonmember banks so long as they choose to keep their reserves in a Federal Reserve bank would remove all incentive to become members of the System." (p. 447)

"American Monetary Policy," by Dr. E. A. Goldenweiser, 1951, pp. 294, et seq., states that, while politically unanswerable, the practical answer to member bank ownership of Reserve Bank stock is simple. "...In effect, it is more in the nature of a compulsory (and, at the 6 per cent dividend rate, a profitable) contribution by member banks to the Reserve Banks' capital funds than of an active proprietorship. Consequently, the ownership of Federal Reserve Bank stock makes little difference. The public relations aspect of the problem could be met by changing the name of the instrument from 'stock' to 'permanent contribution.' ... If the movement for nationalization should become politically important, however, the best policy would be to arrange for repayment to the member banks of the face value of the stock, and for the operation of the Federal Reserve Banks without capital. Their surplus is such that this would in no way hamper their operations."

Board's Replies to Questions of the (Patman) Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report on "Monetary Policy and the Management of the Public Debt," 82d Congress, 2d Session, Part 1, January 1952, pp. 261, 262. The Board's answer to the Subcommittee's question No. 10 was as follows:

"The Federal Reserve Banks are corporate instrumentalities of the Federal Government created by Congress for the performance of governmental functions. They have been variously described by the courts as 'important agencies of the Federal Government in its control of banking and currency', and as governmental agencies under the direction of the Federal Reserve Board.

"In the report of the House Banking and Currency Committee on the original Federal Reserve Act, Chairman Carter Glass stated that the Federal Reserve Banks would have 'an essentially public character'. Their public nature is indicated by the governmental character of the functions assigned to them by the law and by the fact that in the exercise of these functions they are subject to general supervision and control by the Board of Governors of the Federal Reserve System.

"Among their many important public functions, the Federal Reserve Banks engage in open market operations under the direction of the Federal Open Market Committee; establish discount rates, subject to review and determination of the Board of Governors; extend credit accommodations to member banks; act as the medium for the issuance of Federal Reserve notes which constitute the bulk of the currency now in use by the public and also as the source of supply for other forms of currency and coin; hold the reserve balances of their member banks; exercise supervisory and examination functions with respect to State member banks; provide an expeditious mechanism for the collection of checks; and act as fiscal agents of the United States and play a vital role in the practical handling of the public debt and in carrying out other Government financial operations.

"The fact that a corporation is created and utilized by Congress as a public instrumentality for the performance of governmental functions, however, does not necessarily make it a 'department' of the Government. Thus, the old Banks of the United States, although public corporations created to perform governmental functions, were not regarded as a part of the Federal Government. In a case involving the Second Bank in 1824, Chief Justice Marshall observed that, though the Government held shares in that Bank, 'the privileges of the Government were not imparted by that circumstance to the bank.' There are other more recent examples of corporate instrumentalities of the Government created for public purposes, such as the Federal Land Banks, which have been distinguished from the Government itself.

"As a consequence of the public nature of the Federal Reserve Banks, ownership of their stock does not carry with it the same attributes of control and financial interest usually attached to stock ownership in private corporations. The amount of Reserve Bank stock which a member bank must own is fixed by law in relation to the member bank's own capital and surplus. Such stock may not be transferred or hypothecated. Ownership of stock entitles the member banks to no voice in the management of the affairs of the Reserve Bank other than the right to participate in the election of six of the nine directors of the Reserve Bank. As the result of the election procedure prescribed by the Federal Reserve Act, each member bank votes for only two of the nine directors. Under the law, dividends on Federal Reserve Bank stock are limited to 6 percent per annum; and in the event of the liquidation of a Federal Reserve Bank, any remaining surplus would be paid to the United States.

"Ownership of Federal Reserve Bank stock by member banks is an obligation incident to membership in the System-- in effect, a compulsory contribution to the capital of the Reserve Banks. It was not intended to, nor does it, vest

"in member banks the control of the Reserve Banks or the determination of System policies. Such control would obviously be inappropriate in view of the functions exercised by the Reserve Banks.

"Stock ownership by the member banks has certain definite advantages. It provides a wide decentralized base for the organization of a Federal Reserve Bank. The element of member bank interest, though without control has contributed to a breadth of judgment and experience on the part of the Reserve Bank directors in evaluating questions of public policy and has helped to foster efficiency and business-like methods in the operations of the Reserve Banks as public institutions. It gives to each member bank a tangible interest in, and direct connection with, the Federal Reserve Bank of its district, and this has real psychological value. It helps to create in member banks a greater interest in the affairs of the System and understanding of its purposes and operations than would be the case in the absence of such ownership.

