The CHAIRMAN. That is what I understood, but I wanted to make it clear.

Governor ECCLES. Yes; the member and nonmember banks.

Mr. CROSS. You do admit that the dollar as it is today, untied to any price level, is no measure of value, do you not? In other words, its purchasing power is constantly expanding and contracting?

Governor ECCLES. That has always been true.

Mr. CROSS. You have an exact measure of length, for instance, in the linear foot; and you have an exact measure of weight in the pound. You also have an exact measure of volume in a cubic foot. But you cannot measure volume by weight. You might have two cubes of exactly the same dimensions, one made of cork and one of lead, but if you attempt to measure them by weight you would not get any idea about it at all, would you? That is a simple question, it seems to me. I am talking about the simple question of measure. You could not get any idea as to the size of those two cubes by using the measure of weight, per pound, could you?

Governor ECCLES. No.

Mr. CROSS. One would probably weigh a hundred or a thousand pounds more than the other.

Now, you attempt to measure the value by the pure unit of weight, do you not, with so many grains of gold, for instance?

Governor ECCLES. I do not think that a fixed gold content results in stable prices.

Mr. CROSS. I do not think it does either.

Governor ECCLES. It never has in the past.

Mr. CROSS. I do not think so, but we put the price at $35 an ounce, whereas it used to be $20.67.

Governor ECCLES. That is right.

Mr. CROSS. So it is no measure of value, is it?

Governor ECCLES. I do not think so.

Mr. CROSS. Now, the only way to get a measure of value is by a price level; do you not think so? Do you have any other suggestion as to a measure of value outside of a price level?

Governor ECCLES. Do you mean by some index figure?

Mr. CROSS. Yes; or some wholesale commodity price level.

Governor ECCLES. That gives you a measure of value, but it is not what you want.

Mr. CROSS. It does give a measure of value, does it not?

Governor ECCLES. Yes; it does give a measure of value.

Mr. CROSS. Now, if you would tie your monetary unit of the dollar, as we call it in this country, to the price level, you would get a measure of value, would you not?

Governor ECCLES. I do not know just how you would tie a monetary unit to the price level.

Mr. CROSS. I say, if you do do it.

Governor ECCLES. Yes; if you can.

Mr. CROSS. I am saying, if you can you would get a measure of value. As it is, you have not any measure of value. Do you know of any other method by which you could approach a measure of value?

Governor ECCLES. I think that a stable price level is a desirable objective.

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Mr. CROSS. I know; we are talking about the price level. What other way is there?

Governor ECCLES. I should not say that I know of a way to get a stable price level, and at the same time get a stable business condition, which is a condition of full employment and prosperity.

Mr. CROSS. Of course, that is what we all want to do, if we can. Let me ask you this question: As the result of this instability, fluctuation, expanding, and contracting in the purchasing power of the dollar, and consequently affecting the earning power of a dollar, credit, or credit money, or check money is very sensitive, timid, and easily affected by any economic disturbance, is it not?

Governor ECCLES. I do not think that check money is more sensitive than any other money.

Mr. CROSS. All right. Any kind of money is sensitive, is it not; any other money, like legal tender?

Governor ECCLES. Yes; that is right.

Mr. CROSS. If you can stabilize it on a price level, it will become a dependable measure of value and relieve credit from the instability and constant fear to which it is now subject, will it not?

That is, if a man knows that he will know that he will have a dollar to spend in the aggregate, and would take into consideration the figures you use in determining the wholesale commodity price level, and he knows it will hold up the purchasing power and the value, would not that tend to stabilize and give confidence?

Governor ECCLES. I think it would.

Mr. CROSS. The only method by which we know how to do that are the levers you have in this bill, rediscount and open-market operations.

Governor ECCLES. Open-market operations, yes; that is right.

Mr. CROSS. Now, with those three levers, do you not think you could approximate holding the purchasing power of the dollar stable with the price level?

Governor ECCLES. Insofar as that can be done through monetary action, I think you could accomplish that.

Mr. CROSS. We know of no other action——

Governor ECCLES. In that connection let me read a short statement I have here which seems to me to cover this question.

Professor Olin, a Swedish authority—and they have possibly had more experience in this question of managed currency——

Mr. CROSS. He has not had a long experience because this just started recently.

Governor ECCLES. That is true of the entire world. As a matter of fact, as to the problem of central banking and money management, there is plenty to learn about it. There is no country which has had any experience for any great length of time.

Mr. GOLDSBOROUGH. There is plenty to unlearn about it, is there not?

Governor ECCLES. About the question of managed money?

Mr. GOLDSBOROUGH. About the way to handle central banks. Can you answer that?

Governor ECCLES. I do not know enough about the history of central bank operations. Of course an automatic gold standard has been a guide in the operation of the world's banking system in the past, up to the time of the war.

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Mr. CROSS. Controlled banking, was it not?

Governor ECCLES. Very largely.

Mr. CROSS. I wish you would read that book written by an Englishman.

Governor ECCLES. This man says, after surveying the Swedish experiment in an article in index, volume 8, that—

> A business cycle policy that aims at as full and regular a utilization of the productive forces as possible, that is a maximization of the real national income per head of the population over a long period, is bound to take many other factors into account besides the development of prices; that is to say, it can not be based on the idea of stabilizing any particular price level, especially if the latter has been brought by an immediately preceding depression, but of equilibrium with the other parts of the price system.

Mr. GOLDSBOROUGH. Which means that there are two factors: One is the factor of a scientific monetary system and the other is the factor of distribution of production. That is what he is talking about, is it not?

Governor ECCLES. That is right; I agree with that.

Mr. CROSS. My idea is that this bill is all right, except that there are two amendments we ought to have.

I think it is up to Congress to provide for the regulation of the value of money, through our agent, which is the Federal Reserve Board.

And since, as I think I showed here yesterday, the member banks are in the business of making money, and the 12 Federal Reserve banks have that idea, too, and as Governor Harrison, of the New York Federal Reserve Bank, said, the very time the Federal Reserve Board wants to hold down inflation or credit, the banks insist on expanding it, and the very time the Federal Reserve Board wants to boost credit, the banks tend to shrink and contract it. As long as they own the stock of the Federal Reserve banks, with their class A and class B directors, with all those influences working, I am afraid there will be cross-purposes, and I think they should be in a position, without any outside influence, to act for the whole people all the time. That is why I believe that the stock should be taken over and owned by the Government in those Federal Reserve banks.

Another amendment which I think should be adopted is this: I think we ought to give them a goal to work to. It is the best we have got; it might not be a perfect compass, and no doubt is not by any means; yet I think we ought to have some kind of a price level, whether you take 50 or 100 commodities, or 784, or use the economists' index, we ought to have some goal set for them to anchor on. We can try it, and if it does not work we can change it.

I notice that England has let the pound slide down, no doubt with the idea of getting constantly under our dollar, giving her the advantage. I think we ought to take 20 percent above the wholesale commodity price level of 1926. If we take that and go very little below that, I think we should do it, because if England or any other country is constantly trying to slide under us and cheapen their money to give them an advantage in the export trade, I think we should be in a position where we can follow along with them.

But I am sold on the question of tying the dollar to the price level within a certain latitude.

Then I will tell you another thing I think about this bill, at least in connection with the psychological effect. You have 40 cents on the

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dollar back of the Federal Reserve note, and I think if you would make it, say, 35, and provide, say, for 10 cents in silver certificates, you would be taking a wise step.

I realize if you can have stabilized and controlled currency you do not need any metal at all, except as a matter of foreign traffic. But as long as the balance of trade is in our favor we do not even need that because they have to be constantly buying money to pay for our goods.

Of course, if we become an importing nation and the balance of trade is against us, we would have to use a different currency.

Governor ECCLES. As to this question of fixing the price level in the bill, I personally would not like to see that. I would suggest that, in lieu of a fixed price level, something of this sort might be put in the bill, as indicating the direction or objective to which the Federal Reserve Board would be required to reach:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. CROSS. That is a lot better than what we have in there now.

Mr. GOLDSBOROUGH. Would you feel like including in that a statement indicating that the Board should also direct its attention toward using its power in such a manner as to absorb the unemployment? You have done that in a way, but it is not quite clear.

You know there are experts who I think are worthy of attention who claim that you can use monetary powers in such a way as to absorb unemployment to a certain point, and that when you do that you then have notice that you have raised your price level to the proper position.

I am wondering if you could put some sort of legislative direction as that in what you have said. I think myself you have done very, very well in what you just pointed out as a possible amendment.

Governor ECCLES. I am trying to avoid a rigid requirement in the law that may be impossible of accomplishment, and hence may cause embarassment. I would like to see enough flexibility in the law; because I do not believe that we can deal with our money, economic and social problems, and they are all interrelated, as an exact science. You have too many emotional factors to contend with, and when you talk about the problems of business stability, stable prices, full employment, and so forth, you have to take into account factors other than purely the mathematical or mechanical factors of money.

Mr. GOLDSBOROUGH. Will you read that proposed provision again?

Governor ECCLES. It says:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. GOLDSBOROUGH. You are stating the objectives.

Governor ECCLES. That is right.

The CHAIRMAN. The present law was designed, of course, to promote sound business conditions and laid down a guiding rule of policy somewhat along the line of your suggestion, although not so comprehensive.

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Under the present law the language is:

The board of directors shall administer the affairs impartially—

And so forth—

and extend accommodations such as may be safely and reasonably made, with due regard to the claims and demands of other banks, and to the requirements of industry, commerce, and agriculture.

It is not so comprehensive, but it is in the law, and to a certain extent it is a recognition of the ends to be desired.

Personally, my view is that you have expressed the true policy, and that is to take the general results that would be desired as the guide and standard of activities.

In connection with Mr. Cross' inquiries, what is the relation between actual currency, or Government currency, or Government money, and check money and its velocity?

Governor ECCLES. So far as their functioning and purchasing power are concerned, there is no difference. They serve the same purposes as a means of payment. Currency is used largely as a matter of convenience in meeting pay rolls, in retail buying by the man with a small income, where the checking account is too expensive, or is not wanted. Even in cases where checking accounts are used, particularly is it true now with service charges and the check tax, people will cash checks for a larger amount and pay bills with currency rather than pay all bills with small checks. The use of the check has been greatly diminished.

The CHAIRMAN. What I am undertaking to develop is the necessary part that must be played by actual money in the present scheme.

Governor ECCLES. I do not know that I quite understand you, Mr. Steagall.

The CHAIRMAN. We cannot get away entirely from the use of actual money, even though we do 90 percent of our business by the use of bank checks.

Governor ECCLES. That is right. We possibly use the bank check more than any other country.

The CHAIRMAN. As we cannot rest our banking structure entirely on air, we have to have a basis for that. What I am directing your attention to and asking you to discuss is the proper basis, and the necessity for it; how far the development of a sound bank-check currency must rest upon the use of actual currency and the opportunity to redeem the bank check in actual currency.

Governor ECCLES. Of course, a bank has to be in a position to pay its deposits in currency. At one time it was required to pay it in gold, and of course we know what trouble that got us into. The bank is required to pay the deposit in currency. We found that, while banks were closing and the great deflation was going on, that a great many people and corporations wanted their deposits in currency, to such an extent that the amount of currency outstanding passed the all-time record of the use of currency, even when business was very active. It exceeded over seven billions of dollars, at a time when our business activity was about 50 percent of what it normally is, showing that a very substantial amount of that currency was not drawn out for current or immediate use but was drawn out for fear of loss through bank failures, to be held in safekeeping. We must prevent bank failures so far as is humanly

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possible. When people found they could get their money if they wanted it, confidence was reestablished in the banking system, and the amount of currency outstanding greatly diminished.

The CHAIRMAN. You say we got into trouble under the system under which we had to redeem everything in gold. Just what do you mean by that?

Governor ECCLES. I mean that when people demanded payment in gold, since gold was used as a reserve for our money system, it did not take the withdrawal of very much gold to force a suspension of gold payments and to put an embargo on gold.

The CHAIRMAN. Let me ask you this question, "Were we forced to suspend gold payments?"

Governor ECCLES. Yes; I think we were, not only because of withdrawals but also because of our price and debt structure and the measures that were absolutely necessary to correct it.

Mr. CROSS. Gold was leaving the country very rapidly, was it not?

Governor ECCLES. Yes; it was leaving the country very rapidly; not only that, but it was being drawn out by corporations and individuals at a rapid rate.

The CHAIRMAN. When we suspended payment we had an unprecedented amount of gold on hand, did we not?

Governor ECCLES. At the time we suspended we had lost a great deal of gold.

The CHAIRMAN. We had lost a great deal of gold, but we still had more than half of the world's gold, did we not?

Governor ECCLES. No; we had about 40 percent of it.

The CHAIRMAN. But we had certainly something like a third—an undue proportion of the world supply.

Governor ECCLES. But at the rate at which it was being drawn out it was evident that we might soon reach a position where it would be necessary to dispense with gold payments and put an embargo on, and therefore, why permit a preference to those people and corporations who demanded payment in gold?

The CHAIRMAN. Had we not always been able, by the use of Government credit, to get our hands on all the gold we needed to redeem the outstanding gold obligations? I do not mean it was a desirable thing to do; far from it; that is not my view of it. I am simply stating the facts.

Governor ECCLES. We had panics in the past where we could not even pay in currency, up until the time we got the Federal Reserve System set-up. I remember the panic of 1907, when they suspended payment in currency and used clearing-house certificates.

The CHAIRMAN. There was not any difficulty in redeeming the currency in gold, was there? Of course, we have always had occasion when quite a number of banks could not pay out any kind of money because they could not get it. But there never was any time in those situations when there was any difficulty about exchanging currency for gold, if you wanted it?

Mr. GOLDSBOROUGH. In the panic of 1873 the gold reserve was depleted.

Mr. CROSS. And there is always a vast difference between dollars and commodities. The whole world was trying to get back, and the whole world was scrambling for it.

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The CHAIRMAN. I am speaking about what did happen when Mr. Cleveland was unable to get gold.

Governor ECCLES. I think he negotiated a loan with Mr. Morgan.

The CHAIRMAN. As a matter of fact, we maintained our gold standard with $150,000,000, did we not? That leads to this question: I am not one of those who think that our gold-standard system was ideal; that is one of the things I think it might be said we had to unlearn. Whether we have learned anything or not, I will not attempt to say.

But I think it will be agreed that is one of the things we have unlearned.

But I was going to ask you this question: Why was it we could not redeem in gold? Why could we not go along with that system? Why was it not safe to continue it? That is what I am talking about.

Governor ECCLES. For the reason that——

The CHAIRMAN. Is not this the fact, Governor, that the trouble was there was not enough gold?

Governor ECCLES. Of course, there was not a fraction of enough gold in this country or in the world to meet the gold obligations.

The CHAIRMAN. We did not have enough gold.

Governor ECCLES. Not a fraction of enough to meet the obligations, but that is always the condition. It works all right so long as no questions are raised about redemption but in case of panic there is not enough gold and payments have to be suspended.

The CHAIRMAN. Let me ask you another question. Was not that the chief difficulty with the banks when they found themselves in the situation where they could not meet their obligations in currency, that the currency was too scarce?

Governor ECCLES. No; the currency was not scarce, because the banks had assets with which they could go to the Federal Reserve System and get credit, and they could have drawn down currency. There was no shortage in the amount of currency available to a bank, if the bank had assets acceptable to the Federal Reserve bank.

The CHAIRMAN. That is the point. The fact was they had deposits, as you have said, I think, amounting to 26 billion, or say 25 billion in round figures, that were in the nature of demand obligations. But they had only a trivial amount in comparison to their deposit obligations of assets upon which they could apply for and obtain actual currency; is not that right?

Governor ECCLES. That is right.

The CHAIRMAN. And the fact was, as against 25 billion dollars of demand-deposit obligations for which the banks were responsible, they had only in the country something like 5 billion dollars in which to meet that responsibility. And for all their cash obligations in the Nation they had only such a portion of actual cash that they could have paid, plus their discountable or rediscountable paper, and the amount of rediscountable paper had gotten to the point where it was trivial as compared with the amount of obligations they had.

Governor ECCLES. Oh, yes; and the amount of rediscountable paper, even in 1928 or 1929, was only a fraction of the total deposit liability.

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The CHAIRMAN. As a matter of fact, the banks now owe deposit obligations that I believe you say amount to about 25 billion.

Governor ECCLES. That is, demand obligations.

The CHAIRMAN. The amount has increased from 19 billion to 25 billion of demand obligations outstanding against the banks?

Governor ECCLES. That is right.

The CHAIRMAN. And they have available today to meet those demands something like three-quarters of a billion dollars of actual money; is not that about right?

Dr. GOLDENWEISER. You mean cash in vaults?

The CHAIRMAN. Yes.

Dr. GOLDENWEISER. That is about right.

The CHAIRMAN. That is what I am talking about. That is a fair way to state that position, is it not?

Dr. GOLDENWEISER. No.

The CHAIRMAN. Of course, they have in addition to the cash available to them their privilege of obtaining currency on their assets, which is still limited to a certain quality of assets.

Governor ECCLES. Besides the cash value which they have in their vaults, they have their balances in the Reserve banks, which are the equivalent of cash, the reason being that they can draw down currency against those balances with the reserve banks, and those balances today are over 4 billion dollars.

The CHAIRMAN. Then they would be entitled to have Federal Reserve notes issued.

Governor ECCLES. That is right; against those balances.

The CHAIRMAN. That is, their excess balances?

Governor ECCLES. They are required, of course, to carry a minimum balance.

The CHAIRMAN. But they could not utilize that.

Governor ECCLES. They could draw down their currency against their excess balances, but they would be penalized if their balances were below the legal requirements.

The CHAIRMAN. Which, of course, means that the legal requirements could not be utilized, as a practical proposition.

Governor ECCLES. Yes. It could be utilized subject to the payment of a penalty for any deficiency in reserves.

The CHAIRMAN. So they would be limited to their excess balances and their cash on hand, and such paper as they would have upon which they might obtain currency.

Governor ECCLES. That is right.

The CHAIRMAN. Does it not follow that the banks found themselves in difficulties in undertaking to meet their demand obligations growing out of the scant supply of actual currency, as compared with the demand upon that supply, not alone by the banks but demands from various sources in the Nation?

Governor ECCLES. The banks found that they were unable to meet their deposit liabilities in currency because of the lack of assets which the Reserve banks would accept. That reduced the amount of currency that they were able to pay out, and the very fact that many of them were unable to meet that demand caused the whole Nation to want to convert their deposits into currency.

As soon as the people found that they could get their deposits in currency, as the result of the emergency banking act of 1933 per-

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mitting the banks, not only the member but also the nonmember banks, to get credit, and hence currency from the Reserve banks upon all of their sound assets, the people of the country did not want their deposits in currency. The reverse action developed and the currency which they had wanted when they thought they could not get it began to come back into the banks and increased the deposits of the banks by an amount of from a billion and a half to two billion dollars.

So that it seems to me that the lesson that that experience should have taught is that the Federal Reserve Board should have some discretionary power in the making of rules and regulations that will permit the Federal Reserve banks to accept the sound assets of banks and thus stop what otherwise would be a repetition of what we have had in the way of a credit contraction and the reduction of our deposit money.

The CHAIRMAN. Governor, it is unquestionably true that we have, to a large extent, restored confidence in the banks, and money in hoarding, and no doubt considerable sums that have been withdrawn for legitimate uses, because of the distrust of the banks, has been returned to the banks.

But does not that result mainly from the insurance of bank deposits?

Governor ECCLES. I think that is a very important fact.

The CHAIRMAN. Let me ask you another question.

Governor ECCLES. I think that is particularly——

The CHAIRMAN. We will not have accomplished much, no matter how fully we accomplish that, if we only succeed in restoring confidence in banks so that the public will leave its funds in banks for safekeeping.

That would be a thing to be desired, and it seems to me a thing which the public has a right to expect, but that would be a long way from accomplishing what we need in this country, to bring about a revival and recovery of normal business conditions; is not that right?

Governor ECCLES. Yes; that is right.

The CHAIRMAN. It is a fact, is it not, that we did find the banks in a condition where their demand obligations were so great that they had no way on earth, with the limited amount of cash or currency available to them, to meet their demand obligations. Even though a bank might be solvent, the practical situation was that there was no way for the bank to get enough currency to meet its demand obligations. That was the situation that existed in many cases, was it not?

Governor ECCLES. That is right.

The CHAIRMAN. That is the situation that confronts us and for which we must find a remedy if we are going to make it possible to bring about business recovery and the normal use of banking credit to support business in the United States; is not that right?

Governor ECCLES. That is right.

The CHAIRMAN. And this is also true, is it not, that the emergency plans embodied in the emergency legislation which we passed in

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1932 have certainly failed to accomplish those desirable results, have they not?

Governor Eccles. I think that is the only conclusion one could reach, from the present evidence.

The Chairman. Those provisions are so hedged about, even though under the law, under the act of 1933, as it was finally written by an amendment that extended to nonmember banks the privilege of having their sound assets treated as eligible for advances by the Federal Reserve banks, and as a basis for the issuance of currency, the rules and regulations were so hedged about, the law being a temporary measure, and being tried out as an emergency measure, was not enough to reassure the banks that they were free to go ahead and use their credit facilities freely for the support of business and to promote recovery.

Governor Eccles. An abundance of excess credit is available in the banking system. Excess reserves are sufficient at the present time for the banking system, as a whole, to extend credit to an amount in excess of 20 billion dollars, without the banking system as a whole having to use its rediscount facilities with the Reserve System. Interest rates are at possibly an all-time low level. The discount rates of the Reserve banks have been steadily reduced until at the present time none of the banks have a rate in excess of 2 or 2½ percent.

The amount of the excess reserves held by the banks, the low discount rate, and hence the low rates that are prevailing for commercial paper, for high-grade bonds, industrial and municipal, and for Government securities, are indicative of the excess supply of money and credit in relation to the demand for it, on a basis largely of short-term credit.

In order to expand the use of money which is necessary for recovery, either those holding deposits in banks must be willing to spend their funds, which would increase the velocity of the total existing deposits, or borrowers who can command bank credit must be willing to go to the banks and borrow funds which they will spend, or a combination of both is necessary.

If, in the first instance, owners of funds spend their funds, you would get an improvement in business through an increase in the velocity of the existing deposits. If new loans are made you would then get an increase in the volume of money as well as an increase in the velocity of money. In the absence of an increase in the velocity of the funds held by the banks, or an increase in the volume of private credit extended by the banks, the Government has been required to inject into our system through using its credit an increased flow of funds. Government spending has the same effect as private spending. It is somebody's income. Every one's spending is somebody else's income.

The Chairman. Let me ask you a question right there. Do you think Government spending has the same effect as private spending? Do you think you want to adhere to that statement upon reflection?

Governor Eccles. From the purely monetary standpoint——

The Chairman. As far as the actual transaction is concerned; but as far as the psychological effect is concerned, and the effect

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upon a lot of men who want the money spread into their business, it would be a different matter would it not?

Governor ECCLES. It may be. It is, of course, desirable to have private spending instead of having Government deficits.

The CHAIRMAN. In that connection, let me ask you this question: In reference to the matter of farm-land values, we have put a certain amount of support under farm-land values by the assistance that has been extended by the Government. But the average citizen who might have some idle cash and might want to invest it for his children does not know how long that policy will continue, or when that support will be withdrawn, and in such an event, what effect it would have on bank values. But if this support was given in a normal way so a citizen would expect it to be maintained and to endure, he would have a different mental attitude toward the situation, it seems to me.

Mr. CROSS. The difference, as I see it, is that money put up by the Government in enterprises that would not come in conflict with the activities of private business would cause those who receive wages from that activity with the Government to spend money with the merchants and others, but it does not affect the feeling or help the condition. Everybody feels like the Government has to quit sometime somewhere, and therefore they remain nervous.

If private enterprise should take up this unemployment people will feel as if that is natural and normal. If you could get prices to where private enterprise could make a profit, I do not see how the credit you are talking about will be used, because neither the fellow will borrow, nor would the bank be foolish enough to loan; but you have to get prices to where a man can get a loan and can sell his products and make a profit and pay it back. Of course, that means the employment of labor, and that means spending power.

I know we are in a jam, and it is hard to get out. Of course, we can dig and dig, and get right back to where we find ourselves in the mud. But I do believe if we could get prices back we will be going ahead.

Governor ECCLES. The only way you could get prices back is through increasing the means of payment in the hands of the people who will spend faster than you increase production. To get them back any other way means to get them back through an artificial restriction of production or the fixation of prices, which are not desirable ways to get prices up. In other words, to raise prices and reduce production does not add anything to the national wealth.

Mr. CROSS. We are in this situation. You have a fixed indebtedness on the people. You say that Tom, Dick, and Harry own these buildings in this city. They do not. In the courthouse you will see a paper title in their names. But there is a mortgage against it, and under present prices, with the taxes they have to pay, they do not own anything. They are mere interest-paying tenants. That is all they are, struggling like the dickens to pay their rent to the fellow who owns the mortgage.

The dollar has so increased in its purchasing power that it takes twice as much for him to get the necessities and comforts that he has than he had to pay before, and with the taxes he has to pay now

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he is up against it. Unless we can get it to where he can pay back with the same kind of dollar that he borrowed, I do not see anything ahead but a general liquidation, and possibly a revolution.

Governor Eccles. Of course, there are two ways out of depressions, it seems to me. One is through the process of liquidation and bankruptcy.

Mr. Cross. Then there may be a revolution.

Governor Eccles. The other is through an inflationary process. We went through a period of liquidation and bankruptcy as a result of allowing nature to take its course until we had extinguished a third of our deposit-money supply and until we had 15 or 16 million people out of employment, and until the quoted values of the resources of America were less than the debt. In other words, we liquidated down to a point where we had created a condition of general insolvency as measured by the ability of the people through the national income to support the debt structure.

The deflation was finally stopped because of the unrest and because of the suffering caused thereby and because it not only was affecting the debtor but the creditor was equally affected. The corner of completing the job of deflation was so hot that it could not be turned, and there was only one other course open. In order to save the system of capitalism and to maintain order, the Government was forced to step in, even under Mr. Hoover.

The first effort was made through the organization of the Reconstruction Finance Corporation, not for the purpose of directly relieving unemployment but for the purpose of using Government credit to support, through further debt, the railroad system, the banking system and the insurance structure, all of which was very necessary to support.

That action did not meet the problem of unemployment. It was an effort to support the private credit structure through the use of Government credit.

That action, plus similar actions by the Government through other credit agencies which have been set up and have not been inflationary—I mean the Home Owners' Loan Corporation, the Farm Credit organization, and the Reconstruction Finance Corporation—stopped deflation. The greatest portion of Government credit which has been used during the depression is not of an inflationary nature, because it is simply a question of transferring the debt from where it is to a Government agency.

The Chairman. And by that process it did stop deflation?

Governor Eccles. Yes; that process stopped, or at least checked deflation. The condition of inflation has to come about through the increase in the volume and velocity of money either by Government spending or by private spending, or by a combination of both.

Mr. Ford. Would not " reflation " be a better term?

Governor Eccles. Yes. The difficulty is that so many people, when you say " inflation ", think it is something unsound; they think of worthless money. What I mean is that a rise in the general price level, in employment, and improvement in the business situation, from wherever it is, would be inflation, no matter how small the extent.

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The CHAIRMAN. Let me suggest that you just use the word politely and call it "expansion."

Mr. CROSS. They deflated until they got into this condition. Now, if you go back to where we were, would we not simply be reflating, or expanding?

Governor ECCLES. "Expanding" or "reflating"—I do not care what the term is. I think it is a question of what is meant.

Mr. CROSS. It ought to be controlled?

Governor ECCLES. Absolutely; it is very important, of course, that it be controlled, and with the private banking system, with the excess reserves now available, if the credit expansion should commence and continue with the use of the present existing reserves, you could get a business activity and a price level substantially higher, I think, than we had in 1926, 1927, 1928 or 1929. You would have an increase in your total deposit money; or, in other words, your total deposit money would be increased beyond any amount that we ever had before.

Mr. CROSS. We know that, Governor; but do you not think that by these levers that have been put in this bill, as you have it, by your control over the reserves, the rediscount rate, and so forth, you could take the situation in hand any time so that you could control it?

Then, too, is it not much easier to control inflation, to stop things from going up, than to stop deflation after it has once started? As one of the Governors who testified here before told us, whenever you attempt to stop deflation, it is the hardest problem with which you have to deal.

Governor ECCLES. I think that the control of inflation is a far less difficult problem than the control of deflation. We have had a good deal of talk for a year or two about the fear of inflation. If there was any real fear of inflation, it would be evidenced by an increase in equities. Stocks would be going up instead of down, high-grade bonds would be going down instead of up, and the interest that would be paid on long-term municipal, Government, and other securities would be increasing rather than decreasing. Likewise, real-estate values would be rapidly increasing, and rents would be going up.

In other words, if there were a fear of inflation that we hear so much talk about, money would be shifting from deposits into things, and there would soon come a demand for increased credit, because it would be profitable, with things going up, to use credit to buy things.

Mr. CROSS. Every time a statement is given out, purporting to come from the White House, that there is or will be no inflation, down drops the stock market and everything else.

If you have any influence over there, I wish you would stop them from doing that. [Laughter.]

Mr. FORD. Is not the situation that you are describing there one of fear on the one hand and cupidity on the other? In a deflationary period, everybody is shivering; and in a boom period, everybody is overconfident and wants to get more. As I said, you have cupidity on the one side and fear on the other. You step from one stage to the other, do you not?

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I am not criticizing that cupidity; that is human nature; but that is what it amounts to.

Governor Eccles. You have, of course, a lack of confidence on the part of a good many people, and a timidity; but on the other hand, if they feel sure of inflation, that these things are going up, the natural result is that they would buy things in order to make a profit.

The Chairman. It is 12:30, and I think that this would be a good time to recess.

Governor Eccles. I would be glad to have the Federal Reserve furnish to the members of the committee mimeographed copies of the first 3 days' hearings.

The Chairman. That will be very helpful. We will appreciate it.

Governor Eccles. And also, when I have finished here, or the hearings have been finished, I will be glad to furnish the members of the committee with a complete brief, just as I have it here, of every phase of this legislation.

The Chairman. All right.

We will meet at 10:30 tomorrow morning.

(Thereupon, at 12:30 p. m., a recess was taken until Thursday morning, Mar. 14, 1935, at 10:30 a. m.)

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I am not criticizing that stupidity; that is human nature; but that is what it amounts to.

Governor ECCLES. You have, of course, a lack of confidence on the part of a good many people, and a timidity; but on the other hand, if they feel sure of inflation, that these things are going up, the natural result is that they would buy things in order to make a profit.

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BANKING ACT OF 1935

THURSDAY, MARCH 14, 1935

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. The committee will come to order. Mr. Eccles, you may continue your statement. Mr. Cavicchia desires to ask you some questions.

STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Continued

Mr. Cavicchia. Governor, I think the other day I asked you to tell me the amount of mortgages held by member banks. I understand that amount has already been inserted in the record, namely, $2,270,000,000.

Governor Eccles. Yes; that is right.

Mr. Cavicchia. The bill before us, as I understand it, authorizes the national banks to lend on amortized mortgages up to 75 percent of the appraised value; am I correct?

Governor Eccles. That is the limitation put in the bill; but I made the recommendation that the Federal Reserve Board be given the power to make rules and regulations governing mortgages to be taken by member banks, in lieu of the 75 percent and 60 percent limitations in the bill.

Mr. Cavicchia. What do you mean by 75 percent and 60 percent?

Governor Eccles. Seventy-five percent of the appraised value of the property and 60 percent of the amount of the time deposits.

Mr. Cavicchia. One of the reasons given for the banks' inability to meet the demands of the depositors, Governor, in this crisis we have been going through in the last 5 or 6 years, was the fact that they had so much of frozen assets on hand. Do you not think that if you give authority to the banks to lend on mortgages on a higher percentage than they have been loaning on heretofore that you will make it still harder for them to meet the demands for payments in case we should have another crisis?

Governor Eccles. I feel that the liberalization of the mortgage provision should be considered in connection with the modification of the eligibility changes in the legislation. It seems to me that unless the eligibility provision be liberalized, permitting the Federal Reserve banks to loan on sound assets in order to meet conditions of deflation, then the banks should be prohibited from loaning on

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5-year 50-percent mortgages. They should be prohibited from loaning on or purchasing any bonds the maturity of which runs beyond 6 months or a year.

Mr. Cavicchia. You think that it is the short-term mortgages that add to a feeling of fear?

Governor Eccles. No; what I think is this, that the banks, having only 12 percent of their loans and investments eligible in 1929, and those eligible assets not equally distributed throughout the banking system were not able to meet a substantial contraction of credit without many of them being forced to the wall and without forcing the payment of loans as they fell due.

There should be no more objection to the long-term amortized mortgage as proposed in the bill than to the 5-year straight 50-percent mortgage, which has been permitted for a period of 20 years, or to the investment in securities of all kinds without regard to maturity.

It is interesting to note as to the banks which closed throughout the country, and I understand that it has been shown by investigation, that the greater number of bank failures was in the area—and this is according to Federal Reserve districts—where the smallest amount of real-estate mortgages were held by the banks. The area where the larger percentage of real-estate mortgages was held by the banks was where the percentage of bank failures was the smallest.

It is found that the investment in securities—in bonds—has a very close relationship to bank failures.

Mr. Cavicchia. That leads me to ask you this question: I think you will agree with me that the decline in the value of real estate has amounted to perhaps 25 percent or more during this crisis as compared with what it was in 1923, 1924, and 1926. Do you agree with me on that?

Governor Eccles. Yes; I think there is an average deflation of real estate of at least 25 percent.

Mr. Cavicchia. So that if a bank loans up to 75 percent of the appraised value on a mortgage, and then there should be a depression, that 25 percent equity would be wiped out overnight, would it not?

Governor Eccles. It would be wiped out over the period that it took to bring about a deflation of that amount.

Mr. Cavacchia. It will not be as good a security as a mortgage based on 50 percent, because if there is that difference there will still be a leeway there.

Governor Eccles. I think that is correct, with this exception: That in the case of the 50-percent straight mortgage, which is now permitted, the owner——

Mr. Cavicchia. What do you mean when you say "which is now permitted"?

Governor Eccles. The law now permits a mortgage of 50 percent of the appraised value—up to 50 percent of the time funds.

Mr. Cavicchia. Is that in the law now?

Governor Eccles. That is in the law now, and it has been there for 20 years.

Mr. Cavicchia. You say "time funds"?

Governor Eccles. That is right.

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Mr. GOLDSBOROUGH. I think you are mistaken about the 20 years. I know that Mr. Steagall and I fought the inclusion of a more liberal provision in the banking act for years and years, and I have only been on the Banking and Currency Committee for 15 years.

The CHAIRMAN. We liberalized the provision in the McFadden Act of 1927.

Governor ECCLES. You might have liberalized it, but they have been making real-estate mortgages for 20 years. I was incorrect in stating that the present provision has been there for 20 years.

Mr. GOLDSBOROUGH. They were not allowed to carry real-estate mortgages before 1926.

Governor ECCLES. There is a provision in the original Federal Reserve Act.

Here is the provision of the original Federal Reserve Act:

SEC. 24. Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land, situated within its Federal Reserve district, but no such loan shall be made for a longer time than five years, nor for an amount exceeding fifty per centum of the actual value of the property offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

Mr. CAVICCHIA. That was confined to farm lands, as you read it.

Governor ECCLES. Yes.

The CHAIRMAN. Just a moment. This seems to be chasing niceties rather than principles. Dr. Goldenweiser, can you give us off-hand the history of this legislation?

Dr. GOLDENWEISER. I think Mr. Wyatt can answer that question.

Mr. WYATT. I cannot give you the details off-hand, but that section has been amended a number of times and all the amendments were in the direction of greater liberality. The last extension of it was in the McFadden Act of February 25, 1927.

Mr. GOLDSBOROUGH. My memory is that Mr. Steagall and I fought that for years and years and years, and finally we were steamrollered in 1927. I also know that this Congress has spent a large part of its time in the last 2 years bailing out the banks that accumulated these real-estate mortgages over our protest.

Mr. WYATT. That section was amended twice: Once by the act of September 7, 1916, which was in the direction of greater liberality, and authorized loans on city real estate as well as farm land. It was amended again by the McFadden Act of February 25, 1927 which authorized loans on city real estate for 5 years, instead of 1 year, removed the prohibition against banks in certain reserve cities making any real-estate loans, and increased the aggregate amount of real-estate loans which might be made by any national bank from one-half of its time deposits to one-third of the savings deposits.

Mr. CAVICCHIA. When we talk of 1-year mortgages, it does not mean that they will be called in at the end of 1 year. If the people will pay their interest and the property is kept up, the mortgage is permitted to run along; am I correct or not?

Governor ECCLES. I think that is true.

Mr. CAVICCHIA. That is the general practice, is it not?

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Governor ECCLES. That is the general practice, in connection with most loans, whether real estate or otherwise.

Mr. CAVICCHIA. I am only cognizant of what takes place in my own State. I know of savings institutions——

Governor ECCLES. The borrower usually pays a commission, however, each time the loan is renewed, and he is always in the position of never knowing——

Mr. CAVICCHIA. That is not true in New Jersey. The savings institutions make their mortgages for 1 year. They never pay a bonus for getting the money. The mortgage is never renewed. Under our law it may continue, even though it is for a 1-year period. You will find mortgages that have been on some pieces of property for 15, 20, or 25 years. As long as the people pay their interest, they run on. They do not have to be renewed.

It does not cost them a nickle, except in the case of some mortgage companies, where some 5 or 6 years ago they got into the habit of writing short-term mortgages for 3, 4, or 5 years. When those mortgages expired, they did have to be renewed, which caused extra cost to the borrower, and sometimes a great deal of trouble in having them refinanced.

Let me ask you one more question in connection with the mortgages. I take it that the reason you are liberalizing the mortgage clause in this banking bill is that you are hoping to be able to provide mortgage money, which has been very scarce during the last 6 years. Am I correct about that?

Governor ECCLES. That is partly true. We had this in mind.

The commercial banking system has over 10 billion of time funds. Those time funds, or savings funds, in the commercial banking system are the equivalent, so far as the people are concerned, of funds held by the mutual savings banks in the New England and New York areas.

Either the banks are going to use those time funds in the long-term lending field, either long-term bonds of various kinds, or long-term mortgages, or long-term Government financing, or they are going to have to stop paying interest and give up those time funds.

If a bank is confined to its loans to eligible paper, in order to be liquid, then the only other avenue for investment of its funds would be Government bonds. That would mean at the present time that 8 percent of the total loans and investments of the banks would be commercial paper, and the 92 percent would be Government securities. This would mean that the Government, through its agencies, would be doing the lending business, furnishing long-term credit, which it is largely doing today, and the banks which hold the funds of the people would be furnishing the Government the funds by purchasing Government bonds or bonds guaranteed by the Government. That is the trend today.

As a matter of fact, 44 percent of the assets of the banks are now Government bonds, or bonds guaranteed by the Government, and I see no——

Mr. CROSS. Long-term deposits?

Governor ECCLES. Forty-four percent of the loans and discounts; that is, the investments of the banks represent Government bonds.

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What I am trying to do is to put the banking sytem in a position where it can furnish long-term credit to the communities, just as the mutual savings banks and savings and loan associations do with the time-funds which they have.

If banks are not to be in a position to compete in that field for loans and investments of that sort, then it seems to me that they are put up against the problem of the use of these funds, which they hold and which are greatly needed to bring about an improvement in business conditions.

As I indicated yesterday, the income velocity of our existing funds was about two, whereas in 1926, 1927, 1928, and 1929 it was over three. Of if we had the same velocity of our deposit money that we had during that period, our national income would be at least from 20 to 25 billions more than it is.

But it is the stagnation of credit, the stagnation of funds, that continues, it seems to me, to retard business recovery. As to the extent to which an easing of credit by the use of long-term mortgages or on the amortized basis, and the liberalizing of eligibility requirements would bring about the use of that credit, nobody, I think, is in a position to say.

Mr. CAVICCHIA. I think you will agree with me when I say that whether they be national banks or State banks, or mutual savings banks, they have a lot of money on hand at the present time and are not loaning it; am I correct?

Governor ECCLES. That is right; they have excess reserves.

Mr. CAVICCHIA. The savings banks or the mutual banks which are now permitted under State laws to loan money on mortgages up to 50 percent of the appraised value are not loaning any, or very little, money at the present time.

Do you think, if this act were passed, that the national banks would do what the mutual banks are not doing now—lend money on mortgages?

Governor ECCLES. The mutual banks are lending money on mortgages in certain sections. The insurance companies are lending on mortgages, and one of the first things this act would do would be to enable the banks which now hold over 2 billion of mortgages, many of which are in excess of 50 percent of the appraised value——

Mr. CAVICCHIA. That is because of the drop in the market?

Governor ECCLES. That is right. Therefore, they are forced to collect on the mortgages, and Congress is appropriating money for the Home Owners' Loan Corporation, the Federal Farm Mortgage Corporation, and the R. F. C., to take up these mortgages.

The banks are not in a position to hold many of the mortgages that they may have for the reason that their mortgages are in excess of 50 percent, and they are due.

I would like to see the banks required to hold the mortgages they have and refund them on a long-term basis, requiring amortized payments with reduced interest. Instead of going through the process of changing the form of the obligations they hold, they have to substitute for their own loans obligations guaranteed by the Government.

Not only that, there are many State nonmember banks which, if they should come into the Federal Reserve System, would have more than 50 or 60 percent of their time funds in mortgages. In many sections the banks are permitted to loan in excess of 50 percent; and, if there is a liberalization of the mortgage feature, the bill will make

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it less difficult for the nonmember banks to come into the Reserve System.

If we are going to proceed on the assumption that we are going to have great cyclical booms and depressions, depressions that can extinguish 30 percent of our deposit currency and can reduce the national income by one-half, then I say that there is no way you can set up a banking system that will serve the money needs of the country and at the same time be prepared to meet that kind of a catastrophe. Liquidity in deflation can only be provided by the Federal Reserve System.

Mr. GOLDSBOROUGH. You mean as long as we are on this fractional reserve basis of 10 percent? Is that what you mean?

Governor ECCLES. Yes.

Mr. GOLDSBOROUGH. Of course, when you have an accordion and just blow the air in and out, you are right, but you do not have to have that system.

Governor ECCLES. Of course, it seems to me we do not have any alternative at this particular time without a very revolutionary change in the whole banking set-up. The 100-percent reserve idea would, of course, eliminate the 10 to 1 ratio. But that is another story.

Mr. CAVICCHIA. Governor, am I right in saying that one of the main reasons why this provision is in the law is to encourage the banks to hold onto the mortgages that they have now, because otherwise they would have to resort to foreclosure, because their mortgages are no longer on a 50-percent basis on account of the big drop in values?

Governor ECCLES. I would say that is true in some cases, and I would say that is one of the constructive effects. The other constructive effect would be that the banks are put in a position to do what the R. F. C. and other Government agencies are now doing.

There apparently is no demand for short-term commercial credit. The business of this country is largely done by concerns with an adequate working capital. But there does seem to be some demand for longer-term credit, and there is no prospect of getting any building activity without providing long-term credit at low interest.

The English have provided 30-year credit for home construction on 80 percent of the value of the property at 4½-percent interest, and that is done by the private savings institutions.

The most unsound type of mortgage credit is the straight loan that we have had in this country. It means that the borrower, the builder, will get a straight 50-percent loan from the banks and insurance companies, and then a second-mortgage loan will be financed elsewhere at ruinous rates, until the cost of the mortgage money, considering the first-mortgage cost and the second-mortgage cost, has made the financing cost of the property ruinous to the home builder and the home owner. The amortizing payments were to be made over a period of time on the second mortgage. The first mortgage became due and it was expected, of course, that the full amount would be renewed.

Mr. CAVICCHIA. Governor Eccles, I appreciate the fact that there are many definitions as to what constitutes centralized banking. One of the charges made about the bill that is before us now is that it tends to centralize banking.

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Is this so, or is it merely regulatory in the sense that this bill tends to do away with the great disparity heretofore prevailing between the national and State banks?

Governor ECCLES. Which part of the bill are you referring to? Title II does not deal, it seems to me, with the problems of national and State banks, except by giving the Board the right to waive the present legal requirements for membership of nonmember State banks.

Mr. CAVICCHIA. I mean in the strict sense that centralized banking is used. This is not a bill aimed to centralize authority in the Federal Reserve Board, is it?

Governor ECCLES. It centralizes some authority in the Federal Reserve Board. The authority that is being centralized through this in the Federal Reserve Board is the authority over open-market operations.

The Board at the present time has authority over the discount rate, and subject to the approval of the President, under the emergency act, has the authority to change reserve requirements by declaring an emergency.

This bill is proposed to place in the Board, with the advice of the governors, the third function of monetary control, that of open-market operations, which, at the present time, is in the committee of governors, subject to the approval of the Board, and then subject, finally, to the decision of the twelve Federal Reserve banks as to whether or not they will participate in the program recommended by the governors and approved by the Board.

Mr. CAVICCHIA. Does that leave the different Federal Reserve banks in different districts to operate independently, if they wish?

Governor ECCLES. It leaves them to operate independently; and that is not changed. The question of extending credit to member banks is left with the credit division of each Federal Reserve bank.

It has been stated that the changing of eligibility requirements would cause the Federal Reserve banks to be loaded up with long-term mortgages. It seems to be assumed that the Reserve banks would discount these mortgages or any slow assets that they may choose to take, during the life of such assets.

In the first place, whether or not credit will be extended to a member bank, and upon what basis, will be determined by the regional Federal Reserve banks, which are responsible for the credits extended to member banks. The Board will only make the rules and regulations governing the basis upon which credit can be extended, and it is proposed here to give the Board power to liberalize the basis upon which the Reserve banks can extend credit to the member banks. The occasion for the extension of credit arises when the reserves of the banks get below the legal requirement, and they find it necessary to borrow to build up the reserves.

Mr. CAVICCHIA. The other day you showed the members of this committee a chart, showing the conditions in England. This chart seems to show that there is no relation between the price level and the increase or decrease in employment; am I correct about that?

Governor ECCLES. That is correct.

Mr. CAVICCHIA. Although we have been proceeding on the theory in this country that if the price level goes up wages will increase and unemployment will decrease; am I correct in that?

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Governor ECCLES. You say we have been proceeding on that theory? I do not know what you mean by "we."

Mr. CAVICCHIA. There are certain economists; everything that this Administration has done in the past 2 years—and I am not criticizing the Administration; I do not intend to be partisan; but it has proceeded on the theory that if the price levels went up wages would go up and unemployment would decrease. But the chart showing conditions in England seems to negative that assumption.

Governor ECCLES. That is correct.

Mr. CAVICCHIA. Governor Eccles, the Canadian banks, I am told, are not permitted to make mortgage loans, and in depression times they are not met with the problem of frozen assets. Is this one of the reasons why they have had no bank failures in Canada during this depression?

Governor ECCLES. I do not accept the assumption that a mortgage is any more of a frozen asset during deflation than nearly any other asset of the bank. The assets become frozen when every banking institution wants to dispose of its assets to meet the demands of its customers for money. The only liquidity that can be provided for a banking system is through the central bank.

The Canadian banking system is a very different structure than the American banking system. In the first place, they have very few very large banks, and the creditor area—the eastern section of Canada supplies the credit to the debtors of the interior provinces of Canada. I have been told that the interior sections of Canada, had they not been tied into the creditor or eastern section of Canada, would have had the same kind of bank trouble that we have had in this country; that it was the eastern section which was really furnishing the funds to develop the interior areas that enabled the system to carry through.

The Canadian system had only a fraction of the credit contraction that we had in this country. Had our credit contraction been 13 percent, as it was in Canada, we would not have had the banking collapse that we had.

The credit contraction in the British banks during the depression was practically negligible. The total amount of deposit money and currency outstanding all during the period of the depression in Great Britain remained almost uniform. Things might have been different here also, had our Federal Reserve System been in a position to loan against sound assets. The demand for money would have ceased—that is, the demand for currency—because we know that when people were able to get their currency after the bank holiday they did not want it, and currency came back into the banks instead of continuing to go out of the banks.

Mr. HOLLISTER. You said Canada had very, very few very large banks. You mean she only has a few very large ones.

Governor ECCLES. That is right.

Mr. HOLLISTER. It sounded as if you meant there were a lot of little ones.

Governor ECCLES. I mean that they have few very large banks, but they have a large number of branch banks.

Mr. HOLLISTER. I thought you might want to clear that up.

Governor ECCLES. Yes; I thank you.

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Mr. Cross. You say that in England they did not have trouble with currency to take care of their deposits. Are the assets upon which those banks loaned money broader than ours? Can they loan upon any sound paper, where we are limited in that respect?

Governor Eccles. Are you referring to central banks—that is, the new Canadian Bank and the Bank of England—or are you referring to the commercial banks?

Mr. Cross. I am just referring to your statement that they could loan on sound security, and that if we had been in their position we would not have had the crash that we had. The question I am trying to get at is, Could they loan upon different assets than we loaned upon, because it is sound paper and ours is sound, but we are not under our law permitted to loan on that paper or discount that paper?

Governor Eccles. In the first place, the Canadian banks, as I understand it—and I am not an authority by any means on that subject; it is just what I have been told and hear—that the Canadian banks and the British banks do not loan on real estate. The banking structure, as I said, is entirely different; it is differently constituted.

The savings funds in Britain are largely built up, as I understand it, in the savings and loan associations, the mutual savings and loan associations, which carry the real-estate credit.

If our banking system was a large branch banking system such as the Canadian system or the British system, it would be a much easier problem to segregate investments or savings funds from the commercial banking system. But so long as we have unit banks operated under the laws of 48 different States and the National Bank Act, these unit banks have two functions: The function of providing the check money through their deposits, and the function of investing the community's savings or investment funds.

Demand deposits representing our deposit currency should be invested in short-term paper, so far as possible, and in Government securities. But when it comes to investment funds, interest-bearing funds, it seems to me that we have another problem, and it is entirely different from the problem in Canada or the problem in Britain, or in any other country.

If we are going to avoid a banking collapse and the extinguishing of a large part of our money supply in the future, it is going to be necessary to make it possible, when contraction starts, for our Federal Reserve System, which is our central bank and bears the same relation to our banking structure as the Bank of England does to the English banks, to loan on sound assets to prevent a continuation of credit contraction and bank failures.

Mr. Cavicchia. You need not answer this next question if you feel that you ought not to, Governor. This is the question: In your opinion, should we have a metallic base for our money, such as gold, or is that an exploded theory?

Governor Eccles. A "yes-or-no" answer could be misunderstood. That is a question which, in order to answer it, would need considerable explaining.

Mr. Cavicchia. The reason I asked it is this: Some people still hold to the theory that we should have a metallic base, and that that should be gold. Others say it has been tried and it as failed.. That is why I asked the question.

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It is a problem upon which many opinions are expressed; but I do not think it has been answered. The fact that the important countries of the world have been wedded to gold by experience and habit for so long a time makes it a very difficult matter to divorce money from gold.

Mr. CAVICCHIA. Governor, it is a moot question whether or not the United States is still on a gold basis just now. What do you say about this?

Governor ECCLES. Our currency and our deposits in the Federal Reserve still require the same gold reserve that they always have, of 40 and 35 percent. To the extent that gold is not being paid out, we might say that we are not on gold. To the extent that we are requiring the same gold reserves, we can say we are on gold. We permit the export of gold under license, so that internationally we are on gold.

Mr. CAVICCHIA. So far as our imports are concerned, we are on gold, are we not?

Governor ECCLES. The dollar has been fixed at a certain price at the present time in relation to gold.

Mr. HANCOCK. It has been stated that we are today on a discretionary international limping gold-reserve standard. What do you think about that?

Governor ECCLES. I would prefer not to discuss that question. I do not believe that has very much relation to title II of the banking bill.

Mr. HANCOCK. Well, it is not irrelevant.

Mr. CAVICCHIA. Under our present system, fear and confidence have a lot to do with the banking question, have they not; and is that not also true in relation to business in general?

Governor ECCLES. Not as much as I think is sometimes claimed. What is confidence with one group would be lack of confidence with another.

An effort to balance the Budget would give confidence to a group of people who feel that, if it is not balanced, their taxes are going to be higher; but it would put fear and consternation in the minds of the group of people who are dependent upon what the Government appropriates for relief.

Therefore, when we speak of confidence, it does not have an equal application to all our citizens.

Mr. GIFFORD. Governor, I question the necessity of title II. Mr. Hancock questioned you and you answered that that is really the primary feature of the bill, while the secondary feature is in reference to the reserve of banks. I want to ask you a few questions leading up to the necessity of it.

What is the total debt of the Nation, having in mind the present expenditures and authorized expenditures? In the President's message, was it 31 billion of authorized expenditure that faced us up to that moment?

Governor ECCLES. I would not be certain. As I recall, I know it is over 30 billion, but I do not remember the exact figures.

Mr. GIFFORD. It is 31 billion and some fraction, I think.

Governor ECCLES. I think that is approximately correct.

Mr. GIFFORD. Having in mind what has been done, we passed the H. O. L. C. bill, carrying one and seven-tenths billion?

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Governor ECCLES. That is right.

Mr. GIFFORD. And if we pass the bonus bill that will be two and three-tenths billions additional, will it not?

Governor ECCLES. It depends on which bill passes.

Mr. GIFFORD. It is two billion three hundred million, is it not?

Governor ECCLES. It will depend on which bill passes.

Mr. GIFFORD. You are following these probable expenditures with the idea in mind of the necessity for this law?

Governor ECCLES. No; that is not correct. This law has no relationship to that. If the Government were to balance its Budget, we would propose the same law.

Mr. GIFFORD. I think my vote, so far as the necessity of this is concerned, would be guided by the actual necessity presented.

Governor ECCLES. I think there has been——

Mr. GIFFORD. If the Public Works bill now pending in the Senate, carrying $4,800,000,000 passes, and we provide for 1 billion to take care of social problems, as suggested, and if another billion should be required for farm-credit loans, we would get into the realm of a national indebtedness of 42 billion dollars, should these things transpire. You may subtract from your total, 3 billion, if you want to, and take into consideration the $1,800,000,000 profit from gold, but you would still have a debt of some 36 billion dollars. How much did you say there were in deposits in the banks?

Governor ECCLES. About 25 billion, eliminating interbank deposits. That represents the demand deposits.

Mr. GIFFORD. There are 38 billion in currency and deposits in the banks of the country. Do you recall the President's warning about the danger of the banks having to absorb the deficiencies in 1932, causing a very dangerous situation—that is, the deficiency caused by the operations of the R. F. C.?

Governor ECCLES. I do not recall that statement, but, of course, I would not feel there was any danger in that.

Mr. GIFFORD. The President spoke very strongly, and I wish you would read what he said, of the great danger of the banks having to absorb that deficiency caused before March 4, 1933, and since then we have added this large amount.

The purpose of this legislation is to control the privately owned banks, which would still be privately owned, by a Government board in Washington, so far as open-market operations are concerned?

Governor ECCLES. You mean control the investments that are made by the Reserve banks?

Mr. GIFFORD. To control open-market operations.

Governor ECCLES. Yes; to control open-market operations by the Reserve Board in Washington rather than by the banks themselves.

Mr. GIFFORD. They will still be privately owned, but they will be Government controlled.

Governor ECCLES. That is right.

Mr. GIFFORD. You mean the Government as constituted at the moment.

Governor ECCLES. I would say they are publicly controlled, rather than governmentally controlled. The control of open-market operations is proposed to be placed in the Federal Reserve Board.

Mr. GIFFORD. Exactly; and that policy will be dictated by this new board.

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Governor ECCLES. It will be carried out by the Federal Reserve Board.

Mr. GIFFORD. So far as the Government as at present constituted is concerned, that means just that, does it not, inasmuch as a provision for refusal to reappoint was included in your bill?

Governor ECCLES. I do not think that has anything to do with the political relationship.

Mr. GIFFORD. Oh, no; there is nothing political in this bill.

Governor ECCLES. The fact is that the Governor has always been appointed by the President, at his pleasure.

Mr. GIFFORD. This bill specifically indicates the method by which the Governor might not be reappointed.

Governor ECCLES. That is entirely incorrect. The bill provides that the Governor shall be—that his term as a member shall expire when he no longer——

Mr. GIFFORD. I am talking about the members of this new Board.

Governor ECCLES. It is not a new Board; there is no difference——

Mr. GIFFORD. The present Federal Reserve Board——

Governor ECCLES. There is no change whatever proposed in that Board.

Mr. GIFFORD. But they retire at 70, under a pension, after a term of years, and there are many changes.

Governor ECCLES. Rertirement at 70 will be compulsory only for future appointive members.

Mr. GIFFORD. My point is, should another government come in, otherwise constituted, could they get control of this Board?

Governor ECCLES. In what way could they get control?

Mr. GIFFORD. I am asking you.

Governor ECCLES. No; they cannot, not unless their terms expire, and the President chooses to appoint some one other than a member whose term expires.

Mr. GIFFORD. By that method could not the new President get control?

Governor ECCLES. By what method?

Mr. GIFFORD. By the refusal to reappoint.

Governor ECCLES. He could, if the terms expired. But a member is appointed for a 12-year term.

Mr. GIFFORD. There is no way of getting rid of them?

Governor ECCLES. There is no way of getting rid of them except for cause. That has always been in the bill. There is no proposal to put in the bill any change in the method of appointing members of the Board, or as to their terms.

Mr. GIFFORD. That reminds me of the lady who insured her home. There was a fire, and when the agent came to the house he said he would look into the cause of the fire. Then she said, "I thought there would be a catch in it."

Governor ECCLES. That has always been in the law; we are not presenting any change.

Mr. GIFFORD. Then the banker who wrote this letter to me was misinformed when he said that nothing short of a revolution could ever change the condition that will be brought about by the enactment of this bill; is that correct?

Governor ECCLES. When the Federal Reserve Act was passed in the beginning, what did the bankers say?

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Mr. GIFFORD. Getting back to the necessity of it, it is not quite as tight as the United States Supreme Court, is it? It is not quite as tight, is it, so far as the appointments are concerned? Would you be willing to provide for the appointments in that way, to have these men appointed in the same way that members of the Supreme Court are appointed?

Governor ECCLES. They are appointed in the same way, by the President of the United States, with the advice and consent of the Senate.

Mr. GIFFORD. I think that has been challenged. But you claim it is exactly the same?

Governor ECCLES. It is the same, so far as the appointment and confirmation is concerned. The term of the members is 12 years, in the case of the Federal Reserve Board, whereas the term of a Justice of the Supreme Court is for life. I believe he may be removed for cause.

Mr. GIFFORD. For what cause may a Justice be removed? What would be the cause in this case?

Governor ECCLES. I suppose for dishonesty or improper conduct.

Mr. GIFFORD. Or unwillingness to cooperate with the Government; would that be a cause?

Governor ECCLES. I am not in a position to say what the cause would be. All I know is that during the life of the Federal Reserve Board of over 20 years no member of the Board has ever been removed for cause. Their terms have expired or they have resigned voluntarily.

Mr. GIFFORD. I think if they made it hot enough for them they would get out, if they did not cooperate.

Now, coming back to the necessity for this bill: Faced with a debt of 38 billion or 42 billion, do you want to make the assets of the member banks sound assets, available for the issuing of currency; is that it?

Governor ECCLES. No; that is not the purpose of it. The law is not being drawn with that idea, of assisting in the financing of the Government.

The Government is having no difficulty with its financing. Its interest rate has been going down steadily. The desire of the banks to purchase Government bonds is so great that whereas at the end of Mr. Hoover's term the interest rate was nearly 4 percent, it is now less than 2¾ percent.

Mr. GIFFORD. Of the present indebtedness of the Nation, how much of it is in short-term loans?

Governor ECCLES. Do you remember, Dr. Goldenwesier, what the exact amount is?

Dr. GOLDENWESIER. I can look that up and let you know presently.

Mr. GIFFORD. You have not been offering many loans to the public on long-time paper, have you?

Governor ECCLES. They have been doing a good deal of refunding. They have just called one billion eight hundred million of the fourth 4½-percent Liberty loan, and they offered in exchange a 25-year bond at 2¾ percent.

Mr. GIFFORD. They did that in other countries, based partly on the ground of patriotism.

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Governor ECCLES. As a matter of fact, the bonds held by the banks of this country are less in proportion than the Government bonds held by the English banks. Thirty-nine percent of the assets of the member banks are invested in Government obligations, whereas 41 percent of the assets of English banks are so held.

Mr. GIFFORD. You said this morning it was 44 percent.

Governor ECCLES. Forty-four percent of the total outstanding bonds; 44 percent of the amount of Government bonds outstanding are in the member and Reserve banks and 39 percent of the assets of the member banks are invested in Government bonds; whereas 15 percent of the total bonds outstanding in Britain are held by the London clearing banks and the Bank of England, but that represents 41 percent of the resources of the British commercial banks.

It takes 5½ percent of the national income of Great Britain to pay the interest on the British national debt.

Mr. GIFFORD. Suppose we had to have an indebtedness of $40,000,000,000, and $9,000,000,000 was to be absorbed in the next year and a half, what proportion would the banks probably hold?

Governor ECCLES. What proportion of their resources in bonds?

Mr. GIFFORD. Yes.

Governor ECCLES. Of course, if the banks took 9 billion of bonds, the banks would increase their deposits by 9 billion.

Mr. GIFFORD. The term " deposits " is a rather tricky term. I suppose if I owed you $100,000, and you should be able to discount that, you would get some more currency and loan me another $100,000, and then take my second note and discount that, and still loan me still another 100 thousand, and that process could go on indefinitely, could it not?

Governor ECCLES. As a matter of fact, the banks could extend $20,000,000,000 of credit without rediscounting anything. The trouble today is not the need of the banks to rediscount; the trouble is the banks are unable to loan the funds that they now hold.

Mr. GIFFORD. We know that is a temporary situation. Idle money is glad to get something to invest in. There have not been many long-term offerings made in these times. They are all anxious to get something. You do not consider that that condition will be regular, do you?

Governor ECCLES. I think—and this, of course, is my opinion only—that for a long time to come there are not going to be in this country short-term loans of sufficient quantity to create the money that is required to carry our business structure.

Mr. GIFFORD. Why has not the Government—knowing that this indebtedness cannot be paid off for many years—why has not the Treasury offered long-term paper or bonds?

Governor ECCLES. Why have they not?

Mr. GIFFORD. Yes.

Governor ECCLES. That is a question I would prefer you ask the Treasury. I would not want to answer that question for them.

Mr. GIFFORD. You have said money was plentiful.

Governor ECCLES. Money is extremely plentiful. But if the Treasury had offered long-term bonds a year ago or 2 years ago, they would have paid a rate of maybe a half or three-quarters of a percent more than they are paying now. So long as the Treasury can borrow at a fraction of 1 percent, and the interest rate on long-term

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financing is going down, would it not appear advisable to finance on the cheapest basis of short-term credit, so long as the long-term market is going down? It has been profitable up to date to defer long-term financing.

Mr. GIFFORD. If they could sell these long-term securities at 2¾ percent they would sell them, would they not?

Governor ECCLES. If they could, you say?

Mr. GIFFORD. Yes; they would offer them if they could be sold, would they not?

Governor ECCLES. I do not know whether they would or not. Personally, I think you will see less than a 2¾ percent rate on long-term financing.

Mr. GIFFORD. Then you think there will continue to be plenty of idle money and that business will not get busy and need this money?

Governor ECCLES. I cannot conceive of business using 20 billion dollars of commercial credit, when in 1929 they only used 4 billion.

Mr. GIFFORD. You do not care to answer as to why the Treasury does not now, when money is plentiful and rates are low, offer long-term paper, that must, necessarily, be refinanced, a lot of it, with short-term paper?

Governor ECCLES. If they can borrow later at 2 or 2½ percent, would it seem advisable now to borrow at 2¾ percent?

Mr. GIFFORD. Let us put it the other way. If business recovers and needs money, and money is at a higher rate, has not that been the fear, that when these short-term securities are forced to be refinanced by long-term securities that the rate will be very high?

Governor ECCLES. That has been the fear, but it has been unjustifiable, and the reverse has been true.

Mr. GIFFORD. I hope you will prove to be a prophet, and a correct prophet, so far as the next 5 years are concerned.

You have no fear, so far as the Government using the method of issuing currency to banks with sound assets is concerned, that they will not always have plenty of money to buy the issues put out by the Government, and that this Government, under this plan of banking, could go into that practically to any amount?

Governor ECCLES. The amount of the Government debt that can be supported depends upon the national income, and a 40-billion-dollar debt here with an 80-billion income, is 6 months of the national income.

Mr. GIFFORD. We had a 90-billion-dollar income once, but what is it now?

Governor ECCLES. I think when Mr. Roosevelt came into office it was around about 38 or 40 billion. It is now some 50 billion.

Mr. GIFFORD. Our capital structure was 38 billion, that being the amount on deposit, available money and credits in the banks?

Governor ECCLES. No; it was 26 billion 400 million in 1929. That was the amount of demand deposits plus currency.

Mr. GIFFORD. There are two other questions I want to ask you, which you may be willing to answer.

You have no particular fear of a 40-billion-dollar national debt in this country?

Governor ECCLES. I have no fear of a 40-billion-dollar national debt.

Mr. GIFFORD. Your answer staggers me. I have.

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Governor ECCLES. I can give you my reasons for not having it.

Mr. GIFFORD. Personally, I wish you would. With the present national income you have no dread or fear of the consequences of a 40-billion-dollar debt?

Governor ECCLES. I am concerned about the present national income, but you do not increase the present national income by diminishing Government expenditures. It is the total expenditures of the Nation that create the national income, and when the community, as individuals and corporations, do not spend, then the Government must.

Mr. GIFFORD. I am looking at it from the standpoint of my corporate interest. If I owed a hundred thousand dollars to you and you discounted my note and loaned me another hundred thousand, you could then go to the bank and discount my second note and loan me still another hundred thousand, and keep that up indefinitely. But then what happens to me, finally? How long do you think that a person, an individual, or corporation, can keep that up, and how long can the Government keep that kind of thing up? The application is the same.

Governor ECCLES. That is just where the mistake is usually made. Government credit is considered in the same way as we consider individual or corporate credit, whereas when the Nation borrows it is a question of the Nation borrowing from itself, so long as it is a creditor Nation. Therefore, when it borrows from itself, that is the——

Mr. GIFFORD. If the citizen owed enough taxes, that is sound. But the whole revenue is based on taxation, is it not?

Governor ECCLES. Taxes are the basis of the Government's income. If by Government spending you increase the national income, you increase the ability to pay taxes.

Mr. GIFFORD. Exactly. Then you have answered the question, that a 40-billion-dollar debt can only be paid by taxes.

Governor ECCLES. But the taxes will not be paid out of the present national income. I believe in the Government spending to a point that could prime the pump. If you increase that spending, in that way you increase the demands for goods.

Mr. GIFFORD. Did you ever try to prime a pump and you did not get quite enough water?

Governor ECCLES. That has just been the case.

Mr. GIFFORD. That being the case——

Governor ECCLES. It is the case today.

Mr. GIFFORD. Does anybody know the exact measure of water to be poured in before you catch?

Governor ECCLES. The measure would be when you get your unemployment problem rapidly diminishing and with private business being required to employ those who are unemployed to meet the demand for goods, by reason of increasing purchasing power and spending.

Mr. GIFFORD. Your statement about the 40-billion-dollar debt will probably be of great comfort to those who vote for the soldiers' bonus; it will probably be of great comfort to those who want social legislation, that is, your statement that you have no fear of a 40-billion-dollar debt. Do you realize the importance of that statement?

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Governor ECCLES. Forty billion dollars in relation to the debt of Australia and in relation to the debt of Great Britain and other countries that we look upon as having met all the problems of the depression possibly as successfully as anybody else——

Mr. GIFFORD. So far as a comparison of our banking system is concerned it is no comparison to compare that with the system of other countries, if you can prove that our indebtedness is nothing to be worried about, in comparison with other countries.

Governor ECCLES. When we speak of a future debt of 40 billion. it seems to me it is only fair to deduct from the 40 billion the assets which the Government has taken in lieu of the debt. We cannot say that the loans which the R. F. C. has made are entirely uncollectible, and we should also take into account the balance in the Treasury in considering the net debt.

Mr. GIFFORD. And the gold profit?

Governor ECCLES. I think any other country would take the gold profit into account. It is there.

So that the debt is less than 23 billion today when you consider the Treasury balance, and without considering the gold profit, but when you consider the assets that you can use to offset the debt. That is less than 4 months of the normal national income of this country.

The indebtedness of Great Britain is 35 billion, and it takes 5½ percent of the national income to support the British debt. That is, what is considered the present national income, which is between 19 and 20 billion.

Mr. GIFFORD. You do not want us to fall into their company, do you?

Governor ECCLES. Our situation would require less than 1 percent of the normal national income to support the Federal debt.

Mr. CAVICCHIA. What percent?

Governor ECCLES. Less than 1 percent of the normal national income to support the present Federal debt.

Mr. GIFFORD. The national income?

Governor ECCLES. I said the normal national income.

Mr. GIFFORD. What is that?

Governor ECCLES. Eighty-two billion was the national income in 1929.

I am as anxious as anyone to see the Budget balanced. The Budget can only be balanced, however, out of the national income. The national income can only be increased by employment.

Mr. GIFFORD. May I say, before I go any further, Governor Eccles, I may appear to be almost brutally frank in my questions, but that is my mannerism. I am the most harmless man on the committee.

I have letters from 25 commercial bankers in my district, all fine bankers and upright men, who are opposed to this legislation, and I want to find out about their opposition.

Governor ECCLES. I appreciate the opportunity for giving my answers. I have met with the bankers, with the representatives of the American Bankers' Association, and with many other bankers, and I find that their opposition to the bill has been largely the result of a misunderstanding. They do not understand what is in the present law, and the opposition they raise to this bill is the

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same opposition which might be raised to the present law, in a great many instances.

Mr. GIFFORD. I am a new member of the committee, and know little about the problems.

Governor ECCLES. I have now the figures of the Government debt as of January 31, 1935, the total interest-bearing debt being $27,952,000,000; due within a year, $5,606,000,000; from 1 to 5 years, $8,792,000,000; and over 5 years, $13,554,000,000.

The CHAIRMAN. Let me suggest that in your statement you incorporate the figures showing the holdings of the Government against those obligations, in order to make the story complete.

Governor ECCLES. Yes; I will do that.

Mr. HANCOCK. You mean the credit balances in the general fund of the Treasury?

Governor ECCLES. The general fund balance is somewhere between a billion and a half and two billion. We will have to insert in the record the exact figures.

The CHAIRMAN. That is what I said, that you should do that to complete the statement, showing the holdings in the R. F. C. and other organizations inuring to the benefit of the Government.

Public debt and net assets of the United States, Jan. 31, 1935

[In millions of dollars]

Gross public debt	28,476
Net balance in general fund (excluding balance of increment resulting from reduction in weight of the gold dollar)	1,519
Net debt	26,955
Proprietary interest of the United States in governmental corporations and credit agencies:	
I. Financed wholly from Government funds:	
Reconstruction Finance Corporation	2,321
Commercial Credit Corporation	41
Export-Import Bank	14
Public Works Administration	269
Regional Agricultural Credit Corporation	90
Products-Credit Corporation	113
All other	506
Total	3,354
II. Financed partly from Government funds	1,120
Total	4,474
Increment from reduction in weight of the gold dollar	2,812

Mr. GIFFORD. We have your Treasury statement every day on our desks. I am speaking this morning of the probable billions to be added. We have that fact staring us in the face every day.

