will always be able to make customers' loans; and the way to do that is not to give them too much money in ordinary times. Don't overfeed them when they do not need it, and then they will have plenty when they do need it.

Senator McAdoo. Have you concluded your written statement?

Mr. Anderson. I was just going to give you some figures that I think might not be readily available to you with reference to real-estate loans and bank failures, because I am aware that testimony has been presented that suggests that statistics do not show any connection between bank failures and real-estate loans, and I wanted to give you what little evidence there is available on that point. I know as a banker—and I have been watching this thing as a banker since 1918—that a great multitude of banks have got into trouble from too large real-estate loans. I never saw a bank in trouble from having too much liquid stuff.

The figures that have been referred to apparently are figures for the whole country, and figures by States and Federal Reserve districts showing how much real-estate paper there was in the banks and how many failures there were. The figures do not mean very much, because they do not make the contrast within a State, a Federal Reserve district, or within the country between the failed banks and the successful banks as to the percentage of real estate. That is the real test. But that has been worked out for the State of Florida in a publication of the University of Florida called "Forewarnings of Bank Failure", by Harward B. Dolbeare and Merle O. Barnd, published by the University of Florida in June 1931. It covers the period from 1922 to 1928. That document shows that during that 7-year period the average percentage of total resources invested in real estate was 5.8 percent for the failed banks and 2.6 percent for the successful banks.

The difference between the failed and successful banks also is shown in the relation of their real-estate holdings to their net worth. In the successful banks the real estate was approximately one-fourth the net worth. In the failed banks the amount of real estate at all times was nearly 50 percent of net worth.

The Reserve Bank of Minneapolis, in a study published in September 1930, of the causes of bank failures in the Northwestern States, by Curtis L. Mosher, Assistant Federal Reserve Agent, analyzing the factors in the failures of banks, on page 19, says [reading]:

> Of all the factors involved, the most important was the collapse of land values following the collapse of agricultural commodity prices, because so great a proportion of the paper hold by banks was collectible only in proportion to the true land and farm products values behind it.

A study made of bank failures in Arkansas by Messrs. Fred L. Garlock and B. M. Gile, published by the Agricultural Experiment Station of the University of Arkansas, at Fayetteville, in March 1935, pages 74–75, says [reading]:

> Bank failures and also less serious difficulties of Arkansas banks during the depression appear to have been due mainly to large withdrawals of deposits and to excessive holdings of unliquid assets.

And they say that "banks held nearly as large a volume of slow assets in 1929 as in later years, hence inadequate liquidity during the depression was due mainly to inadequate liquidity before the depression. With proper enforcement of the suggested liquidity require-

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ments, banks would not have entered the depression in a frozen condition."

That completes the statement I wanted to make, Senator.

Senator GLASS. We are very much obliged to you, Doctor.

Senator MCADOO. I was very much interested in your testimony, and I know it is valuable because of your high reputation as an economist. I want to ask you one or two questions, because you referred in your testimony to sound money. What is your definition of sound currency?

Mr. ANDERSON. A general definition—I might want to think about it a minute—covering all times and all ages—

Senator MCADOO. I am speaking of our country and of this period in time.

Mr. ANDERSON. Real money is gold of a fixed weight and fineness. Paper money is a promise to pay real money—gold. Paper money is sound if the promise is kept on demand; and a sound monetary system is one in which this promise not only is kept but can certainly be kept. It involves not merely the question of the size of the gold reserve, but also the question of the general liquidity of the rest of the assets of the issuer and his other liabilities. It involves also the question of budgetary soundness on the part of the Government, and things of that sort. The question of how much gold is needed in order to have an adequate backing varies enormously under different conditions. England in 1913 had about $600,000,000 in gold in the country, including a great lot of gold in circulation among the people because they had no paper of less than $25—the 5-pound note of the Bank of England. We had about 18 hundred million. We were pretty hard pushed to make 18 hundred millions serve our purpose. We got along, but there were times when we felt we would like to have more. England easily did the banking business of the world with 6 hundred millions, the reason being that it kept everything else liquid. It had its credit based on readily marketable commodities. It had experts grading of commodities; it had an experienced body of speculators willing to buy at a concession in price anything that came to London; it had the very finest sort of credit methods; it had houses that did nothing but guarantee names, because they were studying names all over the world; it had in the banks a great lot of paper due from foreign countries.

Senator MCADOO. Of course, their whole banking system and structure are different from ours.

Mr. ANDERSON. By that method they did not need to have as much gold as a less liquid system requires.

Senator MCADOO. Precisely. Do you know what gold reserve the Bank of England carries against its currency?

Mr. ANDERSON. Against its notes it kept 18,000,000 pounds in Government securities.

Senator MCADOO. What percentage?

Mr. ANDERSON. Against notes I would have to look to see, but everything else was gold, pound for pound for any note issue above that which in 1844 was looked upon as about the minimum. All additional after 1844 it has built up, pound for pound, on gold.

Senator MCADOO. I was just wondering whether you knew what percentage of gold was carried against the outstanding circulation of the Bank of England?

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Mr. ANDERSON. Far above 50 percent. It was easily 75 percent, I would say, and perhaps more than that. That is subject to correction.

Senator MCADOO. In our country it is generally accepted as axiomatic—that is, bankers have usually so informed me—that a 40-percent reserve of gold against our currency made it sound. Do you subscribe to that?

Mr. ANDERSON. Forty percent if you are paying on demand. Grover Cleveland got along once with 11 percent, and kept on paying.

Senator MCADOO. He had some trouble.

Mr. ANDERSON. He had some trouble, but he kept on paying.

Senator MCADOO. I am differentiating, of course, between our Government and any other government. Here the Government issues the currency and is primarily responsible for it. With a Government issue of currency do you think that a 40-percent gold reserve is adequate to make it sound in the sense that the bankers use that term?

Mr. ANDERSON. It becomes a question of the general credit of the Government——

Senator MCADOO. I am speaking of our Government, now, and its credit.

Mr. ANDERSON. Our Government is not now redeeming on demand except for export purposes.

Senator MCADOO. Government notes with 40-percent gold reserve—would you consider them good and sound?

Mr. ANDERSON. I would want to know what else there was for the 60 percent. What is it? The general credit of the Government, its taxing power, its borrowing power and its disposition.

Senator MCADOO. You know what that is in this country. I am asking the direct question, Doctor, whether or not our Government, issuing its notes as we have them out now, all our notes, whether in the name of the Federal Reserve banks or anything else, but being Government notes, United States Government obligations—I want to know if you consider that those notes are sound money with a 40-percent gold reserve back of them.

Mr. ANDERSON. May I make a statement off the record, Senator?

Senator GLASS. Yes.

(Informal discussion took place which the reporter was directed by Senator Glass not to report; after which the following proceedings occurred:)

Senator GORE. I would like the doctor to tell us what would have happened if we had stayed on gold at the peak of the depression in the summer of 1932—if you do not think I am taking too much time, Mr. Chairman. I do not want to impose upon the committee.

Mr. ANDERSON. I will try to make as brief an answer as I can. Let us trace some history. That is the best way. The shock that came to the world in 1931, when England went off gold, precipitated the gravest disorders of the whole period. Things had been pretty bad before that; but if we get back to the first half of 1931 in our railroad earnings and employment, we would feel very good. With that there came the worst disorders of the whole period. We had, by the way, from February of 1932 to July of 1934, the biggest percentage

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break in our securities in any single movement. We had the biggest slump in the volume of production, and all those things. In June aud July of 1932 there came three heartening things: One, we had the satisfaction of being able to announce to the foreigners—and I had the pleasure of announcing it on that day in a speech to the foreign press correspondents in New York—that the foreigners had taken all the gold they could take! if they wanted any more, let them come and get it, but we still had a billion dollars more in the Federal Reserve System than the legal reserve requirements. I felt very cocky that day, and I told them so. Then came the magnificent vote of the United States Senate on the soldiers' bonus, voting 62 to 18 against the Patman bill; and then came the declaration by both political parties in favor of sound money.

Senator McAdoo. And then came the prospect of Democratic success. Don't forget the fourth.

Mr. Anderson. Then there came a rally in securities, followed by improvement in commodity prices and an impressive rally in business and employment. Do not let me make a political speech here, gentlemen, but there came in the campaign itself a renewal of the fears regarding the gold standard, and then a variety of other things partly political, partly financial, that took us into the banking disorders; but that turn in 1932 could very easily have been the bottom of this whole trouble for the United States, as it was for the world generally; and the best thing that can be done to get things going straight again is to restore confidence in the gold content of money in this country and in England and elsewhere.

In 1920 we did not think that it was good to go off gold or that it was good to let our currency slip with the countries which perforce were having their currencies slipping. There was talk about the danger of imports from those countries, fear of imports from Germany, and all that sort of thing; but we stuck to gold and we had the quickest revival of all. We had a labor shortage by early 1923.

Senator McAdoo. You do not attribute that to gold, do you?

Mr. Anderson. That was a very vital part of it. Holland and Sweden and Switzerland, which clung closest to gold, had the best recovery on the other side, and the countries that let their currencies keep on slipping went on down and down.

Senator McAdoo. I think we have got to know pretty thoroughly the economic situation of those countries, to arrive at an explanation as to how those recoveries came about. I do not think they can be attributed solely to money.

Mr. Anderson. No. One other thing that my friends in Sweden and Holland both attribute their recoveries to was that they did not allow themselves to be tied up with high tariffs but kept their low-tariff policies; and the combination of free trade, as one of the Swedes put it, and sound money was the thing that they base their recovery on.

Senator McAdoo. I notice Mr. Montague Norman attributes the British recovery very largely to the fact that they went off gold——

Senator Glass. They went off gold because they did not have any. We went off gold when we had 43 percent of all the gold in the world.

Senator McAdoo. I am not speaking of that. I am speaking of the fact that it did go off gold and had a very considerable increase

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in the currency; and Mr. Montague Norman says that he attributes their recovery in very considerable measure to those facts.

Senator GLASS. It is an interminable problem, gentlemen. It is very interesting, but there are two other gentlemen here who wish to be heard, and they want to leave for their homes.

Senator GORE. Would it be agreeable to the committee if Dr. Anderson would insert in his statement an explanation of the policies pursued by Japan, one in the depression of 1920 and one in the depression of 1929 and '30?

Senator GLASS. We would be very glad to have him do so.

Mr. ANDERSON. I will try to do that, Senator. [Dr. Anderson later called attention to his discussion of Japan in his Rotterdam speech, which appears in the record above, and to his reference to Japan in his testimony in the morning session.]

(Witness withdrew from the committee table.)

STATEMENT OF ROBERT M. HANES, PRESIDENT WACHOVIA BANK & TRUST CO., WINSTON-SALEM, N. C.

Senator GLASS. Please give your name and occupation for the record.

Mr. HANES. My name is Robert M. Hanes. I am president of the Wachovia Bank & Trust Co., Winston-Salem, N. C.

I cannot tell you anything about economic theories or anything of that kind, but I do want to talk to you about how this banking bill is likely to affect us in North Carolina.

We are opposed to the one-eighth of 1 percent compulsory assessment. We do not believe that the banks in our section are earning enough to pay one-eighth of 1 percent annually. One-sixteenth of 1 percent is as much as the banks in their present condition can stand in our section, certainly.

Also in the bill is the provision that 10 percent of earnings must go into surplus. We have got increased costs of labor due to the N. R. A., increased cost of all supplies, and those banks that took R. F. C. capital have dividends to pay on that. So the earnings today of banks in my section will not permit, I think, of their paying one-eighth of 1 percent into this fund. I think it ought to be decreased materially.

Senator MCADOO. You are speaking of the insurance fund?

Mr. HANES. Yes, sir. I think that the fund could be lowered very safely for the F. D. I. C. if it is allowed to have the powers which I believe it should have to regulate the banks. I believe they should have the right to accept what banks they want and to expel those that do not carry out the orders that they give. If the banks are regulated properly and made to run properly, the losses will not be large. If they are not regulated, there is no fund that you can set up at all, because wildcat bankers are going to "bust" any fund in the world, no matter how big you make it. With the power that the F. D. I. C. has we do not think it is necessary to have a large yearly assessment.

Senator GLASS. What have you to say to the suggestion that has been made that the assessment should terminate when the fund amounts to $500,000,000 and be automatically resumed when the amount is impaired by 25 percent?

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Mr. HANES. I think, sir, that is a question of the conditions at the time. Personally I should prefer a smaller assessment that would keep going. You would know exactly what your costs were to be every year, and you would not have it raised some years and dropping out entirely in others.

Senator GLASS. What is the use of assessing banks when there is no need of it?

Mr. HANES. I would not think there was any use. I think if you leave that optional with the Board, it could use its discretion, but under the bill as it is now written they have no discretion.

Senator GLASS. I am talking about the suggestion that the assessment be made annually until a certain fund is provided, and then automatically ceased, and then automatically be resumed when the sum is impaired to the extent of 25 percent.

Mr. HANES. If in the discretion of the Board that was assessed, it would be perfectly all right.

Senator GLASS. I do not know that we would want to leave it in the discretion of the Board. We would want to make it a statutory requirement. That is the suggestion that is made.

Mr. HANES. Under title II, I believe, sir, that the Government should not have control of the Federal Reserve Board. I do not believe the Federal Reserve Board ought to be connected with any administration, whether it be this administration or any other administration. I am not dealing with administrations, but I believe that the Federal Reserve Board should be divorced from the Government entirely. I think it ought to be disassociated entirely from politics or from any administration that might be in power, in order to run the Federal Reserve banks in the best interests of the stockholders of the banks and of the public generally.

I believe that the open-market committee as set up by the bill is thoroughly unsound. In my opinion, governors of the Federal Reserve banks certainly should have equal representation, not in number but in voting power, with the members of the Board on the open-market committee. As the bill is now set up it would mean that the Secretary of the Treasury, I believe, could put our reserves in the Federal Reserve banks into anything he chose, long-time Government bonds in any amount and any length of time, and whether we needed them or not, there they would be. It is not our money; we are trustees for it. It was put in by our depositors, and I think we are bound to accept responsibility for it and keep that responsibility. I do not think it is right that a law should be passed that this responsibility should be placed with others over whom we have no control at all. That is what would happen under the present set-up of the open-market committee.

I believe the rediscount privilege of Federal Reserve banks should be tremendously limited over what it is in the bill. If you let all sound assets be rediscounted, it would mean, I think, certainly, that the Federal Reserve banks in times of stress would find themselves just as frozen as would the member banks, and the Board could not come to the help of the member banks as it should be able to, because they would be filled with all sorts of nonliquid investments themselves. They would probably not be in position to redeem the currency which they have issued and not be in position to help the member banks.

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Under title III, sir, the limitation on officers' loans in banks to June 16, 1935, is totally unfair. I am not speaking personally, because I do not happen to owe any money to my bank or any other bank, but I do not think the officers should be singled out as a group and told that they have either got to get those loans out by June 1935 or else write them off the assets entirely.

Senator BYRNES. How much time should be given, in your opinion?

Mr. HANES. I should say, 3 years ought to be a fair time for that, a 3-year extension. A great many of those loans are backed by real estate in the smaller communities, and they have had no opportunity to sell that real estate. They are perfectly willing to do it, but they cannot even give away real estate in some places.

Senator MCADOO. You really ought to have time enough to liquidate that class of stuff. A lot of it is perfectly good, but there is no market for it at the time.

Mr. HANES. That is correct.

Senator TOWNSEND. Do you think 3 years will be a sufficient time?

Mr. HANES. I hope so, if we have the recovery in real-estate values that I hope will come in that time.

I think bank officers ought not to be allowed to borrow from their banks, but I believe you ought to give them a reasonable time to get out from under the loans that were made when it was legitimate to do it.

Senator GLASS. I think that is the purpose of the committee.

Senator BYRNES. You have no information as to any percentage secured by real estate; you are just speaking generally?

Mr. HANES. Yes, sir. That is all I have to say, Mr. Chairman.

Senator GLASS. We are very much obliged to you.

(Witness withdrew from the committee table.)

STATEMENT OF MILLARD F. JONES, VICE PRESIDENT, PLANTERS' NATIONAL BANK & TRUST CO., ROCKY MOUNT, N. C.

Mr. JONES. Gentlemen, I am just here to discuss a few of these matters. I am neither an economist nor an authority on banking and finance, but I want to say that I concur in what Mr. Hanes has expressed as to title I. I will not repeat any of that.

With respect to the question the Senator asked about raising the fund to $500,000,000 and then discontinuing the assessment on a yearly charge, I think that is proper if it can be done. If it is impaired to the extent of 25 percent, then to reinstate the annual assessment until the fund is built up again to $500,000,000, and to give the banks the advantage of that. I happen to know in respect to our bank on the basis of average earnings in the last 3 years at the rate of one-eighth of 1 percent would have paid close to 16⅔ percent of the bank's earnings.

Senator MCADOO. Is yours a State bank?

Mr. JONES. A national bank.

Senator TOWNSEND. Sixteen and two-thirds percent of its net earnings?

Mr. JONES. Yes, sir. In 1934 our earnings were very good, but in 1932 and 1933 they were somewhat lean.

Senator TOWNSEND. 1934 has been pretty poor with a lot of them, and also 1935.

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Mr. JONES. There was one thing in title I that I was very much interested in, and that is the matter of the F. D. I. C. being permitted to regulate the maximum rate of interest paid on time deposits. I think if that could be made the universal rate in line with what the Federal Reserve Board is now requiring of member banks it would have a tendency to promptly prevent some dangerous competition that could lead to future trouble among member banks.

For instance, where the maximum was 2½ percent and they elected to pay 2 percent where the other bank is probably paying 3.

Senator BYRNES. The Board would have no jurisdiction over any bank which is not a member of the Federal Reserve System, whereas a lot of State banks can be members of the F. D. I. C. Under the circumstances could we fix that by putting a provision in the bill that so long as they are not members of the Federal Reserve System one of the conditions before they are admitted to the F. D. I. C., to give them the benefit of insurance, is the acceptance of the rate on time deposits of the Federal Reserve Board?

Senator TOWNSEND. But they are already in existence.

Senator BYRNES. We can still impose that condition.

Mr. JONES. It would give a uniform rate of interest throughout the country.

Senator TOWNSEND. Would you expect them to cooperate?

Senator BYRNES. I think it is easily made a matter of legislation, to put the authority somewhere where it would be applicable to all.

Mr. JONES. With reference to title II, I would like to state that, my bank being a national bank, of course, we are a member of the Federal Reserve System and we appreciate the membership and thoroughly recognize its value to us. These thoughts I am giving are the result of interviews with bankers in North Carolina. I have just retired as president of the State association, and this information is more or less what I gathered from interviews around through the State. I am informed that there are a large number of insured nonmember banks in the United States in apparently weak condition, and if those banks were to go into the Federal Reserve System, until their condition is improved it would appear to me that the Federal Reserve System would be proportionately weakened by those weak members coming in. But possibly by giving them time in which to get their condition in better shape, it would not reflect upon the system by having some weak members come into the System at this time.

With regard to the matter of the Governor of the Federal Reserve Board, who, as I understand the bill, is appointed by the President to serve at his pleasure, I believe that in the event he is relieved of the duties of Governor he has a right to continue on his unexpired term as a member of the Board. It appears that that is putting a good deal of authority—and I do not refer to our present President—in the hands of the administration to control the Federal Reserve Board. If the Governor is not going along with the administration or in harmony with the policy of the administration, he might be removed and someone substituted who might be in full accord. There appears to be a great deal of authority here which is more or less centralizing things, and, as I understand it, we are trying to decentralize rather than to centralize too much. That can have its ill effect on banks as well as possibly some good effect.

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There is also a provision in the bill on the open-market policy, having a committee—I believe it is now in the bill—of five members elected by the 12 Federal Reserve governors. They are merely an advisory committee to advise and discuss, but have no authority in the adoption of the open-market policy, the policy being entirely in the hands of the members of the Board.

I think the suggestion has been made by the American Bankers Association of having four of the Federal Reserve governors to serve on that open-market committee, giving those governors authority to vote and have some power rather than being purely in an advisory capacity, and that would be of great benefit. The deposits in the member banks constitute legal reserve of member banks, and the excess reserve is very largely held by the Federal Reserve. That is more or less trusted money of our depositoirs. We carry those funds, and we of course would like to see them properly handled and the policies adopted by the open-market committee to be more or less universal and give each bank, if possible, the right to act as they think best in the handling of it. The conditions in Boston would probably be different from those in Dallas. If they have one policy that we all have to follow and each reserve bank has to carry out, there might come a time when it would not be entirely in the best interest of the community in which that Reserve bank is serving.

The question of the discount rate which the Board has authority to regulate can be used to advantage as well as to the disadvantage of business, to create business conditions or to improve them or reduce business, as the case may be. The same rule would apply to the reserve requirements being raised or lowered. The reserve requirements, as I understand it, can be raised either in the district or in the central reserve or reserve city banks, whichever it may elect. That condition might possibly bring about a situation where member banks, having their reserve requirements raised, would be unable to take care of the loans in their respective communities until the reserve had been built up to the requirement that had been specified.

Senator McADOO. Your argument is directed against the Federal Reserve Board having the power to establish uniformity as to reserves throughout all the districts instead of being permitted to establish different rates in the different districts?

Mr. JONES. It ought to be more of a uniform rate.

Senator McADOO. You are speaking of reserves?

Mr. JONES. Yes. It ought not to be necessary, under normal conditions, to raise that. There could come an emergency, which we have had, where it was necessary to change those conditions, which I believe the President had approved.

Senator McADOO. As the law stands today they can increase or decrease the reserve requirements only in cases of emergency on a vote of five members of the Board approved by the President. Are you talking about the House bill?

Mr. JONES. Yes.

Senator McADOO. What do you understand it to be there?

Mr. JONES. That they can raise it at the pleasure of the Board. They can make it uniform or make it apply to central Reserve cities, Reserve cities, or some district. I think the present plan is much more acceptable, as it is in the old law.

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On the question of the eligibility of paper of Federal Reserve banks, I believe in the old theory, that it ought to be strictly paper that was received by member banks for commerce, industry, and agriculture, and be paper that is self-liquidating. The matter of loosening up on this appeared to me to be running into ground that some banks had had trouble with and would create a type of assets which would come behind our currency and not be as sound, possibly, as has been true in the past when the currency was secured by 40 percent gold and now by the 40-percent gold certificates——

Senator McADOO. To the extent of 60 percent?

Mr. JONES. Yes. In addition to that, as I understand the bill now, the assets of the Federal Reserve bank are of various natures, whether real-estate notes they have taken in or bills payable to the bank secured by sound assets or termed "sound assets." I think the eligibility rule ought to stand.

Senator McADOO. The prevailing rule?

Mr. JONES. Yes. In cases of emergency we could possibly consider making an adjustment to take care of other assets.

As to title III there is very little I would say on that. In North Carolina the State nonmember banks will have the double liability removed on July 1 of this year. Naturally the member banks and all national banks in North Carolina would like very much to see the double liability in this bill made July 1936, instead of July 1937. As Mr. Hanes stated, it would appear that by giving them some extension, in view of the fact that one third, if I am correctly informed, of officers' loans have been reduced, they should be liquidated and conditions would probably warrant their ability to do so. I do not personally believe that an officer ought to borrow from his own bank. If he has proper security he should be able to make connection with some of his corresponding banks to obtain his financing, if that security would be satisfactory to his own bank; and it relieves him of any embarrassing situation at any time.

That is, briefly, gentlemen, what I have to say. If there is any question that I can answer I would be glad to endeavor to answer it.

(Whereupon, at 4 p. m., the subcommittee adjourned until tomorrow, Friday, May 17, 1935, at 10:30 a. m.)

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BANKING ACT OF 1935

FRIDAY, MAY 17, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON
BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met, pursuant to adjournment on yesterday, at 10:30 a. m., in room 301, Senate Office Building, Senator Carter Glass presiding.

Present: Senators Glass (chairman of the subcommittee), Bulkley, McAdoo, Byrnes, Townsend, and Couzens.

Senator GLASS. The committee will come to order. Mr. Secretary will you be good enough to take the stand, please?

STATEMENT OF HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY, WASHINGTON, D. C.

Senator GLASS. Mr. Secretary, I did not imagine that you cared to make any detailed statement about these bank bills. I merely wanted to ask you one or two questions. The first one is, whether or not, as Secretary of the Treasury, you have had the cooperation of the existing Open Market Committee, provided by the statute, to conduct open-market operations?

Secretary MORGENTHAU. Senator Glass, I have been in the Treasury, now, about a year and a half, and it so happened that it was the week that I came into the Treasury that was the last week of the Open Market Committee purchases of securities, and from that day to this they have not increased their holdings. I have gotten along extremely well with the Open Market Committee. There have been no differences. I have no complaints to make as to their attitude toward me, and I do not think they have any complaints to make of my attitude toward them. But as to their effectiveness, during the past year and a half I must say that they have played a very unimportant role, during the year and a half that I have been in office. They stopped their purchases the week I came in; and with the exception of turning over their securities as they came due and reinvesting, they have played a very minor part in Government securities.

Senator GLASS. They have not put any of your securities out on the market, have they?

Secretary MORGENTHAU. I think their investments are about two and a half billion dollars, and they have kept them constant.

Senator GLASS. Do you not regard that as cooperation with the Treasury?

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Secretary MORGENTHAU. I have no complaint to make. They have kept them constant. At times I thought that they might have shown a little more courage and bought long-term securities. They did not think so, and they have kept the bulk of their money in short-term securities. But that is their judgment against mine, and I do not say that they are wrong or that I am right.

Senator GLASS. That is simply the difference between long term and short term Treasury securities, is it not?

Secretary MORGENTHAU. That is right. During the period up to very, very recently they have constantly, as their securities came due, invested the proceeds in short term securities.

Senator GLASS. Is not that good business?

Secretary MORGENTHAU. It has not proven to be in this last year and a half, because the investors investing in long-term securities have made money out of them.

Senator GLASS. At a little higher rate of interest?

Secretary MORGENTHAU. A bigger return on their money, much bigger.

Senator GLASS. Have you any substantive reason to anticipate that you cannot get on in agreement with the existing Open Market Committee?

Secretary MORGENTHAU. The relationship is such that we can get on perfectly well, because there is nothing really to have a row about. They use what they think is their best judgment in investing their money, and as custodian for the various trust funds I use my best judgment. I think that the record would show that in the last year and a half I have done better for my clients than they have for theirs; but I invested largely in long-term securities and they have invested largely in short-term securities, and as a result of that my trust funds have done better than theirs.

Senator GLASS. You have the taxing power behind your operations, have you not?

Secretary MORGENTHAU. I do not quite understand what you mean, Senator.

Senator GLASS. I mean, the Treasury can appeal to Congress to issue securities and tax the people of the country to redeem them when they mature. Is not that a fact?

Secretary MORGENTHAU. I still do not quite understand, sir.

Senator GLASS. The Open Market Committee has no such authority as that, has it?

Secretary MORGENTHAU. No. Their only authority, as I understand it, is to buy and sell Government securities for the Federal Reserve System.

Senator GLASS. They are not confined to Government securities altogether, are they?

Secretary MORGENTHAU. I don't think so.

Senator GLASS. I want to ask you this specific question. Have you any substantive reason to suppose that an open market committee composed of the present membership of the Federal Reserve Board would operate more efficiently than the Open Market Committee which is now established by statute?

Secretary MORGENTHAU. It would take me a minute or two to answer that, if you do not mind. I have a definite philosophy and thought back of it. The various controls of credit I believe should

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all be centered in one place. I believe that they should all be centered with a Government authority; and, looking toward the future, I think that the engineer and the fireman should be working together and that there should not be a possibility, if a crisis should arise, that one might want to go full steam ahead and the other might not want to put the coal under the boiler.

Senator BULKLEY. It might be better not to have any independent judgment on the part of the Open Market Committee, you think?

Secretary MORGENTHAU. No; I would not say that, sir. But these various methods are for controlling the credit for the whole Nation, and I think that that function should be lodged with a Government agency. By that I do not mean the Treasury.

Senator GLASS. But that does not answer my question, Mr. Secretary.

Secretary MORGENTHAU. I did not mean to avoid it. I was trying to explain how I felt.

Senator GLASS. I wanted to know if you have any substantive reason to suppose that an open market committee, for example, composed of the present membership of the Federal Reserve Board, would operate more efficiently or more satisfactorily than the existing open market committee.

Secretary MORGENTHAU. Well, again, it may sound as though I were trying to avoid; but what I am trying to say—and if I do not answer your question, you may ask me again—is that we have three functions for credit control, and I believe that those three functions should be located in the same place.

Senator GLASS. I understand your belief as to that. But still that does not answer my question.

Secretary MORGENTHAU. Well, I would hope that they would operate as well or as successfully if they were located with the Federal Reserve Board. But time would answer that. I could not.

Senator BULKLEY. Suppose we should abandon the theory of an open market committee exercising independent judgment and put the investment policy of the Federal Reserve banks under your discretion as Secretary of the Treasury; would you place more long-term Government securities with the banks?

Secretary MORGENTHAU. I will have to answer that question in two sections. In the first place, I would not want that authority. I do not think I should have it. If I did have it I would follow the same policy that I have followed during the past year for the various trust and other funds that we have, representing over a billion dollars. With regard to these various funds, during the past year as the money comes due we have invested it in long-term Governments, and it so happened that we have been able in every case to increase the value of the portfolio through that policy. That is a matter of record; and we have followed a uniform policy for all of our trust funds, to put them into long-term Governments.

Senator BULKLEY. In answer to my suppositious question, you say that you would not want that power as Secretary of the Treasury. However, you would like to see that power concentrated somewhere, would you?

Secretary MORGENTHAU. I would like to see it concentrated in an independent Government agency.

Senator BULKLEY. Independent of what?

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Secretary MORGENTHAU. Of all outside influences—just as independent as you can make it.

Senator BULKLEY. Independent of the President, too?

Secretary MORGENTHAU. Only that he should have the appointive power, the way he has with regard to the Supreme Court.

Senator BULKLEY. You mean, appoint somebody that he had no more power to remove or influence than he has with regard to the Supreme Court?

Secretary MORGENTHAU. Right.

Senator GLASS. That would mean that no member of that board could be removed except by impeachment?

Secretary MORGENTHAU. Yes.

Senator GLASS. Mr. Secretary, I do not want to embarrass you by pressing my particular question. I can realize why you might not want to answer it more definitely than you have; but you have answered it sufficiently to enable me to conjecture what your real judgment of it is.

Senator COUZENS. Have you any statement to make in connection with the bill, Mr. Secretary?

Secretary MORGENTHAU. No, Senator.

Senator COUZENS. Have you read the bill?

Secretary MORGENTHAU. I have read the summary which I have here, and I have studied it.

Senator GLASS. But you had not read that summary until recently, had you?

Secretary MORGENTHAU. The summary was not written until recently.

Senator COUZENS. I would like to have the Secretary's opinion. It seems to me that the question of membership on the board and the whole operation of the Federal Reserve System is closely allied to the Treasury under this proposed bill. It does not seem to me that up to date we have got any expression from him as to his views about the bill and whether he believes in it or not, and I would like to be informed, because it seems to me that his position justifies some influence with this committee.

But I understand you to say that you have nothing to say with respect to this pending bill?

Secretary MORGENTHAU. We have discussed this bill for months in the Treasury, and we have had meetings with the various agencies who lend money, that is, the heads of the various agencies, and we have gone over the controversial points and spent hours on it, and I think I may say that I understand the fundamental philosophy, the important points. I am frank to say that when you get into title III and title I, containing a lot of technical banking questions, as you know, I am not a banker; I am not trained as one; but we have experts on that in the Treasury and we leave those questions to them. I have personally spent hours and hours discussing this bill and the important points in the bill I am in favor of. But the experts in the Treasury have spent literally hours on this bill.

Senator TOWNSEND. Are you in favor of title II as it is now written in the bill?

Secretary MORGENTHAU. I am in favor of the principles of title II.

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Senator GLASS. Do you think the Government, without one dollar of proprietary interest in the Federal Reserve banking system, should be authorized, without restraint, to loan the money of the System in open-market operations?

Secretary MORGENTHAU. Senator, I happen to belong to that school that thinks that the Government should own the stock of the Federal Reserve System; and then it would have that right.

Senator GLASS. You belong to the school that believes the Government should own the stock?

Secretary MORGENTHAU. Yes.

Senator GLASS. That is a different proposition. I am asking you if the Government, which does not own a dollar of pecuniary interest in the system, with the assets acquired over a period of 20 years by the exercise of banking skill—that the Government which has no pecuniary risk at stake should be permitted to spend other people's money without any restriction?