"In view of the positive advantages in System operation of the present plan of stock ownership and in the absence of serious disadvantages, it is believed that a change in this arrangement would not result in any substantial improvement in System organization or functions. The direct relationship between the Reserve Banks and the member banks makes possible a maximum of cooperation between commercial banks, business enterprises, and the Government in the attainment of the public objectives for which the System was created."

Hearings before the Patman Subcommittee on General Credit Control and Debt Management were held in March 1952. During the appearance of Governor Powell at the hearings on March 19, 1952, the following colloquy occurred between Congressman Patman and Board's General Counsel, Mr. Vest, on the matter of taxability of dividends on Federal Reserve Bank stock (Hearings, pp. 480, 481, and 910):

"Representative Patman. All right. Now, the banks get 6 percent on this stock. On this 6 percent, do they pay income taxes, like other people?

"Mr. Vest. The banks?

"Representative Patman. The commercial banks I am talking about. They get 6 percent on their stock investment.

"Mr. Vest. Yes, sir. Up until March of 1942 the dividends on that stock were not subject to taxation.

"But in March of 1942 Congress passed a law amending the law of 1941, providing that income from all obligations of any agency of the United States would thereafter be taxable.

"Since that time--or, rather, any stock issued since that time is subject to tax on dividends on the stock.

"Representative Patman. Now, I have a memorandum here and I think it was obtained from, if not your office, someone connected with the Federal Reserve Board, which gives the information that there is a total amount of \$237,000,000 in stock outstanding to the commercial banks and of that stock \$139,000,000 was issued prior to December 3, 1940, and since that time there has been an increase of \$98,000,000.

"You mean to say, then, if these figures are correct, that the \$98,000,000 has a tax paid on the 6 percent dividend each year, but there is no tax paid on the \$139,000,000?"

"Mr. Vest. On the dividends on that stock, that is correct.

"Representative Patman. That is, the \$139,000,000?"

"Mr. Vest. That is correct.

"Representative Patman. Well, is that not kind of unusual, I wonder why----

"Mr. Vest. It results, I think, Mr. Chairman, from the language of the statute which was passed in 1942.

"Representative Patman. Has the Board ever called that to the attention of Congress or asked it be changed?"

"Mr. Vest. I do not recall they have.

"Representative Patman. A lot of the bankers I know are hard against these tax exemptions; they are hard against them and, of course, I do not blame them, they should be against exemptions, you know, for private industry making profits and not paying taxes.

"I wonder why they would accept the tax exemptions here in a case like that--it has never been called to the attention of Congress?"

"Mr. Vest. I do not believe so, sir.

"Representative Patman. And the Board has never taken any action on it?"

"Mr. Vest. No action that the Board could take up--we did take it up with the Internal Revenue, to get their viewpoint.

"Representative Patman. Their interpretation of it?"

"Mr. Vest. Yes, sir." (pp. 480, 481)

In connection with the "Financial Institutions Act of 1957," the Board recommended to the Senate Committee on Banking and Currency that the law be amended to make dividends on Federal Reserve Bank stock taxable regardless of when the stock was issued. (Letter of September 28, 1956, from Chairman Martin to Senator Robertson, Board recommendation 56.) This recommendation had been made also by the Patman Subcommittee in its Report in July 1952 (Senate Doc. 163, 82d Congress, 2d Session, pp. 61-62). However, the "Financial Institutions" bill (S. 1451) as passed by the Senate in March 1957 did not adopt this recommendation.

The Patman Subcommittee Report in July 1952, pp. 59, 60, reviewed the various aspects of "private ownership" of Reserve Bank stock and concluded that it saw "no reason" for any change. In making this conclusion, the Subcommittee said:

"The private ownership of the stock of the Federal Reserve banks, then, is one of those anachronisms which, although it has lost its original significance, lives on because it continues to be practically useful. One of its functions is to serve as a memo from Congress to itself that it has chosen to leave to the System a great deal of autonomy in its day-by-day and year-by-year operations. This is so because, as long as the private ownership continues, the System will not be amenable to the ordinary techniques of detailed Congressional control.

"The private ownership of the stock of the Federal Reserve banks also serves as a practical and well-understood link between the System and the private business community, and has been of great help in obtaining the services of able men as directors of the Federal Reserve banks. In theory, an equally effective link might be established by other means--as by the election of local advisory committees--but a newly-established link would not enjoy the sanction of tradition and it would be difficult to devise one which would conform so well to the mores of the business and financial communities." (p. 60 of the Report)

Jerome W. Shay  
May 6, 1960