I want to bring out the fact that with this continual financing by the Government of Federal indebtedness we need this sort of protection.

Governor ECCLES. The budget of any government must be balanced over a period of time; there is not any question about that.

Mr. GIFFORD. Would you suggest a time—possibly 5 years?

Governor ECCLES. I would say it might be desirable over a 5-year period, but I do not think it necessarily need be fatal if it is only balanced over a 10-year period. A war condition could create an

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unbalanced budget for a considerable period of time, if sufficient taxes were not imposed to pay as it was carried on.

Mr. GIFFORD. Would you advise my creditors to carry me along for 5 years? If so, I wish you would send me a letter.

Governor ECCLES. It has been my philosophy that the amount and the rapidity with which the Government spends will reduce—that is, if the amount and the rapidity are sufficiently great—they will reduce the total amount that the Government may be required to spend. To do that we have had a 40-billion-dollar deficiency in national income and a 3-billion priming process last year; that is about what it was.

I do not consider the transfer of the existing debt from where it is to the Government as a priming process. It stops deflation, but the actual amount of the budgetary deficit as a result of the Government spending and the Government lending for new structures that increases the buying power of our people has not been sufficient to stop the process of deflation and to give the momentum necessary when you consider the size of the pump.

By that I mean that with 10 or 12 million unemployed the buying power cannot be sufficiently increased by a 3-billion-dollar spending to utilize our existing productive capacity.

Mr. GIFFORD. That is a fine statement you are making, but I am sure that the priming process must reach down far enough to give constructive money that not only feeds and clothes people, but begins to construct something out of which people can get an income.

If the Government had spent this money and it was being used by people who were constructing something which was employing labor, that would be different than simply feeding and clothing people and building beautiful roads or race tracks, and ornamental things in the country which, in the end, does not keep very many people at work bringing in an income. That does not keep many people at work for any length of time bringing in an income, does it?

Governor ECCLES. I think so. I think to spend money, or increase productive capacity when you already have an excess of productive capacity, is just the place where you do not want to spend it.

Mr. GIFFORD. In my section, they want to spend money on public works, or on race tracks and beautiful roads through the woods, and after they spend that money how much of an income will that produce?

Governor ECCLES. After all, income has to come from spending.

Mr. GIFFORD. But if that spending is simply for feeding and clothing people and putting up ornamental unnecessary things, that will not help them any in the future, so far as any income in the future is concerned.

Governor ECCLES. Of course, I do not believe that Government spending should be in a field of competition with private enterprise, where Government spending will be expected to return an income.

Mr. GIFFORD. You do not believe in the Government loaning to help private business, do you?

Governor ECCLES. I would prefer that the lending should be done by the private-credit system, but when you reach an emergency such as we had in 1932, and set up the R. F. C., it became necessary to save the credit structure and lend money.

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Mr. Gifford. Would you prefer that the $4,800,000,000 in the bill pending in the Senate be loaned to private industry, the whole of it, rather than have it expended in the method suggested?

Governor Eccles. I would prefer that no part of it be loaned; that every part of it be used as a grant, as leverage, so as to induce private borrowing and spending.

Mr. Gifford. Would it be possible to make such a grant to private industry by any such process without favoritism?

Governor Eccles. It is possible to make grants to cities, counties, and States for noncompetitive public works, and induce leverage through that process.

It is possible, through a subsidy to home owners, to induce the construction of new homes, and the subsidy will be the difference between the cost and rents.

Mr. Gifford. Do you prefer non-Federal projects?

Governor Eccles. When it is a pure Federal project there is no multiplying. If the funds are used as a leverage, as a subsidy, we will say, to cities, counties, and States, you get an increased spending or a leverage added to the spending by the home owner. We have a differential between costs and rents today which is retarding private construction.

Mr. Gifford. You mean, do you not, if you grant 30 percent to municipalities and the municipalities are putting up 70 percent, therefore you get three times as much work done?

Governor Eccles. Yes.

Mr. Gifford. Exactly.

Governor Eccles. But instead of the Government loaning 70 percent, let the municipalities arrange their own credit. I think 30 is possibly not sufficient.

Mr. Hancock. I am very much interested in the statement you made with respect to subsidizing the private home owner to induce him to build a new home. If such a program as that were carried out by the Federal Government, would it not have a tendency to stagnate every private lending institution in this country?

Governor Eccles. It would stimulate them greatly if the subsidy represented the difference between costs and rents.

Mr. Hancock. Are you explaining the proposal that the newspapers carried not long ago, to the effect that you advocated or suggested a plan whereby the Government would make a grant or a gift to a prospective home owner up to, say, 20 percent of the cost of construction?

Governor Eccles. I am not sponsoring any plan. The question was with reference to the spending of the $4,800,000,000, whether I would prefer that to be spent by the Government or used as a loan.

In answer to that I am simply making some observations here, or some suggestions as to what would be my own personal view, in order to get the most out of the proposed appropriation.

Mr. Gifford. I think you have answered my question sufficiently.

Mr. Cross. It seems to me we are going far afield from this bill, and that we have taken in all of the theories of loaning, most of which have nothing whatever to do with this bill, and if we continue along that line we will never get through with this hearing.

Mr. Gifford. Mr. Cross went very far afield.

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Mr. HANCOCK. I think the gentleman's questions have been interesting and pertinent.

Mr. GIFFORD. I will be through in 2 minutes, if you will give me 2 minutes longer. I want to make two remarks.

I believe thoroughly in non-Federal grants, where the Government itself pays only 30 percent and the municipality puts up 70.

I want to say simply in connection with this matter of priming the pump, the answer seems to be suggested to me that we have poured in the water, but the well is frozen. Lack of confidence has frozen the well, and it does not amount to very much.

(Thereupon, the committee took a recess until 3 p. m. this day.)

AFTERNOON SESSION

The CHAIRMAN. All right, gentlemen. I believe we finished with Mr. Cavicchia. Now, does anybody on this side want to interrogate Governor Eccles?

Mr. SPENCE. I want to ask him some questions.

Mr. DIRKSEN. I would like to ask some questions.

The CHAIRMAN. All right, proceed. Let us get along.

Mr. DIRKSEN. Governor, I shall try to be brief. Perhaps I ought to restate the question Mr. Gifford had in mind this morning, I think, namely, that the President has authority to designate one man to the Board as Governor of the Federal Reserve Board; is that a Presidential designation?

Governor ECCLES. That is right.

Mr. DIRKSEN. And when a man ceases to be designated by the President, he is no longer a member of the Board?

Governor ECCLES. No; he is no longer Governor, but he is a member of the Board.

Mr. DIRKSEN. He remains a member of the Board?

Governor ECCLES. Yes; unless he resigns, which is usually the case if he is no longer designated as Governor.

Mr. DIRKSEN. I got the impression from reading your observations on the bill that, when the President ceased to designate him as Governor, he automatically divorces his membership as a member of the Federal Reserve Board.

Governor ECCLES. The present Federal Reserve Act requires that the President designate a member of the Board to serve as Governor at his pleasure.

Mr. DIRKSEN. I think I see, and it will not take very long to state the question. Now, with respect to the government of the Federal Reserve bank, I think the residence requirement has been taken out of the old act, has it not? In the new provision there is a statement to the effect that the Governor no longer has to be a resident of the Federal Reserve district or Board on which he should serve.

Governor ECCLES. That is right.

Mr. DIRKSEN. I am wondering whether it would be possible, under this provision, to take a man from New York, for instance, and by virtue of the fact that the power of approval is vested in the Federal Reserve Board, insofar as the class C directors are concerned—if it would be possible to transplant such a man to the seventh Federal Reserve in Chicago, and by either the giving or withholding of the

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power of approval, you could make him a member of the Board? Do you think that is possible, if not probable?

Governor ECCLES. Yes; it is possible to transfer a man from any other reserve districts, and the proposal simply applies the same and class C director. At present the Governor may be chosen from other reserve districts, and the proposal simply applies the same principle to the chairman and class C director, which is necessary in combining the offices of governor, chairman, and class C director.

Mr. DIRKSEN. It would be possible then, to take somebody from another section of the country and transport him to some other place?

Governor ECCLES. Yes. The idea of that was to promote able men in the Reserve System by moving them from one bank to another bank, creating a career system. The selection of the Governor, however, must be made by the local board of the reserve bank.

Mr. DIRKSEN. However, you have the power to approve?

Governor ECCLES. That is right.

Mr. DIRKSEN. And you could approve, or you could disapprove anybody that you desired to disapprove? In other words, you could prevent a man from becoming a combination governor, chairman, and Federal Reserve agent by simply giving your disapproval to his selection?

Governor ECCLES. They would have to submit some other name.

Mr. DIRKSEN. So really you would have the power to control?

Governor ECCLES. Well, whether the power of approval is the power to control may be open to debate. It would become necessary for the board of the Reserve bank and the Board here—at least a majority of the board of the Reserve bank and the majority of the Board here to agree upon a man that would be the executive head of the bank.

Mr. DIRKSEN. I think the matter is important, for this reason, and this is not very familiar to me and may not be familiar to you, but in 1927, I think, the rediscount rate was reduced for the purpose of stimulating the investment interests and also stop the flow of gold toward Europe, and the directorate of the Chicago Federal Reserve Bank was rather opposed to it, because they saw a possibility of the flow of capital from every agricultural bank. They resisted the idea, but it was done anyway; and I am not so sure but what, in the light of hindsight, that was right, after all. So if it depends on somebody out there who is absolutely sympathetic with all of the things that are done, that might prejudice the interests of the particular area. That brings up, of course, this question: I was interested in your observations that it was seeking to make them responsive to the national interest. That was the idea I think that you enlarged upon in the course of your remarks some days ago.

Governor ECCLES. Make who responsive?

Mr. DIRKSEN. Well, your Federal Reserve Board, and I suppose your open-market committee; they would be responsive to the large public interest, rather than to the sectional or local interest.

Governor ECCLES. Yes; that is right.

Mr. DIRKSEN. That would, of course, eliminate the checks and balances that did exist between the open-market committee and the Federal Reserve Board and the directors of the respective Federal Reserve banks. In the light of that experience back in 1927 I am

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just wondering whether it would be wise to eliminate that check, because, in that instance it would have had a most salutary effect upon the country, if the directors of a particular Federal Reserve bank had prevailed, and that probably had been able to carry out their own policies with respect to that Reserve bank district.

Governor ECCLES. Well, of course, if each of the 12 Reserve banks is going to be permitted to operate independently of the interests of the country as a whole, with reference to their monetary policies, it seems to me you would be sure to have great confusion.

Mr. DIRKSEN. If carried to the extreme?

Governor ECCLES. So long as you have 12 banks without a Federal Reserve board, without coordination and the power to deal with the problems of national interest, I cannot imagine how you could have a monetary policy that would be effective in meeting a situation that the Nation might be confronted with. No other country, so far as I know, has a divided responsibility with reference to the monetary policy that would be comparable to a policy made by the 12 different Federal Reserve banks.

Mr. DIRKSEN. You know, section 205 of this bill, in speaking, for instance, of the open-market committee, contains this language: It says that you are to deal, instead of through the Federal Reserve Board, with the Federal Reserve banks, and then the language is, "and the Federal Reserve banks shall conform their open-market operations to the provisions hereof." So, you are going to establish, after all, complete control at a time that might be disadvantageous to the interests of a particular geographical section. For instance, I suppose in Atlanta and Dallas you have certain cotton interests, in Minneapolis you have the grain interests, in Chicago you have not only grain but industrial interests; and that very question came up in 1927, and I am not so sure that, if it had prevailed, we might not have been infinitely better off. Of course, that is a speculative thing, I admit, but that was one instance where it proved out.

Governor ECCLES. I feel that monetary policies must be dealt with on a national basis, and that for each Reserve bank to act independently with reference to open-market policy or discount rates would cause great confusion. Money is like water—it seeks a level; and to raise rates in one section would cause the funds to flow to the section where the rates were raised from the section where the rates were low, which would act to increase the excess reserves in one area substantially and, therefore, make for expansion of credit and cheap money, and have the opposite effect in another area.

Mr. DIRKSEN. But I think you will admit that was practiced in one Federal Reserve district, and we might have had a 2 percent rediscount, and in another place $2\frac{1}{2}$ percent, and another place possibly 3 percent, because that seemed to fit the conditions of that Federal Reserve district at that particular time.

Governor ECCLES. I do not believe it is necessary to have a uniform discount rate at all the Reserve banks and, as a matter of fact, there has rarely been uniformity in the discount rates. The discount rate is proposed by the Reserve banks and approved by the Federal Reserve Board, as a general rule.

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Mr. DIRKSEN. But, examining the maximum possibilities of the bill with respect to the open-market committee, it is quite possible that the Federal Reserve directorate in any particular district would not have anything to say about it, the System insisting that they conform to whatever regulation is laid down about it?

Governor ECCLES. That is correct. If the committee felt it was in the national interest to raise rates to prevent undue expansion and speculation, they would do so; and, if they felt on the other hand that there was an unnecessary contraction, they would want to reduce the rates and the reserve requirements in an effort to stop the deflationary process, so far as they could. It seems to me that must be done in the interests of the Nation, because we have found that every part of the country is very interdependent with every other part of the country, and that money has a very rapid flow and is movable and transferable almost instantaneously.

Mr. DIRKSEN. When Mr. Crowley was before the committee, I asked him about the section entitled I, which provides that mutual savings banks and other banks may become member banks, or insured banks, after July 1, 1937. In other word, you would have to become a member of the Federal Reserve or otherwise have no Federal Deposit Insurance. I presume you are familiar with that?

Governor ECCLES. Yes; I am.

Mr. DIRKSEN. That, in the light of section 202 entitled "II" of the bill, which provides that the Federal Reserve, in order to facilitate their entry into the System, can waive the capital requirements. You enlarged on that somewhat in your observations and said, "and any other requirements that may be necessary." Now, you are familiar with the facts, also, that in organizing many of these State banks, you had to give deferred certificates in lieu of deposits, and I think you have answered that that is a contingent liability charged against the capital and, therefore, you cannot take those banks into the System.

What would you do about those banks, particularly in cases where most of the deposit liability was made up by deferred certificates, and there may be in small banks, as much as $30,000 or $40,000 outstanding of those certificates, and it may take 10 years to earn enough money to pay them off?

Governor ECCLES. I am familiar with that rule and I do not know that I, personally, agree with it.

Mr. DIRKSEN. The rule does exist, however?

Governor ECCLES. Yes; it was the opinion of counsel at the time the question came up, that in the light of the present banking legislation, by reason of those deferred certificates which the banks had issued, although they were secondary to the depositors' claims, still the bank was unable to qualify for membership. Now, one of the reasons for this provision which you just read is, to permit the membership of the banks of the class that you referred to.

Mr. DIRKSEN. Well, now, the corollary of that is this: What will the present members of the Federal Reserve System say if by wholesale, you should take in these banks? They might object to the fact that you are cutting corners in order to get them into the System, might they not?

Governor ECCLES. I cannot see that the other members of the Reserve System could be, in any way, affected by that, except favor-

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ably. It would be to the interest of all of the member banks of the System to have all of the nonmember banks members of the System, for the purpose of uniformity in carrying out the banking practices and procedure, and so forth. Admitting those banks into the System does not, in any way, place any liability upon the present member banks.

Mr. DIRKSEN. Well, if this is a fair question, would you care to say, categorically, whether you favor all banks coming into the Federal Reserve System at this time?

Governor ECCLES. I think that it is in the interest of the banking situation as a whole, nonmember banks as well as member banks, to have all banking institutions, which have the power to create money, members of the Federal Reserve System.

I think that the period of 1937 is helpful, in that it gives to the banks an element of time in adjusting their affairs to any extent that they may desire to, before applying for membership; and I think that, if this proposed legislation is passed, permitting the Board to waive the requirements that the nonmember banks are unable to meet, and providing the eligibility features that this bill carries, it will be a great source of strength to the Federal Deposit Insurance Corporation and to the banking system as a whole, through all banks being members of the Federal Reserve System.

Mr. DIRKSEN. Well, now, Governor, if I remember the figures, I think 41 percent of all of the banks in the United States are in towns of 1,000 in population. I am just wondering what distinct advantage will accrue to a bank in a small town which is simply subserving the money and borrowing interests of that community to buy 6 percent of the stock of the Federal Reserve, on which they will get no interest and discount benefits and privileges, which they probably would not use.

Governor ECCLES. They get 6 percent on the stock which they buy, which is a very profitable investment right now. Six percent is what they get on the Federal Reserve bank stock which they buy at the present time. Furthermore, the opportunity of rediscounting or borrowing from the Reserve bank for seasonal requirements or for emergency requirements should be a great source of help to the local community and would tend to prevent bank failures which otherwise might develop.

Mr. DIRKSEN. Well, now, if all of these banks come into the Federal Reserve System, manifestly, you are first destroying the banking authority of your State, and that would be possibly, or would possibly have the effect of superseding the laws of the State with reference to branch banking, and you might have an extension and development of branch banking; is that possible?

Governor ECCLES. I have not said very much about branch banking——

Mr. DIRKSEN. Will you allow me to interpose and tell you that my interest is aroused in the matter because of Senate bill 1926, which was introduced recently by Senator Fletcher, a very short bill, and the last phrase provides that—

> Any national banking association may, with the approval of the Federal Reserve Board, consolidate with or purchase the assets of, and thereafter operate as a branch or branches thereof, and national or State banks, or banks, located in the same State, with which such national bank association was on

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January 1, 1935, and still is affiliated, or shares or majority of shares of which were, on January 1, 1935, and still are owned by an affiliate of such national banking institution.

Mr. GOLDSBOROUGH. I am putting the committee on notice of the fact that the bill is before us now, and there seems to be a trend toward unification of the banking system. The extent of the branch banking would be easier than it is at the present time, when you still have checks and safeguards of some State law.

Governor ECCLES. Of course, there has been a rapid development of branch banking in the last few years.

The CHAIRMAN. Since the passage of the act that was to restrict branch banking.

Governor ECCLES. The National Banking Act or the Federal Reserve Act permits State-wide branch banking in those States where branch banking is permitted by State law.

Mr. GOLDSBOROUGH. Just to give the historical fact, we let the branch-banking features slip by with the express assurance on the part of those who wanted it that they would stand by the permanent insurance plan, and as soon as the law passed they began to fight the permanent insurance plan; we have had that fight on our hands ever since. Our theory was that it would be impossible to make any branch-banking law effective, because the independent banks would be so strong under the permanent insurance plan that they could preserve themselves. That is the history of that legislation. The branch-banking features would not have passed had we not had the assurance that the permanent insurance plan would be allowed to stand.

The CHAIRMAN. Governor, in connection with what Mr. Goldsborough said, the remark I made a moment ago had reference to the McFadden bill, which dealt with the matter of branch banking.

Governor ECCLES. The development of branch banking has been brought about by the action of the various State legislatures, and I understand that at the present time about one-half of the States permit branch banking, either on a State-wide basis or in some form; and, of course, the national banks are permitted to carry on the branch-banking business to the extent that is permitted in the States in which they operate.

Now, there is nothing in this proposed legislation that in any way changes the present laws with reference to branch banking, and there is nothing that interferes, or encroaches upon, the State banking organizations. The provision that requires insured nonmember banks to become members in 1937 is not in this legislation, but in the legislation that was passed last year. So there is nothing in this legislation that is being considered now that in any way changes the relationship of the State banking authority with reference to the banking structure.

Mr. DIRKSEN. I quite agree. What I was getting at, of course, is that, if a little later, it was all set up it would be made infinitely easier to extend the branch banks.

Now, getting over to section 206, there is a section there that provides that any sound assets may be discounted, that any Federal Reserve bank may discount any commercial, agricultural, or industrial paper and may make advances to any certain member bank on its promissory notes secured by any sound assets of such member

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bank. I presume an asset may be sound and still be "ill-liquid" rather than liquid, can it not? In other words, it might be good security behind it, but still not liquid?

Governor ECCLES. Yes. Many of the assets which are considered to be eligible and held to be liquid were less sound than many of the assets held by banks which could not qualify for rediscount or security for borrowing from the Reserve banks.

The CHAIRMAN. Mr. Dirksen, let me ask him a question right there, please.

If you have not already stated it, what percentage of the investments of the banks, exclusive of Government securities, is eligible for rediscount with the Federal Reserve bank?

Governor ECCLES. Well, at the present time, I do not know the exact percentage, but I understand it is less than 8 percent of the total loans and investments of the banks that are eligible; and that is according to the classifications made by the banks themselves and not according to the classification made by the Reserve banks. I think, upon experience, the banks would find, if it were necessary to use all the paper which they considered eligible, that some of it would not be so considered by the Reserve banks. So that the figure given, which is as I say, less than 8 percent, is the maximum.

Mr. DIRKSEN. I see section 207 provides that guaranteed obligations of the United States may be bought and sold without regard to maturity. Those are such bonds as Home Owners' Loan Corporation——

Governor ECCLES. And Federal farm mortgages, and so on.

Mr. DIRKSEN. Well, now, I suppose that has to be considered in the light of the provision in the bill which calls for the repeal of the collateral requirements. Is there any notion of policy that something else should be substituted for 50 percent of the eligible paper and collateral in addition to the 40-percent gold reserve?

Governor ECCLES. No. You see, this is providing for the elimination of the collateral requirements against the Federal Reserve notes. The reason for the provision that you have just read is that it is felt that there should not be discrimination between Government bonds and bonds guaranteed by the Government. The fact that the Reserve banks may buy direct obligations of the Government, and the fact that they may not buy long-term guaranteed obligations of the Government is an unjustifiable discrimination between the guaranteed bonds and direct obligations.

Of course, at the time the law providing for the purchase of direct obligations was originally passed, there were no guaranteed obligations; and I feel that, had there been guaranteed obligations at that time the law would very likely have included both direct and guaranteed obligations.

Mr. DIRKSEN. Well, now, heretofore, of course, the note-issuing power was used largely commensurate with the rise and fall of business in that area; and if there had to be a 40 percent gold reserve and 60 percent of eligible paper, there had to be commercial transactions behind all of that paper. And so as there was a fixed volume of business, the chances of any demand on the Federal Reserve agent for more Federal Reserve notes, or less, depended on whether the tide of business was high or low.

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Now, that collateral requirement is to be repealed and you are authorized to buy and sell in the market, and these guaranteed obligations of the Government—that is what is called elasticity, which does not mean a great deal to me—however, it is taken away, and from then on the amount of notes that will be issued will bear no definite relationship to the amount of business in the 12 Reserve districts, or it may be a very arbitrary amount.

Governor ECCLES. That was the theory upon which the collateral requirements for note issue were based, but that is proving to be inapplicable to the facts in the case. The greatest requirements for notes in any year in this country happened when the business volume was at its lowest, showing that the demand for currency does not necessarily follow the fluctuations of business. The fluctuation of bank lending on short-term eligible paper reflects to some extent the activity of business. The call for Federal Reserve notes in the United States, a country where 90 percent of the business of the country is done by check, has very little relationship to the volume of business.

As I stated a few days ago in discussing this question, the Reserve banks have two classes of liabilities: One is the deposits to the member banks and the other is the notes outstanding.

The CHAIRMAN. Will you not add to that, the capital held by the other banks?

Governor ECCLES. That is a liability to the stockholders, of course; and the surplus is a liability to the Government. In liquidation, the assets of the Reserve bank consist of the gold certificates, and the investments that the Reserve banks make in governments, and loans and discounts which they make to member banks.

I see no reason for putting up 40 percent gold certificates back of notes and then putting up eligible paper to the extent of 60 percent. As a matter of fact, it would be perfectly impossible to cover the note requirements of the banks by 60 percent of commercial paper; because the banks do not have the paper to cover that proportion of the note requirements. Therefore there would not be sufficient Federal Reserve notes to meet the requirements, if the Reserve banks were required to secure notes, as originally contemplated in the act, by 60 percent of the commercial paper.

There is no difference between note liability and deposit liability. They are both liabilities of the bank and there would seem no more occasion for the securing of notes than it would for the securing of deposits. All of the assets of the Reserve banks are back of all of the liabilities of the Reserve banks. The type of assets that the Reserve banks hold—outside of the Government bonds which they buy and the gold certificates which they hold—is determined by each Reserve bank, when that Reserve bank extends credit to member banks.

Mr. DIRKSEN. Well, Governor, if you have more than 40 percent gold reserves, that means that the Federal Reserve bank has got to issue $2.50 for every gold certificate dollar that it has; is that correct?

Governor ECCLES. What is that?

Mr. DIRKSEN. If you have that 40-percent gold reserve behind every dollar of Federal Reserve notes issued, you will have issued

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2½ times for every gold certificate that the Federal Reserve banks may have?

Governor ECCLES. That would be right.

Mr. DIRKSEN. Then in the light of the fact that you could buy and sell without limit, virtually, all of the outstanding contingent obligations of the Government, or those that are guaranteed, you could retire most of them today if you so chose, and if that was going to be the policy, by rather copious note issue; that would be entirely possible under the bill, would it not?

Governor ECCLES. As I understand it, the bill would not change that situation, at all.

Mr. DIRKSEN. But I would think that would be possible, would it not?

Governor ECCLES. The present law permits notes to be secured by Government bonds and gold certificates. That is not in the present law, it was in the Emergency Banking Act of 1932.

Mr. DIRKSEN. You could, instead of just securing them, retire them altogether?

Governor ECCLES. What is that?

Mr. DIRKSEN. I say, instead of securing them, you could retire them altogether?

Governor ECCLES. Retire what?

Mr. DIRKSEN. Retire these bonds that had been guaranteed as to principal and interest, being nothing more than a note issue——

Governor ECCLES. You mean that the Reserve Bank, through open-market operations, could purchase all of the outstanding, or as many of the outstanding Government bonds and guaranteed bonds as they chose to do?

Mr. DIRKSEN. Yes; as far as there were gold certificates available that would be possible, would it not?

Governor ECCLES. Yes; but, of course, that would increase the reserves of the members by the amount of bonds which were purchased, and the excess reserves of the members today are something over $2,000,000,000. To extend that reserve, banks purchase additional Government bonds or bonds guaranteed by the Government—they would increase the reserves of the member banks.

Mr. DIRKSEN. I think this morning, or yesterday, you made the observation that the relationship of income to the deposit currency was as 3 to 1, or substantially so?

Governor ECCLES. In 1928, and 1929 it was 3.12. That was about the average, as I recall, of the deposits and currency to the national income. In 1933 the relationship, or what is spoken of as the income velocity, was about 2⅓. At the present time, it would be substantially less than that. That increase of money, deposits plus currency, has been much more rapid than the increase in income, and hence, the velocity has been reduced.

Mr. DIRKSEN. Has that relationship of 3-to-1 between the income and deposit currency existed for a longer period than since 1929?

Governor ECCLES. No; it has been steadily going down.

Mr. DIRKSEN. It has been going down since that time, but I mean anterior to that period. I do not know where I got that figure, but——

Mr. GOLDSBOROUGH. Does income mean the same as production?

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Governor ECCLES. Yes; it is spoken of as the national income. Dr. Currie says the figure was very stable from 1923 to 1929.

Mr. DIRKSEN. At 3-to-1?

Governor ECCLES. Yes.

Mr. DIRKSEN. And before that time, what was it?

Governor ECCLES. I do not have the figure on it. Of course, during the war period and during the period of depression in 1920 and 1921, I imagine there would be some changes in ratio.

Mr. HANCOCK. May I ask a question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. Governor, what do you mean by "national income?"

Governor ECCLES. What I understand to be the basis for figuring the national income is the price of all goods, whether consumer's goods or capital goods, that are produced in any one year.

Mr. HOLLISTER. For ultimate sale?

Governor ECCLES. Would that be sale?

Dr. CURRIE. It is the wages, profits, dividends, of all the money actually received by the income receivers.

Governor ECCLES. It is supposed to represent all the goods bought and sold.

Mr. HOLLISTER. That is, the ultimate sales?

Governor ECCLES. The ultimate sales, yes; otherwise you get duplication. That is right, the ultimate sales.

Mr. HOLLISTER. Dr. Townsend refers to $1,200,000,000,000, and I wanted to be sure about it.

Governor ECCLES. No, you have $900,000,000,000 to $1,000,000,000,000 of bank debits, which, based upon the amount of demand deposits would possibly give a velocity of deposit currency turn-over of over 50 times in the period of 1928 and 1929.

Mr. HANCOCK. At what rate is the national income running today?

Governor ECCLES. Well, I do not know. I do not know that there are any figures at all on it.

Mr. HANCOCK. What was the national income in 1934, as defined by you?

Governor ECCLES. Do you have the figures of the Department of Commerce?

Dr. CURRIE. No; not for 1934.

Governor ECCLES. I have heard it variously estimated from $50,000,000,000 to $50,000,000,000, but you would really have to have the complete figures for 1934.

Mr. DIRKSEN. At any event, that ratio is invariable and goes back to 1923?

Governor ECCLES. It was relatively constant.

Mr. DIRKSEN. And for any increase of $1,000,000,000 in deposit currency, you would get an increase of $3,000,000,000 in national income?

Governor ECCLES. Well, theoretically, but that has not been the case from 1929 to 1934.

Mr. DIRKSEN. But if it were invariable, there would be a great incentive then to increase the amount of deposit currency, in the hope of increasing the national income by just exactly three times that amount and all the good that we could do with that amount of money?

Governor ECCLES. It would be fine—there is no question about that—if we could do that by an increase of our volume of money, without regard to who owns the money, and thus regulate our

national income. I do not believe that is possible. I do feel, as I have said before, that of course the volume of money is an important factor; and, certainly, with high interest rates and shortage of reserves today, you could expect no credit expansion, and such a situation would be very deflationary. Excess reserves, such as we have today, which bring down the rate of interest, should ultimately lead toward creating credit expansion—whether we can do that and recover time alone can tell. That is one of the factors and one of the elements that will help make for recovery, if private credit expansion can induce recovery.

Mr. DRISCOLL. Governor, I am not entirely clear in my mind as to the expression "national income"; does that mean the price of every taxable article that is produced in the United States per year?

Governor ECCLES. It is the income received from the production of all goods.

Mr. DRISCOLL. We will say all of the hay, tobacco, textiles, wool that is sold?

Governor ECCLES. No; you would get duplication then.

Mr. DRISCOLL. Not if you sell it only once?

Governor ECCLES. That is right. For instance, you would sell wheat to the miller, and the miller would sell the flour to the wholesaler and so on, and you would get, of course, a duplication, because that would be the flour sold to the consumer——

Mr. DRISCOLL. And not the wheat sold by the farmer?

Governor ECCLES. No.

Mr. SISSON. In other words, there is a great distinction between the national income and the total turnover of business.

Governor ECCLES. A very great distinction.

Mr. SISSON. Many times?

Governor ECCLES. A very great distinction, but the national income determines the actual wealth produced, which determines the well-being of the people if it is properly distributed.

Mr. FORD. Might I suggest that my interpretation of "national income", is all wages, interest, dividends, ultimate sale prices of goods. Does not that fairly well cover it?

Governor ECCLES. I think that is the rule.

Mr. SISSON. That would not include the lawyers' income, who are not productive members of society, as a part of the national income?

Governor ECCLES. Yes; it includes a lawyers' income.

Mr. WILLIAMS. How about wages?

Governor ECCLES. The same thing applies.

Mr. HOLLISTER. Would not the real test be not the national income in dollars, but the units of articles sold in respect to these other particular years? If your prices are quite different, your national income may look different, but it is the units of things that happen to be sold in a particular year, with reference to the other year?

Governor ECCLES. Yes, the production; that is right.

Mr. DRISCOLL. Governor, I see that section 209 of this bill confers upon the Reserve Board the authority by regulation to change the requirement as to the reserves to be maintained against demand or time deposits. As I understand the percentage on demand is now 13 for Chicago and New York, and 10 for other eastern cities, and 7 for the country banks, and 3 percent on time deposits?

Governor ECCLES. That is right.

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Mr. DIRKSEN. Now, at one time, I think when the Federal Reserve was raising prices, it was up to 25, 18, and 15, was it not? Was it not much higher, and mounting higher when the Federal Reserve was first enacted?

Governor ECCLES. It was higher than it was in 1925; it was 18 and down below 18.

Mr. DIRKSEN. It has been reduced?

Governor ECCLES. Yes. Dr. Goldenweiser, I wonder if you know the reason for the drop in the Reserve requirements, from those higher percentages to the percentage that applies at the present time?

Dr. GOLDENWEISER. The reason requirements were reduced at the time was that it was the theory that the cash held in the bank vaults amounted to about that much. When this cash in the vaults held by the banks was excluded from the legal reserve, there was an allowance made for it.

Mr. DIRKSEN. You do not require any cash in vault now, do you?

Dr. GOLDENWEISER. No. When they would not let it count as reserves any longer they reduced the requirement.

Mr. DIRKSEN. No; actually, there is no cash in the vault at the present time, only of course these reserves against the deposits that are deposited with the Federal Reserve bank?

Governor ECCLES. There is cash in the vault, and these reserve requirements of 7, 10, and 13, as I understand Dr. Goldenweiser, were reduced because previously the cash held was considered as a part of the reserve requirements, and the cash now held by the banks is not considered a part of the reserve. There is no legal cash requirement, but banks have to hold sufficient cash to be able to meet the cash requirements of their customers, and those requirements fluctuate from day to day.

They have to ship money, from the Reserve bank to their bank and the amount of cash required by a bank that is not in a Reserve center, that is, in centers where there is no Reserve bank or branch of a Reserve bank, is relatively higher than the percentage of cash that is carried in a bank where there is a Federal Reserve branch bank or Reserve bank.

Mr. DIRKSEN. What reserves do the Bank of England and the Bank of France require, as compared to these requirements here?

Governor ECCLES. I am unable to say.

Mr. DIRKSEN. Dr. Goldenweiser, what can you say about that?

Dr. GOLDENWEISER. There are no legal requirements about the reserves of commercial banks.

Mr. DIRKSEN. In practice, what do they maintain?

Governor ECCLES. Well, in England, somewhere around 10 percent, as a rule.

Mr. DIRKSEN. Yes; both the demand and time deposits?

Dr. GOLDENWEISER. Yes; against their deposits.

Mr. DIRKSEN. Against all deposits?

Dr. GOLDENWEISER. Yes; and in France I do not know, because in France they hold so much of it in actual notes and the ratio varies, but it is not very greatly different from the English system.

Mr. DIRKSEN. Well, now Governor, section 209, of course, would confer upon the Federal Reserve Board the power to raise or lower

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those reserve requirements; in other words, instead of 13, 10, and 7, you could reduce them to 10, 7, and 3, and you might reduce the reserve against the time deposits to 2 percent or even 1 percent. In practice, how much of that reserve deposit do the Reserve banks, as a general thing, carry?

Governor ECCLES. You mean the member banks?

Mr. DIRKSEN. No; of the deposits that are carried by member banks in the Federal Reserve bank, do they keep all of the 13 percent or 10 percent or 7 percent on hand, or do they use it?

Governor. ECCLES. The Reserve banks.

Mr. DIRKSEN. Yes.

Governor ECCLES. The Reserve banks do not invest their money—that is, their deposit money—from the standpoint of keeping their money operating at a profit. It is their business to invest their money in open-market purchases as a regulatory measure of the monetary system.

Mr. DIRKSEN. Well, the purpose, apparently, of that section is to give greater flexibility and give the Federal Reserve Board the authority to raise or lower their reserve requirements, and——

Governor ECCLES. That provision with reference to the reserve requirement is now in the law. The Thomas amendment to the act of May 12, 1933, added to the Federal Reserve Act a provision giving the Federal Reserve Board the power, by declaring an emergency, to raise the reserve requirements, with the consent of the President. That was put in there as a supplemental monetary control to open-market operations. It is a control against inflation.

Mr. DIRKSEN. Against inflation?

Governor ECCLES. Yes; that would be the purpose of that—a control against inflation. For instance, assuming that the excess reserves of member banks greatly exceeded the amount of Government bonds which the Reserve banks held and the bills which they held, there would be no way of controlling through open-market operations an inflationary credit expansion on the part of member banks. There would be no way of reducing or wiping out their excess reserves upon which credit inflation is built. For instance, if the authority now granted to issue $3,000,000,000 of greenback currency was exercised, and if the $2,000,000,000 of gold profit now in the stabilization fund were used, $5,000,000,000 additional bank deposits would be created.

Mr. GOLDSBOROUGH. Right there, if that money were used to retire Government bonds, the deposits would not be increased but the reserves would be increased?

Governor ECCLES. That is right. In that case it would increase the reserves by that amount, but it would increase deposits to the extent that it retired Government bonds not held by the banks. If the money was used to retire Government bonds held by individuals, it would increase deposits and increase reserves; to the extent that it was used to buy Government bonds held only by the bankers, to that extent it would increase the reserves alone without increasing deposits.

It is possible with the use, we will say, of the $5,000,000,000 referred to, to increase the reserves by that amount. Additional gold may continue to come into the country, which would also tend to increase the reserves. So that the banking system could build up excess reserves

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from the $2,300,000,000, approximately, that they hold now to $7,300,-000,000 plus any increased gold that comes in. You would have a potential agency for bank-credit inflation that would simply be terrific and no open-market operation could control it. An increase of reserve requirements would have the same effect in extinguishing the excess reserves as a sale of securities, and that is why this proposal is made.

Mr. DIRKSEN. That is the sense of the 20 percent in this bill?

Governor ECCLES. Yes.

Mr. DIRKSEN. Ultimately to extinguish the reserve requirements, if necessary?

Governor ECCLES. Yes.

Mr. DIRKSEN. I think I have only one more question, and that is with reference to section 210, dealing with real-estate loans. I was much interested in the discussion this morning, and I wondered whether, after all, we could not keep the banks on a commercial basis and keep them liquid by letting the building and loan associations handle the amortized real-estate mortgages up to 20 years, and pursue the policy of greater leniency with respect to bank loans, to such thrift agencies that now operate. I say that for this reason—the building and loan associations are equipped to handle the amortized loans, and if the banks were going to handle them in any quantity, they would have to set up separate establishments and take on additional personnel to do that.

Mr. CAVICCHIA. May I say this, Mr. Dirksen?

Mr. DIRKSEN. Yes.

Mr. CAVICCHIA. The great trouble was that many building and loan associations were running businesses in opposition to the banks. They got in the habit of going to the banks to borrow money on notes and pay, say, 5 percent on the money that they borrowed from the national bank or trust company; and they would proceed to lend it to me, or the man who wanted to buy himself a home; and they would get 3 percent or 4 percent or 5 percent bonus; and if they started to sell preferred shares to depositors and some of these companies borrowed—they did not borrow, but they took on deposit money on which they guaranteed as much as 7 percent per annum, which no bank could afford to pay. If the building and loans had not gone to that field, they would not have suffered as much as they did when the crash came in 1929.

Mr. DIRKSEN. Well, let me say there are probably 700 or 800 Federal savings and loan associations that have been established now; and, of course, their sole mission is to deal in amortized loans.

Governor ECCLES. Well, I may answer that by stating that the Federal savings and loan associations are members of the home-loan banks.

Mr. DIRKSEN. And those are rediscount institutions?

Governor ECCLES. Yes; and those institutions can borrow money from the home-loan banks at 3 percent. Therefore I do not know how commercial banks owning substantial savings funds upon which they pay 2½ percent could compete with the home-loan banks in providing funds to savings and loan associations.

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Mr. DIRKSEN. It could, but for one thing, and do you know what it is? It is the bank examiners. There are lots of buildings and loans that would go to the banks and make their notes signed by all of the directors, get the money, and pour it into the development of building and construction in their communities; but I doubt very much whether the examiners would permit that at the present time.

Governor ECCLES. The only thing is that a bank, in order to pay 2½-percent interest on time funds, which it will likely have to pay to hold the funds against the competition of the 3- and 3½-percent rates paid by savings and loan associations, must lend those time funds on a basis to yield them not less than 5 percent.

A building and loan association, as a member of the home-loan bank, would not be willing and could not afford to pay the banks 5 percent for funds which they in turn would have to loan out at 8 percent; and in borrowing from the banks, they would borrow on a short-term basis and would be loaning in the community on homes on a long-term basis. Therefore I do not think it is practicable to expect the building and loan companies to borrow from the savings or time funds of commercial banks.

Mr. DIRKSEN. There is one statement in here, one proviso in the section dealing with real-estate loans, section 210, that says:

> Nothing contained in this section shall prevent any national banking association from acquiring, as additional security for loans, previously made in good faith, second or subsequent liens on real estate or shares or participations in such liens.

Those are junior liens, or they would not be second mortgages?

Governor ECCLES. That is right.

Mr. DIRKSEN. There would not be anything to prevent a bank from taking a $2,000 first mortgage on a $10,000 property, and then stepping in a little bit later and taking another junior mortgage for $1,000, and making a junior lien against the first mortgage against the property, if they so desired. I believe you stated this morning you thought that was rather poor financing to even indulge in junior liens, if it could be avoided.

Mr. ECCLES. A bank should be prohibited, in the first instance, from taking a junior lien—from making a loan secured by a junior lien; but if a bank has a loan, and even though it may be an unsecured commercial loan or a collateral secured loan, the bank is justified in taking a second lien, for additional security, if conditions develop where the loan, which was adequately and properly secured, or a loan which was made to a concern which had ample resources, gets into a position where it becomes a doubtful loan. In such cases the bank may take a second mortgage or take any other security that it can get; and banks have always done that, in fact. They have always been doing that.

Mr. DIRKSEN. The only requirement, however, in that language, is the faith of the bank, "previously made in good faith."

Governor ECCLES. I think possibly the only reason for that language there is this: The banks, we know, have always taken, and there has been no prohibition upon banks taking, for debts previously contracted, second mortgages or any other collateral.

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Mr. DIRKSEN. Have they that authority now?

Governor ECCLES. Yes.

Mr. DIRKSEN. To take second mortgages?

Governor ECCLES. Yes; they have always done that.

Mr. CAVICCHIA. Is there not some confusion here, Mr. Dirksen? I think you mentioned about a bank lending their $10,000, and subsequently he wants to borrow another $1,000 on the same piece of real estate. That is perfectly legitimate, because it is considered practically one mortgage loan—is it not—whether it is made in one loan or two loans; am I correct, Governor?

Governor ECCLES. It would seem to me that it would be considered a first and second mortgage, because the first mortgage might be sold without recourse, and certainly the $1,000 mortgage would then be a second mortgage. So long as both pieces of paper are held by the same institution, they would be, for all practical purposes, the equivalent of a first mortgage.

Mr. CAVICCHIA. I had in mind the building and loan practice, where a man has $5,000 mortgage, and a year or two later wants another $1,000; in all respects, that is considered as one mortgage. Now, a second mortgage is never taken by a building and loan—by a member bank unless it wants to secure some loan that it had already made; is that correct?

Governor ECCLES. That is right.

Mr. HANCOCK. Mr. Dirksen, may I ask one question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. In addition to the fact that there is such a small amount of eligible commercial paper available for rediscount, did I understand you to say the other day that one of the reasons why you were suggesting that 20-year amortized real-estate mortgages should be made eligible for borrowing was the fact that unless the banks did handle this type of paper, these loans would continue to gravitate to the home-building and thrift institutions?

Governor ECCLES. We are not proposing that 20-year mortgages, as such, be eligible for rediscount. The proposal is that the banks be permitted to make amortized real-estate loans on improved property up to the maximum period of 20 years, up to a certain percentage of their time funds.

Mr. HANCOCK. Sixty percent, is it not?

Governor ECCLES. Yes. Now, with reference to the question of eligibility, there is nothing said at all about the right to rediscount those mortgages. The wording of the eligibility provision is to the effect that the Federal Reserve Act would be amended to authorize the Federal Reserve banks, subject to regulations of the Board, to discount for member banks any commercial, agricultural, or industrial paper, and to make advances to member banks on promissory notes, secured by any sound asset.

Mr. HANCOCK. I understand. This is something that was recognized in the Emergency Banking Act, that the member banks be permitted, on their bills payable or promissory notes, secured by sound assets, to borrow from a Reserve bank, and the credit department of each Reserve bank would determine the terms upon which the member bank could borrow.

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Let us see if we understand each other right there for a minute. Under that provision, would the member bank be able to endorse, without recourse, a first-mortgage note to a Federal Reserve bank?

Governor ECCLES. A member bank now cannot endorse without recourse any paper to a Reserve bank. All borrowing from the Federal Reserve bank is done on eligible paper, on the discount basis, with recourse, and all the bill does is to broaden the borrowing privilege so as to give to the Reserve banks the power to lend to member banks on the member bank's note for a period of 3, 6, or 9 months, according to the regulations that the Board may make, those notes to be secured by bonds, mortgages, or loans secured by collateral, with such margin as the Reserve banks may consider adequate to make the loans safe and sound to the Reserve bank.

Mr. HANCOCK. I think I understand that now; you see if I do. In other words, the member banks, under this provision, would not be able to rediscount a 20-year amortized mortgage with the Federal Reserve System, but use the mortgage as collateral for a loan.

Governor ECCLES. That's correct.

Mr. HANCOCK. But it could give its own note, secured by the 20-year amortized mortgage, and secure a loan from the Federal Reserve bank, if that was a sound asset?

Governor ECCLES. The Reserve bank would determine what margin might be required, and would also determine whether the loan would be made for 3 months or 6 months, or a longer period.

Mr. HANCOCK. But that would enable the member bank to be in a position, in time of emergency, to take that paper and use it for the purpose of liquidity?

Governor ECCLES. The same as it could with eligible paper; that is right.

Mr. HANCOCK. In other words, you mean put real-estate mortgages on parity, as they should always have been, so far as eligibility is concerned, with bonds?

Governor ECCLES. Government bonds, you mean?

Mr. HANCOCK. Yes; Government bonds?

Governor ECCLES. Yes; so far as being able to borrow money from the Reserve bank is concerned.

Mr. CAVICCHIA. Is this inflation, Governor?

Governor ECCLES. This is not inflation, because no member bank is going to borrow from the Reserve bank as long as it has excess reserves. Now, when the borrowings of member banks reach the point where you can get credit inflation, just as we have had in this country in the past, it was said to be the duty of the Reserve Board and the Reserve banks to raise the discount rates and to discourage future credit expansion.

Inflation can only be brought about by the willingness of the people and corporations to borrow money, and that is one thing we are trying to get; we are trying to induce the borrowing and lending of money upon which recovery is based. We are talking about the fear of inflation or reflation, when, as a matter of fact, that is what we want.

Mr. DIRKSEN. Governor, I have one more question, and that is predicated on the question asked by the chairman of the committee

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last week, when, off the record, he observed something about the condition of one of the Federal Reserve banks. Was that early in 1933?

The CHAIRMAN. I am not sure that I remember the remark you refer to.

Mr. DIRKSEN. Well, I got the impression at that time that it was the Federal Reserve banks that had lost their liquidity; is that possible?

Governor ECCLES. The Reserve bank lose its liquidity?

Mr. DIRKSEN. Yes.

Governor ECCLES. I never heard of that.

Mr. DIRKSEN. I got that impression at the time, but that is neither here nor there. I am just wondering if, carried to its logical conclusion, there is plenty of demand for this money; and, as you say, the assets can still be sound and still not be liquid, but if those were infiltrated to the Federal Reserve banks, you may have another flurry similar to the one we went through.

Governor ECCLES. An asset that may be considered sound and liquid with business activity and a high rate of employment and national income becomes frozen and unsound when the national income diminishes. Soundness is not determined only by the substance of a loan or asset at the time the asset is purchased or the loan is made; it depends upon the state of trade and business which follows, and it is up to the banking system to maintain a state of trade and business that will preserve soundness, if soundness existed when the credit was created, in so far as it is possible.

When certain foreign bonds were purchased, German bonds, prior to the war, we considered those the best in the world, and they were sound assets. When wheat was selling at $2 a bushel, it would have been considered perfectly sound, and the paper would have been eligible to have been loaned upon, and it would have been proper to have loaned upon that wheat with a 25-percent margin, on the warehouse-receipt basis. The same thing is true in any other commodity.

I remember when sugar was selling at around $21 a bag, and within a 6-month period it fell below $5 a bag. I am not arguing that a loan of 80 percent of the value of $21 sugar would have been sound.

I remember when sheep were selling at $16 a head, when within a 6-month period you could not sell them at $4 a head, yet a loan made on sheep at $16 for 9 months—that is, on the basis of 50 percent of $16—say, $8 a head for 6 months was eligible; whereas before that loan came due that security was not selling for one-half of the amount of the loan.

The point I am trying to make is that the question of liquidity and the question of soundness depends upon the state of trade and the state of business; and to the extent that forced deflation through forced credit contraction is obviated through making available the rediscount facilities of the Reserve banks—to that extent you provide liquidity. The only liquidity that really exists in a serious depression is the liquidity that is provided through the money-issuing agency, the Reserve System. Even Government bonds cease to have

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liquidity at the price at which corporations can sell them without going bankrupt.

The price of Government bonds in 1932 was down, the 3's, I think, to $83. A bank holding any substantial amount of those bonds—to have sold them at that market—and if any substantial amount had been sold, the market possibly would have gone to $50, and the bank would have been ruined. The banks, however, could go to the Federal Reserve banks and borrow on those Government bonds, and that was a protection to the market, and also a protection to the banks, which would not have existed if the banks had been forced to sell those bonds to get money to meet the demands, instead of going to the Reserve bank and getting the money.

Mr. HANCOCK. Mr. Dirksen, may I ask one other question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. Now, deposits you have already written off.

Mr. DIRKSEN. I think if the Governor wanted to, in the light of the fact that it was related to the bonus, he might make a further observation.

Governor ECCLES. I do not care to express an opinion on matters of that kind, because I feel it is entirely outside of my official position. I have my personal opinion, but I think it is outside of my official position.

Mr. DIRKSEN. I have just one observation to make with reference to this last section of title II, and it is this: Whether or not the time deposits will be drained off in the form of real estate amortized loans to any appreciable extent, will depend entirely upon the public demand?

Governor ECCLES. Entirely.

Mr. DIRKSEN. The public demand must necessarily be occasioned upon the purchasing power?

Governor ECCLES. There is no question about that.

Mr. DIRKSEN. If you have not got the purchasing power, they might demand until they are blue in the face, and it would not do any good; and that, in turn, is conditioned upon the state of employment in the country?

Governor ECCLES. That is correct.

Mr. DIRKSEN. The question that comes up to us is: Which is the first, the hen or the egg? And I question whether it is going to do any good.

Governor ECCLES. If you get demand for long-term credit for home construction or for other construction, and the facilities for providing it do not exist, that would be most unfortunate.

Now, I feel that, with low interest, and abundance of excess funds, that the need and desire of institutions with those funds should be to put them to work, and that may tend to create some construction. I do not believe that the demand, today, throughout the country as a whole, for long-term, amortized loans is entirely being met. What you say about the hen and the egg is true, and I am not claiming for the eligibility feature of this legislation and the real-estate feature, one of which is the corollary to the other, that it will bring about recovery; but it would create the machinery upon which recovery can be brought about.

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I might say this: That the increase in private expenditures for equipment and construction await upon the increased demands for products of industry. The increased demand depends upon the increased incomes, as a whole. Increased incomes await upon increased expenditures in construction. There is your circle.

Now, the impasse can be broken in the first instance, I believe, only by the various Government activities, and if the impasse is broken, then you have created here the machinery with which to help carry forward, just as you are creating in the case of the Home Owners' Loan Act and providing funds for your home-loan banks to loan to the members of the home-loan banks. That is the agency that will help in the mortgage field as well.

Mr. HANCOCK. That is what you said in 1933, is it not?

Governor ECCLES. Something like that.

Mr. DIRKSEN. That is all I have to ask, Mr. Chairman.

The CHAIRMAN. All right. Mr. Wolcott, have you any questions?

Mr. HANCOCK. Let us adjourn now until in the morning, Mr. Chairman.

Mr. FORD. May I make one observation before we adjourn?

The CHAIRMAN. Pardon me just a minute. Let this be off the record.

(Here follows discussion off the record.)

Mr. SISSON. As I understand it, this bill makes no change in the law with respect to the liability of the banks that are members of the permanent insurance fund for assessment; that is, in other words, the assessment is still based upon the total amount of the deposits; that is correct, is it not, whether insured or not?

The CHAIRMAN. That will be the situation under the new law, but it is not the basis on which the assessments are made under the law as is stands now.

Mr. SISSON. I know, but it was contemplated as a permanent fund?

The CHAIRMAN. Well, under the permanent plan, there would be an assessment of one-fourth of 1 percent, to be repeated in case of necessity. The necessity depends upon whether or not the total fund on hand equals one-fourth of 1 percent of the amount of the total deposits of insured banks.

Mr. SISSON. Well, what I am getting at, Mr. Chairman, is this: You all know that was one of the points at issue last year, and that is going to be one of the points in controversy this year. We are getting some letters from certain banks to the effect that that is inequitable; that is, when the total amount of the deposits that are insured are a relatively small percentage of their total deposits, as compared with their uninsured deposits, they are making the claim that there should be a change made.

I am not taking any position. In fact, if I were to take any position now, I would be opposed to that contention.

The CHAIRMAN. I think you will find, Mr. Sisson, in Mr. Crowley's testimony, and in Mr. O'Connors' testimony that that phase of the legislation is fully covered, not only as to the changes made and the systems being employed, but all fields that enter into the calculation are covered.

Mr. HANCOCK. Mr. Chairman, may I respond to my good friend from New York?

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I had occasion, today, Mr. Sisson, to go into a case affecting an institution in my own State. I received a letter recently criticizing the method proposed under title I of the new bill, whereby the proposed assessment of not more than one-twelfth of 1 percent would be levied against the total deposits in any one institution, annually. This institution that I have in mind, under the present law, insured $20,700,000 of its total deposit liability of $58,000,000, and the present cost to that institution is approximately $51,000 a year. Under the provisions of the new act, whereby the assessments apply to the total deposits of $58,000,000—on the basis of not in excess of one-twelfth of 1 percent, the cost of insurance to this institution is actually reduced $3,000, to $48,000 a year; and 13,000 institutions that are insured today would carry this insurance at a lesser amount under the new act than they do under the temporary plan at the present time.

Mr. WILLIAMS. The fact is, there is no insuring under the permanent system and——

Mr. HANCOCK. No; I say, under the temporary plan.

The CHAIRMAN. Well, gentlemen, have we decided to adjourn for the afternoon? We will meet at 10:30 in the morning, and I hope we shall finish with Governor Eccles tomorrow.

(Thereupon, a recess was taken in the hearing until 10:30 a. m., Friday, Mar. 15, 1935.)

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BANKING ACT OF 1935

FRIDAY, MARCH 15, 1935

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committe met at 10: 30 a. m., Hon. Henry C. Steagall (chairman) presiding.

The Chairman. All right, gentlemen, there is nothing in the House to interfere with our meeting today.

We will resume with Governor Eccles. Mr. Ford, have you something?

Mr. Ford. Mr. Spence is next.

The Chairman. That is all right. Mr. Spence, if you have any questions, you may proceed.

Mr. Spence. Governor Eccles, what will be the practical effect of waiving the collateral requirements for the issuing of Federal Reserve notes? In other words, is there any limitation, or will there be any limitation on the issuance of notes?

Governor Eccles. There is no limitation now, for all practical purposes. What determines the use of currency is not the Federal Reserve banks, nor the member banks, but the people of the country who have claims on the deposits in the banks. They have the right to request a bank to pay them in currency. The bank, in order to be able to pay them such currency as they request, goes to the Federal Reserve bank to get the currency. The bank, in order to get the currency from the Federal Reserve, must have a balance with the Federal Reserve, just as an individual depositor with a bank must have a balance with the bank. Therefore, the only limitation upon the issuance of currency is the demand for currency by the people of the country that have bank deposits, and the collateral requirements in no way affect or change the amount of the currency.

Mr. Spence. What was the philosophy of the original act which so meticulously made the requirements for collateral?

Governor Eccles. I do not know that I can say. I could only surmise what was in the minds of the framers of the act at that time. The theory apparently was that the demand for currency would fluctuate directly with the volume of activity of business, and as business increased in activity, it would increase its borrowings on eligible paper, which, together with the gold, would supply the necessary collateral for the Federal Reserve notes; and, as business activity slackened or decreased, the volume of eligible paper held by the banks would be reduced, and hence the volume of currency would be reduced.

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It has been found, however, that there is nothing in the history of the Federal Reserve System to warrant such a conclusion. This is the only country where there is a central banking system, outside of Great Britain, which requires collateral to be held back of the note issue of the central bank. All of the new central banks which have been established in recent years recognize that, in essentially a check-using country, there is no necessary relationship between the use of currency and the volume of business.

We heard a great deal of talk about issuing currency with the idea that, if that currency is issued in greater quantity than is now outstanding, it would improve or help business. The direct spending by the Government of currency, from the standpoint of the actual money in circulation, and the business activity created thereby, would be no different than the same amount of money spent by the Government as the result of its present method of financing; because you cannot keep out in circulation more currency than is required by the country to meet its convenience in doing business. The currency comes right back to the banks and from the banks goes to the Federal Reserve banks and is destroyed. We have noticed that, from the time of the bank holiday up until the present time, the amount of currency in circulation has been reduced by about $2,000,000,000.

Mr. SPENCE. What is the total amount of gold held by the Federal Reserve, Governor?

Governor ECCLES. I do not recall the figures. Do you have that, Dr. Goldenweiser?

Dr. GOLDENWEISER. Gold certificates held by the Reserve banks amount to $5,400,000,000.

Mr. FORD. $7,866,000,000 in 1934.

Governor ECCLES. That would probably include the gold held by the Treasury as well. The Federal Reserve would not have that.

Mr. SPENCE. The amount of gold reserves upon which the circulation is based; what would that be?

Governor ECCLES. The law requires a 40-percent reserve against Federal Reserve notes in circulation. Those gold certificates, plus the Government bonds or commercial paper, or both, are held by the Federal Reserve agent as collateral. In the absence of commercial paper, it was necessary to accept Government bonds to make up the 60-percent difference between the 40-percent gold and the total of notes outstanding.

Mr. SPENCE. And this act is that 40 percent of the gold reserve is the sole basis of the circulation?

Governor ECCLES. Yes; 40-percent gold reserve is the only limitation. There is also a reserve required against the deposits of the Reserve banks, which is 35 percent in gold or lawful money.

Mr. SPENCE. And the circulation, based upon the gold now held, would be two and one-half times that?

Governor ECCLES. So far as gold is concerned——

Mr. SPENCE. So far as gold is concerned?

Governor ECCLES. Yes; there is almost sufficient gold now to back up the outstanding currency 100 percent.

Mr. SPENCE. As I understand, the Federal agent was the agent of the Federal Reserve Board in its dealings with the Federal Reserve banks?

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Governor ECCLES. The Federal Reserve agent is the chairman of the board of directors, and is appointed by the Federal Reserve Board and not by the banks, and he is the person at the bank through whom the Federal Reserve Board deals.

Mr. SPENCE. He, in a sense, represents the Federal Reserve Board in dealings with the Federal Reserve bank; is not that the philosophy of it?

Governor ECCLES. That is right.

Mr. SPENCE. And he saw that the Federal Reserve banks complied with the requirements of the Federal Reserve Board. How will those functions be performed now?

Governor ECCLES. Through the Governor and the chairman, who will be one and the same. Instead of having a dual organization, which creates cleavage and which is bad administration, it is proposed to combine the two offices. That is one proposal in the bill to which there has been practically no opposition from any source. The bill will save, in the operation of the Federal Reserve System, about $400,000 a year.

Mr. SPENCE. But the functions that were performed by the Federal Reserve agent are still being performed, but the Board will select the person to perform them?

Governor ECCLES. One of the principal functions of the agent was to hold the collateral as a sort of trustee against the notes which were issued. He was responsible at all times to see to it that these gold certificates and these Government bonds or commercial paper were deposited with him in sufficient amount to meet the legal requirements for the issue of notes.

Mr. SPENCE. Under the law, one Federal Reserve bank may rediscount—it says under the orders of the Board and regulations prescribed by the Board, may rediscount its paper in other Federal Reserve banks. To what extent has that been taken advantage of?

Mr. ECCLES. I could not tell you just to what extent. I understand, however, that in 1920 and 1921 there was some of that done, when the reserves of the Reserve banks got down to practically the legal limit and they were unable to extend further accommodations and, at the same time, have sufficient gold to meet the legal requirements for deposit and note-coverage. Do you remember to what extent that was, Dr. Goldenweiser?

Dr. GOLDENWEISER. In 1920, from memory, about $250,000,000.

Mr. ECCLES. How many banks were involved in the rediscount?

Dr. GOLDENWEISER. There were 11.

Mr. SPENCE. That provision, really, in effect, makes the Federal Reserve bank a central bank, does it not?

Governor ECCLES. It does so only to the extent of making the resources of the system available for the benefit of all the member banks, and that is all.

Mr. SPENCE. There is one other thing: I believe you said that you thought that some policy ought to be prescribed with reference to the administration of the bill, and you made a suggestion, or you suggested an amendment. Will you tell us what that amendment was, again?

Governor ECCLES. I suggested that I thought that fixing the price level as an objective would not be desirable, and as an alternative

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I suggested that something like this might be better as a definition of objective:

It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate, by its influence, unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

That is better, I feel.

Mr. WILLIAMS. That would be their duty even if you did not put it in there, would it not?

Governor ECCLES. The present law does not give them such a duty, at all. The present law only provides for——

Mr. WILLIAMS. Ought it not to be their duty?

Governor ECCLES. I do not know. The law has looked upon the Federal Reserve banks as agencies to provide credit for agriculture, commerce, and industry. The original act never contemplated the Federal Reserve bank as a monetary factor, as I understand it.

Mr. CROSS. May I interject right there, that the testimony of the members of the Reserve Board and some of the governors—they testified that it was not their duty and they did not consider they had anything to do with it.

Governor ECCLES. I think it was thought that, if credit was provided for commerce, agriculture, and industry, that is all that could be done toward creating business stability.

Mr. WILLIAMS. You think they made no effort along that line, at all?

Governor ECCLES. What is that?

Mr. WILLIAMS. You think they have paid no attention to the objective that you set out there, heretofore?

Governor ECCLES. I would not say that. Of course, the powers of the Board have been limited, their authority and their duties——

Mr. WILLIAMS. And they made no effort, at all, to stabilize business conditions and mitigate the evil effect of fluctuating prices and unemployment, and things of that kind?

Governor ECCLES. I have only been on the Board, as you know, for a very short time, and what the Board may have done is a matter of record, and it would appear in the record, from the condition of unemployment, the fluctuations of business activity, that whatever may have been done was a long way from creating stable conditions. Whether a condition of business stability can be brought about by monetary policy, only time can determine; and, as I stated the other day, monetary action has its limitations and has to be considered in connection with the tax program and Government expenditures.

Mr. WILLIAMS. I do not mean to be understood to be opposed to the suggestion you made here. I had had the impression that was their duty all right, and I still think, if it has not been their duty, we ought to make it their duty.

Governor ECCLES. I do not believe that under the existing law they are required to carry out or to perform that function.

The CHAIRMAN. Well, the fact is, is it not, Governor Eccles, that there was an attempt to incorporate specific directions of that type in the original Federal Reserve Act, and finally, it was left out of the bill.

Mr. FARLEY. Mr. Chairman, may I have an opportunity——

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The CHAIRMAN. Mr. Spence, will you yield to Mr. Farley?

Mr. SPENCE. I just want to ask a question. Governor Eccles, do you consider that this bill, if passed, will be an attempt by the Congress to exercise its constitutional legislative function to regulate the value of money?

Mr. ECCLES. I should say that it would be a case of Congress delegating to a body that power and that responsibility, as defined in this statement that I just read. We often think of regulating the value of money as having reference to gold.

Mr. SPENCE. Well, as a corollary to that, that would be regulating the price levels, too, would it not?

Governor ECCLES. It would be an attempt to regulate the price level. If these instructions or requirements are prescribed for the Federal Reserve Board the price level will be one of the objectives, but not the only objective. Others will be stable production and employment.

Mr. SPENCE. Well, how far do you think you could go in obtaining some definite objective as to the regulation of price levels?

Governor ECCLES. The controlling of production and the fixation of prices can tend to create whatever price level is desired.

By the operation of the National Recovery Act and the Agricultural Adjustment Administration you can restrict production and bring about a rise in prices; but it seems to me that the thing that we are most interested in is to get a maximum of production in the country as a whole and a maximum of consumption. That is far more important than the price level.

In order to be able to get a maximum of production, it is necessary to get a proper distribution, and the question of price naturally has to enter into the problem. I do not know that I could add anything to what I said when Mr. Cross was examining me with reference to the problem of prices.

Mr. CROSS. May I ask a question?

Mr. SPENCE. Go right ahead.

Mr. CROSS. Governor, you said that three factors come in there: The question of price and production and employment. If you check the price level when the country was prosperous and when its indebtedness was created, much of it fixed by bonds and taxes, and the cheap dollar compared to the present dollar that existed—if you get a price level that is comparable to the price level then in that period, is not that the very thing upon which depends both production and employment? In other words, to get employment you have got to get the price to where the producer makes a profit—a probable profit, because not everybody makes a profit, of course, but under good management, he can make a profit, and when he can do that, he employs labor and in turn labor is given a purchasing power and the country can function as a result of that, and you get rid of your unemployment and you keep a stable product and you keep a stable price level on the standard you take of some prosperous year.

Governor ECCLES. You know, from 1923 up to about 1929, we had a fairly stable price level. Now, why was it that that stable price level became an unstable price level and we got into the depression we did?

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Mr. CROSS. If you will let me answer that, if you put that as a question——

Governor ECCLES. I think maybe asking a question is the best way for me to answer it.

Mr. CROSS. I would say the Federal Reserve Board fell down in its duty, or fell down under the law as it existed—I could not say it was a duty. But in addition to that, we did not have then the securities act to control the wild speculative gambling that took place throughout the country on the stock exchanges. Now, we have controlled it largely through the laws enacted in the Seventy-second Congress.

Governor ECCLES. You assume that, if the volume of money in relation to total production is kept at a certain ratio, you would thereby maintain a uniform or fixed price.

Mr. CROSS. Not a fixed price of anything?

Governor ECCLES. No, I know; I mean a fixed index, uniform prices according to some index. And you overlook, it seems to me, the income velocity, which is an element as important in our economy as is the quantity of money. As I indicated the other day in reading the quotations from the Brookings Institution report on our capacity to consume, there must be a more equitable distribution of income than existed in 1928 and 1929, in order to keep up income velocity and to prevent production capacity getting all out of balance or relationship with consumer buying power.

Mr. FORD. In other words, Governor, if you have a national income of $100,000,000,000, but if it was confined to a small percentage of the people in the country, it would not accomplish the result of wide-spread purchasing power, would it?

Governor ECCLES. It would only so long as those receiving this income continued to spend or invest those funds, but you reach a point where——

Mr. FORD. A saturation point, in other words?

Governor ECCLES. They no longer invest.

Mr. FARLEY. Mr. Chairman, may I ask the Governor a few questions about the bill itself?

Mr. SPENCE. When I get through; yes.

The CHAIRMAN. When Mr. Spence gets through, I will recognize you immediately, Mr. Farley.

Mr. SPENCE. Governor, the maintenance of a stable dollar is something that is very greatly to be desired, is it not, because if the dollar would raise 10 percent in value and buying power, the wealth of the Nation would be raised that much. For instance, if there was $400,000,000,000 of wealth in the Nation and the dollar raised its buying power, or was increased 10 percent, that would reduce the money value of the wealth of the Nation $40,000,000,000, would it not?

Governor ECCLES. A stable price level is very desirable. If I knew of some way to maintain stable prices, and at the same time maximum production, naturally I would be very much in favor of pursuing that method. But prices are influenced by so many factors, crop failures, for instance, prices of imported goods as they are influenced by the variation in the exchanges—those are two factors that we may have very little or no control over, and they all enter into the price structure.

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Mr. SPENCE. Now, in this bill we state a new policy, or new standards, or new criterions, or new objectives to be attained. The provision here in regard to the open-market committee says it shall set forth policies that, in the judgment of the committee, should be followed with respect to the open-market operation of the Federal Reserve bank. Now, if this is a delegation of constituted legislative power to regulate money, would it not be necessary for the Congress, in making that delegation to state some objective to be attained?

I have not gone into that, but I want to read a paragraph from a decision of the Supreme Court in *Panama Refining Company et al.* v. *Ryan et al.*—one of the "hot-oil" cases:

The Constitution provides that "all legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives" (art. I, sec. 1). And the Congress is empowered "to make all laws which shall be necessary and proper to carry into execution" it general powers art. I, sec. 8, par. 18). The Congress manifestly is not permited to abdicate, or to transfer to others, the essential legislative functions with which it is thus vested. Undoubtedly legislation must often be adapted to complex conditions involving a host of details with which the national legislative cannot deal directly. The Constitution has never been regarded as denying to the Congress the necessary resources of flexibility and practicality, which will enable it to perform its function in laying down policies and establishing standards, while leaving to selected instrumentalities the making of subordinate rules within prescribed limits and the determination of facts to which the policy as declared by the legislature is to apply. Without capacity to give authorizations of that sort we should have the anomaly of a legislative power when in many circumstances calling for its exertion would be but a futility. But the constant recognition of the necessity and validity of such provisions, and the wide range of administrative authority which has been developed by means of them, cannot be allowed to obscure the limitations of the authority to delegate, if our constitutional system is to be maintained.

I have not gone into that question, but do you not think there ought to be some objective, definite objective placed in the law?

Governor ECCLES. You mean as to price?

Mr. SPENCE. As to price level, the purchasing power of the dollar?

Governor ECCLES. By purchasing power of the dollar you mean the price level?

Mr. SPENCE. The price level; yes.

Governor ECCLES. If the price level is placed in the law as an objective for the Board to reach as a result of monetary action, and the other factors are left out, we may get the result of having a stable price level and not getting any of the other factors which we want. I believe that the price level is less important than employment. I think the most important element, after all, is total production, because that is the real measure of wealth. I do not know what monetary policy could possibly be pursued to bring about a fixed price level and maintain it; I do not know how that would be possible.

Mr. SPENCE. Well, the price level does have a very great relation to the production, does it not?

Governor ECCLES. It may or may not. The thing that, after all, has relation to production is the buying power of the people of the country as a whole. When the national income is increasing faster than production, prices rise and production is stimulated thereby; and when the national income is diminishing, prices decline, and production is diminished thereby.

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Therefore, it seems to me that the problem of the national income is a determining factor with reference to prices and production. So, rather than an arbitrary fixation of prices, if we could get an increase in the national income, we would get an increase in production and an increase in prices; and that is why in 1929, after we had had a period from 1923 to 1929 of stable prices—because we had had reasonably full employment during that period—and then our national income started to diminish and we got into a cyclical depression, prices went down and production went down.