Secretary MORGENTHAU. Well, Senator, I am very timid about putting myself up against your opinion, because you have lived with this thing——

Senator GLASS. I am asking you your opinion.

Secretary MORGENTHAU. I think that the Government has got everything at stake in this. This gets right down to the whole question of credit. After all, as I understand it, the Government is the people. And we have got everything at stake.

Senator GLASS. Does the Government own a dollar of pecuniary interest in the Federal Reserve System?

Secretary MORGENTHAU. No; but I think it should.

Senator GLASS. You are for a central bank owned by the Government, then?

Secretary MORGENTHAU. If I may put it this way, I would like to see, if Congress could work it out somehow, that the Government owned this stock and would surround the trustees of it with every possible protection and precaution, that they should not be subjected not only to political pressure but to that of private business and banking interests as well, and that they should keep just as independent as possible, and serve the financial and business interests of the country with only one motive in mind, and that is to serve them well.

Senator GLASS. And to absorb all of the individual banks?

Secretary MORGENTHAU. No; oh, no.

Senator GLASS. What does your central bank amount to if it does not absorb all the indiviudal banks and use them as branches?

Secretary MORGENTHAU. You see, I came up to this position through Farm Credit, which is a pretty big institution, and we have a somewhat similar situation there, I believe. We have strong regional banks with directors. But the question of interest is fixed here in Washington. The question never has been raised that the control of the Farm Credit should be held by anybody else but the Government, and I honestly believe that the trust that the Farm Credit had for the farmers and the millions and millions of dollars which they handled have been handled without outside influence.

Senator GLASS. That was an emergency measure, was it not?

Secretary MORGENTHAU. I would not call it that.

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Senator GLASS. I am not talking about the Land Bank System.

Secretary MORGENTHAU. I consider Farm Credit a permanent institution.

Secretary GLASS. I know you gentlemen consider everything that has been done as permanent, but it started out simply as an emergency.

Secretary MORGENTHAU. I look forward to Farm Credit as an institution which I hope will live to serve the farmers for a long time.

Senator GLASS. I can readily understand how one might advocate a central bank owned by the United States Government. We have had them. But I would like to get more definitely your judgment as to whether a Government should have the right to loan somebody else's money without restraint or restriction.

Secretary MORGENTHAU. I think it should have that same supervision over the credit of the country that it has over inspecting the banks or anything else. After all, I cannot make a distinction between the Government and the people.

Senator GLASS. The inspection of banks is to require them to conform to the law in the conduct of their business. But when you take charge of their business, that is a different proposition, is it not?

Secretary MORGENTHAU. I do not say that we should tell the Federal Reserve Bank of New York or Chicago or San Francisco whether they should make a commercial loan, or how they shall conduct their actual transactions; but when it comes to having a national policy as to rates of discount for example, I believe that is a function which should be exercised by a public body. I make that distinction.

Senator GLASS. Well, considering a central bank, I can very readily understand how you would think that.

Senator COUZENS. The Chairman spoke a while ago about whether you were satisfied with the operations of the Open Market Committee as it now exists under the law. I recall your answer, and I ask this question in connection with it. Is it not possible, under the existing open-market operations and the activities of the Treasury for there to be a very definite conflict?

Secretary MORGENTHAU. Oh, yes.

Senator COUZENS. Is it not the purpose of this bill to avoid such conflict?

Secretary MORGENTHAU. I should say so.

Senator GLASS. Do you conceive that the Federal Reserve System was set up to finance the Government?

Secretary MORGENTHAU. No.

Senator GLASS. But under this bill it could be used for that purpose, could it not?

Secretary MORGENTHAU. I would have to take your judgment for that.

Senator GLASS. Then my judgment is in accord with yours?

Senator TOWNSEND. Presumably.

Senator GLASS. No; there is no presumption about it.

Senator MCADOO. Mr. Secretary, we hear a good deal of talk about inflation these days. I wonder if you would give us your definition of inflation.

Secretary MORGENTHAU. To go up against two Secretaries of the Treasury is kind of tough.

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Senator GLASS. You are only up against one, now. I did not vote for the Patman bill.

Secretary MORGENTHAU. Senator McAdoo, in view of the fact that that bill is pending before the President, I would like to be excused from answering your question.

Senator MCADOO. The definition of "inflation" has nothing to do with that. We are talking finance and economics now.

Secretary MORGENTHAU. If you do not mind, with the bill pending before the President, I would like to be excused.

Senator MCADOO. Of course, I will excuse you if you do not want to answer. On the other hand, I suppose you do not object to telling us what you think is sound money?

Secretary MORGENTHAU. I am not a very good theorist on these things, Senator. I think the President put me in there as an administrator and not as a money theorist.

Senator MCADOO. I am not asking your theories, but your judgment as a practical business man as to what you consider sound money.

Secretary MORGENTHAU. I would be glad to hear from you, sir.

Senator MCADOO. I want information; I am looking for information. Would you consider United States notes, commonly called "greenbacks," that now have back of them and have had for some time a 40-percent gold reserve, to be sound money?

Secretary MORGENTHAU. Senator, I am not very smart at these things. I have just got to go back to your question. There is a bill pending before the President that has this question of greenbacks in it at this time, and if you do not mind I would like to ask to be excused from getting into that discussion.

Senator MCADOO. We have had statements which show a little more than 40 percent of gold back of a certain amount of greenbacks. I was just curious to know whether you considered that sound money or not.

Secretary MORGENTHAU. Would this be fair? If after the President has taken action on the bonus bill, and this committee still wants me to come here and theorize, I would be glad to do it then.

Senator MCADOO. This does not involve the question before the President at all, because there is no gold reserve back of this proposed note issue. I am just trying to get an idea, in view of the present state of our finances, what your view is as to sound money; that is, whether 40 percent gold back of our currency would be considered sound.

Secretary MORGENTHAU. We have got a lot of experts down at the Treasury who can discuss the theory of money and currency.

Senator MCADOO. I am not talking about theory. I am talking about actualities.

Secretary MORGENTHAU. I cannot qualify.

Senator MCADOO. All right.

Senator GLASS. Have you ever come in contact with unexpert experts?

Secretary MORGENTHAU. Here is one right here.

Senator GLASS. Unless there are further questions we will excuse you, Mr. Secretary.

(Secretary Morgenthau withdrew from the committee table.)

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STATEMENT OF MAX B. NAHM, DIRECTOR, FEDERAL RESERVE BANK IN ST. LOUIS, MO.; VICE PRESIDENT, CITIZENS NATIONAL BANK, BOWLING GREEN TRUST CO., BOWLING GREEN, KY.

Senator GLASS. You may state your name and occupation, Mr. Nahm.

Mr. NAHM. Max B. Nahm. Mr. Chairman and gentlemen, I am a resident of Bowling Green, Ky., a small town of about 18,000 inhabitants, and I am vice president of the Citizens National Bank there, a country bank. I have prepared a statement that I will be glad to dip into now and then if it please you. The first paragraph of it is a bit of history drawn with a view of attempting to show that what I stand for is in line with the thought of the makers of the Constitution, and that particular part, if you do not mind, I will read.

The founders of the Government of the United States, in their wisdom, set up three great independent departments, the executive, the legislative, and the judicial.

The judicial department, the Supreme Court, through the genius of John Marshall, Chief Justice from 1801 till 1835, became one of the great courts, if not the greatest court of law in the world.

Only twice in its history, both in the previous century, did politics ever enter into its judgments. Its decisions are accepted as final.

In line with the thought of setting up an independent department of government, in 1913 there came into being an entirely new department of government that was not contemplated at all by the founders of the Government. In 1913 a new element entered into American national development, the Federal Reserve System, set up by Congress to furnish an elastic currency, to rediscount commercial paper and to establish a more effective supervision of banking. This system as originally conceived was an adequate working machine and functioned well through the World War, for which it was highly praised. At that time there was no criticism about it whatever that I know of. Everybody accepted its work as being as good as could be done, and it certainly piloted us and is given credit for having piloted us financially through the Great War.

In the years following the Great War there have arisen many emergencies and problems, and to meet these emergencies there have been set up many Government loaning bureaus, all functioning well in their own spheres, the physical and clerical labor of which was committed in some of the principal bureaus to the Federal Reserve regional banks.

The result, unforeseen at the time, was to diminish the functions of the Federal Reserve System, and of the commercial banks, to such an extent that at the present time there are in the Federal Reserve System only about 6 to 7 millions of loans.

In January 1932, the Reconstruction Finance Corporation was organized; in July 1932, the Federal Home Loan Bank Act was passed; in May 1933, the Farm Credit Administration Act was passed, and in October 1933, the Commodity Credit Corporation was organized.

All of these have functioned wisely and well, and for all of them the Federal Reserve banks have done a large volume of work as fiscal

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agents, custodians, and depositaries. As a matter of fact, the physical labor is being done by the Federal Reserve System for all of these organizations, and had the law that we are advocating been in existence in 1932 it is possible that all of this work would have been committed to the Federal Reserve System as the loaning agent of the Government.

However, the unintended result has so curtailed the functions of the great Federal Reserve System and the commercial banks that the necessity for a new banking act has arisen. In saying this, I refer chiefly to sections I and III.

The Bank of England is so national in character that Parliament placed in its charge the management of the equalization fund to carry out the national policy.

Right in line with that, the work that was done in England has been done through the Bank of England.

The Government lending bureaus in their nature are not permanent. Their usefulness will pass away in time. Their functions, important and necessary, must finally land somewhere for settlement and liquidation.

The Federal Reserve regional banks are carrying on a large part of their work for them now.

The Federal Reserve System was originally conceived as the permanent financial arm of Congress, acting for the whole nation; and that should be the landing place of all these lending agencies that I have mentioned, when the time comes that they will have liquidated and their work have ceased.

We suggest the formation of the Federal Reserve Board into a supreme court of finance and banking; that a body of such independence from political influences, and of such prestige, be established that the ideal of the founders may be realized.

To accomplish this we suggest a board of five members, four appointed by the President for terms of 12 years staggered so they would not all be appointed hereafter at the same time; that the fifth be the governor and be appointed by the President for a term coterminous with his own, and to represent in his appointment the sentiment of the administration. We suggest that the salaries be raised to $15,000 a year as the bill provides with adequate pensions to render the directors entirely independent of any influence for life.

We would not think so much of the proposition if we did not know that that is just about what foreign nations are doing with their central banks. The foreign central banks have met the problem in a similar way. They have all avoided political appointees in their directors, but the governor represents the administration. The boards in Belgium, England, France, Germany, and Switzerland and in the new Central Bank in Canada are selected by the stockholders. The governors in all except in England and Italy are appointed by the administration.

We suggest that the terms of office be as the bill is drawn for 12 years, except that of the Governor for 4 years, but subject to reappointment.

The purpose is to draw to this great board, men of outstanding ability to induce them to accept a call for service giving them financial independence and prestige.

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It might be said that those men would not have the time to wind up and to attend to these great lending agencies of the Government, but Congress in its wisdom has provided in section 204 (a) of the 1935 act for the assignment of duties for specific performance so as to leave the board opportunity to concentrate on problems of national importance and to relieve them of burdensome details. The opportunity to realize this ideal of a supreme court of finance may not occur again.

It has been said that this bill delegates the power of Congress to an independent board. It is true that the Constitution delegates to Congress the coining of money and regulation thereof, but this is an arm of the Congress set up by them.

With such a board in existence many problems in the bill will settle themselves in the high judgment of men of this type. They will by regulation adjust these problems from time to time without the rigidity of legal enactment.

It is said that the Federal Reserve System should be subject to the policies of the administration. Perhaps the Supreme Court in history has been a stumbling block in the path of administrations and yet, no one is heard to argue that this great Court should be subrogated to political policies. Neither then should a supreme court of finance be under political domination.

With reference to open-market operations, under present conditions all control is minimized. When few members banks seek to borrow, control by rediscount rates is not effective, because when nobody wants money it does not make any difference what the rate is. We have had times in the Federal Reserve Bank of St. Louis, in which I happen to be a director, when that has been the situation.

Even open-market operations exercise but little real effect just now. These conditions however cannot always prevail, so control of future use of funds must be provided in a logical manner, for the protection of sound banking.

With a small Federal Reserve Board of high type, all the five members of the board should constitute the open market committee, together with four governors of the Federal Reserve banks with equal rights to vote to reflect conditions in the country at large. These 4 governors should be rotated annually among the 12 governors by their own selection.

As to reserve requirements, to abandon all reserve requirements, either minimum or maximum, is unwise. Unlimited right to fix reserves, if abused, is the right to destroy. It is not the object of this act, even remotely, to obliterate private banking and abolish credit to the distress of the people by excessive reserves; neither is it proper to invite future disaster by small reserves inadequate to necessary safety.

Therefore it is wise, if we do set up this board, may I say, that it should have some restrictions, just as the Supreme Court itself, which is an independent body, has its restrictions in the Constitution of the United States.

Therefore we would suggest that the minimum reserves be left as they now are, 7 percent for small cities, 10 percent for Reserve cities, and 13 percent for central Reserve cities, but that the maximum reserve for all banks should be fixed at not to exceed 30 percent as a ceiling beyond which the public service would be endangered.

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During this severe depression, which is an excellent test, banks have carried 20 to 30 percent reserve. The problem, after all, is one that varies in different districts. But I do believe more or less in autonomy in the 12 regional banks, and as far as I can see it, from my experience, the more the better.

With respect to real-estate loans, to amortize real-estate loans is one thing in cities and truck-farming districts adjacent to cities, but quite another problem in strictly farming regions where the crops are harvested but once a year. The farmers in such localities have nothing to amortize with until they sell their crops. Amortized real-estate loans mean nothing to them for they are impractical.

Our experience has been that our greatest difficulty is to collect on farm loans in depressions, though in the end our losses are less on them than on stocks and bonds, for eventually their value returns, but they are frozen beyond redemption till the turn comes; and it would have been far worse, Mr. Chairman, if we had had the proposed law during 1933, because the banks would have been even fuller of real-estate loans than they were.

We cannot favor advances against real estate up to 75 percent of actual value of the property, amortized within 20 years. We cannot create and administer such loans.

We do favor a limit of not exceeding 60 percent of appraised values of the property and loans permitted not over an ultimate limit of a period of 5 years.

For instance, let us go back 20 years and see what the value of farm property was. If we had taken those loans then and amortized them for 20 years they would not be worth half of what they are. The value today would not be half of what it was then. Furthermore, in cities in 20 years centers of population shift to such a degree that a real-estate loan today may be absolutely worthless which 20 years ago was possibly the very best loan there was in that part of the country. So 20 years is absolutely too long for a banking purpose.

With reference to the combination of the offices of the governor and chairman of the board, that can serve absolutely no useful purpose in the Federal Reserve Bank of St. Louis, and I am talking about that bank because it is the only one I am familiar with. Each of the incumbents is an active, serviceable official performing his duties efficiently and thoroughly and each earns his salary beyond all question.

The governor elected by the board of directors represents the bank satisfactorily and is well qualified for his duties.

The chairman of the board represents the board at Washington as Federal Reserve agent, presides with dignity, and is fully occupied with duties that must be performed by someone.

In the event that the two offices are combined the positions of governor and vice governor will effect only a change of title of one officer and will amount to no saving of salary whatever, although it is claimed that the saving would amount to $400,000. There are still the two salaried officers.

One of these officials in the very prime of his time of service must be demoted to no purpose whatever, either the governor or the chairman of the board. If other Reserve banks can gain by this change, it must be because their personnel is badly selected, and there can be no service in destroying existing relations when the proper course is

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to make better personal selections of officials. The individuals may need changing, not the official titles, nor the System as a whole.

With regard to the terms of directors of regional banks, I happen to be a director of the Federal Reserve Bank of St. Louis, May I be permitted to contribute my experience in that service? It appears to me that the paramount object is one of the character of the service rather than of the length of service.

Some directors' services might be so entirely without value as to make it important to drop them after 3 years, or better still, that they never should have been elected.

On the other hand, some directors demonstrate such value in their service that the best interests of the System in their districts would be served by continuing them in office indefinitely.

It requires about one term for a new member to learn the System, and it is noticeable that all matters of great importance are decided by the seasoned members of experience.

To limit the terms to two periods of 3 years each is to put a premium on inexperience and injure the service. After all, this can best be left to the banks of the district to decide.

Regarding the willingness of banks to loan, neither the Federal Reserve banks nor the member banks can go far to create loans. They do not initiate business, but they create credit when business seeks it and expand or contract credit as needed. The inception of loans is with the people and the needs of business and not with the banks.

It is charged that banks will not loan money. That is not true. There is no demand for loans, and they cannot loan when none seek loans. They are willing and anxious to have loans that will be paid.

In Louisville, a bank received a telephone message about a $400 loan. The bank sent a taxi for the customer and made the loan. It is far easier to negotiate a Government loan that does not require liquidity to pay demand deposits which is necessary in commercial banks.

Of course Government loans have all the rest of time to liquidate, but commercial banks must pay depositors with the result of their loans, and if they cannot do that they have got to close up.

However, loans are increasing and business is expanding and agricultural sections are regaining confidence. If these conditions continue neither the banks nor their critics will complain about few loans.

This is not exclusively a banker's bill. Title II carries the great problem of the people at large. In it may be wrapped their whole monetary future.

Any legislation created during periods of emergency, which may seen entirely justified by the needs of the moment, must also be regarded from another standpoint. There are the possibilities for abuse when the powers created are used in future years. After the emergency no longer exists, those having the powers may be men who might have been injected into office by one of those waves of emotional hysteria to which we are prone and are becoming more susceptible. Then comes the danger—so let us take time to think it out to a proper conclusion.

My thought is, Mr. Chairman, that if we go ahead and pass titles I and III, and take our time with title II, so that we do not make any

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mistake that we would feel that we should have corrected, I believe it would be far better for the country at large, and everybody else.

Senator GLASS. We are much obliged to you for your statement.

STATEMENT OF R. S. HECHT, PRESIDENT AMERICAN BANKERS ASSOCIATION

Senator GLASS. Give your name and occupation to the reporter, please.

Mr. HECHT. R. S. Hecht, president American Bankers Association.

Senator GLASS. As you know, we are considering the Senate and House bank bills, with which you are familiar. The committee would be very glad to have any statement you may desire to make in that connection.

Mr. HECHT. I am appearing officially as president of the American Bankers Association. The American Bankers Association includes in its membership banks of all kinds and sizes, operated by bankers of all shades of political and social opinion. It is natural, therefore, that there should be some difference of opinion among our membership in regard to certain details of this pending legislation, but I am glad to be able to say that on the really fundamental provisions, which it is my purpose to discuss with you, there is a remarkable unanimity of opinion in the banking fraternity. I think I can truthfully say that in studying the changes contemplated by this law our members approached the subject not from the narrow view of selfish interest but with a sincere desire to be helpful to Congress in enacting effective and workable banking legislation in the interest of all of our people. With that end in view the association, through its fully authorized bodies, has given very careful study and consideration to this measure and has reached certain conclusions regarding it. It is my purpose to present today a brief statement of these activities and conclusions of the association.

While the committees realize that certain provisions of title I of the pending bill affect adversely the larger banks, and that other provisions of the bill are not entirely acceptable to some of the (Federal Reserve) nonmember banks, they believe that the aims and purposes expressed in the provisions of title I and III of the bill are, in the main, in the public interest, as well as in the interest of banking. The committee have, therefore, on behalf of the association, approved in substance, title I and III of the bill. Since the introduction of the bill in Congress, the executive officers of the association have conferred at length with leaders of Congress and administrative heads of the Government regarding the provisions of title II. The committees believe that certain constructive changes should be made in this title. They recognize that some members of the association are of the opinion that it would be advisable to postpone definite action on this title of the bill until such time as a more detailed and careful study of its provisions can be made, but the committees believe that, if the changes which they have in mind can be brought about through conferences, it will then be possible for the committees to approve the entire measure.

A special committee has therefore been appointed consisting of the president, the first vice president, the chairman, and one other member of the banking studies committee, and the chairman of the committee on Federal legislation. The above-mentioned special committee is authorized and directed to confer with the leaders of Congress and the administrative heads of the Government with a view to procuring such changes in the bill as are believed by the association to be in the best interest of commerce, industry, and the public.

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This special committee subsequently drew up a schedule of recommendations approving titles I and III as they then stood but proposing a number of fundamental changes in title II.

Senator COUZENS. Are you in agreement with the way the House passed title I, providing for an assessment of one-eighth of 1 percent?

Mr. HECHT. No; I am coming to that in a moment. I take very definite issue with that change.

A copy of these recommendations was mailed in March to each of the 12,000 members of the association with a covering letter urging a careful reading and earnest consideration of the statement setting forth the position of the association. In reply to this communication we have received a great many letters from our members. The overwhelming majority expressed full accord with the position we have taken. These recommendations were also thoroughly discussed in April by the executive council of the association, which is a representative body consisting of members from every State in the Union authorized to formulate policies for the general association. This body unanimously approved of the recommendations of the special committee.

I would further add that in recent weeks I have had an opportunity to come in personal contact with bankers in a large section of the United States at various State bankers associations' meetings. I may say that almost universally the bankers whom I met expressed approval of the stand the association has taken, and at every such meeting resolutions were passed expressing substantially the same views.

A great deal of testimony has already been presented before your committee by city bankers, country bankers, economists, and business men concerning the specific provisions of the proposed bill. It is therefore not my intention to go into a discussion of each provision, but I shall direct my remarks only to what seem to us to constitute the few major issues.

As already stated, we approved title I, which provides for Federal Deposit Insurance, in substance as originally introduced. However, since then several important changes have been made in title I as passed by the House and I therefore find it necessary to make the following additional observations.

Our approval was based on the original provision for an annual assessment of not exceeding one-twelfth of 1 percent on total deposits. The House bill changed this basis of assessment and now provides that the F. D. I. C. directors must make an annual assessment of one-eighth of 1 percent, which is an increase of 50 percent to be paid by the banks, besides making the assessment compulsory instead of discretionary with the F. D. I. C.

Even with the permissive assessment of one-twelfth of 1 percent, I can say without reservation that practical banking experience shows that a very heavy burden would be placed on all banks, especially on the large city banks. Such banks would feel particularly the use of total deposit liabilities as the basis of the insurance assessments instead of using only insured deposits. In banks, with large average deposits, the result is that they will be obliged to pay the assessment on a very large volume of deposits that will not be insured. Our information shows that in some instances only 5 or 6 percent or less

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of the deposits used as the basis of the assessment would be protected by the insurance.

In the interest of the general situation, our members who felt that they would be disproportionately assessed by reason of the facts I have just described, have nevertheless forborne to oppose the provision of a permissive assessment of one-twelfth of 1 percent. I feel it my duty to emphasize, however, that the changes made in the House bill would very materially change the essence of the proposition which we originally approved. They would aggravate the inequity of the burden which would be imposed on the large banks and also place too heavy a levy on all banks.

We firmly believe that the permissive levy of one-twelfth of 1 percent represents the maximum that should be contemplated in this connection. We feel that in view of various other increased costs which are now imposed upon banks, and in view of low interest income and reduced earnings, any increase in the severity of the levy would create an excessive burden which could not well be borne by our banking institutions without endangering their ability to build up proper reserves to take care of individual losses which are bound to occur.

The House bill also eliminates compulsory membership in the Federal Reserve System as prerequisite to continued membership in the F. D. I. C. Candor compels me to state that this is one provision on which there is a distinct division of opinion and indeed of material interest among our membership.

Many of our members whose capital is very small but adequate for the needs of their communities would find it practically impossible to qualify for membership in the Federal Reserve and continue in business. Others of our members feel that we should strive for the ideal of a wholly unified banking system under uniform standards of regulation and supervision.

It seems to me that perhaps a fair solution would be not to enforce compulsory Federal Reserve membership on banks below a certain size on which it would inflict undue hardships if they had to choose between compulsory membership in the Federal Reserve System or giving up their membership in the F. D. I. C., which in many instances at least would be tantamount to forcing them out of business.

Instead of this the necessary standards of management and operation could be accomplished by giving the F. D. I. C. appropriate powers of regulation and supervision over all insured banks that would still remain outside of the Federal Reserve System. In any event, we are strongly in favor of retaining in title I the effective supervisory powers given the F. D. I. C. over its membership in the original bill but which provisions have unfortunately been stricken out of the revised draft passed by the House.

Before entering into a detailed discussion of the provisions of title II, I would like to restate the position of our association; that is that the question of whether or not there should be any legislation on this subject at this time is one of policy which Congress itself must determine.

However, if it is finally decided that it is necessary to carry this legislation through at this session, we are strongly of the opinion that important changes should be made in the bill as passed by the House

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and that special care should be taken to keep our credit control and banking mechanism free from any sort of political considerations.

Senator GLASS. Is it the judgment of your committee that there is any existing emergency that makes legislation such as is contained in title II immediately necessary?

Mr. HECHT. It is not our opinion that any emergency exists which makes it immediately necessary to have this legislation.

In making this statement I do not wish to appear to question the propriety of the Government's exerting a certain amount of control over banking operations so far as they affect the Nation's currency and general monetary policy. Nor do we object to broad powers of supervision over the operation of our banking institutions because of the semipublic responsibilities they carry. But when it comes to such matters as the granting of credit and the making of investments by our banks, these are questions of business policies that surely should not be under the sole control of a board so constituted as to be dependent upon partisan or political considerations under any administration.

The real conditions that create the necessity for the expansion or contraction of credit arise from the needs of agriculture, industry, and trade themselves, wholly independent of the administrative policies of the party which happens to be in power. We feel that the financial requirements of the Nation's business constitute a continuing economic process that is not related to political changes. The fundamental principles of sound credit do not vary with variations in public thought. All experience teaches that the quality of credit is sound only so long as it is based purely on the requirements of sound business. It is not sound when any other considerations or motives enter into its composition.

Title II of the Banking Act would centralize in the Federal Reserve Board at Washington means aimed to control the supply of money in the country, which term includes the sum total of currency in circulation and demand deposits in the banks which become current through checks. The powers which it is proposed to give the Board are intended to enable it to influence the quantity of this deposit money through open market operations, the discount rate and reserve requirements.

That is the reason why we are so strongly in favor of making the Federal Reserve Board a body of such independence and prestige that it would be definitely removed from all political thought, influence, and dictation. Its members should be free to study and to act in accordance with the needs and conditions of agriculture, industry, and trade. The policies of the board should have no reference to the politics or the changes in politics of the national administration.

In our studies of title II, we have been strongly impressed with the fact that it would set up a situation under which the Federal Reserve Board and its policies might be subject to control from the political administration of the country. In saying this I do not charge that it is the intention of the present administration to bring about any undue control over the Nation's banking mechanism. The point is that if the bill passed as now proposed, opportunity for control would be there for the use of the present or whatever future administration might be in power.

Our criticisms of the bill are not aimed, therefore, at the motives of the present administration, but they are wholly impersonal and nonpolitical and are aimed entirely at the basic principles involved.

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We have therefore prepared a study of the bill with suggested changes which we think would tend largely to correct those features to which we object. What I shall say immediately following is a presentation of the recommendations as prepared by our special committee and approved by our Executive Council, as I described at the outset of my remarks.

This committee was deeply impressed with the fact that the changes contemplated by title II go to the very root of the theory and practice of banking as it has existed in this country. It felt that it would be difficult, if not impossible, to formulate final conclusions in the brief space of time which has elapsed since the bill was introduced. However, the committee feels that the following suggestions, if carried out, would remove many of the defects of the present bill.

First, as to the Federal Reserve Board, the committee agreed that many of the changes in the Federal Reserve Act proposed in title II are of a constructive nature and should have the support of bankers, if the method of appointment and the tenure of office of the members of the Federal Reserve Board, in whose hands it is planned to concentrate greater power than ever before, could be so altered, as to insure, as far as possible, the absolute independence of the Board from partisan or political considerations. It was its view that if a satisfactory solution of this problem can be found, one of the greatest objections to title II of the bill, as proposed, will have been eliminated. It addressed itself first, therefore, to section 203 of title II of the bill which deals with the all important question of the membership of the Federal Reserve Board. On this point it said:

> Since the passage of the Federal Reserve Act, informed opinion both in Congress and among bankers has been striving toward the ideal of making the Federal Reserve Board a body of such independence and prestige that it might be described as the "Supreme Court of Finance and Banking." We believe there is greater need now than ever before for realizing this ideal.
>
> We recommend that the Board be reduced from 8 members to 5. We believe this should be accomplished by the retirement from the Board of its ex-officio members, namely, the Secretary of the Treasury and the Comptroller of the Currency, and by reducing the appointive members of the Board to five as soon as a vacancy occurs (such a change would necessarily involve an adequate revision of the salary of the Comptroller who now receives a portion of his compensation through the Federal Reserve Board).
>
> We heartily approve the proposed increase in the salaries of the members of the board and would, in fact, like to see their compensation fixed at a somewhat higher figure than that mentioned in the bill so as to attract to these tremendously responsible positions the very best talent available. We believe that that the plan of providing suitable pensions for the members of the board is especially desirable because the security which such an arrangement assures would be a further help in inducing outstanding men to accept a call for service on the board and give them the financial independence which such a position requires.

I should like to pause for a moment to say that we feel that the action of the House in eliminating the pension provision is most regrettable since we had from the start considered this one of the important factors tending to maintain the independence of the members of the board.

I should like to take a moment to emphasize the fact that our committee's suggestion for the elimination of the Secretary of the Treasury and the Comptroller of the Currency from the board, of course has absolutely no personal or individual element in it. In other words, it does not refer in any sense to the present incumbents

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of these offices. The suggestion is based wholly on a matter of principle, namely, to reduce numerically governmental influence in the board. We feel that the representation of the administration on the board would be sufficiently provided for through the appointment of the governor by the President under conditions proposed by our committee as follows:

I again quote:

The bill as originally introduced provided that the Governor should serve only at the pleasure of the President and that his service as a member of the Board should cease upon the termination of his designation as Governor. It has already been suggested that an amendment be made in the bill as proposed which would provide that the Governor, if no longer designated as such by the President, might, if he chose, continue his membership on the Board, but would be permitted to reenter private business (without the 2-year limitation) if he chose to resign upon not being redesignated. We would be entirely satisfied with this suggested change. (The House has since adopted this suggestion). If, however, it is deemed essential to give each incoming President the right to name a Governor of his own choosing, because of the fact that the administration will no longer be represented on the Board by the Secretary of the Treasury or the Comptroller of the Currency, it may be desirable to give the President the power to select the Governor of the Board and to provide that the term of the Governor of the Board will be the same as that of the President. It should also be provided in the act that the members of the Federal Reserve Board, including the Governor, shall be removable during their term of office only for cause.

(I continue to quote from our committee's report:)

It has been suggested that section 201 of the bill be modified so that the governor of each Federal Reserve bank shall be approved by the Federal Reserve Board every 3 years rather than annually, so that his term as governor would coincide with his term as a class C director. We believe that in order to preserve the independence of the governors of the Federal Reserve banks the term during which they may serve without having to be reapproved by the Federal Reserve Board should be as long as possible and that this approval should certainly not be required more often than every 3 years. Corresponding changes should be made in the act with regard to the election of vice governors of the Federal Reserve banks.

With regard to open-market operations, I quote further from our committee's report:

Neither the original text of section 205, providing for the open-market committee of three members of the Federal Reserve Board and two governors of the Federal Reserve banks, nor the subsequent suggestion which has been made that authority over the open-market operations be vested in the Federal Reserve Board, which would be required to consult with a committee of 5 governors selected by the 12 governors before adopting an open-market policy, a change in discount rates or a change in member bank reserve requirements, seems to us to constitute a satisfactory solution of the open-market problem.

Our suggestion is that the open market committee shall consist of the entire Federal Reserve Board (reduced to five members) and four governors of the Federal Reserve banks, selected by the governors of the 12 Federal Reserve banks annually, each member of the open market committee having a vote in the deliberations of the committee on the three subjects to be entrusted to it, i. e., open market policy, change in discount rates or change in member bank reserve requirements.

The new provision since included in the House bill vesting authority over open market operations, discount rates and reserve requirements in the Federal Reserve Board which is directed to only "consult" with an "advisory" committee of five governors who would have no vote in the determinations of the open market committee is an entirely unacceptable substitute.

With respect to changes in reserve requirements, I am reading again from the committee's report.

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It has been suggested that section 209 of the bill be amended so as to provide that the open market committee shall not have the power to change reserve requirements by Federal Reserve districts but only by classes of cities and it has been suggested further that for this purpose banks be classified into 2 groups, 1 comprising member banks in central reserve and reserve cities and the other comprising all other member banks, and that the reserve requirements be uniform within each group. We believe that these suggested changes are desirable but we think serious consideration also should be given to the desirability of fixing limits in percentage of deposits beyond which reserve requirements cannot be increased or decreased by action of the open market committee.