Mr. SPENCE. Do you think the changing price level comes from conditions over which we have no control?

Governor ECCLES. Over which we do not have anything like complete control. We possibly can exercise some control through monetary action; but I do not think that we can exercise absolute control, unless we undertake to fix prices, by legislation, and attempt to regulate production accordingly. Even then, I doubt that we could maintain stability of the price structure as a whole.

Mr. SPENCE. The power given to the Congress, in the Constitution, to regulate the value of money is a power you do not think can be exercised?

Governor ECCLES. I do not think it can be exercised to the extent of maintaining a uniform price level, and at the same time keeping up maximum production.

Mr. SPENCE. Well, a good many of our ills have resulted from changing the value of the dollar and the fluctuating price level.

Governor ECCLES. Oh, yes; but the changing value, as I say, has been brought about primarily through the decrease in the national income, which was brought about through the inequitable distribution of income. That is where the trouble commenced very largely.

Mr. SPENCE. How far do you think legislation can go to stabilize the value of the dollar? Suppose we set the objective that we might not hit, but could we come anywhere near it?

Governor ECCLES. I do not know how. Certainly, interest rates could not be very much lower than they are now. The volume of money that is not in use is very great, and to increase it, it seems to me, would accomplish nothing toward either price raising or increasing business activity.

We have a potential increase of $20,000,000,000 in the supply of money. The excess reserves provide that. True, if Government spending were greatly increased, you would get an increase in the price level, because you would get an increase in the national income, and you would get an inflationary or reflationary effect as the result of that increased spending.

Mr. SPENCE. That would be an artificial condition?

Governor ECCLES. It would bring about the same result as an equal volume of spending by our people of their own funds, or their being willing to borrow and spend a like amount. That would inject into the circulation an increased amount of money and increase the velocity of money and raise the price level, and the buying power of the people would increase through that spending, and production would then have to increase to meet the increased buying power, and with the general increases, prices should tend upward.

Mr. CROSS. May I ask a question?

The CHAIRMAN. Mr. Farley is next.

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Mr. Spence. There is one question more. I have gotten so many letters from State banks—there is a provision in the law that you can waive the capital requirements of the State banks and then give them such additional time to conform to the requirements as the Board may, by regulations, prescribe. A good many of them feel that they ought to know just how long they have to comply with these requirements, when they become members of the Federal Reserve System, with the ultimate purpose of remaining in.

Governor Eccles. I suggested an amendment to that the other day that would give the Board the power not only to waive the capital requirements, but all other requirements, and also to permit banks to continue with less than $50,000 capital, if it is adequate in relation to their liabilities. So there would be no time limit if a bank with $25,000 capital did not need a greater capital in relation to its deposit liability.

Mr. Spence. Well, I suppose it works both ways.

Governor Eccles. That was the suggested amendment to liberalize that section.

The Chairman. All right, Mr. Farley.

Mr. Farley. That is right in line, gentlemen, with what I had in mind. In section 202 you provide——

Governor Eccles. Where?

Mr. Farley. Section 202, that the time in which this shall become effective is July 1, 1937. But why is there any objection to writing into the law 1940, for instance?

Governor Eccles. That is not in the banking bill of 1935. As I understand it, that is in the banking act which was passed in 1933. Personally, I see no reason for an extension of time in lieu of the provisions that are being made, in order to make it possible to admit all the State nonmember banks which are insured. I believe that it would be in the interest of those banks and the System as a whole to be members of the Federal Reserve System, if this legislation broadening the eligibility features is passed.

Mr. Farley. I wanted to ask this, because in the State of Indiana we have, in round numbers, 420 banks, and only six now are in the Federal Reserve, and I have the fear that, if they are compelled to qualify by July 1, 1937, there will be many of them left out. Do you not think that, if the insurance feature is withdrawn from these banks, because they have not qualified, it is just the same as closing the banks?

Governor Eccles. Why do you think they cannot qualify?

Mr. Farley. Well, they might be able to qualify in a little additional time, but if the rules governing the examination of these banks continue as rigid as they have been for some months past, they probably would not be able to qualify, because they have a lot of frozen assets yet.

Governor Eccles. I am sure that, so far as the present Federal Reserve Board is concerned, they realize fully that situation, and it is their expectation to take into the System all, or practically all, banks which are insured. It is for that reason that we are proposing this amendment to the Federal Reserve Act.

It is true that, as a condition of admission to membership, the Federal Reserve Board has rather rigid regulations, which are not requirements of law. They require banks to charge off all paper that is classified as a loss, by the reserve examiners, and all depreciation on

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bonds except those in the four highest classifications. However, the Federal Reserve Board, under this provision, would be expected to give the same consideration to the bond accounts of these banks that is now given to the bond accounts of existing member banks both by the Reserve Board and by the Comptroller's office.

Mr. FARLEY. Well, the inference, then, is that you mean to undertake to liberalize them; and I do not mind saying that, from the impression I have of you and your public work, I should not be much afraid that would not be done.

Why object to writing it into the law and making it 1940? I have in mind a case where I tried, a year and a half ago, to get a bank into the Federal Reserve System, and they were declined, because they had something like $360,000 of what they counted doubtful paper. Now, even in these hard times, that bank has been able to reduce that now over $200,000, and collect——

Governor ECCLES. When was that, you say?

Mr. FARLEY. About a year and a half ago.

Governor ECCLES. With the guaranteeing of bank deposits by the Federal Deposit Insurance Corporation and with help from the Reconstruction Finance Corporation, with reference to capital structures, providing funds at 3½ percent for preferred stock, the banking problem is very different than it was. As a practical matter, it seems to me that the banks which are insured by the Deposit Insurance Corporation should be admitted to membership in the Reserve System. There would be no point in making requirements upon those banks which would exclude them from the Reserve System, and thus exclude them from the benefits of the Deposit Insurance Corporation, and possibly close them. That would be a foolhardy thing to do.

So long as the depositor is protected by the Federal Deposit Insurance, there should be an effort made to get all of the banks into the System, so as to have unification of the banking system and thus be able more effectively to carry out a monetary policy; and by that means, also, greatly to assist in dealing with deflation as well as inflation.

It is true that by far the greatest decline, both as to the percentages of deposits and as to total deposits, was in nonmember State banks, practically twice as great as it was in the member banks.

Mr. GOLDSBOROUGH. I did not catch that.

Governor ECCLES. I said the shrinkage in deposits of nonmember banks, the deflation in nonmembers banks from the peak of their highest deposits down to their lowest deposits—in other words, the deflation of nonmember State banks—was almost twice as great as the deflation in the deposits of member banks.

That was a very great hardship on the communities which those banks served, and the bank failures were far greater in the case of nonmember State banks than in the case of member banks, both State and national, and that of course——

Mr. GOLDSBOROUGH. I would like to inject that that was not the condition in the State of Maryland; it was the failure of the large member banks in the important cities which carried the reserves of the country banks which burst the nonmember country banks.

Governor ECCLES. I think there are exceptions all over the United States; but what I am speaking of is the United States as a whole. I am taking the entire country.

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The CHAIRMAN. Somebody in the Senate, Governor Eccles, and I believe it was Senator Norbeck—I never ran it down like I should possibly have done—gave the figures, as I remember, for the year 1931, which show that the deposits, the casting up of accounts, showed that there were as many deposits tied up in the failed national banks as there were in the State banks; that I think the figures would show that, in 1931, there were more deposits tied up in failed national banks in the State of New York and in the State of Pennsylvania than there were in the State banks. I would not say that I could not be mistaken in those figures, because I am not an authority, but that is my recollection.

But let me ask you this question: What happened was that the failures first took place among the smaller banks; and of course that involved, at least in number, the State banks more than the national banks, and the nonmember banks probably more than the member banks; but when the fire spread from the back alleys and side streets to the mansion on the front and to the important centers, and began to involve the large banks, they were not helpless; they did not stand by and let the fire ruin them, but they came to Congress and had us open the Treasury of the United States to them.

So that it seems to me that an appraisal of that situation should be taken in the light of the fact that the processes were started by resort to the Federal Treasury, and never allowed to reach that end. So we do not know what the complete picture might have shown.

Mr. GOLDSBOROUGH. I think it ought to be stated here, as well as any other time, that another direct cause of the failure of the small banks was the fact that the large national member banks in the great centers, through the years immediately preceding 1929, unloaded securities on those banks, practically all of which securities afterward were shown to be sour.

Governor ECCLES. I have pointed out the effect of the bond acount when I was upholding the real-estate loan provision.

With reference to the chairman's remarks, I am not here making any odious comparisons between member and nonmember banks, for the purpose of putting the nonmember banks to any disadvantage. I am only trying to argue for the need of all banks to be members of the Reserve System and have available to them borrowing and rediscount facilities of that System, as well as of deposit insurance, so that we may avoid fires starting in the back alleys, et cetera; because, after all, the net result of the conflagration of the bank failures is finally to burn down the System, if it is not stopped; and in the process it is not only the bankers and the stockholders of the banks that we are directly or particularly interested in, but it seems to me we are interested in this problem as the duty of Congress and as the duty of officials who are responsible for our money situation.

Mr. GOLDSBOROUGH. Mr. Eccles, right there. Yesterday, I think, you stated that the stockholders in the Federal Reserve System receive 6 percent on their investments?

Governor ECCLES. That is right.

Mr. GOLDSBOROUGH. But the Federal Reserve System, in turn does not redeposit those funds in those little country banks; so that, in case of an investment which they make in the Federal Reserve System, they only get interest once; whereas on the ordinary in-

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vestment, where they get a redeposit, they may lend the same money 10 times. Is not that the reason why they object to coming into the Federal Reserve System, because they do not get the benefit of the deposits which they can reloan?

Governor ECCLES. As I understand it, most State laws provide that State banks—whether members or nonmembers they are subject to State laws—are required to maintain reserves, either in money or in balances with other banks, or both, of a certain percentage of their deposits. Now, I know the requirement for State banks in two of the Western States that I am familiar with is 15 percent of demand deposits and 10 percent of time deposits, which must be carried in cash or with other banks.

Mr. GOLDSBOROUGH. Yes; but that does not answer my question. I do not know whether you want to direct your attention to my question, but what I asked was, whether or not, as a matter of fact, when one of these small country banks enters the Federal Reserve System and gets its 6 percent, that is all the interest it gets on that particular investment. The investment is not redeposited with them so they can loan it over again, as the ordinary investment is which they make.

For instance, if they loan me $5,000, they expect me to simply take a bank book from them, so they can reloan that same money.

Governor ECCLES. When you buy a Government bond, the proceeds are not reinvested, or when they buy other bonds that are marketable, we will say, or listed on the New York Exchange, or when they buy Canadian bonds or other bonds, those funds are not redeposited with them.

Mr. GOLDSBOROUGH. They are not redeposited with the country bank, but they are redeposited with some bank?

Governor ECCLES. That is correct.

Mr. GOLDSBOROUGH. But the small banks are not loaded up with Government bonds.

Governor ECCLES. Their percentage of Government bonds is pretty high; it is much higher than it was, because there was no other place——

Mr. GOLDSBOROUGH. When one of these national banks buys $100,000 worth of bonds, all the Government gets is an entry by some $25-a-week clerk to the effect that the Government has deposited or has a deposit in that bank of $100,000. That is what happens.

The CHAIRMAN. Just one moment, in connection with what has been said, I think it might be well to call attention to the situation: It means more to the small bank, the bank of small capital, to tie up 6 percent of its stock in the Federal Reserve bank than it does for the large institution to carry that burden, it would seem to me. The little banks, under the old order, were permitted to carry their reserves in a correspondent bank, upon which they were accustomed to draw interest, which was no little thing to small banks. That operated in this way: In the South, for instance, or in the West, the demand for credit is seasonal. When marketing time came and collections came in, the bank had a plan by which it could use its surplus funds, to put them to earning, by carrying them to the city bank; and that, in turn, gave them a large borrowing privi-

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lege during seasons when the demand for loans was accentuated. So that was an advantage that they enjoyed.

In addition to that, the small banks, members of the system, had to surrender their right to charge for the services rendered in remitting checks, and that is, of course, a big item to any small bank where the problem of overhead is great, and where the volume of business is small, and, of course, that requirement kept many banks from joining the Federal Reserve System. And those banks that were automatically taken into the Federal Reserve System—the national banks—conducted a war against the efforts of the Federal Reserve Board to take away such earnings, as long as they were able to carry on the fight. They finally lost through legislative action and processes that I will not take the time now to review, but which were not altogether justifiable, in my view of the matter.

You may resume, Mr. Spence.

Mr. SPENCE. I want to address——

Mr. FARLEY. There is one other question I want to ask, in connection with your statement of the wide difference between the assets of the nonmember banks and the member banks. Was that arrived at by the same committee's examination?

Governor ECCLES. I do not just understand your question.

Mr. FARLEY. You said, a few moments ago, that the nonmember banks had a much larger amount of worthless assets than the member banks. Did the same group examine the nonmember banks, or arrive at the same conclusion?

Governor ECCLES. You must have misunderstood me. I did not make a comparison between the assets of the member and nonmember banks.

Mr. FARLEY. Then I misunderstood you.

Mr. ECCLES. I made no comparison between the assets, because I am not familiar with the condition of the assets of the nonmember banks.

Mr. FARLEY. I thought you said that the losses were greater in the nonmember banks than in the member banks, or their portfolios were not so good.

Governor ECCLES. No; what I said was, that the shrinkage in deposits and the liquidation at nonmember banks was far greater than that at member banks; that the deposit deflation, as the result of bank closings and credit contraction in the nonmember banks——

Mr. FARLEY. I get the idea.

Governor ECCLES. Was about twice as great as that in the member banks, in proportion to the total deposits of each group of banks.

Mr. FARLEY. I have a letter in which the Indiana Bankers' Association makes this very emphatic statement:

> The Indiana Bankers' Association is unalterably opposed to central banking in any form, and especially to a central banking system in which credit granting and management will be vested in any political body.

That gets back to the question of control. You thought, the other day, there was no danger of anything of that kind happening.

Governor ECCLES. I see no reason to expect the Federal Reserve System, under this bill, to be any more subject to political control than has been the case in the past under existing legislation.

Mr. FARLEY. I remember your answer. There is another item I would like to get a little information on. I have read your speech

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at Columbus over several times, and it is a very excellent presentation of the subject.

I personally think you never can have a price level until you control all products of every kind and description, from the farmer to the market, or to the consumer. I do not ask you to say whether you do or not concur in that suggestion. But now, about this provision by which you are going out and loan on all types of real estate, making provision for the rediscount of those securities at the Federal Reserve bank, and then permit the Federal Reserve itself to issue currency against all securities. It seems to me that the wildest inflationist in the world could not have had a better term than that. When you take on anything and issue securities—and issue currency against those securities, it seems to me it is just like Germany did at the end of the war. Is there anything in that?

Governor ECCLES. I though I had answered that point. That question has been asked a number of times. I will try to answer it very briefly and cover the subject. Three phases of this legislation have a bearing on this matter: Changing eligibility requirements, permitting long-term real-estate loans, and eliminating collateral requirements for Federal Reserve notes.

In the first place, I think that you will probably agree that the amount of Federal Reserve notes that go into circulation has no relationship to the collateral requirements. I attempted this morning, and yesterday, and I think the day before yesterday, to explain why that is the case.

Mr. FARLEY. If that is already in the record, Governor, it is not necessary to repeat it.

Governor ECCLES. With reference to the question of eligibility, what we are proposing is to permit the banks, subject to rules and regulations by the Board, not only to discount eligible paper, but also to make advances to member banks on notes of the member banks, secured by any of their sound assets. That does not mean that the Reserve bank would have the power to discount a 20-year mortgage. What it does mean is this: That the Board could, by regulation, permit the Reserve banks to loan to member banks on bills payable of the member banks, for such——

Mr. GOLDSBOROUGH. A promissory note; that is what you mean?

Governor ECCLES. That is right, a promissory note, secured by bonds, mortgages, collateral loans, on a basis to be determined by each Reserve bank to be a sound basis for the loan.

Those loans would be made for periods of 90 days or 6 months, according to the regulations that the Reserve Board may make with reference to maturities. The member banks in the aggregate do not borrow for the purpose of reloaning. What is usually done is that the banks borrow to meet a shrinkage of deposits, the shifting of funds back and forth, which always happens seasonally under normal conditions, and it is usually seasonal borrowing.

If an emergency situation developed, the only way that the fire of deflation and bank closing can be stopped is by the banks being able to meet the demands of their depositors, and when they are able to do that, the depositors do not want their money. But when the depositors find banks are unable to meet the demands and banks start to close, it is a progressive condition of deflation that develops; and, therefore, this eligibility feature becomes effective.

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By the way, I believe that the governors of the Federal Reserve banks and most of the member banks favor that requirement and recognize the advantage of it in protecting the banking system. The banking system, as a whole, would have to expand its credit by $20,000,000,000 before there would be any occasion to do any borrowing from the Reserve System, on the basis of present excess reserves.

The amount of real-estate loans to be made is not determined by the member bank's ability to borrow from the Federal Reserve bank, but by the percentage of time deposits, which, in itself, puts a limitation upon the expansion of real-estate loans.

I do not know that I answered your question——

Mr. FARLEY. Well, I have 2 or 3 other little questions I want to get a little light on. Does the practice still prevail of buying foreign bonds?

Governor ECCLES. I do not know to what extent. I would think, however, that if experience is any teacher, there would not be any great traffic today in foreign bonds. There are, however, certain foreign bonds, such as the Canadian issues, if that could be considered foreign, and Australian issues, and British bonds, and I think the bonds of Finland, and Poland, and Scandinavian bonds, which maintain their strength, their marketability, and have a very much better record than many domestic bonds of our cities, and counties, and States.

Generally speaking, foreign bond accounts of banks have been disastrous to them, particularly some of the South American issues and some of the European issues.

Mr. FARLEY. Would you care to state whether they need the Postal Savings System now, Governor?

Governor ECCLES. You mean is it a necessity?

Mr. FARLEY. Well, is it a good business proposition?

Governor ECCLES. For the Government?

Mr. FARLEY. Yes; for the Government?

Governor ECCLES. It is a good business proposition to the extent that they have been able to get money for 2 percent. I do not think that it is necessary for the Government for its own interests. I think the Postal Savings System has operated for the convenience and benefit and security of citizens who prefer to deposit up to $2,500 with the Government through the Postal System.

Mr. FARLEY. Well, would the guaranteed bank-deposit proposition——

Mr. ECCLES. It is less needed.

Mr. FARLEY. I think it is obsolete and ought to be put in the place where the interest that would be collected would be so low that nobody would even try it.

Governor ECCLES. I know that bankers, generally speaking, feel that there is a competitive relationship, and I think many of them would like to see the Postal Savings System eliminated, and feel that it is unnecessary in view of the Federal Deposit Insurance Corporation insuring $5,000 accounts. I do not believe it is very important, however, because the total funds in the Postal Savings System I think are somewhere around $1,000,000,000, and that is a comparatively small percentage of the total deposits of the banking system.

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Mr. FARLEY. On page 69 of this act, in paragraph (g), we wrote into the law in 1933 that bank directors could not borrow from their own banks. Has any good purpose been served by that act? In other words, do you not think that it is time that we liberalized that?

Governor ECCLES. It is not bank directors, it is bank officers.

Mr. FARLEY. Well, bank officers.

Mr. ECCLES. Yes. I think it is a very constructive piece of legislation. There is not any question that, in principle, officers of a bank should not be in position to loan to themselves funds of the bank. It may be very difficult for an officer to be impartial in dealing with himself.

However, to the extent that officers of banks have loans in banks, which were made prior to the passage of the legislation, those loans should be treated, it seems to me, with due regard to the ability of the borrower to meet the obligations. There is a time limitation provided in the law, which I think is July 1935.

Mr. FARLEY. June 16, 1935.

Governor ECCLES. June 16, 1935, and, of course, there are many officers' loans in banks that it has been impossible, during this period of depression, shrinkage of values, and lack of market for securities to meet by June 16, and it is proposed in section 3 of this bill that that time be extended for 3 years.

Mr. FARLEY. Three years from June 16, 1935?

Governor ECCLES. Yes.

Mr. FARLEY. Now, would it not be infinitesimally better to prohibit bank officers from borrowing outside of their own bank, and thus compel an officer to do his borrowing from the bank with which he is connected, and if desirable and with the approval of the majority of the board, to the end that his board may be able at all times to know what he is doing, and also place some responsibility on the board. Is not there this danger, that to permit the executive officers to borrow outside of their own banks could prove very dangerous? There is nothing to prevent an officer from an inland bank to borrow excessively from a large and distant city bank, for which he may furnish proper security, but which might involve him beyond the point where his directors would consider it safe for him to go?

Governor ECCLES. There is in the law a provision that requires officers who borrow outside of their own banks to report those loans to the chairman of the board, or the president of the bank; and if it happens to be the president or chairman himself, he is required to report to the board of directors.

I feel that officers should be prohibited from borrowing from their own banks, and I feel that they should also be required, if they borrow outside, to report their borrowings, as now provided in the law.

Bank officers in the past have always been required to report their loans within their own bank to the board of directors, because it is the duty of the board of directors of a bank to approve all loans, and, therefore, officers' loans in their own banks have been reported to the boards of directors; but we have found that not only officers' loans but many loans to directors have, in instances, created real banking difficulties, and I cannot help but feel that, in view of the record of the past, the prohibition now imposed should be continued,

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with the extension of 3 years for those officers' loans which cannot be paid at the expiration of the period on June 16 of this year.

Mr. FARLEY. Have you already put in the record whether you think we have money enough in circulation or not?

Governor ECCLES. If I have not, I am willing to.

Mr. FARLEY. In your speech at Columbus, you stated there were $24,000,000,000 in circulation. Do you think it would be a good thing if we increased that circulation?

Governor ECCLES. How is it possible to increase it?

Mr. FARLEY. Why do we not use the authority we gave the executive department to issue $3,000,000,000, to take up some of these bonds bearing interest?

Governor ECCLES. How would that increase circulation?

Mr. FARLEY. Well, it would give these banks the actual cash instead of bonds.

Governor ECCLES. What would they do with the cash? They would immediately send it back to the Federal Reserve bank and it would be in the Reserve banks as their excess reserves, and actual circulation would not change. The banks would have, in lieu of Government bonds, $3,000,000,000 additional excess reserves.

Mr. FARLEY. I was in a bank not so long ago and the banker made this statement, and he said he wanted to sell $50,000 worth of bonds, and he could get immediate credit without any trouble if he called Chicago and New York, but he could not dispose of them. He wanted the money on the bonds he had in his safe——

Governor ECCLES. You mean Government bonds?

Mr. FARLEY. Yes.

Governor ECCLES. You mean he could not sell Government bonds?

Mr. FARLEY. That is the statement that he made—that is, without a little sacrifice at that time.

Governor ECCLES. He is misaken. He could have gone to the Federal Reserve bank and borrowed par on those bonds and possibly at a discount rate of 2 percent. If they were 3-percent bonds he would have gotton more than the interest on his loan. He could have borrowed the funds at par from the Reserve bank.

Mr. FARLEY. In your judgment, we do not need any more circulating medium right now?

Governor ECCLES. In my judgment, you cannot possibly force out and keep in circulation more currency than you have now. You may substitute——

Mr. CROSS. Right there, may I ask a question?

Governor, if that be true that this money would go right back—if that be true—and if you were to take the $3,000,000,000 that he refers to and buys bonds with it and you could not keep that money in circulation, it would go right back out of circulation?

Governor ECCLES. That is right.

Mr. CROSS. That is unquestionably true, is it?

Governor ECCLES. There is no question about it.

Mr. CROSS. Why not pay off all of the Government bonds and get rid of paying any interest—because that would be inflation itself?

Governor ECCLES. Here is what would happen: We have outstanding some twenty-odd billions of dollars and Mr. Cross asked the question, why do we not do that, and I think I should explain

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that such action would simply increase the reserves of the banking system by the amount of Government bonds which were purchased with currency. The currency would go out, if it was $10,000,000,000 or $20,000,000,000 or $3,000,000,000, whatever amount the Government paid out in currency to retire its bonds; but the currency would immediately go into the banks and from the banks into the Federal Reserve banks and be destroyed, and you would just have additional reserves, additional excess reserves.

The CHAIRMAN. Do you not think this bill rests upon the theory that it is necessary to control the excess reserves, because of the fact that it would have a bearing on the circulation?

Governor ECCLES. Yes. You get to the point of increasing the reserve requirements a sufficient amount to extinguish the excess reserves created by the amount of the Government bonds retired.

Mr. GOLDSBOROUGH. That is when the banks really begin to fight, is it not?

Governor ECCLES. Now, let me follow that point through and see what the situation would be. In the first place——

Mr. GOLDSBOROUGH. Can I just carry out the question so you can answer this too? Have we not actually given the banks over $13,000,000,000, and if we undertake to pay the bonds off in the way indicated by Mr. Cross we would simply be taking away from them what we have already given them?

Governor ECCLES. The thought is that you are giving the banks an interest payment that is unnecessary and is therefore a subsidy; and that, by the Government paying its bonds in currency and thus increasing the reserves of the banks by the amount of Government bonds retired, it would be necessary to increase the reserve requirements by that amount in order to extinguish the reserves; otherwise this operation could carry possibility of credit inflation to almost unknown heights.

The CHAIRMAN. You mean by that that the release of that currency would tend to bring about inflation, but there would be under this bill the power in the Board to control that tendency or defeat it?

Governor ECCLES. It would have to get started first. Of course, the $2,000,000,000 that we now have in the excess reserves should tend to do that, and it has not done it. But following out the extinguishing of these reserves, that would close thousands of banks for this reason: About 39 percent of the total loans and investments of banks is represented by Government bonds. Therefore, if the bonds, we will say, which are held by the banks are retired, it would mean that the reserve requirements would be increased by the amount of Government bonds that are retired. Some banks have only 10 percent, and that is particularly true of nonmember State banks; and, of course, if this only applied to the member banks, you would destroy the Reserve System, because they would all leave it and become nonmember State banks. That is one thing that it would do.

If all the banks were members of the Reserve System, and the principle of increasing the reserve requirements by the amount of total bonds that were retired through currency were put into effect, a bank that had 10 percent of its assets in Government bonds would be required to increase its reserve requirements, we will say, by 39 percent. That would mean that that bank would have to liquidate the difference between the 39 percent and its Government bonds,

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unless you simply would say to the bank that its reserve requirement increases only by the amount of the Government bonds taken up with currency; in that case the bank that had the largest amount of Government bonds would suffer the greatest loss of earning assets and would have the largest increase in reserve requirements. This would be thoroughly unworkable.

For the time being, it does not seem to me that is the alternative at all, because it would create a condition that would do anything but make for recovery. It would create a condition that would be terribly deflationary. It would put the banking system in the position that you do not want to put it in. After all, whether we like the system or not, we have it today; and to make a change of this sort would be so revolutionary that it would bring about, as I said, a condition of great deflation.

Mr. HOLLISTER. Would it not, incidentally, scare every sound business man to death?

Governor ECCLES. I say, without question, that it would bring about a condition that would be almost as bad as the bank holiday.

Mr. HOLLISTER. Which would be reflected immediately in decreasing employment, would it not?

Governor ECCLES. It would close up thousands of banks, because there is not any question that you cannot take away from the banking system 39 percent of its present investments, when we all know that they are not operating today very profitably——

Mr. CROSS. Governor, if that should happen——

Mr. HOLLISTER. Let him finish, please.

Governor ECCLES. We have not taken a most important feature into account, and that is the service which the bank renders. If a bank has to carry reserves equal to its demand deposits, why on earth would a bank take demand deposits and become the bookkeeper for the community funds, for every individual that carries an account, and act as a collection agency for the purpose of clearing and facilitating individual business transactions from all over the Nation, unless that institution made up by service charges, what it lost through having to carry increased reserves by the amount of Government bonds retired with currency? This would be anything but popular with the people of this country.

Mr. GOLDSBOROUGH. The service charge would be assumed by society, of course. The Government would assume the service charge?

Governor ECCLES. Of course, and that is exactly what is being done today through the Government paying this interest on its bonds. That means that the service charge is being assumed by society.

Mr. GOLDSBOROUGH. In other words, you agree that bonds—it is not necessary for the Government to issue bonds; in other words, to borrow money, it is just the same as the Government issuing a circulation medium, is it not?

Governor ECCLES. As a mechanical proposition, yes. But after all, we have established a method of financing, not only in this country, but in every other country—Russia is the only exception——

Mr. GOLDSBOROUGH. Well, we do not have to do things that are wrong simply because somebody else does it.

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Governor ECCLES. Whether it is wrong or not, is a question. I am pointing out what are the customs, what are the practices, and to make a change, as proposed, which is revolutionary, would destroy confidence and so delay and retard recovery that I do not think it is desirable, and I do not believe that there are any particular advantages or arguments for the retirement of Government bonds by the issuing of currency.

It may be interesting to see just what the Government is paying the banks. There have been some very exaggerated statements made with reference to this subject, and it has been claimed that the banks were getting as much as $1,000,000,000 a year subsidy in the form of bond interest.

Mr. GOLDSBOROUGH. You are the only one that ever has called that by its true name, subsidy. We have never heard that before. You cannot find a metropolitan daily in the country that has the guts to call it a subsidy. You are the only one who has ever had nerve enough to call it by its right name.

Governor ECCLES. Society, then, is paying the banking system for a service—and you admitted that it was necessary that society should pay for the service which the banking system renders the people and communities——

Mr. GOLDSBOROUGH. Yes; but they should pay it directly and not by the banking system. That is the bunk, and if the public understood what the banking system was, if the public knew that the banks were allowed to loan the same money 10 times, they would not exist 24 hours, because Congress would be forced to change the law.

Governor ECCLES. I do not know that the banking business has been the most desirable or profitable, even with all of the subsidies and privileges you claim it gets.

Mr. GOLDSBOROUGH. Your reasoning is that, when deflation starts there is no way on earth to stop it?

Governor ECCLES. I would not go that far.

Mr. GOLDSBOROUGH. If you are on a 100-percent basis, you could not have deflation, because the money would always be in existence.

Governor ECCLES. I think that, mechanically, inflation is far more easy to control than is deflation.

Mr. GOLDSBOROUGH. You cannot control deflation under our system, and you cannot do it for this reason: That the creation of money amounts simply to the extension of credit, and whenever the banks start—when the banking system starts to collect its debts, it immediately decreases the circulation medium, it immediately causes a fall in all values, and it immediately causes the calling in of other debts. You just cannot stop it when you once start it under our system of fractional reserves.

Can I illustrate that in this way? In 1920 a very distinguished Member of this House, who is now on one of the boards down town, came to speak for me in my district. He said he had just had a talk with Mr. W. P. G. Harding, who was then Governor of the Federal Reserve Board. Cotton was then 30 cents a pound. He said Harding had told him they were going to bring the price of cotton down to 25 cents and stabilize it. I said, "My God! If you

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ever start that, you can't stop it." And cotton did not stop until it got down to 5 cents a pound. That is what happened.

Mr. FORD. Mr. Chairman, the Governor was going to read something that I am very much interested in——

The CHAIRMAN. Yes; we are all interested in that.

Governor ECCLES. I had a memorandum on this subject, because I had anticipated that that question might be discussed. With reference to the general opinion that banks are being paid $1,000,000,000 a year by the Government in interest, that is a greatly exaggerated statement. The total interest paid on the national debt during the calendar year 1934 was $817,000,000. Now, the banks, under the most generous estimate that you can figure, taking the bonds that they had, received about $260,000,000. And these are member banks. Figuring all banks, $320,000,000 is the maximum.

If the refunding operations of the Government continued until the holdings of the banks were converted into securities, bearing the current average yields, the interest received would fall to $180,000,000.

Now, it must be remembered that there are expenses in connection with the issuance of currency and keeping it in circulation; and it may be interesting to note that the cost of keeping the greenbacks and notes of the United States in circulation today is more per annum than the present rate that the Government is paying on its 180-day bills.

Mr. GOLDSBOROUGH. If they are entitled to some further consideration, do you not think it is a shame that we are refunding and giving them less interest?

Governor ECCLES. I am not arguing for consideration. I am pointing out the difficulties with no advantages of making the adjustments which you propose and which would be revolutionary, of the whole banking and monetary system, and I think, at this time, it would be disastrous.

Mr. HANCOCK. Will the cost of keeping the greenbacks out compare with the cost of issuing the 180-day bills?

Governor ECCLES. It is estimated here about fifteen-hundredths of 1 percent per annum on the greenbacks, and the 180-day bills were on the basis of eleven-hundredths of 1 percent, about one-tenth of 1 percent, which is less than the cost of keeping the greenbacks out.

Mr. HANCOCK. Where is the cost in keeping the greenbacks out?

Governor ECCLES. The destruction is rather rapid and they have to be reprinted, and the cost of shipping them out and shipping them back is something. Then there are insurance charges and express charges and there is personnel accounting, and other expenses.

Mr. HANCOCK. Does that same cost ratio apply to the Federal Reserve notes?

Governor ECCLES. I do not know what that cost ratio is. Do you, Doctor?

Mr. GOLDENWEISER. It is less than that, because of the fact that the denominations are large. In the Federal Reserve notes there are no $1 bills.

Mr. FARLEY. Mr. Chairman, I read into the record a while ago a rather emphatic protest from the State Bankers Association of Indiana, and just for the Governor's benefit I want to read just a little

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paragraph from the second largest national bank in the State of Indiana, and which, by your grace, survived all of the storms and is still a wonderful institution:

We might say we have given the whole bill very careful consideration. In fact, we discussed it for nearly 2 hours in our directors' meeting yesterday, and we believe that the bill, on the whole, is pretty good and meets the present needs.

That is a national bank's attitude.

Governor ECCLES. I am interested, of course, to get that reaction, and I have found, whenever I have had an opportunity to sit down and meet the arguments and questions with reference to the legislation, invariably the bankers feel that this bill is not what it has been reported to be by many of our financial writers and economists. Most of the criticism directed at the bill could be directed toward the act that we have been operating under for the last 20 years.

The CHAIRMAN. Mr. Williams, did you say you have a question to ask?

Mr. WILLIAMS. Yes. Governor, in connection with the interest that is being paid by the Government to the banks—there has been a good deal said about the interest that has been paid on bonds in the national banks and Federal Reserve System, and keeping or using those same bonds as the basis for issuing and lending out money which they get on account of that issue, and getting interest on it. Of course, in other words, that would be double interest, interest on the bonds which they deposit, or which they sell for the purpose of securing the issue, and the currency which they lend out, so they would get double interest on it, would they not?

Governor ECCLES. You are speaking of national bank notes?

Mr. WILLIAMS. National and Federal Reserve notes.

Governor ECCLES. The Federal Reserve member banks, of course, do not deposit bonds and issue Federal Reserve notes, but the national banks have the privilege of issuing national bank notes, which right has now been eliminated.

Mr. WILLIAMS. Here is the question. How much, in number of bonds, is used as the basis of the currency issue?

Governor ECCLES. There is about $800,000,000 of national-bank notes outstanding. They are the only cases where the bonds are used by banks for the purpose of issuing currency.

Mr. WILLIAMS. What about the Federal Reserve bank notes?

Governor ECCLES. The Federal Reserve banks have paid off their liability on Federal Reserve bank notes.

Mr. WILLIAMS. That is right recently, is it not?

Governor ECCLES. Yes; recently. There was never more than about $150,000,000 issued, and that was issued right after the bank holiday; and those Federal Reserve bank notes were put out on the basis of sound assets other than Government bonds and other than gold.

Mr. WILLIAMS. Well, now, I see a statement that the Treasury proposes also to retire bonds upon which the national banks issue notes.

Governor ECCLES. That is right.

Mr. WILLIAMS. When that is done, that activity will be removed from the picture?

Governor ECCLES. That is right.

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Mr. WILLIAMS. In other words, there will be no cost of Government interest upon its bonds?

Mr. ECCLES. There are greenbacks which, of course, have been out for a good many years, about $300,000,000——

Dr. GOLDENWEISER. $346,000,000.

Governor ECCLES. $346,000,000, with a certain amount of gold held back of those greenbacks.

Mr. WILLIAMS. And there is the argument that is being made by a great many people, that the Government has favored the banks by permitting them to deposit bonds——

Governor ECCLES. And issuing currency.

Mr. WILLIAMS. And issuing currency, receiving currency, and lending it out and securing interest on it, and at the same time securing interest on the bonds which they deposit for that purpose. Now, as I understand, that is a thing of the past?

Governor ECCLES. The Treasury last Monday announced that they were calling the 2-percent consols and 2-percent Panama's as of July 1, approximately $675,000,000 in total, and on July 1 the circulation privilege which was given to other Government bonds expires.

Mr. WILLIAMS. Have there been none of them used for the purpose of Federal Reserve note issue?

Governor ECCLES. No; not used by the Reserve banks. The Federal Reserve banks are required to deposit with the Federal Reserve agent gold equivalent to 40 percent of the notes outstanding, and the balance of 60 percent may be made up of eligible paper or Government bonds.

Mr. WILLIAMS. That is what I am getting at. Those bonds have been deposited, have they?

Governor ECCLES. Only by the Federal Reserve banks, from one department of the bank to another. In other words, the bank has been required to deposit with the Federal Reserve agent, who is the chairman, gold certificates and bonds, or gold certificates, bonds, and eligible paper.

We are proposing to eliminate the collateral requirement for the Federal Reserve notes; because it serves no purpose, it only adds additional expense, and has no relationship to the amount of currency in circulation, and is not required in any other central bank that has been recently set up anywhere in the world.

Mr. WILLIAMS. In other words, you propose to abolish the principle that has heretofore been followed of issuing currency based upon Government bonds?

Governor ECCLES. Yes.

Mr. SPENCE. Have all of the banks that had that privilege that availed themselves of it been national banks?

Governor ECCLES. Yes; no other banks had that privilege.

The CHAIRMAN. They are using about $150,000,000 extended under the relief act and——

Dr. GOLDENWEISER. That was in the Home Loan Act of 1932.

Mr. SPENCE. What proportion of them have not availed themselves of the privilege? Have you any figures on that subject, Governor?

Governor ECCLES. Mr. Smead could get that. What percentage of the national banks have not availed themselves of that privilege?

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Federal Reserve Bank of St. Louis

Mr. Smead. Of the 5,422 reporting licensed national banks on June 30, 1934, there were 4,600 banks issuing circulating notes, and 822 banks which did not exercise the circulation privilege.

The Chairman. Well, there will be no more notes issued by the national banks, based upon Government bonds?

Governor Eccles. That is right.

Mr. Cross. Governor, I want to go back to where we were awhile ago, when I asked you about the $3,000,000,000. As I understood your first statement, it was that if you were to take that $3,000,000,000 and buy bonds with it, call it in or buy that much bonds, it would not cause any inflation to come back; but, as a secondary proposition, there would be inflation through the banks, because they would have more business; is that correct?

Governor Eccles. There would be a possibility of inflation through the banks, by reason of the increased reserves from——

Mr. Cross. The $3,000,000,000?

Governor Eccles. You have a potential inflation, but you would have to use the existing $2,000,000,000 of excess reserves before the $3,000,000,000 would have any effect.

Mr. Cross. Now, we realize one thing, and this is what is disturbing me: As I get your attitude, we cannot get a measure of value—that is, we cannot make the dollar the measure of value, and I do not know why the atmosphere seems to be so surcharged with the idea of expanding the currency. Everybody is talking about inflation, yet we have inflation until we are as flat as a flounder in the mud.

Now, we certainly cannot come back until we reflate, and I should say that, if we started reflating, we can get back to the normal situation; that we are helpless, or we must go ahead and start on a wild spree of inflation until we explode and plunge back and down into the mud again.

Governor Eccles. I do not think that is necessary.

Mr. Cross. That is what I am contending, that it is not necessary. My idea is that, with the levers you have, you ought to be able to agree on a price level that would give you a measure of value in dollars, but if we have these things recurring and are helpless, that is a tremendous indictment of our intelligence.

My idea is that we should certainly be able to get a measure of value. In other words, just to illustrate the proposition, that A borrows from B a certain amount of money, and the present price of the dollar, we will say, is money covering one particle of all of the things that are necessary to feed and clothe and supply the comforts and luxuries of life. Now, the next year, when he wishes to pay it off, because there is no value in the dollar, he has got to pay back two particles of that commodity that will buy the necessities and comforts of life, and it appears to me it is just as much within the law robbing the poor devil as if I had loaned you $100 and I met you on the street next year, when it was due, and took out a 6-shooter and said, "Give me that $200 you have in your pocket", because I am taking it from you, and it will supply me with twice the things that the $100 I let you have would supply me with. In other words, if $1 will take care of me all of my life, I do not need but $1.

Governor Eccles. Yes; what you say is true, that it is an injustice for a debtor to have to pay back debts in goods and services that have

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substantially less value when he pays his loan than it had when he received it.

Assuming that a dollar a bushel is fixed for the price of wheat, and the total wheat production at $1 is 400,000,000 bushels, are the farmers, as a whole, any better off than they would be with 800,000,000 bushels of wheat selling at 75 cents a bushel? In one case the income from the wheat would probably be $600,000,000 and in the other case it would be $400,000,000.

Mr. CROSS. I do not think you can take any one commodity.

Governor ECCLES. The point I am making is, it is production we are interested in. No one can pay his debts in terms of the price level. Higher prices do not help a business that only has one-half of the volume of business with which to pay its debts. You need to maintain not only the price level but also production.

Mr. CROSS. I understand. You said that a number of times; but do you think it is possible to get a measure of value or have the dollar come to where it would be the true measure of value?

Governor ECCLES. I do not think that is possible.

Mr. CROSS. Then we are helpless.

Governor ECCLES. No; I do not think we are helpless.

Mr. SPENCE. The Federal Reserve can exercise their power to regulate the rate of interest paid by banks to depositors on time deposits and savings deposits?

Governor ECCLES. That is right.

Mr. SPENCE. I think that is a very beneficial thing, because they have been the victims of competition or of the depression. Now, there is no authority in any national agency to regulate the rates paid by State banks, is there, at this time?

Governor ECCLES. Nonmember?

Mr. SPENCE. Yes.

Governor ECCLES. There is no authority, unless the Federal Deposit Insurance Corporation has it.

Mr. SPENCE. I do not think the Federal Deposit Insurance Corporation ought to have that power.

Governor ECCLES. That is taken care of in the Banking Act of 1935.

Mr. SPENCE. I think that would be welcomed by the banks, because they are the victims of their own competition.

Governor ECCLES. It is absolutely essential that member banks should not be subject to competition of nonmember banks by a limitation of the maximum interest that the member banks can pay and have the nonmember banks benefited and protected by the Deposit Insurance, and at the same time permitted to pay any rate of interest, whether it is a sound rate or not, that they wish to pay.

Mr. SPENCE. It would be very much better, if they could all do that and——

Governor ECCLES. The Banking Act of 1935 provides for that in section 323 (c), page 67, lines 1 to 7.

Mr. SPENCE. Have they exercised that power?

Governor ECCLES. The act has not been passed.

Mr. SPENCE. This act, you mean?

Governor ECCLES. Yes.

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Mr. FORD. Let me make an observation there. The banks are fixing the amount of interest that they can pay for deposits, are they not?

Governor ECCLES. We fix the maximum only. There are a great many cases where they pay much less.

Mr. FORD. Would there not be a good deal—there is no attempt made to fix the maximum interest they might charge when they loan that money?

Governor ECCLES. Most States have usury laws.

Mr. FORD. I understand, but they are pretty liberal. We make the price, we will say, to the miller, of wheat at $1 a bushel, but he can charge $10 a barrel for the flour, if he can get it, and that is a competitive matter and I do not think can be fixed. You could not say any maximum rate of interest that the bank would charge, because it was getting money from its depositors at 2 percent, because the demand for that money and the volume of it would determine what rate it would get?

Governor ECCLES. It will bring the rates down, and it is bringing the rates down.

Mr. FORD. But it is a fixed thing, is it not?

Governor ECCLES. Fixing the maximum rate of interest on deposits tends to bring down the rate on loans. That is the effect.

Mr. WILLIAMS. Governor, in order that we might have this clear, did I understand you to say that there is in the proposed law a provision which authorizes the Insurance Corporation to fix rates that could be paid by any member bank?

Governor ECCLES. Requires them to fix the rate? It is fixed by the Reserve Board for the member banks.

Mr. WILLIAMS. Where is that?

Governor ECCLES. Pages 66 and 67. We have not gone into that, because that is in title III of the bill. That is in title III.

Mr. FORD. What page?

Governor ECCLES. Pages 66 and 67.

Mr. WILLIAMS. Does that apply to the nonmember banks?

Governor ECCLES. Yes, that is what it does apply to.

The CHAIRMAN. The purpose of that is to prevent one bank inside of the Federal Deposit Insurance Corporation fighting against another bank?

Governor ECCLES. That is right.

The CHAIRMAN. And taking an undue advantage of it?

Governor ECCLES. That is right.

The CHAIRMAN. Gentlemen, may we not quit until 3 o'clock? I think we had better adjourn until 3 o'clock.

(Thereupon, a recess was taken in the hearing until 3 p. m.)

AFTERNOON SESSION

The CHAIRMAN. Governor Eccles, I believe Mr. Ford desires to make some inquiries.

Mr. FORD. Governor, I am not going to take you into the back-alley finance in my statement. I am just simply going to say, in a very short statement, that it is my reasoned conviction that the present bill, while not perfect as to all of its details, and undoubtedly

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requiring some minor technical amendments, seeks, on the whole, to accomplish the following desirable results:

First, by broadening the eligibility requirements of the Federal Reserve bank discounts, to uncover a great reservoir of potential credit, which will be made available. Is that true?

Governor ECCLES. There is ample credit today, but, without change in the eligibility features, there will be great hesitancy on the part of the banks to loan on other than short-term commercial paper or Government bonds.

Mr. FORD. All right. We will change that to make it "available so far as the borrower is concerned."

Governor ECCLES. It makes it available, not because they need to borrow funds to do it, but it makes it available because they would be willing to loan existing funds, if they could get borrowers, on longer time loans, that, otherwise, they would feel unsafe in making.

Mr. FORD. My second point is that, by placing in the hands of the Federal Reserve Board the authority to initiate open-market operations, we give them the power to regulate in a material degree or to stabilize in a material degree business operations. Would it do that?

Governor ECCLES. The three powers of monetary control—open market, discount rate, and reserve requirements—put into the hands of the Federal Reserve Board a power to control inflation. And they also put into their hands the power to prevent deflation, so far as can be done by the creation of excess reserves and by the reduction of interest rates.

There is no action that the Board itself can take that will induce people to borrow, induce corporations to borrow, the excess funds which the banks may have as a result of the Board's action in creating excess funds.

Mr. FORD. But it is an effective check on the impulse for inflation, on the one hand, and credit deflation, on the other hand, is it not?

Governor ECCLES. I think so. I think the eligibility changes and the control over the supply of money would certainly tend toward a prevention of deflation.

Mr. FORD. In addition to that, in the third place, does it not add two other desirable things: By broadening the eligibility requirements of the Federal Reserve Board, each member bank with sound but long-term paper could, under emergency conditions, take this paper to the Federal Reserve bank and get currency and thus better serve the needs of its community or meet a sudden emergency? Would that be a clear statement?

Governor ECCLES. The Reserve banks will have the power to loan to member banks on sound assets, which would enable the member banks to meet the demands of their depositors.

Mr. FORD. Certainly.

Governor ECCLES. Which otherwise they might be able to meet only by forcing a contraction of credit or by selling securities; or it might be that they would be unable to meet the demand and thus be forced to close.

Mr. FORD. Now, if I understood you correctly when you were making your various statements, you said that the Federal Reserve banks today had at least $10,000,000,000 that seeks profitable investment.

Governor ECCLES. No, sir. I said that the commercial banks had $10,000,000,000 of time deposits.

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Mr. FORD. I mean the member banks of the banking system had excess funds.

Governor ECCLES. No. The banking system has excess funds seeking investment of over $2,000,000,000.

Mr. FORD. What was that 10-billion-dollar figure that you used:

Governor ECCLES. I said that the time funds or saving funds held by the commercial banks amounted to more than $10,000,000,000.

Mr. FORD. But that would be seeking profitable investment, would it not?

Governor ECCLES. A good deal of those funds are loaned already in various types of loans. A great deal of those funds are no doubt invested in Government bonds and other securities and bonds guaranteed by the Government. The excess reserves of the banks, which are in excess of $2,000,000,000, are sufficient in amount to enable the banking system as a whole to extend new loans or to purchase additional bonds to the extent of more than $20,000,000,000 without the banking system as a whole being required to borrow from the Federal Reserve System.

The banking system creates money through its loans and investments. A bank making a loan of $1,000 to a customer creates $1,000 of deposits. However, for every $1,000 increase in the deposits of the bank the excess reserve decreases by 10 percent of the amount of that deposit increase, so that a loan of $1,000 increases the assets of the bank by $1,000 and the liabilities, in the form of deposits, by a thousand, and the reserve requirement by $100, approximately. You see, this increase in deposits would increase reserve requirements by 10 percent of that amount.

Therefore, 2 billion dollars of reserves in the System as a whole are a sufficient amount to enable the banks, on the basis of 10 for 1, to extend credit to the extent of 20 billion dollars, without having to go to the Reserve banks and discount or borrow money.

Excess reserve can be increased or decreased by open-market operations or by a change of reserve requirements? That is where you get your monetary control.

Mr. FORD. Now, then, at the present time we have a potential credit reservoir of about 20 billion dollars.

Governor ECCLES. That is right.

Mr. FORD. If paper eligible for rediscount came along, the banks would be free to make those loans, wouldn't they, knowing that they could take that paper, in an emergency, to the Federal Reserve banks, if they got into trouble?

Governor ECCLES. They would be. It would be very profitable to make those loans if they were available.

Mr. FORD. In comparison with the 2⅞ percent to the banks on long-term Government bonds, you are holding out an inducement to the banks, through this bill, to exercise their functions as banks and make every possible loan that they can——

Governor ECCLES (interposing). With safety.

Mr. FORD. I did not mean that they should go out and go crazy. But, when people come in wanting money, they would be in a position to loan it to them.

That is a thing that has always bothered me. I do not know whether I have got the explanation of it or not.

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Now, I note that since 1922 the volume of commercial paper in the United States—the normal commercial paper, under the old law, the 90-day paper, has been greatly diminished. Now, my understanding or my belief is that the reason for that diminution in that commercial paper was that many corporations, both large and small, instead of going, as they used to do, to their banks and getting their short-term requirements, have found that, through the investment bankers, they could issue securities and get that money all in a lump. And in many cases much of that money, after they had gotten it, did not go to their own bank, but went to New York, to be used for other loans, for speculation. Is not that true?

Governor Eccles. Partly. It seems to me that the transition that has taken place in our business and banking systems during the life of the Federal Reserve System has been that our business system has become more concentrated, into larger and larger units; and that there is today a greater concentration of corporate operations in the country, in fewer companies, than we have ever had before. The trend is in that direction, as evidenced by the chain-store development and the developments in almost every field of manufacturing activity.

Mr. Ford. Steel and all others.

Governor Eccles. We see a drift toward consolidation and mergers, making for bigness and a greater concentration of control.

That has tended to concentrate commercial deposits to a greater extent than formerly in the centers where the headquarters of the various companies are located; and it has also, in cases where there has been borrowing, largely concentrated all borrowing, at very low rates, on the commercial-paper basis, in the money market; so that the average small bank, or the banks in the towns of 10,000 people or even 25,000 people, and less, have not had the demand, and have not had even during the period of our great activity, in the twenties, the commercial loans to their local business concerns that they had prior to the developments to which I have referred.

It is true that many of the consolidations and mergers were brought about through flotations of securities, bonds, and stocks, and the effect of those flotations was that the banks that formerly carried commercial loans and short-term loans for the carrying on of business transactions, furnished the money through the purchase of bonds, or through loaning to customers, who purchased bonds or stock. So that there was a substitution, to, no doubt, quite an extent, of bonds and collateral loans in banks; whereas, formerly, particularly before the war, commercial paper was used to a far greater extent.

And, of course, in the case of farmer financing, that has been taken away from the local banks to quite an extent through the Production Credit Corporation. The Production Credit Corporations, which are a part of the Farm Credit Administration, get most of their funds by the sale of 6-month and 9-month debentures, outside of their capital, which has been furnished to them by the Government.

These debentures are sold in the market and the present rate is somewhere on the basis of 1½ percent per annum. The big banks, in the centers, with the surplus funds, are the purchasers, largely, of

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these debentures, thus providing the funds to the Production Credit Corporation, and the Production Credit Corporation supplies the funds to the farmers, through the local communities. So, it means that the banks in the centers, through the Production Credit Corporation, are financing agricultural production; and that, of course, takes away from the banks in the agricultural areas the eligible agricultural paper.

Mr. FORD. I note that in 1929 the commercial paper; that is, the commercial loans made by banks, were only $4,396,000,000, and that was at the peak of our so-called " prosperity ", and that in 1934 that sum had dropped to $2,144,000,000; so that there has been a gradual diminution or gradual disappearance of commercial paper as a source of business to these banks, and there is very little likelihood of any substantial increase in that.

Governor ECCLES. For the reason that, if you will examine the statements of most of our business concerns, it will be found that they have an excessive working capital. One of the difficulties today is that they are the owners of huge pools of deposit money now in the banking system, which they are not using and are not able to utilize; so that, even with an improvement of business the most that could be expected from many of our business concerns would be that they would put into use the funds that they now have, and under no circumstance would they be required to borrow.

Now, I am speaking of our business concerns in very general terms. In number there may be, and no doubt are, a great many business concerns that would be required to borrow; but, measured in the volume of the business which they do, which, of course, is the important element, there would be a small percentage.

Mr. FORD. Well now, that being the case, if the reason for the existence of our banks is continued, then we have got to afford them some additional opportunity, where their funds can be employed; and it seems to me that the long-term real-estate loan is about the only outlet that appears on the horizon at the present time to any great volume.

Is that an admissible statement?

Governor ECCLES. There is no prohibition now against banks making collateral loans which are not eligible; and there is no prohibition against banks buying long-term bonds. So long, then, as there is no prohibition now against the banks investing depositors' money in those fields, which are likely, in the event of depression, to be just as frozen as real-estate loans, there should be some liberalization with reference to the power of the member banks to make long-term real-estate loans. To what extent that will be utilized by borrowers it is impossible to say.

Mr. FORD. Oh, I realize that. But we all know, if we read our correspondence, and I know from my particular experience, that it is almost impossible, or it has been up to quite recently, to get a real-estate loan from any bank. Now, the reason the banks gave for that was that that was an unliquid paper, and if they put their money in there it would stay there, and they would have no way of getting it out if they had a call.

Governor ECCLES. They had been made to feel that a real-estate loan is a slow and an undesirable asset to have. And inasmuch as

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the banks have most of the loanable funds, and mortgage companies and the savings and loan associations, as a whole, have very little, and in most of the communities have no funds to loan, but are in the process of reducing and bringing pressure to bear, it would seem that the situation would be helped and relieved by permitting and encouraging the banks to make long-term, sound, real-estate loans.

Mr. FORD. Not with the idea, Governor Eccles, of making the loan today and taking it to the bank tomorrow and getting a discount, getting the money and coming back to make another loan; but with the idea of making a loan that was a profitable loan—and in our country the rate is 7 percent, which is quite different from 2⅞ percent—they could put that money into that market. Then, should there be a sudden demand on them for more money, they could always take those securities to the Federal Reserve bank and get the money for them, could they not, under this law?

Governor ECCLES. The Federal Reserve banks would have the power legally to loan to member banks on the notes of the member banks, secured by mortgages or other collateral, with such margin as they thought was advisable to make the loan sound. Certainly member banks would not loan money on mortgages and then borrow from the Reserve banks so long as the member banks had excess funds to loan. It could be expected that the member banks would be willing to pay interest on borrowed money from the Federal Reserve banks only when a condition was reached by any member bank that made it necessary for it to borrow to meet its shrinking deposits.

It has never been a policy of the Federal Reserve System to permit its member banks to borrow continuously or to borrow for the purpose of reloaning because there was a profit between the discount rate at the Reserve banks and the loaning rate of the member banks.

Mr. FORD. They were only there for the purpose of the bank getting the money when it actually had to have it and for a proper purpose?

Governor ECCLES. To meet the current demand.

Mr. FORD. Now, Governor Eccles, there is just one other observation I want to make.

There seems to be some apprehension in the minds of some of my correspondents as to this bill being an inflationary measure. We have had that out here before, but I just want to make an observation on it. We discussed this morning the question of fixing a price level.

Now, my conception of the possibilities lying dormant in this bill, and which can be developed if it is passed, for credit, is this: It will make available—and when I say available I do not mean that it does not now exist—but it will make it a little easier and more attractive for the banks to go into the business of loaning money, for the purpose of bringing our production up to a maximum. If we could do that we would bring our unemployment down to a minimum. The result would be a large pool of money poured out over the country and that would give purchasing power to the consumers of the country generally, and that would tend not only to stabilize business but to bring a gradual increase in the price level, up to some point where there might be an attempt made to

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peg it, within certain limits. Would not that be one of the ways of doing it?

Governor ECCLES. I do not know that I understand what you mean when you say, "Would not that be one of the ways of doing it"? Do you mean the bill as now drawn?

Mr. FORD. I am talking about bringing our production up to a maximum.

At every meeting that this committee has had there have been people who said, "Now, industry cannot get money; and, when industry cannot get money, it cannot produce; and the reason it cannot get money is that the banks are afraid to loan."

Now, the loaning of money of real estate might conceivably have a tremendous influence on industry, because it would put men to work. Now, if you could create conditions so that money could be easily gotten by industry, with a prospect of getting it back and getting a profit, that would immediately create a wage pool, and it would give an increase of income to the country and, with the increase of income to the country—and the wide-spread of the purchasing power that goes to the men that do the work is one of the factors—it would naturally put purchasing power in the country, and, with an increased demand for goods, the price level of all goods would come up, would it not?

Governor ECCLES. Yes.

Mr. FORD. And if there was a tendency on the part of prices to go up wildly, could not the Reserve Board, under this bill, put an appreciable brake or check on that?

Governor ECCLES. Yes; a general increase means an inflation; and that can be, in my opinion, controlled through the powers that this bill provides to be given to the Federal Reserve Board.

Mr. FORD. Well now, taking the questions that I have asked and the picture that I have painted, I ask if this bill tends to make that possible? Do you think it does?

Governor ECCLES. I do.

Mr. FORD. All right. That is why I say in the beginning, that I believe this is the measure that the country needs and that I am going to feel very comfortable in supporting this bill in the House.

The CHAIRMAN. All right.

Does anybody else on this side have any questions?

Mr. CLARK. It will take only a minute for my questions, Mr. Chairman.

I do not think that Mr. Cross, Governor, is very much satisfied with our helplessness in this situation.

In the amendment that you have proposed three objectives are tentatively stated: First, stable business conditions; second, full employment; and, third, a more or less stable price level.

I believe that you stated that, if this bill were passed, it would give the Federal Reserve Board a control over the volume of money. That is right, is it not?

Governor ECCLES. I think it gives the Board a control of the volume of money on the up side. It does not give it such a complete control of the volume of money on the down side.

Mr. CLARK. No; but it tends to give the Board a more nearly complete control of the volume of money than it has had heretofore.

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Governor ECCLES. Oh, yes; through monetary control plus the eligibility features.

Mr. CLARK. But you stated, however, that in order to achieve these desirable results—stable business conditions, full employment, and a more or less stable price level—that in addition to the control of the volume of money, there would necessarily have to be more control of the velocity of money—by the velocity of money meaning the ratio between the volume and the national income.

That is right, is it not?

Governor ECCLES. That is right.

Mr. CLARK. And you stated—I believe this is of fair inference from your testimony—that monetary action alone could control only remotely the velocity of the money; that is, by making the money available?

Governor ECCLES. That is, to the extent that low interest rates and abundant supply will induce its use; only to that extent.

Mr. CLARK. Then that is where Mr. Cross, I believe, stopped; that is to say, that is where the matter was let drop. However, I believe that, earlier in your testimony, you stated that there were two other factors which, if added to the control of the volume of money, might tend, in your opinion, to have a control over the velocity of money, namely, a tax system and a program of Government spending. Am I correct in that?

Governor ECCLES. Those are the other two elements which, it seems to me, in our capitalistic economy, must be taken into account to bring about a sufficiently equitable distribution of the national income, to keep up a full employment, full production, and keep the productive facilities adjusted in relationship to the buying power of the Nation.

Mr. CLARK. Yes; that is right. In other words, we have got, in your opinion, a three-legged stool; and this bill is one leg of the stool.

Governor ECCLES. That is right.

Mr. CLARK. This bill is designed to give control over the volume of money.

Governor ECCLES. That is right.

Mr. CLARK. Now, in order to make our stool stand up and in order to get out of that helpless condition in which Mr. Cross assumed we are—as we are—it is desirable, in your judgment, not only to pass a bill of this kind, or something of this kind, in order to build up this leg, but we should do more. Let us take the second leg of the stool—and I do not want to lead you astray, Governor Eccles, but it ties in. We are going to try to get somewhere and we want to get to a stable basis. Mr. Cross thinks it is an indictment of the human intelligence if we do not get somewhere, and I agree with him.

You say we need a tax system, and by that, I assume, you mean regulation of income taxes to the extent that when times are getting better and the price level is increasing and the full employment is reached the income taxes would be raised, as, I believe, you said they should have been raised in 1928, instead of having been lowered. So that is the second leg of the stool.

And then your third leg is a fixed national policy of Government spending, which would be controllable as conditions fluctuated.

By using those three things: first, monetary control, as proposed by this bill; secondly, shifting the income-tax rates; and, thirdly, increasing and diminishing the Government expenditures, not as an

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emergency proposition only, but as a fixed national policy; those factors would tend, in your opinion, to achieve this desirable state of stable business conditions, full employment, and reasonably stable prices, within limits.

Does that state it thoroughly?

Governor ECCLES. You have stated the case, I think, very completely.

Capitalism, sooner or later, has got to pay whatever it may cost, through the tax bill, to provide employment for people who are employable, and to provide an adequate, decent living for those who are unemployable, when the private employer fails to give employment on a sufficient scale to utilize our available labor.

That is the cost that we have to pay for capitalism; and the sooner we begin to recognize it when unemployment develops, the less the cost will be.

We have never questioned the duty of the Government to protect its citizens, no matter what the cost, against the encroachment of a foreign enemy. We have no more reason to question the obligation of the Government to protect the citizens, through insuring them employment, when private capitalism fails to insure that.

Mr. FORD. That is it.

Mr. CLARK. I think that is all. I really wanted to get that picture, because this is the first step along those lines.

Mr. SISSON. By Government spending, Governor Eccles, the third leg of the stool of which Mr. Clark spoke, am I right in assuming that what you mean is what might be called and what has been termed a long-range or long-term plan of public works, to be carried on when employment shows signs of becoming slack; and that kind of public work or that kind of Government spending to be carried on largely——

Governor ECCLES (interposing). To keep up the national income.

Mr. SISSON. Yes; and such as will least come into competition with private industry, with private business.

Governor ECCLES. I believe that, under capitalism, Government cannot compete with private business without the socialization of whatever field of private business it undertakes to compete in; and that Government spending should be in the fields of socially beneficial, public, noncompetitive activities, either directly or through grants to cities, counties, and States, for use in the same field.

I have no brief to offer against Government entering those fields which may be better handled in the public interest if owned and operated by the Government than if operated privately. But I do believe that when the Government steps in beyond the exercise of its regulatory powers, as a competitor, the natural effect is that all investment in that field, all private investment, stops; and that the field then must be absorbed and monopolized, sooner or later, by the Government.

Does that answer your question?

Mr. SISSON. Yes.

Mr. HANCOCK. Governor Eccles, is there any way of intelligently estimating what percent of short-time paper is usually renewed?

Governor ECCLES. You mean commercial or business paper held by the banks?

Mr. HANCOCK. Yes.

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Governor ECCLES. I think it would be practically impossible to do that.

The loan is paid in one bank out of the proceeds of a loan gotten in another bank. That is the way commercial paper is usually handled.

We will take, for instance, a concern is borrowing $10,000,000 on 90-day commercial paper. A number of banks buy that paper and, at the expiration of the 90-day period, the loans are paid. You will find that the borrower on that paper has possibly only reduced the amount outstanding, or may even have increased it, by borrowing, by offering paper in the market, and another group of banks, or the same banks, will purchase their 90-day bills, just as the Government now does in its short-time financing. It is offering 182-day bills; and the purchasers of that paper have short-time paper; but it is only paid by a refunding operation for 182 days, or for two hundred-and-some-odd days by selling new bills—maybe not to the same institutions, but in the market.

Mr. HANCOCK. Well, the reason that is permitted, and the bankers up to now have been seeking short-term paper, has been due to the fact that, if it ran beyond a certain period, it would not be eligible for rediscount.

Governor ECCLES. Under the law, it would not be eligible except as 90-day commercial paper or 9-month agricultural or livestock paper.

Mr. HANCOCK. But, under this bill, there is no time limit with respect to the eligible paper?

Governor ECCLES. You mean there is no time limit as to maturity of the paper that is used to secure advances?

Mr. HANCOCK. Yes.

Governor ECCLES. No; there is no time limit.

Mr. HANCOCK. That would be left to the rules and regulations of the Federal Reserve Board or to the rules and regulations of the individual Federal Reserve banks?

Governor ECCLES. It would be left to the rules and regulations of the Reserve Board, yes, sir; as to the terms upon which advances could be made by Reserve banks to members on sound assets.

Mr. HANCOCK. Governor, there is no limit to the maturity of the paper that could be discounted, is there, under the bill?

Governor ECCLES. What?

Mr. HANCOCK. There is no limit as to the maturity paper which could be rediscounted, is there?

Governor ECCLES. Except as the Board may make rules and regulations.

Mr. HANCOCK. I mean under the proposed law.

Governor ECCLES. No.

Mr. HANCOCK. Is it not a fact, Governor Eccles, that the banks have usually made most of their profits and earnings on so-called "slow paper"?

Governor ECCLES. I think that, without question, the greatest part of the banks' income would be on paper that is not eligible, because over 80 percent of all the paper of the banks, even in 1929, was not eligible.

Mr. HANCOCK. Now, Governor, just one or two other questions.

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This morning, you made a comparison as to the cost, between keeping greenbacks out and the cost on 182-day paper. With respect to the 182-daybills, is there any actual money passed in that transaction? Is it not just a sheer bookkeeping transaction? Is it not as I asked just a matter of bookkeeping? No real money is passed or put out.

Governor Eccles. That is true of any loan, any loan a bank makes. It is a bookkeeping entry, and the money does not pass until the borrower wants to draw it out in currency or check against it; and the check has the same effect as currency. The money is passed then as the account is checked against or as currency is drawn out and used. And the same is true with the Government borrowing. The banks take the bills or bonds and they credit the account of the Treasury and they debit the assets account of their loans and investments; and the Treasury draws against those funds as and when it desires to, just like any other depositor.

Mr. Hancock. How much money does the Government carry on deposit with the banks today?

Governor Eccles. I do not know exactly. I would say around a billion and a half.

Mr. Hancock. And what interest do they receive on those deposits?

Governor Eccles. They do not receive any.

Mr. Hancock. No interest return whatever?

Governor Eccles. No, sir.

Mr. Hancock. Of course, the banks that carry those large deposits would naturally buy this short-term paper at a very low rate of interest. Its really the Government's money they are lending to the owner.

Governor Eccles. The deposits that they have are of absolutely no value to them, because they carry those deposits to the Federal Reserve at no interest. So there is really a loss in the handling of them under the present circumstances.

As a matter of fact the Government deposits of a billion and a half, upon which the banks pay no interest to the Government, and which the banks must secure by Government bonds, are not profitable for the banks at this time when they have large excess reserves.

Taking the banking system as a whole, it carries with the Federal Reserve banks more deposits in excess of what is required than the Government carries with the banks. Therefore, the entire Government deposits could be moved to the Reserve banks; and thereby the excess reserves of the member banks would be reduced from something over $2,000,000,000—whatever it is today—by the amount of the transfer of those Government funds. For that reason, so long as the banks have excess reserves larger than their Government deposits, the Government deposits are of no value; there is no profit to the banks.

Mr. Hancock. Governor, let me get this straight in my mind. Did I understand you to say this morning that the policy of this administration and the Government from now on would be not to issue any more currency against Government bonds?

Governor Eccles. I have no way of knowing what the future policy may be. All I know is that the action which was taken by the Treasury to call, as of July 1, the bonds which were used to

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secure circulation, means that it eliminates from the national banks the right to issue national bank notes. Now, unless legislation is passed which again permits the national banks to issue currency against bonds which they deposit with the Treasury, that privilege will not exist.

Mr. HANCOCK. I may be misinformed about it; but I was under the impression that, under the present act, the President had the right to extend the time within which that process could be carried on; and that he had recently extended that time for another 2-year period.

Governor ECCLES. No. It may be that you are referring to the extension of the right of the Federal Reserve banks to issue Federal Reserve notes, secured by Government bonds, in lieu of commercial paper.

Mr. HANCOCK. I was probably confused about that. That right still exists?

Governor ECCLES. That was extended a short time ago.

Mr. HANCOCK. Were any other bonds originally issued to the national banks to support their circulation other than the Consols and Panamas?

Governor ECCLES. All of the bonds yielding 3⅜ percent or less. That right expires some time in July, and it cannot be extended without legislation, which means that any currency of the national banks that has been issued on a basis of the 3⅜-percent bonds, or bonds yielding a lesser amount, will have to be taken up.

Mr. HANCOCK. Well, I am glad to get that information from you, because I had wondered, in my own mind, why the Treasury was calling in the 2-percent Consols and 2-percent Panamas while leaving out the 3⅜-percent bonds if the purpose was to lighten the interest burden on the people.

Governor ECCLES. They are not calling in the bonds, but the bonds lose their circulation privilege, which was conferred upon them for 3 years——

Mr. HANCOCK (interposing). The circulating privilege?

Governor ECCLES. The circulation privilege, which will make it necessary for the banks which have used that circulation privilege to pay to the Treasury the amount of money representing the notes which they have used.

Mr. WOLCOTT. Governor Eccles, I have a very few questions to ask. I think all the questions that I had have been quite fully covered, with the exception of one or two.

There has been a feeling on the part of many economists that there should be very little affiliation between the currency of the country and the national debt. I presume that they have in mind that if we are called upon to manipulate the currency as our national debt increases or decreases, that that tends to an unstable currency.

In reading this bill I can see some affiliation between the action of the Federal Reserve Board and the national debt, inasmuch as they have the right, in the open-market operations, to help the Government in maintaining its credit, by at least retiring that part of the national debt which matures within the current year. Do you think that is rather a dangerous practice?

Governor ECCLES. It seems to me that the Government spends only those funds which the Congress appropriates. The Congress

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that has the power to appropriate money also has the power to create a means of providing that money, if it is not done through the existing banking system. Therefore, I do not feel that to make it impossible for the Government to finance the appropriations which Congress makes is necessarily going to defer what the Government spends, but it is likely to jeopardize the existing banking and credit structure. For that reason, it is desirable and necessary that there should be a relationship existing between the banking system and the Government in the interest, it seems to me, of the preservation of the existing banking system.

Mr. WOLCOTT. And would you say, also, the maintenance of the national credit by the use of the banking system of the country?

Governor ECCLES. The national credit is not dependent upon the willingness of the banks to supply it.

Mr. WOLCOTT. Now, in that connection, I assume that those open-market operations—that the Federal Reserve Board can, by adopting a policy which I understand to be mandatory in its operations upon the member banks, compel the member banks to invest in Government securities, so that, if we came to a time when, as I understand now, a great deal of our Government indebtedness is in the form of short-term paper?

Governor ECCLES. About $13,000,000,000.

Mr. WOLCOTT. About half of our national debt is in the form of short-term paper?

Governor ECCLES. Under 5 years.

Mr. WOLCOTT. And there was an endeavor on the part of the banks to unload that for the purpose of making more remunerative investments in industry, then, the Federal Reserve Board, through its open-market committee, could control that situation. So I see a direct relationship between the national debt and the possible amount of currency which is in circulation and the volume of currency which is in circulation.

Governor ECCLES. Do you mean by currency, deposit money as well?

Mr. WOLCOTT. I think we can confine it to Federal Reserve notes, because, if I understand this bill, together with the policy of the administration, our trend is toward a single currency.

Governor ECCLES. Yes; but I think there is absolutely no relationship between the Government debt and the amount of Federal Reserve notes in circulation. There may be absolutely no Government debt, and there still may be, and likely would be, the same amount of currency in circulation. There is no relationship between the two.

And it was interesting to note, in looking over some charts of other countries, where the debts have greatly increased—in Japan, particularly, I noticed the amount of its currency did not vary 5 percent. And the same thing would show here, that, as a matter of fact, our debt has increased during the last 2 years, and the amount of currency outstanding has come down as the debt has gone up.

Mr. WOLCOTT. Surely it has not increased in proportion to the debt?

Governor ECCLES. It has decreased.

Mr. WOLCOTT. When the debt was about $20,000,000,000, we had $4,250,000,000 of currency, or something like that, and at the present time we have $5,600,000,000.

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Governor ECCLES. Something like $5,500,000,000 in currency at the present time.

Mr. WOLCOTT. When you say that it has decreased——

Governor ECCLES (interposing). Decreased in comparison with what it was 2 years ago.

Mr. WOLCOTT. It has increased about $1,000,000,000 in the last 4 years. It has not increased in the last 2 years, but in the last 4 years.

Governor ECCLES. Yes, I think that is right; and that is due to two causes largely: One is the decreased use of checking accounts, due to the service charges and check tax, and also due to reduced incomes of people, which caused many of them to carry currency instead of using the checking account. There has also been a reduction in the number of small banks throughout the country, and thus there are many small communities which formerly supported banks and which today do not and cannot possibly support banks, thus requiring the use of currency in those communities. I think that is largely responsible for the increased use of currency. There is also some hoarding, I suppose, but I do not know how much of a factor that is now.

Mr. WOLCOTT. In other words, instead of a man who owed several people an aggregate of $100, drawing as many checks as he has debtors, he would either draw one check or go to the bank and draw it out in cash, and, for that reason, there has been more demand for cash.

Governor ECCLES. That is right. There have been less checks and more currency in circulation.

Mr. WOLCOTT. So that you claim there is no relativity between the amount of the national debt and the amount of currency in circulation?

Governor ECCLES. That is right.

Mr. WOLCOTT. Getting back to the question which was asked a few minutes ago, about the use of some of this gold profit to retire these Consols, upon which the national banks based their circulation, I assume from that and from this bill that it is the policy of the Government to eventually create a situation where we have a single currency, which will be whatever silver is needed for change and the Federal Reserve bank notes.

Governor ECCLES. This action will reduce the currency to the silver certificates which, from all present indications, may be a permanent part of our currency, and the greenbacks, which are $346,000,000. Outside of those two currencies, the Federal Reserve notes will be the only other currency in use; and, of course, the Federal Reserve currency will represent the great percentage of the currency in use.

Mr. WOLCOTT. So that the Congress, in the adoption of that policy, by passing this bill, would further contribute to the criticism of the Congress as having delegated its authority to coin money. I am not criticizing that policy. I am merely asking for the information. If there has been criticism of our having delegated heretofore to the Federal Reserve banks the prerogative of Congress to regulate the currency, there is a likelihood of a further criticism of our having centered the control of the volume of money in the Federal Reserve System, is there not?

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Governor ECCLES. Reaction of Congress in taking away from the national banks this right to create money does not seem to me that it should subject Congress to criticism. It has not deprived the Congress of any of its power to regulate money.

Mr. WOLCOTT. Well, it surely cannot be considered as a recapture of any of the prerogatives of Congress, which they have under the Constitution, to issue currency, can it?

Governor ECCLES. I do not think that it either takes away from or gives to the Congress any powers.

Mr. WOLCOTT. Well, I listened with a great deal of interest to a radio address by Father Coughlin, whom you have no doubt heard.

Governor ECCLES. I have not. I have never heard Father Coughlin. I have heard of him a plenty.

Mr. WOLCOTT. I will not attempt to quote him exactly, of course, but, in the course of his discussion, which was, I believe, the night that it was announced that $642,000,000 of the gold profits would be used for the purpose of retiring these consols, he at least expressed some pleasure at the fact that, at last, the administration was using some part of this fund as a base for the issuance of currency. Now, if I understand that operation correctly, we merely retired national bank currency and substituted therefor Federal Reserve notes. Is that right?

Governor ECCLES. That is right. The calling of the consols, $675,000,000, by the use of the gold profit, resulted in reducing the national debt out of the profits that were created through devaluation, to the extent of $675,000,000.

Mr. GOLDSBOROUGH. It was a deflationary gesture, too, wasn't it?

Governor ECCLES. The national-bank notes outstanding, which were secured by the consols which were called, were naturally retired.

Mr. WOLCOTT. Well, then, by retiring the consols, the Panama consols and these other consols—and there is another consol. What is the other?

Governor ECCLES. The Panamas and the consols.

Mr. WOLCOTT. By reason of having retired those consols, of course, it is necessary to retire a like amount of the currency that was started by those consols.

Governor ECCLES. That is right.

Mr. WOLCOTT. So that, unless we issued Federal Reserve notes to replace them, the volume of money we have outstanding will be $642,000,000 less, provided that was the money out against the consols?

Governor ECCLES. That is right.

Mr. WOLCOTT. So that, instead of being inflationary, instead of using any part of the gold profit for the purpose of increasing the amount of money outstanding, it takes out of circulation the national-bank currency in that amount?

Governor ECCLES. No. There is no difference in the amount of money. Federal Reserve notes will be substituted for the national-bank currency; and it will be done unconsciously, because people holding national-bank notes will use them in the course of business, just the same as they would use Federal Reserve notes or silver certificates. There is no distinction made in the use of the currency. Now, as the national-bank notes become mutilated, the banks will

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send in the currency, as it comes in through the deposit windows and is sorted—and, as the old notes are sent in to the Reserve banks, new Federal Reserve notes will be sent to the member banks in place of those notes, to meet the demands of the customers. The Federal Reserve banks will send in these mutilated national-bank notes to the Treasury and the Treasury will destroy them; whereas, in the past, they would issue new notes, keeping up the flow.

Now, the national-bank notes will just gradually pass out of existence as they become mutilated and, as they pass out of existence, Federal Reserve notes will take their place. It might take a year before the whole process is worked out.

Mr. WOLCOTT. It was on that that I predicated my previous question concerning the concentration of the circulating medium in the—or the regulation of the volume of the currency in the Federal Reserve System, taking from the national banks the money outstanding against these consols, and the Federal Reserve System issuing in place Federal Reserve notes.

Governor ECCLES. That is right.

Mr. WOLCOTT. There are two provisions in the bill on which I have had a great deal of correspondence. I do not know whether you are acquainted with one of them, Governor; that is, the provision with respect to the examination of private banks. Now, in the bill which we passed in 1933, we provided that within 1 year after the operation of the act all private banks which were not inspected by a State examiner, must, in order to continue to receive deposits, submit to examination by either a Federal Reserve examiner or a national-bank examiner. They had their choice as to which they would elect to be examined by.

Now, I notice that in this bill the law is to be amended somewhat; and I wondered what the reason for that was. It is amended in subsection (b) of section 303, page 52 of the bill. It is an amendment to paragraph 2 of subsection (a) of section 21 of the Banking Act of 1933 and it provides that:

> The expense of the examinations required hereunder shall be assessed against and paid by, the institution subject to examination in the manner and with the same effect as provided by section 5240 of the Revised Statutes, as amended.

What would you say was the purpose of that?

Governor ECCLES. That is under title III of the bill; and there are, of course, a good many phases that the Federal Reserve are interested in under title III, that have not come up or been discussed here. It was my understanding that the discussion at this time would be confined to title II of the bill.

Mr. WOLCOTT. Well, this directly affects the Federal Reserve System.

Governor ECCLES. Well, there are quite a number of——

Mr. WOLCOTT (interposing). I do not quite understand it. I am not very well acquainted with this and it is something that you might not be acquainted with, because it is a matter of detail, and these are a few isolated cases.

Governor ECCLES. Title III is composed largely of the legislation that was in the omnibus banking bill of the last Congress. There are some additions and some modifications and the particular section

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referred to is a section that is recommended by the Comptroller of the Currency. Under title III there are, I think, some 32 provisions. Thirteen of the provisions, of the total of 32, are provisions that the Federal Reserve System recommended and was interested in. The other sections were proposed by the Comptroller of the Currency and the Federal Deposit Insurance Corporation. They are largely of a technical nature.

Mr. WOLCOTT. Then, you are not in a position, as coming from the Federal Reserve Board, to say what the purpose of those was?

Governor ECCLES. No; I am not; because that was developed by the Comptroller of the Currency.

Mr. WOLCOTT. Would that be true also of the prohibition against bank officers and executives borrowing from their banks?

Governor ECCLES. That prohibition is already in the existing law.

Mr. WOLCOTT. But, there is a change. I have introduced a bill, at the suggestion of the Treasury, and Senator Copeland introduced the bill. It was suggested that I introduce it in the House; and I understand that they have used the language of it here in this bill. I wanted to ask some questions on that. This bill gives bank officers and executives 2 years in which to retire their investments.

Governor ECCLES. Three more years in which to retire loans made before the enactment of the Banking Act of 1933.

Mr. WOLCOTT. I wondered if any thought had been given to placing a limit upon the amount that they could borrow after that or at the present time.

Governor ECCLES. There was no consideration given to that by the officials of the administration who considered that particular legislation. And the Federal Reserve Board and, also, the Office of the Comptroller of the Currency have felt, as I stated here this morning, that bank officers should be prohibited from borrowing from their own institutions; and that, in cases where they have loans, they should be given an extension of 3 years.

Mr. WOLCOTT. I was interested in the matter only to the extent that several have written me about it; and it seems to me that the prohibition would work an injustice in small cities, where there is only one bank. And they think that they should be permitted to make emergency loans, up to $1,000 or $1,500, or something like that. I am not particularly interested in the section, but I am inquiring.

Governor ECCLES. We are not recommending that bank officers be permitted to borrow from their own banks under any circumstances; and it is my personal view that it would be a mistake to permit bank officials to borrow under any conditions from their own institutions.

Mr. WOLCOTT. I appreciate the purposes of this legislation. Yesterday, I think, Congressman Gifford was questioning you, and you remarked that the British national debt is only 7 percent of the national income.

Governor ECCLES. That the servicing, the interest, on the British debt is a little over 5 percent of the national income.

Mr. WOLCOTT. And that the interest on the United States national debt is about 1 percent of the national income.

Governor ECCLES. That is right.

Mr. WOLCOTT. In arriving at that conclusion did you take into consideration the internal, municipal debt of the United States?

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Governor ECCLES. No; only the national debt. I think I have the figures on the other debt in my mind. The British municipal debt is, of course, much smaller in proportion than the American debt.

Mr. WOLCOTT. They have a more centralized government?

Governor ECCLES. That is right. I think that the total public debt of Great Britain, so far as the figures are available—and it is difficult to get very accurate figures—is about $48,000,000,000. That, of course, is figuring the pound on the old parity basis of $4.85, and the American debt—in considering the Federal debt, as I said yesterday, the question of what we deduct from it by way of assets which are held in the form of loans that are made by the Reconstruction Finance Corporation, or other loans that are made by other Government agencies, should be given consideration.

Mr. WOLCOTT. After those deductions were made, I believe you said it was about $25,000,000,000?

Governor ECCLES. I said it was less than $25,000,000,000, without deducting the gold profit, which now makes up the stabilization fund—say, $22,000,000,000. I think the municipal debt would be around $17,000,000,000 to $18,000,000,000.

Mr. WOLCOTT. So that our total public debt would be in the neighborhood of $40,000,000,000?

Governor ECCLES. That is right, as against the British debt of about $40,000,000,000, whereas our national income——

Mr. WOLCOTT (interposing). Governor, for my purposes, probably we can shorten this up by saying that the public debt of the United States, based upon your previous statement, is something less than 2 percent of the national income?

Governor ECCLES. No. The public debt of the United States, in total, would be about 50 percent of the annual national income—the normal national income.

Mr. WOLCOTT. I should not have said that. I should say the carrying charges—the interest—for the total public debt.

Governor ECCLES. The ratio between interest on the public debt and national income depends, of course, upon what income you figure—whether you figure on the present income or whether you figure on what you term a normal national income.

Mr. CROSS. What is a normal national income?

Mr. WOLCOTT. Based on the normal national income.

Governor ECCLES. It would be less than 2 percent of the normal national income. Our normal national income, if we can figure 1927, 1928, and 1929 as normal, was about $83,000,000,000.

Mr. WOLCOTT. Do you know what the normal national income of Great Britain has been?

Governor ECCLES. Last year it was about $18,000,000,000, and $20,000,000,000 is about as high as it has been.

Mr. WOLCOTT. Does public debt, in the sense that you are using it, include the debts of municipalities, counties, towns, and villages?

Governor ECCLES. That is right. It is between $17,000,000,000 and $18,000,000,000, in addition to the Federal public debt, making a total of around, say, $46,000,000,000 of public debt.

Mr. SISSON. Do you use the term "national debt" in the same sense?

Governor ECCLES. No.

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Mr. Wolcott. No. At least I am distinguishing between the national debt of the United States Government itself and the internal public debt of the States, counties, cities, townships, and so forth.

And that public debt, other than the national debt, is between $17,000,000,000 and $18,000,000,000; and the national debt of the United States Government, according to the testimony, is, in round figures, $22,000,000,000.

Governor Eccles. The national debt, as I stated, depends on what you deduct by way of the gold profit and the assets.

Mr. Sisson. The guaranteed obligations of the Home Owners' Loan Corporation was not included in the national debt?

Governor Eccles. No.

Mr. Sisson. They are not a direct part of the debt, are they?

Governor Eccles. No. I am not including those as a direct part of the debt.

Mr. Cross. When you said a little less than 2 percent, you meant that the national debt, plus the other debts of the municipalities, and so forth, required a little less than 2 percent to service the interest charges?

Governor Eccles. Yes.

Mr. Cross. Do you include in public debts, national debts, municipal, State, and other local governmental debts?

Governor Eccles. The questions of Congressman Wolcott called for making a comparison between the total public debt, which included the State, county, and city debts, plus the Federal debt, as between the United States and Great Britain.

Mr. Cross. Yes; I understand that; but I wanted to get it stated in the record so that those statements would show clearly that when you said public debt you meant by that the public debts, Federal, State, county, municipal, and so forth.

Governor Eccles. That is right.

Mr. Wolcott. Then, inasmuch as we have not taken into consideration the contingent debt of Great Britain, but have taken into consideration the contingent debt of the United States Government, our total national debt at the present time, without making these deductions, is $31,000,000,000, and our State, county, and municipal debts are $17,000,000,000. That would make a gross public debt of $48,000,000,000, would it not?

Governor Eccles. That is right.

Mr. Wolcott. Or within $1,000,000,000 or $2,000,000,000 of the total British debt?

Governor Eccles. I think the gross national debt now is $27,000,000,000 plus. It is not $31,000,000,000. It would be $45,000,000,000, if we included State and municipal debts without deducting the balances on hand or the advances which will be repaid, or the gold profits.

Mr. Ford. Governor, do the obligations include any of the obligations of the Reconstruction Finance Corporation?

Governor Eccles. Yes; that is included.

Mr. Ford. That includes their obligations?

Governor Eccles. Yes.

Mr. Ford. And from that should be deducted their assets?

Governor Eccles. Most of the increase in the Government debt is not due to spending but to lending. For instance, $1,000,000,000 of

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the increase in the Government debt went to the purchase of preferred stock and debentures of the banks and $800,000,000 have gone to the receivers of closed banks as loans against their assets, in order to hasten their liquidation. There are other loans which have gone to the insurance companies, the railroad companies, the mortgage companies, and so forth. In fact, the entire Reconstruction Finance Corporation operation is a huge credit-expending operation, and the amounts will largely be recoverable.

Mr. SISSON. Are you taking into consideration at all the matter which Mr. Ford referred to? I would assume that what be meant by the assets of the Reconstruction Finance Corporation was the repayments. You cannot tell exactly what those repayments are going to be.

Governor ECCLES. That is right.

Mr. SISSON. You are not deducting, then, from the national debt the probable repayments, are you?

Governor ECCLES. Not in figuring the $27,000,000,000. There was no deduction. That was the total outstanding debt; and, from that you would have to deduct the balances on hand, which were over $1,500,000,000, as well as all of these assets; and, of course, there are also the commodity credit loans that have been made, running up to $600,000,000 or $700,000,000. There is also, as I say, the $2,000,000,000 in the stabilization fund. That is not taken into account.

Mr. SISSON. In this comparison which was made between the national debt of this country and the national debt of Great Britain, did your figures contain any comparison which would show what the debt of this country is per capita, as compared with the British debt per capita and what our income is per capita as compared with the British income per capita?

Governor ECCLES. I do not recall just what those figures are. Of course, it would be a very easy matter to get those figures.

Mr. SISSON. I remember reading them, getting them from other sources; but I thought that, before basing any conclusions on those figures, we ought to have them authoritatively. I know that our debt is very much less in proportion than the British debt and that our debt is very much less per capita than the British debt.

Governor ECCLES. Oh, yes. If the committee is willing, I think it may be well, in this connection, and I would like to insert in the record a coordinated, connected statement covering this comparison.

The CHAIRMAN. There is no objection to that. We shall be glad to have it.

STATEMENT BY GOVERNOR ECCLES ON THE PUBLIC DEBTS OF THE UNITED STATES AND THE UNITED KINGDOM

The kind of comparison most frequently made between public debts of two countries is in terms of debt per capita. The most recent authoritative figures of this kind were prepared by the Treasury for the Joint Committee on Internal Revenue Taxation. For national debt per capita—that is, the debt of the central government alone—the figures originating from that source are $850 for the United Kingdom and $215 for the United States. The debt per capita for all public bodies, including central governments, counties, municipalities, school districts, etc., is $991 in the United Kingdom and $370 in the United States, or about two and a half times as much in the United Kingdom as in the United States. Only very tentative estimates can be made of the national income in

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the two countries for the year 1934, but such information as we possess indicates that the national income in the United Kingdom was about $430 per capita as against $400 per capita in the United States. In all these comparisons the rate used to convert the British into the American monetary unit is $5 to the pound.

Because of the very difficult questions connected with selecting the proper rate of exchange between two currencies in making comparisons of this kind, and because the income of a country is more important than its population in considering questions as to the burden of its public debts, per capita figures of the kind just given may be misleading. For this reason the figures below on the relation of interest on public debt, public debt, and national income are presented. National income as used here means the total money incomes actually paid to all the inhabitants of a country.

Net central government debt, after deduction of Treasury balances, stabilization funds and other assets, is 38 percent of national income in the United States and 158 percent in the United Kingdom, or about four times as much of the national income in the United Kingdom as in the United States.

The debt of all public bodies—that is, the net central government debt plus the debts of all other civil divisions—is 74 percent of national income in the United States and 194 percent in the United Kingdom, or about two and one-half times as much of the national income in the United Kingdom as in the United States. In round numbers, the net debt of all public bodies in the United States is $37,000,000,000. If it was as large in relation to our national income as the British public debt, it would be $97,000,000,000.

Interest on the central government debt is 1.6 percent of the national income in the United States and 5.4 percent in the United Kingdom. Interest on the debt of all public bodies is 3.3 percent of the national income in the United States and 8 percent in the United Kingdom.

The following are the figures on which these comparisons are based:

As of 1934	United States	United Kingdom
	Billions of dollars	*Billions of pounds*
Gross central government debt	27.9	[1] 6.9
Net central government debt (after deduction of treasury balances, stabilization funds, and other assets)	19.4	6.3
Debts of all other government bodies	17.6	1.4
Total public gross debt	45.5	8.4
Total public net debt	37.0	7.7
National income	50.0	4.0
	Millions of dollars	*Millions of pounds*
Interest paid by central government	817	215
Interest paid by all other government bodies	844	105
Total interest paid on public debt	1,661	320

[1] Excluding war debt.

The CHAIRMAN. Governor Eccles, I want to suggest to you that it would be instructive if you would at some place in the record explain what eligible paper is, or what may be eligible paper under the existing law. I will not ask you to do that now. Just put it in the record.

Governor ECCLES. All right.

The CHAIRMAN. If there is no objection, the committee will meet again Monday morning at 10:30. Governor Eccles, we want you back here at that time, please.

Thereupon the committee adjourned until Monday, Mar. 18, 1935, at 10:30 a. m.)

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BANKING ACT OF 1935

MONDAY, MARCH 18, 1935

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. Gentlemen, we are ready to resume the discussion with Governor Eccles. Mr. Hollister, if you wish, you may have the discussion this morning.

Mr. Hollister. Governor Eccles, I would like to ask you a few preliminary questions before going into the actual gist of the bill itself.

Would you mind telling the committee—and these questions are with respect to title II, because with respect to title I and title III, I think there will be very little discussion. Would you mind telling the committee how this title II was prepared, who wrote it chiefly, and how it was drafted?

Governor Eccles. The members of the legal, economic, and operating staff of the Federal Board, together with myself, were appointed a committee by the board, to prepare Federal Reserve legislation to be considered by what is known as the "Interdepartmental Loan Committee", which the President had asked to consider all legislation dealing with financial matters. That in general is the way the legislation was prepared. Of course, it was——

Mr. Hollister (interposing). That was initiated by the Federal Reserve Board?

Governor Eccles. What is that?

Mr. Hollister. Was that initialed by the Federal Reserve Board, did I understand you to say?

Governor Eccles. The Federal Reserve Board appointed, at my request, a committee to develop this legislation.

Mr. Hollister. And who was that committee?

Governor Eccles. The committee were members of the staff. I was the chairman of the committee. The other members of the committee were Dr. Goldenweiser, who has been with the Federal Reserve Board for about 15 years, Mr. Wyatt, general counsel, who has been with the Board for nearly 18 years, Mr. Morrill, the secretary, who has been with the Federal Reserve Board for 4 or 5 years and prior to that was with the Federal Farm Loan Board, and Dr. Currie, who is Dr. Goldenweiser's assistant. That was the immediate committee.

They were assisted, of course, by other members of the staff, such as Mr. Smead, chief of the Division of Bank Operations, and Mr.

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Paulger, chief of the Division of Examinations. Those men have been with the Federal Reserve Board for a good many years.

This committee worked with me in the development of legislation which was considered necessary and advisable. The proposed legislation was, in turn, cleared with a subcommittee of the Interdepartmental Loan Committee, which reviewed it and suggested modifications and changes. Mr. Morgenthau was appointed by the President as chairman of the Interdepartmental Loan Committee.

Mr. HOLLISTER. May I ask you there, was not that Interdepartmental Loan Committee appointed some time ago as a clearing house for the various departments' financial requirements?

Governor ECCLES. No; not altogether. It was appointed to clear any legislation that was coming up from certain departments. All legislation that was to come up from nine departments, including the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Reconstruction Finance Corporation, the Home Owners Loan Corporation, and the Farm Credit Administration, was to be cleared through this committee or a subcommittee. That committee was to——

Mr. HOLLISTER (interposing). It was to clear legislation as well as to coordinate finance?

Governor ECCLES. Largely to clear legislation.

Mr. HOLLISTER. This draft went before a subcommittee for consideration?

Governor ECCLES. Yes, sir.

Mr. HOLLISTER. Who were the members of that subcommittee, if you remember?

Governor ECCLES. Yes. There was Mr. Coolidge, the Under Secretary of the Treasury, Mr. Oliphant, general counsel of the Treasury, Mr. Jesse H. Jones, Mr. Lynn P. Talley, who was formerly governor of the Federal Reserve Bank of Dallas and is now assistant to the directors of the Reconstruction Finance Corporation, and Mr. Leo T. Crowley. I think, Mr. J. F. T. O'Connor, Comptroller of the Currency, was in at one or two meetings, at the last. But most of the work on title II was gone over and discussed by Mr. Coolidge, Mr. Oliphant, and myself, and——

Mr. HOLLISTER (interposing). Title II, then, as it was drafted and presented in this bill, was the result of the preliminary draft which the committee appointed by the Federal Reserve Board had prepared, after it had been checked over by the subcommittee of the Interdepartmental Loan Committee?

Governor ECCLES. That is right.

Mr. HOLLISTER. Was that discussed at all with, or was the benefit of the advice received of, any of the governors or the directors or officers of any of the Federal Reserve banks?

Governor ECCLES. No; not the governors. The matter was not discussed with them.

Mr. HOLLISTER. This was a presentation, it might be said, from the point of view of the present Federal Reserve Board?

Governor ECCLES. That is right.

Mr. HOLLISTER. Was this draft, before being presented to Congress, approved by the Federal Reserve Board?

Governor ECCLES. No. The Board was not asked to approve it. The Board was kept advised of the legislation.

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Mr. HOLLISTER. The Board did not give any final approval of the legislation?

Governor ECCLES. In fact, they felt that it would be better to take no official action in the matter; but they were constanly advised as to the development of the legislation, and individually they were invited to express themselves about it, which they did.

Mr. HOLLISTER. But, prior to the introduction of this bill, there was no consultation whatsoever with any of the individual bankers of the country?

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. Federal Reserve or otherwise?

Governor ECCLES. Officials of the American Bankers Association. Mr. Rudolph S. Hecht, president, Mr. Robert V. Fleming, first vice president, and Mr. Tom K. Smith, second vice president, of the American Bankers Association, were advised with—particularly Mr. Smith.

Mr. HOLLISTER. While the bill was being drafted?

Governor ECCLES. Yes; and the report in the press as to the attitude of the American Bankers Association is entirely untrue. I think that, as a matter of fact, they have been cooperative and constructive.

Mr. HOLLISTER. I do not know what that report in the press is that you refer to.

Governor ECCLES. I just saw a report that represented the American Bankers Association as being opposed to title II of the bill. I think it appeared along with an account of the Liberty League's opposition, which, of course, was not——

Mr. HOLLISTER (interposing). There was consultation, then, with some of the officers of the American Bankers Association?

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. But not with any of the governors of the Federal Reserve banks?

Governor ECCLES. Not specifically with reference to this particular bill; but I discussed banking legislation with Governor Harrison, in a general way, but not the specific provisions of this bill.

The proposal to broaden the eligibility requirements has been generally recognized by all the bankers as desirable for some time. The proposed combination of the positions of chairmen and governors is desirable to the governors. It is undesirable to the chairmen, if they are to be eliminated, or it is undesirable to the governors if they are to be eliminated. But the principle of the combination of those officers——

Mr. HOLLISTER (interposing). I do not want at the present time to go into that in detail.

Governor ECCLES. Yes.

Mr. HOLLISTER. What I was trying to get was the preliminary picture and how much consultation there was with those who were to be very substantially affected by the bill, if it were to go into effect in its present form.

Governor ECCLES. Yes.

Mr. HOLLISTER. You have submitted to us a memorandum containing some eight modifications, which you suggest.

Governor ECCLES. There is one of them which is not important, and I prefer to withdraw it. That is the one that suggested——

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Mr. HOLLISTER (interposing). No. 6, you mean, the suggestion as to the authority over open-market operations being vested in the Federal Reserve Board?

Governor ECCLES. It is the one which suggested that two members on the Federal Reserve Board be selected from Federal Reserve banks, men who have had experience as officers or directors of Federal Reserve banks.

Mr. HOLLISTER. Well, I do not seem to find such a provision on this memorandum.

Governor ECCLES. Well, anyway, I don't think that is very important.

Mr. HOLLISTER. Well, these modifications that you have suggested to us, have they been checked up in the same way in which the original bill was drafted? Were they prepared by your committee of the Federal Reserve Board and checked with the Interdepartmental Loan Committee?

Governor ECCLES. No. They have been checked only with some of the individual members of the committee, not as official committee action. They were, of course, checked very thoroughly with our own committee and were also checked with the officials of the American Bankers Association.

Mr. HOLLISTER. Now, as I understand it, there is still another change suggested—that is, the withdrawal of one of these suggestions?

Governor ECCLES. Well, I do not think it is very important one way or the other. It was not mandatory but simply a suggestion that, in selecting the members of the Federal Reserve Board, the President considered the advisability of including at least two members who shall have had experience as officers of the Federal Reserve banks. The difficulty I see about that is that it is practically impossible to get any officials from a Federal Reserve bank to go on the Federal Reserve Board; because the compensation paid the officials of the Federal Reserve banks is two or three times the compensation paid the members of the Federal Reserve Board.

Mr. HOLLISTER. Is it probable that, as we go along, there will be still further suggestions made to change the draft of the bill as presented?

Governor ECCLES. You mean by me?

Mr. HOLLISTER. By you or those representing the Interdepartmental Committee or the Federal Reserve Board.

Governor ECCLES. I do not think there will be any. Of course, I cannot say. I cannot speak for others.

Mr. HOLLISTER. I realize that.

Governor ECCLES. There may be.

Mr. HOLLISTER. What I am trying to get at, of course, is to what extent the draft of the bill presented to us is a kind of rough draft, which is perhaps quite controversial at points, and how much it is the well-considered judgment, as you might say, of all the financial interests of the administration. Of course, if it is to be submitted in one form and suggestions made for changes by, perhaps, first one branch and then another branch, perhaps the committee would have a little different feeling about it than if it was in one form, which could be finally agreed upon and considered the united suggestions of all the financial branches of the administration.

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Governor ECCLES. All except one of these suggested changes were very minor modifications. For instance, the approval of the appointment of governors by the Board each 3 years, instead of annually.

Mr. HOLLISTER. That is rather a major change.

Governor ECCLES. Some may consider it major, but, at least, it is not fundamental. It is extending the period of approval only. When we prepared the legislation we expected, certainly, that modifications would be suggested or made, as is true in all legislation.

Mr. HOLLISTER. Perhaps we might discuss section 201, then, right off. Of course, a Federal Reserve bank is a private bank, which is owned by private capital, the individual banks having the capital stock in that Federal Reserve bank.

Governor ECCLES. It is quite different from the ownership of most private corporations, since the member banks are limited to a 6-percent return on their capital under every circumstance. The board of directors of a Reserve bank must get the approval of the Federal Reserve Board with reference to expenditures and so forth. It is quite different from the average private bank.

Mr. HOLLISTER. It is not exactly the same, of course.

Governor ECCLES. No.

Mr. HOLLISTER. But the fact is that it is the money of private banks which goes to buy the stock of the Federal Reserve banks; and the theory of the Federal Reserve banks was that the private banks, which have the stock, would control the boards.

Governor ECCLES. Of the Federal Reserve Board?

Mr. HOLLISTER. Of the individual banks. Now, you have stated——

Mr. BROWN (interposing). May I interrupt a moment?

Mr. HOLLISTER. Yes.

Mr. BROWN. I have not seen a discussion of it yet, but the law still provides for the issuance of stock to the Government of the United States. I do not think any was ever taken.

Mr. HOLLISTER. But, at the present time, all of the stock is owned by the private banks.

Mr. BROWN. That is the fact, is it not, Dr. Goldenweiser?

Dr. GOLDENWEISER. Mr. Wyatt says there is such a provision. I had forgotten it.

Mr. BROWN. It was in the original Federal Reserve Act.

Governor ECCLES. The purpose of that provision was to enable the Government to provide capital for the Federal Reserve banks if the banks failed to subscribe for sufficient stock; but they did not fail to do so.

Mr. BROWN. It was not put in the alternative, like that, was it?

Governor ECCLES. Yes; I think it was.

Mr. HOLLISTER. It was similar to the method by which the Government had to establish a number of these organizations which are private organizations; to start them by Government backing. It was similar to the home-loan banks, for instance.

You have stated that you did not consider that the change suggested (as to the approval of the Governor) from 1 year to every 3 years, was a major change?

Governor ECCLES. Nothing fundamental. It in no way changes the operation of the system.

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Mr. HOLLISTER. It is true, is it not, that the right of the Federal Reserve Board to approve every year the appointment of the chief executive officer—the governor—of the regional banks, makes it possible, of course, for the Federal Reserve Board to insist on someone who is absolutely satisfactory to the Board, and to do it every year.

Governor ECCLES. Well, of course, the right of approval would make it necessary that the Governor be satisfactory to the Federal Reserve Board.

Mr. HOLLISTER. And if that is changed to 3 years, just to that extent the power of the central board over the chief executive of the regional bank is weakened.

Governor ECCLES. It was intended in the original Federal Reserve Act that the chief executives of the regional banks should be the chairmen.

Mr. HOLLISTER. Theoretically, but not as a matter of fact.

Governor ECCLES. Yes; but I think they could possibly be made to be.

Mr. HOLLISTER. Under existing law?

Governor ECCLES. Oh, yes. The law has not been changed in regard to the chairmen at all.

Mr. HOLLISTER. I know that. But I know of no situation, in any corporation, where the board of directors might not designate powers in such a way as to make either the chairman of the board or the president chief executive officer. In some corporations the chairman of the board is the chief executive officer and the president has very little authority, and in some corporations the president is the chief executive officer and the chairman of the board is merely a figurehead.

Governor ECCLES. It depends largely on the strength of the men the respective offices of governor and chairman. The governors have usually exercised more influence than the chairmen. If it was their purpose, the board might make the chairman the chief executive of the bank.

Mr. HOLLISTER. But in the ordinary corporation, if it came to a conflict between two executive officers, the one that would get the power would be the one that the board of directors backed up, would he not?

Governor ECCLES. I suppose he would. That is one of the reasons, if you are going to operate a unified Federal Reserve System; that it is very necessary and desirable that such conflicts should not exist and that there be cooperation throughout the entire system. Otherwise the function of a central bank cannot be successfully carried out.

Mr. HOLLISTER. Well, there is a difference, of course, between cooperation, coordination, and control. What I am trying to get at is whether section 201 does not really take away the control of the regional banks from those who are duly appointed to handle their affairs; that is, their directors, two-thirds of whom are appointed by the banks who own the stock, and actually vest that control in the Federal Reserve Board.

Governor ECCLES. You are not vesting it in the Federal Reserve Board because the Federal Reserve Board would not designate the governor.

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Mr. HOLLISTER. They can throw him out at the end of the year if they do not like him. It is rather a strong weapon to hold over his head.

Governor ECCLES. They can only disapprove of the person selected by the board of directors of the bank. The proposal is that the head of the bank be acceptable to the Federal Reserve Board and to the board of directors of the bank, which is certainly necessary if you are going to have coordination. It would not be good organization for a local board to elect or appoint a governor who is also to be a class C director and chairman of the board of directors, under this provision, if that appointee were not acceptable to the Federal Reserve Board.

Mr. HOLLISTER. Is the governor at the present time a class C director?

Governor ECCLES. No; he is not a class C director. He cannot be. Under the present law the Federal Reserve Board appoints all three class C directors and designates one of them as chairman. Under this bill the Board is giving up its power or right to appoint one of the class C directors and to designate a person of its own selection as chairman.

Mr. HOLLISTER. There is no necessity of that if this other suggestion is not effected. There is no particular need of making the governor a class C director.

Governor ECCLES. If he is going to be chairman he would have to be a class C director.

Mr. HOLLISTER. Yes; if he is chairman he would have to be a class C director; but could you not provide for a governor and not change the law with respect to class C director?

Governor ECCLES. The legislation could be left just as it is and you would continue to have a chairman and governor, just as you now have.

Mr. HOLLISTER. You could abolish the chairmanship and still leave the governor, the chief executive officer, appointed by the board of the bank itself.

Governor ECCLES. And have no chairman?

Mr. HOLLISTER. And have no chairman.

Governor ECCLES. The chairman of the board is always a director.

Mr. HOLLISTER. Yes; but the governor could be appointed from one of the class A or class B directors.

Governor ECCLES. That would require that the banks give up their selection of one of the six directors they now select.

Mr. HOLLISTER. I should imagine that in order to keep their control, by having a governor who would not be removable each year, they would be willing to give that up.

Governor ECCLES. I find that the combination of the offices of governor and chairman is universally looked upon as desirable.

Mr. HOLLISTER. And I agree with that. The thing I am doubtful about, very frankly, is the increase in the control of the Federal Reserve Board over the powers of the individual banks.

Governor ECCLES. With this change to a 3-year period, the American Bankers Association is very favorable to this feature. The only opposition comes from one source, and that is New York. Every other place except New York agrees to that change.

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Mr. HOLLISTER. The question is whether the independent banks ought not to have the right to name their own chief executive officers without any interference by the Reserve Board.

Governor ECCLES. They cannot do that without at the same time depriving the Federal Reserve Board of the power of appointing or approving of the officers. In that case you might as well do away with the Federal Reserve Board. The Board has no purpose if you are going to make 12 separate banks, to operate as separate banks. Why have a Board if you do that? I do not know what the desire of Congress may be in that regard, but certainly if you want to have 12 independent banks, then there is no reason or no purpose for having a Federal Reserve Board. But if you are going to have a Federal Reserve Board, then it has to be charged with responsibility and it has to be given some authority.

Mr. HOLLISTER. But you have today a Federal Reserve Board that is charged with responsibility, and no one would deny that the Federal Reserve Board today has enormous power, enormous authority, and enormous responsibility; and also that, to all intents and purposes, there are 12 banks which have considerable—not considerable, but some— independence; not as much as they used to have. I am not asking that they have more, but I just dread taking away what that have left.

Governor ECCLES. I do not believe that we are taking it away, because you are giving to them the right to select a chairman and class C director, which they do not now have; and as a consideration for that the Federal Reserve Board would be given the right to approve of the appointment every 3 years. You would have anything but a satisfactory bank situation if the executive head of each of these 12 banks were entirely unsatisfactory to and uncooperative with the Federal Reserve Board.

Mr. HOLLISTER. Well, just to be more specific, at the present time, under the present set-up, what are the unsatisfactory conditions that arise out of the fact that governors of the regional banks are not subject to removal each year or at the end of any specified time by the Federal Reserve Board? I do not mean exactly removal, but they will be in such a position that they may be unapproved at the end of a certain specific time. What are the conditions that arise——

Governor ECCLES (interposing). You mean with the present law?

Mr. HOLLISTER. At the present time in operation.

Governor ECCLES. All the legal relationship of the Board with the bank is through the chairman. The governors, as I stated a while ago, are not directors of the banks. It seems to me that it is a bad organization and that no one would set up a private organization on such a basis.

Mr. HOLLISTER. Well, I understand there are certain mechanics that have to be ironed out, but what I am trying to get at is this: What are the objections under the present operation to having the chief executive officer, who is appointed by the regional bank's board itself——

Governor ECCLES (interposing). The regional banks will appoint their chief executive officers.

Mr. HOLLISTER. Yes; I know. But he can be disapproved at the end of a year. He could be disapproved at the time he is appointed, and if he does not act the way——

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Governor ECCLES (interposing). He can be disapproved at the end of 3 years.

Mr. HOLLISTER. That is under the suggested changes?

Governor ECCLES. That is under the suggested changes. He could be disapproved at the end of 3 years, which, I think, is very necessary and desirable in order to avoid friction and to have cooperation and coordination.

Mr. HOLLISTER. Can you point out instances of where governors of the regional banks have conducted themselves in such a way that the Federal Reserve Board has disapproved, and to what extent and what are the nature of such actions? What I would like to get before the committee, if there are such things, is what action these governors take which the Federal Reserve Board feels it should have the right to disapprove. If it is merely a question of making one man both the governor and the technical chairman of the board—that is, of course, easy to settle. What I am trying to get at is, what is the purpose of giving the Federal Reserve Board the right to say to a regional bank, " You cannot appoint the man you want ", or, at the end of the year, " You cannot reappoint the man you want "?

Governor ECCLES. Do you not think that there are enough good men so that it is possible to get a man that would be agreeable both to the Federal Reserve Board and to the regional bank board? Do you think it is necessary to have as the head of one of the Reserve banks a man who is unacceptable, because of inefficiency, we may say, or because of incapacity, and yet have him retained because of the personal relationship existing between the managers of these banks, or the governors, and the local boards? There is a sentimental relationship and friendship that is built up due to very close contacts, and a director of a bank, who personally has no stock ownership in a bank, and only goes to a meeting once every week or so, or every month, is not likely to oppose the reappointment of a governor, even though he may feel that he could be improved upon, or that he may not be entirely desirable.

Mr. HOLLISTER. I can answer that very easily by saying that such a man should not be a director.

Governor ECCLES. That is very true. But, after all, the directors are not stockholders. You must realize that.

Mr. HOLLISTER. Would not your objection be met by a suggestion that the governor could be removed for cause, just as you pointed out the other day that the members of the Federal Reserve Board may be removed for cause, or the Governor of the Federal Reserve Board?

Governor ECCLES. I think they already have that power now—to remove for cause.

Mr. HOLLISTER. What did you say?

Governor ECCLES. They already have that power—to remove for cause.

Mr. HOLLISTER. The governor or one of the directors of one of the regional banks?

Governor ECCLES. Yes.

Mr. HOLLISTER. Well, then, there would be no necessity for this. If a man is inefficient or incapable, he can be removed, so that this legislation is not needed for that purpose.

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Governor ECCLES. The legislation, I think, is very greatly needed. The matter of inefficiency or inability is a very difficult thing to prove. A man may be filling a position that somebody else could fill more satisfactorily. Questions of ability or efficiency are matters of degree and you would have a very difficult problem if you should attempt to remove a man for cause unless there were some glaring lack of capacity or some personal act that would justify the removal.

Mr. HOLLISTER. Well, it really comes down to this, then: that you believe that, as between the relative efficiency or inefficiency of several men, the power of designating one of such men to conduct that regional bank should be in the Federal Reserve Board rather than in the board of directors, the majority of whom have been elected by those whose money is invested in the stock of the regional bank.

Governor ECCLES. I think that, in the interest of the System, it is very necessary that the Federal Reserve Board have the approval of these governors who are selected by the directors of the Reserve banks; and, as I stated, it would seem to me that there should be a sufficient number of able men to permit appointments that are desirable to both the Federal Reserve Board and the local board. The governors are the liaison officers under this relationship between the 12 Federal Reserve banks and the Federal Reserve Board; and, for this reason, it seems to me, the Federal Reserve Board should have the approval. Any governor who objects and any board that objects to this Board approving would be actuated by the desire to retain office, even though their retention was unsatisfactory and unacceptable to the Federal Reserve Board.

Mr. HOLLISTER. Of course that is a question as to whom the heads of the regional banks should be acceptable. I had understood that the theory of the Federal Reserve organization was that high-class bankers, of independent judgment, should have some say in the conduct of the System. Now it would seem to me to be fairly clear that, if the head of each regional bank must completely follow what the Federal Reserve Board indicates at all times, he ceases to be a banker of independent judgment. Of course, if that is the desire of Congress, that settles it; but that was not the original plan of the Federal Reserve System.

Governor ECCLES. There is no thought or expectation that such a thing will happen. In practice, I am certain that the banks will be run under this bill very largely, so far as everything except monetary policy is concerned, by the local boards of directors and by the governors of the banks. There is nothing in this bill that provides that the Federal Reserve Board shall select or force on a bank a governor who is unacceptable to the board of the bank.

Mr. HOLLISTER. No; they could not force anybody on the bank who was unacceptable to them; but they could keep refusing to appoint people who might be acceptable to the board of the regional bank, indefinitely.

Governor ECCLES. Why should not the governor be acceptable to both boards? If you want good organization, is it not better to have the governor acceptable to both boards?

Mr. HOLLISTER. You have had enough experience to know that if you have a situation of that character, where something must be acceptable to people, absolutely, that they would have the control.

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Governor ECCLES. The Farm Credit Adminstration operates in that way, in the question of the appointment of land-bank officers. They are appointed by the local boards, subject to the approval of the Farm Credit Administration, and the banks are owned by the local farm associations, which is private ownership, so that you have an example and it has worked out very well.

Mr. HOLLISTER. Of course their functions are somewhat different from those of the Federal Reserve System.

Governor ECCLES. Yes.

Mr. HOLLISTER. Now, moving to section 203, and raising again this question of independence: In the draft of the bill at the present time the Governor of the Federal Reserve Board cannot be very independent if he can be removed by the President at will. He cannot be particularly independent from the Executive's desire.

Governor ECCLES. You mean in the present legislation?

Mr. HOLLISTER. The proposed legislation.

Governor ECCLES. That is true in the present legislation. There is nothing in the proposed legislation with reference to that.

Mr. HOLLISTER. What is the exact wording of the present legislation with respect to the removal of the governor?

Governor ECCLES. Do you have that, Mr. Wyatt?

Mr. HOLLISTER. What section is that?

Mr. WYATT. Section 10, page 26, of the 1933 edition of the Federal Reserve Act.

Mr. HOLLISTER. Would you read that into the record?

Mr. WYATT (reading:)

> Of the 6 persons thus appointed, 1 shall be designated by the President as Governor and 1 as Vice Governor of the Federal Reserve Board. The Governor of the Federal Reserve Board, subject to its supervision, shall be its active executive officer.

Mr. HOLLISTER. Is that all there is?

Governor ECCLES. Is that all you have on that?

Mr. HOLLISTER. Is there anything in that which permits the President to remove the Governor of the Federal Reserve Board?

Mr. WYATT. It has been interpreted in practice that it does.

Mr. HOLLISTER. I realize that it is so stated, and it has been stated in this room a number of times. It has been stated in the papers, but I have never yet been able to find where the President of the United States has the power to remove the Governor of the Federal Reserve Board.

Mr. SISSON. Is it not true, Mr. Hollister, that these officers are executive or administrative officers, and is it not true that any executive or administrative officer may be removed arbitrarily by the President?

Mr. HOLLISTER. I think it has been settled by the United States Supreme Court.

Governor ECCLES. Yes, sir.

Mr. SISSON. It has been settled, I think.

Mr. HOLLISTER. Let us not get into a discussion of that. I do not want to get into a discussion with any members of the committee, although I think I can point out to Mr. Sisson that he is incorrect in his interpretation of the decision.

Let me ask you a question right in that connection. The Comptroller of the Currency is appointed for how many years?

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Governor ECCLES. Five years.

Mr. HOLLISTER. Can the Comptroller of the Currency be removed by the President?

Governor ECCLES. I do not think so. The term of his office is provided under the statute.

Mr. HOLLISTER. Is the term of office of the Governor of the Federal Reserve Board provided by the statute?

Governor ECCLES. Not as Governor. His term as member is provided for.

Mr. HOLLISTER. It is a 12-year term as director?

Governor ECCLES. That is right.

Mr. HOLLISTER. Then he is appointed Governor?

Governor ECCLES. Yes.

Mr. HOLLISTER. So, theoretically, he is Governor up until he is removed?

Governor ECCLES. Up until the time Governor Meyer was appointed the President designated the Governor each year. It had been the custom from the beginning of the Federal Reserve System for the President to designate the Governor from year to year.

Mr. HOLLISTER. And the fact remains that at the present time it is provided that the Governor shall be appointed, and there is no statement as to how he can be removed. It is also true that the change from the existing statute to the proposed statute is that, in the existing statute, there is a provision for the appointment of the Governor, with no provision as to removing him from office; whereas in the proposed statute it is specifically provided that he shall serve solely at the will of the President. That is the case, is it not?

Governor ECCLES. That is correct. It seems to me that it is a matter that should be clarified and that, if it is not the wish of Congress that the Executive shall have the right to appoint a Governor and remove him, the term of office as Governor should be made specific, and the interpretation that has always been placed upon it should be clarified.

Mr. HOLLISTER. I agree with you fully. I am merely trying to bring out by questioning what this bill does. Naturally, the Congress must make the decision as to what they want. I want to make it perfectly clear what the provision of the proposed law will bring about; and it is also true, is it not, that if the changes which you have suggested in your memorandum are not made effective, as I think you have stated earlier in the hearing, it would be possible, always assuming that an Executive desires to do it, for the President to change completely the personnel of the Federal Reserve Board by designating each member of the Board Governor in turn and removing him the next day.

Governor ECCLES. I do not believe that is possible.

Mr. HOLLISTER. I think it is highly improbable, but it is possible.

Governor ECCLES. If a member of the Reserve Board desired to retain his position on the Board, he would refuse to accept the position of Governor, knowing that he would go out the next day or the next week. If, on the other hand, he did not choose to stay on the Board if the President desired to remove him, he very likely would resign without going through the formality of being appointed as Governor.

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Mr. HOLLISTER. I think that is highly probable. What I am trying to get at is—I do not like to be influenced into legislation which would make make possible the arising of a dangerous condition, when some irresponsible person might be in the position of Chief Executive, and when such legislation is not necessary. I believe, to that extent, the suggestions for amendment which you have made are excellent.

Governor ECCLES. The possibility of a President resorting to sharp practice of that sort in order to change the Board, of course, did not occur to me, or, I think, anybody else who had anything to do with this legislation. The reason for providing that a Governor's term as a member shall expire when he is no longer designated as Governor was not to give to the President additional power but to make it possible for a Governor who was no longer designated as "Governor" to resume business without waiting for a period of 2 years.

Mr. HOLLISTER. Of course, that could be done by other phraseology.

Governor ECCLES. That is what is proposed. In other words, the same thing has been accomplished, for all practical purposes, by the suggested change; and because of the objection that was raised, that you mention now, the amendment was proposed.

Mr. HOLLISTER. Do you consider it wise that the President should have complete control over the Governor of the Federal Reserve Board?

Governor ECCLES. I think so. It is my feeling that the President should have the right of appointment of the Governor of the Federal Reserve Board. That is true in practically every country in the world.

Mr. HOLLISTER. He should have the right of appointment; but I am talking about the right of removal.

Governor ECCLES. That is right. He should have, it seems to me, the right of appointing the Governor to serve at his pleasure. I think that is in the interest of the Federal Reserve System. I think it is very necessary that there be a very close relationship and liaison between the banking system and the administration in power; and I think that the Governor of the Federal Reserve Board is the channel through which that relationship should develop, in the interest of the banking business.

Mr. HOLLISTER. Can you not conceive of a situation where political exigencies might be in direct conflict with wise banking policy and wise credit policy?

Governor ECCLES. All I can say is that, if you have such exigencies—war is a case in point and depression is a case in point—then I think it would be very unfortunate if the administration was unable to carry out its program. I stated, I think, when I first testified, that the responsibility of any administration in power is largely a social and an economic one. Practically all political questions relate to social and economic problems. An administration cannot be charged, when it comes into power, with dealing with those problems separately, free, apart, and divorced from the money system.

Mr. HOLLISTER. You believe that even though from the point of view of wise banking and a wise handling of the financial business of the country a certain policy would be desirable, that if an admin-

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istration decided that it should pursue a policy which might be otherwise, it should be in a position to control the banking and credit systems, to force it along with its policy, irrespective of what the best minds of independent banking might think?

Governor ECCLES. Of course, we have an independent banking system, to an extent; and I do not believe that anybody would feel that for the system to be more independent would be in the best interests of the bankers——

Mr. HOLLISTER. I do not want to interrupt you. I believe there is a great deal in what you say. I do not believe we can answer present questions by referring to the improper actions of the past. I am just asking the question of whether or not it is unwise to put the complete control into the hands of the Executive; and I am generalizing entirely, with reference to no particular executive and no particular condition of the country. Before you answer, let me put it a little more specifically. In our democracy, every so often the party in power must appeal to the country, once every 4 years for Presidential elections and once every 2 years for congressional elections. It is a definite time at which such things have to be done, unfortunately. Is it not very unwise to give the power of manipulation to the Executive entirely when it comes to the credit situation and the banking situation? Would it not be probable that the greatest man imaginable, with an election coming on, would try to take advantage of every possible facility to see that that election is assured, and would it not be possible for him to control the banking and credit system of the country for that purpose?

Governor ECCLES. There is nothing in this bill that proposes that.

Mr. HOLLISTER. But it gives the President a much greater control over the credit and banking facilities of the country?

Governor ECCLES. In what way, except as the Federal Reserve Board has increased power?

Mr. HOLLISTER. It gives the Federal Reserve Board increased power.

Governor ECCLES. That is right.

Mr. HOLLISTER. It gives the President greater power over the Board?

Governor ECCLES. No. The President has no different power over the Board.

Mr. HOLLISTER. Well, the President has greater power over the Governor, who is the Chief of the Board.

Governor ECCLES. Not unless you construe the proposal to mean that it gives the President greater power than he now has. Of course, there has never been a legal test as to the power of the President to remove the Governor; but as I say, in practice it has always been accepted as giving him that power.

Mr. HOLLISTER. If it does not give any more power than at present, there is no need of the change.

Governor ECCLES. No; there is no proposal to make the change, except——

Mr. HOLLISTER (interposing). As to the ability of the Governor to go back into business?

Governor ECCLES. That is the sole purpose of it; and there was no purpose or expectation that this was giving to the President additional power.

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Mr. HOLLISTER. Then you would be perfectly willing to strike out the provision for removal?

Governor ECCLES. I do not see a particle of objection to it, because, in practice, that is what happens and will happen.

Mr. HOLLISTER. You say you see no objection to striking it out?

Governor ECCLES. The whole purpose of getting that into the legislation was to make it easier to get someone to act as Governor; in other words, to make it easier to get a man to accept.

Mr. GOLDSBOROUGH. May I interrupt? In that connection, Governor Eccles, if there is in fact any legal obstacle to putting into effect the practice that now obtains, you would favor a change in the language which would legalize and carry forward the practice?

Governor ECCLES. Yes; I think it is desirable in the interest of banking and in the public interest that the administration in power designate the governor and that the governor serve during the pleasure of that administration. That has been true in most other countries.

Mr. HOLLISTER. That is not true in England.

Governor ECCLES. England is about the only exception. It is true in practically every other country. It has been recognized, in the establishment of all the central banks, within recent years, that it is very necessary and desirable that the administration in power have that responsibility and that authority.

Mr. HOLLISTER. Now, with respect to those banks, of course, you have one central bank, where the board is privately elected or appointed, and the chief executive, governmentally appointed, who, of course, cannot exceed what the board will let him do. The board itself controls the executive officers, even in the Bank of France—or in most of the great countries, outside of Italy and Russia. In all those cases the board itself, which ultimately controls the chief executive officer, is privately elected or appointed.

Governor ECCLES. There are differences in the various organizations. The Bank of Canada is the most recent; and in Canada the board is really an advisory board and the governor can veto an action of his board. He does not have to follow their recommendations or their authorizations, as I understand it.

Mr. HOLLISTER. In the Canadian bank a board of seven directors is elected from diversified occupations by the shareholders.

Governor ECCLES. That is right.

Mr. HOLLISTER. The Canadian bank has a governor, a deputy governor, and an assistant deputy governor, who have to be appointed for 7 years by the Governor General in council.

Governor ECCLES. The board does not control the governor there to the extent——

Mr. HOLLISTER (interposing). But, after the first term, however, these officials shall be selected by the directors, subject to the approval of the Governor in council.

So that still puts the control of the central bank pretty well in the hands of the private shareholders.

Governor ECCLES. It puts it in the hands of the Governor in Canada, practically. Of course, there is this difference. In every other country except this country, the commercial banks are not the shareholders, but the public are the shareholders.

Mr. HOLLISTER. That is so in England.

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Governor ECCLES. It is so in Canada, too. I think it is so in France, and it is so in practically all the countries. I believe this is the only coutnry where the banks control the central banking system through their stock ownership and the majority of the board of directors.

Mr. HOLLISTER. But the public owns the stock in the banks, which, in turn, own the stock in the Federal Reserve banks.

Governor ECCLES. There is a great difference between——

Mr. HOLLISTER (interposing). The governors——

Governor ECCLES (interposing). In fact, in some of the countries the banks are directly prohibited from owning any stock whatever in the central banks, and the bankers are prohibited from being represented on central banks.

Mr. HOLEISTER. Well, of course, under our system, with our regional banks, we have only half of the directors that can be appointed by the member banks.

Governor ECCLES. No. Two-thirds of them are appointed by the member banks.

Mr. HOLLISTER. Yes; but half of these are drawn from industry, and only half may be bankers.

Governor ECCLES. Yes; but they are appointed by the banks. Two-thirds of the board are appointed by the banks, and the stock is owned by the banks.

Mr. HOLLISTER. I want to bring out the change in control this bill will make, so I will take up for a few minutes section 205, which provides for the open-market committee, a committee of five, which is to be appointed and will consist, first, of the Governor of the Federal Reserve Board, who, in turn, serves at the pleasure of the President; next, two members of the Federal Reserve Board; and, next, two governors of the Federal Reserve banks, who, in turn, if the provisions of this bill should become effective, may fail of approval by the Federal Reserve Board at the end of a year, in the event, we will say, that they are unwililng to go along with what the Federal Reserve Board desires. That, of course, places the open-market committee and its operations entirely in the control of the Federal Reserve Board, does it not?

Governor ECCLES. You are discussing the provisions of the bill with reference to the operation of the open-market committee, as provided in the bill.

In my opening statement, if you will recall, I stated that that provision of the legislation was not satisfactory, and that open-market operations should be placed with the same body that had the authority to fix discount rates and reserve requirements; that they were three functions of monetary control that should be together, in the same body, and that I felt that the Federal Reserve Board was the body charged with the public interest; and that it should, therefore, have that power and authority, subject, however, to securing the advice of a committee of 5 governors selected by the 12 banks. I made that suggestion in my opening statement. I suggested that, rather than having an indirect way of putting the Federal Reserve Board in complete control.

Mr. HOLLISTER. Your theory is that it might just as well take the whole thing right over and have no control whatever by the regional banks?

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Governor ECCLES. I feel that the authority over open-market policy must be placed in a body that is charged with the responsibility that the present legislation gives to the governors, who are not even directors of the banks, the right to make open-market policies. The Board approves or disapproves of the policy, and then the 12 banks can either participate in the adopted program or they can refuse to do so, so that you have——

Mr. HOLLISTER (interposing). You say all of the 12 banks or each of them?

Governor ECCLES. Each or any.

Mr. HOLLISTER. And any of them might nullify what the others did.

Governor ECCLES. And what this proposed legislation is doing is putting the responsibility and the authority for open-market policy, discount rates, and reserve requirements, which are three instruments of monetary control, in the Federal Reserve Board.

Mr. HOLLISTER. You feel, then, that, notwithstanding how clear it might be, we will say, to practically all the bankers in one particular locality of the country, Dallas, San Francisco, or wherever it might be, they should not participate in the open-market operations. The Federal Reserve Board should have complete power, and no matter how much the bankers might disapprove they should be compelled to take participation?

Governor ECCLES. Absolutely. The question of monetary policy is a national matter, and it cannot be dealt with regionally without having such situations as we have had in the past. I think open-market policy, discount rates, and reserve requirements should be controlled by the Federal Reserve Board, while making it mandatory that the Board advise with the committee of governors before any action is taken with respect to any one of the three instruments of monetary policy that the Board controls.

Mr. HOLLISTER. That, however, is not in the draft as presented.

Governor ECCLES. No. That is the recommended provision.

Mr. HOLLISTER. Just a few questions on the matter of the collateral behind the Federal Reserve notes. In discussing this question on the days you have been before us you have stated that you did not see the collateral added anything to the value of the notes.

Governor ECCLES. That is right.

Mr. HOLLISTER. Do you feel that the gold provision does?

Governor ECCLES. It certainly does not under present circumstances. And under past circumstances, when there was not sufficient gold, or we felt there was not, to back up notes which were secured and issued, the requirement was suspended, as an emergency matter. In other words, when we get into an emergency, these rigid requirements are suspended. So long as everything goes normally and there is no difficulty in carrying out the requirement, they seem to operate all right.

Mr. HOLLISTER. Well, of course, there are those who do not quite agree with the wisdom of suspending such requirements, who do not believe that the emergency justified the suspension. But I am trying to get at your viewpoint. You say that the collateral does not add anything, neither does the gold. Query: Do you go the whole way, that we should remove all provision for some kind of collateral behind Federal Reserve notes?

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Governor ECCLES. No. Personally I think it is very desirable to leave the gold-reserve requirement back of the Reserve notes, and also back of the deposits. The law provides that 35 percent of gold should be held back of the deposits.

Mr. HOLLISTER. Gold or lawful money?

Governor ECCLES. Gold or lawful money; and, of course, our lawful money now is——

Mr. HOLLISTER (interposing). Not gold.

Governor ECCLES. Gold certificates and other forms of currency.

The CHAIRMAN. That provision was written into the law when the law was that the legal money was gold?

Governor ECCLES. Yes.

Mr. HOLLISTER. What is the advantage of that gold behind the notes? Is it the limitation on the amount of notes that might be issued?

Governer ECCLES. That is the effect it might have, I suppose.

Mr. HOLLISTER. So that there is some upstairs limit, beyond which you cannot go?

Governor ECCLES. If you have a bank run, and banks closing, just as we did have, and you permit demands in gold again, and you permit the exportation of gold freely, then, through that action you precipitate financial troubles and bring about a suspension of the requirement. Now, if the payment of gold against deposits and the free exportation of gold should be suspended, and serious banking difficulties develop again, we would possibly go off the gold standard, and then these restrictions would be suspended.

Mr. HOLLISTER. Oh, we are off it today, of course, aren't we? But I don't want to get into a long discussion of that. Some people say there is a gold standard, simply because we can ship gold to settle international obligations.

The CHAIRMAN. Nobody can get gold.

Governor ECCLES. We have a price for gold now.

Mr. HOLLISTER. You believe there should be a gold reserve behind the Federal Reserve notes that should be maintained?

Governor ECCLES. I think it is desirable that it should be.

Mr. HOLLISTER. What is the reason for it? Is it to give confidence to the holder of the note that there is something behind it, or what is it?

Governor ECCLES. I think that there is no necessity of making the change. There would be nothing particularly to be gained by it. Without that requirement of holding so much gold back of deposits and back of currency, you would have, I suppose, no restriction of any kind. I think, psychologically, it would have a very bad effect upon the country, and it is unnecessary. It would, of course, leave our money a completely managed currency without any relationship to gold.

Mr. HOLLISTER. In other words, it would shake people's confidence in the pieces of paper that they carried around in their pockets?

Governor ECCLES. I think it would. Whether justifiable or not, that is the effect it would have.

Mr. HOLLISTER. And the shaking of that confidence would immediately be inflation of a kind, would it not?

Governor ECCLES. I doubt that. It has seemed difficult to get inflation.

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Mr. HOLLISTER. What I am trying to get at is, if the gold reserve of the Federal Reserve notes were entirely removed, you say it would have a bad psychological effect and it would shake the people's confidence in some way?

Governor ECCLES. Yes.

Mr. HOLLISTER. What would be the result of that, stagnation of business and increasing unemployment?

Governor ECCLES. If you eliminate any gold requirement for Federal Reserve notes and for Federal Reserve deposits, then you would be completely divorced from gold. Your currency would be purely and completely a managed currency, without any regard whatever to a metallic base. It would be a complete divorcement. Now, if it is desirable completely to abandon gold now, to make all the gold we have serve only as a commercial commodity, then, of course, it would be desirable to abandon all Reserve requirements for Federal Reserve notes. Otherwise, it is desirable to keep them, because it is the only recognition we have of the use of gold as a base for money.

Mr. HOLLISTER. You see, what I am trying to get at is the advantage of collateral behind notes.

Governor ECCLES. That is a very different matter, the question of gold and that of collateral.

Mr. HOLLISTER. Both are some assurance of value.

Governor ECCLES. Why not have collateral back of deposits? Gold is held as a reserve against both deposits and notes. Now, other countries have gold requirements back of their notes, but most have no collateral requirements back of them. They have gold requirements back of their deposits, but they do not have collateral requirements——

Mr. HOLLISTER. But we do not have.

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. It does not require gold.

Governor ECCLES. Or lawful money.

Mr. HOLLISTER. Yes.

Governor ECCLES. But, of course, that was based upon the requirement that lawful money was redeemable in gold.

Mr. HOLLISTER. You think that there is an advantage in retaining that?

Governor ECCLES. I think at this time there is, until it is determined what is likely to develop in the future, with reference to the gold standard, and whether other means of stabilizing exchanges can be developed. To divorce completely our money from gold at this time would seem to me to be rather a costly thing for us to do, while we own 40 percent of the world's gold supply.

Mr. HOLLISTER. You feel, as I understand you to say, that there is some advantage in limiting the total amount of Federal Reserve notes that may be issued by the keeping of the gold requirement?

Governor ECCLES. The keeping of the gold requirement does not put a limit, in and of itself, on Federal Reserve notes. As I explained the other day, the notes which the Federal Reserve System issues are the notes which the customers, the depositors, of the commercial banks require to conduct the business of the country. Only when unlimited hoarding is permitted would there be any possibility of the need of suspending specie payments and gold exports.

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The amount of gold, of course, which is held, without regard to the gold held by the Treasury, is considerably more than 100 percent of the amount of notes outstanding. The amount of notes outstanding is as great as we have ever normally used in our business operations.

Mr. HOLLISTER. But the existence of the gold requirement does make a decided limit, beyond which Federal Reserve notes could not be issued?

Governor ECCLES. It is a limit beyond which Federal Reserve notes could not be issued. You would have terrible inflation long before you reached the limit.

Mr. HOLLISTER. Unless further devaluation occurred, in which event you would have still more?

Governor ECCLES. That is right.

Mr. HOLLISTER. Still more gold, against which you could issue more Federal Reserve notes?

Governor ECCLES. Yes.

Mr. HOLLISTER. I would like to ask this question: Is there anything in the existing situation, or what anybody could reasonably predict, that makes this legislation a matter of great present urgency?

Governor ECCLES. I think it is very desirable and necessary that it be passed. I think it is several years late. I think that if legislation of this sort had been passed 4 or 5 or 6 years ago we might have avoided most of the banking difficulties that the country went through.

Mr. HOLLISTER. One of the chief purposes to be accomplished that you see, is the power of checking speculation under the powers granted by this proposed legislation?

Governor ECCLES. Control of speculation is one of the important features. Another is to make a better coordination of the system through the changes in the relationship of the Board to the banks and the governors, combining the governors' positions with those of the chairmen. The eligibility feature is a very necessary and important change in the legislation, in order to make banks feel more free to extend long-term credit.

Mr. HOLLISTER. There are many of the provisions of the Federal Reserve Act, are there not, that ought to be revamped, gone over, and studied pretty thoroughly?

Governor ECCLES. There are quite a number of provisions proposed in title III of the bill.

Mr. HOLLISTER. I realize that.

Governor ECCLES. That go quite a way toward correcting and toward clarifying the existing Federal Reserve legislation. I do not believe that we will ever reach a point in this country where we will have perfection in our banking legislation. We are, of course, in a changing economy and, looking over the past hundred years, we have found that no one has been able to develop a perfect system of money and banking; and I do not believe that this proposed legislation means that we have reached the millenium in banking and in dealing with our banking and money problems.

Mr. HOLLISTER. It comes down to the individuals who are running the thing, finally.

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Governor ECCLES. What is that?

Mr. HOLLISTER. I say, it comes down to the individuals who are running the thing, finally.

Governor ECCLES. The individuals who are managing the enterprise are certainly a very important element in any private or public field of activity. The administration can go a long way toward either wrecking or making successful what is done under any legislation.

Mr. HOLLISTER. I asked that because there is a difference in philosophy of government. Some people say there is no need of checks and balances, if you can secure a race of supermen to run things properly. But there is no indication that we are going to have supermen running the banking system any more than in the past, no matter in whose hands it is put.

The CHAIRMAN. You mean there is no such thing as a benevolent despotism?

Mr. HOLLISTER. I think that is very well put. I think that question really answers itself.

With respect to the raising of rediscount rates, the strengthening of reserve requirements, and entering the open market, it has been stated by you and others, with a great deal of justice, that our trouble in the past has been that our so-called "great bankers" have not been equal to the emergency and have not foreseen what was to happen, or, if they did, they did not have the strength to take advantage of the machinery which was available to stop the inflation and boom. Realizing that these men were theoretically the best bankers of their time, are we going to be in any better position by placing the matter entirely in the hands of a Federal Reserve Board, appointed by the Chief Executive? What is there to indicate that the men so appointed, having these supreme powers, would be able to handle them any better than they were handled by the so-called "great bankers" of the past?

Governor ECCLES. There is a great difference between thousands of banks acting independently and a small board charged with the responsibility of monetary control. In the first place, the bankers acting independently have no way of expanding money, and they had no way of stopping the contraction of money, even had they so desired, because they did not have control over the issuance of money, such as is held by the Federal Reserve System. In other words, the independent, private, commercial bank is not a central bank charged with or having central-bank functions, neither has the Federal Reserve Board in the past been charged with the duty of creating business stability. I feel that certainly a board, if given the authority and charged with the responsibility for our monetary policy, is more likely to feel personally that great responsibility and to discharge its obligations and its duty in the public interest than we have had any reason to expect in the past of the banking system, as it has been constituted.

Mr. HOLLISTER. Do you not fear that—and this is a repetition of the question that I asked you a little earlier—that in the event the situation were to create a condition of continued deficits, a time arising when the floating of Government bonds became more and more difficult—would it not be almost impossible for the Federal Reserve Board, constituted as it would be under this bill, to refuse

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to cooperate with the Treasury in continuing a financial policy which independent bankers might deem was unwise?

Governor ECCLES. I think it would be extremely unfortunate for the bankers if a situation was reached where the Government, having a continuous budgetary deficit, was unable to get the cooperation and support necessary from the Reserve banks and the bankers; for the reason that it would probably mean, under those circumstances, the issuance of currency rather than bonds to pay for the budgetary deficits. It would mean the possibility of the Government taking over the banking system. As I stated the other day, it seems to me that a Congress that can appropriate money to carry out emergency needs, which create deficits, also has the power to create the means of providing that money, in case the existing private system fails to do it. Certainly we would not question that, if we were in war, and the private system failed to meet the demands of Congress in the emergency, the means would be provided otherwise. I think that, in the interest of the banking system, it is important and it is necessary that you have this cooperation in helping to finance the program of the administration in power.

Mr. HOLLISTER. You have just stated that Congress, of course, would have to use its various powers. That is admitted.

Governor ECCLES. Yes.