Senator GLASS. What would you say is the difficulty about the existing law on reserve requirements?

Mr. HECHT. The existing law permits the increase in reserve requirements only under certain emergency conditions, which, of course, no one would like to have declared to exist. Under this plan some limited authority might well be given to this open-market committee, if properly constituted, so that the public and the Federal Reserve point of view were represented, and within certain limitations I, as an individual, should not feel that it was very objectionable if some change were made, but I do think that by all means there should be a limit within which such operations could take place.

Senator GLASS. The proposed bill gives the Reserve Board unlimited authority.

Mr. HECHT. It does, which I think is very objectionable.

Senator GLASS. To change the reserves at any time and in any degree.

Mr. HECHT. That is correct, and I think it is very dangerous, because it could very easily be abused by some administration. I consider it a very dangerous provision without some limitation.

Regarding real estate loans, I quote further:

We do not favor section 210 as originally proposed, permitting advances against real estate up to 75 percent of the actual value of the property if amortized within 20 years, or up to 60 percent of the actual value of the property for a term of not more than 3 years, in both instances without territorial limitations.

We are in favor of the suggestion subsequently made that all real estate loans hereafter made shall not exceed 60 percent of the appraised value of the property and that the Board be given discretion to make regulations governing real-estate loans held by banks at the present time.

We also believe that the presently existing territorial limitations, or some similar limitations, should be retained in the law and that unamortized real-estate loans should be permitted up to a period of 5 years. (We are glad to say that the House bill now contains most of these suggested changes.)

In summary the report concludes as follows:

We believe that the foregoing modifications in title II of the bill (numbered 1 to 6 inclusive) are fundamental and that all of them are in the national interest. If changes substantially along these lines cannot be made in the original draft of the bill, we would be strongly opposed to the enactment of title II. However, if these changes, some of which in whole or in part have been heretofore recommended by Governor Eccles are adopted, we would be in substantial agreement with the provisions of title II, provided that the following additional changes which have also been suggested by Governor Eccles are included in that title:

(a) ADMISSION OF INSURED NONMEMBER BANKS

It has been suggested that section 202 of the bill should be amended so as to provide that the Federal Reserve Board shall have authority to waive not only capital requirements but all other requirements for admission of insured, nonmember banks to the System, 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. (The House bill practically meets this suggestion.)

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(b) FEDERAL RESERVE BANK EXPERIENCE FOR FEDERAL RESERVE BOARD MEMBERS

It has been suggested that section 203 (1) of the bill be amended so that as a general policy two members of the Federal Reserve Board shall be selected, when possible, from persons who have had experience as executives of the Federal Reserve banks.

(c) FEDERAL RESERVE BOARD PENSIONS

It has been suggested that section 203 of the bill be modified so as to provide 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 70 years of age; that is, he is to receive an annual pension of $1,000 for each year of service up to twelve.

This ends my textual citation of the report.

As to title III of the bill, the committee expressed the belief that its provisions, which consist of amendments to the Banking Act of 1933, would materially clarify and improve the present law and therefore that it was of the opinion that the various provisions of this title should also be approved in substance.

I wish to call your special attention to the fact that the time element is an essential factor in the provision of title III (325) which makes it possible for boards of directors to grant extensions up to 3 years on loans heretofore made to their own executive officers. These loans will become outlawed on June 16, 1935, if no new legislation is passed before that time and this would create a very serious situation in many banks.

In closing, I desire to express once more the genuine desire of the banking fraternity to be helpful and constructive in making suggestions in connection with this pending legislation. The changes we are urging are, we believe, essential to the continued independence of the Federal Reserve System. We have made it clear that we do not object to a measure of public control in the national interest for proper coordination of our manifold credit operations and we do not believe the sponsors of the legislation desire any political domination over these activities through our Federal Reserve System. Under such circumstances we feel that our recommendations should be favorably acted upon because they would enable the reconstructed Federal Reserve Board to function freely as a nonpolitical body actuated only by the dictates of sound financial and economic policies conceived in the interest of all of our people. Their adoption would place the operations of the Federal Reserve System wholly and distinctly apart from the fluctuations and vicissitudes of political conditions and free from undue influence by banking opinion only. Such a solution would thus have a stabilizing and confidence inspiring effect on the entire business situation.

Senator GLASS. Do the members of the committee have any questions? (No response.)

Mr. Hecht, are we to infer that in view of the time element involved your committee would like to see titles I and III acted on independently, and as speedily as possible, and further consideration given to title II?

Mr. HECHT. Senator, as I stated—and I purposely quoted from our committee report on that, because I am speaking in an official capacity—there is a difference of opinion among our membership, and the association frankly feels that there is no emergency, but that the question whether that should be done or not is one that we prefer to leave entirely to the Congress to decide. There are many who

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feel that there should be a separation. There are some who feel that title II, very much changed, might as well be reenacted rather than have it come up next year when there will be, perhaps, more political discussion in the air than there is this year. That is, very frankly, the divided opinion in the association, and we feel that that question is one that Congress itself had best decide, but, to repeat, we do not feel that there is any emergency requiring immediate action.

Senator GLASS. Do you know of anything in title II that may be necessary now or in the immediate future, that might not be done under existing law? You will recall, if you heard his testimony, that Professor Sprague said that there was not a thing in title II that would help the existing situation that could not be as readily and as effectively done under existing law.

Mr. HECHT. I have already stated, Senator, that it is my personal opinion that no emergency exists which requires the enactment of title II. I see nothing in the near future, speaking of the next year or two, that is likely to require this particular legislation.

Senator GLASS. If the members have no questions to ask, we are very much obliged to you, sir.

I have a request from Senator Gore to present for the record resolutions of the Oklahoma State Bankers Association. In this connection I may state that I have quite a large number of resolutions which, at the appropriate time, will be presented, but Senator Gore seems to want his resolutions presented now, so I hand them to the reporter.

(The resolutions referred to are as follows:)

RESOLUTION

We, the undersigned committee on resolutions at the annual meeting of the Oklahoma Bankers Association, held in the Biltmore Hotel, Oklahoma City, on May 7–8, 1935, submit for the consideration of the convention the following resolutions, to wit: Be it

Resolved, That the provisions of the Banking Act of 1935, known as "Senate bill 1715" and "House bill 5357", contain provisions which would be beneficial to the banking structure of our Nation. We do, however, urge that serious consideration be given to certain provisions of this bill, which, to us, seem objectionable.

We are in favor, and strongly urge, that the annual assessments be limited to one-twelfth of 1 percent, as provided for in the original House bill 5357, believing that the present provisions which would force an annual assessment of one-eighth of 1 percent would be an unduly heavy burden on our banks, we commend the Banking and Currency Committee of the House for its support of the small banks of the country in eliminating that provision of the present and proposed law which would deprive such banks of the benefits of the Federal Deposit Insurance Corporation unless they joined the Federal Reserve System by July 1, 1937; be it further

Resolved, That in regard to title II of the Banking Act of 1935, that this association recommend to Congress that further study be given to the provisions of this section before it is enacted into a law. We particularly object to the apparent political control of the financial institutions and business in general, which would come about under the present proposed provisions of this title. And we further venture to express the opinion that the banking business should be left in the hands of the citizens of our country subject, of course, to proper supervision by the existing agencies, and, therefore, oppose any law that takes away the right of individual banks to control the banking business of the country, we being of the opinion that the future welfare of our country depends upon the initiative of its citizens and anything restricting this initiative would be detrimental to the future banking business and future welfare of the country; be it further

Resolved that in the main title III of the Banking Act in 1935 is in keeping with what we concede to be sound supervision of the banks. We venture to express the

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opinion that the Comptroller of the Currency, in the future as in the past, should supervise the national banks; be it further

Resolved that we commend the Federal Deposit Insurance Corporation for the stabilizing influence it has exerted over our banking institutions for its share in the return of public confidence; be it further

Resolved that we offer Howard C. Johnson, our bank commissioner, the complete cooperation and support of our association in his thus far successful effort to build a better banking structure in the State; be it further

Resolved that we commend the present administration in its apparent effort to improve the conditions of the State banks of our own State, and particularly do we recommend the accomplishments of our present commissioner to this date, and express the opinion that he can be relied upon to continue to give the State an excellent administration of its banking affairs; be it further

Resolved that we extend to the officers of the Oklahoma Bankers Association our appreciation of the service it has rendered during the last year and commend it to the favorable consideration of the bankers of this State: be it further

Resolved that the sincere thanks of this organization be extended to the citizens of Oklahoma City, and particularly to the Oklahoma City Clearing House for the very splendid cooperation given in entertaining the bankers at the meeting, and we express the opinion that Oklahoma City has well sustained its reputation as being a friendly city and its ability to entertain so far as this committee believes cannot be excelled and we hope that the visiting bankers will be pleased with their entertainment and will go away feeling that they have been well entertained.

Respectfully submitted.

E. A. WALKER.
A. E. BRADSHAW.
H. W. KOENEKE.

STATEMENT OF C. B. EILENBERGER, THIRD ASSISTANT POSTMASTER GENERAL

Senator GLASS. We have been told, Mr. Eilenberger, that you wanted to have something to say about the Postal Savings.

Mr. EILENBERGER. Yes, Senator.

Senator GLASS. Give your name and official position.

Mr. EILENBERGER. C. B. Eilenberger, Third Assistant Postmaster General. I have a memorandum here which I can file with you, if you do not have the time to take it up, or, very briefly, I can tell you what I am here for, whatever is your pleasure.

Senator GLASS. You might tell us briefly what you are here for, and then file the memorandum for the record.

Mr. EILENBERGER. Thank you. We are concerned in the House bill, the proposed amendment to section 8 of the Postal Savings Act. There are two sections of the amendment to which we object. I will state them very briefly. I might say just a word about the way we operate, insofar as the payment of interest to our depositors, and withdrawals, are concerned. We are bracketed in 90-day periods for our Postal Savings deposits. The way we operate, if proper notice is given, as required by the Banking Act, a depositor can withdraw his deposit and get his interest, but if he wishes to withdraw with the 90-day bracket, of course, he forfeits the interest. This amendment has a provision which would penalize a Postal Savings depositor if he desired to withdraw within the 90-day period, or any time in that bracket. They would go back and take 3 months' interest off his Postal Savings certificate. We do not think that is fair, in view of the fact that the commercial banks of the country are not treating their savings depositors that way. They are not penalizing more than 30 days at the most, as I understand the situation, and I think my information on it is correct. So, we do not feel that our depositors

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should be singled out to pay a penalty when the savings depositors of the commercial banks of the country are not, and we do not feel that it is fair at any rate, that the man who is getting 2 percent on his Government security that he holds should pay that penalty.

Senator BYRNES. What section of the House bill is that?

Mr. EILENBERGER. Section 340, pages 90 and 91. Shall I proceed?

Senator GLASS. Yes. You may file your full statement.

Mr. EILENBERGER. I have one other point here. The other section to which we object, or the part of the amendment to which we object, gives the Federal Reserve Board the right to fix the rates of interest on the Postal Savings certificates, in effect. We object to that. I may state this, that since the enactment of the Banking Act of 1933 we have tried to comply, in spirit and practice, with its provisions. We have not tried to extend the service of the Postal Savings System, or to give it a freer rein of service. We have not advertised. We have not tried to push it, but we feel that if it is to go out of existence it should go out by natural processes, and not be any decided reduction of interest, or what not, that may affect it.

Senator BYRNES. Have you the figures showing your total deposits?

Mr. EILENBERGER. Yes, sir. I can file them with this memorandum.

Senator BYRNES. Will you let me see them please?

Mr. EILENBERGER. Yes, sir [handing paper to Senator Byrnes]. Those are run down from the year 1932.

Senator BYRNES. The total deposits seem to be practically the same from January 1, 1934, to February 4, 1935.

Mr. EILENBERGER. Yes, sir; that is right.

Senator BYRNES. I would like to put that into the record.

Mr. EILENBERGER. Yes, sir. I will file that with my memorandum, if I may.

We would like to have the Postal Savings System left alone, to operate as it is. It is operating successfully. It is not harming any of the banking institutions of the country today. The old cry was that it was taking deposits out of the banks. Today the banks of the country have more money than they know what to do with. There are 2,600,000 people who have invested their money in these securities, and we feel that they should have the 2-percent income on them. Bear in mind that many of them carried them at times when rates on Government securities were decidedly higher, and even now, at 2 percent, they are under any long-term Government security that has been offered to the people. The lowest is 2⅞ percent.

I will file these matters for the record.

(The matter referred to is here printed in full, as follows:)

POST OFFICE DEPARTMENT,
OFFICE OF THE POSTMASTER GENERAL,
Washington, D. C., May 17, 1935.

Hon. CARTER GLASS,
Chairman Subcommittee on Banking and Currency,
United States Senate.

MY DEAR SENATOR GLASS: Reference is made to section 340 of H. R. 7617, pages 90 and 91, which carries a proposed amendment to section 8 of the act entitled, "An act to establish postal-savings depositories for depositing savings at interest with the security of the Government for repayment thereof, and for other purposes", approved June 15, 1910, as amended, reading as follows:

"Subject to such regulations as the Postmaster General may prescribe, any depositor may withdraw the whole or any part of the funds deposited to his or her

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in th[illegible] crued interest after the expiration of 60 days after giving notice in writing of intention to withdraw, and any depositor may withdraw the whole or any part of such funds without such notice only on condition that there be deducted from the funds to his or her credit derived from interest an amount equivalent to interest for a period of not less than 3 months on the amount withdrawn.

"Notwithstanding any other provision of law, no interest shall be paid on any deposit in any postal-savings depository office at a rate in excess of that which may lawfully be paid on savings deposits under regulations prescribed by the Federal Reserve Board pursuant to the Federal Reserve Act for member banks of the Federal Reserve System located in or nearest to the place where such depository office is situated.

"Postal-savings depositories may deposit funds on time in member banks of the Federal Reserve System subject to the provisions of the Federal Reserve Act and the regulations of the Federal Reserve Board regarding the payment of time deposits and interest thereon."

The Post Office Department feels that this amendment in its entirety is unnecessary and its elimination from the bill is requested for the following reasons:

It would be cumbersome and expensive to require postal-savings depositors to give a 60-day notice in writing of intention to withdraw funds. Furthermore, it would be difficult to procure written agreements from all of the depositors and such effort would invoke confusion and distrust, particularly on the part of depositors of foreign nativity, and would serve no useful purpose. Attention is called to the fact that we now have a 90-day bracket and that no interest is paid on deposits which remain for a period of less than 90 days, and it frequently happens that depositors lose interest for periods of 1 and 2 months, also for periods of a few days short of 3 months. It will be seen, therefore, that in reality the Department is at least complying with the spirit of the Banking Act of 1933 in that interest is paid only on a quarterly basis, that is, for each 3 full months that funds have remained on deposit. A great majority of postal-savings depositors are persons of limited means and it would be manifestly unfair to penalize them by deducting from their funds derived from interest an amount equivalent to interest for a period of not less than 3 months on the amount withdrawn. It is understood that it is the custom of banks to penalize a time depositor when withdrawing funds only to the extent of the amount of interest payable for the part of the month in which the amount is withdrawn. As will be noted above, the Postal Savings System as now administered penalizes the depositor to a much greater extent than the banks, as the depositor to the Postal Savings System may lose very nearly 3 months' interest when making a withdrawal.

In the event the Federal Reserve Board should be vested with the power to control the rate of interest paid on postal-savings deposits in the various Federal Reserve districts, the difficulty of administering the system in an equitable manner would be greatly increased and such control is not desirable for several reasons. For instance, inasmuch as some of the States embody parts of two Federal Reserve districts, the auditing incident to interest payments would be vastly increased with attendant cost and it might frequently happen that offices quite near each other in the same State would be paying different rates of interest, thereby making for confusion and discontent among the patrons. There is ample precedent for continuing the policy of maintaining a uniform rate on postal-savings deposits throughout the country. The rate on Government obligations in general does not vary according to the Federal Reserve districts. There is no desire on the part of the Post Office Department to have the Postal Savings System a competitive institution and the low rate paid on postal-savings deposits has been for years less than the prevailing interest rate.

With reference to proposed power to the Federal Reserve Board to regulate the rate of interest paid by banks on postal-savings deposits, it seems that this particular provision is needless since the Banking Act of 1933 empowers the Federal Reserve Board to control interest paid by member banks.

The Postal Savings System was established in 1910, primarily for the convenience and protection of persons with limited means. The need for such an institution is widely recognized by the public, as evidenced by the fact that it is now patronized by 2,600,000 persons. The deposits in the Postal Savings System began an abnormal increase during the banking moratorium of 1933, reaching a high figure in December of that year. The amount of deposits has remained practically unchanged since that time. The law requires that these funds, with the exception of the 5 percent reserve retained in the Treasury, be made available to the banks in the sections whence the money came; that if the banks decline

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to take such funds, they may be invested in Government securities. It is certain, therefore, that the funds are being used in the public interest.

It is our understanding that the banks of the country have on deposit a great deal more money than they are able to profitably use. It is apparent, therefore, that the Postal Savings System is not hurtful to the banks and there would be no good purpose served in hampering or restricting its operation by an amendment such as that proposed.

The Post Office Department has made every effort to comply with the Banking Act of 1933 consistent with an equitable and economical administration of the Postal Savings System, and it is our earnest conviction that the best interests will be served by maintaining the system under control and regulation of the board of trustees, as provided for under existing law.

Very truly yours,

JAMES A. FARLEY,
Postmaster General.

MEMORANDUM

Statement of depositors' balances in the Postal Savings System on the dates shown:

Jan. 1, 1932	$605, 593, 749
Jan. 1, 1933	901, 555, 572
Jan. 1, 1934	1, 208, 884, 255
Jan. 1, 1935	1, 207, 428, 162
Feb. 1, 1935	1, 200, 767, 408

Senator GLASS. We will adjourn until Monday morning at 10:30.

(Whereupon, at 12:30 p. m., the subcommittee adjourned until Monday, May 20, 1935, at 10:30 a. m.)

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BANKING ACT OF 1935

MONDAY, MAY 20, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON
BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met, pursuant to adjournment, on Friday, May 17, 1935, at 10:30 a. m., in room 301, Senate Office Building, Senator Carter Glass presiding.

Present: Senators Glass (chairman of the subcommittee), McAdoo, Byrnes, Townsend, and Couzens.

Senator GLASS. The committee will come to order. Representatives of the Federal Advisory Council have asked to be heard on the bills which we have before us, and Mr. Walter W. Smith, president of the Federal Advisory Council and president of the First National Bank in St. Louis, will be the first witness. Mr. Smith, you may proceed.

STATEMENT OF WALTER W. SMITH, PRESIDENT OF THE FEDERAL ADVISORY COUNCIL AND PRESIDENT OF THE FIRST NATIONAL BANK IN ST. LOUIS, ST. LOUIS, MO.

Mr. SMITH. Senator, if it is agreeable to your committee we would like to present the Federal Advisory Council's report, dated April 10, 1935, on Senate bill 1715 and the House of Representatives bill 5357. We would like to have it made a part of the record if that is in order.

Senator GLASS. Yes. Just hand it to the reporter.

(Statement of Federal Advisory Council referred to and submitted by the witness is here printed in full, as follows:)

STATEMENT OF THE FEDERAL ADVISORY COUNCIL ON S. 1715, H. R. 5357—BANKING ACT OF 1935

Title I: Title I of the proposed Banking Act of 1935 amends section 12B of the Federal Reserve Act which deals with the subject of deposit insurance. The Federal Advisory Council approves this title of the proposed bill, but suggests the following changes, the *italic* portion representing new material.

Section 8, page 10, change to read as follows: By striking out subsection (h) and inserting in lieu thereof the following:

"(h) (1) The assessment rate shall be one-twelfth of 1 per centum per annum upon the total amount of the liability of the insured bank for deposits (according to the definition of the term 'deposit' in and pursuant to paragraph (11) of subsection (c) of this section, without any deduction for indebtedness of depositors) based on the *daily* average determined from such total ~~as of the close of business~~ *for the six months ending* on the last day of June and the last day of December of each year: *Provided*, That the board of directors from time to time may fix a lower rate *or may determine that there shall be no assessment* or may provide for a refund or credit by a percentage upon the last annual assessment

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rate ~~not exceeding 50 per centum thereof,~~ when it finds that such action will provide or leave, as the case may be, adequate revenue and reserves for the corporation having due regard to experience and conditions affecting banks. *In computing the total deposits for the purpose of this subsection any bank may deduct from the amount of its gross deposits the amounts of balances due from other banks (except balances due from foreign banks, and required reserve balances carried with Federal Reserve banks) including cash items with Federal Reserve banks and other banks in process of collection, checks on other banks in the same place, and exchange for clearing houses.* The rate or percentage so fixed shall be applicable to all insured banks, except that the board of directors on a similar finding, from time to time may provide that the rate so fixed shall be applicable to insured mutual savings banks only or may provide a different rate applicable to mutual savings banks only."

Explanation: The above changes provide that the assessment shall be based upon the average deposits for the six months' period, instead of the total deposits as of June 30th and Dec. 31st, thereby providing a more stable basis, inasmuch as the deposits for a single day might be affected by special temporary conditions.

It was also felt that the Board of Directors of the Federal Deposit Insurance Corporation should have the power to decrease the assessment in accordance with their judgment, even by eliminating it entirely when the fund reaches such volume as they may believe will serve its purpose.

The definition of total deposits appearing in Title III, Section 323, has been here inserted, except that excess reserve balances with Federal Reserve banks are treated the same as balances due from other banks.

Section 8, *subsection (h), page 10, change to read as follows:*

"(2) On or before the 15th day of July of each year, each insured bank shall file with the corporation a certified statement under oath showing the ~~total~~ *average* amount of its *total* ~~liability~~ *liabilities* for deposits ~~as of the close of business~~ *for the six months ended* on the 30th day of June last preceding, *computed as provided in subsection (h) (1) of this section,* and shall pay to the corporation the portion of the annual assessment equal to one-half of the annual rate fixed by this subsection (h) multiplied by its said ~~total~~ *average* deposits ~~on the date for which such statement is made~~ *as shown by such statement.* On or before the 15th day of January of each year each insured bank shall file a like statement showing the ~~total~~ *average* of its *total* ~~liability~~ *liabilities* for deposits *for the six months ended* as of the close of business on the 31st day of December last preceding, *computed as provided in subsection (h) (1) of this section,* and shall pay to the corporation the portion of the annual assessment equal to one-half of the annual rate fixed by this subsection (h) multiplied by its said total *average* deposits ~~on the date for which such statement is made~~ *as shown by such statement.*"

Explanation: Amended to conform with Section 12 (b), Subsection H (i) above.

Section 8, change the proviso in paragraph (5) line 24, page 12, to read as follows:

"Provided, That where a fiduciary bank deposits any of such trust funds in *another* insured bank~~s, the amount so held by other insured banks on deposit on the last day of the month preceding~~ *such fiduciary bank may upon* the filing of the certified statement required by paragraph (2) of subsection (h) of this section, *deduct the average daily amount of such trust funds so deposited which* for the purpose of such statement shall not be considered to be a deposit liability of the fiduciary bank, but shall be considered a deposit liability of the bank in which such funds are so deposited by such fiduciary bank."

Explanation: To conform with changes recommended in Section 8 basing assessments on average daily deposits rather than deposits at December 31st and June 30th.

Section 13, (5), page 30, change as follows:

"If any depositor in a closed bank shall fail to claim his insured deposit from the Corporation, or shall fail to claim or arrange to continue the transferred deposit with the new bank or other bank assuming liability therefor within ~~one year~~ *two years* after the appointment of the receiver for the closed bank, all rights of the depositor against the Corporation in respect to the insured deposit or against the new bank and such other bank in respect to the transferred deposit shall be barred, and all rights of the depositor against the closed bank, its shareholders or the receivership estate to which the Corporation may have become subrogated shall thereupon revert to the depositor. The amount of any transferred deposits not claimed within said ~~one~~ *two*-year period, shall be refunded to the Corporation."

Explanation: It is believed that one year is not sufficient time for depositors to make their claims, in view of the difficulties which sometimes exist of ascertaining ownership of deposits.

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Section 18, page 34, change to read as follows:

"By adding at the end of subsection (r) the following:

"'The board of directors, from time to time, shall gather information and data and shall make investigations and reports upon the organization, operation, closing, reopening, reorganization, and consolidation of banks, banking practices ~~and management,~~ and the security of depositors ~~and adequacy of service to borrowers.~~ The board of directors, in any annual or special report to Congress, shall report its findings and make such recommendations and requests as it shall find necessary and appropriate for the purpose of carrying out the purpose of this section and fully providing for all of the obligations of the Corporation.'"

Explanation: It is felt that the elimination of the clause indicated above will not impair the proper functions of the Federal Deposit Insurance Corporation. The elimination is made to avoid duplication of examinations.

Section 22 (3), page 36, change to read as follows:

"No insured bank shall pay any dividends on its capital stock while it remains in default in the payment of any assessment due to the Corporation; and any director or officer of any insured bank, who *with knowledge of such default* participates in the declaration or payment of any such dividend shall, upon conviction, be fined not more than $1,000 or imprisoned not more than one year, or both."

Explanation: It would seem obvious that no penal liability should attach to a director or officer who participates in the declaration of a dividend without knowledge of such default. Such a provision would be contrary to all penal statutes which only make liable those who wilfully do an act which is unlawful.

Section 22 (5), page 36, change to read as follows:

"Each insured bank shall provide such protection and indemnity against burglary, fidelity, and other similar insurable losses *in such amounts* as the board of directors by regulation may require adequately to reimburse the bank for such losses. Whenever any insured bank fails to comply with any such regulation the corporation may contract for such protection and indemnity and add the cost thereof to the assessment otherwise payable by such bank."

Explanation: The above changes clarify the apparent intent of this section and would eliminate the possibility that the section, as now worded, might confer upon the Federal Deposit Insurance Corporation the power to discriminate between insurance companies.

TITLE II

The Federal Advisory Council has considered most carefully title II of the proposed Banking Act of 1935. The provisions of title II change fundamentally in many respects the Federal Reserve System as it has existed since its inception. The Council questions whether there is any emergency at the present time which makes it necessary to enact into law the provisions of title II without further careful consideration and study. The Council wishes to point out that in recent years so many changes have been made in the whole fiscal and financial structure of the country that there may well be some real concern entertained as to whether a proper relationship between the various parts has been maintained. These doubts are not concerned with this or that detail of title II. Twenty-five years ago, before the Federal Reserve Act was enacted, a series of studies was undertaken by a national commission. Since then many different types of financial institutions have sprung up, so that it would seem most desirable to have another detailed study made analogous to the one which preceded the enactment of the Federal Reserve Act.

In spite of what has been said, if the Government deems it advisable to enact at this time legislation making fundamental changes in the Federal Reserve System, the Federal Advisory Council after a careful study of the proposed measure suggests certain amendments which it regards as fundamental. The Council deems it essential to preserve the autonomy of the regional Federal Reserve banks as provided in the original act and in order to maintain this principle, it makes certain suggestions which will be detailed below.

Title II may be divided into three general subjects:

The first has to do with the control of money, the organizations set up to exercise this control, and the powers to be employed. The control over money may be maintained by a change in the discount rate or by the increase or decrease of the percentage of reserves kept by member banks with the Federal Reserve banks, or finally by operations in the open market, i. e., by the purchase or sale of Government bonds by the Federal Reserve banks.

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The exercise of these powers is of the greatest importance to the commerce, industry, and agriculture of the country. As far as possible the members of the body to whom is to be entrusted this vast authority should be free of wrongful influences whether political or financial. While, therefore, there should be independence of judgment, it is recognized that there is a proper relationship between governmental financial policies and the action of those authorities controlling the banking system of the country and that it is desirable that there be close cooperation and harmony between the two. With this in mind, the Federal Advisory Council recommends the following changes in the proposed law:

1. That the Secretary of the Treasury and the Comptroller of the Currency cease to be members of the Federal Reserve Board.
2. That the Board be reduced to five members.
3. That the Governor and members be appointed for 15 years, but compelled to retire at the age of 70.
4. That the Federal Reserve bank governors be appointed by the directors of the Federal Reserve banks with the approval of the Federal Reserve Board, but that after the approval of the Federal Reserve Board has once been obtained, the governors may be re-elected annually by the directors of the banks subject to the approval by the Federal Reserve Board every 3 years.
5. Thata committee composed of the members of the Federal Reserve Board and 4 of the bank governors, selected by the 12 governors, shall be given the power to fix the discount rate, the percentage of reserves, and direct the open-market policies of the banks.

The second general subject dealt with in title II is the liberalization of rediscount privileges. The Council recommends the re-enactment of section 10 (b) as detailed below.

The third general subject dealt with in title II is that of real estate loans. There is unquestionably need of some effective private agency to finance the requirements of real estate. The difficulty is that banks are in a very different position from other institutions; they have limited capital, and such capital as they have must be protected as far as possible.

It is the opinion of the Council that a further study of this subject should be made, but if a law is to be passed at the present time the Council feels that the power should be given to the several Federal Reserve banks to lower the percentage of value up to which a bank may loan, and to lower from time to time the percentage of individual bank capital and surplus which may be represented by loans secured by real estate in banks within its district. Any percentage so fixed by the Federal Reserve bank should be subject to change from time to time, upon 10 days' notice, and it should be the duty of the bank to establish such percentages with a view to preventing the undue use of bank loans for the speculative carrying of real estate. The Federal Reserve bank should have power to direct any member bank to refrain from further increase of its loans secured by real estate for any period up to 1 year, under penalty of suspension of all rediscount privileges at the Federal Reserve bank. The Council also feels that the present provisions of the law, restricting the area within which banks should be permitted to make real estate loans, should be incorporated in this act, i. e., within the Federal Reserve district or within a radius of 100 miles of the place in which such bank is located.

The detailed changes necessary to carry out these recommendations will follow, the *italic* portion representing new material.

The proposed amendments, if accepted, would take from title II the features which the Council conceives to be the most dangerous. Without them the Council feels that prior to the independent study which is earlier suggested, title II must be disapproved in its entirety.

Section 201, *page 39, change paragraph beginning at line 9, to read as follows:*

"Effective ninety days after the enactment of the Act containing this amendment, the offices of Governor and chairman of the board of directors of each Federal Reserve bank shall be combined. The Governor shall be the chief executive officer of the bank and shall be appointed annually by the board of directors, ~~subject to the approval of the Federal Reserve Board.~~ He shall not take office *for the first term* until approved by the Federal Reserve Board and thereupon *and thereafter* he shall be *subject to the approval by the Federal Reserve Board every three years, and after such approval he shall be* appointed and *reappointed* by the Federal Reserve Board as one of the Class C directors of the bank, etc."

Explanation: The Federal Advisory Council originally proposed that the Federal Reserve Board should have the right to confirm the governors of the respective Federal Reserve banks only at the time of the initial election of such a governor

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and that thereafter the governors should be reelected by the boards of directors of the local Federal Reserve banks without the necessity of reapproval by the Federal Reserve Board. In view, however, of the amendment suggested by Governor Eccles in the second paragraph on page 40 of H. R. 5357 which would turn over to the governors of the respective Federal Reserve banks all the functions at present exercised by the Federal Reserve agents, it seemed to the Council that there was merit in the suggestion of the Governor that the Board have the right periodically to pass on the question as to whether a given governor was the one whom the Board desired to have as its representative.

Section 201, page 40. Strike out the sentence beginning at line 14, reading as follows:

~~"All duties prescribed by law for the Federal Reserve agent shall be performed by such person as the Federal Reserve Board shall designate"~~ and substitute the following: *"All duties prescribed by law for the Federal Reserve agent shall be performed by the Governor of the bank or by such other person or persons as he may designate."*

Explanation: This is in accord with Governor Eccles' suggestion and will turn over to the Governor of the Federal Reserve bank all the functions at present exercised by the Federal Reserve agent of such bank.

Section 201, page 40. Eliminate paragraph beginning at line 17 reading as follows:

~~"No member of the Board of Directors of a Federal Reserve bank, other than the Governor and Vice Governor, shall serve as a director for more than two consecutive terms of three years each. This shall not prevent the present incumbents from serving out the remainder of their present terms."~~

Explanation: It is felt that the inclusion of this paragraph might deprive many of the regional Reserve banks of the services of directors who are invaluable on account of their experience gained by length of service, especially in such districts where the number of men most qualified to serve as directors may be limited. At the present time, a number of the Federal Reserve banks have already adopted restrictions similar to the one proposed in the bill, and it seems to the Council that this matter might well be left to the discretion of each Federal Reserve bank.