Mr. HOLLISTER. This bill, however, asks Congress to give to the Federal Reserve Board these powers, which is quite a different proposition; and I ask you whether it is wise to give these powers to a board which undoubtedly would have to be, to a great extent, controlled by the Executive. The question is whether we could afford to give these powers to follow a certain procedure which might be very unwise, from a banking point of view. If Congress were retaining its power, that would be quite a different matter, but it is not.

Governor ECCLES. If I understand your question, it is whether or not I think it is desirable that the Federal Reserve Board, or the Federal Reserve System should be in a position where it could finance a continuing budgetary deficit.

Mr. HOLLISTER. No matter how unwise it might appear.

Governor ECCLES. Yes.

Mr. HOLLISTER. That is, you understand the question?

Governor ECCLES. Yes.

Mr. HOLLISTER. Your answer to that is yes?

Governor ECCLES. Yes.

Mr. HOLLISTER. I meant to follow up the question asked you a little while ago. If the fate of any system depends ultimately upon men, whether or not it was not wiser to include checks and balances? Has consideration been given to the fact that legislation might be so drafted that, in the event of a rise of a certain percentage in commodity prices or an expansion of deposits over and above commercial loans by certain proportion, or of stock prices, or of capital exports, that then there should be, automatically, rediscount raises, and the reserve requirements strengthened, and open market operations, so that the discretion is not as broad as this bill would give—almost unlimited discretion?

Governor ECCLES. It is not unlimited. The proposal which was made the other day as to what should be the objective confines the responsibilities of the Federal Reserve Board and places upon it a

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very definite obligation. The proposal was that it should be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability.

Mr. HOLLISTER. Exactly. I understand that. But the very point I am raising is that, because of the frailty of human nature, the Board either would not perform its duty or would not be able to do it, and is it not wiser to put some checks and balances in there? Would the Board be gifted with such insight that they would be able to tell——

Governor ECCLES (interposing). In the past, the Board had neither the authority nor the responsibility. That has been the trouble in the past.

Mr. HOLLISTER. The trouble in the past was not the lack of authority or responsibility. The trouble in the past was that they did not see what was coming. No one has intimated that the failure to check the boom was due to lack of authority or responsibility.

Governor ECCLES. I do not know; but certainly there were a good many people who thought they knew what was coming.

Mr. HOLLISTER. They were voices crying in the wilderness.

Governor ECCLES. However, I personally think it would be a great mistake to put into this bill rigid mandatory requirements that may be impossible of accomplishment; and, even if they are possible, they may not be desirable. Even if the attainment of certain mandatory requirements were desirable at the moment it may be that the conditions and circumstances would be such in a year or in 2 years or 3 years that these automatic controls would not be desirable at all.

Mr. HOLLISTER. I note that there has been stricken out in the proposed act subsection (c), section 12A of the Federal Reserve Act, which provides that:

> The time, character, and volume of all purchases and sales of paper described in section 14 of this act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

What was the purpose of taking that out?

Governor ECCLES. Because we do not think that should be the objective of monetary policy. The provision that we are proposing to substitute for it, and which I think is much more desirable, as expressing what should be the objective, is the promotion of conditions conducive to business stability and the mitigation of unstabilizing influences in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. HOLLISTER. That is a pretty big order.

Governor ECCLES. I know. But simply to attempt to provide credit for agriculture, commerce, and industry does not meet the problem at all. Credit is now provided for agriculture, commerce, and industry.

Mr. HOLLISTER. If these powers are granted, if the bill should go through approximately in its present form, what powers of a central bank will the Federal Reserve Board not have, outside of its ownership of gold, or the right to change its value, of course?

Governor ECCLES. It will exercise all the powers of a central bank, so far as monetary policy is concerned, which is very desirable and very necessary.

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Mr. HOLLISTER. That is what I am getting at. This bill really makes an entirely Government-controlled central bank.

Governor ECCLES. No; not an entirely Government-controlled central bank. The Federal Reserve System is not a Government-controlled system.

Mr. HOLLISTER. When this bill becomes effective, what powers are there, which the Federal Reserve Board, which is appointed by the President, and the Governor, who is subject to removal by the President—what power hasn't it got?—You say it has the power but is not governmentally controlled?

Governor ECCLES. No; it is not governmentally controlled.

Mr. HOLLISTER. You say it is not governmentally controlled?

Governor ECCLES. The members are appointed for 12 years.

Mr. HOLLISTER. It will be more governmentally controlled than it is at the present time.

Governor ECCLES. The Board will not be more governmentally controlled. The Board will be given more power. What I am contending for is not a governmentally controlled central bank at all. What I am contending for is a central body, charged with responsibility for monetary control, in the public interest. Now, whether it is the Federal Reserve Board or some other board is a thing for Congress to decide. But what I am advocating is that the power and the responsibility for monetary policy be placed in a central body that is charged with the public interest, and if it is felt that the Federal Reserve Board is a political board and will be dominated by political expediency, let us say, rather than public interest, in monetary policy, then, certainly, there should be some changes. But I do not think that the Federal Reserve Board under this legislation should be considered a body that will act in connection with its monetary policies, by reason of political expediency rather than in the public interest.

Mr. HOLLISTER. Is it not true, as a matter of fact, however, that, as a general rule, boards with limited terms, appointed by the Executive, are to a great extent under Executive control, particularly when the chief officer can be removed at will?

Governor ECCLES. I do not think that that is necessarily true. Twelve years is rather a long period for board members. I have suggested, in order to make the board members even more independent, that there be an increase in compensation for future appointive members, and that pensions apply to all members, if they are not reappointed. I think that would give them a degree of independence, under the provision which is suggested or provided for in this legislation.

Mr. HOLLISTER. That is all.

The CHAIRMAN. Well, gentlemen, it is 20 minutes to 1. I suggest that we meet again at 3 o'clock.

Mr. GOLDSBOROUGH. Just one moment. This is not a question of mine, but one of the members called my attention to it. On page 46 of the bill, at the bottom of the page, the second paragraph of section 16, it is said:

> Every Federal Reserve bank shall maintain reserves in lawful money (other than Federal Reserve notes or Federal Reserve bank notes) of not less than 35 percent—

And so forth.

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At this time, what is that lawful money—what does it consist of? Do you remember?

Governor Eccles. There is, first, the national-bank notes, which have just been called; and then there are the greenbacks, $346,000,000; and there are silver certificates. And there is coin, of course, the silver dollar and smaller coins.

Mr. Brown. Gold certificates could be used also for that purpose.

Mr. Goldsborough. Do you remember how much that amounts to—how much that reserve could amount to?

Governor Eccles. Well, of course, the national-bank notes will soon be out.

Mr. Goldsborough. Yes; I know that.

Dr. Goldenweiser. I can give you an answer in a few minutes.

Mr. Goldsborough. Will you give us that later?

(Recess, 12:45 p. m. to 3 p. m.)

AFTERNOON SESSION

The committee reconvened at 3:15 p. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. Tell us about the amount of money in circulation.

Governor Eccles. According to Doctor Goldenweiser, the amount of lawful money outside of Federal notes was approximately $2,400,000,000.

The Chairman. This language excludes Federal Reserve notes and Federal Reserve bank notes?

Governor Eccles. With the retirement of the national-bank notes, which have now been recalled, the amount of lawful money will be reduced to approximately $1,500,000,000.

The Chairman. Of what would that consist?

Governor Eccles. Silver certificates——

The Chairman. How much?

Governor Eccles. $702,000,000 the first of the year; silver dollars, $32,000,000; subsidiary silver, $309,000,000; and minor coin, $130,-000,000; United States notes, $346,000,000. The national-bank notes, on January 1, amounted to $888,000,000, and Federal Reserve notes amounted to $3,520,000,000.

The Chairman. Federal Reserve notes are excluded?

Governor Eccles. Yes. After the call of the national-bank notes, there will be $1,500,000,000 lawful money outside of Federal Reserve notes.

Mr. Sisson. I should like to clear up or correct a statement that I made this morning which has reference to an observation of Mr. Hollister. He made the statement, in substance, that it was well settled by the Supreme Court of the United States that the President has the power arbitrarily to remove any administrative or executive officer appointed by him. I want to modify that in this way: It is my understanding that in every instance where the question has been raised as to the power of the President arbitrarily to remove any executive or administrative officer appointed by him, where that question has been decided by the Supreme Court the Court has upheld the power of the President so to do. Mr. Hollister, very likely with some reason, says that is not settled. There is, of course, as we know, a case before the United States Supreme Court involving that

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question, which case has not been decided. My own opinion is that at any time that question is decided by the United States Supreme Court that power of the President will be upheld. In view, however, of the fact, that it is not entirely conceded, at least it seems to me, as the chairman this morning suggested, that it becomes of some importance to the committee to decide whether the language recommended by Governor Eccles in this bill should be contained in the bill. Therefore, that question does become of some importance here. It appears to me, aside from the reason that the chairman advanced, that it becomes of some importance to have it in the act, so that, in the light of experience, it might obviate a contest in the future. I think that any limitation upon the power of the President in this regard would be unconstitutional—that is, if we attempted to say that he shall not have the power—but for the reason stated by the chairman and also in the interest of clarity, as Governor Eccles has said, and also that it might obviate any question being raised about it in the courts, if we believe that this should be a national body in which there should be some unity of purpose between the administration and the body in control of the monetary policy, it seems to me that at least this committee should decide it while considering the bill. I myself favor the language recommended by Governor Eccles.

I think that is all I have to say.

The CHAIRMAN. Mr. Brown, do you desire to ask questions?

Mr. BROWN. I should like to ask Governor Eccles what the present policy of the Federal Reserve Board is relative to open-market operations.

Governor ECCLES. The open-market committee is composed of the 12 governors. The law recognizes it as their responsibility to intiate a policy and to submit recommendations to the Board. for its approval, disapproval, or suggestions; so that the law as now constituted does not require the Federal Reserve Board as such to adopt an open-market policy; except, as I understand it, in giving their approval or disapproval to the policy initiated by the governors' committee, they are required to take into account the credit needs of agriculture, commerce, and industry.

Mr. BROWN. Under the present section B of 12–A you are given practical control of open-market operations, are you not?

Governor ECCLES. In the present law?

Mr. BROWN. Under present law.

Governor ECCLES. Under proposed amendments?

Mr. BROWN. No; under present law. Section B of 12–A provides that—

> No Federal Reserve bank shall engage in open-market operations under section 14 of this Act except in accordance with regulations adopted by the Federal Reserve Board. The Board committee from time to time shall constitute, adopt, and transmit to the committee and to the several Federal Reserve banks regulations relating to the open-market transactions of such banks and the relations of the Federal Reserve System with foreign-controlled or foreign banks.

It seems to me that the power to regulate there is the power to control. I addressed my question having in mind that you are asking us to vest complete authority which will be largely, I think to a greater extent than at present, under the control of the Federal

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Reserve Board; and I think it would be interesting to Members of Congress, and particularly to this committee, to know what your policy would be under present conditions. I assume it is the same policy we have at the present time.

Governor ECCLES. I cannot speak for the Federal Reserve Board as to what the policy of the Board would be if this legislation is enacted. That would naturally be a matter that the Board would have to determine.

Mr. BROWN. Do you not think it is fair for us to ask what you would do if given this power under present conditions? It seems to me that we ought to know, that Congress ought to know your attitude as chairman of the Board.

Governor ECCLES. I can speak only for myself with reference to the matter. I cannot speak for other members of the Board, who would be just as independent in exercising their judgment as I would try to be.

Mr. BROWN. When I say "your" I am referring directly to you.

Governor ECCLES. Yes; I understand. Under present circumstances there is very little, if anything, that can be done.

Mr. GOLDSBOROUGH. You mean you cannot push a string.

Governor ECCLES. That is a good way to put it, one cannot push a string. We are in the depths of a depression and, as I have said several times before this committee, beyond creating an easy money situation through reduction of discount rates and through the creation of excess reserves, there is very little, if anything that the reserve organization can do toward bringing about recovery. I believe that in a condition of great business activity that is developing to a point of credit inflation monetary action can very effectvely curb undue expansion.

Mr. BROWN. That is a case of pulling the string.

Governor ECCLES. Yes. Through reduction of discount rates, making cheap money and creating excess reserves, there is also a possibility of stopping deflation, particularly if that power is used combined with this broadening of eligibility requirement.

Mr. BROWN. Does not a Federal Reserve bank have two main functions? Eliminating the temporary loans we provided for last year and other various forms of aid to all banks and industries, are not the main functions of a Federal Reserve bank, first, rediscounting of paper turned in by the member banks?

Governor ECCLES. Eligible paper.

Mr. BROWN. And, secondly, to engage in open market transactions, which, as I understand, relates to the buying of warehouse certificates and other evidences of property back of indebtedness throughout the country as a whole and not confined to the particular Federal Reserve district?

Governor ECCLES. It is largely the purchase of Government bonds.

Mr. BROWN. Do you not engage in the purchase of warehouse certificates?

Governor ECCLES. Bankers' acceptances.

Mr. BROWN. Sometimes you do and sometimes you do not. Is not that a question which the open-market committee decides whether you shall engage or not in that line of work?

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Governor ECCLES. The open market committee determines whether or not it shall purchase or sell Government bonds and bankers' acceptances.

Mr. BROWN. Under section D of 12-A of the present law you cannot compel a particular Federal Reserve bank to engage through your open-market committee or Federal Reserve Board in open-market operations, can you?

Governor ECCLES. That is right.

Mr. BROWN. Under the proposed bill is it your idea that such authority will vest in the open-market committee?

Governor ECCLES. That is right.

Mr. BROWN. In other words, you feel that it is proper for the Federal Reserve Board to say to a Federal Reserve bank that it shall engage in the purchase of Government bonds and bankers' acceptances?

Governor ECCLES. That is right. The way it is done is through the system account. The holdings are largely prorated to the banks in relation to their size and their own reserve situations.

Mr. BROWN. Under the second portion of the present bill, section 12-A, it really does not seem to me that it gives you authority to compel banks to engage in open-market operations. I do not find anything in there requiring them to do so. It says that " they shall conform open market operations to the provision hereof." I do not think it provides that they shall engage in open-market operations against the wishes of their own board of directors.

Do I understand that you have proposed an amendment to section 205?

Governor ECCLES. Do you mean additional amendments to the bill that was introduced?

Mr. BROWN. Yes.

Governor ECCLES. Yes.

Mr. BROWN. Is there any language in your amendments that makes it obligatory upon the Federal Reserve banks to engage in open-market operations if they do not want to do so.

Governor ECCLES. It was expected in the original legislation that, where there was a committee of five proposed, the governor and two other members of the board, and two governors of reserve banks, the reserve banks would be required to participate in the purchase of securities or bills as determined by the open-market committee.

Mr. BROWN. Does your general counsel think that the language of the act as you propose is sufficiently broad to enable the Board to so command the Federal Reserve banks? It does not seem so to me. If it is desirable that such an authority should be effected, I think the language of the bill should be broader.

Governor ECCLES. It was intended to be; whether it is or not I do not know.

Mr. WYATT. The bill as introduced contains this language, on page 45, lines 3 to 9: " The committee from time to time shall consider, adopt, and transmit to the Federal Reserve banks resolutions setting forth policies which, in the judgment of the committee, should be followed with respect to open-market operations of the Federal Reserve banks, and the Federal Reserve banks shall conform their open-market operations to the provisions thereof." That means that the

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Federal Reserve banks must conform their open-market operations to the provisions of the resolutions adopted by the committee.

Mr. BROWN. Suppose the bank says, "We have only sufficient funds, in our judgment, to take care of the necessary rediscounting of our own member banks and we do not desire to engage in open-market operations." Is there anything in that law to compel them to so engage in open market operations?

Mr. WYATT. Suppose that the committee adopts a resolution directing that the banks shall purchase a billion dollars worth of Government bonds and that each bank shall buy its pro rata share of such bonds. How can they conform to the provisions of that resolution without each bank buying its pro rata share?

Mr. BROWN. By simply refusing to engage in open-market operations and confining their business to rediscounting with its own member banks. That is a logical conclusion, I believe.

Mr. WYATT. I think the point you raise is a good one and that the bill should be clarified so as to eliminate any doubt on the point.

Governor ECCLES. The intention is to make it mandatory, otherwise it would be impossible effectively to carry out any monetary policy.

Mr. BROWN. I do not mean to say that I approve the policy, because I am inclined to agree with some things Mr. Hollister indicated this morning, among them being that such control of Federal banks and district banks is more than we ought to give. I want to point out that it did not seem to me that your statement at the beginning of these hearings said it was desirable.

Governor ECCLES. It seems to me that when we speak of centralizing control outside of the banks we fail to recognize the peculiar structure of our Federal Reserve banking system as contrasted with central banks elsewhere in the world. If we had here, which may have been the more desirable arrangement, one bank with 12 branches, or as many branches as may be necessary to serve the country, then the board of directors would be charged with the responsibility of the monetary policy as well as the responsibility of providing credit to business, agriculture, and industry.

Mr. BROWN. Instead of that kind of system we have 12 separate, distinct banks.

Governor ECCLES. Yes.

Mr. BROWN. With 12 different capital set-ups varying in amounts of surplus.

Governor ECCLES. Capital and surplus do not determine the ability to lend or to participate.

Mr. BROWN. It determines the amount of money they have available.

Governor ECCLES. No; they create money.

Mr. BROWN. Only based upon the assets?

Governor ECCLES. Only based upon the gold limits.

Mr. BROWN. So that you are attempting here to give such control to the Federal Reserve Board similar in authority to that of a board of directors over one bank with 12 branches?

Governor ECCLES. But, actually, so far as open-market policy is concerned, if we recognize the need of a monetary policy, it must be carried out in the public interest. It cannot be left to the 12 banks, acting independently.

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Mr. Brown. I grant that. But I do not agree with you that your control relates only to open-market operations. You are establishing under this law, or, at least, you are given the right to establish, general rules for the eligibility of paper for discount.

Governor Eccles. That is correct; but that does not mean that the Federal Reserve Board has anything to do with the passing upon the loans which are made. The Board has only the responsibility of making rules and regulations with reference to the conditions under which Federal Reserve banks can rediscount for or lend to member banks; and its power is strictly limited, according to the present statutes, to permit loans only upon certain specific types of paper, of which there is very little in existence.

If the Board were given more discretion, the system would become more flexible. The proposed amendment in no way gives the Board power to compel the Reserve banks to make the loans. It is expected that the Reserve banks will be just as independent as they have been with reference to their autonomy in matters of regional interest.

Mr. Brown. Principally rediscounting?

Governor Eccles. Not only in rediscounting, but also in all relations with member banks. The examinations are all conducted through the Reserve banks. The Federal Reserve Board depends upon the Reserve banks to carry on all of the relationships with the member banks and with the communities. We are only providing here for the placing of responsibility in a comparatively small body that can be charged with the public interest, to deal with monetary policy. That seems to me to be absolutely essential, if we expect to avoid in this country the dangers inherent in a purely banker control over the creation and the extinguishing of credit. We have had experience with that, and we know that it does not work very satisfactorily. Whether it will work any differently under the proposed arrangement, time alone will determine. But it does seem to me that to deal with the monetary needs of a Nation on other than a national basis and with any other purpose than that of serving the public interest is to invite disaster.

Mr. Brown. In that connection, I note that by section 208 of the pending bill, you repeal the provisions of the banking law, I think, of 1933, by which we authorized the issuance of Federal Reserve notes based upon the eligible paper that had been turned over to the Federal Reserve banks by the member banks. And it was under the authority of that section that the President recently extended the right so to do from March 3, 1935, on for 2 years. That was done 2 or 3 weeks ago, was it not?

Governor Eccles. That is right.

Mr. Brown. Now you are repealing that provision of the law?

Governor Eccles. That is right.

Mr. Brown. And you propose to substitute section 16 of the law, I presume, where the Federal Reserve Board have practically complete control of that matter of the issuance of new money. Is that right?

Governor Eccles. As I understand what you mean, the Emergency Banking Act referred to permitted the Federal Reserve banks to secure Federal Reserve notes with Government bonds, in addition to commercial paper. The period of time during which that could be done was extended, very recently, for a period of 2 years.

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Mr. Brown. That is right. Governor Eccles, not only Government bonds, but notes, bills of exchange, and acceptances were eligible as collateral for the issue of Federal Reserve notes, were they not?

Governor Eccles. Yes; that is right.

Mr. Brown. Now we are repealing that section of the law.

Governor Eccles. Because we are making it unnecessary to put up any collateral with the Federal Reserve agent for the purpose of securing Federal Reserve notes. It adds nothing whatever to the value of the notes, as I have explained here on several occasions; and it is an unnecessary requirement. No central bank requires it except that it is still adhered to in the Bank of England; but no other bank in the world requires it, and the amount of Federal Reserve notes that are used has no relationship whatever to the collateral requirement. Federal Reserve notes may be required in great amount when there are practically no discounts. The amount of the rediscounts by member banks with the Reserve banks has no direct relationship to the amount of Federal Reserve notes required. Only the people of the country can determine the amount of currency is required by the drawing of currency instead of checks.

Mr. Brown. It seems to me that there is a considerable disagreement upon that matter of policy. We specified in the Banking Act of 1933 certain types of commercial paper that were eligible as collateral for the issue of Federal Reserve notes, the issue of new money. Now, you repealed that, and, under section 16, you cover it all by one sentence: "Federal Reserve notes shall be issued and retired under such rules and regulations as the Federal Reserve Board may prescribe and shall be legal tender for all purposes." Now, is it not a fact that when people borrow money from banks it shows that they are engaging in business, that they need credit? Their notes are turned over to the Federal Reserve banks and money issued.

Governor Eccles. No.

Mr. Brown. It was under the Banking Act of 1933.

Governor Eccles. No currency is issued as a result of that transaction at all.

Mr. Brown. I am glad to hear that, because we have heard a great deal over in the House about money being issued. You say there is none issued?

Governor Eccles. No. The borrowing by a member bank from the Federal Reserve bank does not determine the amount of currency that the member bank or the banks as a whole or the public as a whole may require or use.

Mr. Brown. Well, was not that law passed for the purpose of supplying the need of banks for currency to pay their depositors when they demand it?

Governor Eccles. No; 40 percent of the amount of notes outstanding must be secured by gold certificates and 60 percent was required to be secured by commercial paper. As a matter of fact, there was so little commercial paper that it was impossible to provide the 60 percent; and therefore at one time there was over a billion dollars of gold, in addition to the 40 percent gold reserve, that had to be used as a substitute for the lacking commercial paper. In other words, it was used to help make up the 60 percent; because there

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Federal Reserve Bank of St. Louis

was not sufficient commercial paper available. There is not the quantity of commercial paper in the country upon which to——

Mr. Brown (interposing). How about the individual banks? Let us take a bank with a capital of a million dollars and a deposit liability of 10 million dollars, and it has commercial paper that would be eligible under this section of the Banking Act of 1933. I think this committee supposed that if that bank wanted to convert that commercial paper into cash it would be able to do so.

Governor Eccles. It still can do it under this. There is no change in the law proposed that prevents that. That bank can still go to the Reserve bank and can take that commercial paper and can get credit in its reserve account with the Reserve bank and can draw down currency to the extent that it needs——

Mr. Brown. That is, by rediscounting its notes?

Governor Eccles. Or, as we are proposing here, if it has not the eligible paper and it has other sound assets.

Mr. Brown. I may be dense on this, but it seems to me that you are throwing out the basis for the issue of currency by issuing currency upon the resolution of the Federal Reserve Board instead of basing the issue upon the assets that are in the vaults of the member banks of the country and the demand for money on the part of the depositing public.

Governor Eccles. Let me explain that again.

The Federal Reserve banks have two kinds of liabilities—three with their capital and surplus: Deposit liability, note liability, and the capital and surplus liability. Loans and discounts and investments, lawful money, and gold certificates are the assets of the Reserve banks.

The member banks which carry their reserves with the Reserve banks ask the Reserve banks for currency only to the extent that they have deposits with the Reserve banks. They must maintain a minimum reserve balance with the Federal Reserve banks, and when they want currency they must acquire additional balances to which they can charge the currency withdrawn. In order to get that, they may send paper to be discounted with the Reserve banks.

The member banks supply currency to their customers, to their depositors, when the depositors want to draw out their deposits, or a portion of them, in currency; and if a bank reaches a position where the customers have called upon the bank for currency and it is unable to meet that call, that bank closes. Many of the banks in this country were unable to meet that call, not because they were not sound but because they did not have the eligible paper with which to go to the Reserve bank and get credit; and therefore, because of the fact that the banks were unable to do that, those banks were compelled to close.

As the number of banks closing increased, the demand for currency increased, not because of the activity of business but because of hoarding; and the very fact that the banks were unable to go to the Reserve banks with sound assets to meet the demands of these depositors meant finally a banking collapse. Had the banks been able to pay their depositors in currency, the depositors would not have wanted the currency, as was demonstrated after the bank holiday.

Mr. Brown. Does it not come down then to this question, or to this situation: That the reason for the collapse of the banks that were actually solvent, but that had so-called "frozen assets" or "frozen loans"——

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Federal Reserve Bank of St. Louis

Governor ECCLES (interposing). Deflation created a frozen condition.

Mr. BROWN. But it was a lack of liberality in regard to the eligibility of paper for rediscounting that caused a good deal of the distress.

And, by your next section, 206, you seek to liberalize those rediscounting rules?

Governor ECCLES. That is right.

Mr. BROWN. Now, that brings me to the meat of my discourse, What are those rules going to be? That is the same question I asked you regarding the open market operations. I think this committee and this Congress ought to know what your own idea, Governor Eccles, is and what those rules of eligibility are going to be. I recognize that the law sets a standard as to real-estate loans.

Before you make your answer let me get one of my favorite objections to Government practice in the past with regard to those notes stated on the record. I am thinking of a small national bank in the country. Now, the Comptroller's office has a rule by which certain collateral listed on the New York Stock Exchange, or other large exchange, is recognized as collateral and the paper which that collateral secures is eligible for loans. We have tens of thousands of small manufacturing concerns, whose securities are good, but which are not listed upon the New York Stock Exchange or the Detroit Stock Exchange or the Chicago Stock Exchange, or any other large exchange. Their statements show them to have plenty of cash assets back of those securities. But, because of the rules of the Comptroller's Office—and I am not very familiar with the examination made by the Federal Reserve banks, but I presume they are the same—the collateral of those small concerns does not stand nearly as well for loans as does the stock of large concerns. Now, it seems to me that that condition is unfortunate for the small banks and the small businesses; and I am wondering, with respect to that situation, whether or not there is going to be any liberalization regarding the eligibility of that type of paper as collateral for loans rediscounted with the Federal Reserve banks.

Governor ECCLES. The matter that you refer to has reference to the treatment of certain types of loans in banks by the Comptroller's office.

Mr. BROWN. Well, and by the Federal Reserve Board's examiners.

Governor ECCLES. The Federal Reserve Board's examiners accept the Comptroller's examinations for all national banks. They make no independent examinations. That would be only a duplication. The Comptroller's examinations are accepted by the Federal Reserve banks.

Mr. BROWN. That would apply to thousands of member State banks.

Governor ECCLES. There are only 900 State banks, and these are examined by the Reserve banks. But there is no prohibition either under the law or in the regulations, to my knowledge, against banks making loans secured by other than listed collateral, either stocks or bonds.

Mr. BROWN. You say there is none?

Governor ECCLES. There is no prohibition either in the regulations or in the law against them.

Mr. BROWN. There is in the practice.

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Federal Reserve Bank of St. Louis

Governor ECCLES. No; not in practice.

Mr. BROWN. I disagree with you.

Governor ECCLES. There is none in practice. The question is, of course, to establish values back of loans which are secured by unlisted collateral. Now, if collateral is listed it becomes much easier to establish whether or not that particular loan is adequately secured than is the case where the loan is secured by some local security that it is very closely held and has no market ability. It becomes difficult for an examiner to determine whether or not a loan is adequately and safely secured for that reason, but——

Mr. BROWN (interposing). Governor Eccles, don't you know it to be a fact that, with regard to the bonds of concerns throughout the country, the Comptroller's office has refused to approve bonds that are not listed on the New York Exchange or some other large exchange so as to be readily marketable?

Governor ECCLES. Refused to accept them for what?

Mr. BROWN. As loans.

Governor ECCLES. To secure loans?

Mr. BROWN. Yes.

Governor ECCLES. There is no prohibition in the law.

Mr. BROWN. There is no prohibition in the law, but the practice is to decline to approve such loans.

Governor ECCLES. There is no such requirement.

Mr. BROWN. What I am wondering is if you are going to be a little more liberal on this?

Governor ECCLES. I know that there are literally thousands of bond issues, municipal issues, all kinds of issues, which are held by banks; and, so long as those bonds are not in default, and their payments are being met——

Mr. BROWN (interposing). I will except municipal bonds.

Governor ECCLES. There is no restriction or prohibition against the holding of those bonds. It is true that the examiners make an effort to establish the value back of them, in the absence of a quoted market, which is very desirable and necessary, in order to determine whether or not the loan which the bonds or stocks secure, or the bonds which are held directly, are worth what they purport to be worth.

Now, in the case of a local stock issue or local bond issue, there is, naturally, the problem of attempting to determine the value of that security.

I know, in my own banking experience, over a period of 20 years, that we have had no trouble with the Comptroller's office with reference to matters of that sort; and many loans have been made on local securities, and various bond issues have been purchased that were not listed. The main thing is to have available and be able to give to the examiner information with reference to the local company whose stock is put up as collateral or whose bonds are put up as collateral. Such information is necessary to establish the value of the collateral which secures the note in question.

I find that most of the trouble is that in accepting local securities, stocks or bonds, banks fail to provide sufficient information to enable the examiners to substantiate the value of the securities which they have taken. It is lack of information.

Mr. BROWN. I want to say to you that it is my judgment, then, that the attitude of the Comptroller's office has been very much more

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Federal Reserve Bank of St. Louis

severe in the Chicago district than it has been in the San Francisco district or the Salt Lake City district, because that rule was enforced when the banks were reorganizing in Michigan and Ohio in 1933 and 1934; and they did insist that those bonds be listed bonds.

I am glad that you have stated in the record what I think is a more liberal policy regarding local stocks as collateral, as well as local bonds.

I have two or three other questions, but I would like a little further answer to my question as to what other classes of paper, in your judgment, the Federal Reserve Board should determine to be eligible paper, for rediscount in the Federal Reserve banks.

Governor ECCLES. It would be my personal opinion—I cannot speak for the Board—that very broad rules and regulations should be made with reference to this subject and that a broad discretion should be left to the Federal Reserve banks. I think that, in matters of local credit concerning each Federal Reserve district, if they are given discretionary power, the Federal Reserve banks can be relied upon to make only sound loans; and I do not think, as a practical matter, that there should be a lot of limitations and restrictions with reference to what may be considered sound paper.

Mr. BROWN. Well, for instance, as I understand it, 3-months' paper has been rediscounted, one renewal allowed, and after that it was taken out of the class of commercial paper that was eligible for discount. That was a general rule in the Minneapolis and Chicago districts and always enforced. Now, that was a general rule, whereas there are a great many businesses that take a year for a turnover; and they were limited there to 6 months' credit. Now, would your own personal disposition be to so liberalize the rule, if what I say is true of that, so that paper for 9 months or 12 months could be taken?

Governor ECCLES. I would not like to say, under normal conditions, that paper should be taken on a bills-payable basis, for longer than a 6-months' period, because it is always an easy matter to renew the paper.

Mr. BROWN. Well, what would you say?

Governor ECCLES. That would be up to the Reserve banks, the question of renewal would be up to them. Certainly it would be bad for the banking system as a whole to permit continuous borrowing from the Reserve banks by the member banks. Continuous borrowing from the Reserve banks by the member banks could only mean that the member banks were lending money and rediscounting or borrowing because of the difference in the rate that they paid the Reserve banks and the rate at which they were able to loan. However, I can well imagine a situation where you would have a crop failure, drought conditions, catastrophes, and so forth, where it would be very necessary for the Reserve banks in those areas not to expect liquidation in that particular area; and it would be desirable to carry the loans over for an additional time. Past experience and the attitude of member banks toward borrowing indicate that we can be assured that member banks are not going to borrow from the Reserve banks except for short, seasonal periods of time, unless an emergency develops, which may require that they borrow for longer periods of time; and that is the purpose of this legislation.

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Mr. Brown. But I am talking about the small business man now. It happens that in my district, in one of the large resorts of Michigan, the practice in the merchandising business there is for a merchant to buy his goods in December. If he can pay for them then he gets a substantial discount. He will not get his return on the bulk of those goods until the following August. Now, it seems to me that it is just as legitimate for that purpose to get a 9 months' loan, in that type of business, as it is in certain other types of business, where the turnover is made in 3 months, as it is in the grocery business; and that he should be accommodated for the 9 months' period. Now, do you have in contemplation, when you lay down these rules and regulations for eligibility, such a situation, and that the normal course of a business of that character should be accommodated?

Governor Eccles. There is nothing to prevent the individual banks from making loans of that sort today.

Mr. Brown. I am talking about rediscounts.

Governor Eccles. Of course, there is not any rediscounting today. There are excess reserves of tremendous amounts.

Mr. Brown. There is, of course, in some banks.

Governor Eccles. That is true of the country as a whole. There is practically no borrowing from the Reserve banks, and most banks have excess reserves. In addition to that, if they had to borrow, they would borrow on their Government bonds; because they would be the easiest assets upon which to borrow.

Mr. Brown. Well, I take it that, on all these questions, you are very much adverse to stating what, in your judgment, the policy of the Federal Reserve Board will be in regard to the rediscounting of paper.

Governor Eccles. I think——

Mr. Brown (interposing). But, with the utmost good humor, I do not think you have told me yet of any particular liberalization that you propose to make in the rediscounting rules.

Governor Eccles. Rediscounting rules today are not made by the Board.

Mr. Brown. But they will be under this bill, if it becomes a law.

Governor Eccles. Yes; but the law today states that only certain specific types of paper, which are known now as eligible, short-term, self-liquidating paper, are eligible. Now, this proposed legislation broadens the power to a point where the Reserve Board is able to make rules and regulations which will permit Reserve banks to make advances against any sound assets.

Mr. Brown. What I am trying to find out is, what is your idea as to what they should do?

Governor Eccles. I would leave that up to the Reserve banks. I would favor broad enough rules to leave discretion to the Reserve banks in passing upon credit. You might put a limitation of 6 months advances on a bills-payable basis. To make rules and regulations in Washington as to what would be adequate security for advances to member banks would be rather a complicated procedure and would certainly be inadvisable and unnecessary.

Mr. Brown. But the banks are given the authority, under the law, to make those rules and regulations.

Governor Eccles. Which banks?

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Federal Reserve Bank of St. Louis

Mr. BROWN. The Federal Reserve banks and the Federal Reserve Board are given that authority.

Governor ECCLES. That is right.

Mr. BROWN. To determine the maturities and other matters.

Governor ECCLES. That is right.

Mr. BROWN. Now, what I am trying to find out is what your present attitude is toward the eligibility of the various classes of paper.

Governor ECCLES. I am just saying that I would permit the Reserve banks to loan on any and all assets, real-estate mortgages, collateral loans, bonds, or other assets, which they considered sound, on such a basis as they considered sound.

Mr. BROWN. And with what maturities?

Governor ECCLES. My personal opinion, without giving any thought or study particularly to the problem, would be that 6 months advances on a bills-payable basis should be adequate. That does not necessarily mean that a bank, at the end of 6 months, could not renew for another 3 months or 6 months. But I do not believe that, on a bills-payable basis, for advances, that 6 months would be working any hardship upon the banks.

But in case of a rediscount, you would have maturity based upon what would be considered the period of natural liquidation. For instance, agricultural and livestock loans are 9 months, as it is considered that the underlying transactions take that length of time. Those are rediscountable now. Collateral loans, loans which are not considered rediscountable and are not self-liquidating, through the completion of business transactions, such as loans against mortgages or loans against bonds, would likely only be made in cases of emergency, in cases of deflationary situations, and they would not be made in the natural course of business except to a very limited extent. Certainly, the Reserve bank should be given the power to enable a bank that has an unusual shrinkage of its deposits, and yet has sound assets, to get credit on them until it can carry out a normal process of liquidation, without closing and without bringing about an undue deflation. That is the purpose of this legislation.

The CHAIRMAN. And you mean sound assets made within the limitation of the law establishing the rules under which those loans should be made?

Governor ECCLES. Yes.

The CHAIRMAN. In other words, if the borrowing bank had made those loans within the law?

Governor ECCLES. That is right.

Mr. BROWN. Now, getting back to commercial paper—expressed in my poor way—should not the rule be that the discount should be permitted for such length of time as would cover the normal period from production to sale of the goods?

Governor ECCLES. I think that is what is contemplated under the law now.

Mr. BROWN. Personally, I would like to have you say that you feel that way about it yourself. In other words, that you feel that that is the kind of rediscounting that you, as a member of the Board, would favor.

Governor ECCLES. You mean in case the Board is making rules with reference to rediscounting?

Mr. BROWN. Yes.

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Governor ECCLES. What do you have in mind, what particular item?

Mr. BROWN. Let us take something that you and I know something about. Suppose we did not have the system of handling sugar by warehouse receipt. It takes from September, generally, to August, in Michigan, to bring about the cycle from payment to the farmer for the production of sugar beets, to the final payment for the sugar and collection. Now, it seems to me that the period of discounts should be that length of time and that notes for that period should be eligible for rediscount.

Governor ECCLES. Do you mean on a straight bills-payable basis?

Mr. BROWN. Straight bills-payable basis; yes.

Governor ECCLES. As a general rule, manufacturing companies, such as sugar companies and other companies, borrowing from the banks, seldom want to borrow for a period longer than 6 months, or, maybe, even 90 days, because they are constantly reducing the outstanding loans.

Mr. BROWN. That is right.

Governor ECCLES. And they do not know exactly by what amount they are going to be able to reduce it; and, hence, they do not want to rediscount up to the maximum amount of the financial requirements for a period of 9 months, because it may be that they can pay a substantial amount in 3 months and renew the balance. I believe that, even if a 9-month rediscount were permitted in that type of transaction, there would be very few that would use it.

Mr. BROWN. But you might find one fellow that would want to do it.

Governor ECCLES. I see no objection to that, if the condition of the company is such that an open line of credit is desirable, and they were willing to borrow for 9 months, and the bank should take 9 months' paper. There would be no reason for the Reserve bank not taking such paper as quickly as they would take livestock paper.

Mr. BROWN. In other words, you feel that no such rule should be established by the Federal Reserve Board as would prevent the taking of paper having such maturity or length of time as would cover the normal period from production to final consumption, sale, and collection.

Governor ECCLES. It would seem to me that that should be permitted. If a borrower wanted to borrow for that length of time and the credit was good credit, and the member bank was willing to accept that type of credit as being self-liquidating commercial credit, there should be no objection and the Reserve bank should be permitted to take that type of loan from the member bank.

Mr. FORD. Governor Eccles, you used the phrase there "good credit." Now, is not the Federal Reserve bank in a district, when a member bank comes to the Reserve bank with its assets, going to be reasonably certain that the assets offered are sound?

Governor ECCLES. I think there is no question about it.

Mr. FORD. Then, I think that the question that Mr. Brown brings up is largely a matter of local prestige, based on the actual knowledge of the member bank that makes the original loan, of the soundness of the person who makes the loan, and it can back him up if it has to go to the Federal Reserve bank.

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Federal Reserve Bank of St. Louis

Mr. BROWN. Up to the present time they have held them down to the 3-months' period, which I think is too short.

Governor ECCLES. I think that is largely due to the member banks, rather than to the Reserve banks. The member banks prefer 90-day paper, because they have seen in the past the very wide fluctuation in the value of commodities against which they loan. In loaning for a period of 9 months on any commodity, there is room for very wide fluctuations in prices; and it is my belief that the member bank passing on the credit, for its own protection, will adhere to 90-day paper, and renew; because, after all, even if it borrows from the Reserve bank, it is responsible for the obligation, and the Reserve bank is not making the loan directly to the original borrower.

Mr. FORD. Would there be anything wrong with this type, or would there likely be a refusal to discount this type of paper: A man borrows $20,000 for 90 days; at the end of 90 days he pays $8,000 back; there is still $12,000 left. An emergency arises, where the local bank has to go to the Federal Reserve bank to rediscount; would there be anything against that remaining $12,000, if it were sound, if it is part of the renewal note?

Governor ECCLES. Not the fact that it is a renewal note.

Mr. FORD. Does it not give it the status of the original?

Governor ECCLES. Yes. In fact, that is what is usually done with commercial paper. It is paid off by renewals.

Mr. BROWN. The rule has been in the Minneapolis district, at least, that they would allow one renewal, and at the end of 6 months you would have to pay back.

Governor ECCLES. The member banks did that.

Mr. BROWN. The member banks would.

I want to discuss with you just a moment a subject that I took up with Mr. Crowley, Chairman of the Federal Deposit Insurance Corporation, this matter of bank examinations. It seems to me that we have too many governmental authorities examining banks. We have 3 at the present time, and 4 if we include the Reconstruction Finance Corporation, which, I grant, is a temporary organization. We have the Federal Reserve banks, the Comptroller's Office; the Federal Deposit Insurance Corporation has now asked for authority, in the present bill, to examine national and member State banks.

I want to ask first if the Federal Reserve Board has followed the policy of appointing only such examiners as are designated by the Comptroller of the Currency? Now, I will explain that. Under the first section of the law on bank examinations, it appears to have been the policy of the act to require that Federal Reserve bank examiners should be designated by the Comptroller of the Currency. Then, under a section or so later, it is provided that the Federal Reserve authorities themselves may designate examiners.

Now, what I am wondering is whether the general practice has been to get examiners designated by the Comptroller of the Currency or to use the authority conferred in the second portion of the law, which is section 483 of the United States Code, annotated. The first section I referred to is section 481.

Governor ECCLES. I cannot speak as to what the Reserve Board may have done in the past. I am not familiar with it. But it is my understanding that the Federal Reserve Board chooses its own examiners entirely. The Examining Division of the Federal Re-

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serve Board deals, of course, with the member State banks. The Comptroller's examinations are accepted for national banks.

Mr. Brown (interposing). For the national banks?

Governor Eccles. There is no point, of course, to duplications of examinations.

Mr. Brown. Well, am I right in assuming, then, that the Comptroller is not examining member banks of the Federal Reserve System who are not national banks?

Governor Eccles. That is correct. They are not examining them, and the Federal Reserve Board is not examining the national banks.

Mr. Brown. No.

Governor Eccles. The examination reports are available and are given to the Federal Reserve banks, so that they can get any and all information that they desire from the Comptroller's office, with reference to national banks, which, of course, are members.

Mr. Brown. The statute says that the Comptroller of the Currency shall appoint examiners who shall examine every member bank. Evidently the law is not being followed in that respect. I do not have any objection to it.

Governor Eccles. Do you know whether that question has ever come up, Walter?

Mr. Wyatt. The original Federal Reserve Act required the Comptroller to examine all members banks; but section 9 was amended by the act of June 21, 1917, so as to say that State member banks shall not be subject to examination by the Comptroller of the Currency but shall be subject to examination by examiners selected or approved by the Federal Reserve Board.

Mr. Brown. You will find, two sections later, that special examinations are provided for by the Federal Reserve Board, but I do not believe that the first section was ever repealed. But that is an academic question; I am not particularly interested in that. But I believe that the examinations should be conducted by 1 bureau of the Government and not by 3.

Governor Eccles. So do I.

Mr. Brown. And I think it is a good time to change the law in that respect. The expense of the Government examination of the bank is borne by the bank?

Governor Eccles. It is.

Mr. Brown. Not only the examination by the Federal Reserve Board but the examination by the Comptroller's office?

Governor Eccles. That is right

Mr. Brown. Take a community having 3 banks, 1 a national bank and 2 member State banks, and you have a great deal heavier expense upon that bank by reason of a trip by the national bank examiner and then a subsequent trip for the examination of the other 2 banks by the Federal Reserve bank examiner; and it seems to me that it is an unjust and unnecessary expense upon the banks.

Now, the Federal Deposit Insurance Corporation is the only all-inclusive bureau with respect to the examination of banks in the Government, is it not?

Governor Eccles. I do not understand that the Federal Deposit Insurance Corporation was given the power to examine national banks.

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Mr. Brown. Yes; it is under this bill. They may, with the consent of the Comptroller of the Currency and with the consent of the Federal Reserve Board, examine any bank.

Governor Eccles. Yes.

Mr. Brown. National banks or member State banks.

Governor Eccles. Yes.

Mr. Brown. I say " an all-inclusive bureau ", with respect to the examination of banks, because of the fact that they, of course, include all national banks, all member banks in the Federal Reserve System, and a great many nonmember banks; in fact, all nonmember banks which are in the Federal Deposit Insurance Corporation. That is a fact, is it not—that they cover them all?

Governor Eccles. They cover them all.

Mr. Brown. And the only banks in the country that they do not cover are the uninsured banks, which are very few in number?

Governor Eccles. That is correct.

Mr. Brown. I think I will close that part of the discussion by this: I understand that you, yourself, feel that it would be best if we could have one examining authority to examine all the banks of the country.

Governor Eccles. Let me first state that the existing duplication is not as serious as it appears on the face of things. The Reconstruction Finance Corporation make no examinations, as a regular thing. The examinations they made were in connection with subscriptions to preferred stocks and debentures; and those examinations were made only once, at the time they were determining their investment in the capital stock of the particular bank.

Mr. Brown. And, to be perfectly fair, I understand now that they are not making even that examination. They are accepting the other examinations.

Governor Eccles. That is right; and they have always accepted the other examinations, except in very important instances, where a great deal of money was involved and there was a good deal of question about the bank.

The Federal Reserve Board only examines the member State banks. Their examinations are usually made along with the State banking examinations, so as to avoid duplication. The Comptroller's office examines all national banks. No other agency examines national banks. The Federal Deposit Insurance Corporation makes no examination of national banks and makes no examination of State member banks but examines the nonmember State banks, along with the State banking departments, so as to avoid duplication there, so that there is really not the duplication in actual examinations that would appear on the face of things.

However, there is, of course, a division of the examining authority between the 48 State banking departments, with reference to State banks, and the Comptroller's office with reference to the national banks, and the Federal Reserve with reference to the State member banks, and the Federal Deposit Insurance Corporation with reference to all banks. There is not any question that you would get a much more general unification of the policy in making examinations if the examining were all done under the direction of one organization.

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Federal Reserve Bank of St. Louis

Mr. BROWN. You certainly would eliminate the duplication of organizations.

Governor ECCLES. That is right. You would eliminate the duplication of organizations, more than duplication of examinations.

Mr. BROWN. Or, we might say, triplication of organizations.

Governor ECCLES. Yes, sir; you would do that; and you would make, probably, for a greater unity of examination policy, which has been very sadly lacking. However, there has been a great amount of work done in the past 6 months with reference to improving the matter of unifying the policy as to examinations. The Comptroller's Office, the Federal Deposit Insurance Corporation, and the Federal Reserve have had a great many meetings, and much progress has been made toward the development of unification of examinations.

The CHAIRMAN. Let me ask you a question. What is the purpose of the examinations?

Governor ECCLES. To determine the condition of the banks.

The CHAIRMAN. What I want to develop in asking you the question is this: Is not one of the purposes of the examination of the banks to develop and disclose bad practice and any fraud that is being perpetrated by those in charge?

Governor ECCLES. It is to see that the bank is carrying out the provisions of the law.

The CHAIRMAN. One purpose of conducting the examination is to make sure there is no criminal violation or mispropriation of funds?

Governor ECCLES. That is one reason.

The CHAIRMAN. Do you think that one system of examination, under one standard, is more likely to uncover or disclose fraud in the conduct of a bank than two examinations?

Governor ECCLES. As a matter of fact, there is only one system in effect now. As I explained, the Federal Reserve accepts the Comptroller's examinations of national banks. If the banks were required to pay the examination expense of all these independent agencies, they could be constantly harassed and bothered with two examinations a year from each one of them; and I cannot see how they could endure it. As it is today, the banks are pretty well harassed with examinations and with the various reports that they are required to make to the various agencies, which is a great expense to them.

The CHAIRMAN. Are not the reports worse than the examinations?

Governor ECCLES. They are both bad enough, but necessary.

The CHAIRMAN. From what I have heard, it would appear that the reports are worse than the examinations.

Governor ECCLES. In most countries they have no examinations. In Canada there are no bank examinations whatever; and there never have been any bank examinations whatever. They have never had them.

The CHAIRMAN. Of course, they enforce criminal law in Canada, you know.

Governor ECCLES. They have reports. As I understand it, in Canada they have complete monthly reports. That is correct, is it not?

Dr. CURRIE. Yes, sir; but they also have examinations now.

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Governor ECCLES. No; not examiners going out into the banks. What they do is this, they get the monthly reports into the head office; and there are two examiners that go over those reports in the head office. What I meant was that there are no examiners who go out into the banks and carry out the examinations.

Mr. FORD. Unless they find something wrong with the report?

Governor ECCLES. They make an inquiry. But, you see, those banks have numerous branches, and the banks themselves have their own examiners. That is the way the British banks operate, in the same manner; they have their own examiners.

It is not expected that this proposed legislation will create a perfect banking system by any manner of means. We will still have plenty to consider, looking into the future.

The CHAIRMAN. Mr. Brown, have you finished?

Mr. BROWN. There is nothing in there to abolish the human equation.

Mr. CROSS. I was wondering how to abolish these glass eyes.

The CHAIRMAN. Well, gentlemen, we will ask Governor Eccles to come back in the morning, at 10:30.

(Thereupon the committee adjourned until tomorrow, Tuesday, Mar. 19, 1935, at 10:30 a. m.)

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BANKING ACT OF 1935

TUESDAY, MARCH 19, 1935

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Governor Eccles, Mr. Goldsborough desires to ask you some questions.

STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Resumed

Mr. GOLDSBOROUGH. Governor, you have been here for some time now and have been exceedingly patient, and I will not take very long, I am sure.

During the discussion of this bill, and, practically every bill the committee considers, the question of inflation is raised. I do not want to get outside of the issue, and I do not think I am. I have made, so far as I am able, a very careful study of so-called "inflation." I understand it means an increase in the volume of money to the point where its value is either worthless or partially worthless. I am unable to find in history any single instance where, under a stable government there has ever been that sort of inflation, and I am wondering if you are able to cite a case where there has been any inflation under a stable government.

Governor ECCLES. I am not much of an authority on the subject of what has happened throughout the history of the world with reference to the matter of inflation. What study I have given to it applies more to recent developments, particularly since the war.

The conditions in this country at the present time are in no way, to my mind, parallel with the conditions in those countries that have had more or less inflation.

Mr. GOLDSBOROUGH. Generally, the cases that are cited by those who are sometimes called reactionaries—and I do not want to be offensive, but that is the best I can do—the cases cited by them are the continental money, the French assignats and the German money after the war. Of course, the Continental money was issued at a time when nobody knew in this country whether we were going to be under a king or under a president, or what the government was going to be. Conditions were almost absolutely chaotic.

The same thing existed when the assignats were issued in France, and insofar as Germany was concerned, that inflation was deliberately created for the purpose of destroying the internal debts.

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I remember not very long ago, Mr. Bernard Baruch had an article on inflation in the Saturday Evening Post—you may have seen it—which was propagandized by pictures, some 3 or 4 pictures or cuts were in the article depicting the printing presses in Germany during the immediate post-war period, which seemed to me to be so utterly unfair and inappropriate as to make the article absolutely valueless.

In this bill which we are considering, the banking system is allowed to remain in exactly the same position that it has been for a great many years. We have in all the banks, State and national, capital, surplus, and undivided profits of less than $7,000,000,000. The deposits of those banks have been as high, I think, as $57,000,000,000 during 1929.

Governor ECCLES. Including time deposits.

Mr. GOLDSBOROUGH. Including time deposits. Do you care to express your opinion as to that sort of a system, or do you think that is outside the inquiry?

Governor ECCLES. What was the question?

Mr. GOLDSBOROUGH. I am asking you if you care to express your opinion about a monetary system which is not the creation of society, but is the creation of a private institution, and which is based on debt.

As I said before, that may be, in your opinion, so far afield that you do not care to discuss it.

Governor ECCLES. I do not believe that it is practical at this time to abandon the present system of creating money by bank credit.

Mr. GOLDSBOROUGH. By bank debt.

Governor ECCLES. Bank credit means a debt of somebody.

Mr. GOLDSBOROUGH. It is better to use the word debt, because that is what you are speaking about.

Governor ECCLES. I do not know that we have any alternative. It is my view that we should attempt through this legislation to make the existing system of banking more responsive to the needs of the country than it has been, and also to exercise a greater degree of conscious control over the creation and the extinguishing of money, and thereby attempt to create a greater degree of business stability than we have had in the past.

Mr. GOLDSBOROUGH. You agree with me, do you not, that permanent prosperity cannot be based on debt? You cannot have debt, which is increasing all the time, and have any sort of permanent prosperity, can you?

Governor ECCLES. I do not agree that it is not possible to have permanent prosperity with the existing banking system, if, in connection with its operation, a taxing system is recognized as an adjunct in helping to bring about a more equitable distribution of income during periods of prosperity.

Mr. GOLDSBOROUGH. We never have had any such tax system, have we?

Governor ECCLES. No; we never have, and we have never had very much control over the banking system.

Mr. GOLDSBOROUGH. Do you or not agree with me that under the present set-up, insofar as banking is concerned and currency is concerned and taxation is concerned, we can only have pseudo prosperity which will collapse from time to time—do you think that is true?

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Governor ECCLES. In our past history we have had periods of prosperity by the process of building up debt and then periods of depression by the process of bankruptcy and the extinguishing of debt. That has been true of all capitalistic countries.

Mr. GOLDSBOROUGH. That has not been the condition in France, has it, where the banks only have about a 50-percent reserve? France has never had these recurring periods of collapse.

Governor ECCLES. It is more or less true of every country, I think. Possibly it may be less true in France than it has been here, and I think it is possibly less true in Britain than it has been here because in recent years they have exercised, I think, a better control over their money system than we have.

The volume of money in Great Britain during the period of our depression did not decline. It remained very stable.

The wiping out of a third of our deposit money by bank liquidation of debt, and by bank closings, accentuated the depression.

Mr. GOLDSBOROUGH. Now I am old enough to remember that part of the deflation period from 1886 to 1896, and I, of course, remember the much better economic condition existing between 1898 and 1914.

I think it is thoroughly understood and agreed by everybody that it was the want of money which caused the depression in 1879 and 1896, which culminated in the Bryan free-silver campaign. After that time gold was discovered in South Africa, in the Klondike, and in Australia—we were on the gold standard, with a continually increasing supply of money—so that from about 1898 to the opening of the World War this country had what can be termed, at least relatively speaking, " considerable prosperity."

It was not the banking system, or fractional reserve system, that gave us that prosperity. It was the fact that we were able to put into the market a continuously greater supply of money. I do not believe anybody disputes that. Let us see what happened to our debt structure during this period about which I have just spoken, from 1896 to 1914, and up until 1920.

After 1920 our supply of gold was of such a character that we could not put it in the market as fast as our production wanted to increase, so our production did not increase, but our debt increased and our speculation increased.

Take, for instance, the period from 1913 to 1921. Our real estate, Government, State, and local debts increased from $38,000,000,000 to $75,000,000,000, and $15,000,000,000 of that was the war debt.

So that, as a matter of fact, our debt increased, outside of the war debt, 60 percent, and our income increased 83 percent. Our national wealth increased 67 percent.

In the period from 1922 to 1929 which is spoken of as a period of prosperity—and I never could see any prosperity during that period and I have never been able to see any since; it was a period of speculation—during that period our debt, that is, our real-estate debt, our Government debt, and our State and local debts increased from $75,000,000,000 to $126,000,000,000. The increase was 68 percent.

Our wealth only increased 20 percent; that is, from 321 billions to 385 billions. Our income only increased 29 percent, from 66 billions

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to 85 billions. We liquidated during that period $4,000,000,000 of long-term debts, and we took on $55,000,000,000 of other debts.

That was a period in which our present monetary system, as handled by bankers, was in full sway, but a period in which our money supply, based on the gold standard, was not increasing. It ended up in collapse.

I have never seen anybody who could, but if you can, I wish you would give us your view as to how, loaded up with all this debt, we are going to get out of this depression under the present system, with what amounts on the average, to a 10-percent bank reserve. How can it possibly be done, unless we have complete deflation and wipe out the debts by bankruptcy.

Governor Eccles. There are two ways of doing it. One is the way you have just stated, that is, continuing a process of deflation and wiping out a large part of existing debts through the process of bankruptcy, because the national income at the present time is not sufficient to support the existing debt structure.

And that is one reason we are possibly not getting recovery today, because liquidation and the pressure of debt is very, very great, and it acts as a millstone around the neck of the economic system.

The other way to get recovery, the only other way I can think of, is by a process of reflation.

Mr. Goldsborough. Under our present system we cannot have any reflation without an accumulation of more debts, you know.

Governor Eccles. I believe it has been very genereally recognized, certainly since March 1933, when the banking structure collapsed and closed, that it was not practical or possible, without involving very great political and social upheavals, to continue the process of deflation. The situation had reached the limit of human endurance, beyond what the people were willing to stand by way of deflation, which creates unemployment and all of the other attendant ills, and reflation was desired and was expected.

The only way that that can be brought about is by increasing the means of payment, either currency or bank deposits, in the hands of those who will spend faster than production increases.

Mr. Goldsborough. Can you spend faster than you accumulate debt, under our present system? That is the difficulty, the debt is always ahead of the spending.

Governor Eccles. Interest is a very important element in connection with the creation of money by debt. Very low interest, it seems to me, creates a far less dangerous situation than debt created on a basis of very high interest.

Mr. Goldsborough. That is true, but of course the banks ordinarily now charge the same interest as they always have been charging.

Governor Eccles. Not generally. Most of the debt today is at a much lower rate than it was. I would say the average interest income of the banks today is 40 percent less than it was in 1928 and 1929.

Mr. Goldsborough. That is because they have accumulated long-term Government obligations.

Governor Eccles. And other Government obligations.

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Mr. GOLDSBOROUGH. When they loan to their customers they do charge a large rate. In our State it is 6 percent. They have not reduced it, certainly within the range of my observation.

Governor ECCLES. I think that is true more in the country banks than in the city banks, where they are largely influenced and affected by the money market. And the rate of lending goes up and down in pretty close relationship with the general supply of money, and you get an excess of money as you have now, when the rates are at a ridiculously low figure for certain short-term eligible paper.

Now, to get back to the question of creating prosperity out of debt. It is true that the bulk of the means of payment under the present system is created by an expansion of bank credit.

Mr. GOLDSBOROUGH. In other words, you create more debt to pay the present debt.

Governor ECCLES. A part of the debt of the country is not bank debt. The debt that the banks create in creating money is, in fact, only a small part of the total debt.

Mr. GOLDSBOROUGH. That is true.

Governor ECCLES. And it is not by any means the burdensome part of the total debt.

Money is created in our present system by banks loaning to corporations, to individuals, and to the Government. During the past 2 years there has been no increase in the supply of money as the result of the banks lending to individuals or to corporations. As a matter of fact, the money supply would have been actually diminished since 1933 had it not been for the Government not only making up the deficiency, but greatly exceeding it by its borrowing and spending. Had it not been for the Government's budgetary deficit, I do not believe the deflationary processes would have stopped.

The credits which the banks have extended to others than the Government are less now by several hundred millions than they were right after the bank holiday.

The Government has been forced to supply the money deficiency by reason of the other creditors being either unable or unwilling to supply it. I believe I made a statement yesterday in connection with the Government supplying money by borrowing from the banks that might have been misunderstood. I am sure it was misunderstood by many of the press comments that were made. That is, the question of the Government paying the banks a subsidy.

Mr. GOLDSBOROUGH. I probably made the mistake of accentuating that too much myself. I am at fault probably more than anybody else.

Governor ECCLES. I would like, for the purpose of the record, to make an explanation of my understanding of the question of the Government interest paid to the banks.

In purchasing offerings of Government bonds, the banking system as a whole creates new money, or bank deposits. When the banks buy a billion dollars of Government bonds as they are offered—and you have to consider the banking system as a whole, as a unit—the banks credit the deposit account of the Treasury, with a billion dollars. They debit their Government bond account a billion dollars, or they actually create, by a bookkeeping entry, a billion dollars.

Mr. GOLDSBOROUGH. By a sort of magic or necromancy.

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Governor ECCLES. The Government in turn draws out those deposits and disburses them in the payment of all of its obligations and various appropriations.

Mr. GOLDSBOROUGH. These payments, of course, go in the banks.

Governor ECCLES. Yes; these payments of the Government, of course, immediately go right back into the banks, and therefore the total deposits of the banks are not changed; but the ownership of the deposits is transferred from the Government to individuals and corporations, who can spend it or use it to reduce their debts to banks.

Mr. Goldsborough brought out the point that the Government, because of its sovereign power, is able, if Congress so wills, to finance its operations by payment of currency for its obligations, and that it could go so far as to take up its bonds by paying out currency. The result of that operation, insofar as the bonds were purchased from others than banks, would be that bank deposits would increase.

Mr. GOLDSBOROUGH. Bank reserves, not deposits.

Governor ECCLES. Deposits. If the Government paid its bills in currency, that currency would be disbursed, the money would come into the banks to the credit of individuals and corporations, and thus the deposits would be increased in exactly the same way.

Mr. GOLDSBOROUGH. I wish you would speak about that for a while. The deposit would not increase, but the reserves would increase.

Governor ECCLES. Both would increase, both the reserves and the deposits would increase. To the extent that the bonds were purchased from banks, reserves would increase and deposits would not. To the extent that bonds were purchased from others both deposits and reserves would increase.

The proposal was that, when you substituted currency for bonds, the reserves would be greatly in excess of what they now are; because the banks would not have the deposits invested in Government bonds, but would be carrying those deposits as excess reserves, and to the extent that present holdings of governments by the banks were taken up by currency, the reserves of the banks would increase by about 11 or 12 billions of dollars. Thus, you would have excess reserves of, say, 13 or 14 billions including the more than 2 billions now held by simply taking up the existing holdings of Government bonds.

That, of course, would be a means of potential inflation of a tremendous amount.

Mr. CROSS. Could you not raise the reserves of the banks so as to check that?

Governor ECCLES. I was just going to say, it was suggested that the reserves of the banks would be increased by the amount of the Government bonds that were taken up, as the result of the issuance of currency in payment for them, and the currency would come right back into the banks as a deposit.

The point I raised was that the banks would under no circumstance be willing to handle the deposits which would be created without getting a return, without being able to invest them at interest. But, if reserve requirements were increased by the amount of the increase in reserves, the banks would be unable to perform the services which they do perform in the handling of the business of the community, of their customers, of the clearing of financial trans-

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actions and the keeping of the individual and corporation accounts without making service charges that would compensate them for their loss of income or interest, as a result of depriving them of interest on the Government obligations.

Mr. Goldsborough stated the other day that that charge could be socialized and I stated that the best way to socialize it was to do as is being done now, by permitting them to get interest on Government bonds.

Instead of the interest on Government bonds being a subsidy to the banks, it seems to me it is a payment for services which they are rendering in handling the deposit accounts which are created as a result of the Government deficit.

Mr. GOLDSBOROUGH. Now, Governor, it seems to me, now, and has always seemed to me that the real way to do a thing is to do it directly, instead of going through the pretense of issuing bonds to the banks that have not anything to loan, except what their bookkeepers can put on their books.

The banks have nothing except their capital and surplus, which amounts to less than 7 billion dollars, and they have used that up long ago in loaning to individuals.

Governor ECCLES. Except their time-deposit funds.

Mr. GOLDSBOROUGH. Except their time-deposit funds.

Governor ECCLES. That represents half of the deposits of the banking system.

Mr. GOLDSBOROUGH. But long before that they come to the Government for help. They have used up all they have.

We go through the racket—and that is all I am able to see that it is—of issuing to the banks, sending to the banks bonds, and they put a money credit on their bank books in favor of the United States Government. The United States Government by depositing that money as it does, when it gets the money credit, lends the money back to the banks and proceeds to pay them interest on it. That is a racket.

If we owe the banks for that service they render, and we do, there is no doubt about that, they render service outside of their lending service and they should be compensated for that; they will have to be compensated for that to live.

But there is created in the public mind the idea, and it is done deliberately by the class which controls the money of the country—there is created in the public mind the idea that there is some economic impropriety in the Government furnishing its own medium of exchange, that it has to do it through borrowing money from the banks that the banks do not have.

Society has everything; the banks have nothing, and yet we go through this farce of borrowing money from the bank and creating the impression that it is inflationary for society itself to issue the necessary medium of exchange with which to conduct the country's business.

What I am getting to is this. I am not suggesting any immediate revolution. But we could pay these bonds as they are callable; we could pay these bonds when they come due with money issued on the credit of the Government of the United States. And if the public knew that would be done it would have two effects, first it

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would reconcile them to this debt, which is having a terribly depressing effect on their minds and on their psychology. It would do that.

And the second thing it would do would be to have them understand, to make them understand, that society is not dependent upon a banking system for its currency. Our currency system in this country was not the creation of society; it was the creation of the banks.

Last year about this time a subcommittee of this committee considered what was called a monetary authority bill. The goal of that proposed legislation—whether it could be reached or not—the goal of the proposed legislation was to separate the profession of banking from the issuing of the money of society. It placed the issuing and the control of the money which society uses in the hands of an independent authority, which would have no selfish interest in making the medium of exchange as scarce as possible and as high as possible.

I am wondering if something of that same idea is not involved in this present bill, which undertakes to take from the Federal Reserve banks and place in the hands of the Federal Reserve Board the control of the open-market operations of the Federal Reserve System.

Governor ECCLES. Discount rates and reserve requirements.

Mr. GOLDSBOROUGH. Discount rates and reserve requirements. Is that so?

Governor ECCLES. It is contemplated to centralize the responsibility and the authority for control over the volume of money.

As I have stated upon several occasions, so long as most of our money supply is created by the willingness of private citizens and corporations to borrow from banks, the control of deflation is much more difficult than that of inflation. If there is too much borrowing from banks and, as a result of that operation, the creation of inflation, when the means of payment is increasing faster than the raising of discount rates and the selling of securities in the market would discourage further expansion of private borrowing from the banks and would act as a means of retarding the inflationary process.

On the down side, the reverse action, the reduction of rates and the creation of excess reserves, would tend to slow up liquidation and would tend to encourage the use of credit.

In our present money system I know of no other means within the banking system itself of influencing or effecting a control over the supply of money.

I have stated that we should seek to use these controls which I have just mentioned to combat deflation, which means unemployment, and unemployment means reduction in national income, in wealth production, and wealth consumption.

That is where the problem must be met, and it must be met, it seems to me, by society as a whole, through government.

The tax system—our income-tax system—must be worked in and timed with the money system. When private credit is expanding and there is a budgetary surplus, the Government debt should be reduced. The reduction of the Government at a time when there is a rapid expansion of private debt tends to offset the inflationary effect of the expansion of private debt. That is where the contraction comes, as result of the banks reducing their holdings of Government bonds.

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It is very important that the problem of income taxation and the operation of a central banking monetary policy should be coordinated and properly timed. A substantial increase in taxes at the present time, if they would pull into the Treasury money which would otherwise be spent and thus reduce private spending, would be of no particular help in our economic as a whole. The time to increase income taxes, of course, is when incomes are such that income taxes would produce substantial revenue; in other words, in the upswing.

I believe that there is only one way by which we will get out of the depression, and that is through the process of budgetary deficits until such time as private credit and private spending expands. The expansion of private credit depends upon the will and ability of private interests to borrow and spend. Until private borrowing and spending expands, and puts people to work, the Government must do the borrowing and spending.

Mr. GOLDSBOROUGH. Governor, going back to the subject of inflation, it seems to me that the fear of so-called "inflation" is the thing which makes it increasingly difficult to improve our monetary system.

I have been following this whole matter through for a great many years, and I remember very distinctly that back in 1931—I do not want to go too far back—but I remember that in 1931 we were told that if we adopted the policy of buying Government bonds that would cause violent inflation. That was when the original so-called "Goldsborough bill" was passed through the House.

During that period, and before that period, if anybody had suggested that it was possible for the Government to raise any money except by borrowing it from the banks, he was immediately cast into outer darkness; he was not even thought fit to sit in the room with intelligent people. That was the exact condition.

We went off the gold standard and nothing happened. We passed the so-called "inflationary bill" in 1933 and nothing happened.

And it is the feeling, I am sure, of a great many Members of Congress—it is certainly my own feeling—that one of the things we need in this country is more real money and less false money in circulation.

If, as a matter of fact, we could get to the point where the money we use was real money and could not be contracted by the payment of debt, then you could not have any violent deflation; we could not have any violent inflation; you could not have either one.

Governor ECCLES. It depends upon the distribution of that money and the willingness of people to put it in circulation.

Mr. GOLDSBOROUGH. I know that it would be very much more difficult than it is now to have deflation, or inflation, either.

Governor ECCLES. I agree with you that all of this inflation talk we have heard for 3 years has been largely imaginary.

It is true that, based upon existing excess reserves of the banks, there is a possible means of creating a tremendous credit inflation. That, of course, does not necessarily mean that you are going to get that inflation.

In the first place, in order to get it, we have to get people willing to use the bank credit. It cannot be gotten in any other way.

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Then it also would be necessary that there be no control exercised after private credit began to expand to a point where prices were going up rapidly and production had reached a peak.

I do not believe that it is going to be so easy to get inflation. Certainly efforts have been made now for several years to get it; but from all indications, we are as far from it now as we were 2 or 3 years ago. There is not the slightest indication of inflation.

Unless the people in this country have money and jobs or are put in possession of money through jobs or without jobs, so that the means of payments increases, and unless those people and corporations with money will spend the money that they have, we cannot get inflation.

It cannot be obtained merely by changing the gold content, or by silver legislation, unless the result of such changes will actually put money in the hands of people to spend, and unless it induces the holders of existing money to spend. Otherwise you do not increase the volume of money and you do not increase the velocity of money, both of which are necessary in order to get inflation.

Mr. KOPPLEMANN. Mr. Eccles, with reference to section 210, page 49, in regard to making loans on mortgages, you know about that?

Governor ECCLES. Yes.

Mr. KOPPLEMANN. As I understand it, it authorizes commercial banks to make loans on real estate for a period of 3 years, and repayment is to be made in full at one time or up to 20 years to be amortized. It puts commercial banks and investment banks in the building and loan business.

Governor ECCLES. They are already in.

Mr. KOPPLEMANN. But this bill is intended to put them into it further than ever.

Governor ECCLES. No. The bill is not for the purpose of putting them into any particular business that they are not already in. They are in the investment business and in the mortgage business and have been to a very large extent for a great many years. They are in the investment business in that there is no limitation as to the amount of long-term bonds of all kinds that they are permitted to buy. There is a limitation with respect to making first real-estate mortgages on improved properties. That limitation is 50 percent of the time deposits and up to 50 percent of the appraised value of the property, and up to a period of 5 years; and the banking system today holds over $2,000000,000 of those mortgages. Therefore, they are not being put into any business that they are not already in. What we are attempting to do in this case is to permit them in the making of real-estate loans to make loans on an amortized basis over the life of the loans or over a period of time which would give to the borrowers some assurance of being able to pay. The straight 5-year mortgage has proven to be a very bad form of instrument, both for the banks and for the borrowers, and also for the building and loan companies engaged in making mortgage loans and a few insurance companies and mutual savings institutions engaged in that type of mortgage lending.

I have said, and I repeat, that either the banks in this country will have to give up their time deposits or they will have to be permitted to invest or loan those deposits in the same field where the mutual savings banks, the insurance companies, and the savings and loan

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institutions, loan their deposits; because the time deposits of the banking system are of the same type and represent the same type of money as the funds which the mutual savings banks and the building and loan companies loan and invest.

Mr. KOPPLEMANN. It was the bad practice of the banks which caused the debacle.

Governor ECCLES. I do not agree with that.

Mr. KOPPLEMANN. Did not the banks themselves claim that it was their long-time loans which were the chief cause of their difficulty?

Governor ECCLES. I do not think so.

Mr. KOPPLEMANN. Is it not commonly so stated?

Governor ECCLES. It is commonly stated; but it is not the fact.

Mr. KOPPLEMANN. I might digress for a moment and ask you if you can in a single statement, without taking too much time of this committee, let me have what is your opinion of the cause of the difficulty of the banks?

Governor ECCLES. I think the record of my answers to the questions that have been asked quite a number of times shows it; but I can state it very very briefly. One of the principal troubles or difficulties that brought about the depression was not the shortage in the supply of money altogether, but it was due in part to the inequitable distribution of income which contributed to a speculative situation in the security markets and to an expansion of productive capacity out of relationship to the ability of the people of the country to consume under the existing distribution of income. That condition was not created by the banking system. Long-term credits were not responsible for the depression; they only became unsound when the national income shrank. A perfectly good credit over a short term or a long term may become a very bad credit if business conditions change. Short-term credit is not necessarily a sounder loan than long-term credit. Most of the short-term bonds which were held by the banks that became due during the depression could not be paid but had to be refunded.

Mr. KOPPLEMANN. Supposing that I ask you this further question.

Governor ECCLES. In order to obviate that situation of forced deflation, this bill proposes that Reserve banks be legally permitted to make advances to member banks against sound assets. The only place where liquidity can be created is through the Reserve System and that would permit the Reserve System to stop forced credit deflation and bank failures so long as banks had assets upon which they could secure credit.

Mr. KOPPLEMANN. In part you anticipated the question I was about to put to you, which is: Are loans made on real estate expected to be rediscounted by the Federal Reserve?

Governor ECCLES. They are expected to be available as security for advances to be made by the Reserve banks. The credit departments of the Reserve banks will pass upon credit extended to member banks in the future as they have always done in the past, except that in the past they have been limited by statute to a certain type of what is known as eligible paper which today is small in volume.

Mr. KOPPLEMANN. Where in this bill does it provide that such discounting, or in effect rediscounting, can be done?

Governor ECCLES. It provides in section 206 that section 13 of the Reserve Act is to be amended so as to authorize the Federal Reserve

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banks, subject to the regulations of the Federal Reserve Board, to discount for member banks any commercial, agricultural, or industrial paper and to make advances to member banks on their promissory notes secured by any sound assets.

Let me say this in connection with extending credit against mortgages. That does not mean that Reserve banks will discount a 20-year mortgage for 20 years. It means that the Reserve banks can make advances to the member banks for such periods as reasonable banking practice permits, which would be 90 days or possibly 6 months, secured by mortgages, collateral loans, or bonds with such margin as the credit divisions of the Reserve banks may deem necessary to protect the Reserve banks.

Mr. KOPPLEMANN. Then it does not compel the Federal Reserve to rediscount these loans?

Governor ECCLES. No.

Mr. KOPPLEMANN. Now, supposing I go to you as a banker and ask for a loan upon my property in the form of a mortgage and the banker knows that he cannot rediscount, what will be the effect upon your mind if I ask for a loan of you as a banker?

Governor ECCLES. The banks today will not make such loans. In the first place, they cannot make real-estate loans for more than 5 years. That precludes people from borrowing. Nobody today that can secure a long-term, amortized loan will go to a bank and borrow on a straight loan for a period of 5 years. They want longer-term credit on mortgage loans.

Mr. KOPPLEMANN. I am trying vary hard not to take any more of your time than possible. Now, if section 210 should succeed in encouraging banks to make long-time loans, they cannot be rediscounted?

Governor ECCLES. But they can be borrowed against.

Mr. KOPPLEMANN. Yes. What becomes the bank's liquidity which, after all, as you and I know, is the foundation of the safety of a commercial banking system?

Governor ECCLES. The liquidity of the banking system depends upon the Reserve System as I have indicated.

Mr. KOPPLEMANN. What I am trying to bring out is this. I am not opposing the bill nor do I want to appear unduly critical. What I am trying to bring out is that the effect of section 210 is more apparent than real. It seems to me that it contains language rather than a real and effective method of giving property owners a chance to obtain mortgage loans.

Governor ECCLES. That will depend entirely upon the willingness of the banks themselves to extend mortgage credit. In the absence of any field for investment of the excess funds of the banks, it seems to me that there will be a willingness, not only a willingness but a desire, of bankers to invest those funds where a substantial portion of the deposit money is represented by time money upon which they are paying 2 to 2½ percent.

Mr. KOPPLEMANN. Right there may I ask you this question? You talk about time loans. Are not time deposits in reality nothing more than demand deposits?

Governor ECCLES. Only in case of bank runs. The time deposits in a bank remain stable unless banks are permitted to fail.

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Mr. KOPPLEMANN. That answers my question. Only in time of bank runs.

Governor ECCLES. That is right. At other times time deposits fluctuate very little and, as a matter of fact, usually, or at least during the past, they have shown a gradual increase over a long period of years.

Mr. KOPPLEMANN. What effect will such loans have upon building and loan associations and do you interpret that commercial banks are to compete with them?

Governor ECCLES. I think there is a field for both. It seems to me that we might ask what effect will it have upon insurance companies and mutual savings banks.

Mr. KOPPLEMANN. That is right.

Governor ECCLES. The more agencies we have for extending credit the more likely the borrower is to get favorable terms for his credit; and I think that, in the interest of recovery, long-term low rates are necessary.

Mr. KOPPLEMANN. Yet under section 210 all of this is quite improbable of happening insofar as banks making loans due to the fact that they cannot rediscount excepting on short time, as you say, 90 days, perhaps 6 months.

Governor ECCLES. That is very true; but that will not deter the banks from making long-time loans. The banks today can only borrow on Government bonds on a 15-day basis but they can renew. Banks are certainly not expected to make real-estate loans and sell them to the Federal Reserve banks and then take the funds and make additional loans, because that would create credit inflation. Banks should not loan beyond the amount of their available funds and the rediscounting facilities of the Reserve banks are for the purpose of enabling the bank system to meet temporary fluctuations in their deposits and to meet withdrawals due to unusual conditions that may develop.

Mr. KOPPLEMANN. I agree with you that commercial banks should do a safe and sound business, and that under section 210 of this bill, it would be bad business to make these mortgage loans. That is all. Thank you.

The CHAIRMAN. Would you like to come back this afternoon or tomorrow morning?

Governor ECCLES. I would appreciate it if I could come back in the morning.

The CHAIRMAN. We will ask you to come back tomorrow morning at 10:30. Mr. Goldsborough and Mr. Cross and Mr. Williams would like to ask you some questions and with that we hope to conclude.

(Thereupon, at 12:05 p. m., the committee adjourned to meet again at 10:30 a. m., Wednesday, Mar. 20, 1935.)

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BANKING ACT OF 1935

WEDNESDAY, MARCH 20, 1935

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 10:30 a. m., Honorable Henry B. Steagall (chairman) presiding.

The Chairman. Mr. Cross, do you desire to interrogate Mr. Eccles at this time?

STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Resumed

Mr. Cross. Governor Eccles, you know, I am very much disturbed about your testimony as it has been given. You have testified that with the levers you have in this bill you feel that you could control inflation, but that the question of deflation was another story. In other words, you have a string with which to pull down inflation, but you have no string with which to pull up deflation.

And you also testified as to the depression, as I recall your testimony, that deflation meant depression, and as long as you have deflation you will have depression.

What is troubling me is how to get some means by which we can lift deflation.

Also, in your testimony you stated that you thought the income-tax question would have to be worked into the monetary system somehow.

I introduced a bill—I do not suppose you ever heard of it, or have ever read it—in an attempt to control the whole commodity price level through the system of the income tax. That bill provided that when the wholesale commodity price level was below the purchasing power of a dollar; say that the purchasing power was up to twice what it was in 1926 and 1927, for the sake of argument, that the Government, or some agency of the Congress be permitted to lower the income tax, to pay the running expenses of the Government, the salaries of the civil-service employees, and the Army and the Navy, and other governmental expenses, and pay off the bonds and other obligations as they fall due by simple currency, having it printed, until the prices of things rise, or the purchasing power of the dollar fell, whatever it was, taking it in the year that you are taking as a standard.

Now, if the prices rise more than 2 percent, as was provided in the bill, above where they were in the year taken as a standard, you are going to be laying on income taxes and taking currency

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out of circulation; in other words, performing the same function as the open-market transactions, and you would take currency out of circulation the same as you would if you were to sell bonds and take it out, or you put currency in circulation by paying the expenses off, doing it in one or the other way.

Do you not think that by means of the currency you could get a string to lift up your depression?

Governor ECCLES. I do not know that I can add anything to what I have already said on that subject.

Mr. CROSS. It is very patent that we cannot get out of this depression, depending upon credit, as long as the conditions remain as they are. You can reduce the rediscount rate to nothing, and you can put the reserves of the banks down to nil, but as long as conditions are such that a man cannot produce his goods and sell them for what they cost him, as long as there is no purchasing power among the people he cannot get a price that will enable him to pay the expenses of operating his factory or his farm, or whatever he is operating, because the banks could not loan him anything. If I was a banker, or if you were a banker, you could not afford to loan him any money; he could not borrow that money to produce the goods and pay the money back because he has to have buyers, and that means purchasing power, and upon that depends credit.

I do not see any way in the world to bring the country out of this depression unless we get it out by deflation.

It is not a question of the income tax taking money out of circulation; it will have the same effect as if you sold bonds and took them out of circulation. It is the same thing, is it not?

Governor ECCLES. I do not see what you mean. You say it is not the income tax.

Mr. GOLDSBOROUGH. Mr. Chairman and Mr. Cross, I was examining the witness yesterday when I yielded to Mr. Kopplemann, and now I have yielded to Mr. Cross. I had under discussion with Governor Eccles yesterday the discussion of a major subject.

Mr. CROSS. You go ahead; I thought you were through.

Mr. GOLDSBOROUGH. You have started on a major operation.

Mr. CROSS. You go ahead.

Mr. GOLDSBOROUGH. Governor Eccles, at a meeting of economists the other day, and also on the floor of the House, I made the statement that, under our present banking system, if every man in the United States had the financial genius of the senior Morgan and the inventive genius of an Edison or a Ford, and the energy of a North German farmer, we could not have any permanent prosperity in the United States because of the fact that just as soon as they began to show their ability and pay off this load of debt it would immediately cause another deflation, and prosperity would therefore defeat itself.

What is your criticism of that statement?

Governor ECCLES. That goes into the whole subject of the way money is created and extinguished.

Mr. GOLDSBOROUGH. I mean under our system.

Governor ECCLES. I feel that it is possible to have prosperity under our system, if we have the intelligence to manage our banking and our money systems, and our tax system in conjunction there-

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with, and our public spending, so as to insure employment; that you can have prosperity under the system whereby money is created through bank credit, and is extinguished by the paying off of the bank credit. Whether there are other ways of getting it or not, I do not know that I am prepared to say. It is difficult to make changes; we found that out.

People are prone to change their habits, their customs, and their belief very, very slowly; and changes largely come about as the result of social and economic pressure.

Mr. GOLDSBOROUGH. I will put it in another way.

Summer before last, at the Century of Progress Fair, a very noted statistician made a speech in which he said that the country owed in debts about $200,000,000,000, but that if we all got good and were thrifty, and saved our money and kept out of saloons, and things of that kind, we could pay off $25,000,000,000 of the debt a year, and in 8 years we would not owe any money at all.

I knew him very well, and I wrote him a letter and asked him what, under our system, we would use for money, when that happy condition arose. He wrote back and said he had not thought of that. When the debts were all paid off we would not have any money with which to do business.

Governor ECCLES. When the community begins to pay its debt to the banks, it extinguishes money, deposits currency, and if that process of deflation gets under way it is more or less self-generating and it is very difficult to stop it.

You can reduce rates through the operations of the Federal Reserve System; you can create excess reserves; you can broaden the eligibility requirements so as to make it unnecessary for banks to bring pressure to collect debt.

When the community's volume of money is rapidly contracting, it means that unemployment is developing; and the compensating factor is the budgetary deficit, which keeps up the volume of money, and those funds are used to give employment when unemployment develops.

That is what I meant when I said that the money system and the tax system, Government borrowing and paying must be worked in with our banking system as the compensatory agency. Otherwise, it seems to me what you say is likely to be what will happen. It is what has happened in the past, to a very large extent.

Mr. GOLDSBOROUGH. Of course, what I have in mind—and I do not know that you should be questioned particularly about it, in view of the fact that it does not bear directly on any item in the bill—but what I have in mind is that society should begin to bear in mind the fact that our present banking system is an artificial one, built up by the bankers themselves for the purpose of controlling money. That society should begin immediately to endeavor to take that control out of the hands of any one class and place it back where it belongs, in society itself, and that one way to begin that is to inject money into business. As an example, by reduction of Government debt, paying off Government debt with currency.

Governor ECCLES. I think that this discussion came up the other day, and I stated my objection to paying off the Government bonds in currency, which would result in the creation of very large excess

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reserves by the banking system, unless the reserve requirements were increased accordingly.

Mr. Goldsborough. Of course, that could be done by legislation, and that very thing is contemplated by the bill we are now discussing.

I have never had in mind, and I have never introduced in Congress any bill which would require the national debt to be paid immediately. There is only about 5 billion dollars of bonds which are callable now. It seems to me that to start a system of teaching society that banking is one thing, and the issuance of currency an entirely different thing, would not only relieve society of a tremendous burden of interest, but would be a great educator, because in my opinion we are never going to do anything by creating more debt except to create a pseudo prosperity which will carry us along a few years longer and then, as by building up capital goods and selling on the installment plan with the use of more credit, have a greater collapse than we have now.

Governor Eccles. I do not think the change in the system that you propose would put money into the hands of people that do not have it.

Mr. Goldsborough. When you reduce taxes you declare a national discount, do you not? You are speaking of income taxes, but that would apply to any kind of taxes, any sort of taxes?

Governor Eccles. Yes; when you reduce taxes that is true.

Mr. Goldsborough. It is fair to suppose, is it not, that society would get the benefit of that discount?

Governor Eccles. If you reduce income taxes it should be kept in mind that they are paid by a very small percentage of the total population—it would mean that the funds saved by the class that received the benefit of the reduction——

Mr. Goldsborough. You do not think the ultimate consumer would get any benefit at all?

Governor Eccles. They would possibly get some benefit; but it would tend to go into the capital field, and get productive facilities out of relationship to consumer buying power.

I do not like the idea, personally, of paying off the Government debt through currency; because it seems to me that it gives to a great many people the idea of expecting benefits that they will not get.

The paying off of the debt by currency would simply increase the bank reserves by the amount of Government bonds that they hold. When the reserves are increased by that amount, you have created a very difficult problem, unless you increase the reserves by the amount of the Government bonds that have been retired. Otherwise you have huge excess reserves.

If you retire the Government bonds with currency, that currency is the property of the banks and they will immediately send it into the Reserve banks; so it would not go into circulation at all. It would simply become a credit to the member bank on the Reserve bank's books; and, as I said, would make for an increase in the excess reserves by the amount of the bonds retired with currency.

Let us see what problems that creates. In the first place, you would have to increase the reserve requirements then by the amount of bonds which you retired, which would be today about 40 percent

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of the banks' loans and discounts. Government bonds are about 40 percent of the total loans and discounts.

Mr. GOLDSBOROUGH. If you retired them all at once.

Governor ECCLES. Of course; or you would increase it as you retired them.

You have a short-term financing of about 13 billion dollars, so that there are more short-term maturities than the total holdings of the banks. So in the course of a year or two the whole amount could be retired, because of the very large amount of short-term financing.

Let us assume, then, that you increase the banks' reserves by the amount of the bonds which you retire, or, we will say, 40 percent. Some banks only hold 10 percent of their resources in Government bonds, and if a 40-percent increase in reserves were imposed upon them they would have to reduce the credit they are now carrying by 30 percent in order to meet the reserve.

Mr. GOLDSBOROUGH. Could not that be controlled by a system of rediscounts between the banks?

Governor ECCLES. Reserves would have to be uniform among the banks; you could not have every one of the banks with a different reserve requirement. If you made a uniform reserve requirement in the banking system, with a bank holding 10 percent in bonds, when the reserve requirement is 40 percent, it would either have to go into the Federal Reserve System and borrow 30 percent, which was the deficiency, or it would have to collect loans and discounts to the extent of the 30 percent, in order to build up its reserves. Most of the banks in small communities hold Government bonds in the small amounts, and the deflation would come in those areas.

In the reserve cities the percentage of bonds held by banks, I think, is in excess of 40 percent, on the average. That is one problem it creates.

Another thing is that the State nonmember banks, which would not be influenced by the increase in the reserve requirements made by the Reserve System——

Mr. GOLDSBOROUGH. Yes; they would be.

Governor ECCLES. They are not members of the Reserve System.

Mr. GOLDSBOROUGH. That does not make any difference, you can put a check tax on them which will make them amenable.

Governor ECCLES. And force them into the Reserve System?

Mr. GOLDSBOROUGH. No; but force them to abide by the Reserve Board's dictum in the matter of raising and lowering reserves, under penalty of having their checks taxed.

Governor ECCLES. Then we get back to this problem. The retirement of these bonds through currency, or through giving the banks credit on the reserve bank books, would not, of course, in any way reduce the total deposits of the banks. It is 12 or 13 billions of the Government bonds issued.

Mr. GOLDSBOROUGH. You said yesterday it would increase the deposits. I agree it would not decrease them.

Governor ECCLES. It would increase deposits if the Government's expenses and its future deficits were paid with currency. That would increase the deposits by the amount of the deficit. But if you simply retire the bonds now held by the banks, it would in no way change their deposits.

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Mr. GOLDSBOROUGH. That was our discussion yesterday, in reference to the retiring of bonds.

Governor ECCLES. That in no way would change the deposits.

Mr. GOLDSBOROUGH. In other words, we agree on that.

Governor ECCLES. The deposits would just remain the same.

Mr. GOLDSBOROUGH. Correct.

Governor ECCLES. But those deposits are not the deposits of the Government now. Twelve or thirteen billions of Government bonds held by the banking system represent money which the Government has spent. It has gone into circulation, and it has become the property of the individuals and corporations, and the banks have the responsibility of managing it and serving those customers in the handling of their business, in their deposit accounts. Unless they can invest those deposits which the Government has created as the result of its borrowings, at an interest return, they would have no object at all in handling the deposits. If they had to carry reserves equal to the amount of the deposits which are created, there would be no interest in the banks handling the accounts. Therefore, I think, as you stated the other day, the cost of handling that business should be socialized, and I stated that it was being socialized through the interest which was being paid on the bonds which the banks hold.

Mr. GOLDSBOROUGH. You think that is the proper way to socialize it?

Governor ECCLES. I think it is, and I do not think it is an unjust way to socialize it for the reason that the banking system as a whole has never been more remunerative than the average business, and there is no indication at the present time that it is particularly attractive. Bank stocks have possibly suffered as much or more than any other kind of an investment security, and based on my own experience in the banking business as well as in various other lines of business, I would say that from an investment standpoint the banking business is the least attractive.

Mr. GOLDSBOROUGH. My dear sir, before the war the banks were extremely prosperous, and there were practically no bonds out at that time.

Governor ECCLES. Before the war we were in a rapidly growing, new country; we were a debtor nation.

Mr. GOLDSBOROUGH. Being a debtor nation does not create prosperity.

Governor ECCLES. Being a debtor nation creates a degree of prosperity for the banks; I mean, in part, because of the shortage of capital, and the high interest rates that were generally being paid.

The banks, like every other business, have had periods of prosperity and profits, and then they have had reverses. But outside of the banks in the large centers, the average banks throughout the country have certainly not been overpaid for the services which they render, and if any revolutionary change is made in the method of creating money, and if we should take all the Government bonds up from the banks, as you propose, by currency and other methods, how would they be compensated for the very necessary and the very valuable and the very useful services which they render the community in the clearing and handling of the transactions which they are required to handle?

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Mr. GOLDSBOROUGH. But now an artificial institution, our present banking system, creates the necessity of rediscounts, intermediate credit banks, and the army of bank examiners, and divides the country into simply a creditor and a debtor class.

It is this artificial system that has created all this trouble, and you cannot cure that by making additional paper or additional collateral eligible for rediscount; you are simply prolonging the final debacle.

You have to get some real money into circulation in this country, in my opinion.

Governor ECCLES. I do not know how, under capitalism, you are going to avoid the debtor and creditor relationship. Communism or socialism, of course, would not——

Mr. GOLDSBOROUGH. I did not even suggest communism or socialism. I did not intimate any such thing as that.

What I am suggesting is that in a country as rich as this is we ought to be stockholders and not bondholders, and we ought to get rid of the enormous creditor element and creditor complex and manipulation which is going on in this country.

That is what I am talking about, and in my judgment, unless it is done, we are ultimately destroyed; the debtor is a slave to the creditor, and the tremendous banking forces of this country absolutely run the country. Either that class has got to take its normal position in society, or else it is going to swallow us all up, and for this reason:

In this machine age where, as a matter of fact, labor is constantly being released from industry, you have got to get some system whereby you can declare a national dividend, either by a direct dividend or by a discount system. It cannot be done in any other way, in my opinion.

I am not suggesting for one minute that we shall revolutionize the banking system in one stroke, but it does seem to me that we are not helping matters any to be saying, "It is not time now; let us wait until next week, or next month, or next year." We have been saying that for 200 years.

Governor ECCLES. I think this bill is taking a very great step forward, and I believe that it is as far as we should go at this time with reference to the matter of control of our system of money.

Mr. GOLDSBOROUGH. Just along that line—and I only have one or two more suggestions I want to throw out—let me say this: During all of the ages the battle of the people has been for a government of laws and not of men; and all of my investigations during a period of 35 years have taught me the truth of a saying of one of the Rothschilds, "If you give me control of the credit and money of a country, I will control everything in it."

So, it seems to me that a legislative direction ought to be directly injected into the monetary system, and that too much discretion, except insofar as the mechanics and the technical phases of the law are concerned should not be left to the administrator. It seems to me it is the duty of Congress to lay down the policy on behalf of the people, that policy to be carried out by technical experts.

Under this bill, members of the Federal Reserve Board—that is, under the bill as amended—who are not necessarily benevolent despots, and who are certainly not immortal, have almost the eco-

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nomic destiny of the American people under their control, without control. Do you think that is a good thing?

Governor ECCLES. I am proposing it. The Board is in session all of the time; Congress is in session part of the time. There is nothing to prevent Congress at any time it is in session giving such instructions by congressional action as it chooses to give to the Reserve Board, which is appointed by the President, and is required to operate in accordance with the Federal Reserve legislation passed, and amended from time to time, by Congress.

I cannot see how it is possible for Congress to operate a money system except through a body such as the Federal Reserve Board, or some other board that they may create for the purposes of carrying out the wishes of Congress, as provided in legislation which Congress passed.

I do not think the proposed legislation in any way takes away from Congress the sovereign power which they have and should have and should retain. It is simply delegating to a body which should represent the Nation and the interests of the Nation, the carrying out of the mandates of Congress.

Mr. GOLDSBOROUGH. Of course, if we are going to assume that Congress has no wisdom in this country, I agree with you.

Governor ECCLES. I am not assuming that.

Mr. GOLDSBOROUGH. But if you are going to assume that Congress has the wisdom it is supposed to have, then it certainly is fair to say that Congress should give legislative direction to those who are to carry out the law.

Governor ECCLES. I think that is being done here.

Mr. GOLDSBOROUGH. It is a declaration of policy.

Governor ECCLES. Yes.

Mr. GOLDSBOROUGH. Which, in the case of a cynical board, would simply amount to a stump speech.

Governor ECCLES. The question of how to make rigid requirements that will better represent the best interests of the people is a question I do not know how to answer, and I doubt if anybody else does.

Mr. GOLDSBOROUGH. I am going to conclude by saying this, that in my judgment what you have proposed is infinitely better than anything we have ever had before.

Governor ECCLES. I thank you.

Mr. CROSS. Governor Eccles, what disturbs me is that it seems that this system upon which you rest, judged by your statement, is that debt is a good thing, and the more debts the better off we are. I cannot figure that out.

You say you think the Budget ought not to be balanced and we should keep going in debt.

Governor ECCLES. No; I did not say that.

Mr. CROSS. In substance.

Governor ECCLES. The Budget must be balanced over a period of time; but I think we should not look at the question of Budget balancing purely on the basis of a year.

Mr. CROSS. No; the more debt you have the more money you create; that is, the more money the banks can create.

As you said a while ago, the banks are prosperous when there are a lot of debts, with high rates of interest. But does that make people prosperous?

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Governor ECCLES. The intimation is that all debts are created and carried by banks, and that if we in some way can create money without bank credit we have prevented people from getting in debt.

As a matter of fact, the money which we create as the result of bank debt is not very much more than 10 percent of the debts of the country.

Then, what about the insurance companies of this country? One class of people save and pay into an insurance company, and another class make it possible for the savings to return something to their posterity, because somebody goes in debt.

The whole system of capitalism is built up on a basis of debtor and creditor relationship, and the debt that the banks create, or the money they create, is a very small part of the debt. You have not taken the people out of the bondage of debt that you refer to by simply changing the banking system and finding some other method of creating money.

Mr. FORD. If it were possible to create money by a Government just making the money, and if it should just go on paying its bills and making money, would it be necessary for the Government ever to go in debt, on the theory that it can just print the money and hand it out?

Governor ECCLES. The Government is a sovereign power, and it has the power to create such money as the Congress appropriates. There is no question about that. It does not have to depend upon the banking system, as I have stated upon several occasions, to provide credit for it. But it is my feeling that that is the most desirable way.

Mr. FORD. If the Government could make all the money it needed, it would not have to go into debt, would it?

Governor ECCLES. You mean if it could collect in taxes what was spent?

Mr. FORD. No; I am talking about this idea of running printing presses. If the Government could print all the money it needed, it never would need to go in debt, would it?

Governor ECCLES. It could do that, but if it did it to a sufficient extent it would certainly make an inflationary condition which would destroy the value of all money.

Mr. FORD. It would break it down some.

Governor ECCLES. Of course.

Mr. CROSS. You have to have controlled currency, if you are not going to stick to a metallic base.

Governor ECCLES. You have to have a managed currency, and I believe that the present system, through the banking system, with the public interest represented through the Federal Reserve Board, is as desirable a way of controlling the value of money as has been devised in capitalistic economies.

Mr. CROSS. The proposition is to devise something more than has been devised, if possible, because under the very system we are talking about you may create debt and prices may rise and you create more debt, and it is inevitable that the crash will come directly, and we go right back into the condition in which we find ourselves now.

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Suppose we have a severe crisis, and people commit suicide, or go into bankruptcy, and then finally come out again. Then the same cycle starts over, and you keep going and coming back.

It seems to me we ought to have, if possible, more of what might be called backbone money, or development money or credit-creating money. If we can, we ought to get something that is more substantial than currency, or money that will fade out over night, pocketbook money.

It seems to me our trouble is that when prices begin to fall, this credit money, or check-book money, all vanishes and leaves us helpless, and ruins us.

Governor ECCLES. It would be very fine if we could find some method of avoiding these cyclical changes and always have complete and full employment and business stability. But I do not know of any rule whereby we can accomplish that. We can make that an objective.

Mr. CROSS. You will agree with me on this, will you not? Suppose there was no money; as long as crops were good and people raised plenty, it would be a golden era, would it not?

And if you had currency that would reflect the real exchange values of those things which society needs; if you could get a currency that would reflect the real values of those things in response to the law of supply and demand, we still ought to be in the heyday of prosperity, ought we not?

Governor ECCLES. It depends on whether or not the currency is distributed so that people could spend. If you still had inequitable distribution to the point where a great majority of the people had no money to spend, it would not make any difference whether you used a currency system or some other system. The buying power has to be in the hands of people, no matter what kind of money system you use.

Mr. CROSS. When you trap a lot of people into debt and distress them and they want to eat something, then what would be the result?

Governor ECCLES. But the banking system, as I have indicated, is not responsible for trapping the people into debt. This system of Government loaning agencies, the Howe Owners' Loan Corporation, the Farm Credit Administration, and the Reconstruction Finance Corporation, are three of the greatest credit-extending agencies or creators of debt that we have in the Nation today.

Mr. CROSS. Really, it is just postponing the day of execution, is it not, to shift that from private concerns to the Government? If the Government insists on foreclosing later on it is just postponing the day of execution, is it not?

Governor ECCLES. There is not any question about it; but a debt can be supported when the national income is sufficient to support it. The trouble was that our national income went down in a hurry, and it was going in that direction through the process of bankruptcy and foreclosure. But debt was adjusting itself through that process so that it could be supported by the national income.

Mr. CROSS. What I am trying to get at is this, if it can be done, to evolve a system that is not fatalistic. I believe that if we continue in this helpless condition, in substance, it will get in time where it means the end of capitalism.

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Mr. FORD. Governor Eccles, is not the plan you have in mind of creating debt on the part of the Government for the purpose of priming the pump, and when the pump catches and the fluid begins to flow, then let the Government, through its taxing power, wipe out that deficit, and therefore have self-liquidating recovery. Is that not what you want to do?

Governor ECCLES. When you correct the causes for the deficit and the deficit disappears, with an increase in employment and an increase in the national income, the Government's revenues would increase and you would no longer have a deficit.

As private-bank credit expands, and the velocity of existing funds held by corporations and people in banks increases, you would likely have a condition of pretty full employment. At that time income taxes should be increased and not decreased, and Government obligations should be reduced as the community's obligations are increasing. Thus you would be creating a compensatory condition in the money system which would help to iron out the difficulties, if it is done with proper timing. If it is done in that way it would help to iron out the tremendous cyclical depressions which create booms and collapses, which create huge armies of unemployed and the terrible loss of national income.

Mr. FORD. We have that condition now, and we are trying to prime the pump, and by priming the pump create increased business and increased national income, and when the income increases, then the plan, in substance, is self-liquidating, is it not?

Governor ECCLES. Yes.

Mr. WILLIAMS. Governor, I do not know that I have anything additional to ask you about, but there is a feeling among some people, as has already been indicated here, that we should substitute currency for Government bonds, retiring them as they become due, not only what the banks hold, but the entire amount that the Government has outstanding. What would be the result of that?

Governor ECCLES. In the case of the bonds that the banks have, it would increase their reserves by that amount.

Mr. WILLIAMS. What percentage of the bonds outstanding do the banks own?

Governor ECCLES. Oh, I think, of the total outstanding it is somewhere around 44 to 45 percent.

Mr. WILLIAMS. Almost half. What would happen to the rest of them, to the other 55 percent?

Governor ECCLES. Insurance companies are very large holders of those bonds, and the savings banks are very large holders, and the trusts of various kinds, hospitals, educational institutions, and charitable organizations of various kinds, as well as private or individual trust estates——

Mr. WILLIAMS. Would not that release their holdings in bonds and give them currency that might be invested in other securities?

Governor ECCLES. Where other securities are available for such investment. If they were available the excess reserves of the member banks would go into those securities; but what that would create would be an inflation of the security markets, because the volume of money available in relation to the volume of investment securities would cause the bidding up of the stocks and other securities.

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Mr. WILLIAMS. Then finally the currency would all come into the banks?

Governor ECCLES. Yes; it would go into the banks immediately.

Mr. WILLIAMS. And in the case of these other institutions that have no use for it for investment purposes, what would they do with it?

Governor ECCLES. They, of course, would deposit the currency in the banks, which would increase the banks' deposits by the amount of the 55 percent of the Government bonds they hold.

As to the bonds held by the banks, it would increase their excess reserves by the amount of Government bonds they held but would not change their deposits.

Mr. WILLIAMS. It would possibly result in the entire amount of Government bonds going into currency being deposited in the banks, increasing their reserves?

Governor ECCLES. That is exactly what it would do.

Mr. WILLIAMS. That would create either one of two conditions. It would present a situation of unlimited inflation, unless——

Governor ECCLES. Unless the reserve requirements were raised by that amount.

Mr. WILLIAMS. It would raise the reserve by that amount, but you would not necessarily have to raise it to the full amount, would you?

Governor ECCLES. You have already over 2 billion excess reserves. You have enough excess reserves now to give you a large inflation; and, if you did not raise reserve requirements by the full amount, you would have additional excess reserves over the 2 billion now held.

Mr. WILLIAMS. Would the fact that the reserves were increased, we will say, to 5 billion, tend to create an inflationary condition? Would that help to make money more easy and induce people or institutions to borrow?

Governor ECCLES. I doubt that it would have any such effect. The rates now on bankers' acceptances and commercial paper, and short-term, high-grade bonds, and Government bonds are almost at the vanishing point, lower than at any time, I suppose, in the history of the country.

But I do not believe that increased reserves, beyond the present excess, would induce any more borrowing or any more lending.

If we begin to get recovery and private credit begins to expand, and the banks increase their investments in securities, and the funds go into the capital markets for building new capital facilities, by the time the banking system had used up their present excess reserves of 2 billion dollars, you would have a volume of money far in excess of anything that the banking system has ever had, and with that volume, with the income velocity that we had in 1927, 1928, and 1929, it seems to me you could have a great inflation, without using any of the increase in the reserves. I mean without using any of the increase in the reserves which would be brought about by retiring Governments through issuing currency.

Mr. WILLIAMS. In other words, the credit expansion potentialities, at least, are as great as you think they ought to be now?

Governor ECCLES. Yes; they are sufficiently great right now, I think, and it would be necessary to carry out open-market operations,

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or to raise the reserve requirements, before the present excess requirements were entirely used up.

Mr. WILLIAMS. I would like now to get down to section 202 of this bill, with reference to the admission of nonmember banks into the Federal Reserve System, about which you talked a great deal.

In the first place, the bill itself as proposed here provides that the Federal Reserve Board may waive the capital requirements for admission, with the understanding that within the time specified by them the bank admitted into the System makes up those requirements.

Governor ECCLES. That is right.

Mr. WILLIAMS. That is the provision of the bill.

Governor ECCLES. That is right.

Mr. WILLIAMS. As I understand it, the amendment offered by you—I did not understand that you presented any definite language.

Governor ECCLES. We have definite language. I did not submit it here, but I submitted this statement before the committee, and I will read it, if you desire.

Mr. WILLIAMS. I did not understand that you submitted definite language.

Governor ECCLES. Not here, but we are prepared to submit to the committee suggested language, if they desire us to do so.

Mr. WILLIAMS. That is exactly what I wanted to ask you about. I understood your general statement to be that they may waive this requirement and other requirements.

Governor ECCLES. This is what that meant. This provision with reference to the admission of insured nonmember banks is very short. It provides—

> On the admission of insured nonmember banks, the Board shall have authority to waive not only capital requirements, but all other requirements for admission, and the Board shall be permitted to admit existing banks to membership permanently with capital below that required for the organization of national banks in the same places, provided that their capital is adequate, or is built up within a reasonable time to be adequate, in relation to liabilities to depositors and other creditors.

Your question was in relation to capital and all other requirements for admission.

Mr. WILLIAMS. What is meant by the waiving of all other requirements?

Governor ECCLES. I have in mind one particular situation. Quite a number of banks that closed during the bank holiday and wanted to reopen found it necessary to get waivers of a certain percentage of their deposits from their depositors. In getting those waivers the banks issued to the depositors certificates of claims for the amounts of the deposits which they waived, which were, of course, secondary to the deposits of the reopened banks, but senior to the stockholders' interest in the banks.

It has been construed by the counsel of the Federal Reserve Board that, under our present Federal Reserve Act, that claim of the depositors is a liability of the bank, and therefore that they cannot figure they have any sound capital so long as those claims exist, whereas those claims are secondary to the depositors' rights.

For all practical purposes, the depositors are as fully protected under that arrangement as they would be if the claim did not exist,

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and they are given that protection. That is the only case I have in mind at the moment; there may be others.

But we felt that we wanted the language of the bill broad enough to give the Reserve Board the power to get nonmember banks into the system; whereas if conditions were imposed that they could not meet, it would be undesirable, and that was not what the reserve organization felt should be done.

Mr. WILLIAMS. Is it your thought that these capital requirements should be waived permanently, or that they should be required to make them up after they get in?

Governor ECCLES. No, sir; it is our thought that they should be waived permanently, if the capital and surplus which they have is adequate in relation to the bank's liabilities.

Mr. WILLIAMS. And you would consider them solvent?

Governor ECCLES. Yes. For instance, a bank with $40,000 of capital and surplus combined and with a deposit liability of $250,000 has adequate protection for its deposit liability. That is as much protection, on the average, as the deposits have throughout the banking system, as a whole.

Mr. WILLIAMS. The thing that has disturbed me, and has disturbed me very much, is what we are going to do with the 8,500 nonmember banks.

Governor ECCLES. Seven thousand.

Mr. WILLIAMS. That is, the banks which during all these years have not seen fit to come into the Federal Reserve System, and now compelling them to come in if they are going to enjoy any of the benefits of the Insurance Corporation.

Governor ECCLES. Of course, that is not a provision of this legislation.

Mr. WILLIAMS. I understand that, but we are legislating on that subject.

Governor ECCLES. We are simply making it possible to liberalize the Federal Reserve requirements so that the legislation requiring their membership which was passed last year can be complied with without hardship to the nonmember banks.

Mr. WILLIAMS. You understand how it was passed?

Governor ECCLES. It was passed and is in the law; and of course I, personally, am very much in favor of it. I feel that this whole banking policy cannot be successfully carried out so long as you have a substantial part of your banking system not under the Federal Reserve System. The control over your reserves and the control over your money is reduced just to the extent that a substantial part of your banking system is entirely out of the Reserve System.

And, since the nonmember State banks came to the Federal Government in an emergency, the same as the banks under the direction of the Reserve System and/or the Comptroller of the Currency, and requested the benefits of the Reserve System and the Reserve System was rquired to lend to the nonmember State banks at the time of the bank holiday, I believe that in the interest of the nonmember State banks the legislation passed last year, with the amendment proposed, is very necessary and a very constructive thing to require.

I have met with a lot of nonmember State bankers, and I know that they feel that it is against their best interests to be members of the Federal Reserve System. That may have been true in the

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past, to the extent that they could carry their reserve balances in the city banks and get 2 percent interest, I think, or 1½ percent interest.

Today they get no interest whatever on their reserves in the city banks, and they would be just as well off to have those balances in the Reserve banks now as to carry them in the city banks, whereas that was not true until the time of the Banking Act of 1933.

Another advantage in becoming a member of the Federal Reserve System, that will exist if this legislation passes and that did not formerly exist, is that by the broadening of the eligibility features, it will give them a protection that they did not have before.

The CHAIRMAN. May I interrupt you right there? That means, of course, with the inducements that are offered to the nonmember banks to join the Federal Reserve System. There is not a nonmember bank in the United States that will object to entering into the Federal Reserve System that tends to induce them to come in. Some of them do not want to be forced in, and I do not think you have given all the reasons for it yet.

For instance, one is in connection with the matter of their right to charge for service rendered.

Governor ECCLES. Exchange.

The CHAIRMAN. Which, in the case of a small community bank with a small capital, goes a long way toward meeting their overhead.

And there is another reason. Nonmember banks come in contact with member banks, or the officials of nonmember banks come in contact with the officials of member banks, and they get from those contacts, in addition to what they gather otherwise, impressions as to the desirability of membership in the Federal Reserve System, and there has been unfortunately an accumulation of complaints on the part of national banks that were automatically taken into the Federal Reserve System.

This question here, if I may say so, comes back to this proposition. It seems to me it must be considered separate and apart from the fundamental thought that enters into the policy that should be finally deermined as to the unification of the entire banking system; that is, our efforts to deal with the emergency that confronts us.

If we attempt to set up requirements of nonmember banks which they cannot meet—if such a provision is put into effect—they can have the benefit of deposit insurance; and I think it is generally conceded that would result in disaster, as a general rule, to small nonmember banks.

Governor ECCLES. It would be suicide for the Reserve Board to set up requirements that the small nonmember State banks could not meet, and thus force them out of the deposit insurance and force them to close. There would be nothing constructive accomplished by any such action as that.

The CHAIRMAN. I here and now register my complete acquittal of you as to any fear of that kind. But we cannot have you in control always. I wish you would live a hundred years, but you cannot.

Governor ECCLES. I do not wish that.

The CHAIRMAN. We do not know who will be Governor of the Federal Reserve Board 5 years from now.

Governor ECCLES. Or next month.

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The CHAIRMAN. Or possibly next month.

What happened when we were faced with the complete collapse, or at least the complete closing—I guess it is fair to call it a collapse—of the entire banking system of the Nation in 1933? The bankers were desirous then of having Congress meet, and for once they were willing to meet with Congressmen and confer, and we did confer. We passed the Emergency Banking Act. You know how it was written, I assume.

Governor ECCLES. I read Huey Long's speech after he had voted for it.

The CHAIRMAN. Huey Long was not the only one who felt that way. The entire administration thought that way, and what happened was this—and that is what I was about to call attention to—that the controlling voice in framing that legislation did not come from nonmember State banks in the United States; and the result was that when member banks found they could not get currency enough to pay their depositors and keep their doors open, they arranged for currency to be printed on their assets and supplied to them.

Governor ECCLES. Clearing-house certificates.

The CHAIRMAN. Under the Emergency Banking Act of 1933, as originally passed, we provided for the issuance of Federal Reserve bank notes to member banks, but nonmember banks were not permitted to have that privilege under that act.

Under that legislation, a town of 10,000 or 20,000 population might have two banks, half of the business activity and life of the community being centered in one bank on one corner and the other half in the other bank.

With this situation affecting the Nation under that bill we provided relief for half of that community and its interest and its deposits in the member banks of the Federal Reserve System. And we said to the member bank, "Here is the way you may print money or get currency to take care of your deposits"; and we said to the people of the community interested in nonmember banks, "You take care of yourselves." Of course, that was finally corrected, but it took a struggle to do it.

They have that recollection before them; and there are a lot of just such experiences, not just exactly like that but experiences of that kind that influenced the nonmember bankers; and if we attempt to set up arbitrary standards to force them into the Federal Reserve System, I am not sure that we will not get into difficulties.

Governor ECCLES. If we had a unified banking system at the time you refer to, the question as to whether or not a bank could get the benefits of advances from the Federal Reserve bank and receiving therefor Federal Reserve bank notes would not have come up.

The question came up, because here was a system set up for member banks, and all banks had been invited to join the Reserve System from its very beginning. An emergency developed after a period of 20 years, and those banks that had not taken advantage of the opportunity to join wanted in the emergency, the benefits of a system of which they were not members.

I recognize that it was in the public interest to do just what was done.

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The CHAIRMAN. What was finally done, but not what was done so long as we were moving under the counsel of one class of bankers.

Governor ECCLES. But I do think that the possibility of the recurrence of such a condition should be prevented by getting a unification of the banking system. I believe you will never have in this country a banking system that can withstand the pressure of periods of financial distress, and we will never have a sound, dependable banking system until we get a unified banking system. And neither do I think it will be possible to exercise through monetary policy the same control over the money system when a substantial number of banks which create money just the same as the member banks are subject in no way to the regulation or control of the authority that is responsible for monetary action.

I have been in the banking business for a period since 1913, a period of 22 years, up until the time I came over here a little more than a year ago.

My first banking connection was with about a million-dollar bank which joined the Federal Reserve System shortly after the Federal Reserve System was organized. It is a State bank. From that period a banking organization of over $55,000,000 was built up, operating over 25 banks, national and State, member and nonmember.

I found, as the result of experience, that it is in the interest of a bank to be a member of the Federal Reserve System, whether it be a small country bank or a substantial sized city bank; and I am stating here my honest conviction of what, as a result of experience and as a result of study for a period of years, I feel is in the public interest and in the bankers' interest.

And I believe that the great majority of the nonmember State banks, if they understood this problem, could be induced, in their own interest, to become members. I have found in talking, as I have upon many occasions, to nonmember State bankers, that invariably they can be sold upon the idea, and the difficulty today with very many of them is a lack of understanding and lack of information with reference to the problem.

The CHAIRMAN. I think one reason why they have not wanted to come in was because they did understand. When a bank becomes a member of the Federal Reserve System its other connections are practically terminated.

Governor ECCLES. You mean its other banking connections.

The CHAIRMAN. Yes; its other banking connections. So far as obtaining relief in an hour of need is concerned, those connections are terminated, and any small bank, a member of the Federal Reserve System, would be dependent upon its Federal Reserve bank for relief in the hour of difficulty, as a general proposition. I think that is undeniably true.

Governor ECCLES. Not altogether, because every bank carries usually an account or two with a city correspondent.

The CHAIRMAN. Sometimes they do, but they do not always do that.

I can point you to instances in my own district where a bank in a town of not over 20,000 population was allowed to close. I know the history of it.

I know that there were criticisms and faults to be found with the management, and its papers were not all desirable. But the bank

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came very near liquidating 100 percent to its depositors during this depression. The Federal Reserve turned them down and abandoned them.

That very institution, if it had not been a member of the Federal Reserve System, and had kept up the other connections that would have existed, in all human probability would have been able somewhere to have secured relief to tide them over their difficulties.

Of course, that is one instance that happened many times.

I want to say in that connection that I think the story would have been different if we had then the experience we have gathered since that time and had had the legislation now proposed and had it administered with some degree of common sense.

Governor ECCLES. I think that there was a lack of power for the Federal Reserve banks to extend the relief that they should have been able to extend; there is not any question about that.

The CHAIRMAN. In connection with what I said, I want to add this, that I have not the slightest doubt that this legislation, if it is administered as I think it will be, and I believe it will be in the light of our experience, with a more liberalized view of the situation to be reflected in the administration of the Federal Reserve System, will induce many State nonmember banks to join the Federal Reserve System voluntarily.

Governor ECCLES. There is not any question that the Reserve banks were extremely rigid in their credit extension, in their interpretation of eligible paper. As the depression proceeded and as deflation continued, the attitude and the action of the Reserve banks, based upon my experience, and I know upon the experience of thousands of other bankers, was to the effect that the Reserve banks became more rather than less restrictive.

I think the experience of the past has been a very salutary one, and I agree with Mr. Steagall that, if this legislation is passed and is administered with understanding and in the spirit that has motivated the legislation, a repetition of the banking catastrophes that we have had in the past would be impossible.

Mr. CAVICCHIA. The other day, Governor, I asked you if this bill aimed at a centralized banking system, or whether it was merely regulatory.

I notice this morning you used the word "unification." As I understand it, this bill aims at unifying the National and State banking systems under the Federal Reserve System; am I correct?

Governor ECCLES. No; this bill does not deal with that problem at all. That matter was covered by the legislation which was passed in 1933.

Mr. CAVICCHIA. In what sense did you use the word unification?

Governor ECCLES. I was simply stating that I thought a unification of the banking system was necessary, and according to the legislation that Congress passed in 1933 unification will be brought about by 1937, when the nonmember State banks will be required to become members of the Federal Reserve System in order to get deposit insurance.

Mr. CAVICCHIA. And your program is to unify the banking systems?

Governor ECCLES. No; that is the program which was passed, and which I am favorable to.

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Mr. CAVICCHIA. The aim of the legislation we passed and that which we are now considering it to unify the banking systems, whether it be National or State?

Governor ECCLES. That is correct.

The CHAIRMAN. You mean this legislation was not designed to accomplish that purpose, but its purpose was of another nature, and you merely accepted the existing law with reference to unification.

Mr. CAVICCHIA. You still have the two systems.

Governor ECCLES. This legislation only facilitates the carrying out of the legislation which has been passed, without imposing unnecessary hardships on the nonmember State banks.

The CHAIRMAN. You might state your views to be that a proper interpretation and understanding of the proposed legislation is that it really liberalizes the requirements heretofore imposed in the act of 1933.

Governor ECCLES. Yes.

Mr. WILLIAMS. I want to ask whether or not you think that State legislation authorizing the creation of State banks ought to be entirely abolished, making it one system, sure enough.

Governor ECCLES. It is my personal belief that that may be desirable, but it is impracticable at the present time.

In practically every other country in the world they have one banking system; and, as the result of that, they have, I believe, avoided many of the banking troubles which we have had. But we are young, and I do not believe that we can make changes in our methods and habits too rapidly. We cannot go faster than the people of the country are willing to have us go.

Mr. WILLIAMS. It seems to me we are inevitably going to that, and I have the view in reference to the general philosophy of the legislation that we are certainly going in that direction.

If it is desirable, as you think—and I am not controverting that here—to have the entire system under a central control, so far as the monetary policy is concerned——

Governor ECCLES. That is what this would do, without eliminating the State banking departments.

Mr. WILLIAMS. Undoubtedly; but it brings them into the picture, subject to that policy.

Governor ECCLES. Not so far as the examination of banks is concerned, and not so far as the chartering of banks is concerned; but it does unify the System by placing State banks under the influence of monetary policy of changes in Reserve requirements and changes in discount rates.

Mr. WILLIAMS. If we are going to bring them into one system, I can see no reason at all for the further existence of State banks. I cannot see the necessity of having a separate examination of them.

Governor ECCLES. There is not any question but what there are many improvements that can be made in the banking system that the proposed legislation has not provided for. But I believe that banking legislation must be evolutionary and not revolutionary. We cannot expect in one session of Congress to get all the banking legislation we want, when we take into account the size of the country and the habits of the country, the adverse and diverse opinions. Therefore, what has been proposed here, it seems to me, is about

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as far as we could expect to go at this time with reference to banking legislation, and the question of other problems of banking legislation which have been discussed from time to time, such as the matter of unification, the examining problem which you raised, Mr. Williams, and the question of branch banking has come up a good many times here and it has come up in many State legislatures. All of those problems are problems which will come up from time to time for consideration. There is not any question about that.

Mr. CLARK. The Federal Reserve System as it has existed and has been administered, as Mr. Steagall pointed out, has not been sold for some reason or other to thousands of banks throughout the country that did not want to join, whether they understood the facts or not.

In title II of this proposed legislation, if it is passed, I think, personally, you have an article that will sell the System, if properly administered.

But why do you think it is necessary to use the F. D. I. C. as a club to force the sale of an article that ought to sell on its own merits?

Governor ECCLES. I think that membership in the F. D. I. C. should be confined in the future to member banks. In 1933 it was found that the Federal Reserve System was the only agency that could provide liquidity to the banking system and thus enable the banks of the country both member and nonmember banks, to reopen and to make available the depositors' money. This had to be done at that time by the Federal Government, even though it had nothing whatever to do with the chertering or the supervision of nonmember banks. The Government had the responsibility through the Reserve System of giving them the benefits and the protection of that system in the same manner in which it was accorded to member banks.

Now, I do believe that, in the public interest, after a reasonable time—and 1937 is a reasonable time—and after providing a liberalization of the requirements of membership, any bank which is being insured by the Federal Deposit Insurance Corporation should be required to become a member of the Federal Reserve System for better protection to the Federal Deposit Insurance Corporation. Although it is a bank mutual insurance plan, at the same time the moral obligation of the Federal Government is there; because the public looks to the United States Government to make that insurance company solvent if the banks cannot or do not.

Mr. CLARK. You think, that the insurance features of the F. D. I. C. are so closely involved with the entire banking system that it is good practice in this instance, whereas ordinarily it would not be, to use one agency as a club to force membership into another agency; that they are so interrelated and tied up that it is a fair thing to do.

Governor ECCLES. I agree with you. I do not like the use of a club at all in dealing with human problems. The F. D. I. C. and the Federal Reserve System are so closely interwoven that it is necessary in the public interest to require membership of insured banks; but I do not like to look upon the use of the F. D. I. C. as a club.

Mr. CLARK. That has been suggested several times while we were discussing title I, and that is why I used the term. I merely wanted to get your statement in the record because numerous State banks have written members of the committee raising that very question,

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stating, in effect, that they were being clubbed by a desirable institution into joining the System, which, as presently constituted, they do not like.

That is one reason why I wanted to get your views in the record so that we might have the entire picture.

Mr. HOLLISTER. With respect to section 210, which pertains to the lending power of national banks, are you going to mention that?

Governor ECCLES. That is just what I was going to refer to.

Mr. HOLLISTER. I was just going to bring that out.

Governor ECCLES. I wanted to put in the record a suggestion with reference to section 210, which is the provision dealing with real-estate loans, a section that has possibly been misunderstood as much or more than any other section, and a section which has been discussed here, possibly, as much as any other section.

I recommended before this committee that, instead of providing in the bill a specific maximum amount based on appraisal that could be loaned, a specific maximum period, and a maximum amount of time funds, that there should be more flexibility, and that the Reserve Board should be required to make rules and regulations governing the making of real-estate loans by member banks.

There are many reasons for that which I do not think it is necessary to review here. It has been suggested that it would be desirable, and that the proposal would be far more acceptable to the bankers in general, if there were a limitation of 60 percent instead of the 75-percent limitation placed in the legislation; that is, to permit the Board to make rules and regulations with reference to real-estate loans, with the limitation that no loan made after the passage of this legislation or after the promulgation of the Board's rules and regulations could exceed 60 percent of the appraised value of the property.

I see no objection to that. I do not believe the banks would loan more than 60 percent on the appraised value in any case.

My purpose in suggesting the 75 percent was not with the expectation that the banks in the future would loan 75 percent of the appraised value of the property; but it would enable them to carry the more than 2 billion of real-estate loans which they have, which, due to depreciation values, are in excess or 50 percent in many cases, possibly as high as 65, 70, or 75 percent in some cases. It would permit them to carry the loans they have and extend them over a long period with an amortized basis of payment, rather than to bring pressure on the borrowers because the examiners bring pressure upon the banks, to reduce these loans to the 50-percent limit, which would force the borrowers on to the Government, through the Home Owners' Loan and the Farm Credit Administration.

I would like to see the banks able to carry the real-estate loans they have, even though they are in excess of 50, or 60, or 70 percent, and to refund those loans.

But I think a 60-percent limitation is desirable in the case of making new loans in the future. I have no objection to it, and would like to recommend that, in connection with giving the Federal Reserve Board the authority to make rules and regulations, such a limitation be put upon that authority.

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The CHAIRMAN. We have concluded with Governor Eccles, and I want to thank you, in behalf of the committee for your faithfulness in attending these hearings, and for the very able presentation you have made of this legislation. All of the committee, I am sure, cannot agree with everything you have said, but we agree with you.

Governor ECCLES. I appreciate your courtesy and the patience which the members of the committee have accorded me.

Statement on National income, money, and income velocity, submitted by Gov. M. S. Eccles

	National income, Copeland [1] (billions)	National income, Department of Commerce (billions)	Money [2] (billions)	Income velocity based on Copeland (I÷III) (times per year)	Income velocity based on Department of Commerce (II÷III) (times per year)	Percentage change in income, Copeland	Percentage change in income, Department of Commerce	Percentage change in money	Percentage change in income velocity, Copeland	Percentage change in income velocity, Department of Commerce
	1	2	3	4	5	6	7	8	9	10
1921	56.8	--------	21.7	2.62	--------	--------	--------	--------	--------	--------
1922	60.3	--------	21.5	2.81	--------	+6.2	--------	−1.2	+7.3	--------
1923	68.9	--------	22.6	3.04	--------	+14.3	--------	+5.5	+8.2	--------
1924	70.2	--------	23.1	3.04	--------	+1.9	--------	+1.8	--------	--------
1925	74.5	--------	24.6	3.03	--------	+6.1	--------	+6.7	−0.3	--------
1926	78.8	--------	25.3	3.11	--------	+5.8	--------	+2.9	+2.6	--------
1927	80.9	--------	26.0	3.11	--------	+2.7	--------	+2.8	--------	--------
1928	83.3	--------	26.4	3.16	--------	+3.0	--------	+1.3	+1.6	--------
1929	87.0	82.3	26.4	3.29	3.12	+4.4	--------	+0.1	+4.1	--------
1930	--------	75.8	25.4	--------	2.98	--------	−7.9	−3.8	--------	−4.5
1931	--------	63.3	23.8	--------	2.66	--------	−16.5	−6.3	--------	−10.7
1932	--------	49.7	20.5	--------	2.42	--------	−21.5	−13.9	--------	−9.0
1933	--------	46.8	19.9	--------	2.35	--------	−5.8	−2.9	--------	−2.9
1929–33	--------	--------	--------	--------	--------	--------	−43.1	−24.6	--------	−24.7

[1] Less imputed nonmonetary incomes.
[2] Deposits subject to check plus cash outside banks as of June 30.

MODIFICATION IN THE BANKING BILL OF 1935 PROPOSED BY GOVERNOR ECCLES IN HIS TESTIMONY BEFORE THE HOUSE BANKING AND CURRENCY COMMITTEE

1. SEC. 201. The governors and chairmen and vice governors of the Federal Reserve banks shall be approved by the Federal Reserve Board every three years rather than annually, so that their terms as governors would coincide with their terms as class C directors.

2. SEC. 202. On the admission of insured nonmember banks, the Board shall have authority to waive not only capital requirements, but all other requirements for admission, and that the Board be permitted to admit existing banks to membership permanently without requiring an increase in capital, provided their capital is adequate in relation to their liabilities.

3. SEC. 203. The pension provision shall be modified so that any member of the Board, regardless of age, who has served as long as five years, whose term expires and who is not reappointed, shall be entitled to a pension on the same basis as though he were retired at seventy. That is, he is to receive a pension of $1,000 for each year of service up to twelve.

SEC. 205. Authority over open-market operations shall be vested in the Federal Reserve Board, but that there be created a committee of five governors of Federal Reserve banks, selected by the twelve governors of the Federal Reserve banks, and the Board shall be required to consult this committee

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before adopting an open-market policy, a change in discount rates, or a change in member-bank reserve requirements.

5. Sec. 209. The Board shall not have the power to change reserve requirements by Federal Reserve districts, but only by classes of cities. For this purpose banks shall be classified into two groups: one comprising member banks in central reserve and reserve cities, and the other all other member banks. Changes in reserve requirements, therefore, would have to be either for the country as a whole or for the financial centers, or for the country districts.

6. Sec. 210. The conditions on which real-estate loans may be granted by member banks shall be left to the discretion of the Federal Reserve Board to be determined by regulation. No real-estate loan hereafter made shall exceed 60 percentum of the appraised value of the property; but this shall not prevent the renewal or extension of loans heretofore made.

7. It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

(Thereupon, the committee took a recess until 3 p. m., this day.)

AFTERNOON SESSION

The Chairman. Dr. Goldenweiser, you have heard the discussion that has taken place in connection with this bill, H. R. 5357. The committee would like to have you discuss the legislation, and I assume that it is to be desired that you give us the benefit of your judgment in the way of explanation of the legislation embodied in title II, in its technical aspects, so that all of us may have a clearer understanding of its mechanics.

Mr. Goldsborough. Mr. Chairman, I do not know whether this suggestion is desired by Dr. Goldenweiser, but on various and previous occasions he stated that, in view of the fact that he was on the staff, he preferred not to give his opinion as to matters of policy.

The Chairman. I undertook to intimate to him that it is not desired to lead him into that field, but that he give us the benefit of his explanations of the mechanics and the technical part of this bill.

STATEMENT OF DR. E. A. GOLDENWEISER

Dr. Goldenweiser. Mr. Chairman, I would like to make a brief statement before you ask me questions, if I may. I have not prepared a written statement. One reason that Governor Eccles thought it would be desirable for me to testify was that I could make it somewhat clearer how the provisions of this proposed legislation have been developed out of the experience of the Federal Reserve System under the provisions as they are in the law today, and it is along that line that I should like to make my opening remarks.

I want to state for the record that anything that I say that is not purely factual expresses my own personal opinion, and I am not speaking for the Federal Reserve Board. In my opinion, this bill accomplishes two important purposes: One is to clarify and fix more definitely the responsibility involved in the administration of the Federal Reserve System; and the other is to improve the administration of the credit machinery that the System sets up.

The proposals do not involve as much change from existing law as has been intimated, chiefly in the comments and the general impression in the discussion of the bill outside of this room.

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I should like, with your permission, to discuss in some detail a few of the sections of the bill on which I can, perhaps, add a little light, and then leave it to you to ask me such questions as you may desire.

The first section of the bill—and I am speaking entirely of title II of this bill, H. R. 5357—the first section is one that arranges for combining the offices of governor and chairman of the Federal Reserve banks, and to make the appointment of the person to occupy the position subject to the approval of the Federal Reserve Board. It has been explained to you just why it is necessary that the Board be consulted, and I shall not discuss that phase of it, but I would like to say a few words about the effect of this dual organization under which we have been functioning for 20 years, which has, in part, not proved entirely satisfactory, either to the banks or to the Board. In many cases it has worked very well. In the final analysis, it is all a question of personalities, but you are setting up a charter for the bank, and you ought to provide against the possibility of undesirable contingencies developing, rather than to depend on human qualities to be such as to result in smooth administration, even though the machinery be calculated to produce the reverse.

I do not want you to get the impression that in numerous cases it has worked in an unsatisfactory manner, but still there have been cases where it has worked in an unsatisfactory manner.

Under existing law and practice the Federal Reserve bank has two heads: The chairman of the board, appointed by the Federal Reserve Board, who is also a class C director and is also the Reserve agent and the Federal Reserve Board's local representative in the banks; and then it has the governor, who is appointed by the directors and is responsible entirely to them, except that his salary is subject to approval by the Federal Reserve Board and he is subject to removal for cause.

In most cases it has worked out that the governor has been the principal executive officer of the bank, although there have been cases where, as a matter of personal equation, the chairman has been the principal executive officer. It has been a question of personalities, as to which one has been dominant. It seems clear that it ought to be made perfectly plain in the law just who is going to run the banks, whether it is going to be the chairman or the governor, and the only way to do that, without defining their duties in very great detail, is to combine the offices.

We have had cases where the chairman and the governor did not get along, where the chairman might have used his prerogatives as chairman to try to keep the governor out of the meetings of the board of directors, which seems absurd, and there ought to be no legal possibility for such a situation. We have had cases where of two men one was first governor and then chairman, and then they reversed themselves and the one that had been chairman became governor, and vice versa, and they continued to be at cross purposes. Usually the Federal Reserve Board feels that it is desirable for it to communicate with the banks through the chairman of the board of directors, who is the Federal Reserve Board's representative on the premises. As it has worked in practice, in some

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cases it has been merely a matter of routing the mail to the governor, who is the executive head of the bank, through the chairman. In some cases, however, where the chairman happened to be jealous of the prerogatives of the governor, it has sometimes resulted in the Board's addressing the chairman and the information not reaching the governor, who has the responsibility for the running of the bank.

It has particularly happened in cases where the governor might be away and the deputy governor, while actively in charge of the bank, would not receive the information coming from the Board to the chairman, and yet the deputy would be the man whose responsibility it was to run the bank.

Now, those things will happen. They are bound to happen so long as we have a set-up where you have two heads responsible and performing different functions. It cannot be expected in all exigencies of daily life and personal equations for them always to be the kind who will talk it over and get along smoothly in their operations. In most cases, they have done that, but there have been cases where they have not.

This proposal will do away with this difficulty and, at the same time, will save the system a considerable operating expense, and will result, I think, within the banks, in smoother operation and also in smoother cooperation between the banks and the board.

The agent's department or the chairman's department in the bank has had several functions of the bank under its charge. It has had the examination division, and the bank-relations division, and the economic services, and while that has worked very well in many cases—you will forgive me for taking a particular interest in the economic services, with which I am connected, myself—the fact that they are connected with the chairman, who is not the executive head of the bank, has been an additional handicap in making those divisions function in a way so as to have the information that they collect, and the material which they assemble, finding its way into the hands of the operating officials, who would use it in formulating policies.

The only purpose of the economic services of the Federal Reserve System is to give the operating officials of the banks and their boards the kind of information that they require for their work, and anything in the nature of a hurdle between the economic services and the bank officials is a handicap to the effective working of the economic services, and I think it has seen that to some extent.

Those are the reasons, as I see them, for combining the offices. Those are the reasons that appeal to me, and the fact, as I said, that the combined officer needs to be approved by the Federal Reserve Board, it seems to me, almost goes without saying, because the Board is given the power to appoint the chairman, and it must naturally have the power of approval of the joint officer.

I have not anything to comment upon in the section that deals with the admission of insured banks into the Federal Reserve System. It seems to me that the Governor covered all of that, all that I can think of on the section.

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In connection with the qualifications of the Federal Reserve Board, which this bill provides for, the principal thing in the way of their qualifications is, that instead of having it stated that they should be appointed with due regard to agricultural, industrial, and geographical interests, there is substituted a statement that they should be persons, who by training or experience or both, are qualified to formulate economic and monetary policies. It seems to me that that substitution is a very good one, because it states the qualifications of the members of the Federal Reserve Board in terms of the principal function which they have to perform, and because it does away with the idea that the board should consist of representatives of different groups of the population, this man representing agriculture, this man banking, this man trade, and so on. It is better that each member of the Reserve Board, as a matter of law, should feel that he represents the country as a whole, and the interests of the country as a whole, and his job on the Board is to be engaged in the formulation of national credit and monetary policies.

I think that the insertion of that qualification into the text of the law is recognition of the growing conviction on the part of the country that the Federal Reserve System's functions are much broader than was clearly understood at the time the Federal Reserve Board was organized. At that time, it was largely conceived that the Board should be a representative Board and that it should represent the different sections of the population, so that none of them would fail to receive equal consideration. Of course, that is important, and it will continue, but an explicit provision for a national, nonpartisan board, that has the sole objection of serving the interests of the people as a whole, with particular reference to those duties that deal with the quantity and cost of money is an advantage.

It is along the same line as the proposal which Governor Eccles has read to you, stating the objectives of the Federal Reserve System in terms of maintaining the stability of various elements of the business structure, that is, to have men on the Board who will devote their energy to maintaining that stability insofar as it can be maintained by monetary means, and men who should be qualified to formulate national policies.

I would like to say, in this connection, that the idea that the Federal Reserve Board has broader responsibilities than the mere accommodation of commerce and business and the serving of agriculture, trade, and industry, is an idea which has been forced upon the Federal Reserve System by actual experience and which has been gradually developed in the System.

The accommodation of commerce and business, which is the only objective that was mentioned in the Federal Reserve Act, is a vague phrase, and has all of the attributes of a statesmanlike pronouncement. It is vague, it is a glittering generality like the Declaration of Independence, and its content can be changed as circumstances change. It has, therefore, not served any very useful purpose, but has not done any particular harm.

It is now time, in the light of 20 years' experience, to substitute a more clearly defined objective than this vague phrase, which, to my way of thinking, held the place for a more definite objective throughout these years.

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As I say, the objective which has been suggested by Governor Eccles and the one that you have clearly in mind, is one that has been gradually evolving. You know, Mr. Chairman, and the other members of the committee, that you have had a great many hearings on various bills for a number of years, and I remember particularly the hearings in 1928, when Congressman Strong, of Kansas, was recommending price stability as the objective of the Federal Reserve System.

The Federal Reserve System, at that time, opposed that particular objective, largely on the same grounds that Governor Eccles stated here he would oppose it as the sole objective now. At that time, former Governor Hamlin, of the Federal Reserve Board, submitted to the committee his alternative for that proposal, which, with your permission, I would like to read. What he suggested was this:

The Federal Reserve System shall use all of the powers and authority now or hereafter possessed by it to maintain a stable gold standard and shall furnish credit facilities commensurate with the requirements of credit stability of agriculture, industry, employment, and the purchasing power of the dollar, so far as such purpose can be accomplished by monetary and credit policy.

I think, with some allowance for changes in fashions as to terminology and for the fact that, at that time, the gold standard was taken more or less for granted, that the objective that Governor Hamlin proposed in 1928 is very similar to the one that Governor Eccles is proposing now.

I call this to your attention in order to indicate that the proposals presented before you now have definite roots in the history of the Federal Reserve System; that they have been developed as part of the System's experience, and, for that reason they are hoped to be and expected to be well adapted to the more effective carrying on of those purposes for which the Federal Reserve System was organized.

The next section on which I should like to make a word of comment is the one that has to do with the open-market operations, and that is entirely in line with what I have been saying on the other sections.

The necessity of having a national body control changes in the cost and volume of money is almost too obvious to require explanation, or to need emphasis, because so far as I can gather, this committee is convinced of the necessity of national responsibility for this national function. The Federal Reserve Act, at the present time, provides that the Federal Reserve Board have power over the discount rate, and over reserve requirements, with the approval of the President. So that two of the powers of monetary control, or monetary regulation, are in the Federal Reserve Board, and it seems only logical that the third power should be vested in the same authority.

I might say a word here about the legal phase of it, on which I feel a little reticence, because I am not a lawyer, but it appears to me, after some consultation that the Federal Reserve Act, as originally drawn, was intended to give the Federal Reserve Board the power to initiate open-market operations. It did not say so anywhere in so many words, because, at the time it was written, open-market operations were a relatively minor matter; there were practically no Government securities outstanding, except those that were

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in back of the national-bank notes, and the open-market idea had not yet developed.

But the Board has the power to fix the discount rates. It has been argued by counsel that under the original act the Federal Reserve Board probably had implied power to order open market operations. The Board's having authority over the discount rate has been questioned. The law says that the rates shall be established by the Federal Reserve banks, subject to the review and determination of the Federal Reserve Board, but the Attorney General of the United States held in 1919 that that meant that the Federal Reserve Board could establish the discount rate, and on one occasion, at least, the Federal Reserve Board has done so.

Mr. HOLLISTER. May I interrupt? I know that is not your regular way of doing it, but do I understand you to say that the counsel of the Federal Reserve Board raised a law question as to the law giving it the right to compel all of the regional banks to enter the open market operations?

Dr. GOLDENWEISER. I do not like to speak for the counsel. If you will wait one second, I think I will make that clear. I meant to say that under the original Federal Reserve Act, prior to the Banking Act of 1933 it could be argued that the Board had the power.

I think that when the Banking Act of 1933 was being formulated, the intention was to strengthen the Board's authority, because that is indicated in more details that you would care to take the time to consider now. But they put in a separate section (12a), and they put this clause there, that no Federal Reserve bank shall engage in open market operations, except subject to the regulations of the Federal Reserve Board, the same language more or less which appeared in another section.

Similar things were done very frequently in the Banking Act of 1933, where the same powers are mentioned over again, in order to emphasize the will of Congress that they should be exercised, and I think it is a fair construction to say that it was intended to increase the powers of the Federal Reserve Board over open-market operation. But when that act was passed there was established a statutory open-market committee, which had previously been a voluntary committee, without any legal sanction, and it was given special powers over the open market, and then there was put in a separate section, which says that the Federal Reserve banks shall have authority to decide whether they shall participate or not. As a consequence, I think that there can be no question whatsoever that, under the law as it stands today, the Federal Reserve Board does not have authority to initiate open-market operations, or to see to it that they are carried out, even after the committee has recommended them and the Board has approved them.