Section 203, page 41, of the Banking Act of 1935, change to amend Section 10 of the Federal Reserve Act, to read as follows:

A Federal Reserve Board is hereby created, which shall consist of ~~eight~~ *six* members ~~including the Secretary of the Treasury and the Comptroller of the Currency who shall be members ex-officio and six members~~ appointed by the President of the United States, by and with the advice and consent of the Senate: *Provided, however, That whenever the membership shall be reduced by death, resignation, expiration of term or other cause, the vacancy thus created shall not be filled if it would increase the membership to more than five.* [The preceding sentence is from Section 10 of the Federal Reserve Act.] In selecting the ~~six appointive~~ members of the Federal Reserve Board the President shall choose persons well qualified by education or experience or both to participate in the formulation of national economic and monetary policies, not more than one of ~~the appointive members~~ whom shall be selected from any one Federal Reserve district, except that this limitation shall not apply to the selection of the Governor. ~~The President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country.~~ The ~~six~~ members of the Federal Reserve Board ~~appointed by the President and confirmed as aforesaid~~ shall devote their entire time to the business of the Federal Reserve Board and shall each receive ~~the sum of $12,000 payable monthly together with actual necessary traveling expenses, and the Comptroller of the Currency as ex-officio member of the Federal Reserve Board, shall, in addition to the salary now paid him as Comptroller of the Currency receive the sum of $7,000 annually for his services as a member of said Board. The appointive members of the Federal Reserve Board appointed after July 1, 1935, shall each receive~~ a salary at the same rate as that of the heads of the executive departments who are members of the President's Cabinet, together with actual necessary traveling expenses. Each ~~appointive~~ member of the Federal Reserve Board heretofore appointed may retire from active service upon reaching the age of seventy or at any time thereafter, and all members hereafter appointed shall retire upon reaching the age of seventy. Each member of the Board so retired from active service who shall have served for at least five years shall receive, during the remainder of his life, retirement pay in an amount equal to the annual salary paid to appointive members prior to the enactment of the Act containing

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this amendment: *Provided*, That if he shall not have served as much as ~~twelve~~ *fifteen* years his retirement pay shall be at the rate of one-~~twelfth~~ *fifteenth* of such annual salary for each year and for any fraction of an additional year of such service: ~~Provided further, That any member whose term expires after he reaches the age of sixty-five and who is not reappointed shall receive retirement pay upon the same basis as if he had been retired under the provisions of this paragraph.~~ *Provided, further, That any member who is not reappointed upon the expiration of his term shall receive retirement pay upon the same basis as if he had been retired under the provisions of this paragraph.* The funds necessary for such retirement pay shall be provided by the Federal Reserve banks in such manner as the Federal Reserve Board shall prescribe.

~~The Secretary of the Treasury and the Comptroller of the Currency shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank. The appointive~~ The members of the Federal Reserve Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed. Upon the expiration of the term of any ~~appointive~~ member of the Federal Reserve Board in office when this paragraph as amended takes effect, the President shall fix the term of the successor to such member at not to exceed ~~twelve~~ *fifteen* years, as designated by the President at the time of nomination, but in such manner as to provide for the expiration of the term of not more than one appointive member in any ~~two~~ *three*-year period, and thereafter each ~~appointive~~ member shall hold office for a term of ~~twelve~~ *fifteen* years from the expiration of the term of his predecessor.

[NOTE.—The above paragraph is from section 10 of the Federal Reserve Act.]

Explanation: The above changes eliminate the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members of the Federal Reserve Board, and provide for the eventual reduction of the Board to five members and increases their term of office to 15 years, thereby giving them, it is felt, greater independence and security.

They also increase the salary of the present members of the Federal Reserve Board to an equality with that proposed for members appointed after July 1, 1935.

Provision is also made that any member of the Board not reappointed upon the expiration of his term shall be pensioned in the same manner as if he had reached the age of 70. (This is in accord with Governor Eccles' recommendation before the House committee.)

Section 203 (3), page 43, change to read as follows:

"By striking out the fourth sentence of the second paragraph and inserting in lieu thereof the following: 'Of the ~~six appointive~~ members of the Board one shall be designated by the President as Governor and one as Vice Governor of the Federal Reserve Board, to serve as such until the further order of the President, ~~and the provisions of the next preceding sentence of this paragraph shall not apply to the member designated as Governor. The term of office of the member designated as Governor shall be the period during which he shall continue as Governor and, upon the termination of his designation as Governor, he shall be deemed to have served the full term for which he was appointed';~~ *provided, that when the member designated as Governor shall cease to be designated as Governor by the President, he may resign from the Board, and in such event he shall be deemed to have served the term for which he was appointed.*"

Explanation: The suggested changes are made with a view to rendering the members of the Federal Reserve Board sufficiently independent so that competent men may be induced to serve, also, to provide that if the Governor is removed by the President he may immediately resign from the Federal Reserve Board and reenter private business.

Section 205, line 11, page 44, change to read as follows:

"Section 12A. There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'Committee'), which shall consist of the Governor of the Federal Reserve Board, who shall be *its* chairman, ~~of the Committee, two~~ *the* members of the Federal Reserve Board, ~~selected by the board,~~ and ~~two~~ *four* governors of the Federal Reserve Banks, selected by the governors of the Federal Reserve Banks, in accordance with procedure prescribed by regulations of the ~~Federal Reserve Board,~~ *governors of the twelve Federal Reserve banks.* The terms of the members of the Committee, other than the Governor *and members*

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of the Federal Reserve Board, shall expire at the end of ~~each calendar year~~ *ten years from the date of appointment, provided, that the four first appointed subsequent to the taking effect of this Act, shall be appointed for terms of four, six, eight and ten years, respectively; and provided further, that if any of the four governors shall cease to be a governor of a Federal Reserve bank he shall thereupon cease to be a member of said Open Market Committee.* Whenever a vacancy shall occur a successor shall be selected, *who shall hold office until the expiration of the term of his predecessor,* in the same manner as his predecessor was selected. Meetings of the Committee shall he held from time to time upon the call of the Governor, at the request of the Board or of any two members of the Committee.

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. The Committee shall aid in the execution of such policies and/or perform such other duties relating thereto as the Federal Reserve Board may prescribe. ~~All open market operations of the Federal Reserve banks shall be subject to regulations prescribed by the Federal Reserve Board. The Committee from time to time shall also make recommendations to the Federal Reserve Board regarding the discount rates of the Federal Reserve banks.~~ *The Committee, from time to time in order to prevent injurious credit expansion or contraction, may, by regulation, change the requirements as to reserves to be maintained against demand or time deposits, or both, by all member banks in (1) central Reserve and Reserve cities, or (2) other member banks; provided that in no event may the reserve requirements be fixed at an amount in excess of thirty per centum of the aggregate of demand and time deposits nor at an amount less than ten per centum of demand deposits and three per centum of time deposits in the case of Central Reserve and Reserve cities, nor less than seven per centum of demand deposits and three per centum of time deposits in the case of all other member banks than those in Central Reserve and Reserve cities. The Committee shall have power to approve and from time to time to amend rates of discount to be charged by the various Federal Reserve banks for each class of paper.* The Committee shall aid in the execution of such policies and/or perform such other duties relating thereto as the Federal Reserve Board may prescribe. ~~All open market operations of the Federal Reserve banks shall be subject to regulations perscribed by the Federal Reserve Board. The Committee from time to time shall also make recommendations to the Federal Reserve Board regarding the discount rates of the Federal Reserve banks.~~ *The employment of the powers herein conferred upon the Committee shall be governed with a view to accommodating commerce, industry and agriculture, and with regard to their bearing upon the general credit situation of the country.*

Explanation: The above changes reconstitute the Federal Open Market Committee to consist of the five members of the Federal Reserve Board and four Governors of the Reserve banks appointed by the twelve Governors, and provides for the serial appointment of the latter for ten-year terms. It also consolidates in the Federal Open Market Committee, in addition to control over open-market operations, control of member-bank reserve balances and control of rediscount rates. The change in regard to reserve balances is in accord with the suggestion of Governor Eccles, and the division between urban and rural districts would seem to be proper. The Council makes an addition to Governor Eccles' proposal in recommending that the limit to which reserve requirements can be increased be restricted to thirty percent of the aggregate of demand and time deposits. This exception is most essential for there can be no conceivable emergency which would justify higher reserve requirements. Essentially higher reserves than thirty percent would probably mean that the commercial banking system would cease functioning.

It also seems advisable to the Council to set minimum reserve requirements.

In order to conform the present bill and the Federal Reserve Act to the preceding changes, the following is necessitated:

1. Eliminate Title II, section 209, from the Banking Act of 1935, inasmuch as the matter included therein is incorporated in Section 205 above, which confers the control over reserve requirements to the Federal Open Market Committee.

2. Amend Section 14 (d) of the Federal Reserve Act to substitute "Federal Open Market Committee" for "Federal Reserve Board."

3. Amend Section 19 of the Federal Reserve Act to eliminate subsection (c) beginning with the words "Notwithstanding the foregoing provisions of this section, the Federal Reserve Board. * * *"

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Federal Reserve Bank of St. Louis

Section 206, page 45, line 18, change to read as follows:

SEC. 206. Section 13 of the Federal Reserve Act, as amended, is further amended by adding at the end thereof a new paragraph reading as follows:

~~"Upon the endorsement of any member bank, which shall be deemed a waiver of demand, notice and protest as to its own endorsement exclusively, and subject to such regulations as to maturities and other matters as the Federal Reserve Board may prescribe, any Federal Reserve bank may discount any commercial, agricultural or industrial paper and may make advances to any such member bank on its promissory notes secured by any sound assets of such member bank."~~ *When any member bank has no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations through rediscounting at the Federal Reserve bank or any other method provided by this act, any Federal Reserve bank, under rules and regulations prescribed by the Federal Reserve Board, may make advances to such member bank on its time or demand notes secured to the satisfaction of such Federal Reserve Bank. Each such note shall bear interest at a rate not less than one per centum per annum higher than the highest discount rate in effect at such Federal Reserve Bank on the date of such note.*

Explanation: Section 206, as presented in the proposed bill, might offer an inducement to member banks to lend indiscriminately and without any regard whatsoever as to the liquidity of the assets obtained. The Council feels that the Section as presented above, which is merely a re-enactment of Section 10(b) of the Federal Reserve Act, which has expired, will meet any situation which is likely to arise.

Note.—In order to conform the Act, Section 10B of the Federal Reserve Act should be stricken out, inasmuch as it has expired, and the matter is now being covered in Section 13 above.

Section 208, page 46, amend to read as follows:

"SEC. 208. Section 16 of the Federal Reserve Act, as amended, is further amended in the following respects:

~~(1) By striking out the first ten paragraphs and substituting therefor the following:~~

~~"Sec. 10. Each Federal Reserve bank may issue Federal Reserve notes, which shall be obligations of the United States, secured by a first and paramount lien on all of the assets of such bank. 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.~~

~~"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 per centum against its deposits and reserves in gold certificates of not less than 40 per centum against its Federal Reserve notes in actual circulation. Each Federal Reserve note shall bear upon its face a distinctive letter, which shall be assigned by the Federal Reserve Board to each Federal Reserve bank, and also a serial number.~~

~~"When received by the Treasurer of the United States from a source other than a Federal Reserve bank, Federal Reserve notes unfit for further use shall be canceled and retired, and, upon receipt of advice of such cancelation and retirement, the issuing Federal Reserve bank shall reimburse the Treasurer of the United States for the notes so canceled and retired. When received by a Federal Reserve bank, Federal Reserve notes unfit for further use shall be canceled and forwarded to the Treasurer of the United States for retirement, and, if issued by another Federal Reserve bank, such issuing bank shall reimburse the Federal Reserve bank which canceled such notes and forwarded them to the Treasurer of the United States.~~

~~"In order to furnish suitable notes for circulation as Federal Reserve notes, the Comptroller of the Currency shall cause plates and dies to be engraved in the best manner to guard against counterfeiting and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of $5, $10, $20, $50, $100, $500, $1,000, $5,000, and $10,000 as may be required to supply the Federal Reserve banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury and shall bear the distinctive numbers of the several Federal Reserve banks through which they are issued. When such notes have been prepared, they shall be held in the Treasury subject to the order of the Comptroller of the Currency for delivery to the Federal Reserve banks. Federal Reserve notes unfit for circulation shall be returned by the Federal Reserve banks to the Comptroller of the Currency for cancelation and destruction."~~

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Federal Reserve Bank of St. Louis

(1) By amending the second paragraph to read as follows:

"Any Federal reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal Reserve agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section 13 of this Act, or bills of exchange indorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this Act, or Bankers' acceptances purchased under the provisions of said section 14, or gold or gold certificates: ~~Providing, however, that until March 3, 1935, or until the expiration of such additional period not exceeding two years as the President may prescribe, the Federal Reserve Board may, should it deem it in the public interest, on the affirmative vote of not less than a majority of its members authorize the Federal Reserve banks to offer and Federal Reserve agents to accept as such collateral security direct obligations of the United States. On such date or upon the expiration of such period so prescribed by the President, or sooner should the Federal Reserve Board so decide, such authorization is terminated and such obligations of the United States be retired as security for Federal Reserve notes.~~ *Provided, however, that should the Federal Open Market Committee, at any time, declare an emergency to exist, it may, upon the affirmative vote of not less than a majority of its members, authorize the Federal Reserve banks to offer and the Federal Reserve agents to accept as such collateral direct obligations of the United States. Upon the determination and in the discretion of the Federal Market Open Committee such authorization shall terminate and such obligations of the United States be retired as security for Federal Reserve notes. In no event, however, shall the aggregate amount of Federal Reserve notes issued upon the security of the obligations of the United States exceed the aggregate amount of one billion dollars. A charge, at the rate of three per centum per annum, shall be paid by each Federal Reserve bank upon the amount of Federal Reserve notes applied for by it and outstanding secured by obligations of the United States. Such charge shall be payable for the period during which said notes are outstanding or until the applicant bank deposits with the Treasurer of the United States Federal Reserve notes for the retirement thereof.* In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it.

[NOTE.—The above quotes the second paragraph of Section 16 of the present Federal Reserve Act, the *italic* portion representing new material.]

Explanation: The Council does not believe it desirable to permit Federal Reserve notes to be issued on the basis of Government bonds, except to meet an emergency. It must be remembered that one of the original purposes of the Federal Reserve Act was to get rid of a bond-secured currency and to substitute therefor an elastic currency responsive to the needs of commerce, industry, and agriculture.

[NOTE.—In order to conform with the above, the Council recommends that section 4, paragraph 4 provision numbered "eighth", and section 18, of the Federal Reserve Act be repealed.]

Section 210, page 49, line 4, change to read as follows:

"Sec. 210. The first paragraph of section 24 of the Federal Reserve Act, as amended, is amended to read as follows:

"Sec. 24. Any National Banking Association may make loans secured by first liens upon improved real estate, including improved farm land and improved business and residential properties, *within its Federal Reserve District or within a radius of one hundred miles of a place in which such bank is located, irrespective of District lines.* A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other instrument upon real estate when the entire amount of such obligation or obligations is made or is sold to such association. The amount of any such loan shall not exceed ~~60~~ 50 per centum of the actual value of the real estate offered for security, but no such loan upon such security shall be made for a longer term than ~~three~~ five years, provided, that loans may be made in amounts not exceeding ~~75~~ 60 per centum of the actual value of the real estate offered for security, if they are ~~required to be completely amortized within periods not exceeding~~

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~~twenty years by means of substantially equal monthly, quarterly, semi-annual or annual payments on principal with interest added or on principal and interest combined~~ *made payable within twelve years and provide for reduction by payments of not less than 5 per centum per annum on principal in addition to current interest.* Any bank may make such loans in an aggregate sum equal to the amount of the capital stock of such association paid in and unimpaired plus its unimpaired surplus fund, or equal to 60 per centum of the amount of its time and savings deposits, whichever is the greater: *Provided, that the Federal Reserve Banks of the respective districts may from time to time set such lower percentage of actual value as may be loaned or such lower percentage of capital funds and surplus and/or time and savings deposits as may be loaned against real estate by banks within their respective districts for the purpose of preventing the undue use of bank credit for the speculative carrying of real estate. The Board of Directors of the respective Federal Reserve Banks shall have further power to direct any member bank within its district to refrain from further increase of its loans secured by real estate for any period up to one year, under penalty of suspension of all rediscount privileges at the Federal Reserve Bank; and Provided further,* That in computing, etc."

Explanation: The above amends the provisions with respect to real-estate loans to reduce the amount which may be loaned, on any property to 50 percent of its value, provided the loan matures within 5 years, permitting the loans to be made up to 60 percent of the value of the property for a 12-year period if they are amortized by substantially equal annual payments. The suggested provisions give the respective Federal Reserve banks power to exercise such control as it is believed is necessary to prevent the use of bank credit for the speculative carrying of real estate. In this connection, Federal Reserve banks are given the same control over real estate as is given to the Federal Reserve Board, in other sections of the banking act, with respect to security loans.

Section 325 of the Revised Statutes amend to read:

"The Comptroller of the Currency shall be appointed by the President, on the recommendation of the Secretary of the Treasury, by and with the advice and consent of the Senate, and shall hold his office for the term of five years unless sooner removed by the President, upon reasons to be communicated by him to the Senate; and he shall be entitled to a salary of five *twelve* thousand dollars a year.

[NOTE.—Section 10 of the Federal Reserve Act provides that the Comptroller of the Currency shall be an ex officio member of the Federal Reserve Board and shall, in addition to his salary as Comptroller, receive the sum of $7,000 annually for his service on said Board."]

Explanation: Inasmuch as the changes suggested elsewhere eliminate the Comptroller of the Currency from the Federal Reserve Board, this change is suggested to compensate for the salary of which he would otherwise be deprived.

TITLE III

The Federal Advisory Council endorses and recommends the adoption and passage of title III of the proposed Banking Act of 1935 (with the changes here recommended), and feels that it will correct many of the operating defects of the present banking law.

The following changes in title III are recommended, the italic portion representing new matter.

Section 314, page 59, change to read as follows:

"SEC. 5199. The directors of any association may, semiannually, declare a dividend of so much of the net profits of the association as they shall judge expedient; but each association shall, before the declaration of a dividend on its shares of common stock, carry not less than one-tenth part of its net profits of the preceding half year to its surplus fund until the same shall equal the amount of its common capital; *Provided, that any amounts paid into a fund for the retirement of any preferred stock of any such association out of the net earnings of such association for the six months' period shall be deemed to have been an addition to its surplus fund, for the purpose of this section."*

Explanation: Some banks, as a result of their preferred stock retirement fund, are currently adding an amount to surplus in excess of the required one-tenth of net profits. The effect of the above suggested change would be to give such banks a credit for the amounts paid to the preferred stock retirement fund against the surplus additions required by this section.

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Section 328, page 73, beginning at line 24, change to read as follows:

"SEC. 8. No director, officer, or employee of any member bank of the Federal Reserve System shall be at the same time a private banker or a director, officer, or employee of any other bank, banking association, savings bank (other than a mutual savings bank), or trust company except in limited classes of cases in which the Federal Reserve Board may allow such service by general regulations when in the judgment of the Federal Reserve Board such classes of institutions are not in substantial competition *or such service is not incompatible with the public interest.*"

Explanation: This suggested addition adopts the wording of the present act enabling the Federal Reserve Board to issue general regulations permitting service when, in its opinion, such action is not incompatible with the public interest.

Senator COUZENS. In making your statement are you going to take cognizance of the changes that are made in the bill by the House of Representatives?

Mr. SMITH. To a considerable extent, Senator.

In the following statement I have confined my remarks primarily to title II, of the proposed banking act of 1935. The provisions of title II change fundamentally, in many respects, the Federal Reserve System as it has existed since its inception. There is nothing in the existing situation that indicates the necessity for enacting into law the provisions of title II without further careful consideration and study.

In recent years, many changes have been made in the whole fiscal and financial structure of the country, and it may well be a question whether proper coordination has been achieved between the various parts. Any effort to make changes of such far-reaching character as those proposed in title II requires, in my opinion, another detailed study analogous to that which preceded the enactment of the Federal Reserve Act. If, however, it is deemed advisable to enact legislation at this time, making fundamental changes in the Federal Reserve System, it is my judgment that careful study should be given to certain sections of title II to prevent the enactment of legislation that goes counter to tried and tested banking experience.

This bill as drawn grants to the Governor and members of the Federal Reserve Board discretionary powers of the widest latitude. While, on the one hand, it requires that the Governor, and members of the Board, be well qualified by education and experience to formulate national economic and monetary policies, it practically nullifies the importance of these qualifications by making the Governor's term of office subject to the pleasure of the President. If such a Board is to attract men of ability, integrity, and a high sence of civic duty, they should be free from any political influences. This can only be accomplished by choosing well qualified men and giving them definite terms of office and making not only the members of the Board, but the Governor as well, removable only for cause. If we propose to place our financial policies at the discretion of such a Board, it should be as well protected from political influence and change of membership as are the members of the Supreme Court of the United States, as there is nothing so vital to our economic life as the control of the finances of our country.

Section 201 provides, among other things, for the consolidation of the offices of governor and chairman of the board of directors of each Federal Reserve bank. This would appear to be a satisfactory provision. It further provides that the governor shall be the chief executive officer of the bank and shall be appointed annually by the

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Federal Reserve Bank of St. Louis

board of directors—his first appointment to be subject to the approval of the Federal Reserve Board. Upon appointment he becomes a class C director and his continuance in office is subject to the approval of the Federal Reserve Board at the end of each 3-year term. The wisdom of this provision is doubtful. In order to provide suitable independence of action a governor once selected by the Federal Reserve Board should, in my opinion, be eligible for reappointment for a period up to 6 years at least, without further approval by the Federal Reserve Board.

This section further provides, on page 46, lines 16 to 21, that no member of the board of directors of a Federal Reserve bank, other than the governor and vice governor, shall serve as a director for more than 2 consecutive terms of 3 years each. It is my judgment that this restriction should be removed. Its inclusion in the bill might deprive many of the regional Reserve banks of the services of directors who are invaluable on account of their experience gained by length of service. This is especially true in such districts where the number of men best qualified to serve as directors may be limited. It would seem that a provision of this nature might well be left to the discretion of each Federal Reserve bank.

Since this section deals with the composition of the Federal Reserve Board, it is my judgment that it should provide that the Secretary of the Treasury and the Comptroller of the Currency cease to be members of the Federal Reserve Board and that the Board be reduced to five members. Provision should be made that the Governor and members be appointed for 15 years with mandatory retirement at the age of 70. In the case of the Governor, his term of office might be made to coincide with that of the President. I would strongly urge that the salaries of the members of the Board be fixed at the same rate as that of the members of the President's Cabinet, with provision for adeuqate retirement allowances to the end that the members would be financially independent and free from any influence. This would result in drawing to the Board men of outstanding ability and experience and would justify many of the sacrifices which membership on the Board has entailed in the past.

Section 204 B requires that the Federal Reserve Board exercise its powers to promote conditions conducive to business stability and to mitigate the fluctuations in production, trade, prices, unemployment, so far as may be possible within the scope of monetary action and credit administration. This is all very well as a general statement of objectives, but unfortunately there exists an increasing tendency on the part of many vociferous elements, who have the ear of a large portion of the public, to assume that monetary control, if exercised in some mysterious manner, can determine not only the volume of business, unemployment, prices and production, but also create and maintain general prosperity. As an individual who has a profound respect for the Federal Reserve System I am deeply concerned that it should be held accountable for the future well being and prosperity of our country through the simple device of a managed monetary and credit policy. I feel sure that it is the judgment of the great majority of those of extensive practical experience that "monetary action and credit administration" can have but slight effect upon the fluctuations in production, trade, prices, unemployment, and so forth. Any banking system, however perfect, is merely a means to an end

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Federal Reserve Bank of St. Louis

and not an end in itself. It can facilitate trade and commerce but it cannot produce it any more than a perfect transportation system can of itself create traffic and maintain its flow.

We have had every evidence in the past 2 years that an abundance of credit at the lowest rates in history does not create loans, and also that in the period of 1928 and 1929 abnormally high interest rates and restricted credit did not diminish the demand for loans, but that the use of credit is dependent almost entirely upon the individual's decision as to the likelihood of a resultant profit from the transaction. It should never be forgotten that in a strict sense banks do not create credit. A bank merely takes an individual's credit which has limited acceptability and converts it into bank credit which has general acceptability either for himself or others.

Section 205 provides for an open-market advisory committee to consult and advise with the Federal Reserve Board with respect to open-market policies. It provides, however, that the Board can, after consulting with the committee, prescribe open-market policies for the System and that such policy is binding on all Federal Reserve banks. Is it wise or just to require compulsory participation of all Reserve banks, particularly where the Board's action might be absolutely contrary to the unanimous opinion of the open-market advisory committee, the members of said committee being men of the broadest experience and having intimate knowledge of the conditions and needs of their respective districts? This provision, if adopted, would entirely eliminate any regional autonomy, thus destroying the original concept of a regional Reserve System and completely centralize our banking system. There is nothing in our past experience that suggests the desirability of identical financial policies for, say, New York and Dallas at one and the same time.

It would seem wiser to provide compulsory participation in open-market operations only when a majority of the Reserve banks have assented to a particular policy, and provision should be made for exceptions in certain districts should special conditions warrant.

Section 206 amends section 13 of the Federal Reserve Act so as to authorize the Federal Reserve banks, subject to regulation of the Federal Reserve Board, to discount for member banks any commercial, agricultural, or industrial paper, or make advances on promissory notes secured by any sound assets. This is a serious departure from the standards that have been set in the past, and it is questionable as to whether a Reserve banking system should endeavor to finance the unliquid assets and long-time paper of the member banks. Such a provision is contrary to conservative banking and, coupled with membership in the F. D. I. C., would be an invitation to many member banks to lend indiscriminately without regard to either the quality of the credit or its liquidity. Definite statutory provisions should control the kind and maturity of paper made eligible for rediscounts, or for the collateraling of advances to member banks and for open-market operations.

Reenactment of section 10 B of the Federal Reserve Act, which has expired, would meet any situation likely to arise and it would be far preferable to the proposed change in existing requirements. It is incredible to me that the lessons of the past 5 years should be so quickly disregarded and that we are now considering provisions

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providing for a lessening in the safety of bank assets. To abandon the tests of quality in favor of the quantity of credit is to court disaster.

Section 208 would repeal the requirement that Federal Reserve notes be secured by a specific pledge of collateral. If this amendment is adopted it will remove a very desirable automatic control over the volume of outstanding Federal Reserve notes. One of the primary purposes of the original Federal Reserve Act was to provide for a currency system which would contract and expand to meet the requirements of commerce and industry. Our Federal Reserve notes should continue to be based upon paper of a definitely sound and liquidating character, as well as on gold or gold certificates. Only in this way can the continued confidence in our currency be maintained. To abandon this principle is to ignore all of the lessons of monetary experience.

Section 209 amends the Federal Reserve Act so as to permit the Federal Reserve Board, without the approval of the President, and without declaring the existence of an emergency, to change reserve requirements. Such changes in reserve requirements might be made different in two different classes of cities; namely, reserve and central reserve cities, and nonreserve cities. This grant of authority is so broad and far-reaching that a serious error of judgment on the part of the Board in the exercise of such unlimited powers might well produce chaotic conditions for the commerce and industry of the country.

It is seriously questioned whether Congress should delegate such unrestricted authority to any board. If, however, it is determined to give this broad and unlimited power to the Federal Reserve Board, then it is suggested that there should be definite statutory provisions fixing the outside limits of such fluctuations. It would seem that in no event should the Board be given authority to increase reserve requirements in excess of 30 percent of aggregate demand and time deposits, nor less than the minimum reserves now required. Such limitations appear essential, for it is harldy possible that any emergency would justify higher reserve requirements than 30 percent. If they are raised above such a figure the result would probably be that the commercial banking system would cease functioning.

Section 210 amends section 24 of the Federal Reserve Act, changing the provisions under which real-estate loans may be made. In lieu of the proposed manedments, it would, in my judgment, be better to adhere more closely to the old provisions of the law, providing that the amount which may be loaned on any property be not in excess of 50 percent of its value should the loan mature within 5 years, and up to 60 percent of the value of the property if the loan is made payable within 12 years and provision is made for reduction of principal by payments of not less than 5 percent per annum in addition to current interest. The present geographical limitations in regard to real-estate loans in the Federal Reserve Act should be continued. The provision giving the Federal Reserve banks power to exercise such control as is believed necessary to prevent the undue use of bank credit for the carrying of real estate, is desirable.

If agreeable, I have a short report on title I that I would like to present.

Senator GLASS. Proceed.

Mr. SMITH. Section 101, subsection 8, page 11, provides an assessment rate of one-eighth of 1 percent per annum based upon the

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average of the total amount of the liability of a bank for deposits, according to the definition of the term "deposits" in and pursuant to paragraph 12 of subsection (c). It is recommended that this section be amended, reducing the assessment rate to one-twelfth of 1 percent. In view of the limited experience available for determining a proper percentage of assessment, and since the banking system has been purged of so substantial a volume of doubtful assets, and in the light of the restricted earning power of banks, particularly under present conditions, I regard one-eighth of 1 percent as an excessively heavy burden on the banks. If the suggested rate of one-twelfth of 1 percent should, through later experience, prove lower than necessary, the F. D. I. C. would have ample opportunity to recommend to Congress any required change in the rate.

This section should be further amended to provide that in computing the total deposits a bank may deduct from the amount of its gross deposits the amounts of balances due from other banks (except balances due from foreign banks and required reserves carried with the Federal Reserve bank) including cash items with the Federal Reserve banks and other banks in process of collection, checks, on other banks in the same place and exchange for clearing houses. In other words, the definition of total deposits for the purpose of determining the amount of assessment liability should be the same as the definition of total deposits appearing in title III, except that excess reserve balance with the Federal Reserve banks would be treated the same as balances due from other banks.

If this is not done it is entirely possible that the same original deposit may be taxed many times by virtue of the fact that the deposit may be repeated through interbank deposits.

This same section provides that the average of such total deposits shall be determined as of the close of business on 1 day of each of 3 or more months preceding July and January of each year, such days to be designated by the directors. It is suggested that instead of determining the average deposits on the basis of merely 3 days, they be based on the daily average for the 6 months ending on the last day of June and the last day of December each year. If the average deposits of a bank are to be determined merely on the basis of 3 days, it may result in an injustice to many institutions because of unusual desposit conditions on those particular days.

The House bill has eliminated the provision (sec. 23 Senate bill) rendering it necessary after July 1, 1937, for nonmember banks to become members of the Federal Reserve System in order to secure the benefits of the insurance feature of the law. It would seem as a matter of equity that the banks which are permitted to become members of the F. D. I. C. should meet the same requirements as member banks of the Federal Reserve System. If the requirements regarding capital, surplus, and safe banking procedure are reasonable for member banks they should be equally reasonable in the case of nonmember banks. Since the member banks become co-insurers for the deposits of nonmember banks it is unfair to require them to bear the cost of insuring banks subject to less stringent requirements than those to which they are subjected.

If I might quote from Mr. Brown's testimony, he says that in a 12-year period the total deposits in national banks that were suspended were $1,187,000,000; in State member banks $680,000,000, and in

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nonmember banks $3,017,000,000, or practically twice the amount of both the national banks and the member banks; and the member banks are being required to insure deposits of the nonmember banks.

Senator GLASS. Are there any questions?

Senator BYRNES. I have no questions.

Senator GLASS. Mr. Smith, is there any considerable difference in the credit and trade facilities and practices of the various Federal Reserve districts?

Mr. SMITH. Very much difference; yes, sir. Custom and tradition and the manner of handling business are very different in different sections.

Senator GLASS. Was it not for that reason that the Congress rejected the suggestion of the Aldrich Commission that there be uniformity of discounts throughout the United States?

Mr. SMITH. That I cannot answer. It does not seem to me that it would apply, Senator.

Senator GLASS. Do you think it always desirable to have the same rate of discount, for example, in the Dallas district that may prevail in the New York district?

Mr. SMITH. No, sir; I do not.

Senator GLASS. Where the supply of money is very much more plentiful at times?

Mr. SMITH. No, sir; I do not.

Senator GLASS. That is all, sir. We are very much obliged to you for your testimony.

(The witness withdrew from the committee table.)

Senator GLASS. We will now hear from Mr. James H. Perkins, who is a member of the Federal Advisory Council, representing the Second Federal Reserve District, and also chairman of the National City Bank, New York.

STATEMENT OF JAMES H. PERKINS, MEMBER, FEDERAL ADVISORY COUNCIL, REPRESENTING SECOND FEDERAL RESERVE DISTRICT, AND CHAIRMAN, NATIONAL CITY BANK, NEW YORK, N. Y.

Senator GLASS. The committee will be very glad to hear from you on the subject of the pending bank bills.

Senator COUZENS. Is there going to be any substantial difference in your testimony and the testimony given by Mr. Smith?

Mr. PERKINS. Not in principle, but I think the approach is quite different, Senator. My statement will be short.

I approve the enactment of title I and title III of the proposed banking bill. Such slight modifications as are suggested in the report of the Federal Advisory Council are technical in character and in no way affect the purposes of these two sections which greatly improve and simplify the present law.

I have never been a believer in deposit insurance, but I have felt that at least one good might result if it could be made the instrument for unifying the banking system. For this reason I wish particularly to endorse the provision requiring all members of the Federal Deposit Insurance Corporation to become members of the Federal Reserve System by 1937. I believe our dual system of National and State banking, operating under 49 different controls, is one of the worst

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features of our banking structure, and I do not think that we shall ever have an effective supervision of banking until this dual system is unified. In setting up the deposit insurance law, Congress very wisely recognized that banks participating in insurance protection ought to conform to uniform standards of soundness and liquidity. The provision requiring all insured banks to join the Reserve System has had the double good effect of both strengthening the basis of the insurance fund and of paving the way for the unification of banking control so badly needed.

Now, however, the lower House of Congress has seen fit to delete from the bill the provision requiring insured banks to be members of the Federal Reserve System. I believe this is a serious mistake, and I wish to add my voice to that of Governor Eccles and others in urging that this provision be retained, with such modification as may be deemed desirable in order to aid banks in qualifying for membership.

Senator COUZENS. When you refer to qualifications, you mean as to the size of the banks that are required to join?

Mr. PERKINS. A series of qualifications.

Senator COUZENS. Is not that the primary one?

Mr. PERKINS. The primary one is that the capital must be intact. There are certain other things. I do not remember exactly what the rule is about the amount of capital in the different places, but there is a rule which is applied to all those that have done it to date, and it seemed to me that there might have to be, in order to bring these in, some slight modifications of that rule.

Senator GLASS. There are various restrictions on member banks which do not apply to nonmember banks; is not that so?

Mr. PERKINS. Yes; that is true.

I am also assuming that the assessment provisions of the Senate bill as introduced will be retained, authorizing the board of directors of the Federal Deposit Insurance Corporation to fix the rate of assessment at any figure up to a maximum of one-twelfth of 1 percent of total deposits per annum.

There has been much discussion as to the wisdom of including title II in the banking bill this year, or withdrawing it and referring the questions dealt with to a commission for further study.

The vital points of title II are the power to fix the discount rate, the power to fix the percentage of reserves which the member banks must carry with the Reserve Banks, the power over open-market operations, the broadening of eligibility requirements for paper submitted both for rediscount and for use as backing for note issues, and the liberalization of the law relative to loans on real estate.

Under the present law the Federal Reserve Board assumes the power to fix the discount rate. Under the present law—section 18 of the Federal Reserve Act—the Federal Reserve Board, with the approval of the President, has the power to change reserve percentages. Under the present law—page 157 of Federal Reserve Act—at the request of the President, the Federal Reserve Board and the Secretary of the Treasury have wide power to control the open-market operation of the Federal Reserve banks within very liberal limits.

Senator GLASS. You mean, in the proposed bill, do you not?

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Mr. PERKINS. No; under the so-called "Thomas amendment."

Senator GLASS. Oh, yes.

Mr. PERKINS. Section 10b of the law which expired in March of this year, if reenacted for a period of time, would cover satisfactorily the question of the broadening of rediscount privileges. The only important new subject dealt with is the extension of the power to loan on real estate. Aside, however, from the assumed power to fix rediscount rates, all of these powers were granted under emergency conditions. While doubtless justified as the emergency measures, they are not in my opinion suitable as permanent legislation either in their present form or as contemplated in this bill.

Moreover, three major subjects which are not covered in the bill are the definite unification of the banking system, branch banking, and the problem of the classification and investment of time and demand deposits.

I know of no probable emergency that cannot be met by the law as it now stands—with the reenactment of section 10b.

Therefore, unless title II is altered to include the changes suggested by the Federal Advisory Council, I feel forced to express my objections to it, and to urge postponement of this title until the best qualified minds of the country can explore the whole subject of our banking system, in the hope that a new law may be enacted that will stand the test for at least a quarter of a century.

Senator GLASS. Do you know of any commission that ever existed—I do not—that ever wrote a sentence of statutory banking enactments?

Mr. PERKINS. I have always felt that the commission that studied the monetary situation, the Monetary Commission, before the enactment of the Federal Reserve Act, did a very thorough study of the situation. It submitted to the Legislature information that was valuable in the drawing of the bill.

Senator GLASS. Neither house of Congress—I speak confidently as to the House of Representatives, because I was then chairman of the Banking and Currency Committee of that body, and I am sure I am right about the Senate—neither banking committee of Congress ever gave any consideration whatsoever to the Aldrich Commission's report. The only thing the Aldrich Commission report did was to assemble a library that cost $200,000, and there was not a member of either Banking and Currency Committee, I venture to say, that ever read a volume of the 36 volumes. I think there were 36 volumes.

Mr. PERKINS. You know that much better than I do, of course.

Senator GLASS. What I mean to imply, Mr. Perkins, is that if the banking acts are to be remodeled and improved, the best expert talent of the country is always available to either Banking and Currency Committee of the Senate or of the House; and in the final analysis those committees are obliged to formulate a statute as proposed for Congress to enact. Just speaking for myself and not for this committee, I have never been favorable to the suggestion that the matter be referred to a commission of experts.

Mr. PERKINS. Well, I think, in my opinion, it is the time element rather than the group that does it. I mean, obviously the two Houses of Congress are the ones that have got to do it. I have been trying to emphasize that I did not think there was any great rush about doing it, and whether they feel that they have thoroughly studied the question or not is for them to decide.

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Senator COUZENS. I think there is one reason for the suggestion of the chairman, and that is the unanimity of testimony that we should have some independent commission to tell us what to do. That seems to be the almost uniform testimony of all the witnesses.

Senator GLASS. I think some of us badly need to be told what to do, for that matter, including myself.

Mr. PERKINS. I want to call attention not only to the powers that a central monetary board has but also to its responsibilities, and to raise a doubt as to the wisdom with which these are likely to be met. The history of the control of central banks by governments both abroad and in this country hardly justifies a belief in an all-wise exercise of such powers. There is no doubt but that the unsound monetary policies of Germany, which contributed so much to the collapse of the German mark, were facilitated by the government control of the Reichsbank. Both in Germany and in France the power of the government to force continuous advances from the central bank was a leading factor in the depreciation of the currency. In our own recent experience with inflation between 1926 and 1929, I am impressed with the fact that there were instances where the directors of the regional Reserve banks proved wiser in their analysis of the situation than the majority of the Federal Reserve Board. In 1927 the Federal Reserve Bank of Chicago opposed the cheap money policies of the Board, which many believe laid the basis for the 1928–29 boom, and was overruled by the Board. In the spring of 1929 the Federal Reserve Bank of New York voted again and again to raise the rediscount rate in order to check the wild speculation in the stock market, and the Board again and again refused these requests for fear of hurting business. I do not mention these instances of failure to foresee coming events with any derogatory intent. I simply refer to them as illustrating the fallibility of human judgment even where there is the sincerest intention to act in the best interests of the country. In short, I have a great skepticism that this idea of the centralization of control and responsibility will work as well in practice as it sounds in theory.

If, however, Congress does not wish to defer action on this bill, I want to point out that title II fundamentally changes our banking system. It places in the hands of a board the power to dictate arbitrarily the money policies of the country—section 205. Although I assume that the purpose of the bill is to provide a system of monetary control, it makes possible the financing of the Government up to many billions of dollars simply on the decision of a small board working in conjunction with the Treasury—section 205, section 208. The latter power would permit an expansion of the currency of the country by about seven and a half billion dollars, more than double the present amount, without the approval or instruction of Congress.

The present Federal Reserve law gave to the country, for the first time a system whereby the supply of credit and currency expanded and contracted automatically with the needs of commerce, industry, and agriculture. In recent years, we have had a tendency toward managed control of credit.

If for the automatic control provided by the original Federal Reserve Act there is to be substituted the conscious control of a Board, the membership of that Board must be as far removed as possible from the influence of any group, be it financial, industrial or political,

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and should be representative not only of the Government through the members of the Federal Reserve Board but of the Federal Reserve banks which are in intimate daily contact with conditions in the country. For this reason I have approved the following recommendations of the Federal Advisory Council:

1. That the Secretary of the Treasury and the Comptroller of the Currency cease to be members of the Federal Reserve Board.

2. That the Board be reduced to five members.

3. That the governor and members be appointed for 15 years and compelled to retire at the age of 70, with adequate pensions, and be removable only for cause and after appropriate notice and hearing.

4. That the Federal Reserve bank governors be appointed by the directors of the Federal Reserve banks with the approval of the Federal Reserve Board, but that after the approval of the Federal Reserve Board has once been obtained, the governors may be re-elected annually by the directors of the banks.

I want to say there, Senator, that that is not the plan as submitted by the Council. The Council voted that they should be subject to the approval of the Board every 3 years. In my statement I have changed that.

5. That a committee composed of the members of the Federal Reserve Board and 4 of the bank governors, selected by the 12 governors, shall be given the power to fix the discount rate, the percentage of reserves, and direct the open-market policies of the banks.

I further believe that even if the greatest success should be attained in the selection of the group exercising these powers, common prudence dictates that there should be limits within which they should operate. I accordingly approve the following recommendations of the Federal Advisory Council:

1. That the open-market committee should not have the power to increase the percentage of reserves required of member banks to more than 30 percent of total deposits.

2. That there be a top limit set on the potential open-market powers. This, at the same time, provides a safeguard in that it limits the extent to which the Federal Reserve System can be forced to finance governmental deficits. The Federal Advisory Council has recommended that this be handled by limiting to $1,000,000,000 the amount of Government securities which can be used as collateral for Federal Reserve notes.

These limits are broad enough to control the situation in normal times, and, in fact to meet any emergency likely to become acute before Congress could convene. The desirability of limits is increased if their incorporation in the statute would eliminate any constitutional question as there being an illegal delegation of legislative power.

It would not be proper to omit from a statement on the bill any comment on that part of it which broadens the discount privileges. I believe a broadening of this privilege to be a good thing, but that as in other of the great central banks, any paper which is not self-liquidating within a reasonable time should pay a penalty rate. In this way there would be a more automatic adjustment of the supply of money to strictly business requirements, and the goodness of discounted paper would be tested by frequent maturities.

Senator GLASS. What is the limit of maturity that the Bank of England has now for current discount?

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Mr. PERKINS. I do not know that, Senator.

Senator GLASS. In 1918 it was 28 days; and you will recall that the proposed Aldrich bill incorporated that requirement of 28 days. We first fixed it at 60 days in the House, and afterwards raised it to 90 days for commercial paper, and 6 months and, later, 9 months, for agricultural paper.

Senator COUZENS. Is there any particular reason why you set 30 percent on the maximum reserve?

Mr. PERKINS. The reason, Senator, is this, that in the old days the central reserve banks used to have to carry 25 percent of reserve, and we just took a shot and added 5 percent to that so as to give them a sufficient leeway.

For this reason I approve the recommendations of the Federal Advisory Council for the reenactment of section 10B of the Federal Reserve Act with slight changes in phraseology, in the place of the provision of the pending bill that all sound assets be rediscountable without discrimination as to their liquidity.

In concluding, I want to emphasize again the two points which, to my mind, are vital in connection with this bill, namely, the necessity for safeguarding the independence of the Board exercising these powers, and the need for limits within which it must operate.

I have refrained from discussing my recommendations in greater detail because they are incorporated in the statement of the Federal Advisory Council.

Senator GLASS. We are very much obliged to you.

(Witness withdrew from the committee table.)

STATEMENT OF HOWARD A. LOEB, VICE PRESIDENT FEDERAL ADVISORY COUNCIL, REPRESENTING THIRD FEDERAL RESERVE DISTRICT; CHAIRMAN TRADESMEN'S NATIONAL BANK & TRUST CO. PHILADELPHIA, PA.

Senator GLASS. You may proceed, Mr. Loeb.

Mr. LOEB. Titles I and III cover matters that do require prompt congressional action. For the most part I am in accord with the provisions of these sections. Later on I shall refer to certain features therein to which I desire to call attention.

I am opposed to the enactment of title II at this time for the following reasons:

1. That no emergency now exists that warrants a fundamental change in our banking laws—in any event until a complete study is made of the subject by a competent commission, made up of representatives of interested groups, both economic and social. Pending the result of such a study it may be deemed advisable to reenact section 10 B (which automatically expired on March 3, 1935), for a definite period.

2. No evidence has been adduced to indicate that the depression through which we are now passing could have been avoided, or its intensity mitigated, had the Federal Reserve Board been clothed with the added authority contemplated in this act. No case has been cited in which any action or policy was desired by the Federal Reserve Board and blocked by the Federal Reserve Banks or the Open Market Committee. The record seems to indicate that in the main Congress has been willing to amend the Federal Reserve

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Act from time to time upon the initiative of the Federal Reserve Board, and at no time during the depression has the Board asked for any such powers as are conferred upon it by this bill.

3. In the last few years we have had a wealth of banking and kindred legislation. While some of the laws are but temporary many, however, are permanent. All have been in force for so short a period that their real effect upon banking, and therefore upon commerce, industry, agriculture and labor cannot be clearly and definitely appraised. Constructive legislation is always eagerly desired and accepted, but its volume should be carefully attuned to the ability of our institutions and the people as a whole to mentally and physically readjust themselves to new laws; otherwise confusion and loss of confidence result, which only too frequently impairs the value of the wisest legislation.

Despite the statements that title II was not hastily drawn and that it represents the carefully considered views of the administration groups, there is no evidence that other groups representative of industry, agriculture, commerce, labor, and more particularly bankers, depositors, and stockholders of banks were given a voice in its preparation or even a hearing. Surely a measure, in many of its intendments so revolutionary in respect to our present practices, justifies the demand that competent and experienced representatives from all groups be included on such a study commission.

If, however, in the judgment of Congress legislation at this session is deemed necessary, careful consideration should be given to the statement of the Federal Advisory Council on S. 1715, H. R. 5357, dated April 10, 1935. A few of the recommendations made therein are now a part of H. R. 7617, which recently passed the House of Representatives. I suggest that in reading this statement S. 1715 be kept before you in order to avoid confusion. In this statement I am referring to the Senate bill from now on.

While the statement referred to above is quite specific in its recommendations, may I give you briefly my personal views on the principles which should be observed in developing legislation at this time?

1. Public control of the System through the Federal Reserve Board, to the exclusion of private participation, which is the avowed purpose of the bill under consideration, is, under our present form of government, tantamount to political control and is not to be tolerated.

2. Private control to the exclusion of public control, which, it is charged by those unfamiliar with the facts, obtains under the present laws, is equally intolerable.

3. Until experience reveals weaknesses and abuses, a dual control should be set up under a system of checks and balances dedicated to the prevention of the domination of one group to the exclusion of the other.

4. In this dual control there should be vested the operation of the System, and more particularly the control of open-market operations, rediscount rates, and reserves, subject always to the limiting provisions of the Federal Reserve Act and the amendments thereto.

The statement of the Federal Advisory Council gives a suggested rewording of the bill before you and in some instances also provides for revisions in the Federal Reserve Act as it now reads when neces-

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sary for the logical development of given points. We now may turn to a résumé of the ways and means devised to overcome some of the objections to the bill in its present form.

FEDERAL RESERVE BOARD MEMBERSHIP

(Sec. 203, p. 41)

It is of the greatest importance that the actions of the Federal Reserve Board be entirely free of political control or influence, and that the Board should be equally removed from other forces that may disturb its independence of judgment and action. Several proposals, contained partly in the present bill or otherwise added by the council in its statement (pp. 6–7–8) are presented for your consideration in this connection. The first of these is that properly the Secretary of the Treasury and the Comptroller of the Currency should not be members of the Board. The Board should consist only of appointed members, and the suggestion is made that the bill further provide that the first vacancy be not filled, reducing the total membership to five, which would constitute a more wieldy body. With certain changes the provisions of the bill with regard to pensions are endorsed and should, together with the council's proposal that the terms of Board members be lengthened from 12 to 15 years, be desirable from the point of view of attracting to the Board men of standing and experience who may devote themselves singlemindedly to the task in hand.

Senator GLASS. Would you like to confide to the President, as is done by the pending bill, the right to appoint all the members of the Federal Reserve Board from a single Federal Reserve district?

Mr. LOEB. I do not think that is representative of the public interests; no.

Senator MCADOO. We are not talking about the present President, but any President that may come along in the future.

Mr. LOEB. Exactly. In my whole consideration I have limited consideration to present factors in the set-up of the System.

Senator GLASS. We are talking about the office of President.

Mr. LOEB. The third paragraph of section 203 provided that the Governor's membership on the Board should terminate when he ceased to be Governor. This opened the way for a possible quick turnover of the Board's membership but was rectified in the bill passed by the House, which provides that he may continue to serve as a member of the Board. This change largely conforms to the Council's suggestion in its statement on this subject.

OPEN MARKET COMMITTEE

(Sec. 205, p. 44)

Of even greater importance are the proposals with regard to the open-market committee. If the Congress sees fit to put into law some of the very broad powers provided for in the bill under consideration, it is felt that they should be circumscribed to the extent of lodging them in a body that not only is representative of the national viewpoint but also is closely conversant with and repre-

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sentative of local problems and needs. It is suggested therefore that the open market committee be enlarged to include the 5 members of the Federal Reserve Board and 4 governors of the Reserve banks selected by the governors of all of the banks in accordance with regulations of their own making. The terms of the governors serving on the committee should be for a longer period than 1 year, in fact the Council suggests 10 years, so that there may be a desirable continuity of policy and less susceptibility to outside influences. Initially varying terms are suggested for service of governors so that at the end of the first 4 years and every 2 years thereafter the term of 1 governor ends.

To this committee, representative of the dual interests of the Nation and the more local views of the reserve banks, it is proposed to give not only the power to decide the open-market policy of the system, but the power to approve or amend the discount rates of the reserve banks as well. To it also may well be delegated the far-reaching power to change the required level of member bank reserves; it appears, however, the part of wisdom to limit the extent to which reserve requirements may be changed and this is covered in the Federal Advisory Council's suggested revision of the bill given on pages 8, 9, and 10 of its statement. This revision consolidates sections 205 and 209 of the present bill.

BOARD APPROVAL OF RESERVE BANK GOVERNORS

(Sec. 201, p. 38)

I feel strongly that the regional autonomy of the Reserve banks should be preserved insofar as this is consistent with national interests. As the proposals for the abolition of the office of Federal Reserve agent and the recognition of the Governor as the active executive officer of a Reserve bank contained in section 201 of the present bill constitute a certain relinquishing of authority by the Board, it is proper that they should have the right to approve the person who fills the Governor's chair. I do not feel, however, that the right to continue him in office should be subject to annual review by the Federal Reserve Board, as suggested in the Senate bill. Stability of position is essential to the development of disinterested and experienced administration; for that reason I suggest that, once approved by the Federal Reserve Board, the Governor of a Reserve bank should continue in office as long as his services are satisfactory to the local board of directors.

Senator GLASS. Just why do you think the Federal Reserve Board should have the authority to approve the selection of the governor of a Regional Reserve bank, in view of the fact that the Federal Reserve Board already has the appointment of 3 of the 9 members of a Regional Board?

Mr. LOEB. Personally, I prefer that arrangement. Apparently mechanically it has some defects. I am personally satisfied that they are vital. My own preference is for the present arrangement.

Senator GLASS. I seem to discover in the testimony of all of you gentlemen a desire to compromise the proposition by yielding to the proponents of this bill upon a question of sound policy rather than to condemn the existing law.

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Mr. LOEB. I do not think that I do that, Senator. I think I have tried, anyway, to impress upon this committee in the preamble to my statement my feeling that no legislation is required at the present time, but that if Congress deem it wise—do I make that clear?—then I suggest these things. So that I do approach that somewhat in the spirit of compromise, do I not?

Senator GLASS. Very much in the spirit of compromise, inasmuch as you delegate to the Federal Reserve Board supremacy in the decision of all these questions.

Mr. LOEB. You mean, this particular question or generally?

Senator GLASS. The open-market committee, for example. You suggest that there shall be 5 members of the Federal Reserve Board and only 4 members of the regional banks. Five can outvote four every time.

Mr. LOEB. Well, that is true; but I do not think the vote should be cast upon that narrow line, and I do not think it would be.

Senator GLASS. I do not think it should be.

Mr. LOEB. I do not think it would be, with a Federal Reserve Board set-up; and if that danger did occur and we got into that, surely Congress would not tolerate it, would it?

Senator GLASS. You cannot tell what Congress would tolerate.

Mr. LOEB. You have had more experience on that subject than I have.

Senator MCADOO. We do not know about that.

Mr. LOEB. Shall I proceed?

Senator GLASS. Yes; excuse the interruption.

Mr. LOEB. I am glad to have it, Senator.

5. Until a further study and report is made by a commission, the eligibility regulations in the present act should be maintained, except that section 10 (b) should be reenacted for a definite period of time.

I share the feelings that prompted the Federal Advisory Council to state, on pages 10 and 11 of its statement, that—

> Section 206 (p. 45 of Senate bill) as presented in the proposed bill, might offer an inducement to member banks to lend indiscriminately and without any regard whatsoever as to the liquidity of the assets obtained.

Senator GLASS. Right on that point, if I am not interrupting you too much, do you think any paper should be discounted at a member bank or rediscounted at a Federal Reserve bank that does not relate itself to commerce, industry, and agriculture?

Mr. LOEB. I wish that I could answer that question, Mr. Chairman, and I have no desire to parry it, but I am not quite sure whether we are entering a new phase of what might be termed "financial operation" or not; I am not quite sure. Therefore, that makes me that much more strongly in favor of having it fully studied and, pending that, that no inequities may occur, no pressures may be exerted upon a rather tense situation. Reenact 10 (b), not permanently, necessarily, and let a study of this whole eligibility problem be had. Coming back to the discussion with the previous witness, I realize, of course, that when you say a commission to study it, that study should be a reasonable study, not made by men who have harum-scarum ideas or a particular theory, but men who are experienced, men who know this problem fundamentally and who are not

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trying to add some crack-brain notion with regard to our whole financial set-up in this country.

Senator GLASS. Do you know any inhibition against the authority of the Federal Reserve Board to define eligible paper except as to the statutory question of maturity and as to the statutory prohibition against rediscounting for speculative purposes?

Mr. LOEB. As it exists in the present law?

Senator GLASS. Yes.

Mr. LOEB. May I have that question again? I do not know that I get it fully.

Senator GLASS. The Board, in my view, under the existing law has very broad powers of determining the eligibility of paper. It must relate itself to commerce, industry, and agriculture; and the only inhibitions that I know anything about are involved in that provision of the bill which prohibits the Board from including in its definition loans that are to be used for purchasing or carrying stocks on exchange or investment securities.

Senator MCADOO. And the maturity, of course.

Mr. LOEB. Yes; in order to maintain the self-liquidating notion of it. I think that is quite true.

Senator GLASS. Aside from those inhibitions, the Board has the widest sort of authority to define eligible paper?

Mr. LOEB. Yes; they have. Do they include real estate under your construction, 15-day loans secured by mortgages?

Senator GLASS. Fifteen-day loans?

Mr. LOEB. Yes.

Senator GLASS. Do you think they should?

Mr. LOEB. No; I do not.

Senator GLASS. It does not include that, because there is a provision in the law relating to real-estate loans, for the first time in 50 years. They put in the Federal Reserve Act the sanction of real-estate loans for a period of 5 years with a certain limitation as to the extent to which an individual bank might act.

Mr. LOEB. They are ineligible for discount. I am quite in accord with you, Senator; but I want again to call your attention to the preamble to this statement.

Senator MCADOO. But what you suggest is a study of the eligibility of paper, as I understand it.

Mr. LOEB. Yes.

Senator MCADOO. We have been studying it for 20 years through the Federal Reserve Board and through the advisory council and through the various governors and organizations of the Federal Reserve banks. Surely after 20 years' experience we ought to have some idea, without having to create a commission to make another study of this particular thing.

Mr. LOEB. Do I take it that this bill is the consolidated view of the Federal Reserve Board on eligibility?

Senator GLASS. The Federal Reserve Board did not see it until it was presented and printed.

Senator MCADOO. Do you not think that we have had enough experience with eligible paper to be able to make a definition of it now?

Mr. LOEB. I should say, Senator, that I am just a little bit confused, and I must confess that I am confused, as to what form of borrowing

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or financing will take place in the future. I do not know. I am not sure about that. I think we have got to study whether or not our financing will go back to the so-called "commercial paper", whether we will have great activity, whether we are going to go more into commodity loans, warehouse loans, and things of that sort. I think those are primary considerations.

Senator GLASS. We have warehouse loans under existing law for agricultural purposes.

Mr. LOEB. For agricultural purposes; yes.

Senator MCADOO. And for commerce, also, as I understand it.

Senator GLASS. Going transactions.

Mr. LOEB. In acceptances; yes.

Senator MCADOO. I suppose what you are probably in doubt about is the provision in this bill which seeks to extend eligible paper to cover loans upon bank assets, regardless?

Mr. LOEB. Yes, sir.

Senator MCADOO. It is that provision that you think ought to be studied more before it is enacted into law?

Mr. LOEB. That is exactly what I say.

Senator GLASS. As a matter of fact, you do not think it ought ever to be enacted into law, do you?

Mr. LOEB. We are sort of chasing each other around a circle, aren't we? We get back to where we started, to the preamble of this statement.

Senator MCADOO. You think that phase ought to be studied more before it is enacted?

Mr. LOEB. I do, because I do not feel that we have had sufficient time elapse to determine just what that form is. As a matter of fact, the whole theme of this statement is that we have had a lot of legislation. Let us find out what is going to happen.

Senator MCADOO. You think, in other words, that we ought to tread softly here and not use a big stick?

Mr. LOEB. Yes.

Senator GLASS. But you forget that Governor Eccles was 6 months Governor of the Board when he drew this bill.

Mr. LOEB. The whole subject of eligibility calls for extended study. The final findings of a commission on such a subject, in the light of possible changes in financing methods, might be to the effect that some broadening in eligibility rules should be made, but it seems inadvisable at this time to incorporate in the act as a permanent feature such a far-reaching clause as that proposed in the bill. Hence my suggestion that section 10 B should be reenacted for a fixed period of time.

6. Until a further study and report is made, the provisions of the present act regarding reserves should not be changed, or, if so, a maximum and minimum within a narrow range should be set.

This point was discussed heretofore in connection with proposals regarding the open-market committee of the Federal Reserve System.

7. Pending a further study and report, the requirements of the present act with regard to the deposit of specific coverage for Federal Reserve notes should be continued.

8. Pending a further study and report, the right to secure Federal Reserve notes with obligations of the United States should be discon-

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tinued, unless a dual control Federal open-market committee, by an affirmative vote of not less than a majority of its members, declares an emergency to exist—that such right be limited to a definite amount, and that a tax be levied upon the currency so issued. In this way a definite limitation may be placed upon inflation by means of bond-secured currency.

Senator GLASS. Would you be willing to modify the existing law, which authorizes any one Federal Reserve bank to decline to engage in an open-market transaction by saying that it might so decline by sanction of a majority of the open-market committee?

Mr. LOEB. I would like to think that over, whether a majority would be the proper way to handle that or whether it should be by a large percentage.

Senator GLASS. Say, two-thirds?

Mr. LOEB. Yes; because this is a great big country—I need not call your attention to that—with conflicting interests to all intents and purposes. I have found particularly in national meetings that they might be international meetings. The only thing we have in common is the language we speak. So it is very hard to, by a majority decision, impose open-market decisions. That is, I mean the protection ought to be increased for the district that finds it impossible for some reason to conform.

Senator GLASS. You know that under the present bill the majority of a quorum of the Federal Reserve Board may do that?

Mr. LOEB. I am not sponsoring that, of course, in this statement.

Senator MCADOO. You are addressing yourself to the subject of inflation now, and I am a little curious to know what you call inflation. I have asked a number of witnesses here to tell me what inflation is, and I have not yet received a definition. Maybe you can give me one. Take the situation in the country today: When you talk about inflation you usually mean the amount of currency in circulation. We have $4,300,000,000 of currency, approximately, in circulation. Do you consider that inflation or do you consider that exactly right?

Mr. LOEB. I think that the mere setting of a figure is not the sole definition. Under an act which is construed by the people to be inflationary you might have two things occur: You might get a withdrawal of gold or you might get a hoarding.

Senator MCADOO. How could you get any hoarding or withdrawal of gold now?

Mr. LOEB. You can get a withdrawal of foreign gold, I presume, through trade. Any laws that were enacted would react again on our industrial situation.

Senator MCADOO. You are engaging there in a wide field of speculation, and you have no definite factor to determine it by. The average man who discusses inflation relates it to the amount of currency in circulation. That is the popular conception of it. Do you think $4,300,000,000 as a circulating medium, considering the conditions in the country today, is inflation of the currency?

Mr. LOEB. No; I do not think so.

Senator MCADOO. What would you think would be the proper line? You have got to have "scratch" somewhere.

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Mr. LOEB. Yes. It is not scientifically determinable; it is not a definitely determinable limit. Too many things are tied up in it.

Senator MCADOO. You cannot define it? That is the size of it?

Mr. LOEB. No. I do not think you can define it. You are talking only of one type of inflation.

Senator MCADOO. Everything that comes up is denounced as inflationary. I remember when the Federal Reserve Act was passed—and it has been a law for 20 years—the denunciation of the currency as fiat money, greenbacks, which was going to destroy the credit of the Government. Some of the most eminent men in the Senate denounced it, and the most eminent bankers of the country denounced it. The point I am making is that it is all just a matter of conjecture, of speculation.

Mr. LOEB. By that very token, as it impinges upon the opinion of the masses, it may develop into an inflation.

Senator MCADOO. How can you tell what the opinion of the masses is?

Mr. LOEB. You can tell, I suppose, by their attitude to investment in Government bonds, and hoarding, and the attitude of other nations.

Senator GLASS. Do you think a bill that authorizes the Federal Reserve Board to unload an unlimited amount of Federal Reserve securities upon the banks of the country would have inflationary potentialities?

Mr. LOEB. I think so; yes, sir.

Senator GLASS. That is all I want to ask you.

Senator MCADOO. Would you think, Mr. Loeb, that $347,000,000 of "greenbacks", so-called, which are United States notes, circulating notes, against which there is a 40-percent gold reserve, would be fiat money?

Mr. LOEB. May I have that question again, Senator?

Senator MCADOO. We have outstanding $347,000,000 of money in United States notes, commonly called "greenbacks." Against them we have a gold reserve of about 40 percent. Do you consider those notes fiat money?

Mr. LOEB. No; I do not, because it has been tolerated. But you may get to a point where it will not be tolerated. I think, in other words, that you could go on indefinitely, by the same argument, and add a billion here or 2 billion there and gradually build it up. I think it depends on what occurs or how these things impinge not only upon the investing public but upon their notions. I think it will come back. You may have your gold coverage, but that does not say it is going to remain with you. By the very act of creating these currency issues based on that gold, you may lose it.

Senator MCADOO. Suppose you own the gold?

Mr. LOEB. You do not own all of it. You can take a certain amount, perhaps. You might be able to stand one drink, but you might not be able to take the whole quart.

Senator MCADOO. Has it not usually been considered an axiom among bankers that if you limit the currency to an amount which is covered by a gold reserve of 40 percent, you have sound currency? That is usually what they have contended for. We carried that in the Federal Reserve Act. It is true we put there also

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60 percent of commercial paper to represent the remaining 60 percent, but it is primarily a Government note. It is not a bank note. There is no Federal Reserve bank note today. The Government has recourse on the banks, if necessary, for that 60 percent. But we have 40-percent gold against these greenbacks——

Senator GLASS. You have no reserve at all now.

Senator MCADOO. According to the daily income statement we have, the 60-percent fiat either had to be bank fiat or Government fiat. The Government's responsibility for 60-percent fiat was greater than that of any bank's responsibility for 60-percent fiat.

Mr. LOEB. I think that the practice or the custom or the tradition, if you want to call it that, of coverage of our circulation has a vast effect. I can easily conceive of the Government's going on a wild orgy or continuing on an unbalanced Budget program for a long time and thus affecting the value of its currency.