It is proposed here to go back to the original Federal Reserve Act and to go a little further in clarifying what was probably authorized, and putting it into perfectly clear language, and placing perfectly clear-cut authority and responsibility on a national body, the Federal Reserve Board.

I suggest that, if you modify that and give actual voting power to the representatives of the Federal Reserve banks in the committee that is going to determine the open-market policy, in my opinion,

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you will not be restricting new, additional powers requested by the Board, but would be giving the regional banks more power in this matter than they have had since the establishment of the System; because, even under the existing law, the committee cannot move without the approval of the Board.

If the committee makes a recommendation and the Board disapproves it, they cannot carry it out, and the Governors have no vote on the Board in passing on these recommendations of the committee. So that, as a matter of fact, the committee that is actually proposed in this bill, which the Governor has suggested to modify, would give the Governors of the Federal Reserve banks more power in the determination of open-market policies than they have ever had. Rather than the Board getting more power by this proposal that is now before you, the proposal that is now before you would only clarify and make perfectly plain and clear the power which probably existed in the Federal Reserve Act prior to the Banking Act of 1933. Whereas a committee in which the governors participated in voting, would give them more power than they have ever had before.

The CHAIRMAN. Give them more power in the inauguration of policies?

Dr. GOLDENWEISER. Yes.

The CHAIRMAN. But that would take away from them the power to nullify the policies that had been inaugurated and later approved by the Board?

Dr. GOLDENWEISER. That is correct; yes.

Hr. HOLLISTER. Is there such a difference between an affirmative right and a negative right?

Dr. GOLDENWEISER. Yes; I think so.

Mr. HOLLISTER. This, for the first time, makes it perfectly clear that the regional bank may be compelled willy-nilly to participate in the open-market operations?

Dr. GOLDENWEISER. The clear-cut statement of the power is new; prior to that, it was an implied power and was not clear. I think, since 1933, the power has not existed, and I think now it is proposed to restore it and make it perfectly clear.

Whether you wish to do it or not is not for me to discuss, but I was trying to make clear that the alternative suggestions are in the nature of giving the governors more power than they have ever had before.

Mr. HANCOCK. May I ask you one question right there?

Dr. GOLDENWEISER. Yes.

Mr. HANCOCK. Do I understand that your suggested amendment to the act, as proposed by Governor Eccles, and discussed by him, that is, the open-market committee of the governors, would have any authority as far as formulating the policies is concerned?

Dr. GOLDENWEISER. The committee of the governors would be a consultative committee——

Mr. HANCOCK. In my understanding, from what he said, was that, under his amendment, this committee would be an advisory committee?

Dr. GOLDENWEISER. It would have no powers, other than to make recommendations to the Board. However, the Board would, under

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that amendment be required to obtain that advice before it took action, either open market or——

Mr. Hancock. And they would obtain advice on a policy which they had formulated, rather to receive, in the first instance, a policy formulated by the committee; is not that correct?

Dr. Goldenweiser. That is correct, except there is nothing to prevent that committee from recommending policies, if it chooses. It has no power to initiate them, but it has the power of recommendation and——

Mr. Hollister. It has not any power at all?

Dr. Goldenweiser. The power of recommendation is the power that anyone may have to suggest something, but it has no statutory power other than to make recommendations.

Mr. Hollister. There is no power except the power of suggestion?

Dr. Goldenweiser. That is right. I would like, on the subject of open-market operations, to say one or two other things in line with what the chairman mentioned, their mechanics.

We have had this system operating in the open market on a considerable scale for 13 or 14 years. When the system was first organized, it met the war emergency, and that was merely a matter of supporting the Government, and it was a matter of discounting paper secured by Government obligations in order to enable the Government to finance its war needs.

After the early period and after the liquidation of 1920 and 1921, the Federal Reserve banks found themselves with a very small volume of earning assets. There was in the market a large amount of Government securities, and so, quite naturally, in 1922, the Federal Reserve banks began to buy Government securities for the purpose of having enough earning assets to meet their expenses. That did not last very many weeks before it began to cause difficulties for this reason: That the market for Government securities and all securities, essentially, is in New York. So that when the Federal Reserve Bank of Kansas City—I am using that as an example—would, for instance, want to buy $10,000,000 of securities in the New York market, what it would do would be to draw a check in favor of a New York broker, the New York broker would deposit the check in a New York bank, and the New York bank would then get that much more gold through the gold settlement fund, put it to its account at the New York Federal Reserve Bank, and this bank would use that balance to extinguish that much of its indebtedness.

So that the consequence of the banks in the interior buying Government securities was to reduce the earning assets of the New York Federal Reserve Bank which was not, of course, particularly pleasing to the Federal Reserve Bank of New York, and which did not change the total earning assets of the Federal Reserve System. So that one bank would be increasing its holdings at the expense of another bank, and the aggregate earning assets would remain constant.

Furthermore, these purchases by the banks, the uncoordinated 12 Federal Reserve banks, were creating considerable disturbance in the Government bond market, and Parker Gilbert, who was Under Secretary at that time, was disturbed about that. It was not long before it was decided that open-market operations must be coordinated.

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A committee of five Governors was appointed to coordinate those purchases. That committee, with rather narrow and limited purposes, one of which was to see that purchases do not unduly upset the Government bond market, functioned for about a year, and during that time the Federal Reserve System did a lot of hard thinking and saw a lot of things developing with which they had not had experience before. They noted that the purchases of Government securities resulted in decreased discounts and in no increase in the total earning assets of the Federal Reserve banks. The Federal Reserve Board suggested in the spring of 1923, and it was agreed, to reorganize the committee, and to create a Federal Reserve System Open Market Investment Committee, which would have the duty to make recommendations in regard to open-market policies; and at that time, the policy was established that those purchases should not be made with a view to earnings because the Federal Reserve System could not afford, and the country could not afford to have the Federal Reserve System run with the view to maintaining its earning capacity.

The Federal Reserve System's duties are entirely different; they relate to monetary control, and it is not their business to worry about earnings; they have to disregard them as a principle of their operation.

Now, in 1923, this open-market committee that was set up established the principle that the open-market policy should be on the same principle as the discount-rate policy, which at that time was the phrase which I referred to before, the accommodation of commerce and business, and with refernce to the general credit situation.

This language clearly had in mind the exercise of the right kind of influence on the business situation. The fact that they meant that is entirely clear from the kind of information on which decisions were based.

From 1923 and until 1930 or so, that committee functioned, and during that period the Federal Reserve engaged in a large volume of open-market operations. Those operations were undertaken in the light of information, in the collection and compilation and organization of which the Federal Reserve System had been the pioneer, and had collected the kind of information which had not been available anywhere before. That information was along lines of keeping track of the physical volume of industrial production, the movement of goods through the channels of trade to consumers, the movement of imports and exports, employment, pay rolls, commodity prices, retail prices, stock-market securities; all of those factors, in addition to changes in deposits and loans and investments, and the different kinds of loans and investments of the different banks, and also foreign exchanges and gold movements.

In other words, the Federal Reserve System based its decisions in open-market policies on a whole array of economic factors that were available, and that were made available by the efforts of the Federal Reserve System, to serve as a basis for these decisions.

The sort of information that the Federal Reserve System uses is indicated in this book of charts, of which every member of the Federal Reserve Board always has one on his desk, and which covers the subjects that I have just enumerated.

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Federal Reserve Bank of St. Louis

The reason I bring that out is to show that the policies and objectives and ideas, which are now incorporated in the objective that Governor Eccles proposed, are the same policies, the same objectives, and based on the same general factual material as that which has been gradually evolved in the Federal Reserve System through actual experience. In the securing of this information, the Federal Reserve System has played a pioneering part.

This committee functioned from 1923 to about 1930, and then in 1930 it was decided to modify it by including all of the governors of the Federal Reserve banks rather than just five. Instead of having a committee of five representing the governors' conference, it was decided that the matter was of sufficient importance, and one the repercussions of which were felt throughout the country sufficiently, so it would be desirable for the committee to bring together all of the governors into a committee called the "Open Market Policy Conference"; and that is the committee which, in the Banking Act of 1933 was made a statutory committee, under a somewhat changed name, "Federal Open Market Committee", a committee of 12 governors.

It does not say, in the law, that they have to be Governors, but it says they have to be representatives of the Federal Reserve banks. But, as a matter of fact, the Governors were selected.

When we speak about the period from 1923, say, to 1933, during which the Open Market Committee functioned, first, as a voluntary, and later as a statutory committee, I should like to say to you that the Federal Reserve System did pioneering work not only in obtaining the information and working out the relationships between these different economic factors in the situation—it did pioneering work also in the magnitude and boldness of its operations.

There has never been a banking system that did more in the way of carrying out the objectives which it is now proposed to write into the act than the Federal Reserve System did during that period.

The purchases which they engaged in, in 1924, were on a large scale partly for the purpose of moderating the business recession, but partly for the purpose of helping the establishment of stable money conditions throughout the world.

The same thing was done in 1927. Then, in 1928, when speculative expansion was so great that the Federal Reserve System proceeded to a policy of restraint through discount rates and open-market operations on a larger scale than had been done before. When business broke in 1929, the Federal Reserve System stepped in and bought a large volume of securities—not large in the sense we have gotten accustomed to thinking of now, but large in the light of what appeared in 1929 to be large—then in 1930, they bought $100,000,000 or more of securities, but they did not proceed as vigorously as may now seem to have been desired in the light of subsequent developments.

In 1931, the world went through a terrible contortion, with first one country and then another being subjected to runs, and, finally, in the autumn, England went off the gold standard. At that time, the United States lost, in a matter of 6 weeks, $700,000,000 of gold.

We had very large foreign balances in this country which were subject to withdrawal on demand; and the Federal Reserve System,

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Federal Reserve Bank of St. Louis

in order to protect itself against continuous drains, followed the orthodox practice of raising its rates, and holding them at a higher level. It seems, in retrospect, that those rates were kept high longer than was desirable, and that is particularly true of the bill rates, which were held above the market rates for 3 or 4 months, during which time there was a rapid run-off of bills.

This should be viewed, however, in the light of the fact that, at that time, we still had a very large volume of foreign obligations subject to withdrawal on demand, and that the legislation under which the Federal Reserve System was functioning was such that the amount of gold, free gold, was beginning to be low. I would like to discuss that matter of free gold a little more, in connection with collateral requirements.

However, when the Glass-Steagall Act was passed, on February 27, 1932, and the Federal Reserve System's gold became available, the system began open-market operations on a scale that is very impressive. First, they decided to purchase securities for awhile at a rate of $25,000,000 a week, and then at a rate of $100,000,000 a week, so that the system's holdings of open-market securities increased from $750,000,000 to $1,850,000,000 in the course of a few months and they were held steady at that, except for seasonal fluctuations; and then, in 1933 they purchased another $600,000,000, so their total holdings now are more than $2,400,000,000. The chart shows this.

The reason I am emphasizing those facts is that I am a little restive under the wide-spread allegation that the Federal Reserve System sat supine and did nothing to combat the forces of the depression. It may be that the Federal Reserve System did not know, in 1929 and 1930 and 1931, as much of the magnitude of the catastrophe that the world was facing as it knows today; it may be that they did not have adequate information; and it is also unquestionably true that the system did not have the necessary legal authority which it has since acquired and which is going to be further increased, if this bill becomes a law. But in considering all of that——

Mr. GOLDSBOROUGH. And they did not ask for any increase of authority. They did not show any knowledge that any increase in authority was necessary.

Dr. GOLDENWEISER. Not until the early months of 1932, when they asked for the Glass-Steagall Act.

Mr. GOLDSBOROUGH. Up until 1932, we were told by the Secretary of the Treasury and the Governors of the Federal Reserve Board that they were doing everything that could be done by the Federal Reserve System.

Dr. GOLDENWEISER. Yes; and I think——

Mr. GOLDSBOROUGH. And they insisted that we stay on a rigid gold standard and no expansion should take place, and if it did, the country would go off like Germany. There was nothing indicated whatever that there was any vision on the part of the Secretary of the Treasury's office, or the Governors of the Federal Reserve Board, as to what was going on in the world, at all.

Dr. GOLDENWEISER. I do not wish to contradict that, but all I wish to say is——

Mr. GOLDSBOROUGH. No; but you did contradict it a few moments ago.

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Federal Reserve Bank of St. Louis

Dr. GOLDENWEISER. No; excuse me. I did not contradict it. I simply said it is a record of a great many things having been done; and as soon as it obtained, under the Glass-Steagall Act, the authority to release our gold, the Federal Reserve System engaged in open-market operations on an exceedingly large scale.

Mr. GOLDSBOROUGH. I will tell you what this committee, or a great part of it, thinks about the open-market operations that took place: This committee thinks that the Federal Reserve System did not want the Goldsborough bill passed, and for that reason it started only buying $25,000,000 a week, and they proceeded; and when the bill was about to pass the House, to increase the purchases, they did buy $100,000,000 a week, in order to indicate that this legislation was not necessary. We were told, time and time again, it was not necessary; and then just as soon as the Glass substitute to the Goldsborough bills was adopted by the Senate, the purchases were immediately stopped. It looked as if the purchases were tactical, instead of being economical.

Dr. GOLDENWEISER. I think, Mr. Goldsborough, that is a matter of opinion. My opinion is that you are all wrong about that; that there was nothing tactical in these purchases. I was in the Federal Reserve System in the fall of 1931, and in January and February 1932, when the question of the possibility of purchasing and relieving the situation was constantly under discussion, and when we were running up against the difficulty of the shortage of gold, and we went to Congress and got the authority and purchased $1,100,000,000 of Government securities in 6 months.

I think that this did represent economic convictions. The Glass-Steagall Act was passed on February 27, 1932, and after that the purchases were $1,100,000,000, and the Banking Act of 1933 was not passed until a year later.

Mr. GOLDSBOROUGH. I want you to understand that what I said is not intended as a criticism of you.

Dr. GOLDENWEISER. I understand that it is not personal, of course.

Mr. GOLDSBOROUGH. You were not engaged in formulating the policies of the Federal Reserve System, so it is no criticism of you.

Dr. GOLDENWEISER. I did not assume that. I think it simply is not the correct interpretation of the facts of the Federal Reserve System. If you have, on the subject, information that is not available to me, that is where the matter has to rest.

Mr. GOLDSBOROUGH. We have information given by the Secretary of the Treasury and the Governor of the Federal Reserve Board, who took the position that we should do absolutely nothing but allow conditions to remain the same and worry through the situation. That is what we were told.

Dr. GOLDENWEISER. I would like to say a few words, Mr. Chairman, on the matter of eligibliity. I know——

The CHAIRMAN. In that connection, I wish you would define to the committee what paper is eligible under the present law, so we may have a clearer idea of what we have been operating under heretofore and what would be involved in the change contemplated in the bill now under consideration.

Dr. GOLDENWEISER. Yes; Mr. Chairman.

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Mr. HOLLISTER. Just one question before we leave the open-market operations.

Dr. GOLDENWEISER. Yes.

Mr. HOLLISTER. Now, if the acquisition by the Federal Reserve banks of Government obligations are directly from the Government, would that be a part of the open-market operations?

Dr. GOLDENWEISER. That comes under section 14 of the Federal Reserve Act, which is the open-market section.

Mr. HOLLISTER. What I am getting at is this: In the event that this bill becomes a law, so that the various Federal Reserve banks may be compelled to enter the open-market operation, may they then be compelled, against their will, to continue buying Government obligations directly from the Government—if not in the open-market—but directly from the Government?

Dr. GOLDENWEISER. I am not a lawyer.

Mr. HOLLISTER. I think that is a very natural thing which the committee ought to know.

Dr. GOLDENWEISER. Yes; and perhaps it would be better if you asked the counsel of the Board that question. As a matter of fact, that is a question which we have not discussed or considered at all.

Mr. HOLLISTER. That is very material—I mean the opinion that some of us have of this power, that it might be used by the Administrative Control Board to compel banks, very much against their will, to put their resources back to the continuous acquisition of Government bonds, even though it were clear that the Government had gone far beyond the necessity of demands of the case in issuing bonds.

Mr. WYATT. I am not prepared to render a definite opinion on this question, because it is something I have not thought about. The question was not raised or discussed while the bill was being drafted; but my off-hand view is that, under the bill as introduced, the Open-Market Committee could not compel the Federal Reserve banks to purchase bonds directly from the Government, because the committee is only given power over open-market operations.

Mr. HOLLISTER. You would not consider that open market then?

Mr. WYATT. Off hand, I would not say so; but I would like to call your attention to the fact that, under the Thomas amendment, there is already a specific provision for the direct purchase of $3,000,000,000 of Government bonds by the Federal Reserve banks from the Treasury. Moreover, the Thomas amendment provides means of coercing the banks to do so.

Mr. HOLLISTER. Yes; I know that.

Dr. GOLDENWEISER. Of course, Mr. Hollister, it is true that the Federal Reserve banks buy Government securities directly from the Government.

Mr. HOLLISTER. I realize that; but they are not compelled to, at the present time, however.

Dr. GOLDENWEISER. No; but they have authority, and usually they are short-term day-to-day certificates.

Mr. HOLLISTER. I understand that, but what worries me is the compulsory end of it.

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Dr. GOLDENWEISER. I say the power of purchase does exist at this time, under the authority of section 14, which is the open-operation section, so that would be a question of legal interpretation.

Mr. HOLLISTER. In other words, if they are proceeding under any vague authorization whatsoever today, if they are not exceeding their powers in acquiring Government obligations, then the same provision of the law which says they are not exceeding those powers also makes it compulsory on them, in the future, to acquire Government securities, in the event that the Federal Reserve Board orders them to?

Dr. GOLDENWEISER. Yes; that would be my opinion, and I should think it would make very little difference, Mr. Hollister, whether they bought directly from the Treasury, or whether the Treasury first had to go through the form of selling them to some individual or some bank before passing them on to the Federal Reserve bank. The fundamental question you are interested in would not be really affected by it, substantially.

Mr. HOLLISTER. Except as a question of amount—I mean the open market might not provide the amounts and they would be compelled to take directly from the Government.

Dr. GOLDENWEISER. There are enormous amounts on the market, you know.

The CHAIRMAN. Before you leave that, the purchases shown by the chart you have just shown the committee, do not represent action directly as a matter of Government policy, but they represent the independent action of the different banks who are free to do as they please, and buy where they please. and decline to buy where they do not please?

Dr. GOLDENWEISER. I am very glad you brought that question up, Mr. Chairman, because I think——

Mr. SPENCE. A little louder.

Dr. GOLDENWEISER. I do not think that is an accurate statement, Mr. Chairman, because they did work through the open-market committee.

The CHAIRMAN. As long as they wanted to?

Dr. GOLDENWEISER. And the purchases were through the open-market committee.

The CHAIRMAN. I am not interested in how the purchases were made. My inquiry was this: Whether or not the purchases made by the banks represented the free action of the banks, or whether they represented the actions carried out as governmental policy?

Dr. GOLDENWEISER. I cannot answer that "yes" or "no."

The CHAIRMAN. The record is quite complete to the effect that the banks were free to act as they pleased.

Dr. GOLDENWEISER. Yes; that is correct; but I would like to add the statement that, while they had freedom to buy or not to buy, they agreed to act jointly through the open-market policy conference.

The CHAIRMAN. That is the very thing I am talking about. They agreed, and what they did represented an agreement on their part, but none of it was necessarily the result of governmental policy?

Dr. GOLDENWEISER. None of it was; no.

The CHAIRMAN. Nor did any governmental authorities have the power to direct and compel these actions?

Dr. GOLDENWEISER. None of it was compulsory.

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The CHAIRMAN. And they opposed any move for governmental authority to require such action?

Dr. GOLDENWEISER. That is probably true, also.

The CHAIRMAN. I think the record will show that.

Dr. GOLDENWEISER. But the fact is, also, that the Federal Reserve Board, especially the governors of the Federal Reserve Board, were in constant touch with the members of the open-market committee, and the policies pursued were agreed upon by all of the participants.

The CHAIRMAN. This would, of course, be true—and I did not, of course, intend to invite you into a question of policy, but this is necessarily true, also, is it not: That, insofar as it affects general conditions, in putting into effect a particular policy of the Federal Reserve banks, the psychological effect would enter into the calculation, as well as the actual transaction?

Dr. GOLDENWEISER. That is correct.

The CHAIRMAN. And such effect would be quite different in the case of action by banks in their independent capacity, which represented simply the purposes of the banks, one at a time, putting in effect their own judgment, and what it would be if the action taken were known to the world to be the expression of policy on the part of the Government, which would be followed up consistently?

Dr. GOLDENWEISER. I think that is correct; absolutely. By " Government " you mean the Federal Reserve Board?

The CHAIRMAN. Oh, yes.

Dr. GOLDENWEISER. I think perhaps it is important to make the distinction.

The CHAIRMAN. Of course, I mean that, because that is the only authority at the time that could do it.

Dr. GOLDENWEISER. I think I have said——

The CHAIRMAN. I suggested that you define eligible paper under the existing law, so we may have in this record a clear definition of it, and thereby be enabled to know what we are doing by the changes involved in this bill.

Dr. GOLDENWEISER. The definition of eligible paper is a complex matter; it covers many pages of law and many pages of regulations, but I should like to have the privilege of reading a paragraph or two of an article that discusses that subject, which appeared in the Bulletin of July 1930, and, if the chairman pleases, I should like to insert these three or four pages into the record.

The CHAIRMAN. That is taken out of the law?

Dr. GOLDENWEISER. That is taken out of the Bulletin—the Federal Reserve Bulletin—and it is stated in terms understandable to the ordinary business man.

The CHAIRMAN. In other words, this will embody the information that I suggested?

Dr. GOLDENWEISER. I would like, however, if you wish, at this time, to read a paragraph of it.

The CHAIRMAN. Certainly.

Dr. GOLDENWEISER (reading):

Eligible paper is a term applied to credit instruments that are eligible for discount at the Federal Reserve banks under the terms of the Federal Reserve Act and the rulings of the Federal Reserve Board. The general principles of eligibility are clearly defined by the act and the rulings, but their application in particular cases is not always a simple matter.

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In view of the fact that the Federal Reserve System was established for the purpose, among others, of creating an agency from which member banks can obtain credit for seasonal or emergency needs, the Federal Reserve Act provides in a general way that so-called "commercial paper" be eligible for discount with the Reserve banks.

The CHAIRMAN. I suggest you read all of it.

Dr. GOLDENWEISER (continuing reading):

Paper created in the process of financing the flow of commodities in production and trade arises out of loans that are ordinarily liquidated by the borrower with funds received in the natural course of events from the sale of goods underlying the transaction. In the majority of cases the rules and regulations relating to eligibility are consequently devoted to defining eligible paper by reference to the nature of the underlying transactions. The first question to ask, therefore, in the process of testing any piece of paper for eligibility, is: Did it arise from, or are the proceeds to be used for, the proper sort of transaction? Other questions, which are equally essential but comparatively easy to determine, are as follows: Is the maturity within the law and regulations? Does the paper meet the physical formalities prescribed? Has the legal limit of the aggregate of paper rediscountable for the particular obligor been reached?

In order to be eligible, paper must arise out of a transaction related to an agricultural, industrial, or commercial purpose; the paper must have been drawn or the proceeds used for producing, purchasing, carrying, or marketing goods. Paper is not eligible if the proceeds are used to finance fixed investments of any kind, or any investments of a purely speculative character, or carrying or trading in stocks and bonds except obligations of the United States, or to finance relending operations except relending by cooperative marketing associations and factors.

Because of the longer maturities for which agricultural paper may be rediscounted, it needs to be distinguished from other eligible paper. Agricultural paper arises out of activities of growers in connection with production, marketing, and carrying of agricultural products, including the breeding, raising, fattening, or marketing of livestock. In classifying paper, the purpose of original negotiation is determining throughout its life.

Some special points should be kept in mind with relation to bankers' acceptances. In respect to this type of paper, the law and regulations are somewhat more specific as to the purpose of negotiation or nature of transaction.

Purposes specifically enumerated are shipment of goods, including export and import, storage of readily marketable staples, and the creation of dollar exchange.

Eligibility versus acceptability.—The Federal Reserve Act, the regulations of the Federal Reserve Board, and the rulings of the Board define the tests that paper must meet in order to be eligible for rediscount. The Federal Reserve banks must observe these tests when taking paper, but to them is left the matter of passing on the desirability of paper from a credit standpoint. Paper may meet the technical tests of eligibility and yet fail to meet the credit requirements of any particular Federal Reserve bank. Moreover, each Federal Reserve bank is charged by the act in extending accommodation to any particular member bank to have "due regard for the claims and demands of other member banks."

Member bank collateral notes.—Member banks, in addition to raising funds from Federal Reserve banks by rediscounting, may borrow for 15 days on their own notes secured by obligations of the United States or for 90 days on notes secured by paper eligible for rediscount.

Indeed, more use has been made in recent years of this method of borrowing than of rediscounting; on December 31, 1929, for example, member banks were borrowing at the reserve banks $454,000,000 on their collateral notes, and their rediscounts at the reserve banks amounted to $193,000,000.

Summary tabulation.—The following pages give a tabular array of the chief points that need to be taken into consideration in testing any particular piece of paper as to its eligibility for rediscount. There are also included, by way of illustration, digests of rulings in connection with the eligibility of paper arising out of specific transactions.

These are the principles, and then the article proceeds to tabulate the kind of cases that come under these rules.

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The CHAIRMAN. I suggest you insert that in your statement.

Dr. GOLDENWEISER. Yes.

(The matter referred to is as follows:)

SUMMARY OF ELIGIBILITY REQUIREMENTS FOR REDISCOUNT AT FEDERAL RESERVE BANKS, JULY 30

[Excerpt from Federal Reserve Bulletin for July 1930, pp. 401–406]

What nature of transactions give rise to notes, drafts, and bills of exchange eligible for rediscount at a Federal Reserve bank?

Eligible paper arises if drawn for or proceeds used for producing, purchasing, carrying, marketing goods in agriculture, industry, or commerce.[1]

Ineligible pape arises if drawn for or proceeds used for fixed investments or capital purposes of any kind;[2] relending[3] except for agricultural purposes by a coperative association[4] or by a factor exclusively to producers of agricultural products in their raw state:[5] investments of a purely speculative character;[6] carrying or trading in stocks and bonds except obligations of the United States.[7]

Specific transactions giving rise to eligible and ineligible paper according to published rulings of the Federal Reserve Board:

ELIGIBLE PAPER

Given by owner to contractor in actual payment for material and services.[8]

Given by motor transport corporation to the seller of trucks.[9]

Given by farmer for tractor—agricultural paper on the ground that a tractor is used for a current agricultural purpose.[10]

Given by farmer—proceeds to be used for draining farm lands when drainage is incidental to cultivation.[11]

Given by water works company—the proceeds of which to be used for pay roll, purchases of coal, etc., if statement of borrower shows excess of quick assets over current liabilities.[13]

Drawn by factor the proceeds used for making advances exclusively to producers of staple agricultural products in their raw state (maturities up to 90 days.)[15]

Given by agricultural cooperative marketing associations (with maturities up to 9 months), when the pro-

INELIGIBLE PAPER

Investment paper

Made by owner—proceeds of which to be used by owner to pay for work of developing or building.[8]

Made by motor transport corporation—proceeds to be used for purchase of trucks.[9]

Given by farmer for purchase of silo.[12]

Given by public-service corporation, if cannot be liquidated within a short time out of current earnings.[14]

Relending or finance paper

Drawn by a finance company to finance another.[16]

Given by Federal land bank or joint-stock land bank, secured by farm loan bonds—proceeds used for relending.[18]

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[1] P. 226 (act, sec. 13); p. 129 (Reg. A, sec. I (b)); p. 130 (Reg. A, sec. II (a)).
[2] P. 227 (act, sec. 13); p. 130 (Reg. A, sec. II (c)).
[3] P. 130 (Reg. A, sec. II (b)).
[4] P. 232 (act, sec. 13a); p. 133 (Reg. A, sec. VI (b)).
[5] P. 226 (act, sec. 13); p. 129 (Reg. A, sec. I (b)); p. 134 (Reg. A, sec. VIII).
[6] P. 130 (Reg. A, sec. II (d)).
[7] P. 227 (act. sec. 13—see also act of June 17, 1929; p. 129 (Reg. A, sec. I (c)).
[8] P. 40 (ruling no. 331).
[9] P. 44 (ruling no. 501).
[10] P. 32 (ruling no. 211).
[11] P. 33 (ruling no. 214).
[12] P. 44 (ruling no. 500).
[13] P. 37 (ruling no. 314).
[14] P. 37 (ruling no. 318).
[15] P. 226 (act, sec. 13); p. 129 (Reg. A, sec. I (b)); p. 134 (Reg. A, sec. VIII).
[16] P. 38 (ruling no. 324).
[18] P. 39 (ruling no. 330).

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ceeds are to be advanced by the association to any of its members for an agricultural purpose.[17]

Made by a manufacturer of pig iron secured by pig iron already manufactured, held waiting delivery under contract of sale. The sale has been made and the carrying of the material is not for speculative purposes.[19]

Paper drawn for investments of a purely speculative character

Note, proceeds of which are used for holding grain for a higher price.[20]

AGRICULTURAL OR COMMERCIAL PAPER

Agricultural or livestock and eligible

Given by a farmer for purchase of agricultural implements (replaceable in a comparatively short time).[21]

Drawn by a dealer on farmer in payment for agricultural implements.[21]

Given by farmer to an irrigation company for water used for crops.[24]

Given by a farmer to raise funds for fattening cattle.[25]

Made by farmer in payment for mules.[27]

Made by agricultural cooperative marketing associations for the purpose of obtaining funds with which to make payments to members, or to finance marketing of agricultural products.[28]

Commercial and eligible

Given by a dealer for agricultural implements to resell to a farmer.[22]

Given to a farmer in payment for agricultural products grown by him.[23]

Given by an irrigation company, in its business of furnishing water to farmers.[24]

Given by a packing company—the proceeds used to purchase livestock.[26]

Made by mule and cattle dealer.[27]

Covering such food products as butter, cheese, eggs, poultry, frozen fish in cold storage under negotiable warehouse receipts.[29]

WHAT MATURITY MAY REDISCOUNTABLE PAPER HAVE?

Ninety days in general, including factors' paper created to make advances to certain agricultural producers.[30]

Nine months in case of agricultural paper including livestock paper.[31]

Indefinite maturities are ineligible except for sight bills which grow out of the domestic shipment or exportation of nonperishable, readily marketable agricultural or other staples and secured by shipping documents. Such bills may not be held for the account of a Federal Reserve bank for more than 90 days.[32]

HOW MUCH PAPER OF ONE BORROWER MAY BE REDISCOUNTED BY A MEMBER BANK WITH A RESERVE BANK?

An amount not in excess of that which may be loaned by a national bank to one person; i. e., 10 percent of such bank's capital and surplus subject to a number of important exceptions.[33]

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[17] P. 232 (act, sec. 13a); p. 133 (Reg. A, sec. VI (b)).
[19] P. 35 (ruling no. 302).
[20] P. 36 (ruling no. 312).
[21] P. 31 (ruling no. 204).
[22] P. 33 (ruling no. 215).
[23] P. 27 (ruling no. 100).
[24] P. 40 (ruling no. 333).
[25] P. 32 (ruling no. 208).
[26] P. 32 (ruling no. 209).
[27] P. 31 (ruling no. 203).
[28] P. 232 (act, sec. 13a); p. 133 (Reg. A, sec. VI (b)).
[29] P. 38 (ruling no. 321).
[30] P. 227 (act, sec. 13); p. 129 (Reg. A, sec. I (a)).
[31] P. 231 (act, sec. 13a); p. 129 (Reg. A, sec. I (a)).
[32] P. 227 (act, sec. 13); p. 129 (Reg. A, sec. I (a)); p. 134 (Reg. A, sec. VII; see also amendment of May 29, 1928.
[33] P. 227 (act, sec. 13)—see also amendment of sec. 13 by act of Apr. 12, 1930; p. 352 (sec. 5200 of U. S. R. S.).

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WHAT TECHNICAL FORMALITIES MUST THE PAPER MEET?

Must be promissory note, draft, or bill of exchange, including bankers' and trade acceptances.[34]

Must be negotiable.[35]

Must be endorsed by a member bank.[36]

The name of one of the parties to underlying transaction must appear upon it as majer, drawer, acceptor, or endorser.[37]

May be secured by the pledge of goods or collateral of any nature, provided the paper is otherwise eligible.[38]

WHAT PHYSICAL EVIDENCE OF ELIGIBILITY MUST BE SUPPLIED BY DISCOUNTING MEMBER BANK?

Application for discount must certify—

Member bank's belief in eligibility.[39]

Paper, not acquired from nonmember bank, unless member has permission to rediscount for nonmember banks.[39]

If offering bank is a State bank, that borrower is not obligated for more than he could be to a similar national bank.[40]

If paper is a promissory note, whether a financial statement of borrower is on file. A Federal Reserve bank may in any case require the financial statement of the borrower to be filed with it. Such statement must be on file if the note was discounted for a nonmember bank or a nondepositor, and in all other cases unless secured by warehouse receipt, prior lien on livestock, or obligations of the United States; or the aggregate obligations of borrower offered for discount is less than 10 percent of capital of bank and is less than $5,000.[41]

A draft, bill of exchange, or acceptance should be drawn so as to evidence the character of the underlying transaction. A stamp or certificate may accomplish this.[42]

BANKERS' ACCEPTANCES

(Certain respects in which the law and the regulations governing eligibility are more specific with reference to bankers' acceptances than with reference to other types of paper are detailed below.)

Nature of transactions giving rise to eligible acceptances:

Shipment of goods in foreign trade, including shipments between two foreign countries.

Shipment of goods within the United States—shipping documents must be attached at time of acceptance.

Storage in the United States or in any foreign country of readily marketable staples, must be secured at time of acceptance by warehouse receipt and acceptor must be secured through life of acceptance.

Creation of dollar exchange.[43]

Maturity of eligibile acceptances: Ninety days in general,[44] 6 months, if drawn for agricultural purposes and if secured at time of acceptance by warehouse receipts covering readily marketable staples;[44] 3 months if arising from the creation of dollar exchange.[45]

Aggregate of acceptances of one customer rediscountable for a particular member bank: Ten percent of capital and surplus of accepting bank, unless acceptance is secured throughout life by documents growing out of same transaction.[46]

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[34] P. 226 (act, sec. 13); p. 228 (act, sec. 13).
[35] P. 130 (Reg. A, sec. II (a)).
[36] P. 226 (act, sec. 13); p. 231 (act, sec. 13a); p. 129 (Reg. A, sec. (e)).
[37] P. 130 (Reg. A, sec. II (a)).
[38] P. 130 (Reg. A, sec. II (e)).
[39] P. 131 (Reg. A, sec. III)).
[40] P. 217 (act, sec. 9); p. 131 (Reg. A, sec. III).
[41] P. 131 (Reg. A, sec. IV (b)).
[42] P. 132 (Reg. A, sec. V (b)); p. 137 (Reg. A, sec. XIII).
[43] P. 135 (Reg. A, sec. XI).
[44] P. 228 (act, sec. 13); p. 137 (Reg. A, sec. XII).
[45] P. 230 (act, sec. 13); p. 137 (Reg. A, sec. XI).
[46] P. 136 (Reg. A, sec. XI).

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DEFINITIONS

NOTE.—Unconditional promise, in writing, signed by the maker, to pay in the United States, at a fixed or determinable future time, a sum certain in dollars to order or to bearer.[47]

Draft or bill of exchange.—Unconditional order, in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.[48]

Trade accepance.—A draft or bill of exchange, drawn by the seller on the purchaser of goods sold, and accepted by such purchaser.[48]

Bankers' acceptance.—A draft or bill of exchange, whether payable in the United States or abroad and whether payable in dollars or some other money, of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits.[49]

Agricultural paper.—Note, draft, or bill of exchange issued or drawn, or the proceeds of which have been or are to be used for agricultural purposes, including the production of agricultural products, the marketing of agricultural products by the growers thereof, or the carrying of agricultural products by the growers thereof pending orderly marketing, and the breeding, raising, fattening, or marketing of livestock.[50]

Goods.—Include goods, wares, merchandise, or agricultural products, including livestock.[51]

Readily marketable staple.—An article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (*a*) the price easily and definitely ascertainable and (*b*) the stable itself easy to realize upon by sale at any time.[52]

Rulings have held these to be readily marketable staples.—Cotton yarns, flour, cotton, potatoes, cattle, sugar in bond, wool, coal, cottonseed. These have been held not to be such marketable staples: Automobiles, automobile tires, whisky, or sacramental wine in bond.[53]

NOTES

The foregoing article is based on the Federal Reserve Act and on the rulings and regulations of the Federal Reserve Board as published from time to time in the Federal Reserve Bulletin, and summarized in the so-called "Digest of Rulings" (described on p. 401). The numbered citations refer, except as indicated below, to pages of the digest, with parenthetical reference to the act (by sections), to the regulation (by letter and section), and to the rulings (by number, all numbers cited being those of rulings given in the digest under the general heading XIII–C).

Mr. BROWN of Michigan. You have just mentioned 90-day paper——

Dr. GOLDENWEISER. Yes.

Mr. BROWN of Michigan. There are cases that are running 9 months, at the present time; are they eligible?

Dr. GOLDENWEISER. Yes; but 90 days is the limit on member banks' collateral notes, unless they are renewed. Eligible paper, that is, rediscounted paper, Mr. Brown, may run 9 months for agricultural or livestock paper, but when a bank borrows on its own promissory note, the limit is 90 days.

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[47] P. 131 (Reg. A, sec. IV (a)).
[48] P. 132 (Reg. A, sec. V (a)).
[49] P. 135 (Reg. A, sec. X).
[50] P. 132 (Reg. A, sec. VI (a)).
[51] P. 130 (Reg. A, sec. II (a), footnote).
[52] P. 136 (Reg. A, sec. XI, footnote).
[53] P. 74 (ruling XIII–E, no. 460).

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Federal Reserve Bank of St. Louis

Mr. Brown of Michigan. As far as time is concerned you have your 90-day paper, your 6-months paper, and your 9-months paper, but those are the maximums?

Dr. Goldenweiser. Yes, sir.

Mr. Brown of Michigan. You do limit them to one renewal, do you not?

Dr. Goldenweiser. I think that is a matter of practice. There is no regulation about one renewal. I think that is a matter for the individual bank——

The Chairman. If there is, it never was followed, I do not suppose?

Dr. Goldenweiser. No, sir; there is no absolute rule, Mr. Brown. I do not think I need to say anything about eligibility, except that it has been suggested, in discussing this bill—I do not know whether it is in this room or in the press—that it would result in looseness of operation, or inflationary danger.

I think, myself, that the proposed bill introduces into the Federal Reserve Act, for the first time, the term "sound assets." As the law stands now, eligibility is defined by technical requirements, maturity, the nature of the underlying transactions, and other rigid rules, which the Federal Reserve Board had no authority to disregard in formulating its regulations, and the Federal Reserve banks have no authority to disregard in making their loans or advances to member banks. But there is nothing said in the Federal Reserve Act about the fact that assets must be sound.

Of course, that is something that any bank understands, and I do not mean to imply that the assets that the Federal Reserve banks have acquired were not sound, but I mean to say that the proposed bill substitutes for the rigid technicalities the fundamental principle that the assets must be sound, and beyond that leaves the actual regulations to the Federal Reserve Board, so that they can be adapted to different conditions that prevail in the country, and to different developments that arise at a time when Congress, perhaps, may not be in session.

That is what happened in 1932. We had banks failing very rapidly. There was a large number of banks that did not have eligible paper to present to the Reserve banks. The banks may have had sound assets and the Federal Reserve was unable to help them, and the banks were unable to get help from the Federal Reserve until the emergency bill was passed, which authorized them, under certain restrictions, to obtain relief from the Federal Reserve banks on other than technically eligible paper.

The Chairman. Did not that act employ the language "sound"?

Dr. Goldenweiser. No; it said any security satisfactory to the Federal Reserve banks.

The Chairman. And we even went to the extent of making it a form of emergency relief available to the nonmember banks?

Dr. Goldenweiser. Yes; you did, about a year later——

The Chairman. No; I beg your pardon. It was not a year later.

Dr. Goldenweiser. The Glass-Steagall Act was passed in February 1932, and the other provision was in the Emergency Banking Act passed in March 1933.

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Federal Reserve Bank of St. Louis

The CHAIRMAN. Yes; you are quite correct. What we did was to amend immediately, first, the Federal Reserve Act as to the privilege of obtaining currency.

Dr. GOLDENWEISER. Yes; you did that.

The CHAIRMAN. On Federal Reserve bank notes, and then to extend that privilege to nonmember banks.

Dr. GOLDENWEISER. Yes.

Mr. HANCOCK. In that connection, what is the total amount of discounts held by the Reserve System today, and what are the classes involved?

Dr. GOLDENWEISER. Mr. Hancock, the total discounts of the Federal Reserve, held today, are $6,000,000, and in view of the fact that it is a small figure, I do not know what it consists of.

Mr. HANCOCK. I do not think it is very important.

Dr. GOLDENWEISER. You see, with excess reserves of $2,000,000,000 the banks are not borrowing from the Federal Reserve banks.

The CHAIRMAN. What proportion of the present holdings of the banks is regulated by paper that might be classed as eligible?

Dr. GOLDENWEISER. You mean what is held by the member banks, themselves?

The CHAIRMAN. Yes, sir; that is what I mean.

Dr. GOLDENWEISER. About $2,000,000,000.

The CHAIRMAN. That might be classified as eligible?

Dr. GOLDENWEISER. That is classified as eligible, by their own classification.

The CHAIRMAN. What portion of their investments does that cover?

Dr. GOLDENWEISER. That is about 8 percent.

Mr. HANCOCK. What are the total assets of the Federal Reserve banks today, about $7,500,000?

Dr. GOLDENWEISER. They total $8,700,000,000.

Mr. BROWN of Michigan. Following the chairman's question, it seems to me that we ought to know what changes are contemplated by the addition of the new paragraph at the end of the present section 13, giving power to the Board to establish regulations for the rediscounting of commercial, agricultural, and industrial paper. What can you do under that provision that you cannot already do under the present section 13; what classes of paper will you add?

Dr. GOLDENWEISER. What we will add I do not know. That is a matter for the Board to decide. You questioned Governor Eccles about his opinion on this subject. My opinion would not be worth anything.

Mr. BROWN of Michigan. I am sure this committee thinks it would be.

Dr. GOLDENWEISER. The Federal Reserve Board would have authority to admit as collateral for member bank notes any asset that was sound, whether it was a commercial loan or bond or stock or real estate or farmer's paper, for the purchase of machinery. All of those long-term loans are completely barred, as the law stands today here, but would be made admissible under the new law.

The CHAIRMAN. And all of those same loans, which are now admissible because of their maturity, would also be admissible under the change?

Dr. GOLDENWEISER. Yes, sir.

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Mr. BROWN of Michigan. That does not change the present status any?

The CHAIRMAN. That is what I am talking about.

Mr. BROWN of Michigan. The present statute remains as it is, and there are additional paragraphs giving the Board additional powers to make loans.

Dr. GOLDENWEISER. Mr. Brown, I think that is a matter of draftsmanship, and I think that the proper way to handle that is when this law is actually being drafted by your drafting forces to repeal all of those sections of the law and substitute this one section.

Mr. BROWN of Michigan. Might I say that if every limitation that we have heretofore had as to the time for which paper may be rediscounted is still in the law——

Dr. GOLDENWEISER. But that is repealed, Mr. Brown, by the proposed amendment, but I think it would be more effective to repeal it in so many words.

The CHAIRMAN. Well, the repeal would be conditioned upon the rules and regulations promulgated in order to put the change into effect?

Dr. GOLDENWEISER. That is right.

The CHAIRMAN. Otherwise they would proceed as they do now?

Dr. GOLDENWEISER. That is right.

The CHAIRMAN. That we do not know; but, if I understand the situation right, it is that you will continue to operate just as you are operating now, and if conditions were to improve and business got better and it was no longer deemed necessary to inaugurate new methods of meeting the situation, we might continue to operate as we are; but we are giving authority to liberalize?

Dr. GOLDENWEISER. Yes, sir.

Mr. HANCOCK. Under the present language of the act that we have before us now, as I understand it, you could not—the Federal Reserve System could not rediscount any paper with security longer than 9 months?

Dr. GOLDENWEISER. You mean under the proposed amendment?

Mr. HANCOCK. Yes; that is what I mean.

Dr. GOLDENWEISER. I think you are mistaken about that. I think, under the proposed amendment, the Federal Reserve banks could discount any paper that was sound. Is that not so?

Mr. BROWN of Michigan. I agree with Mr. Hancock to a certain extent. I think the authority is somewhat clouded, unless section 13 was repealed, as Dr. Goldenweiser suggested, in its entirety, and section 206 of the proposed bill substituted for section 13 of the law.

Dr. GOLDENWEISER. The counsel, I believe, has drafted a form by which that will be accomplished, and my personal recommendation would be that it should go into the law, because I know, positively, that it is the intention of the proponents of this bill that it should, in effect, take the place of existing section 13—I mean the parts of it dealing with eligibility.

Mr. BROWN of Michigan. Do you not think that the authority is somewhat clouded if section 13 remains as it now is?

Mr. WYATT. No; I do not think so. I think the broad authority given by the later statute, which would be construed as repealing by implication the restrictions contained in the old law. Certainly, there would be nothing in this statute that would prevent making

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advances on any sound assets. That is distinct from rediscounting. They could make advances on any sound assets, subject only to such regulations as the Board might prescribe. As a matter of fact, that is the way the banks would do it. They prefer to borrow on their own promissory notes secured by collateral, because that is less trouble than rediscounting.

Mr. HANCOCK. Under that language, it seems to me you could make advances on any sound assets for longer than 9 months; whereas if you discounted the paper, you would have to limit it to 9 months.

Mr. WYATT. That is not important, because if this goes through, the chances are that nearly all of the borrowing would be done on a promissory-note basis.

Mr. BROWN of Michigan. But your new section 206 speaks of assets—speaks of discounts as well as advances, and it seems to me there will be some complication between the paragraph we added this bill and the present law. Have you an amendment drafted to take the place of section 206?

Mr. WYATT. Yes. You cannot repeal all of section 13, because there are some other things in that section. What you really have to do in order to repeal the provisions which would be made obsolete by this amendment, is to repeal all of section 10 (a), all of section 10 (b), several paragraphs of section 13, several paragraphs of section 13 (a), and then amend several of the other paragraphs in sections 13 and 13 (a). We have it written out, and it takes 5½ typewritten pages to do it; but we can give it to you, if you want it.

Dr. GOLDENWEISER. Mr. Chairman, there is only one other subject on which I should like to have just a word to say, and that is the proposed repeal of the collateral requirements against the Federal Reserve notes. That is a technical subject and one that has given rise to a good deal of misunderstanding.

I would like to say, in the first place, that there is nothing in this proposed amendment that would, in any way, change the security back of the Federal Reserve notes.

The Federal Reserve bank holds certain assets, and against these assets it has its liabilities, principally the liabilities to the public in the form of notes and deposits.

There is one reservoir of assets and there are two kinds of claims against it. The present law provides that you take that reservoir of assets and pick certain ones out that are made eligible for that specific purpose by law, and put them in another box and call it collateral for Federal Reserve notes, and leave the rest as security against the deposits. All this bill proposes to do is to do away with that separate box and call the entire box of assets security against all of the liabilities. You are not changing the quality of the security in any way, you are simply doing away with an expensive and unnecessary segregation; and since Federal Reserve notes, by the terms of law, are prior liens and continue to be prior liens, they have as security the best part of the assets, so that the note holders would have to be satisfied before the claims of the deposit holders could be satisfied.

There is absolutely nothing in this proposal that changes the quality of Federal Reserve notes in any way whatsoever. It does

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not repeal the reserve requirements; it does not change the quality of the assets back of them; it merely does away with the segregation. I think that very simple point is one that has been very frequently overlooked.

There are just a few more things about this collateral that I would like to say.

Mr. WILLIAMS. Right in that connection, if I may, under the present law, there is a certain part of the assets that are segregated; is that correct?

Dr. GOLDENWEISER. That is correct; yes.

Mr. WILLIAMS. And back of each note issue?

Dr. GOLDENWEISER. No; against all of the notes. They are not earmarked for any particular note issue.

Mr. WILLIAMS. Under this law, do not the banks, in case they need notes, make application to the Federal Reserve agent?

Dr. GOLDENWEISER. Yes.

Mr. WILLIAMS. And offer certain classes of assets, and he receives them, and they are placed in a separate box, as you say, or a separate place, as the paramount security on any notes that are issued at that time?

Dr. GOLDENWEISER. The Federal Reserve agent holds all of the assets that have been pledged with him. The Federal Reserve agent gets collateral for all of the notes that he pays out to the Federal Reserve bank, but I do not think he holds any particular batch against any particular batch of notes.

Mr. WILLIAMS. Is not there also a provision in there which authorizes a bank to take down and substitute other ones for ones which have already been put up?

Dr. GOLDENWEISER. That is right.

Mr. WILLIAMS. And is there not also a further provision which permits the board to require a bank to put up additional security?

Dr. GOLDENWEISER. Yes; all that is correct, but all that applies to the entire collateral that the agent holds against the entire note issue, and not any particular note issue.

Mr. WILLIAMS. I was under the impression it was the other way.

Dr. GOLDENWEISER. Excuse me. That is correct, is it not, Mr. Smead?

Mr. SMEAD. That is correct.

Mr. WILLIAMS. That was not my understanding of the way the language reads.

Dr. GOLDENWEISER. That is the way it has always read, Mr. Williams. For instance, they have never taken a particular batch of Government securities and held them against those particular notes, because it would be almost impossible to do that. If the bank returns notes and wants to have a corresponding amount of collateral released, it asks for the collateral it wants.

Mr. WILLIAMS. In that event, that makes the assets of the bank be prime and paramount lien as to the payment of the notes?

Dr. GOLDENWEISER. They continue to be under the proposed law.

Mr. WILLIAMS. And they are now, and in that respect the law is not changed?

Dr. GOLDENWEISER. That is correct.

Mr. WILLIAMS. In other words, the redemption of the notes would come first, over the depositors of the bank?

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Dr. GOLDENWEISER. Yes.

Mr. WILLIAMS. They are the first paramount liens?

Dr. GOLDENWEISER. Yes; that is right, and that is continued in the law.

Mr. WILLIAMS. Now, while I am asking questions, may I continue on another subject?

Dr. GOLDENWEISER. Yes.

Mr. WILLIAMS. The question of reserves, as I understand, the reserves under the present law, are fixed at a certain percent?

Dr. GOLDENWEISER. Which reserves do you mean, of the member banks?

Mr. WILLIAMS. Yes; depending upon their locality?

Dr. GOLDENWEISER. That is correct.

Mr. WILLIAMS. I also understand that is still left in the law?

Dr. GOLDENWEISER. Yes, sir.

Mr. WILLIAMS. Well, in addition to that, we have this provision in this new law, which gives the Federal Reserve Board complete and entire authority and jurisdiction over the fixing of those reserves?

Dr. GOLDENWEISER. Yes; it gives them authority to change them.

Mr. WILLIAMS. Well, now, if we are going to have that, why not repeal this fixed limitation in the law?

Dr. GOLDENWEISER. I think the theory of that is, Mr. Williams, that the reserves shall not be disturbed, and shall continue as they are, but if there is danger of expansion—I do not remember exactly what the language is—injurious expansion or contraction, and a change becomes desirable, the Federal Reserve Board can act and change it, but otherwise the reserve requirements continue as they are; and the banks must continue to keep their reserves at a certain ratio, unless action is taken by the Federal Reserve Board.

Mr. WILLIAMS. That is the law now, is it not?

Dr. GOLDENWEISER. But at the present time, the Federal Reserve Board has no authority to raise the requirements.

Mr. WILLIAMS. That is in case of emergency?

Dr. GOLDENWEISER. No, sir; they cannot raise them. They may suspend them, but they cannot raise them.

Mr. HANCOCK. You can only do that with the consent of the President?

Dr. GOLDENWEISER. Excuse me. What I meant to say is, that under the original Federal Reserve Act they had no power to change reserve requirements. This particular amendment in the bill does not do anything more than to clarify the section that was in the so-called "Thomas amendment", passed in 1933, which does give the Board, with the President's approval, authority to make the change. I was talking about the original Federal Reserve Act at the moment. This proposed amendment simply clarifies the existing amendment and extends it somewhat.

The CHAIRMAN. What was the language of the Thomas amendment?

Dr. GOLDENWEISER. The language of the Thomas amendment, quoting from memory, is that in case of emergency——

Mr. WYATT. Would you like for me to read it?

The CHAIRMAN. Yes.

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Mr. WYATT. The Thomas amendment added this paragraph to section 19 of the Federal Reserve Act:

Notwithstanding the provisions of this section, the Federal Reserve Board, upon the affirmative vote of not less than five of its members and with the approval of the President, may declare that an emergency exists by reason of credit expansion and may, by regulation during such emergency, increase or decrease from time to time, in its discretion, the reserve balances required to be maintained against either demand or time deposits.

Mr. WILLIAMS. The power is there?

Dr. GOLDENWEISER. That emergency power exists, but it is quite illogically worded, because it says the Board could either increase or decrease the reserve requirements, if an emergency arises because of credit expansion. Now, you would not want to decrease the requirements if an emergency arose from credit expansion, so that, literally, you could never decrease them, because of the way the provision is worded. The bill proposes a clarification and extension of that power, and removes from the President the necessity of approval and the requirements of a vote by five members of the Board.

Mr. WILLIAMS. This simply gives the board power to change when they think it is necessary?

Dr. GOLDENWEISER. That is right, sir.

Mr. WILLIAMS. In order to prevent undue expansion or contraction of currency, to regulate the reserve requirement?

Dr. GOLDENWEISER. That is true.

Mr. HANCOCK. And under the act, it could be done, without declaring such an emergency exists?

Dr. GOLDENWEISER. Without declaring there is an emergency, yes; and it also gives them the power to do that for financial centers, alone, or for the country districts, alone, or for the country as a whole, depending upon the circumstances, which the present amendment does not give.

Mr. WILLIAMS. I just wanted to clear that up in my mind.

Dr. GOLDENWEISER. I was not trying to mislead you for a moment. My mind slipped.

Now, if I may make a few more remarks about the collateral requirements, I would like that to conclude my statement.

I think I made it clear that Federal Reserve notes continue to be prior liens, that there is nothing in the law that, in any way, weakens the Federal Reserve note whatsoever. At the same time, the existence of those collateral requirements is not merely a matter of economy that we are asking you for, although it is economical, but it also has created many complications. The fact that we required that collateral made it necessary to have assistant Federal Reserve agents, or else have a lot of issued notes in the hands of the branches, and that created a lot of difficulty, because nobody could issue notes except the Federal Reserve agent, or his assistant, and you would have a large supply of issued notes and collateral, which would not be necessary, because they were not in the home office where there was an agent, you had to carry them as issued notes, or else you had to have an assistant agent, and have a high corresponding salary, to be on the job in the branch.

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So that it has created a whole lot of unnecessary, purposeless difficulty and expenditures. In addition to that, it has created, sometimes, a very bad situation.

In the early months of 1932, a very large amount of gold had flowed out of the country. The Federal Reserve banks had bought a good many Government securities, because there was an awful deflation going on and it was necessary to keep down the indebtedness of the member banks to the Federal Reserve bank, in order to stop the deflation. And so the eligible paper in the hands of the Reserve banks was relatively small in amount. Since they had to put up against their Federal Reserve notes outstanding enough eligible paper or gold to make up 100 percent, and since the eligible paper was in a small amount, they had to put up a whole lot of gold, with the consequence that, at that time, the Federal Reserve banks, though they had $1,400,000,000 of gold in excess of their reserve requirements of 40 percent against notes, and 35 percent against deposits. had to put up $1,000,000,000 of that $1,400,000,000 as collateral against the Federal Reserve notes, where it could not be gotten out except by selling Government securities, and putting the banks in debt again. And they only had about $400,000,000 of " free gold " available to meet a foreign demand.

A liberal open-market policy could, therefore, not be undertaken until Government securities could be substituted for the eligible paper or gold with the Federal Reserve agent.

So we came to you, gentlemen, and asked you to give us that authority, and that authority was given, and has since been extended, and the President has now extended it for 2 more years.

That is the kind of thing that happened and, in logic, is apt to happen again, because when we want to exercise immediate restraint that is usually the time when the banks are heavily in debt, and going further in debt, and at that time there will be plenty of collateral, so it will not act as a restraining influence at a time when you want to restrain, but at a time when business is going flat and contraction is going on, if you buy Government securities in order to help out the banks, that is the time when you are going to be short of collateral and you find that your collateral requirements will be pinching.

This requirement always works against the interests of the country, and against the interests of the credit policy pursued by the Federal Reserve System. In 1932 we were up against it, with nothing but $400,000,000 available, with $1,000,000,000 or more of foreign short-term bonds in this country that could be withdrawn on demand in gold, when the Federal Reserve System was unable to pursue a policy of monetary ease, which was clearly indicated by all of the elements of the situation. Congress then passed an emergency measure to relieve the situation.

Now, it is requested and proposed that you do away with this obsolete and useless, expensive and dangerous provision altogether.

There is just one other thing I would like to say, and that has not any direct bearing on the collateral, but it has an indirect bearing on it, and that is, the question of demand for currency and the ability of the Federal Reserve banks to issue currency without any collateral, which question has been raised.

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I have gone through the problem of what is back of the notes already, and Governor Eccles has discussed that in some detail, but I would like to make it clear that, in our banking and credit system, currency is the small change of business. Currency is not a big element in our means of payment.

Currency fluctuates in response to certain influences. In normal times, it fluctuates chiefly in response to certain parts of our economy that are still handled by cash payments, principally retail trade and pay rolls.

During a long period there was a trend, gradually, from year to year, for a decline in the amount of currency, because more and more business corporations were adopting the policy of paying their pay rolls by check, partly for the purpose of avoiding hold-ups, and partly because it is more convenient, and the habit of depositing checks was spreading throughout the country.

That particular trend has been reversed recently, because of the tax on checks, because of the service charges, because of the fact that communities are left without banks in many cases. But in general, the level of money, cash money, has remained reasonably steady, except for seasonal fluctuations. Its elasticity is indicated by the fact that it goes up $100,000,000 over the Fourth of July, and goes up again over Labor Day. Whenever people go away from home, they get a little more currency, and currency goes up for a few days, but then goes right down again.

Mr. HANCOCK. It goes up around Christmas time?

Dr. GOLDENWEISER. Yes; but it goes back down again in January. But those are seasonal fluctuations, and the year-to-year fluctuations are relatively minor.

The fluctuating element in our banking system is not cash but deposits. The reason I put it that way is that the elasticity of our currency rests on the habits of the people and the customs of the banking system. No one carries in his pocket more money than is needed for such small cash payments as he is in the habit of making. Possibly he pays for his gasoline in cash, he may pay for his lunch in cash, and carfares, and a few things like that. People are in the habit of keeping in cash a certain amount of money out of their pay checks, and the rest of it they deposit in the banks.

When they deposit it in the banks, the banks do not keep it in their vaults, either, because it is a dead asset in their vaults and involves unnecessary risk from burglars. So they immediately take it to the Federal Reserve bank, where it is added to their reserve and gives them a basis of expansion.

Mr. HANCOCK. How much money is in circulation, in pocket change, so to speak?

Dr. GOLDENWEISER. I could not tell you how much is actually in pocket change, but I think the amount that is outside of the banks, the Treasury, and the Federal Reserve banks is around $5,000,000,000.

Mr. HANCOCK. I mean the amount that is outstanding usually and not in the Federal Reserve or member banks or any bank.

Dr. GOLDENWEISER. About $5,000,000,000. Now, I would like to add this: That is the usual relationship between the seasonal fluctuation in currency, with no sensational changes, and with gradual

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declines occasionally. When the banking system began to crack, all this changed, because people began to want money, cash money, not for change but as a matter of safety. They lost their confidence in banks. There is one other chart here that I should like to show you, if you will bear with me. This shows the amount of money in circulation—and that is a technical term—I mean outside of the Treasury and the Federal Reserve.

Mr. WILLIAMS. Right there I want to ask a question: What do you mean by money in circulation?

Dr. GOLDENWEISER. I mean all of the money issued, outside of the Federal Reserve bank and the Treasury. That does include the banks' money, the money in the vaults of the member banks——

Mr. HANCOCK. You say it does include that?

Dr. GOLDENWEISER. It does include that; yes.

Mr. HANCOCK. And does it deal with money in the nonmember banks?

Dr. GOLDENWEISER. This includes all of the money outside of the Treasury and the Federal Reserve banks. I want to show you—here is 1929, a year of great prosperity, and money in circulation is $4,800,000,000.

Then in 1930 came along a time when the pay rolls went down and prices went down, and currency went down a little in the early part, a little more than seasonal; you can see it was moving below 1929, until about November, when the Bank of the United States in New York and the Bank of Kentucky failed, and hoarding began, and it shot up. That was the first appearance of hoarding on a large scale.

Then in 1931, first we had the seasonal liquidation, and then things continued fairly evenly. Then in the latter part of 1931, when all of these events all over the world were happening—first the run on Germany, then the one on England—and our banks were failing, we had a tremendous increase in hoarding.

Then in 1932 that level was the same, no particular increase in hoarding and no decrease until the middle of the year, and then there was another lot of bank failures in the Chicago district; and it rose again, and stayed at that level. That is the way we ended in 1933.

Then when the panic began, the currency in circulation shot up a couple of weeks by $2,000,000,000, to $7,500,000,000.

Mr. HANCOCK. That was in February?

Dr. GOLDENWEISER. That was in February, toward the very end of February 1933 and early in March.

Mr. HANCOCK. We were experiencing a money boom?

Dr. GOLDENWEISER. Yes; you can call it that if you wish. There was a terrible panic. And then when the President ordered the banks reopened and said that only sound banks would reopen, people's confidence was restored, and as soon as the banking bill was passed and the banks reopened, the people found they could have their money, and they did not want it, and the money came right back in the course of a few months, and we were getting back to the level at the beginning of the panic. But even yet, even right now, in 1935, there is still a whole lot more currency outstanding than there was in 1929, because when money finds its way into hoards,

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being hidden away under mattresses and in tin cans, it is likely to take it some time to come back.

And while those things that Governor Eccles mentioned about service charges, taxes on checks and communities without banks, are all factors in the situation, there is also a very considerable amount of hoarding, because we find that it is the very large denominations that are held out, and large denominations are not used by people in paying their bills.

The CHAIRMAN. I note that your chart makes no reference to postal savings, but postal savings are exclusive of the funds in the banks and in the Treasury?

Dr. GOLDENWEISER. This is exclusive of that; yes. Postal savings also went up.

The CHAIRMAN. How do you classify postal savings?

Dr. GOLDENWEISER. That is just the cash, the currency. This is not the deposits.

The CHAIRMAN. You do not figure the postal savings in this, at all?

Dr. GOLDENWEISER. No, sir; that was another method of protecting themselves, and it went up from $300,000,000 to above $1,000,000,000.

Mr. HANCOCK. I understand it went up to almost $700,000,000. How much money was there in existence at that time?

Dr. GOLDENWEISER. The amount of money in existence does not mean anything, because the reserve banks could print any amount they wanted to. There was any amount printed available to pay out, if there was any demand. The amount of money in existence——

Mr. WILLIAMS. I understood you to say this represented all the money, except what was in the Treasury and the Federal Reserve bank?

Dr. GOLDENWEISER. Yes; but the Federal Reserve bank had many billions of money available in case the panic continued and people wanted more.

Mr. WILLIAMS. But they did not issue it?

Dr. GOLDENWEISER. No, sir.

Mr. WILLIAMS. What I meant was, What was the outstanding issue of money?

Dr. GOLDENWEISER. That is all that was issued, because what is in the Federal Reserve banks and the Treasury is more or less like a book of blank checks; it does not mean anything. The only money that means anything is in your pocket, or money that has been paid out. The money that the Federal Reserve banks have printed is kept in case somebody wants it—it does not become money until it is paid out. The money that was available—I could not give you the exact amount, but it was billions of dollars of cash money that had been printed and was available in case it was needed.

Mr. WILLIAMS. Undoubtedly so, but does that represent all of the money that was issued at that time?

Dr. GOLDENWEISER. I do not quite get your point, Mr. Williams.

Mr. WILLIAMS. I want to know whether it represents all of the money there was?

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Dr. GOLDENWEISER. It represents all of the money that had been paid out; yes.

Mr. WILLIAMS. When it was down here to $5,000,000,000, for instance, where was the balance of that money then?

Dr. GOLDENWEISER. Some of it may not have been printed, and what had been printed was lying in the Treasury or Federal Reserve banks. I get word from the Chief of the Division of Banking Operations that the Federal Reserve banks at that time had $5,000,000,000 of money printed, ready to issue in case the public wanted it. I am trying to explain exactly what the situation was.

Mr. WILLIAMS. I am trying to find out the money that was issued at that time.

Dr. GOLDENWEISER. This is all of the money that was issued at that time.

Mr. WILLIAMS. Does that line represent—whatever it is, whether it is $7,000,000,000 or $5,000,000,000—the amount of money that was issued at that time?

Dr. GOLDENWEISER. That is all of the money that has been issued and has not been retired; yes.

Mr. KOPPLEMANN. If money is put in a country bank, is it retired?

Dr. GOLDENWEISER. Not at that stage; but the country bank is likely to send it to a Federal Reserve bank, and it will then be retired. All the money outside of the Reserve banks and the Treasury is on this chart.

Mr. WILLIAMS. Then it is all on there.

Dr. GOLDENWEISER. All of the money—that is, the actual currency—is in there; yes.

The CHAIRMAN. How much was that?

Dr. GOLDENWEISER. $7,500,000,000.

Mr. WILLIAMS. That represents all of it? I did not have that impression.

Dr. GOLDENWEISER. That is all of it; yes.

Mr. WILLIAMS. What is the low ebb of it?

Dr. GOLDENWEISER. It gets as low as $4,400,000,000.

Mr. WILLIAMS. That represents all of the money that was issued at that time?

Dr. GOLDENWEISER. All of the cash money.

Mr. WILLIAMS. And when it got up to $7,500,000,000 it represented all of the money that was issued at that particular time?

Dr. GOLDENWEISER. Yes.

Mr. FORD. And suppose the Patman bill passes, what would happen to that chart?

Dr. GOLDENWEISER. That chart would not change, except for a very short time. You would pay out $2,000,000,000 of currency, but it would be immediately redeposited in the Federal Reserve banks, and the so-called "money" in circulation would not change. All of that money——

Mr. HOLLISTER. The only change would be in its purchasing value?

Dr. GOLDENWEISER. Well, its purchasing power—it is a complex question whether it would change or not. The only time that money in circulation would be likely to increase very rapidly would be when the people again lose confidence in the banks. That is the only thing that makes it go out.

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Mr. KOPPLEMANN. Then what is the relationship between money and wealth?

Dr. GOLDENWEISER. You mean cash money? If you mean cash money, there is no relationship.

Mr. KOPPLEMANN. No relationship?

Dr. GOLDENWEISER. No relationship whatsoever. Mr. Chairman, that is all I wish to say, on my part, and if you wish to ask questions——

Mr. HANCOCK. On the question Mr. Hollister asked you, it does not follow as a point of logic that the purchasing power of the dollar would be changed, does it?

Dr. GOLDENWEISER. Not necessarily.

Mr. HANCOCK. If funds were released of currency——

Dr. GOLDENWEISER. Not necessarily, unless that action resulted in the people losing confidence in currency, or losing confidence in the Government, in which case the repercussions are very difficult to deal with.

Mr. HANCOCK. The obligations of the Government would be the same?

Dr. GOLDENWEISER. The Government would have outstanding a large amount of non-interest-bearing debt, instead of interest-bearing debt.

Mr. HANCOCK. Which would have to be redeemed at some time?

Dr. GOLDENWESIER. That raises a question of redemption, which at the present time, is in abeyance.

Mr. HANCOCK. Both of which would have to be paid off at some time?

Dr. GOLDENWEISER. Not necessarily.

Mr. HOLLISTER. How are you going to pay off the non-interest-bearing paper, behind which there is nothing?

Mr. HANCOCK. There is only one way you can pay any obligation of the Government, and that is through taxation, is it not?

Dr. GOLDENWEISER. Actually, the Government can reduce its indebtedness by one of three ways, but your answer is really exactly right; the only real way is taxation. Another way is repudiation, and the third way is what I recently more or less facetiously called "evaporation." That is what happened in Germany when they did not repudiate it, and they did not raise taxes, but they made the mark so completely worthless that it just evaporated.

Mr. HANCOCK. I am speaking of honest obligations?

Dr. GOLDENWEISER. Yes; you are right.

Mr. WILLIAMS. What did you call the German system, Doctor?

Dr. GOLDENWEISER. I do not really think it is fit to repeat.

The CHAIRMAN. All right, gentlemen, Mr. Hancock moves that we adjourn.

We thank you very much, Dr. Goldenweiser.

We will meet again tomorrow at 10:30 o'clock.

(Thereupon, a recess was taken in the hearing until 10:30 a. m. Thursday, Mar. 21, 1935.)

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BANKING ACT OF 1935

THURSDAY, MARCH 21, 1935

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. Gentlemen, we have with us this morning, Mr. Coolidge, the Under Secretary of the Treasury, who will discuss the bill H. R. 5357.

Mr. Coolidge has prepared a brief statement which he would like to read to the committee, after which he will be glad to answer any questions members of the committee may desire to propound.

Mr. Coolidge, you may proceed.

STATEMENT OF T. JEFFERSON COOLIDGE, UNDER SECRETARY OF THE TREASURY

Mr. Coolidge. Mr. Chairman, I have a brief statement covering only title II of the bill.

The Chairman. I presume you desire to address yourself to title II of the bill, and that is really what the committee would like to hear you about.

Mr. Coolidge. Title II is the part of the bill which is of most interest to the Treasury Department, because in that portion of the bill it is proposed to amend the Federal Reserve Act.

When the Federal Reserve System was formed conditions were very different from those of today. There were practically no Government securities in the market. The reserve requirements of the System were based on the amount of gold that was in the country and there was no insurance of bank deposits by any agency. The adjustment of money rates was largely automatic and only partially a matter of judgment. Should gold leave the country it became necessary for the banks to borrow to replenish their reserves. The same was true when there was a demand for currency or for an extension of loans. When either of these situations arose it was almost axiomatic to raise the rediscount rates to discourage further borrowing or to replenish the gold stock.

These conditions are very different today. The gold in the country is in excess of any normal legal reserve requirements; Government securities are obtainable for liquidity in large quantities, whereas commercial paper is small in amount compared with previous times, and bank deposits have largely been insured by the Federal Deposit Insurance Corporation. The proposed bill attempts to adjust the

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banking laws so that these new conditions can be met in a suitable manner.

In that portion of the bill covering amendments to the Federal Reserve Act, I want to take up the proposed change in the method of appointing the governors and vice governors of the individual Federal Reserve banks; the proposed change in collateral requirements for loans from the Reserve banks; the proposed change in restrictions on real-estate loans; and the proposed method of open-market operations together with the power of the Fedral Reserve Board to change reserve requirements.

It seems incongruous to have a governor appointed by the directors of the local bank and a chairman of the board by the Federal Reserve Board at Washington. Under the bill, the directors of the local Federal Reserve bank choose a governor who shall be chairman of the board and a class C director, and their choice is subject to the approval of the Reserve Board at Washington. The approval of the Board should, I believe, make for harmonious relations between the banks and the Federal Reserve Board, while at the same time not deprive the local directors of any of their proper responsibility in the choice of the officers.

At present the Federal Reserve banks are restricted in their loans to member banks, being able to loan only on specified types of assets. This bill will permit them in their discretion to loan a member bank on any of its sound assets when in their judgment it is a wise thing to do. At the present time this may seem unnecessary as the member banks have great quantities of funds; nevertheless, should there be an unwarranted flow of funds from an individual bank or from certain parts of the country, the banks under the bill could be given proper support by the Federal Reserve banks should their general condition justify it and unnecessary liquidation be prevented.

It is proposed that the existing restrictions on real-estate loans be somewhat liberalized. I personally believe that banks should be permitted to work out their old loans without restriction, while in the case of new loans 60 percent of an appraised value should be high enough. The Federal Reserve Board could properly be given further authority to make regulations within this limit of 60 percent.

Our control of money rates has passed from the automatic stage, because of the great amount of excess reserves, into a condition where automatic standards cannot, I believe, be improvised which can be expected to work under the conditions of the present or immediate future. It would seem that this control must be entrusted to a group of men, and, presumably, will be exercised by open-market operations in Government securities, by a change in the reserve requirements and in rediscount rates, or by a combination of the three.

I would like to state that there are no important conflicting interests in regard to the proper rate for short-time money. Everyone's interest is best served by the proper rate to help make business stable and prosperous. There may be differences of opinion between men or groups of men as to what is the rate most suitable under the conditions of the time, and the best methods of obtaining the desired results. The Treasury has, of course, great powers in influencing the rates for money and it is most important that it coop-

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erate with those to whom like powers are committed. It is not important to choose men from any particular group to perform this important function, but it is essential that wise men experienced in the effect of money policies be chosen and that they not be influenced by unwise demands of special groups.

For this purpose the bill sets up an open-market committee, three to be chosen by the Federal Reserve Board from their members and two to be chosen by and from the governors of the Reserve banks. It is contemplated that these five men have the responsibility of the difficult and delicate job of buying and selling acceptances and Government securities with Reserve bank money for the purpose of furnishing to the country a proper supply of funds at proper rates to the extent that it is advisable to use this method for the purpose. With conditions as uncertain as they are and with the vast amount of gold in the country this power of buying and selling acceptances and Governments may be insufficient to insure proper control and in ths bill the Federal Reserve Board is given power to change legal reserve requirements of member banks. A raise of legal reserves would impound the idle money of the member banks, thus raising rates; or a reduction of reserve requirements would give the member banks additional funds. These two methods used in combination will equip the Federal Reserve System with supplemental control devices to be available for use when required, although it is to be expected that the need to change legal reserves will occur very seldom.

The CHAIRMAN. Mr. Coolidge, the Treasury favors the enactment of this bill?

Mr. COOLIDGE. The Treasury favors the enactment of this bill and the purpose for which it is intended. The question of changes that may be made, or the methods of accomplishing the purposes is entirely a question for this committee, and there is no reason why the bill should not be considerably modified to carry out the purpose for which it is submitted, so far as the Treasury is concerned.

Mr. GOLDSBOROUGH. The Treasury is in favor of the bill; is that correct?

Mr. COOLIDGE. That is correct.

The CHAIRMAN. That is what I wanted to ask you.

Mr. GOLDSBOROUGH. Under the bill, the directors of the Federal Reserve banks would still elect their governors, subject to the approval of the Federal Reserve Board, and the majority, that is, 6 of the 9 directors are bankers?

Mr. COOLIDGE. That is note quite correct. Six of the nine are elected by the stockholders who are the banks, but only three may be bankers. I think I am correct in that statement. So the other three would not be bankers.

Mr. HANCOCK. The three appointed by the Federal Reserve Board must be bankers, which would mean——

Mr. GOLDSBOROUGH. I mean the six would either be bankers or would be members appointed by bankers, which, in my judgment, amounts to the same thing.

Mr. HOLLISTER. You have stated that the bill in its present form is satisfactory to the Treasury. Are you aware of the suggested changes that Mr. Eccles presented to the committee in his testimony?

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Mr. COOLIDGE. When you say in the suggested form, I would like to make clear that the purposes and general form of the bill are favored by the Treasury. The exact form is not of particular consequence, or the particular business of the Treasury.

Mr. HOLLISTER. Of course, inasmuch as the bill itself does not state what is purposes are, some people might read different purposes in the bill than others.

Mr. COOLIDGE. My only point is that I do not want to approve every dot on every " i " and every cross on every " t." I do not feel that I am in a proper position to do that, because I have not spent the time that Governor Eccles has spent on the subject.

Mr. HOLLISTER. You have not looked over the memorandum of several pages which Governor Eccles submitted to the committee?

Mr. COOLIDGE. I have seen the changes proposed, but I am not prepared to state that the Treasury is back or is not back of those changes. I will be glad to have you enumerate the changes and to say what I feel about them.

Mr. HOLLISTER. I have not that memorandum before me, but there are several of the changes that I can remember.

One, particularly, is this. As I understand it, Mr. Eccles has changed his views with respect to this open-market committee of five, and suggests that it would be much better that the Federal Reserve Board have complete control over the open-market operations, with a committee consisting of the governors of the various regional banks, with which a member would be compelled to advise prior to taking any action.

Mr. COOLIDGE. I do not think I would be personally prepared to back that particular recommendation. I think the committee should be composed of a combination of the two.

Mr. FORD. Was that the testimony given before the committee by Mr. Eccles? I do not remember that that was brought up before the committee; I thought it was suggested that it be composed of two from the Federal Reserve banks and three from the Board.

Mr. HOLLISTER. That is in the bill, and as I understood Mr. Eccles' suggestion, he thought it would be much better to have the Federal Reserve Board have complete control.

I questioned Dr. Goldenweiser yesterday when he was before the committee concerning the statement that the power was left in the regional banks to control in some way the open-market operations, and he finally admitted that the only power given was the power to advise; that there was absolutely no power whatsoever either to initiate or to compel action, or to veto. The full power, under Mr. Eccles' suggestion, would be in the Federal Reserve Board to compel the Federal Reserve banks to enter upon open-market operations.

Mr. HANCOCK. I think Mr. Coolidge should be informed about the suggested amendment before he undertakes to answer that question.

Mr. COOLIDGE. I have seen the suggested amendment, and what I say is——

The CHAIRMAN. He thinks that the provision of the bill is more desirable.

Mr. HANCOCK. Mr. Hollister failed to state that under the Governor's suggestion, an advisory committee would be appointed from the governors to advise with the Federal Reserve Board before any such power became effective.

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Mr. COOLIDGE. I understand that, and I do not wish to make a great point of it. But my personal feeling is that the money is owned by the Reserve banks, and that some Reserve bank governors should be on the committee investing those funds.

Mr. HOLLISTER. There are two purposes, I suppose, for which open-market operations can be carried on. One is the easing or tightening of credit or money. That is the chief purpose, so far as I understand it, of the whole theory of open-market operations.

Is it not also true that if full compulsory powers are given with respect to open-market operations, we will say to the Federal Reserve Board, or even to a committee which the Federal Reserve Board controls, that also this power might very well be used to compel the Federal Reserve banks to acquire securities directly from the Government, in the event that the Government has the securities it wishes to sell, and there is no other way of selling them?

Mr. COOLIDGE. That, presumably, would be within the power of the proposed committee if they so wished to use it.

Mr. HOLLISTER. That is something new in the law?

Mr. COOLIDGE. The same powers can now be exercised, only in a more complicated manner. The committee and the Reserve Board combined have the use of the same powers that is now proposed to concentrate in this committee.

Mr. HOLLISTER. But at the present time no reserve bank may be compelled to enter open-market operations if it decides it does not want to.

Mr. COOLIDGE. I think that is true.

Mr. HOLLISTER. Whereas under this bill, if it is passed, the Federal Reserve banks could be compelled by whatever body we decide upon, whether the committee or the Federal Reserve Board, after consultation with the advisory committee, to acquire bonds.

Mr. COOLIDGE. To both buy and sell; that is the intent.

Mr. HOLLISTER. The thing that worries me chiefly about the bill is the compulsory feature, the fact that the credit resources of the country might be compelled, notwithstanding what the great majority of good bankers might think as to the advisability of it—the great credit resources might be compelled to be used in the handling of bond issues, in the event that the Government continued to pile up deficits, and I would like to ask you whether you think that is a wise power to put in any board which is, to some extent, if not entirely, under administration control.

Mr. COOLIDGE. I would like to answer that very directly. I think the power is going to exist somewhere. I think it is rather unfortunate to have the power wielded by 12 separate banks.

I think the power should exist in a board, and that the board should be very carefully selected. The power is going to be somewhere.

Mr. HOLLISTER. The affirmative power to compel the regional banks to cooperate in acquiring, and you say also in selling—and I am worried about the acquiring end of it—in acquiring Government securities.

Mr. COOLIDGE. It seems to me, otherwise a regional bank may act on its own and interfere with the action of others, and then you have the picture of 12 regional banks, each with the power to do what you say you do not like to see concentrated.

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Mr. HOLLISTER. Of course, if a majority vote of the regional banks could settle it, that would be one thing. But here would be the power in a board outside of the regional banks, and even if the regional banks unanimously thought that was a mistake, under this power they could be compelled to go into these open-market operations.

Mr. COOLIDGE. Your suggestion would be that the regional banks be given a veto over the open-market operations——

Mr. HOLLISTER. Yes; or a majority of the committee.

Mr. COOLIDGE (continuing). Of the committee.

Mr. HOLLISTER. What the open-market committee proposes that might not be wise, and it seems to me there should be some way in which the mass opinion of the bankers of the country might be able to check what they might consider as dangerous administration policies.

Mr. COOLIDGE. You have there a question as to the best method to attain the end.

Mr. HOLLISTER. Yes.

Mr. COOLIDGE. I am not prepared to recommend any method as the best possible.

The CHAIRMAN. As a matter of fact, Mr. Coolidge, under the present plan 11 of the banks might agree upon a policy which might be approved by the Board, and the entire 11 banks might desire to carry it out; but it would be in the power of one bank, if it was sufficiently strong in resources, practically to nullify a policy that might be desired and determined upon by all the other banks of the System.

Mr. COOLIDGE. That is the present situation.

The CHAIRMAN. That is the situation now.

Mr. COOLIDGE. It is that situation that we desire to correct.

The CHAIRMAN. And the truth is, as the matter now stands, instead of having control in the 12 banks, we have control in a very small minority of the banks in number. That is the practical situation. The whole truth is, the power is in one bank to dictate the policy of the Reserve System.

Perhaps you do not care to say that, and I will put it in the form of a statement instead of a question. That seems to be the situation.

Mr. HOLLISTER. I do not consider the present situation satisfactory at all, and I only feel we are going too far in this bill in taking all powers whatsoever away from the regional banks except the advisory power.

Mr. HANCOCK. Mr. Coolidge, I assume that both your position and the attitude of the Treasury Department is that, since you are to a large degree charged with the responsibility of furnishing the Nation with an adequate supply of money at fair cost, the present law should be changed so that you may have the control or power necessary to carry out that responsibility.

Mr. COOLIDGE. I see a situation which is proposed under this bill with great powers of control vested in the open-market committee and the Reserve Board and other types of control in the Treasury, and I see a great need of cooperation between those two. But they are independent parties; one is not dominated by the other.

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Mr. HANCOCK. Under the open-market plan suggested in the bill, would it not be possible, under certain circumstances, for the will of the Federal Reserve Board to be thwarted in the event that one member of the Federal Reserve Board out of 8 members serving on this committee, together with 2 of the governors, also serving on this committee, should agree on a policy contrary to the known or expressed view of the entire Federal Reserve Board? I hope I make myself clear.

Mr. COOLIDGE. I do not quite follow that. The Federal Reserve Board can elect 3 members, although 1 must be the Governor. They can choose which three members they desire to sit on the open-market committee. I do not vision an alignment where special parties are going to line up against other parties. I visualize them as a group of men who meet to discuss conditions, and I do not think there are 2 against 3 in the matter.

Mr. HANCOCK. I am just wondering whether that situation might not exist, in view of the fact that there have been conflicts heretofore due to the lack of coordinated effort on the part of all the parties interested. That suggestion was made by Mr. Eccles, I think, as the basis for the suggested change in one of his amendments. He recommended that the powers should vest in the Board as a whole rather than in a joint committee as the bill provides.

But if you do not care to make any further expression on that point, it is all right. It is vitally important, however, in my judgment.

Mr. COOLIDGE. I think that is a matter of opinion. I personally feel that there should be governors of Reserve banks on the open-market committee.

Mr. HANCOCK. In Mr. Eccles' statement before the committee he referred to certain language used by President Woodrow Wilson in his address to the joint session of Congress on June 23, 1913. I am wondering whether you subscribe to Mr. Wilson's idea and conception of the control of banks. Here is what he said:

> The control of the system of banks of issue must be vested in the Government itself so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

Is that your conception?

Mr. COOLIDGE. I want to be rather certain; I am not quite sure of the meaning of his conception. He set up the Reserve System, and whether that was his idea of control by Government, thinking of the Federal Reserve Board as exercising that control, would be a question. I certainly feel the Reserve System is an instrument, not a necessity, of business.

Mr. HANCOCK. Of course, I do not know exactly what was in his mind, but it is my own personal idea that he would have been disappointed in the operations of the Federal Reserve, based upon my interpretation of his conception of the right kind of banking system that would function in all conditions for the welfare of the Nation, rather than for a few small parts of it.

Mr. COOLIDGE. The control has to exist somewhere, and the control should exist, in my opinion, in some rather independent body of men.

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Mr. HANCOCK. Do you think it would be better to vest control in the Government, or vest control of the note issuing power of the Nation in an independent body, which might be called the "supreme court of finance", that would be insulated against direct Government or political influence and commercial banking influence at the same time?

Mr. COOLIDGE. I think that the banking system grows rather slowly. I do not see, off-hand—I am not an expert on these things—I do not see a final solution. I see this bill tending toward certain concentration of power, and I do not feel qualified to state what is the final solution of our banking situation, but I believe it is a long way distant.

Mr. HANCOCK. Mr. Coolidge, I assume you have read in the papers about the number of suggestions from the different organizations that seem to oppose very vehemently title II (and perhaps sincerely), and as a result of their attitude they are suggesting that a comprehensive study of banking and monetary matters by a national commission of appropriate character should be undertaken, rather than for Congress to proceed further with the consideration of this bill.

Is it the attitude of the Treasury that a commission of that character is necessary at this time?

Mr. COOLIDGE. I do not think I can express the Treasury attitude on that very well. I do not think the Treasury has taken any attitude on that question.

Mr. HANCOCK. But you say the Treasury does favor the main purposes of this bill and want them enacted into law, is that correct?

Mr. COOLIDGE. Yes.

Mr. GIFFORD. You have said that the Treasury favors this bill. Is not that because of the necessities of the situation, in connection with the financial deficits of the Government?

Mr. COOLIDGE. I personally favor it, to give some control over the money market. In my opinion the control does not exist today in proper form.

The Treasury is able to finance at very low rates, and I do not see that we need this in order to finance the Treasury operations.

Mr. GIFFORD. The Treasury does not attempt to advise Congress as to its expenditures, perhaps; but you think now that the banks are holding an undue amount of Government securities?

Mr. COOLIDGE. I do not say that. The banks have the Government securities because they wished to have their earning power.

Mr. GIFFORD. Is that not a rather temporary situation?

Mr. COOLIDGE. It may be temporary; someone else may buy them later. I feel that the whole situation is a very involved one, and it is difficult to forecast.

Mr. GIFFORD. Have you made a survey of the probable deficits that are going to be created by this Congress?

Mr. COOLIDGE. I have not.

Mr. GIFFORD. Is not that a matter of great concern to the Treasury, if they have to finance those deficits?

Mr. COOLIDGE. The problem of the Budget is important to the Treasury.

Mr. GIFFORD. After Congress passes these measures, bringing the deficits up to 10 or 12 billion dollars, does not it follow then that

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the Treasury will be quite interested as to how they are going to finance them?

If you were the treasurer of an organization, as a rule, you would be glad to inform the members of the organization, and even the president of the organization, of the situation regarding the treasury and the dangers, perhaps, involved in making great expenditures. That would be the ordinary procedure, would it not?

Mr. COOLIDGE. I think you have really gotten me a little bit out of my depth. The President has submitted a Budget, and that is before Congress.

Mr. GIFFORD. What I am getting at is this: The Treasury does not feel that they should advise the President of the dangers of the financial situation or the financial deficits, or even advise Congress of the danger of the financial deficits. Is it not the duty of the Treasury to suggest that they may have difficulty in financing the deficits, if they go over a certain amount?

Mr. COOLIDGE. The Treasury has expressed its views in the Budget, and what Congress will do is a matter of your knowledge rather than mine.

Mr. GIFFORD. The Treasury does not feel like even suggesting to Congress that it is all right to spend 10 or 12 billion dollars this year above ordinary expenses, and that you can handle it all right?

Mr. COOLIDGE. I think I would really rather have you ask the Secretary questions on matters of general policy. I trust there will be no such deficit.

Mr. GIFFORD. I do not know whether you want to express any personal opinions, but you are here representing the Treasury. Somebody must represent the Treasury when they come here, and I think we are entitled to the views of the Treasury Department relating to the dangers and difficulties of financing deficits.

You and I come from a section of the country where we once heard a voice say this, which illustrates what I have in mind, that if the bankers lend too much money to their Government they will not have enough left to lend to the people.

Under this theory of financing, there would not be any limit to the amount that the member banks are allowed to rediscount all the time and loan back again.

I am getting back to this point, which I would like to impress upon you, and that is this: Do not the necessities of the times in connection with these vast expenditures of the Government, bring about the actual necessity of this legislation, and is not that the purpose of it?

Mr. COOLIDGE. I cannot agree with that. This legislation, in my mind, is to control the rate for money. From the point of view of Treasury financing, we do not need this legislation in the least.

Mr. GIFFORD. Not if we appropriate $12,000,000,000 in Congress this year?

Mr. COOLIDGE. The effect may be very bad, but from the point of view of Treasury financing I do not feel that we need this legislation in the least.

Mr. GIFFORD. Temporarily, not. But suppose business should decide to go ahead; will not business need this money?

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Mr. Coolidge. To my mind, the money available, without changing the law, is of an enormous amount, ample for business as well as for proper expenses of Government.

Mr. Gifford. That is because of the amount of gold we have in the Treasury.

Mr. Coolidge. Yes; and from the point of view of Treasury financing I can see no need for this bill.

Mr. Gifford. You can take care of the $12,000,000,000 deficit this year?

Mr. Coolidge. I am not prepared for one moment to say that.

Mr. Gifford. You will have to be prepared, will you, if we pass appropriations causing a $12,000,000,000 deficit, appropriations calling for that amount of money?

Mr. Coolidge. That is a subject which is beyond this banking bill, it seems to me, and it is a broad subject.

Mr. Gifford. It is so broad that it seems that it is desired to pass this political bill.

Mr. Coolidge. I do not follow that.

Mr. Gifford. Is not this bill going to give the Government control over the banking system of the country?

Mr. Coolidge. I do not see that it gives it any more than it has today.

Frankly, I do not see the need of this bill for financing the Treasury. There is no need of it from that point of view, in my opinion.

Mr. Gifford. You encourage Congress to spend any amount of money, and if I should follow that out I might as well vote for the soldiers' bonus tomorrow.

Mr. Coolidge. I am not encouraging Congress. So far as I am concerned, the question of the Budget, to my mind, is entirely aside from the question of this banking bill.

Mr. Gifford. It is not entirely aside from it when you have to find the money with which to pay it.

Mr. Russell. Would it not be appropriate to suggest that Mr. Gifford confine his questions to the bill before us instead of going into the question of the appropriations which Congress may make?

Mr. Gifford. Mr. Chairman, because my friend has suggested that, I will be glad to do that. But the amount, in all probability, will be 12 billion, and my idea was that there should be somewhere some power that might say to Congress that it looks probable that you will spend $12,000,000,000, and I have named $12,000,000,000 here without anyone contending that that is not true.

I would rather protect you, Mr. Coolidge, than embarrass you, and I will withdraw from any further questioning.

Mr. Hancock. Mr. Coolidge, in your own mind there is nothing political about this banking bill, is there? It is designed to help the entire country rather than any particular class or group.

Mr. Coolidge. Yes; it is designed to improve the banking situation.

Mr. Hancock. It would be used for the welfare of all, regardless of politics, would it not? And any suggestion to the contrary is unwarranted and absurd.

Mr. Coolidge. I feel so.

Mr. Brown of Michigan. Is not the main purpose of the bill to increase the power of the Federal Reserve banks to rediscount paper

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for member banks in the Federal Reserve? Is not that one of the main purposes of the bill?

Mr. COOLIDGE. The question of whether it is the main purpose, I think, would be open to some argument.

Mr. BROWN of Michigan. One of the main purposes?

Mr. COOLIDGE. Opinion would differ on that. But the bill does enable the Federal Reserve banks to loan on any sound assets rather than on certain specified types. The bill leaves it to the judgment of the individual bank whether they desire to make these loans.

Mr. BROWN of Michigan. But when the individual banks know they can borrow on any sound asset, as expressed in section 13 of the Federal Reserve Act, as amended, they are more likely to be more liberal in their loaning attitude toward business generally, when they know they can rediscount that paper, or borrow upon it at the Federal Reserve bank? When they know that they are going to be less harsh than they have been in the past. Is not that true?

Mr. COOLIDGE. It prevents the past preferences for certain types of assets that are rediscountable. All assets are on the same basis instead of there being a preferred class for certain assets.

Mr. BROWN of Michigan. But the effect of the amendment would be to liberalize, as far as the Federal Reserve System can do it, the loaning policy of the member banks?

Mr. COOLIDGE. I should think so.

Mr. BROWN of Michigan. When they know they can turn over their sound assets and get assistance from the Federal Reserve banks, they will be more willing to loosen up and make loans; is not that a fact?

Mr. COOLIDGE. I should think so. I feel it will be of use in time of trouble, but, on the other hand, it may lead to some careless lending in good times.

Mr. BROWN of Michigan. I want to say, in commenting upon your statement, I am pleased to find you recommend the reduction from 75 to 60 percent as the basis for real-estate loans.

Governor Eccles expressed somewhat the same attitude; and I think, personally, that it is a little dangerous to go as high as 75 percent on long-term real-estate loans on the part of commercial banks, and I want to commend your view in that respect.

Mr. HANCOCK. On the point about which Mr. Brown questioned you, as to changing the law so far as eligibility is concerned, under the provisions of this bill an honest effort is being made to insure liquidity for all sound assets; is not that correct?

Mr. COOLIDGE. I think that is correct. I would rather phrase it a little differently myself. I would rather say that the banks were given power to borrow from the Reserve banks when the Reserve banks desire to loan, and not just when there are certain specified assets in their possession.

Mr. HANCOCK. Under the old system, do you not think that the opinion or obsession of a great many bankers, which was perhaps natural under the system, that everything in their bank had to be liquid, had more to do with destroying real values than almost any other thing? This was particularly true with reference to real estate and local securities.

Mr. COOLIDGE. That is a hard question for me to answer. It is a matter of opinion.

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Mr. HANCOCK. You do not think, do you, that the value of an asset, so far as its eligibility for discount alone is concerned, should depend on its quoted value on an exchange? Is that a fair or always honest test?

Mr. COOLIDGE. I think that should be taken into account; I will not say " depend "; I think it should be taken into account.

Of course, at the present time there is no borrowing, and the surplus of funds is such that that provision is of little use. It is of use only in times of trouble.

Mr. HANCOCK. Do you not think that back in the bank panic days, the fact that bankers looked to the exchange quotations rather than to the intrinsic value of the assets in their bank had much to do with the failure of many banks and was in some instances a curse?

Mr. COOLIDGE. It had something to do with it.

Mr. HANCOCK. Do you not know that that system for years and years operated against sound real-estate assets and almost made them worthless?

Mr. COOLIDGE. I think it caused a great destruction of sound assets during the panic. I do not think it operated against them until the depression came on.

Mr. HANCOCK. Do you think that values should be determined by the price you can get for the property within 24 hours, or by the ticker service?

Mr. COOLIDGE. No; and I agree with you entirely on that, at least in times of great panic, but the whole problem is difficult.

Mr. FORD. Mr. Coolidge, I would like to make not so much a question as a statement, and ask you if you agree with me: Under the Federal Reserve Act as at present constituted was it not the idea, in a period of expansion, that it supplied money in a large measure and made it easy to get money for going concerns for going ahead? Was that not true?

Mr. COOLIDGE. Yes; that is true.

Mr. FORD. Then we came to a period of—it was all right for expansion, but when we came to a period of contraction the character or class of assets held by a bank that were rediscounted in an emergency was so restrictive that it did not furnish a cushion to take sudden reactionary or sudden dropping; is not that true?

Mr. COOLIDGE. That is so.

Mr. FORD. Now, then, this measure undertakes to broaden the basis of the assets in the banks on which loans can be made?

Mr. COOLIDGE. Yes; that is correct.

Mr. FORD. So that in a period of emergency a bank can take its sound assets to the Federal Reserve bank and, for temporary purposes, get sufficient currency to meet its demands?

Mr. COOLIDGE. I agree.

Mr. FORD. Therefore, by giving people the money that they are clamoring for, you stop the clamor?

Mr. COOLIDGE. I agree; but the bank has to be sound, and many were not.

Mr. FORD. There has been an attempt made in this committee by the minority to show that the sole purpose of this measure was to make it easier for the United States Government to borrow from the banks. That has been the purpose of the minority right through,

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and they have left out any possible good that was contained in the bill for the purpose of using it, the banking system, as a national institution as against a particular institution that was particularly framed for the facility of just a limited class.

Mr. COOLIDGE. I stated already that I saw no possible need of this bill from the point of the Government financing, as far as that is concerned.

Mr. FORD. This bill does not cover that; in other words, they are going on and doing the financing without it, and it will not even facilitate your financing?

Mr. COOLIDGE. I do not see that it facilitates financing. We have always sold our bonds to people who wanted to buy, and expect to continue so.

Mr. FORD. And the attempt to show that this is simply a bill for the purpose of enabling the Treasury Department to finance its needs is pure bunk?

Mr. COOLIDGE. In my opinion, there is no need for the bill for that purpose.

Mr. HANCOCK. You are pulling your rate of interest down practically every new issue, are you not?

Mr. COOLIDGE. Yes; interest rates are running lower and lower and we are selling a lot of bonds at lower rates.

Mr. HANCOCK. I have no other questions, Mr. Chairman.

The CHAIRMAN. Any questions by anybody?

Well, Mr. Coolidge, this is not important, but I think there was one slight unintentional inaccuracy in your statement as to the make-up of the committee. I understood you to say that there would be three members of the Federal Reserve Board to be elected to the Board. As I understand the provisions of the bill before us, it is that the Governor would be a member and two others would be elected; is that correct?

Mr. COOLIDGE. That is correct. I was careless in that statement.

Mr. HOLLISTER. I would like to ask one question on the theory which is, perhaps, too broad and you would not like to answer it; but if that is so, you are at perfect liberty to say so. As I stated before, it is the compulsion that worries me in this bill, chiefly worries me. When the situation gets such that it is compulsory, in the very nature of things, to take the bonds, that is the first step, of course, in credit contraction. That is, I suppose, axiomatic, is it not?

Mr. COOLIDGE. I do not quite follow "compulsion" in it.

Mr. HOLLISTER. You say, of course, it would not be compulsory, but if it were compulsory and compelling upon the banks of the country to take Government bonds against their better judgment—I suppose when that time comes, it is really compulsory, is it not?

Mr. COOLIDGE. That is a very bad time; yes.

Mr. HOLLISTER. In other words, when it comes to financing by any government, the difference in financing the Government's expenditures by the issue of bonds—which is, of course, borrowing from the accumulated resources of the country—and financing by the issuing of currency, the difference in the two is that the issue of bonds is a voluntary matter; it is a question of bargaining between the parties, of the seller on the one hand and the buyer, being a willing buyer,

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on the other hand; but when a government once reaches a situation where it decides to do its financing merely by running the printing presses, the difference is that they are compelling a person who would ordinarily be a buyer—compelling that person to take the piece of paper, which is the promise of the government, and really against his will—then, of course, the value of that paper goes down, because the person does not want what he is compelled to take.

Therefore, if the situation should ever come about where bonds must be taken, where there is a compulsion placed upon the credit resources of the country to take the bonds, there is not much difference between the sale of bonds and the issue of currency, is there?

Mr. Coolidge. Yes; that sounds pretty logical.

Mr. Hollister. And I simply wanted to bring that out for the record, wherein a central board, as long as it is not constituted by the people, or on which they might not have majority control, or at least the veto power—that is the situation which is dealt with in this bill.

Mr. Hancock. Mr. Coolidge, apropos of what my good friend, Mr. Hollister, has just said, it is also true, is it not, that the Government should have the right, at all times, to use any profit which it might have in the Treasury for the payment of its obligations, without resorting to he further issuance of bonds?

Mr. Coolidge. Well, that seems perfectly logical.

(Here follows discussion off the record.)

Mr. Cross. Are you through, Mr. Hancock?

Mr. Hancock. Yes.

Mr. Cross. Mr. Coolidge, what do you think, what is your idea about the open-market operations, having the effect of being able to raise or lower the wholesale commodity prices?

Mr. Coolidge. I do not pose as much of an economist on that subject. I should say the effect was a slow one, and only one of many forces affecting price levels.

Mr. Cross. You remember—or were you with the Department in 1923 and 1924, and through there—I think it was in 1924, or 1923, that they had an open-market committee, and their open-market committee bought $510,000,000 of bonds, and almost immediately the wholesale commodity price level rose 11 percent, and agricultural commodities rose 20 percent. Do you remember that occurrence?

Mr. Coolidge. I am sorry to say I do not. I remember it, but not in detail sufficient to help you.

Mr. Cross. Anyway, the theory is that, when you buy bonds, you tend to lift the price level and when you sell bonds you take the currency out of circulation and tend to lower the price level, and that is one of the levers you expect to use along that line?

Mr. Coolidge. That is a lever. I feel that is one of many other forces. If you look back to the war time, when we entered the war, the Federal Reserve banks had pretty high money rates, but under of the force of spending money, and so on, prices were driven to very high levels. So I would not feel that the rate for money caused by open market operations is more than one of several forces that operate on the commodity price levels.

Mr. Cross. How long have you been in the Treasury Department?

Mr. Coolidge. Just under a year.

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Mr. CROSS. Have you discussed the question of there being put in the law a goal to which the Board should seek to go, for instance, something along the lines suggested by Governor Eccles, that you attempt to reach the price levels, for instance, in 1926 or some such period through there? Did you discuss that with them? What is your idea?

Mr. COOLIDGE. I did a little, and tried to apply it to different periods of the past. Now, if it were applied in 1917, when we entered the war, the Board would have been almost under a duty to stop the Government spending money to fight the war, because that would have been their only method of keeping the price levels where they were. When we get to 1932, we all knew the price levels were too low, yet that language seemed to tell the Board to keep the price levels stable and not permit a rise.

Mr. CROSS. Are you familiar with the system that Sweden has put in force?

Mr. COOLIDGE. Not sufficiently to discuss it.

Mr. CROSS. I believe that is all.

Mr. HANCOCK. Mr. Chairman, I would like to ask one more question. Go ahead, however, Mr. Williams.

Mr. WILLIAMS. I have in mind one or two questions to ask you about this board. You have perhaps answered it while I was out, but as I understood you, before I left, you were of the opinion that open-market operations should be centered in one particular board, for the reason that it was a national policy, and it should not be interfered with, or have divided authority by each bank or each group of banks being permitted to pursue their own course along that line.

Now, it is desirable, is it not—that is true, I think, myself, as a general policy—that the board should be brought in contact with, and kept in close touch with the representatives of the various individual banks throughout the country, in order to get a true picture of the situation that exists at any particular time throughout the country?

Mr. COOLIDGE. I agree entirely.

Mr. WILLIAMS. Now, under the present set-up as it has been from the beginning, the Secretary of the Treasury has been a member of the Board. Has there been any thought given to setting up a board without him on it?

Mr. COOLIDGE. I have heard that discussed by different people. I think I would rather have him answer that question.

Mr. WILLIAMS. Well, no; I do not mean to be personal at all, not because of this particular Treasurer, but what is the idea back of any of the Treasurers being a member of the Board?

Mr. COOLIDGE. I do not see that it is of any particular importance.

Mr. WILLIAMS. No particular importance? Well, then, what is the idea of having the Comptroller of the Currency being a member; is there any reason at all for that?

Mr. COOLIDGE. I would rather leave that to him. I do not know his duties and——

Mr. WILLIAMS. I mean to say, any reason——

Mr. COOLIDGE. I am not sufficiently familiar with the connection of his duties with the Reserve Board, the bank examiners, and so on, to answer that. I would really prefer not to go into that subject.

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Mr. WILLIAMS. I do not mind saying, myself, that I do not see any reason for the existence of his office at all, much less for him to be a member of the Board.

Mr. COOLIDGE. Both of those are questions I would rather have addressed to them, or to the particular or appropriate persons involved.

Mr. WILLIAMS. I thought perhaps, in framing this legislation, the need of membership on the Board of the Comptroller of the Currency and the Secretary of the Treasury had been considered.

Mr. COOLIDGE. It was decided not to recommend changes in the Reserve Board.

Mr. WILLIAMS. Well, unless there is some good reason why they should be there, I do not know why they should be members of the Board, and I was just inquiring as to what the reason was.

Mr. COOLIDGE. We decided not to go into the composition of the Reserve Board.

Mr. WILLIAMS. You have gone into the composition of it, in submitting this bill, have you not?

Mr. COOLIDGE. We did not change the composition of the Reserve Board.

Mr. WILLIAMS. Of the Reserve Board, but you did change somewhat their functions in the open-market operations.

Mr. COOLIDGE. Yes.

Mr. WILLIAMS. I believe that is all.

Mr. HANCOCK. Mr. Coolidge, just one further question: From the statements made by the different members of the committee and the discussion which has taken place here for the past 10 days, it seems that there is a fear being planted in the minds of some people that, under this measure, the Government might be in position to compel or force banks, against their will, with respect to the open-market operations. Do you not believe that it is necessary that there should be some central control, so far as open-market operations are concerned, and especially when we review what happened back in 1929?

In other words, do you not believe that there might come a time when the compulsory powers contained in this bill, if you care to call them that, would be absolutely necessary, and especially if the country should be off again on a wild speculative "jamboree"; and if you had those powers, you would be able to enforce uniformity by all of the banks, in order to serve the country, and save the country from the sort of crash like we experienced in 1929, 1930, and 1931; and then, by the reverse use of those powers, in a period of great depression and deflation and dislocation, the Government could and should employ those powers in the interest of all of the people, going so far if necessary of forcing banks to purchase Government obligations, to sustain and protect the Government in its duty to enable people to live and not starve?

The CHAIRMAN. Well, have you finished?

Mr. HANCOCK. Let him answer that question, Mr. Chairman.

Mr. COOLIDGE. Excuse me. I agree with you. I think that the power should be concentrated, and I think the open-market committee should act to prevent excessive speculation and furnish money in times of deflation.

Mr. HANCOCK. And that is the main purpose why these changes are put in this bill, is it not?

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Mr. COOLIDGE. That is the purpose that I see in it.

Mr. HANCOCK. That is all, Mr. Chairman.

The CHAIRMAN. Well, gentlemen, if there are no further questions, we will excuse Mr. Coolidge. We thank you for your able and informative statement.

Mr. COOLIDGE. Thank you, Mr. Chairman.

The CHAIRMAN. We will adjourn and meet tomorrow at 10:30, gentlemen.

(Thereupon a recess was taken in the hearing until 10:30 a. m.. Friday, Mar. 22, 1935.)

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BANKING ACT OF 1935

FRIDAY, MARCH 22, 1935

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. The committee will be in order.

We have with us this morning Mr. Robert Hemphill, who was the first credit manager of the Atlanta Federal Reserve Bank and is well known as an authority on money and banking and as a financial writer contributing to the Hearst newspapers and to financial magazines. He will discuss this bill, and I am going to suggest that he be permitted to make his statement without interruption, after which members of the committee may propound any questions that they may desire.

STATEMENT OF ROBERT H. HEMPHILL, WASHINGTON, D. C., REPRESENTING THE NATIONAL MONETARY CONFERENCE

Mr. HEMPHILL. Mr. Chairman and gentlemen of the Committee on Banking and Currency, I am not an orator; I have been in business all my life, so I am going to get down to business as rapidly as possible.

This banking bill which is offered, in my opinion, crystallizes in a large measure, and perpetuates and exaggerates what is today the worst monetary banking system in the world.

In the founding of our country the patriots who had vision enough to protect us from tyranny and to imagine a society composed of intelligent individuals who would be permitted to carve their own destinies, saw that the control of money would control the total amount of business transactions, and that the total amount of goods and services people can produce and exchange with each other marks the measure of civilization.

That is all there is to civilization, creating and exchanging the facilities for a higher standard of living. That is all there is to it.

Necessarily, in our system, we cannot directly exchange our goods and services; we have to first convert them into money. Money is the intermediate commodity, if you wish to call it that, into which we have to exchange everything we produce.

So this subject, Mr. Chairman and gentlemen, is necessarily as important, just as important as all of the rest of the subjects which a civilized people has to consider. I think that point is worth getting clearly in your minds.

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To exchange those goods and services there must necessarily be in existence an available quantity of money which is equal to all of the goods and services in process of exchange. That is a self-evident proposition. We cannot exchange in any other way.

If you diminish that quantity of money, you are going to restrict the exchange of goods and services, and restricting the exchange of goods and services means that you lower your standard of living, and that means that you destroy civilization to that extent.

That is a principle that has been recognized by every philosopher of ancient and modern times. But there has been for 200 years, since one certain man came into power as a financial genius, Mayer Anselm Rothschild, who was born in 1790—since he came into power there has been a constant, organized, shrewd conspiracy to convince the people of the world that this is not true, to convince men against their own judgment, against a thing which is self-evident. And that conspiracy has involved the press, it has involved the pulpit, it has involved our schools, a conspiracy to mislead people about the importance of a very simple thing—money.

The interests who promote this confusion profit by retaining for themselves the monopoly of manufacturing our money.

If you will pardon me a bit, I will read you a little fable at this point which illustrates how our private banking system originated. Sometimes these things get home the central idea a little clearer than by technical explanation.

This is the fable of the Temple of the Thirteen Suns, a very ancient fable.

Once upon a time to the Temple of the Thirteen Suns came the rich and powerful chief, Oomah the Third, who said to the goldsmith of the temple, Hansen L. Roschab, "I have much gold and am about to depart for a far country. Wilt keep this gold safely for me against my return a year hence? I will pay thee well."

The wily Hansen coughed loudly and covered his countenance with a cloth lest the rich Oomah the Third observe his joy to have this treasure in his possession. When he was calm and could look serious he said unto Oomah, "It is a very great responsibility and risk but I will undertake it for a tithe which shall be 1 shekel in every 10."

Then said the Chief Oomah, "it is a deal", and forthwith his slaves delivered many bags containing in all a thousand shekels of gold for which Hansen L. Roschab, the goldsmith, gave the chief a parchment deposit writing payable to whomsoever, and thereupon Chief Oomah departed happily upon his journey.

As soon as he was well out of the country the shrewd Hansen called his confidential scribe and bade him thus, "Go thee now to the merchants whom I tell thee of and secretly say to each that thy master hath a little gold for hire upon good security", and the servant departed swiftly.

Soon there came to him a great merchant, who said, "Hansen, you old crook, I am in a jam for a few shekels of gold. Wilt lend me?" and Hansen replied, "Money is very tight these days, but it might be so arranged. What is thy need?"

The merchant answered, "Two hundred shekels."

Then said Hansen, "It is much money. What security couldst thou pledge for so great a sum?"

Then the merchant shewed Hansen a writing of his possessions of merchandise to the amount of a thousand shekels. Hansen said, "It is not enough; thou must also pledge thy dwelling and thy slaves and thy raiment", whereupon the merchant, after much protest, pledged all his possessions, even to his innermost raiment.

Then said he to Hansen, "I have no place to store so much gold—keep it safe for me and give me a writing which I may deliver to whomsoever I will", and Hansen did even so.

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The next day came another merchant, and another, and still another, and to each Hansen loaned a portion of the gold of Chief Oomah the Third, taking from each as security his entire possessions, including his innermost personal raiment, and gave to each a writing upon parchment shewing that each had on deposit the gold he had borrowed, until upon the tenth day he had given parchment deposit writings for the whole of the thousand shekels; but he still had all the gold.

Hansen reflected much upon this curious state of affairs, and said to himself, "These birds know not how much gold I possess. They do not want the actual gold itself—what they really want is credit, some deposit writing which they may pass from hand to hand as money. I have one grand idea."

On the next day came another merchant, and another, and still another, and to each Hansen shewed the great store of gold of Oomah the Third, and to each he pretended to loan a portion, although he had previously loaned it all to the first ones who came.

And it came to pass that at the end of another 10 days Hansen had pretended to loan to many more merchants and had given writings of deposit for a second thousand shekels, making 2,000 shekels in all, although he had only the 1,000 shekels of Oomah the Third.

And still he had all the gold.

Whereupon Hansen reflected to himself, "What a leaden-pipe cinch. I wonder I did not think of this before. I can collect just as much usury for the phony deposit writings as for the genuine—verily I am a financial wizard."

Thereupon Hansen caused it to be noised about that he possessed a vast store of gold for hire, and many more merchants came to borrow, and to each Hansen delivered writings of deposit and collected generous usury and demanded pledges from each of all his possessions even unto his innermost personal raiment, until he had issued writings of deposit for 10,000 shekels and held mortgages on substantially the whole city.

Then went Hansen to the wise man of the city and said unto him, "Verily I have discovered the greatest racket of all time. I have learned the magic of making gold out of "baloney"; and if I can keep my formula secret for a few years, I will collect a fortune that will make Solomon's treasure look like a second-hand clothing store. Tell me how I may keep secret this bonanza for mine own profit."

Then said the wise man, "Look wise and say little and only upon little known matters afar off. Obtain the ear of the town crier. Engage him to spread the impression that money is a mysterious subject which no one understands save thee alone. Be friendly with the king's councilors and grant their favors that the king may smile upon thee."

And Hansen did as he was bid and collected much usury from his phoney loan deposits and built for himself a mansion, collected works of art, and clothed his wives and concubines with fine linen and jewels, and when his business had grown to many times its humble beginnings, he took over the entire temple and by way of a sly joke called it the first national bank, the same being from an obscure language and meaning "Place of imaginary money."

And that is the reason all banks have great marble pillars and bronze doors, so that they may resemble outside as well as internally the "place of imaginary money" which Hansen L. Roschab builded upon the gold of Oomah the Third in the Temple of the Thirteen Suns.

I have read this fable because sometimes a little foolish parable like that will give one a very much clearer idea of what we use for money than a whole book of economics.

When this country was founded and the Constitution was framed, it was unquestionably the idea of the patriots who founded this country that Congress should issue all the money necessary to exchange the goods and services of this Nation. To get what passed in those men's minds we would have to go back and picture the situation at the organization of the United States, the Thirteen Colonies, who were not so sure of their own governments, and were not so sure of this federation that they were forming.

They were afraid to delegate very much authority but they did delegate to the Congress of the United States the sole power to issue

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money, and took it away from the States, prohibiting the States from issuing it. But they failed to provide a system by which Congress would issue the money. They failed to visualize the rate at which the commerce and industry of this country would grow, and to provide some system which would be under the direction of Congress, which would keep pace with the growth of industry and commerce and provide a sufficient quantity of money and keep it in circulation, to enable the exchange of goods and services.

Private banks were formed, and the pressure for more money than there was in circulation was so great that these banks began issuing their own money, wildcat bank notes, we call them, and it was an important service. It was an unsafe and an unsound service, but it was an important service, because that money was greatly needed.

They say that there is in use in the United States today a very considerable sum of counterfeit money which is passing from hand to hand, and making it possible to exchange goods and services. I do not know how much there is; I have heard some people estimate there is half a billion dollars constantly in circulation, performing just as important service as the money which is issued by the United States Government.

Now, we go further and find that these banks which issued this wildcat money, one after another failed, and created enormous disturbances. One bank failure back there in the early eighteen hundreds was a matter of very great importance in the United States. At that time we were a country of small population and commerce, so that one bank failure was a tremendous event and created a panic, and we had a succession of those panics.

Finally, the Government prohibited the issuance of these private bank notes. And again, Congress failed to supplant that mechanism with some other adequate mechanism. Congress failed in its duty to provide for the issuance of enough money to sustain our rapidly expanding industry and commerce, and another disastrous depression ensued.

The pressure for more money than Congress has ever furnished has built up another system, which is just as wild, just as uncontrolled, and just as uncontrollable as the wildest bank-note system, and that is our present wildcat bank-credit system.

In every particular, and in every effect the issuance of bank credits by the commercial banks today is exactly the same thing that we prohibited back there in the sixties, and it is just as dangerous.

I have no quarrel with the bankers; the bankers are doing wonderfully well with the most imperfect system, the most unsound system which could possibly be devised.

There is no business man anywhere who would operate a commercial bank today. I know; I am talking as a banker to you, although I am now out of the banking business. But, there is no business man who would operate a commercial bank.

There is no business man who would operate an institution so inherently unsound as a commercial bank. There is no man who would take hold of a business which had demand liabilities 10, 15, or 20 times its currency and liquid assets.

It is a preposterous thing, when we look at it in a cold, calm, dispassionate way. It is the most preposterous institution in the civil-

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ized world today, and yet we are absolutely dependent upon that unsound, preposterous institution to issue the money with which to transact our business, our exchange of goods and services.

Congress has consistently failed, or declined to study this monetary question and devise some instrument which would efficiently execute the power that was conferred upon it in the Constitution.

Do not blame the banker; he is simply filling an essential need, a facility which civilization must have, in the only way he can do it, in the creation of bank credits, just as this fabulous character I have read about this morning issued phoney deposit writings.

The banks are still doing the same thing. They are creating imaginary money because commerce and industry has to have money of some kind. If Congress continues to fail in its most important duty, some private device must supply the deficiency. But I do want to make it clear that we have got to have a quantity of money which is absolutely, mathematically related to the amount of goods and services which we are in process of exchanging. The speed with which they can move from one transaction to another is determined by the facilities of our present state of civilization, facilities used in our trade such as transportation, and that sort of thing, and the method of clearing checks. All these elements are fixed and move only so fast.

So, the amount of money which is in circulation, of some kind, some usable medium of exchange, necessarily determines the total amount of our exchange of goods and services.

That is the central proposition in this whole money question. That is the central proposition to which we have got to give consideration; I do not care whether you are monetary students or not, you can certainly understand that one thing, that you have got to have in circulation a quantity of money equal to the total amount of goods and services you are going to exchange, because you have to first convert them into money to exchange them. They have all got to be converted into money first. That is the central and controlling proposition.

It is only in recent times that we have collected enough data to get some fairly dependable idea of that relation; not because we could not have collected it 50 or 100 years ago, but because there has been a constant effort, as I told you a while ago, on the part of interested parties, to talk about anything in the world except money.

Therefore, we have all grown up and accepted money as a matter of course, and nobody makes any inquiry about it until it stops coming in.

When it seems as if the common source of our money is drying up, as it has been for the last 5 or 6 years, then people begin to think about money. Then they are told, through the daily press, that it is a mysterious subject which no one can understand. But that is "baloney."

There is nothing at all about money or finance, or about banking, that a 12-year-old boy clearly grasp and understand.

Banking is simply a private system of creating the money that commerce and industry has got to have, because Congress has failed to issue it. That is all there is to it.

Today, in the situation which has developed since this depression started, we have almost completely reversed the intention of the

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men who founded this Nation. It was intended then that the Government should issue the money, all of it that we should use, and that the banks should receive that money and care for it and loan the idle surplus of their customers, their time deposits, and their savings. Today the banks are creating the money and the Government is lending it. We have the Government in the banking business and the banks in the Government business. That is the present situation.

This bill that is before you gentlemen is designed to make no fundamental change in the banking business. It is designed to bring under control of one body of men, who may be good, bad, or indifferent, and who may be ethical or who may not be, and who may be impressed with a duty to the public, or who may be impressed with a duty to some private interest, the control of the monetary system of the United States. And when I say that, I am going to tell you that it puts into the hands of those men the control of your business and mine, because those men will control the total volume of money, and you and I can get our share, and that is all we can get, of the total amount. If they double the amount in circulation, we can get our share of the increase, and if we compete properly, our share will be twice as great as it is now.

You can take the contraction in demand deposits, subject to check, today as compared to 1928–29 and figure the gross income of your own business, whatever business you are in, if you have a business, and you will find that the contraction in your business is almost identical with the contraction of demand deposits. The contraction of the business of the Nation is almost identical. In fact, it is so close that it is absolutely astonishing, because it is figuring on a rule of thumb formula, and we have available for our calculations the total amount of money represented in these demand deposits for 1 day only in the year, 1 day only, and we now nothing about what the average is. Assuming that these total figures for 1 day, June 30, is the average for the whole year, which certainly cannot possibly be more than an approximation, we find that the national income is invariably about 3 to 1.

If we had some accurate figures for every day in the year and had an actual average, I am convinced—and when I say that, gentlemen, I want you to understand I have given this particular subject profound study for 20 years and have made extensive researches—I am convinced that it would always be within 10 percent of 3 to 1 of our national income, under all circumstances, in good times and bad, that is to say that the total income of this Nation in prosperity or depression is within 10 percent of three times the total amount of the medium of exchange in circulation.

Mr. Cross. Do you include check money and all the backbone money?

Mr. Hemphill. Yes; money—checking accounts and cash.

I have prepared some figures here which are rough figures; I want that understood. I simply took them out of the Comptroller of the Currency's statements and took the income figures from the Department of Commerce, without any adjustment for "float" or without any other adjustments, but simply compared those figures as they run. I have done that as far back as I could get accurate figures,

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and they invariably run very close to 3 to 1, showing that there is no great difference in the velocity of our total money from one year to another.

	Billions of dollars		
	Demand deposits	National income	Ratio
1929	24.3	81	3.3
1930	24	75.4	3.1
1931	21.3	63.3	3 [illegible]
1932	16.4	48.9	3 [illegible]
1933	15.2	46.8	3 [illegible]
1934	[1] 17.6	52.8	3 [illegible]

[1] Estimated.

Now, then, there has been some increase in the national income, and while the figures are not yet available, the 1934 figures ought to be about the estimated amount shown on this sheet, 52 billion, but the general price level which has been forced up by the Government's artificial price-raising activities more than offsets this increase in income. Normally increasing the amount of money in circulation should produce a greater income through greater activity until we reached full production before there would be any substantial rise in the average level of prices. After that if we continued to increase the money in circulation prices would rise exactly in proportion to this increase. As long as we are operating below full production because of a scarcity of money increasing the money in circulation increases the volume of business but not prices. Profits increase because costs decrease when the volume increases, and wages also increase with the volume of business without increasing prices. In fact, profits and wages may increase very substantially if the volume of business increases greatly and at the same time prices may decrease.

A great many of our economists who talk about the wide variation in velocity of demand deposits are confused because they include in their calculations the money employed in speculation, and at times there is a great deal of money employed in speculation. There was a great sum in 1929. For instance, brokers' loans, I think, ran up to 7 or 8 billion dollars at one time. I do not think they were all entirely employed in speculation, but there was at least $5,000,000,000 at the peak in 1929. A large amount of deposits which should have been classed as demand deposits in 1928 and 1929 were classed as time deposits, and so forth.

These factors eliminate any very fine calculation for that year, any very accurate calculation; for instance, if you wanted to get the figures down to four or five decimal points you would have to take the money employed in speculation into consideration. But this sheet which I have here does not go into the matter to that extent. I think, however, it is dependable as a rough-and-tumble calculation.

This brings your problem, gentlemen, to a very definite objective—that of putting into circulation approximately 8 billions of dollars in such a manner that it will permanently increase our individual demand deposits that amount—to restore the status quo ante this depression.

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Now then, the banker has the privilege today of issuing our money, practically all of it. The amount of currency and coin in circulation actually transacts, I believe, less than one-half of 1 percent of our total business. I do not believe that statement has ever been made before.

That does not mean that the proportion of actual money to bank credit should be one-half of 1 percent. But it does mean that you can almost disregard money in your banking calculations, not only because the total of transactions performed with currency are small but also for another reason. The money that we have in our pockets was drawn out of a bank by ourselves or somebody who had a deposit and who drew a check for it, and we ordinarily use it for one transaction only while it is outside the bank. That is, we buy cigars, or pay off the grocer, or pay for some other thing, and it goes directly back into the bank. It does not circulate through several transactions as in our early history before the days of the check book.

Say there is a check for $100 on which you drew out the money you have in your purse. This check has no direct effect on commerce, but you spend this money in several transactions whose total is $100 so that in your total of checks you have automatically all of your cash transactions. But you do not have to bother with the cash at all in your calculations.

Currency and coin in circulation has very little effect on any calculation in which you are trying to determine the velocity of money.

As I see it, the problem before Congress is one of refurnishing this Nation with a sufficient quantity of money of some kind, not guessing at it, and not leaving it to expand or contract by accident—not leaving it entirely to a mechanism that is operated entirely by emotion of two kinds, optimism and fear. Those are the two controlling factors in the operation of the banking system today, optimism and fear, and under this absurd system these two emotions are responsible for our recurring periods of inflation and depression.

When things go along good our banks, prudently and properly, in order to make money for their stockholders, expand this credit money until their reserve is so thin that it looks like cellophane. And as far as our State banking system is concerned, it can go beyond that; it can borrow book credit from another bank and use it as a reserve, so they have no reserve at all. And they loan some more on that bank credit reserve, hoping to God that nothing will happen, and the banker goes around all day in nervous apprehension hoping that nothing will happen. He is out on a limb, clear out on the outermost twig of a limb. And then something does happen. It may be in Russia, it may be at the North Pole, but the banker is trying to operate a machine which requires such a delicate balance of income and outgo that its preservation depends upon the succession of a series of improbable accidents and when something happens, real or imaginary, he gets frantic to get on a safe basis. He begins calling every loan, destroying our active medium of exchange, and industry and commerce are shot as innocent bystanders.

That is the picture of our monetary system today. That is the absurd, impossible system which we, an intelligent and resourceful Nation, are trying to create and exchange wealth with.

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Now then, gentlemen, I calculate that since 1929 it has cost this Nation in loss of property values and loss of income $400,000,000,000 to preserve the sensitive feelings of a few men and to preserve a $3,000,000,000 investment in the bank stocks of this country. That is what it has cost us. That is what it has cost this Nation, $400,000,000,000 in material loss, to say nothing of the total of human suffering and misery and despair, to preserve a $3,000,000,000 institution, and we need not necessarily have destroyed the $3,000,000,000.

New, gentlemen, really, you know, we ought to be approaching the point in intelligence when that sort of thing is no longer possible. We ought to be getting nearly to the place where we could understand this situation and where we, as a Nation, could have some reliable medium of exchange to do business with.

We all know what the banking system is; let us be frank about it. If we could get one week's open honest discussion in America, a perfectly frank discussion, unlimited or uninfluenced by prejudice or selfish interests, we would have a monetary system through the operation of which this country would soon rule the world. We have the resources, and we have a surplus of inventive genius and a very extraordinary capacity for organization in this country. The other nations do not seem to have it. We have the natural resources, and there is no computing, there is no imagination sufficiently active to fully picture what this country could be if we had a sound and adequate monetary system which would permit us to operate at full capacity. We have everything else. We have the resources, we have the productive facilities, we have the machinery for distribution, but we have not got the money to make the transfers that we ought to have. That is all that matters with us today. Eight billions of our demand bank deposits which were in active use—one-third of our active medium of exchange, has been withdrawn from circulation.

That is the only reason all of these alphabetical monstrosities are being created daily by people who have a cloud over their imaginations, who apparently cannot distinguish between cause and effect, but who are trying to remedy, by some obscure means, a glaring thing which is right out before us where everybody can see it, simply the lack of sufficient money to effect the transfer of goods and services we can create. That is all we lack and all we have lacked.

We do not have to promote the interests of any groups, gentlemen, to balance production and consumption. Under the capitalistic system and with a sufficient amount of money in circulation to transfer the things that we produce, we will continue to produce and exchange more until we are at the limit of our producing capacity, until every man in the country is producing all he can, to get all he can in return.

We do not have to protect labor, because when we reach that situation—and I have seen that situation many times in various sections of our country—labor is at a premium.

Your total capacity for production depends upon the labor you can secure, and when labor is at a premium the employer, in competition with other employers, forces automatically and will force without an organized labor effort a fair division of the gross income for labor.

We have had in this country, sometimes for 4 or 5 years at a time, a condition in which we had that perfectly balanced situation. Every time we have reached it some selfish interest strong enough to influence

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Congress has opened our immigration doors, getting in a lot of cheap labor, or something of that sort, or has shut off the money and created a panic.

Now, then, Mr. Chairman and gentlemen, my objection to this bill is that it does not amount to anything positive and certain. You have not done anything definite and fixed. You have made no real progress at all in monetary science. You have come no nearer supplying this Nation with a stable, adequate, and permanent supply of money when you have passed this bill than we have now. But you have created the machinery, gentlemen, by which selfish interests could take hold of this central organization and in a very short time own what little of the country they do not already own.

I am afraid of such a device, tremendously afraid of it.

I mean to cast no reflection on Mr. Eccles or the other members of the Federal Reserve Board. They apparently are unable to imagine any system other than the present one. They unquestionably have done in this bill what they could to help make usable the machinery which they propose to control. I believe their intention to use the power they seek for the public good is sincere. But what about future bodies of men you are going to turn this machinery over to, who you cannot control? What are they going to do with it?

Suppose Mr. Eccles passes out of the picture tomorrow and we get somebody out of Wall Street, or some of the partners of Rothschilds in Europe—and we have some of them here in America, and they are the most powerful influence in America today.

Ordinarily, they run our Government as certainly as though they owned it. Suppose you give them this mechanism? That is something to think about, because they are going to be in power again. They may be out of power temporarily, but they will not be for long.

You are creating a mechanism, exactly the mechanism that they have tried to put into operation in this country since the Declaration of Independence. It has no brakes on it anywhere. It just simply creates the mechanism and the power and puts it in these men's hands and says, do what you darn please with it and with this Nation. There are no safety devices; there are no mandates from this Congress, which has the power to say, under the Constitution what they shall do with the volume and value of our money, which controls our destiny.

I think it is the most dangerous piece of legislation that has been offered in the United States Congress for many, many years.

I think it could be amended. I think the objectives of the men who have designed this bill are all right. I think they are moving toward giving this country enough money, but it is for this Congress to put in this bill definite mandates which will compel these men to attain their objectives.

Some time ago there was a call issued by one of the Senators and some men who are devoting their lives to a study of this question for a conference here in Washington of the representatives of a large number of independent organizations, all of whom have made their own independent study and concluded that our present situation is purely a monetary phenomenon. They met here in Washington, and it was called the National Monetary Conference.

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I was present at that conference as an independent monetary student, representing nobody but myself. Men were called upon to express their views as I was, and I expressed my views there, and at the conclusion of the meeting certain resolutions were drawn up. I was appointed chairman of the committee to draft the legislation contemplated by those resolutions.

On that committee is also former Senator Robert L. Owen, who designed the Federal Reserve law and, as you all know, is one of the profound monetary students of the country, and who has devoted the major part of a lifetime to this study.

On this committee is also Prof. Irving Fisher, who, I will say, is unquestionably the outstanding monetary authority in this country, and who has devoted at least 20 years to intensive monetary study under circumstances which have given him the opportunity, the extraordinary opportunity, for arriving at correct conclusions. As I say, he was on that committee.

Mr. Robert Bruce Brougham, who has also—in recent years at least—devoted considerable time to this study; Mr. Ward, who is an attorney associated with Father Coughlin, and who was quite prominent in this discussion, and myself were on the committee.

The conclusions of this committee do not represent any personal ideas that these men have. Three of these men are students, real students, not for the purpose of promoting some pet idea but for the purpose of assembling and digesting all of the knowledge that is reliable and available anywhere in the world, and all of the conclusions of all other outstanding men who have studied this monetary question extensively and concentrating for their own guidance, as clearly as possible a summary of the most enlightened thought and investigation and conclusion upon this monetary question, in addition to their own extensive experience and knowledge.

Those men also know this Nation; they know the United States, and I believe are able to distinguish between the necessities of this country and that of other countries in so important a movement as improving our monetary system.

Some things which we need would not fit Europe at all. Some things which they require would not fit us at all.

So we cannot simply take the English banking system or the French banking system, or some other foreign system, and apply it here, because it would not work, for a great many very simple reasons. But some of the foreign systems do have some good features which are abundantly proven by long satisfactory use.

We have drawn up a bill and intended to attempt to interest some of the Members of Congress here who have made a particular study of this question, when this bill which you are now considering came on from the Treasury Department. This bill, which was drawn by Mr. Eccles and by Mr. Morgenthau, or perhaps Mr. Coolidge, the Under Secretary of the Treasury, and the man who is at the head of the Federal Deposit Insurance Corporation, Mr. Crowley. They were the principal parties, as I understand it, in drawing the administration bill. How much advice they took from other people, or how much study they made of the question, I do not know.

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I do not think the bill is very adroitly drawn. In some respects it seems to me to be very amateurish.

I perhaps ought not to say that, but it does not seem to me like a fininshed bill, even for what they want to accomplish. However, it is what it is.

We decided—and I am speaking now not as an independent monetary student, but as the representative of the monetary conference—we decided that the cause would be more swiftly advanced if we joined in with the progressive sentiment in Congress which was unquestionably for monetary reform, to see if we could not get all of our ideas together and amend this bill, instead of promoting the measure we had prepared.

I prepared a little statement, which I have here, which presents the concensus of our opinion as to the amendments necessary to make the administration bill constructive, practical, and safe.

I would like to say in reference to these suggestions that there are three proposals here, and they are to a large extent already anticipated, perhaps in other proposed legislation, which has been discussed for the past 3 or 4 years.

The most important proposal, it seems to me, is to create a Federal Monetary Authority. This proposal was first advocated by Mr. Frank Vanderlip, who is perhaps our ablest commercial banker with a full and useful lifetime of experience, and Mr. Goldsborough of your committee, who is regarded as one of your outstanding monetary students.

Mr. SISSON. Do you expect to answer questions asked by members of the committee at some point in your statements?

Mr. HEMPHILL. Yes.

Mr. SISSON. Would it interrupt you now if I asked you one or two questions?

Mr. HEMPHILL. May I read this recommendation first, and then we will have it on the fire.

Mr. SISSON. Yes.

Mr. HEMPHILL. It is recommended that the bill now being considered be amended by striking out title II and substituting therefor three paragraphs in appropriate language which will, first, establish the Treasury of the United States and its branches as the sole depository for all bank reserve funds.

Second, require all banking institutions in the United States and the Territories—and the United States post offices in certain rural districts—to carry checking-account deposits as trust funds in cash in their vaults or deposited in the United States Treasury, or invested in United States Government bonds; and all banks to maintain a 5-percent cash reserve against all time, savings, or other than checking-account deposits.

Third, create a politically independent Federal monetary authority which would exercise, under definite congressional mandates, the constitutional monetary powers of Congress.

As to the last provision I want to say that owing to Congressman Goldsborough's activities you have had before you for 2 years, I think, a monetary bill, or a bill to establish a monetary commission, which is what we have in mind here.

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I think it is greatly to the credit of Congress and it is a great compliment to the intelligence and the sincerity of this House of Representatives that you gave that bill such an enormous vote.

Mr. GOLDSBOROUGH. We had a bill passed in 1932 which would simply declare a policy, which was a different bill from the monetary authority bill.

Mr. HEMPHILL. But it had the same objective. You have that principle in all the bills you have introduced here, have you not?

Mr. GOLDSBOROUGH. Yes.

Mr. HEMPHILL. Now, this recommendation further suggests that the mandates should require (*a*) that the Federal Montary Authority purchase for cash or credit upon the books of the Treasury of the United States all United States bonds not held by banks as of some past date, preferably June 30, 1934, or so many of same as may be necessary to restore full employment at a satisfactory price level, and thereafter to keep the price level stable by, first, the purchase or sale of United States bonds; and, second, the issue of currency or assessment of taxes.

(*b*) That the Federal Montary Authority liquidate all Government financing organizations as rapidly as possible by transfer of their business and assets to commercial and savings banks of the Nation.

In other words, let us take the Federal Government out of banking business entirely.

These additional recommendations are suggested: Repeal the Federal Reserve Act, as amended; repeal the National Bank Act, as amended; and let our banks go back to the supervision of the States, all of them.

The program I have read, which is suggested, would put in circulation approximately 15 billions of additional currency and would restore full employment in the Nation, and elevate prices, wages, and property vaues to about the 1928–29 level. It would increase the national income by 45 billions. Thereafter, the payment of normal Federal Government expenses would be substantially the correct amount to preserve full employment without elevation of the price level.

Thereafter the wealth of the Nation would increase as fast as our productive capacity increased.

Attention is called to the fact that it was no doubt the intention of the founders of this democracy that the Government should issue all the money necessary for our exchange of goods and services and that the banks of the Nation should care for it and loan our savings and surplus profits. That situation is now precisely reversed. The private banks of the Nation are creating the money and the Government is loaning it to agriculture, commerce, and industry.

The program proposed is merely a return to the status originally contemplated.

It is also designed to end the present period of wildcat-bank-credit issue, which in effect is but a continuation of the wildcat-bank-note period of the first half of the nineteenth century.

I do not believe, gentlemen, there ever has been a time in our history when the opportunity was so favorable to create for this Nation for the first time, and, in fact, for the first time in civilized history,

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a real monetary system. We have none today. We have no monetary system.

We have to borrow every dollar that we have in circulation, cash or credit.

If you will examine the consolidated statements of all the banks you will see—we took all the money that the Government issued and bought bank stock with it, and when we finished doing that we had neither money nor bank credit and since that time the individuals in this Nation have been obliged to borrow from their banks every dollar of cash or credit there is in circulation. That may be a startling statement to you, but that is true.

Every dollar you have in your pocket, every dollar of credit you have in your bank account, was borrowed by somebody from some bank. It may have been borrowed by the man who gave you a check for it, or it may have come to him through several different transactions. But if you will go back far enough you will find it was borrowed from somebody, and you are lucky that you have it. If someone, in the chain of transactions between the borrower and you had been compelled to pay a note to the bank, you would not have your bank account today. That will show you how absolutely we are dependent upon a system which is essentially unsound. If we had a system which did not have to destroy commerce and industry to preserve itself, every few years, nobody would kick about it. I am not kicking about the interest we pay; that is a small matter. It is unnecessary, but I am not kicking about that.

But this institution, for its own preservation, has periodically to almost destroy this Nation in order to preserve itself.

Those are the considerations which I think that this Congress of the United States ought to think about. You gentlemen are here representing the people of this Nation and not a few banks in Wall Street or elsewhere; and not just a few subsidized newspapers.

You are here to pass as few laws as possible to preserve individual freedom in this country.

We are slaves today; we are the absolute slaves of an impossible, unsound, unworkable system which creates what we call "business cycles." When things are going good they will go along, but they almost immediately get out on a limb and when everything happens they are compelled to contract the currency we are using to exchange our goods and services and we have a depression and we call these recurrent periods of bank credit expansion and contraction "business cycles."

I think, Mr. Chairman, that I have said all the mean things I can think about for a while, and I will be glad to answer any questions the members of the committee may desire to ask.

The CHAIRMAN. Your objection, as I understand you, to the bill before us is that it continues and emphasizes the present condition; it does not enlarge the absolute control of any limited number of men in charge of the Federal Reserve System or the business life of this country?

Mr. HEMPHILL. Yes, sir.

The CHAIRMAN. As I understand you, the thing you advocate is to set up a similar body with similar powers and similar authority and similar possibilities?

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Mr. HEMPHILL. No, sir. We propose to set up a body which will operate strictly within the lines prescribed by this Congress, who will be nothing but office boys, nothing but clerks, with nothing to do except to carry out the specific provisions in the law.

The CHAIRMAN. Are you sure that your statement is entirely accurate, in the light of the program which you have just read or the resolutions which you have just read to the committee?

If I caught the reading of those resolutions, you would have a monetary authority with the power, and whose duty it would be, to establish a satisfactory price level. Could that be accomplished automatically?

Mr. HEMPHILL. Yes, sir.

The CHAIRMAN. Who would determine whether it was satisfactory?

Mr. HEMPHILL. I think Congress should determine that—put it in the law.

The CHAIRMAN. You do not say that Congress shall determine what the satisfactory price level shall be. You provide that Congress shall set up a body who shall conduct their operations and exercise their powers to the end that they may establish a satisfactory price level which, of course, would be determined by them, would it not?

Mr. HEMPHILL. I am glad you mentioned that point, because I want to make that very clear. Our proposal as I have read it here is merely a statement of objectives in general terms—you understand it is not in any way a bill.

The CHAIRMAN. I understand that you have not put it in the form of a bill, but to the extent I have pointed out you have been specific.

Mr. GOLDSBOROUGH. May I interrupt for a moment? If you will remember, in the monetary authority bill considered in the last Congress by a subcommittee of this committee the powers of Congress were not delegated except insofar as delegating to the authority as experts the power to carry out the specific mandate contained in the bill.

Mr. HEMPHILL. Exactly. Let me read this recommendation again.

The CHAIRMAN. Mr. Goldsborough is quite correct in what he says about the bill he introduced last year, which was considered in this committee. But you are not following that bill in toto. You leave to that Board the exercise of discretion which would be used to bring about a satisfactory price level and restore employment. But they would be the judges of whether or not that had been accomplished.

Mr. HEMPHILL. Not necessarily. Let me make myself very clear. This recommendation provides: Create a politically independent Federal Monetary Authority which would exercise, under definite congressional mandates, the constitutional monetary powers of Congress.

The CHAIRMAN. Let me make myself clear. I think that is all desirable and that it is a good mandate, insofar as you may give one in generalities; that is the thing that is desired.

But that leads me to this inquiry. I have never been able to see the difference in any machinery that might be set up under the new suggestion of a monetary authority and the authority that we establish or preserve under the bill now before us. And, just as you said a few minutes ago, I think it is quite true that, after all, the selection

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