Senator MCADOO. I agree that if the Government were just to issue Treasury notes to pay running expenses of the Government it would be absolutely vicious and absolutely indefensible. I would not stand for that a moment. But I am not going into such an extreme case.

Mr. LOEB. If you were going to be around, perhaps, Senator, it would be all right, but we are setting up here——

Senator MCADOO. With a 40-percent gold reserve, every banker that I have ever known until recently has not hesitated to say he considered it the basis for a sound currency issue.

Mr. LOEB. You will have realized by this time, Senator, that I am not an economist.

Senator MCADOO. They all give me that excuse.

Mr. LOEB. Well, I am not, and I do approach it with great amount of hesitation. I should like to discuss it with you some day.

Senator MCADOO. I should like to discuss it now.

Mr. LOEB. I want to think about it.

Senator MCADOO. The point that I want to bring out is that when you talk about inflation, it is just about every man's opinion, except that there are a few fundamental things. It is conjectural whether or not a certain amount of currency issued is going to be regarded as inflationary or is inflationary in fact. I have not found anybody who was willing to give any definition that would convey any idea of certainty.

Mr. LOEB. I do not want to "pass the buck", so to speak, but I think another member of our council will perhaps be able much more intelligently to discuss what apparently is in your mind, Senator.

Senator MCADOO. I would like to see him. I want to meet him.

Senator GLASS. Well, I am not intelligent enough to do it; but, as a matter of fact, up to recently no part of our currency was fiat money. A 40 percent gold reserve was there. It was there to be paid out on demand, and the 60 percent commercial paper was there. It represented a commercial transaction.

Mr. LOEB. And the man that held the note knew that.

Senator GLASS. Yes. It represented a commercial transaction. It was not fiat.

Senator MCADOO. But the Government was primarily responsible.

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All the gold now belongs to the Government. You can see that, can you not?

Senator GLASS. No; I do not see it.

Senator MCADOO. I am not asking you; I am asking Mr. Loeb.

Mr. LOEB. I am very grateful for the Senator's help. I think he is quite right. It is in the Government's possession. There is that difference.

Senator GLASS. The Government has got it.

Senator MCADOO. That is nine points of the law, is it not?

Mr. LOEB. The bill proposes, in section 208, that no specific collateral be pledged by the Reserve banks as security for the issue of Federal Reserve notes, although it retains the provision that a reserve of 40 percent in gold certificates should be maintained against notes in actual circulation. This leaves the door open for an indefinite increase in the issue of currency, particularly if the rules covering eligible paper are materially broadened. An expansion of currency that partakes of the nature of inflation should be avoided. On the other hand, the supply should be sufficiently adequate to care for the seasonal and the somewhat longer demands of industry, commerce, and agriculture. Under proper safeguards it should also be sufficiently flexible to cover emergencies.

The pledging of specific collateral against issues of Federal Reserve notes as provided in section 16 of the Federal Reserve Act should be continued; broadened, however, to include the right to pledge assets arising out of the operations under section 10 (B). Recognizing, however, that emergencies may arise, an open-market committee, constituted as suggested earlier in this statement, should be clothed with the power to permit the use of United States securities as collateral under emergency conditions and subject to the limitations herein suggested The proposal of the Federal Advisory Council, on uages 11 and 12, essentially covers my thought on the subject.

9. Because of the impossibility of developing general legislation for loans on real estate that would be uniformly equitable throughout the United States, it is suggested that a maximum of appraisals that may be loaned by member banks be fixed in two classes:

First. Five-year loans—the regulations of the present act regarding such loans should be continued.

Second. That loans may be made for a period not longer than 12 years in an amount not in excess of 60 percent of the appraised value at the time the loan is made, based upon an annual reduction of 5 percent of the original amount of the loan. The present regulations regarding the area in which member banks may make loans, as well as the aggregate amount of real-estate loans a member bank may make, should be limited as provided in the existing act, except that, subject to rules and regulations from time to time promulgated by a Federal Reserve bank for its district, the volume of real-estate loans made by member banks may be increased to an amount not exceeding 100 percent of the unimpaired capital of the lending member bank plus its unimpaired surplus fund, or not in excess of 60 percent of the total of its time and savings deposits, whichever is the greater. Real-estate loans should be defined not only as loans secured by first mortgage on real estate but also "other real estate" acquired through foreclosure or otherwise, excepting bank premises.

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It seems entirely desirable to continue to limit bank loans on real estate to properties located within the Federal Reserve district or situated within a radius of 100 miles if across the district lines, as a bank will be in a better position to ascertain values if the property is not too far distant. And, too, if no amortization feature is to be included in the agreement, too large a loan should not be made, hence the suggestion that short-term unamortized loans be restricted to 50 percent of value, as provided in present law. With the inclusion of an amortization clause, it would seem proper to raise the loan to 60 percent of value, for the added 10 percent would be paid off in 2 years, and to extend loans for a longer period. It is not felt, however, that such loans should be made for as long as 20 years; it is suggested, therefore, that 12 years be made the maximum.

In connection with this discussion, which relates to section 210 of the proposed bill, and which is covered in page 13 of the Federal Advisory Council's statement, the thought also is advanced that real estate taken over by a bank, other than that required for its banking facilities, should be included in calculations of the permissible amount of real-estate loans. In effect, such properties constitute a very direct loan on real estate.

The proposal that the reserve banks should control the volume of loans that the banks in their respective districts may make on real estate over and above the present statutory limit is prompted by the fact that they are more closely in touch with local developments than is the Federal Reserve Board and are in a position to apply control at the proper time should unhealthy developments manifest themselves.

FACTORS TO BE CONSIDERED BY FEDERAL DEPOSIT INSURANCE CORPORATION IN PASSING UPON APPLICATIONS

(Title I, sec. 7, p. 9)

The Senate bill on page 9 provides that the directors of the F. D. I. C. shall give consideration to the following factors:

> The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section.

In the bill finally passed by the House this was reduced to "the financial condition of the bank and the adequacy of its capital structure."

Having erected a structure of deposit insurance, it is essential that the highest standards of banking be maintained. Some may hold that consideration of the financial condition of a bank and adequacy of capital structure automatically involve consideration of the more detailed factors originally listed, but this need not be so. The seeds of future difficulties at times may be found in the bank itself or in the community which it serves. It is of importance, therefore, that the preliminary investigation should be thorough and the Congress should throw about the system it has created such specific safeguards as may be effective and at the same time practical.

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Accordingly, I favor the retention of the provisions as they appear in the Senate bill.

OPTIONAL ASSESSMENTS BY BOARD OF FEDERAL DEPOSIT INSURANCE CORPORATION

(Title I, sec. 8, p. 10)

The Senate bill provides that the directors of the F. D. I. C. may fix a lower rate of assessment or make refunds on the previous payment if available funds, experience, and conditions warrant such a course. The proposal of the Federal Advisory Council, given on page I of its statements, goes a little further and would permit the directors to "determine that there should be no assessment." The bill passed by the House, however, in section 8 of title I does not provide for possible reductions or elimination of the assessment.

It may happen that there will be an undue accumulation of funds in the hands of the F. D. I. C., so that there would be no good reason for further accumulation of an insurance reserve. Realizing that at most only optional reductions are provided for, and that the F. D. I. C. would always be in a position to levy assessments in full if necessary, I think that such optional privileges of reducing or eliminating assessments should be retained in the bill.

PARTICIPATION OF NONMEMBERS IN INSURANCE

(Title I, sec. 6, p. 7)

The paragraph designated (2) on page 9 of the bill before you provides that national nonmember banks and State nonmember banks may participate in deposit insurance until July 1, 1937, if they can meet the requirement of the corporation as nonmember banks, after which membership in the Federal Reserve System is obligatory. The time limit is removed in the bill as it passed the House of Representatives.

I am in favor of retaining the time limit within which an insured bank must become a member of the Federal Reserve System, although I would not be averse to the inclusion of a provision that this requirement should be waived in the case of nonmember banks with deposits of less than an amount to be agreed upon. In setting this deposit amount or deadline consideration should be given to the extent to which the volume of deposits of such nonmember banks could impair the effectiveness of Federal Reserve System action and thus impair one of the most important elements in the deposit-insurance program, to wit, the unification of the banking system. In order that no considerable volume of banking resources may develop outside of the Federal Reserve System, I suggest that regardless of size no bank organized hereafter, whether nonmember National or State institution, should be permitted to become a member of the F. D. I. C. unless at the same time it becomes a member of the Federal Reserve System.

Senator McAdoo. Let me interrupt you just a moment. Do you consider an amortized real-estate loan where there is a monthly payment plan a more liquid loan than a firm loan of 5 years?

Mr. Loeb. Yes, sir; that is my experience.

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Senator McAdoo. Would it be preferable to grant the power to make a longer term amortized real-estate loan, inasmuch as the short-term real-estate loan is authorized by the present law?

Mr. Loeb. Do you mean whether it would be better to make all loans on an annual-payment basis?

Senator McAdoo. Well, make it in the alternative.

Mr. Loeb. That is what I suggest here.

Senator McAdoo. Do you suggest 12 years?

Mr. Loeb. Yes, sir.

Senator McAdoo. Do you think that is long enough?

Mr. Loeb. Yes, sir, I do; for a national bank set-up as we are today in trust relationship to our depositors and with the experiences that we have passed through. And, again, personally I cannot attune myself to real-estate loans, but I can realize that in the rest of the country it is a very vital and important consideration in banking, and I am approaching it from that standpoint, at the same time keeping in mind the element of safety to those banks.

Senator McAdoo. That of course is vital; but what I am trying to arrive at is whether or not the short term of 12 years does not impose an amortization charge that makes it very burdensome to the borrower.

Mr. Loeb. The payments are based on a 20-year term, 5 percent a year. As far as the borrower is concerned, he pays on that basis as though it were completely amortized.

Senator McAdoo. That would not be difficult, because that is a 20-year loan. You said 12 years, I understood.

Mr. Loeb. And the annual payment to the 5 percent so that at the end of the 12 years the lender's advance is 40 percent of the original amount. I am speaking of the annual reduction.

Senator Glass. Do you think commercial banks should engage in real-estate loans?

Mr. Loeb. Senator, I thought I answered that by saying that I could not attune my mind personally to it. It seems to be hard for me to shake my traditions, so to speak. But I do see that there is a place for it, particularly as we do not appear to have developed up to the present time any method or way for capital groups to take care of those situations properly.

Senator Glass. We have developed an immense capital group to take care of that. The Government owns them all now, does it not?

Mr. Loeb. I am contemplating that that is not permanent. My theory or my hope, at least, is that the thing may not be made permanent.

Senator Glass. Are you familiar with the Canadian banking system?

Mr. Loeb. Not sufficiently to discuss it.

Senator Glass. There has not been a bank failure in Canada during this whole depression period, has there?

Mr. Loeb. I thought you meant, Was I familiar with the new Canadian bank act?

Senator Glass. I think that statement is substantially correct.

Mr. Loeb. I have been told there are some few failures.

Senator Glass. Do they permit commercial banks to make real-estate loans?

Mr. Loeb. I do not know. I am rather inclined to think they do.

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Senator GLASS. I think not.

Senator MCADOO. In any case, you have the right to restrict the amount that can be invested in such loans.

Mr. LOEB. Until we can take care of what appears to be a justifiable demand, always sufficiently safeguarded, because even though we have this percentage of time or savings deposits, we are using what is very likely to be looked upon by the time or savings deposits as something that is more liquid than we contemplate.

There is one thing in connection with real-estate loans to which I would like to call your attention, and that is the fact that the House bill seemed to change the Senate bill with regard to the inclusion in real-estate loans of other real estate which might arise out of foreclosures or in other ways. The Senate bill covers that beautifully, but the House bill changes it and leaves it in rather vague terms. I think that that ought to be quite definitely included in the volume of real-estate loans.

There is just one other feature that I want to stress with reference to the suggestion that I understand has been made for permitting membership in the Federal Deposit Insurance Corporation of banks with deposits of less than an agreed-upon amount. It simply should apply to those banks, and that banks hereafter, nonmember national banks and State banks hereafter organized and chartered should be compelled to enter the system if they are members of the F. D. I. C. That is not clearly stated in the House bill. It is clearly stated in the Senate bill.

Senator GLASS. We are obliged to you for your statement.

The subcommittee will recess until 2 o'clock, when we will meet in the Appropriations Committee room at the Capitol to hear the other witnesses.

(Whereupon, at 12:15 p. m., a recess was taken until 2 p. m., to meet in the committee room of the Senate Committee on Appropriations in the Capitol.)

AFTERNOON SESSION

The subcommittee resumed its session at 2 p. m., at the expiration of the recess, in the committee room of the Senate Committee on Appropriations, in the Capitol.

Senator GLASS. Mr. Frost, you may proceed.

STATEMENT OF JOSEPH H. FROST, MEMBER, FEDERAL ADVISORY COUNCIL, REPRESENTING THE ELEVENTH FEDERAL RESERVE DISTRICT; PRESIDENT FROST NATIONAL BANK, SAN ANTONIO, TEX.

Senator GLASS. For the record, just give your name and position, and we will be glad to hear you.

Mr. FROST. My name is Joseph H. Frost, member of the Federal Advisory Council, representing the Eleventh Federal Reserve District, and president of the Frost National Bank, San Antonio, Tex.

In listening to the questions this morning I formed an idea that I ought in the beginning to make a statement before presenting my evidence, to this effect, that it was my own feeling and I think I can safely say that it was the feeling of every member of the Advisory

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Council, that it would have been very much better for title II never to have been introduced and that all the statements that have been made by the Council and recommendations made by the Council are made purely for the reason that it was introduced and sponsored, as we thought, by the Federal Reserve Board, which is such a high authority that we believed it was liable to become law. So that we made these recommendations fearing that and thinking that if it should become law it would be better for us to get our recommendations in to modify the original title II as written.

Senator GLASS. You supposed it had been authorized by the Federal Reserve Board?

Mr. FROST. Certainly, sir; naturally.

Senator GLASS. My very definite information is that no member of the Federal Reserve Board saw the bill until it was introduced in the House and Senate and printed.

Mr. FROST. Well, of course, you know about that, and we did not know. I do not know just how we got the impression, but I know personally that I was under the impression that it was sponsored by the Federal Reserve Board and therefore it very likely would be looked on with favor by Congress.

Senator GLASS. Do you know of anybody ever associated with the Federal Reserve banking system who was conferred with about this bill before it was prepared and introduced?

Mr. FROST. No, sir; I do not know of anyone.

Senator GLASS. The Secretary of the Treasury is on record as telling me here in this room that he had never read a word of it; and the Comptroller of the Currency is on record as saying that he had not favored its incorporation in this bank bill; and my information, which I am sure is correct, is that no member of the Federal Reserve Board saw the bill until it was introduced and printed.

You may proceed with your statement.

Mr. FROST. My statement is a little different in type from the statements which the other members of the Council have offered, in that I have not attempted to cover the bill in detail, but have confined myself to the part that has disturbed me the most, and that has to do with the management of the Federal Reserve System and the dangers, as I believe, of uncontrolled inflation.

It is my understanding that my appearance before this committee has come from the fact that I am a member of the Federal Advisory Council, and I believe that it is appropriate, therefore, that I express myself to the committee as being in entire accord with the statement and recommendations made by that body and which are already on file with you.

I presume, however, that it is the desire of your committee to have me express my own personal views with regard to what seems to me to be the most important features of the Council's report and of the proposed banking legislation, and I would like, therefore, to submit this as a general statement.

In the first place, title I and title III of the bill do not seem to me to provide for changes in the existing law which justify serious apprehension on the part of those engaged in the banking business or on the part of business or the general public. On the contrary, in title I of the bill a definite maximum annual assessment against

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banks which are members of the Federal Deposit Insurance Corporation has been provided for, which is, of course, a most desirable and necessary provision. It is, however, my opinion that one-eighth of 1 percent of the total deposits is a burden which is unreasonably high and entirely too great for member banks to bear under either normal or abnormal conditions. It is my own feeling (and I believe that this feeling is concurred in by practically all experienced bankers in the United States) that the theory of deposit insurance, or a guaranty of deposits of any kind, is basically unjust, unsound, and doomed to ultimate failure. However, realizing that Congress and the administration in power have definitely decided to give it a trial, I shall not impose upon the time of this committee by discussing the theory, but shall be content to urge the recommendation of the Federal Advisory Council to the effect that a limitation of assessments in any one year to one-twelfth of 1 percent of deposits be made, and that annual assessments be not mandatory but levied only as necessary.

Believing that no good purpose can be served by a further discussion on my part of titles I and III, I shall confine my further statement to title II, which provides for basic changes in law affecting the Federal Reserve System.

In discussing the proposed changes I feel that it is necessary to outline my own understanding of the purposes underlying the original Federal Reserve Act. The experiences gained during the panic of 1907 made it seem apparent to Congress and the public generally that the difficulties which had arisen could have been very much more efficiently met and controlled if we had had in this country a more elastic currency medium, one more susceptible to expansion and contraction, in the place of a definite, fixed volume, which could only be affected by the export and import of gold. As a result of this impression, some years of study and investigation followed, which produced as a temporary measure the Aldrich-Vreeland Act and ultimately the Federal Reserve Act itself.

The Federal Reserve Act, as I understand it, in the first place attempted to place the control of currency and banking credit in the hands of a body, the Federal Reserve Board, and a system of regional banks, and it is my further understanding that the theory of complete independence from political influence or the influence of any administration in power was one of the principal objects attempted to be attained.

Probably the most basic underlying principle of the Federal Reserve Act was that the elasticity feature of the currency was to be automatic and governed by the requirements of industry, commerce, and agriculture, as well as by unusual requirements of currency for hoarding caused by fright and movements of gold into and out of the country. It was believed (and correctly so, I think) that these requirements would obtain expression by the rediscounting of assets of member banks when the larger volume of currency or credit might be necessary and by a gradual retirement of such rediscounts as the bank credit or deposit structure might be able to adjust itself to a needed contraction.

At the time that the Federal Reserve System was established the reserves of member banks, as well as the subscriptions to stock in

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the Federal Reserve banks, represented gold or its equivalent; and there was no thought that anything else was or should be considered a proper reserve against deposits except for the purpose of temporarily meeting additional requirements for currency or credit by commerce, industry, and agriculture. Whenever such requirements might appear, banks would automatically, in order to be able to meet these requirements, rediscount with the Federal Reserve banks; and the law provided that such rediscounts should be obligations obtained by the member banks in the granting of credit to commerce, industry, and agriculture. After such rediscounts had been acquired by the Federal Reserve banks, it was contemplated that their retirement would likewise be automatic, for the reason that member banks would normally prefer to be out of debt to the System and would have the further incentive of preferring not to pay the penalty of interest on the rediscounts.

The open-market operations of the System to any such extent as they have developed in recent years were not remotely contemplated, and, as a matter of fact, were not actually entered into as a practice of the Federal Reserve banks until 4 or 5 years after the end of the World War, and then only in a comparatively small volume. The first time that anyone ever thought of creating excess reserves in any appreciable volume for member banks was during the year 1932, when the Federal Reserve System undertook an easy-money policy for the purpose of increasing the market price not only of Government bonds but of all bonds, and for the further purpose of inducing, or forcing, member banks to make loans of a character which they had never before felt justified in making—the underlying thought, of course, being that this would prevent further contraction of bank credit and further losses to banks by low market values on bonds and other investments which they already held.

It is my own opinion that, at the time the tremendous open-market purchases were inaugurated in 1932 and again revived in 1933, the intention was not to produce a condition which would make it a simple matter for the Government to finance continued deficits by selling its bonds to the member banks at inflated, abnormal, and artificial prices, but, nevertheless, such a result was sure to and, as a matter of fact, did follow the operation.

Today, the Federal Reserve System holds $2,430,000,000 of Government obligations which have been purchased in the open market, and the proceeds of such purchases have passed through the hands of the member banks and created reserves of those member banks in the Federal Reserve System to an exact corresponding amount. Since reserves in the System amount to identically the same thing as gold or currency, member banks are able to make loans, purchase Government bonds or other investments, and thus create a corresponding deposit liability of fully 10 times the amount of this reserve of $2,430,000,000 which has been created purely by open-market purchases of the System. These reserves of member banks are, for all practical purposes, potential currency, 60 percent of which are secured by nothing except other unsecured promises of the Government, and to that extent are pure fiat currency. The difference between reserves created by open-market purchases and those created by rediscounts, or borrowing of member banks, is basic

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in that the one has behind it an unsecured promise for money borrowed and spent, whereas the other has behind it obligations arising from commercial, industrial, or agricultural operations which will, as a normal completion of these operations, be liquidated in full within a short maturity date. Also, there is always the urge on the part of member banks to get out of debt and decrease their rediscounts, whereas there is no such urge for the disposal of open-market purchases.

This is very well evidenced by the fact that, during a great part of the time that the open-market purchases were made, those responsible for such purchases gave the country to understand that they were necessary in order to offset gold exports and hoarding. During the past 15 months, tremendous amounts of currency have come out of hoarding back into the banks, and at least a billion and a half of gold imports have come into the country, and there has been no urge sufficient to make it seem desirable to those in authority to decrease open-market holdings by a corresponding amount, or by any amount whatsoever. The result of all this is that member banks have become so loaded up with Government bonds and other securities at inflated and artificially high prices that if normal conditions are ever allowed to return, the market loss to member banks on their investments necessarily will be of such great proportions as to seriously endanger the capital structure of the entire banking system of the country.

With this background, my attitude with regard to the provisions of the proposed banking bill can be easily appreciated. In the first place, it is my belief that the recommendations of the Council with regard to section 203 (p. 48) of the bill), reducing the membership of the Federal Reserve Board and eliminating the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members, is extremely important in connection with the effort to remove the Federal Reserve Board from political influence.

Also, the recommendations of the Council with regard to section 205 outlining a plan for an open-market committee comprised of the entire Federal Reserve Board and four governors of Federal Reserve banks elected by all the governors of the Federal Reserve Banks, would be helpful in further eliminating political influence and in securing a broader viewpoint and more independent decisions as to open-market policies.

Section 206 in my opinion, is directly in violation of the spirit of the original Federal Reserve Act, since it permits the accumulation of assets in the Federal Reserve System against which currency and reserves are, or can be, created—which assets may not be of a self-liquidating character, such as real-estate loans, bonds, and other investment securities. The recommendations of the Council with regard to that section recognizes the desirability of permitting the Federal Reserve System to come to the relief of solvent member banks who do not have eligible self-liquidating assets, but they have suggested a condition which would tend to prevent an undue or unreasonable amount of such assets as a basis for currency or reserves. Their recommendation is that the Federal Reserve bank may make advances on any sound assets provided the member bank applying for such advances shall first have exhausted its presently

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eligible paper and shall also pay a penalty rate of 1 percent higher than the rate required for the rediscount of eligible assets.

Senator GLASS. Did you say specifically 100 percent or at least 100 percent?

Mr. FROST. The higher the better. At least 100 percent would be very much better than what I have here.

The recommendation of the Council with regard to section 208 is, to my mind, the most important of all the recommendations which they have made. This recommendation takes cognizance of the fact that, under the provisions of the bill, the Federal Reserve System may, and under political influence probably would, purchase Government obligations, thus creating either currency or reserves for member banks in order to finance continued deficits of the Government.

When it is realized that an open-market purchase of $100,000,000 of Government bonds absolutely creates the ability on the part of member banks to purchase $1,000,000,000 of Government bonds, thus increasing their deposit liabilities to that amount, it is not difficult to understand how Government deficits to the extent of 20 billion, 30 billion, 40 billion, or any conceivable amount can be forced into the hands of the banks in the form of Government bonds.

The recommendations of the Council are made for the purpose of preventing the issuance of currency on the basis of Government bonds held, and while the Council's recommendations would still permit the Federal Reserve System to create reserves by open-market purchases, those in charge of the System would necessarily have in mind the fact that currency can be demanded against reserves and that this demand could very well arise through currency hoarding caused by fright. They would also have in mind that sufficiently large exports of gold could produce a condition where the Federal Reserve System would not have sufficient collateral to protect their present outstanding note issues without disposing of some of their excessive holdings of Government bonds, thus bringing about the necessity for rediscounting on the part of member banks, which would, of course, put them in possession of an eligible base for the issuing of currency.

Naturally it is possible under the new bill for a wise administration of the System to refuse to allow the use of the System as a medium for the financing of Government deficits, or to permit reserves and currency issues to be based on Government obligations, but if we are to expect such an administration of the System under the new bill, there can be no possible advantage to be gained by enacting into law the permission to base unlimited currency issues on Government bonds and to finance Government deficits without limit through open-market purchases of Government bonds. In other words, if the proponents of this provision of the bill do not intend to use it, why do they want the permission? Permissive legislation should never be passed unless it is expected and intended to be used.

If this does not seem reasonable, please refer to section 204, on page 51 of the bill, which provides that it is the duty of the Federal Reserve Board to exercise its powers in such manner as to promote conditions conducive to business stability, and to mitigate by its influence unstabilizing fluctuations in the general level of production,

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trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration. Can anyone imagine the Governor of the Federal Reserve Board asking for the power provided in section 208, accepting the mandate of section 204, and then failing to use the power asked for?

Senator McADOO. Are you speaking of the House bill or of the Senate bill?

Mr. FROST. I am speaking of the House bill, because I did not have a copy of the Senate bill when I prepared my statement. Section 204 (o) provides for the duties of the Board.

Any can anyone contemplate with equanimity the issuance of billions and billions more of fiat currency, either for financing Government deficits or for the purpose of raising the price structure and consequently cost of living? No. The experience which we have had in this country with "permissive" legislation has not been such as to inspire any great amount of confidence in such powers not being used by those requesting the permission. I am personally disposed to follow the American tradition of limiting by written laws the powers of those whom we have placed in authority above us, and this does not in any way indicate that I do not have proper confidence in and respect for the judgment and wisdom of our present rulers.

In conclusion I wish particularly to direct your attention to the general statement which the Federal Advisory Council has made in their preamble to their recommendations in connection with title II, on page 4. In the first paragraph of that statement the council questions whether there is any emergency at the present time which makes it necessary to enact into law the provisions of title II without further careful consideration and study; and in the final sentence of that paragraph the council states that it would seem most desirable to have another detailed study made, analogous to the one which preceded the enactment of the Federal act.

It is my own personal strong belief that, even if Congress should at this time enact a law putting into it all of the safeguards which the Federal Advisory Council has recommended, it would be far safer and better, from every point of view, to refuse to enact any part of title II at this time, but, on the other hand—and I will have to apologize for this; we have all made this recommendation—to appoint a commission to make a study, such as has been recommended by the council, and leave basic changes in the Federal Reserve Act open for consideration at a later date when a greater degree of calmness and sober thought may prevail.

And now, about appointing a commission I would just like to say that in suggesting that I really believe that back in the mind of everybody that has suggested it, was the thought that a study by a commission or a further study by the members of the Senate and the House would result in their saying that the old Federal Reserve Act is still good and that it had better not be changed. These emergency powers which the Federal Reserve System has now for issuing currency against Government bonds and taking in sound assets for banks are all right as emergency provisions, if they were necessary—I do not know that they were—but we can always have emergency legislation when it is necessary. I believe that any commission that studied it would decide that the old act is still all right,

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and let the emergency provisions expire with the emergency, and be reenacted on another emergency if it should ever come.

Senator GLASS. I believe, Mr. Frost, I have already stated for the record that that permissive power was reported because we were very definitely and repeatedly assured that it would not be used, that it was intended for its psychological effect.

Senator COUZENS. Has it been used to any great extent?

Mr. FROST. Yes; they used it to some extent.

Senator COUZENS. Not very much, though, did they?

Mr. FROST. To the extent of about five or six hundred millions; but they did not need to use it at all.

Senator GLASS. It amounts to $2,346,000,000.

Mr. FROST. Did they put that much up as collateral?

Senator COUZENS. I was talking about bond currency issues.

Senator GLASS. As security?

Senator COUZENS. Yes.

Mr. FROST. I think they only put up about five or six hundred millions, and they only did that because they wanted to accustom the public to the Federal Reserve bank notes as being perfectly all right. They did not need to use it at all.

Senator COUZENS. That is what I thought.

Senator GLASS. But they have used the purchasing power to the extent of exceeding $2,000,000,000?

Mr. FROST. Yes.

Senator MCADOO. Mr. Frost, I want to ask you about the provision in section 208, beginning at line 22——

Mr. FROST. Is that the Senate bill?

Senator MCADOO. That is the House bill, page 53 [reading]:

> 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 against its deposits and reserves in gold certificates of not less than 40 percent against its Federal Reserve notes in actual circulation.

Do you think, in the present state of our finances, that that is an adequate reserve?

Mr. FROST. The question of a reserve against deposits and note issues is not really the important point, to my mind. The important point is what the entire security behind your note issue or your deposits may be.

Senator MCADOO. You always regard a certain amount of reserve as being of fundamental importance?

Mr. FROST. A certain amount of reserve is necessary; but it is not the important point as to whether currency or deposits are safe.

Senator MCADOO. No; it is not, of course. But let us restrict it to note issues. Do you think a 40 percent gold reserve and gold certificates we now issue are a sufficient reserve in gold?

Mr. FROST. Without any other security?

Senator MCADOO. I am talking merely of the reserve required in coin against note issues.

Mr. FROST. I would not consider, Senator, that a note issue is safe with 40 percent in gold behind it unless there was something else behind it for the 60 percent.

Senator MCADOO. What is behind the other 60 percent? First of all, it is the credit of the United States, is it not?

Mr. FROST. Yes, sir.

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Senator McADOO. Nothing else?

Mr. FROST. I do not consider that enough.

Senator McADOO. You do not consider that enough. The Government of course is primarily liable?

Mr. FROST. I think the Federal Reserve bank is primarily liable.

Senator McADOO. All Federal Reserve notes run in the name of the Government of the United States.

Mr. FROST. The Government agrees to pay.

Senator McADOO. The Government of the United States agrees to pay on demand. The Government has recourse, of course, on the banks, but the people look to the Government for those notes. They accept them at full faith and credit because the Government of the United States is issuing them. All of our money is issued by the United States Government; but in view of the changed or altered condition of the currency since all the gold has been taken by the Government, I am wondering if you think that this kind of a reserve, plus the Government's credit for the remaining 60 percent, constitutes a good note?

Mr. FROST. No, sir; I do not think so.

Senator McADOO. What would you consider a good note?

Mr. FROST. I would consider a note good when it is secured by either 100 percent of gold or any percent of gold not below 40 percent, plus self-liquidating assets up to the 100 percent.

Senator McADOO. Suppose you have 40-percent gold and the Government has recourse on the banks for the remainder, then what do you think of it?

Mr. FROST. The recourse on the banks would only be good if the assets of the banks were invested in self-liquidating assets. If they are invested in Government bonds they have got recourse on the banks, but you have 60 percent fiat currency under that plan.

Senator McADOO. You are up against that situation always, so far as our currency is concerned. Sixty percent of it has primarily Government responsibility.

Mr. FROST. No, sir; I do not agree with that.

Senator McADOO. Why do you not agree with it?

Mr. FROST. Because, under the original Federal Reserve Act, you could not put up Government bonds as security. Your currency or Federal Reserve notes had 40 percent gold at least, and the balance in self-liquidating assets. So that your currency was 100 percent secured, part by gold and part by self-liquidating assets that were in no way dependent on the promise of the Government.

Senator McADOO. On the contrary, you could not collect that note from the Federal Reserve bank; you had to collect it from the Government, and the Government had recourse on the banks.

But the point I am trying to bring out is that having a note with 40 percent of gold back of it and a responsible Government for the other 60 percent, and that Government in turn having recourse on the banks for the remaining 60 percent, I want to know if you think that is a good note?

Mr. FROST. I do not think it is safe currency.

Senator McADOO. Do you think a national bank note is safe?

Mr. FROST. I think a national-bank note is safe, for the reason that there are so few of them in comparison with the volume of currency in the country, and I think absolutely they are not sound.

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Senator McADOO. They have been sound for nearly 70 years, or something like that. They pass current.

Mr. FROST. They pass; yes.

Senator McADOO. Is not any note good which the people are willing to accept at par in full payment for commodities or services or as legal tender for debts, public and private, or for taxes?

Mr. FROST. No, sir; I do not think so. You might just as well say that if a man can borrow money from a bank, is he not good for it? He may be and he may not be.

Senator McADOO. You think a sound currency, then, is sound only if you have 100-percent gold back of it, or 40 percent of gold and some self-liquidating assets of a bank?

Mr. FROST. Yes.

Senator McADOO. And you do not think that the Government of the United States back of a note adds anything to it?

Mr. FROST. I would not say it does not add anything to it, but I say it is fiat currency to that extent.

Senator McADOO. It would be fiat currency of a bank, in a way, because you would have to depend upon the resources of the maker of the note.

Mr. FROST. It is fiat currency of a bank to the extent of 60 percent of it, but it has self-liquidating security behind it, and the Government only has its taxing power.

Senator McADOO. Do you not think the taxing power of the United States is worth more than the assets of any bank?

Mr. FROST. No; not when they have continued deficits.

Senator GLASS. Here is a note that I have been carrying around [exhibiting] which used to be worth $46,000. It is not now worth the paper that it is printed on.

Senator McADOO. That is a German note?

Senator GLASS. Yes. It was receivable for taxes, and it was legal tender. Everybody had to accept it. But there it is [indicating]; it is not worth the paper on which it is printed.

Senator McADOO. Undoubtedly if a government issued an unlimited amount of currency for some express purpose, and where it also has as its objective the extinguishment of private debts, I think that is a very different situation.

Senator GLASS. It may do it under this bill.

Senator McADOO. We are not intending to do any such thing in this country.

Mr. FROST. You can do it under this bill; yes. I do not think you will.

Senator GLASS. I do not agree that the Government is primarily responsible for the Federal Reserve notes. As a matter of fact, Mr. Wilson called them the shadow of responsibility of the Government's liability, a mere shadow of the responsibility.

Senator COUZENS. Are you trying to develop the soundness of the Patman bill?

Senator McADOO. Not at all. I am primarily interested in finding out what sound money is. If we are going to enact banking legislation, we must know what sound money is.

Senator GLASS. The primary responsibility is that of the bank, with its 40-percent gold that it has to hold and pay—not merely to

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promise; it has to hold and pay its 40-percent gold and its 60 percent of liquid commercial paper. That is the primary responsibility.

Mr. FROST. That is what I thought.

Senator GLASS. I think the Government's responsibility is so remote——

Senator MCADOO. The Government's liability.

Senator GLASS. Yes; the Government's liability—"liability" and "responsibility" are so synonymous, I think, that it does not make much difference. At any rate, the President thought it was so absolutely remote that he spoke of it as a shadow, and he said, "If we can retain the substance and give the other fellow the shadow in order to pass this bank bill, why not do it?" That is why it happened to be in there. It ought never to have been in there at all.

Senator MCADOO. I remember the discussion very well and how we happened to arrive at the conclusion to issue these Government notes. You will recall the speech that Mr. Root made on the floor of the Senate in which he denounced the Federal Reserve notes as fiat money.

Senator GLASS. The fact that he denounced them did not make them that way.

Senator MCADOO. No. They were primarily a Government obligation. He said the issuance of these notes, by the Government, even though it had the right to assert claims against the banks afterward, was a matter of such consequence—I do not remember the language, but I think I am stating the substance of his argument—that it would imperil the credit of the Government.

Senator GLASS. As a matter of fact, whoever heard of a Government note that the Government could not issue except upon demand of a bank? That settles whether they are Government notes or not. The Government cannot issue one of them except upon demand of a bank.

Senator MCADOO. It can issue silver certificates.

Senator GLASS. I am talking about Federal Reserve notes.

Senator MCADOO. It can also issue gold certificates.

Senator GLASS. The gold certificates it issues now are not gold certificates. You know that.

Senator COUZENS. I came in a little bit late in the midst of Mr. Frost's statement, but if I recall correctly he said something about the condition of the banks due to the inflated values of their assets. Did you make some such statement as that, Mr. Frost?

Mr. FROST. I do not think I said "inflated."

Senator COUZENS. I do not want to interrupt your statement, but I thought I would like to ask you that question. I am quite sure what language you did use.

Senator MCADOO. It was toward the close of your statement. I think we were discussing the effect——

Senator COUZENS. It is not necessary to go back to the specific language.

Mr. FROST. Inflated and artificially high prices?

Senator COUZENS. You mean by that that all of the assets of the banks are of that character?

Mr. FROST. No; not all the assets. I would say that of the bond assets, not only Government bonds but all bonds.

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Senator COUZENS. You mean, then, that all of the industrial, utility, railroad, municipal, or other bonds are all inflated?

Mr. FROST. Yes, sir.

Senator MCADOO. Now?

Mr. FROST. Yes.

Senator COUZENS. That is the most astounding statement that I have heard. I have not heard that expressed before. I just wondered whether that was the consensus of opinion of the banking fraternity.

Mr. FROST. I would say, on bond prices, where the bonds are in the mind of the purchaser perfectly good, the price of the bond is then entirely regulated by the price of money, the interest rates that are prevailing. I do not know that the interest rates that are prevailing are due entirely to the large excess reserves that have been built up by the open-market operations of the System. That is artificial. If the price of money or the interest rate is an artificially low one, consequently the prices for investment in securities of all kinds are artificially high.

Senator COUZENS. And that covers all kinds of securities, including Governments and all the rest of them?

Mr. FROST. Assuming that they are absolutely good in the mind of the purchaser; yes.

Senator GLASS. We are obliged to you for your statement, Mr. Frost.

(The witness withdrew from the committee table.)

STATEMENT OF THOMAS M. STEELE, MEMBER, FEDERAL ADVISORY COUNCIL, REPRESENTING THE FIRST FEDERAL RESERVE DISTRICT; PRESIDENT FIRST NATIONAL BANK & TRUST CO., NEW HAVEN, CONN.

Senator GLASS. Mr. Steele, we are here to consider these bank bills, and we would be very glad to have you, as a member of the Advisory Council, give us your judgment of them.

Please state your full name and occupation to the reporter.

Mr. STEELE. My name is Thomas M. Steele. I am a member of the Federal Advisory Council, representing the first Federal Reserve district, and am president of the First National Bank & Trust Co. New Haven, Conn.

Senator COUZENS. Are you going to give substantially the same testimony as the other members of the Council have given?

Mr. STEELE. I do not think so, Senator Couzens. There is a little repetition in the first page or two of Mr. Loeb's statement, but there are some additional things. The bulk of my statement is not parallel. Of course, these statements were not made in collaboration at all, and they all differ.

Senator MCADOO. It might be well, in order to save time, to have the paper put into the record as a whole, and then you bring out such specific points as you think should be brought out. Will it be convenient for you to do that? Put the whole thing in the record and then proceed to elaborate the specific points you have in mind that you want to emphasize.

Mr. STEELE. Yes; of course. You do not want me to read it?

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Senator McAdoo. The entire statement?

Mr. Steele. I will not read the entire statement, but there are some few things that I should like to call your attention to.

(The statement of the witness will be found in full at the end of his testimony.)

On April 22, 1935, the Federal Advisory Council filed with the Chairmen of the Committees on Banking and Currency of the Senate and the House of Representatives a statement on the Banking Act of 1935 which had been prepared at the request of the Federal Reserve Board and previously filed with its Governor. Before preparing its final draft the Council had conferred at length with the Governor and adopted some of his suggestions, but in many important respects had found itself unable to concur with his viewpoint. The report so filed was the unanimous report of the Council.

The next two pages simply contain what the Council states, and therefore I will omit that.

I do not understand that the council, although recommending the changes above referred to, intends to be understood as acquiescing in the general principle of insurance of bank deposits which was disapproved by it prior to the adoption of the Banking Act of 1933. I therefore desire at this point to subscribe to the objections to permanent insurance made by the Connecticut Bankers Association in resolutions which have been filed with the committee, although I realize the futility of detailed argument on this point at the present stage of events. And I do not deny that the adoption of the insurance plan during an extremely critical period did much to revive confidence in the banking system, but I think that it should be a temporary, not a permanent, measure. Moreover it is generally recognized that deposit insurance was inserted in the Banking Act of 1933 largely as a device to force all banks into the Federal Reserve System. Without arguing the desirability or the undesirability of accomplishing that end, the plan entirely loses its justification on this ground if the provisions of the present law which require all insured banks to become members of the System by July 1, 1937, or at least to apply for such membership, are to be eliminated. This, of course, will be the case should H. R. 7617 become law.

There are certain other new features of H. R. 7617 to which attention may be called at this point.

It oversimplifies the entrance of nonmember banks into the insurance system. It is unfair to forget that one-half of the surplus of the Federal Reserve banks was taken from them to provide capital for the Federal Deposit Insurance Corporation; that this surplus was earned on capital all of which was supplied by the member banks, and on deposits belonging to the member banks. If nonmember banks are desirous of receiving what seem to them to be the benefits of the insurance plan without putting up any capital themselves, the standards of admission surely ought not to be lowered. H. R. 7617 distinctly lowers the standards set by S. 1715. This invitation to State banks to join the Federal Reserve System or, as nonmembers, to join the insurance system without conforming to the standards required of banks which are already members, appears at numerous points in H. R. 7617 as, for example, where it omits, at the end of title II, the requirements set up in S. 1715

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that new real-estate loans made by State member banks conform to the requirements for national banks. It appears also in S. 1715, where the F. D. I. C., in order to facilitate the entry of an insured nonmember bank into the Reserve System, is empowered to waive, in whole or in part, the requirements of the section as to capital. This same tendency appears at various points throughout title III. Why should the Comptroller, for example, be allowed to waive the requirement of a 20-percent surplus in the case of a State bank converting into a national bank (as provided in sec. 308, p. 55 of S. 1715), when a national bank cannot commence business without such surplus? Why should the Comptroller permit such a converting bank to retain and carry, at valuations determined by him, assets of such converting bank which do not conform to national bank requirements (as provided by sec. 311, p. 57 of S. 1715)?

A careful examination and comparison of S. 1715 and H. R. 7617 will show the lengths to which H. R. 7617, particularly, is ready to go in sacrificing soundness in order to secure unification.

I will omit, in accordance with the Senator's suggestion, what I have to say on title III.

While the Council has reported fully on the provisions of title II, in compliance with the request of the Federal Reserve Board, it has prefaced its discussion by expressing grave doubt whether there is any emergency existing at the present time which makes it necessary to alter profoundly our present banking system without further careful consideration, and it recommends that a detailed study be made analogous to the one which preceded the enactment of the Federal Reserve Act.

It has further stated in its report that if title II is proposed for enactment prior to the proposed study, it must disapprove it in its entirety unless certain specified amendments are adopted.

It is a vital consideration that what is intended here is permanent legislation, devised to meet not only the present situation but to shape the banking system of the country for years to come. It is true, of course, that conditions have changed substantially since the Federal Reserve Act was adopted in 1913, but no impartial study has yet been made of just what those changes are, how permanent they may be, and what effect upon accepted banking principles they are likely to have. Neither can it be forgotten that an enormous mass of emergency legislation of various types has been enacted during the past 3 years.

This legislation is uncoordinated, sometimes confusing, and altogether undigested. It includes, among other measures, the Banking Act of 1933, the Glass-Steagall emergency banking bill, the Federal Home Loan Bank Act, a number of amendments to Section 5200 of the Revised Statutes, the Bank Conservation Act of 1933, the so-called "Thomas amendment", numerous changes in the act creating the R. F. C., various amendments to the Farm Loan Act, and numerous laws creating such auxiliary agencies as the Home Owners Loan Corporation, the Agricultural Credit Corporation, and others. The interplay of all these new organizations and their effect upon the Reserve System cannot be understood or intelligently considered without an exhaustive and impartial study made outside of, and apart from the arenas of political strife. The Federal Reserve Act

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is the result of years of exhaustive study of the banking systems of the world, as well as of this country, and it is not an exaggeration to say that the situation today is much more involved and complex than was the situation facing the Congress in 1913. To make the revolutionary changes in title II proposed without a comprehensive and impartial study such as suggested, is without justification.

Then I refer to some of the specific recommendations, but I will leave that part out.

As to the liberalization of rediscount privileges, the Council recommends the elimination of the so-called "sound assets" clause proposed by Section 206 of S. 1715 and proposes that section 10 (b) of the Federal Reserve Act, which has expired by limitation, be reenacted as permanent legislation with one change in phraseology (p. 10 of its report).

Closely allied with this subject is the proposal of S. 1715, to eliminate those portions of the Federal Reserve Act which require the pledging of collateral for Federal Reserve notes. The council objects to the elimination of the requirement for collateral and urges that the present provisions of the act in this respect be retained. It also recommends that the present emergency provision embodied in the proviso of the second paragraph of section 16 of the act, under which direct obligations of the United States may be accepted as collateral security for Federal Reserve notes until March 3, 1937, be amended by inserting a provision limiting the outstanding volume of notes so issued to $1,000,000,000 and providing for a tax thereon while any part of such amount is outstanding. The detailed changes necessary to effect such amendments are set out on pages 11 and 12 of the council's statement.

I will eliminate what I say on the matter of real-estate loans.

Senator McAdoo. What do you recommend as to the amount of tax?

Mr. Steele. Three percent of the amount outstanding.

Senator McAdoo. The circulation tax?

Mr. Steele. Yes.

Since it is unlikely that the convictions which have impelled the members of the council to join in these unanimous recommendations are precisely the same in the case of each member, the remaining portion of this memorandum must be regarded, except in its broad outlines, as an individual expression of opinion.

Title II of the Senate bill as drawn and the House bill as passed by that body involves a complete departure from the idea of the commercial banking system contemplated by the Federal Reserve Act. It encourages the rediscounting of nonliquid assets not merely in times of emergency, to which no one objects, but as a regular practice. In so doing it directly invites what has heretofore been considered unsound commercial banking; this partly upon the theory that the insurance of deposits makes liquidity of minor importance and partly upon the theory that rediscountability is equivalent to liquidity. It makes "any sound assets" not defined except as a remote central body inevitably subject to political influence, may from time to time define the term, "eligible to serve as a basis for the Nation's currency."

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It makes possible the issuance of currency under governmental pressure through the forced sale of bonds by the Treasury to the Reserve banks to meet fancied needs of Government for funds which it is not considered expedient to raise by taxation and which cannot be borrowed from the savings of the people in a free market at rates which the Government is ready to pay. It ignores the fact that, aside from the preferred stock held by the R. F. C., which it is proposed under existing law to retire as soon as possible, the capital, surplus, and undivided profits of the member banks is private capital belonging to tens of thousands of individual stockholders; and that, aside from the present abnormal Government deposits, the billions of dollars of deposits in these banks belong to individual depositors.

To all intents and purposes it socializes all these funds. It ignores the fact that the member banks, by virtue of having supplied all the capital of the Federal Reserve banks, by virtue of the deposits constituting their legal reserves, through their liability to further assessment for capital stock and through their double liability on their stock subscriptions, have a vital interest in the soundness of management of the Reserve banks of their several districts and a right to a voice in the management of the resources of these banks. It takes away, by various devices, all real voice of the reserve banks in open-market operations and rediscount rates, places these vital subjects, together with control over reserve percentages of member banks, entirely in the Federal Reserve Board and at the same time tightens the influence of the executive branch of the Government over the conduct of the affairs of the Board itself.

It is submitted that even though one grant that the Federal Reserve System is loosely organized, nevertheless to allow the member banks and the 12 Reserve banks to safeguard the funds intrusted to their care by stockholders and depositors, and to administer them according to the varying needs of their customers and their respective localities, is far more likely to be compatible with business stability, the interests of commerce, industry, and agriculture, and the general public welfare than is administration by politically appointed agents centralized in Washington. Impartial administration is humanly impossible when the course of those nominally in control may so easily be influenced by considerations of political expediency or by current theories as to political or social needs, as is bound to be the case under any system dominated by current political appointees.

It is argued that, since the present law makes the chairmen of the Reserve banks representative of the Federal Reserve Board, there is no tightening of control or loss of local autonomy when the office of chairman is abolished and the Governor becomes chairman under similar control by the Board. Under the provisions of existing law, however, the chairman of each Reserve bank must have been at least 2 years a resident of his district and must be "a person of tested banking experience." Under section 201 of S. 1715 neither of those requirements is now to be applied to either Governor or Vice Governor. In each of the 12 districts, therefore, the Federal Reserve Board might have power to control the installation of two dominant representatives—both strangers—with no practical banking knowledge, their appointment thus dictated by a Board whose mem-

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Federal Reserve Bank of St. Louis

bers may also be without banking experience, and whose only prescribed qualifications are capacity to participate in the formulation of national, economic, and monetary policies. Under existing law, moreover, the regional boards of directors are authorized (Federal Reserve Act sec. 4) to appoint their own officers and employees, with a limited few exceptions, to define their duties, and to dismiss them at pleasure, but section 201 of S. 1715 (p. 39, lines 20 and 21) makes all officers and employees of the regional banks directly responsible to the respective governors alone. In this situation it cannot possibly be said that any real autonomy is left with the regional banks. Even nominal autonomy is greatly restricted by the provisions (S. 1715, p. 40, lines 17–32), denying class A and class B directors, who are direct representatives of the member banks, the right to serve for more than two consecutive terms, no matter how desirous the stockholding member banks may be of having them continue in office.

It is safe to say that almost no head of a well-managed bank or of any other business would wish so arbitrary a restriction to apply in the case of his own corporation. The reduced status of the directors of the regional banks in the minds of some, at least, of the proponents of this legislation, is seen in the interpretation put upon the act by the H. R. Report No. 742 accompanying H. R. 7617. In commenting upon section 204, S. 1715, page 43, line 24, et seq., which authorized the Reserve Board to assign to "representatives of the Board" the performance of duties under rules and regulations, H. R. Report No. 742 states, at the bottom of page 8, that "one of the important consequences of these provisions would be that the Board would have authority to assign to the Governor or Board of Directors of a Federal Reserve Bank" certain duties. How long, it may be asked, have the directors of the Reserve banks been regarded as representatives of the Reserve Board?

The power of any current administration to dominate completely the personnel of the Reserve Board under the provisions of S. 1715, page 43, lines 11 to 21, has been frequently discussed before this committee. It is no answer to say that the drastic power conferred would never be exercised. It is axiomatic that a legislative body should never grant to an executive a broad authority in reliance upon a belief that he will be too benign to act under it.

The possible extension of political control is further seen in the proposed provisions governing the Open Market Committee. S. 1715, section 205, page 44, gives minority representation to two governors of the Reserve banks elected for 1-year terms under procedure prescribed by regulations of the Reserve Board. Regardless of the best intentions, this means power to deprive the Reserve banks of any effective representation. H. R. 7617, section 205, page 51 et seq., gives the Reserve banks merely an advisory committee of four governors with no voting power, real authority resting solely with the Board. Under both bills this committee is entrusted with vast powers.

Something can be said for a more centralized responsibility for the proper performance of the duties now performed by the Open Market Committee, but little has been said, or can be said, for depriving the Reserve banks of all effective voice in the use of the funds belonging to them and to the member banks. Any investment of

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the assets of a Reserve bank, whether in Government bonds or otherwise, is an investment of the property of member banks. If such investment is the voluntary act of the board of directors, representatives of the member banks, they have no cause of complaint. But if such investment can be commended by a central board upon which member banks are not represented and contrary to the will of their representatives of the boards of the Reserve banks it is, in substance, taking away their property without their consent and is contrary to fundamental American concepts.

The plan proposed by the Advisory Council is for an open-market committee of 9, 5 being the members of the smaller Reserve Board, which is proposed, and 4 being governors of the Reserve banks selected by the 12 governors in accordance with procedure prescribed by them, their terms being so arranged as to give real continuity of service. It is a sane plan, insuring wise administration by a dignified and powerful body worthy of public confidence, so constituted as to enjoy real freedom of action, to which the vast powers proposed to be centralized might be entrusted with safety, alike to the interests of the public, the Reserve banks, and the stockholders and depositors of the member banks.

Senator GLASS. It means to me it is essentially a compromise on principle. You are proposing to permit the Board, a majority of the members of which have no proprietary interest whatsoever in the funds of the banks, to use the funds in the banks. The only difference in your proposition is that the Senate bill proposes to remit that whole business to the Federal Reserve Board, and you propose to let a majority of a contemplated committee do that.

Mr. STEELE. There are two distinctions, I think, Senator, if I may say so. Our plan provides for 10-year terms for the governors, which will give them quite a bit of continuity and make their views a great deal stronger——

Senator MCADOO. It does not make their votes any stronger, though.

Senator GLASS. It does not make their votes any stronger and it does not make their influence any stronger. There are members of the Federal Reserve Board now who have served since the foundation of the System, nearly 21 years, and who were never even consulted about the bill which was sent up here. They did not see it until after it was set up and printed.

Mr. STEELE. I think I would have to concede, so far as I am personally concerned, that there was an element of compromise there, but I think there was a desire on our part not to ask for anything which we did not think it was reasonable to hope we might get, and there was a desire of that kind——

Senator GLASS. Yes; it is a compromise with principle.

Senator MCADOO. It does not better your position any to give the same identical board that is proposed the majority here instead of all of it.

Mr. STEELE. I think we felt—and understand that the reasons are bound to be my original reasons—that with the governors making their own rules of procedure as to how their four representatives should be chosen, and putting them on for terms of 10 years, it would be fairly likely that they would have a pretty powerful voice and

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fairly apt to carry some of that at least to the members of the Board.

It is stated, and it must be believed even without statement, that there is no desire for runaway inflation on the part of the present administration. Of course this is true. No government ever wilfully brings ruin upon its own people. But certain courses, if followed too long, lead to conditions under which no government can resist the temptation to try this desperate course. It has been so in all history. Economic law respects no age or era and no international boundaries. If we follow courses which in all human experience have proved disastrous, disaster is likewise inevitable here. It might well prove tragic for Congress to create machinery so clearly adapted to the ends of inflation.

It cannot be forgotten in this connection that the so-called "statement of objectives" which has been made a part of section 24 of H. R. 7617 as it passed the House, page 51, contemplates a profound change in the considerations which are henceforth to guide the Open Market Committee. I understand that a similar amendment has been offered to the Senate bill. A comparison between this statement of objectives and the governing principles of the present law, as expressed in clause (c) of section 12–A of the Reserve Act will clearly indicate the far-reaching possibilities of the new proposal. There is not a business in the United States; there is not a man, woman, or child who has a dollar of his own or who is working for a solvent employer who is not potentially affected by it. Its far-reaching implications could not be overstated. It should not be tossed lightly into legislation enacted under pressure either of time or circumstances, but should be adopted, if at all, only after a study of the type which the council has recommended.

With respect to the so-called "sound assets" clause (S. 1715, sec. 206, pp. 45–46) but little argument should be necessary. It is naive to profess that this provision would not encourage banks to adopt—perhaps quite unconsciously—a greater laxity in loaning policies. and they have short memories indeed who do not recall the part played in bringing on the banking crisis by the mass of frozen long-term loans and investments which had crept into the system. One of the important motives behind the Banking Act of 1933 was to rid the banks of just that character of assets. We are dealing with human nature and it is a certainty that with this provision in the law it would not only be more difficult for individual banks to decline to make slow loans which they would hope could be rediscounted if necessary, but would also be more difficult for the Reserve banks to decline to grant such rediscounts. It was with the experience of the banking crisis fresh in mind that the Federal Reserve Board, in making its annual report of May 28, 1934, just a year ago, and when the personnel of the Board was exactly the same as at present, with the exception of the Governor, recommended, without a dissenting voice, that section 10 (b) of the Reverse act be reenacted in permanent form and stated their reasons as follows: I quote from page 56 of the report:

> In view of the fact that this section has enabled the Federal Reserve banks to render valuable assistance to member banks in difficulties, without impairing the liquidity of the assets of the Federal Reserve banks, it is believed that

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the authority of the section should be made permanent. However, it is the view of the Board that loans should not be made thereunder except during periods of a banking emergency when member banks may be in unusual need of assistance and that the section should be enacted in permanent form only if an appropriate safeguard is incorporated therein to enable the Board to prevent an undue use of such credit facilities. The Board recommends, therefore, that the section be enacted in permanent form with an amendment providing that loans may not be made by Federal Reserve banks under the provisions of the said section except pursuant to authority granted by the Federal Reserve Board upon the affirmative vote of not less than five members and under rules and regulations prescribed by the Federal Reserve Board.

This recent and clear recommendation of the Federal Reserve Board for the reenactment of section 10 (b) for use solely in emergencies the Council now reiterates. There is no evidence that the Board itself has changed its attitude.

Closely tied in with the question of rediscounting "any sound assets", is the recommendation of the council that the present provisions of law respecting collateral behind Federal Reserve notes be retained. The act, after exhaustive study, adopted the principle that Federal Reserve notes were to have definite security behind them. The literature of the period shows conclusively that these notes were regarded as backed by specific security and that the obligation of the United States was a secondary consideration.

Senate Document No. 117 of the Sixty-third Congress, first session, accompanying the currency bill, states specifically that "the primary security" of the currency was to be "short-time commercial notes" followed by the resources of the Reserve banks, the double liability of the member banks, the gold reserves, and finally the credit of the Government. "The history of the world", it is stated, "offers no case where any currency note ever had behind it such a volume of security." It is indeed a far cry from this situation to one where Dr. Kemmerer can say that the Government debt is secured by notes and the notes secured by Government debt. It is true that Reserve notes are now secured by a lien upon all the assets of the Reserve banks and that therefore the pledge of specific assets does not add to the security behind them. But we are dealing with human nature and with human psychology and no amount of logic can alter the fact that the necessity of setting aside definite collateral does, in practice, operate as a check and a caution signal and that the retention of these safeguards would give added protection against an expansion of currency upon the basis of second-rate assets.

I shall touch briefly on but two more points: The first is the disquieting increase in bureaucratic control under both the Senate and the House bills, although vastly greater under the House bill. It is true that amid modern complexities of government a certain amount of detail must necessarily be left to administrative bodies, but the proper limits of such delegation of legislative authority were carefully defined in a recent case by the United States Supreme Court (*Panama Refining Co. et al.* v. *Ryan et al.*, Supreme Court R. 241, decided Jan. 7, 1935). I do not believe, for example, in the soundness of the policy under which in S. 1715 the board of directors of the F. D. I. C., who are not required to have had banking experience, are given the power to define "unsafe or unsound practices" in banks, and, in addition to exercising this legislative power, are made investi-

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gators, prosecutors, witnesses, jury, judge, and executioner. I do not believe in the broad power conferred upon this same board of directors on page 18, lines 5–7 of S 1715, to make any rule or regulation which it may think necessary to carry out whatever it may conceive to be the meaning of any provision of section 12 (A). I do believe that the existing provisions of the sixth and seventh clauses of subsection (J), already give to this board all the powers in those respects which it is necessary and proper that the board should have. Both bills are filled with provisions of this character, but perhaps the most amusing is that in lines 15 and 17, on page 73, of H. R. 7617, where the Reserve Board is authorized to define the United States. This is not a fantastic pleansantry, but an actual power which would, of necessity, be exercised if the bill, as passed by the House, becomes law.

Senator GLASS. To define what?

Mr. STEELE. The United States.

Senator COUZENS. That is too deep for me.

Senator MCADOO. That would be easy to do.

Mr. STEELE. It is on page 73, in lines 16 and 17. It reads [reading]:

> In estimating the reserve balances required by this act, member banks may deduct from the amount of their gross demand deposits the amounts of balances due from other banks (except Federal Reserve banks and foreign banks) and cash items in process of collection payable immediately upon presentation in the United States within the meaning of these terms as defined by the Federal Reserve Board.

They must decide whether Guam, the Philippine Islands, Puerto Rico, the District of Columbia, and so forth, are parts of the United States or not.

The final point to which I shall refer is the argument that the executive department and the Reserve Board already have most of the powers to which objection is now being made. The obvious inquiry instantly arises as to why these changes are sought if the powers already exist. But that is a superficial reply. The fact is that the argument suggested is not based upon fact and is completely misleading in its implications.

It is true that the Board, under clause (f) of section 11 of the Federal Reserve Act, has power to suspend or remove any officer or director of any Federal Reserve bank, but such removal can be only for cause, while the Board and the officers selected by them administer the bank's affairs with the aid of employees whom they select and who are responsible to them alone.

It is true, as has been pointed out, that in an emergency statutory provisions as to reserves may be suspended, but only in an emergency the existence of which has been ascertained in a manner prescribed by statute and only for its duration.

It is true that the Board claims the power to initiate changes in rediscount rates and to compel the Reserve banks to adopt them, but this power is disputed and the question has never been finally settled.

It is probably true that a President would have it in his power in divers ways to compel the resignation of an unsatisfactory member of the Federal Reserve Board. It has been pointed out that there is a decision of the Supreme Court which appears to justify the claim that a President may remove, without the consent of the Sen-

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ate, any officer he has appointed, even though the consent of the Senate has been necessary for the appointment, but neither this nor any other of the powers just mentioned could, under present law, be arbitrarily exercised without sharp and immediate challenge, both from the public and from the two Houses of Congress. It is a long step for Congress deliberately to adopt amendments which would place the existence of powers like these definitely beyond question. It is earnestly to be hoped that it will not do so.

Ten years ago David F. Houston, who was Secretary of Treasury in the Cabinet of Woodrow Wilson, wrote a book entitled "Eight Years With Wilson's Cabinet." One of his chapters was devoted to the Federal Reserve System, which was one of Wilson's great achievements. In closing his discussion of this topic, Mr. Houston said:

> Whether the System will survive is, of course, a question. Whether it can be kept out of politics or politics can be kept out of it remains to be seen. The ignorant and the demagogues we still have with us. The test will come in some period of great stress. If prices should fall and many people, for causes over which banks have no control, should come to grief, there will be those who will ascribe their ills to evil designs of those who direct the System. It will be pictured as the monster "who plays upon the hopes and fears of the masses of the plain people." We shall then see what we shall see. We shall see whether we have developed enough popular intelligence and courageous leadership to save us from our folly. We shall see whether we have learned anything from experience.

Senator McAdoo. We have 12 Federal Reserve banks, and all the note issues of those banks run in the name of the United States of America, which is responsible primarily, I contend. My distinguished colleague here [Senator Glass] does not agree with me. All the notes now run in the name of the United States. Suppose the name of the Government of the United States was not on any Federal Reserve notes, and every note was issued by the Federal Reserve banks, secured only by their assets or a gold-reserve backing, do you think those notes of the banks, current at par in all parts of the United States, would be just as good as the others?

Mr. Steele. I think they would, so long as we had a gold dollar of fixed and unchanging value.

Senator McAdoo. I know; but you cannot assume ideal conditions. I am talking about practical things. The Government of the United States has a right to change the value of the dollar any time it pleases, the gold content of the dollar.

Mr. Steele. It has the power.

Senator Glass. It has done it once in 150 years. It might do it in the next 24 hours.

Senator McAdoo. But what I am getting at is, under our system of government, and knowing that the Congress has the right to exercise that power from time to time, if notes were issued only by Federal Reserve banks upon their own assets, having a gold reserve prescribed by Congress, do you think they would pass all over the country at full value equally with each other?

Mr. Steele. I think they would.

Senator McAdoo. Do you think a Federal Reserve bank note, for instance, of some small district would be regarded as equally strong as the note of the New York district?

Senator Glass. Under the existing law the 12 Federal Reserve banks are equally responsible for their notes issued by any Federal Reserve bank. It is not a mere regional proposition.

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Senator McAdoo. I understand that; but I am asking a hypothetical question.

Mr. Steele. Obviously, Senator, I am speculating, but my belief is that they would. I think that the whole history of the original enactment of the act shows that that provision under which the Government became liable was put in late and put in to satisfy a small group——

Senator McAdoo. I know about the history of that. That is not quite correct.

Senator Couzens. Do you not think it is advisable that the Government should be behind this currency?

Mr. Steele. Yes; I think I would say advisable, but not necessary.

Senator Couzens. I am not talking about that. I am talking about the advisability.

Mr. Steele. I think it simplifies it.

Senator Glass. I think it is the only blot on the Federal Reserve Act as enacted.

Senator McAdoo. This may or may not be material, but here is the point that I have in mind. You refer to the banking history of the United States. After the destruction of the second United States Bank, the only central bank we had—we had one and then we had two, and that was destroyed by Jackson—we had banks all over the country, State banks.

As to the currency issued by those banks, you always had to have an investigation made before you knew whether you should take it at par or not. That continued up to the time we had the National Bank Act during the Civil War, and then in order to make it absolutely clear to the people that every note in the form of money which they received was good, no matter in what part of the country it circulated, the Government of the United States put its credit back of the currency. Since that time all currencies of the United States run in the name of the Government of the United States, so that our money is good everywhere. If we were to revert to the old system, inevitably, especially in times of stress, we would begin scrutinizing bank issues and we would not know whether they were good or not. Therefore I regard it as of primary importance that the full faith and credit of the United States should be on all currencies of the United States as well as on coin. Coin, of course, has an intrinsic value to a certain extent, and the stamp of the Government shows that it is of the requisite weight and fineness. So I would always be much averse to having any kind of a reversion to the old discredited system of letting banks issue their own currency, for we would not know what sort of money we were getting.

Senator Glass. I just want to ask one question, and I regret that I did not ask it of every witness that we have had before the committee.

Senator McAdoo. You might recall them.

Senator Glass. It is unnecessary to do that. I know what the answer would be.

Have you found a single intelligent banker in the United States or a single business man who understands the philosophy and the mechanism of banking who is in favor of this bill?

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Mr. STEELE. Personally I have not talked to anybody who is in favor of it.

Senator MCADOO. Have you talked to any intelligent people?

Mr. STEELE. Surely I have. I have talked with a great many bankers up in my district, the First Federal Reserve District.

Senator GLASS. Have you found any of them in favor of title II of this bill?

Mr. STEELE. Not one that I have talked with.

Senator MCADOO. Are they just as unanimously against this bill as they were against the Federal Reserve Act?

Mr. STEELE. Oh, no. There are a great many parts of title III that everybody is anxious to have enacted.

Senator GLASS. I confined my question to title II.

(The statement referred to and submitted by the witness is here printed in full, as follows:)

STATEMENT OF THOMAS M. STEELE, MEMBER OF ADVISORY COUNCIL FROM FIRST FEDERAL RESERVE DISTRICT; PRESIDENT FIRST NATIONAL BANK & TRUST CO., OF NEW HAVEN, CONN.

On April 22, 1935, the Federal Advisory Council filed with the chairmen of the Committees on Banking and Currency of the Senate and the House of Representatives a statement on the Banking Act of 1935 which had been prepared at the request of the Federal Reserve Board and previously filed with its Governor. Before preparing its final draft the Council had conferred at length with the Governor and adopted some of his suggestions, but in many important respects had found itself unable to concur with his viewpoint. The report so filed was the unanimous report of the Council.

Thereafter, on May 9, a radically revised draft of H. R. 5357, known as "H. R. 7617", was, with some minor changes, passed by the House of Representatives.

The Council has had no opportunity to meet as a body and discuss H. R. 7617. A single member, in commenting upon new matter contained in this bill, or upon portions of the earlier draft materially amended before passage, must speak only as an individual. The same is true of any comment with respect to matters in the two earlier drafts not touched upon in the Council's statement.

So far as title I is concerned, the Council has expressed approval, but has recommended a limited number of amendments, largely in the interest of clarity and certainty. The reasons for them are fully set forth in the report. Briefly stated, they are as follows:

(1) Instead of an assessment on insured banks based on aggregate deposits as of the close of business on the last days of June and December, as provided in S. 1715 (p. 10, lines 10 and 11), it recommends (pp. 1 and 2 of its report) that assessments be based on the daily average of each 6 months. The provisions of H. R. 7617 (p. 11, lines 22 to 25), basing the assessment on the average for 1 day of each of 3 or more months, as designated by the directors of the Federal Deposit Insurance Corporation, is only a slight improvement and does not seem to meet the council's suggestion.

(2) The council suggests (p. 1 of its report) the insertion of a definition of total deposits to conform to the definition in section 323 of title III (S. 1715, p. 64, line 25 et seq.). This proposal is not met in H. R. 7617.

(3) The council asks (p. 1 of its report) that the directors of the Federal Deposit Insurance Corporation be given power from time to time to determine that there need be no assessment. H. R. 7617 not only fails to adopt this suggestion, but eliminates the provisions of S. 1715 (p. 10, lines 11–13) which allow either a lower rate or a refund when the Federal Deposit Insurance Corporation finds this warranted, and it increases the rate of assessment from one-twelfth of 1 percent to one-eighth of 1 percent. At the present perilously low rate of current earnings for banks in general, this increase of 50 percent in the assessment rate would be a serious matter. The rate of one-twelfth of 1 percent in S. 1715 was arrived at after careful investigation and should stand.

(4) The council recommends (p. 2 of its report) a change in the language of S. 1715 (p. 12, line 24 et seq.) to bring the provisions concerning trust funds

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deposited in other insured banks into line with its suggestion to base assessments on daily average deposits. This point is not covered in H. R. 7617.

(5) The council proposes (p. 2 of its report) that changes be made in lines 16 and 24 on page 30 of S. 1715 so as to give an insured depositor 2 years, instead of 1 year, in which to make his claim. This suggestion is only partially met by H. R. 7617 (p. 34, line 16, and p. 35, line 2), which provides for a period of 18 months.

(6) The Council recommends (p. 3 of its report) that to avoid duplication of examination, the rights of the Board of Directors or the Federal Deposit Insurance Corporation be somewhat restricted by striking out in S. 1715 (p. 34, lines 17 and 18) the word "management" and the phrase "adequacy of service to borrowers." It would seem that this suggestion is met by H. R. 7617, which eliminates the entire paragraph.

(7) The Council objects to the provision of S. 1715 (p. 36, lines 3 to 7), which imposes heavy criminal liability upon an officer or director who, with or without guilty knowledge, participates in the declaration of a dividend while his bank is in default in the payment of an assessment. H. R. 7617 (p. 40, lines 8–17) substitutes an entirely new paragraph which eliminates this objectionable provision.

(8) The Council asks that the apparent intent of S. 1715 (sec. 22, clause 5, p. 36) which requires insured banks to carry certain insurance under regulations by the directors of the Federal Deposit Insurance Corporation, be clarified by inserting in line 21 the words "in such amounts" after the word "losses." Although H. R. 7617 (p. 41, lines 5–11) changes the language of S. 1715, it does not meet the Council's point.

I do not understand that the Council, although recommending the changes above referred to, intends to be understood as acquiescing in the general principle of insurance of bank deposits which was disapproved by it prior to the adoption of the Banking Act of 1933. I therefore desire at this point to subscribe to the objections to permanent insurance made by the Connecticut Bankers' Association in resolutions which have been filed with the committee, although I realize the futility of detailed argument on this point at the present stage of events. And I do not deny that the adoption of the insurance plan during an extremely critical period did much to revive confidence in the banking system, but I think that it should be a temporary, not a permanent, measure. Moreover, it is generally recognized that deposit insurance was inserted in the Banking Act of 1933 largely as a device to force all banks into the Federal Reserve System. Without arguing the desirability or the undesirability of accomplishing that end, the plan entirely loses its justification on this ground if the provisions of the present law which require all insured banks to become members of the System by July 1, 1937, or at least to apply for such membership, are to be eliminated. This, of course, will be the case should H. R. 7617 become law.

There are certain other new features of H. R. 7617 to which attention may be called at this point.

It oversimplifies the entrance of nonmember banks into the insurance system. It is unfair to forget that one-half of the surplus of the Federal Reserve banks was taken from them to provide capital for the Federal Deposit Insurance Corporation, that this surplus was earned on capital, all of which was supplied by the member banks, and on deposits belonging to the member banks. If nonmember banks are desirous of receiving what seem to them to be the benefits of the insurance plan without putting up any capital themselves, the standards of admission surely ought not to be lowered. H. R. 7617 (p. 11, lines 1–12) distinctly lowers the standards set by S. 1715 (p. 9, lines 17–25). This invitation to State banks to join the Federal Reserve System or, as nonmembers, to join the insurance system without conforming to the standards required of banks which are already members, appears at numerous points in H. R. 7617 as, for example, where it omits, at the end of title II, the requirements set up in S. 1715 (p. 51, lines 3–8), that new real-estate loans made by State member banks conform to the requirements for national banks. It appears also in S. 1715 (sec. 202, p. 41), where the Federal Deposit Insurance Corporation, in order to facilitate the entry of an insured nonmember bank into the Reserve System, is empowered to waive, in whole or in part, the requirements of the section as to capital. This same tendency appears at various points throughout title III. Why should the Comptroller, for example, be allowed to waive the requirement of a 20-percent surplus in the case of a State bank converting

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into a national bank (as provided in sec. 308, p. 55 of S. 1715), when a national bank cannot commence business without such surplus? Why should the Comptroller permit such a converting bank to retain and carry, at valuations determined by him, assets of such converting bank which do not conform to national bank requirements (as provided by sec. 311, p. 57 of S. 1715)? A careful examination and comparison of S. 1715 and H. R. 7617 will show the lengths to which H. R. 7617 particularly is ready to go in sacrificing soundness in order to secure unification.

With respect to title III, the Federal Advisory Council has given its cordial endorsement and has expressed the view that the enactment of this title into law will cure many operating defects at present existing. It has suggested but two changes.

(1) It has suggested (p. 15 of its report) that section 314 (p. 59, of S. 1715) be altered by the addition of a proviso that amounts paid into a fund for the retirement of preferred stock out of net earnings be deemed an addition to the surplus fund which must be built up prior to the declaration of dividends.

(2) The Council asks (p. 15 of its report) that at the end of the paragraph which is proposed by S. 1715 (sec. 328, p. 73) as a substitute for section 8–A of the Clayton Act, there be added words which will permit the Reserve Board to allow bank directors, officers, or employees to serve certain other financial institutions—not only when such classes of institutions are not in substantial competition, but also when, for other reasons, "such service is not incompatible with the public interest." The wording of this proposed alteration is taken direct from the present section 8 of the Clayton Act and seems a reasonable addition. Neither of the Council's suggestions is met by H. R. 7617.

While the Council has reported fully on the provisions of title II, in compliance with the request of the Federal Reserve Board, it has prefaced its discussion by expressing grave doubt whether there is any emergency existing at the present time, which makes it necessary to alter profoundly our present banking system without further careful consideration and it recommends that a detailed study be made analogous to the one which preceded the enactment of the Federal Reserve Act.

It has further stated in its report (p. 5) that if title II is proposed for enactment prior to the proposed study, it must disapprove it in its entirety certain specified amendmens are adopted.

It is a vital consideration that what is intended here is permanent legislation, devised to meet not only the present situation but to shape the banking system of the country for years to come. It is true, of course, that conditions have changed substantially since the Federal Reserve Act was adopted in 1913. But no impartial study has yet been made of just what these changes are, how permanent they may be, and what effect upon accepted banking principles they are likely to have. Neither can it be forgotten that an enormous mass of emergency legislation of various types has been enacted during the past 3 years. This legislation is uncoordinated, sometimes confusing, and altogether undigested. It includes, among other measures, the Banking Act of 1933, the Glass-Steagall emergency banking bill, the Federal Home Loan Bank Act, a number of amendments to section 5200 of the Revised Statutes, the Bank Conservation Act of 1933, the so-called "Thomas Amendment", numerous changes in the act creating the Reconstruction Finance Corporation, various amendments to the Farm Loan Act, and numerous laws creating such auxiliary agencies as the Home Owners' Loan Corporation, the Agricultural Credit Corporation, and others. The interplay of all these new organizations and their effect upon the Reserve System cannot be understood or intelligently considered without an exhaustive and impartial study made outside of, and apart from, the arenas of political strife. The Federal Reserve Act is the result of years of exhaustive study of the banking systems of the world, as well as of this country, and it is not an exaggeration to say that the situation today is much more involved and complex than was the situation facing the Congress in 1913. To make the revolutionary changes in title II proposed without a comprehensive and impartial study such as suggested, is without justification.

In its discussion the council has divided title II into three general subjects:

(1) The control of money, including the organizations set up to exercise this control and the powers to be employed by them.

(2) The liberalization of rediscount privileges.

(3) Real-estate loans.

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As to the control of money, the recommendations are:

(*a*) That the Secretary of the Treasury and the Comptroller cease to be members of the Federal Reserve Board.

(*b*) That the number of the Board be reduced to five upon the occurrence of the next vacancy.

(*c*) That the Governor and members of the Board be appointed for 15-year terms with compulsory retirement at the age of 70 years.

(*d*) That Governors of the Reserve banks be appointed subject to the approval of the Reserve Board for their first term and thereafter be subject to approval every 3 years. I join with the witnesses who have preceded me in urging that the approval of the Board be required only at the time of the original appointment.

(*e*) That the Open-Market Committee consist of 5 members of the Reserve Board and 4 of the Governors of the Reserve banks selected by the 12 Governors under procedure prescribed by them, and that this Committee be given power to fix discount rates, fix reserve percentages varying within statutory limits, and direct open-market policies. Various amendments for the purpose of effecting these proposals are detailed on pages 6 to 10 of the Council's statement.

As to the liberalization of rediscount privileges, the Council recommends the elimination of the so-called "sound-assets" clause proposed by section 206 (p. 45 of S. 1715) and proposes that section 10 (b) of the Federal Reserve Act, which has expired by limitation, be reenacted as permanent legislation with one change in phraseology (p. 10 of its report).

Closely allied with this subject is the proposal of S. 1715 (sec. 208, p. 46, et seq.) to eliminate those portions of the Federal Reserve Act which require the pledging of collateral for Federal Reserve notes. The Council objects to the elimination of the requirement for collateral and urges that the present provisions of the act in this respect be retained. It also recommends that the present emergency provision embodied in the proviso of the second paragraph of section 16 of the act, under which direct obligations of the United States may be accepted as collateral security for Federal Reserve notes until March 3, 1937, be amended by inserting a provision limiting the outstanding volume of notes so issued to $1,000,000,000, and providing for a tax thereon while any part of such amount is outstanding. The detailed changes necessary to effect such amendments are set out on pages 11 to 12 of the Council's statement.

As to real-estate loans, the Council has recognized the need of some effective private agency to finance real-estate requirements, but objects to the degree of liberalization provided for in section 210, pages 49 and 50, of S. 1715. The Council has recommended that loans be permitted up to 50 percent of actual value, but for a term not to exceed 5 years: *Provided, however*, That loans may be made up to 60 percent of actual value if they are made payable within 12 years, and if they provide for a reduction of principal in the amount of not less than 5 percent per year. It recommends, however, that the Federal Reserve banks be given somewhat broad discretionary power to restrict real-estate loans within their respective districts, but only within fixed statutory limits. Detailed amendments which would effect these recommendations are set out on page 13 of the Council's report.

Since it is unlikely that the convictions which have impelled the members of the Council to joint in these unanimous recommendations are precisely the same in the case of each member, the remaining portion of this memorandum must be regarded, except in its broad outlines, as an individual expression of opinion.

Title II of the Senate bill as drawn and the House bill as passed by that body involves a complete departure from the idea of the commercial banking system contemplated by the Federal Reserve Act. It encourages the rediscounting of nonliquid assets not merely in times of emergency, to which no one objects, but as a regular practice. In so doing it directly invites what has heretofore been considered unsound commercial banking; this partly upon the theory that the insurance of deposits makes liquidity of minor importance, and partly upon the theory that rediscountability is equivalent to liquidity. It makes "any sound assets", not defined except as a remote central body, inevitably subject to political influence, may from time to time define the term, eligible to serve as a basis for the Nation's currency.

It makes possible the issuance of currency under governmental pressure through the forced sale of bonds by the Treasury to the Reserve banks to meet fancied needs of Government for funds which it is not considered ex-

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pedient to raise by taxation and which cannot be borrowed from the savings of the people in a free market at rates which the Government is ready to pay. It ignores the fact that, aside from the preferred stock held by the Reconstruction Finance Corporation, which it is proposed under existing law the retire as soon as possible, the capital, surplus, and undivided profits of the member banks is private capital belonging to tens of thousands of individual stockholders; and, aside from the present abnormal Government deposits, the billions of dollars of deposits in these banks belong to individual depositors. To all intents and purposes it socializes all these funds. It ignores the fact that the member banks, by virtue of having supplied all the capital of the Federal Reserve banks, by virtue of the deposits constituting their legal reserves, through their liability to further assessment for capital stock and through their double liability on their stock subscriptions, have a vital interest in the soundness of management of the Reserve banks of their several districts and a right to a voice in the management of the resources of these banks. It takes away, by various devices, all real voice of the Reserve banks in open-market operations and rediscount rates, places these vital subjects, together with control over reserve percentages of member banks, entirely in the Federal Reserve Board and at the same time tightens the influence of the executive branch of the Government over the conduct of the affairs of the Board itself.

It is submitted that even though one grant that the Federal Reserve System is loosely organized, nevertheless to allow the member banks and the 12 Reserve banks to safeguard the funds entrusted to their care by stockholders and depositors, and to administer them according to the varying needs of their customers and their respective localities, is far more likely to be compatible with business stability, the interests of commerce, industry, and agriculture and the general public welfare than is administration by politically appointed agents centralized in Washington. Impartial administration is humanly impossible when the course of those nominally in control may so easily be influenced by considerations of political expediency or by current theories as to political or social needs, as is bound to be the case under any system dominated by current political appointees.

It is argued that since the present law makes the chairmen of the Reserve banks representatives of the Federal Reserve Board, there is no tightening of control or loss of local autonomy when the office of chairman is abolished and the governor becomes chairman under similar control by the Board. Under the provisions of existing law, however (Federal Reserve Act, sec. 4), the chairman of each Reserve bank must have been at least 2 years a resident of his district and must be "a person of tested banking experience." Under section 201 of S. 1715 (p. 38, lines 21–23), neither of those requirements is now to be applied to either governor or vice governor. In each of the 12 districts, therefore, the Federal Reserve Board might have power to control the installation of two dominant representatives—both strangers—with no practical banking knowledge, their appointment thus dictated by a board whose members may also be without banking experience, and whose only prescribed qualifications are capacity to participate in the formulation of national, economic, and monetary policies.

Under existing law, moreover, the regional boards of directors are authorized (Federal Reserve Act, sec. 4) to appoint their own officers and employees, with a limited few exceptions, to define their duties, and to dismiss them at pleasure; but section 201 of S. 1715 (p. 39, lines 20 and 21) makes all officers and employees of the regional banks directly responsible to the respective governors alone. In this situation it cannot possibly be said that any real autonomy is left with the regional banks. Even nominal autonomy is greatly restricted by the provisions (S. 1715, p. 40, lines 17–32) denying class A and class B directors, who are direct representatives of the member banks, the right to serve for more than two consecutive terms, no matter how desirous the stockholding member banks may be of having them continue in office. It is safe to say that almost no head of a well-managed bank or of any other business would wish so arbitrary a restriction to apply in the case of his own corporation. The reduced status of the directors of the regional banks in the minds of some, at least, of the proponents of this legislation is seen in the interpretation put upon the act by the H. R. Report No. 742 accompanying H. R. 7617. In commenting upon section 204 (S. 1715, p, 43, line 24, et. seq.), which authorizes the Reserve Board to assign to "representatives of the Board" the performance of duties under

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rules and regulations, H. R. Report No. 742 states, at the bottom of page 8, that "one of the important consequences of these provisions would be that the Board would have authority to assign to the governor or board of directors of a Federal Reserve bank" certain duties. How long, it may be asked, have the directors of the Reserve banks been regarded as representatives of the Reserve Board?

The power of any current administration to dominate completely the personnel of the Reserve Board under the provisions of S. 1715 (p. 43, line 11–21) has been frequently discussed before this committee. It is no answer to say that the drastic power conferred would never be exercised. It is axiomatic that a legislative body should never grant to an executive a broad authority in reliance upon a belief that he will be too benign to act under it.

The possible extension of political control is further seen in the proposed provisions governing the open-market committee. S. 1715 (sec. 205, p. 44) gives minority representation to two governors of the Reserve banks elected for 1-year terms under procedure prescribed by regulations of the Reserve Board. Regardless of the best intentions, this means power to deprive the Reserve banks of any effective representation. H. R. 7617 (sec. 205, p. 51 et seq.) gives the Reserve banks merely an advisory committee of four governors with no voting power, real authority resting solely with the Board. Under both bills this committee is entrusted with vast powers.

Something can be said for a more centralized responsibility for the proper performance of the duties now performed by the open-market committee, but little has been said, or can be said, for depriving the Reserve banks of all effective voice in the use of the funds belonging to them and to the member banks. Any investment of the assets of a Reserve bank, whether in Government bonds or otherwise, is an investment of the property of member banks. If such investment is the voluntary act of the board of directors, representatives of the member banks, they have no cause of complaint. But if such investment can be commanded by a central board upon which member banks are not represented and contrary to the will of their representatives on the boards of the Reserve banks it is, in substance, taking away their property without their consent and is contrary to fundamental American concepts.

The plan proposed by the Advisory Council is for an open-market committee of 9; 5 being the members of the smaller Reserve Board which is proposed and 4 being governors of the Reserve banks selected by the 12 governors in accordance with procedure prescribed by them, their terms being so arranged as to give real continuity of service. It is a sane plan, insuring wise administration by a dignified and powerful body worthy of public confidence, so constituted as to enjoy real freedom of action, to which the vast powers proposed to be centralized might be entrusted with safety, alike to the interests of the public, the Reserve banks and the stockholders and depositors of the member banks. No satisfactory reason has been advanced why this suggestion should not be complied with. The only apparent result of either the Senate plan or the House plan would be to turn the banking system of the country into machinery for making the issue of fiat money so simple as to invite disaster.

It is stated, and it must be believed even without statement, that there is no desire for runaway inflation on the part of the present administration. Of course this is true. No government ever willfully brings ruin upon its own people. But certain courses, if followed too long, lead to conditions under which no government can resist the temptation to try this desperate course. It has been so in all history. Economic law respects no age or era and no international boundaries. If we follow courses which in all human experience have proved disastrous, disaster is likewise inevitable here. It might well prove tragic for Congress to create machinery so clearly adapted to the ends of inflation.

It cannot be forgotten in this connection that the so-called "statement of objectives" which has been made a part of section 24 of H. R. 7617 as it passed the House (p. 51) contemplates a profound change in the considerations which are henceforth to guide the open-market committee. I understand that a similar amendment has been offered to the Senate bill. A comparison between this statement of objectives and the governing principles of the present law, as expressed in clause (c) of section 12–A of the Reserve Act will clearly indicate the far-reaching possibilities of the new proposal. There is not a business in the United States; there is not a man, woman, or

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child who has a dollar of his own or who is working for a solvent employer who is not potentially affected by it. Its far-reaching implications could not be overstated. It should not be tossed lightly into legislation enacted under pressure either of time or circumstances, but should be adopted, if at all, only after a study of the type which the Council has recommended.

With respect to the so-called "sound assets" clause (S. 1715, sec. 206, pp. 45–46) but little argument should be necessary. It is naive to profess that this provision would not encourage banks to adopt—perhaps quite unconsciously—a greater laxity in loaning policies, and they have short memories indeed who do not recall the part played in bringing on the banking crisis by the mass of frozen long-term loans and investments which had crept into the system. One of the important motives behind the Banking Act of 1933 was to rid the banks of just that character of assets. We are dealing with human nature and it is certainty that with this provision in the law it would not only be more difficult for individual banks to decline to make slow loans which they would hope could be rediscounted if necessary, but would also be more difficult for the Reserve banks to decline to grant such rediscounts. It would with the experience of the banking crisis fresh in mind that the Federal Reserve Board, in making its annual report of May 28, 1934—just a year ago—and when the personnel of the Board was exactly the same as at present, with the exception of the Governor, recommended, without a dissenting voice, that section 10 (b) of the Reserve act be reenacted in permanent form and stated their reasons as follows: I quote from page 56 of the report:

"In view of the fact that this section has enabled the Federal Reserve banks to render valuable assistance to member banks in difficulties, without impairing the liquidity of the assets of the Federal Reserve banks, it is believed that the authority of the section should be made permanent. However, it is the view of the Board that loans should not be made thereunder except during periods of a banking emergency when member banks may be in unusual need of assistance and that the section should be enacted in permanent form only if an appropriate safeguard is incorporated therein to enable the Board to prevent an undue use of such credit facilities. The Board recommends, therefore, that the section be enacted in permanent form with an amendment providing that loans may not be made by Federal Reserve banks under the provisions of the said section except pursuant to authority granted by the Federal Reserve Board upon the affirmative vote of not less than five members and under rules and regulations prescribed by the Federal Reserve Board."

This recent and clear recommendation of the Federal Reserve Board for the reenactment of section 10 (b) for use solely in emergencies the Council now reiterates. There is no evidence that the Board itself has changed its attitude.

Closely tied in with the question of rediscounting "any sound assets", is the recommendation of the Council that the present provisions of law respecting collateral behind Federal Reserve notes be retained. The act, after exhaustive study, adopted the principle that Federal Reserve notes were to have definite security behind them. The literature of the period shows conclusively that those notes were regarded as backed by specific security and that the obligation of the United States was a secondary consideration. Senate Document No. 117 of the Sixty-third Congress, first session, accompanying the currency bill, states specifically that "the primary security" of the currency was to be "short-time commercial notes" followed by the resources of the Reserve banks, the double liability of the member banks, the gold reserves and finally the credit of the Government. "The history of the world", it is stated, "offers no case where any currency note ever had behind it such a volume of security." It is indeed a far cry from this situation to one where Dr. Kemmerer can say that the Government debt is secured by notes and the notes secured by Government debt. It is true that Reserve notes are now secured by a lien upon all the assets of the Reserve banks and that therefore the pledge of specific assets does not add to the security behind them. But we are dealing with human nature and with human psychology and no amount of logic can alter the fact that the necessity of setting aside definite collateral does, in practice, operate as a check and a caution signal and that the retention of these safeguards would give added protection against an expansion of currency upon the basis of second-rate assets.

I shall touch briefly on but two more points: The first is the disquieting increase in bureaucratic control under both the Senate and the House bills, although vastly greater under the House bill. It is true that amid modern

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complexities of Government a certain amount of details must necessarily be left to administrative bodies, but the proper limits of such delegation of legislative authority were carefully defined in a recent case by the United States Supreme Court (*Panama Refining Co. et al.* v. *Ryan et al.*, Sup. Ct. R. 241, decided Jan. 7, 1935). I do not believe, for example, in the soundness of the policy under which in S. 1715 (p. 13, line 15 et seq.) the board of directors of the Federal Deposit Insurance Corporation, who are not required to have had banking experience, are given the power to define "unsafe or unsound practices" in banks, and, in addition to exercising this legislative power, are made investigators, prosecutors, witnesses, jury, judge, and executioner. I do not believe in the broad power conferred upon this same board of directors on page 18, lines 5–7 of S. 1715, to make any rule or regulation which it may think necessary to carry out whatever it may conceive to be the meaning of any provision of sec. 12-A. I do believe that the existing provisions of the sixth and seventh clauses of subsection (J), already give to this board all the powers in those respects which it is necessary and proper that the board should have. Both bills are filled with provisions of this character but perhaps the most amusing is that in lines 15 and 17 on page 73 of H. R. 7617 where the Reserve Board is authorized to define the United States. This is not a fantastic pleasantry but an actual power which would, of necessity, be exercised, if the bill, as passed by the House, becomes law.

The final point to which I shall refer is the argument that the Executive Department and the Reserve Board already have most of the powers to which objection is now being made. The obvious inquiry instantly arises as to why these changes are sought if the powers already exist. But that is a superficial reply. The fact is that the argument suggested is not based upon fact and is completely misleading in its implications.

It is true that the Board, under clause (f) of section 11 of the Federal Reserve Act, has power to suspend or remove any officer or director of any Federal Reserve bank, but such removal can be only for cause, while the Board and the officers selected by them administer the bank's affairs with the aid of employees whom they select and who are responsible to them alone.

It is true, as has been pointed out, that, in an emergency, statutory provisions as to reserves may be suspendid, but only in an emergency, the existence of which has been ascertained in a manner prescribed by statute and only for its duration.

It is true that the Board claims the power to initiate changes in rediscount rates and to compel the Reserve banks to adopt them, but this power is disputed and the question has never been finally settled.

It is probably true that a President would have it in his power in divers ways to compel the resignation of an unsatisfactory member of the Federal Reserve Board. It has been pointed out that there is a decision of the Supreme Court which appears to justify the claim that a President may remove, without the consent of the Senate, any officer he has appointed, even though the consent of the Senate has been necessary for the appointment, but neither this nor any other of the powers just mentioned could, under present law, be arbitrarily exercised without sharp and immediate challenge—both from the public and from the two Houses of Congress. It is a long step for Congress deliberately to adopt amendments which would place the existence of powers like these definitely beyond question. It is earnestly to be hoped that it will not do so.

Ten years ago David F. Houston, who was Secretary of the Treasury in the Cabinet of Woodrow Wilson, wrote a book entitled "Eight Years with Wilson's Cabinet." One of his chapters was devoted to the Federal Reserve System, which was one of Wilson's great achievements. In closing his discussion of this topic, Mr. Houston said: "Whether the System will survive is, of course, a question. Whether it can be kept out of politics or politics can be kept out of it remains to be seen. The ignorant and the demagogues we still have with us. The test will come in some period of great stress. If prices should fall and many people, for causes over which banks have no control, should come to grief, there will be those who will ascribe their ills to evil designs of those who direct the System. It will be pictured as the monster 'who plays upon the hopes and fears of the masses of the plain people.' We shall then see what we shall see. We shall see whether we have developed enough popular intelligence and courageous leadership to save us from our folly. We shall see whether we have learned anything from experience" (vol. I, p. 92).

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Senator GLASS. The subcommittee will adjourn, now, until tomorrow morning at 10:30. We will meet in the committee room of the Senate Committee on Banking and Currency, in the Senate Office Building.

(Whereupon, at 3:40 p. m., the subcommittee adjourned until tomorrow, Tuesday, May 21, 1935, at 10:35 a. m., to meet in the committee room of the Senate Committee on Banking and Currency in the Senate Office Building.)

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BANKING ACT OF 1935

TUESDAY, MAY 21, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON
BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met, pursuant to adjournment on yesterday, at 10:30 a. m., in room 301, Senate Office Building, Senator Carter Glass presiding.

Present: Senators Glass (chairman of the subcommittee), Bulkley, McAdoo, Townsend, and Couzens.

Senator GLASS. The committee will come to order. Gentlemen of the committee, we are to hear this morning representatives of the United Sates Chamber of Commerce.

Mr. Sweet, will you please come forward and take a seat at the table, opposite the committee reporter?

Mr. SWEET. Yes, sir.

Senator GLASS. Mr. Sweet, as you know, we have under consideration the banking bill, S. 1715, and I have understood that representatives of the United States Chamber of Commerce desired to present the views of the chamber. We will be very glad to hear from you.

STATEMENT OF WILLIAM L. SWEET, TREASURER AND GENERAL MANAGER OF THE RUMFORD CHEMICAL WORKS, RUMFORD, R. I.; CHAIRMAN OF A SPECIAL COMMITTEE ON BANKING LEGISLATION OF THE UNITED STATES CHAMBER OF COMMERCE

Mr. SWEET. Mr. Chairman: My name is William L. Sweet. I am treasurer and general manager of the Rumford Chemical Works, Rumford, R. I. My appearance today is as chairman of a special committee of the Chamber of Commerce of the United States, upon banking legislation.

The special committee was established by the directors of the chamber to study and present its findings upon the proposals for changes in the Federal Reserve Act that are contained in title II of the pending banking act of 1935.

It is my desire to state very briefly the steps which the chamber has taken looking toward the improved functioning of the American banking system and to present a statement outlining in general terms its position upon the pending banking act of 1935. With your permission I should like to introduce at the close of my remarks another member of the special committee, Mr. Frederic S. Snyder, to discuss in some detail the findings of the committee upon certain provisions of title II.

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The interest of the Chamber of Commerce of the United States in matters pertaining to the Federal Reserve and commercial banking systems is of long standing. One of the chamber's earliest referanda was upon the question of the establishment of the Federal Reserve System. As a result of that referendum the support of the business community was shown clearly to be back of the then pending Glass-Owen bill. You will recall that the business community took this position at a time when banking support of the measure was by no means unanimous. Indeed, it is not too much to say that by cooperation with the National Citizens League much public appreciation was developed by business men of the fundamental principles which you, Senator Glass, and your associates maintained should be written into the law. Since the passage of the Reserve Act numerous features of the banking system have been the subject of public reports by the national chamber. Many recommendations for improvement of banking laws and practices have had its strong support.

Shortly after the introduction of the proposed banking act of 1935 the finance department committee of the chamber reported to the board of directors upon title I of the bill that relates to insurance of bank deposits and title III that relates to technical revisions of banking laws. The finance department committee indicated that the provisions of titles I and III of the banking bill, in the main, reflected the considered judgment of public and banking officials as to desirable legislation. It expressed the opinion, however, that the significance of the proposals contained under title II were understood in commercial and industrial circles only to a limited extent and that these proposals would affect the interest of all, the customers of banks no less than the banks themselves.

The board of directors of the chamber accordingly urged that the commercial and industrial interests of America study the pending proposals without delay so as to be prepared to register their opinions upon the measure and upon the announced purposes underlying it. To aid such study the chamber distributed to its members and others a comprehensive analysis of the proposed banking act of 1935. I submit a copy of this analysis for insertion into the record, if your committee desires. It presents the gist of the main proposals of title II, the gist of pertinent provisions of present law, explanatory comment upon both sides of the controversial aspects, and modifications of the bill that had been advanced by others than the national chamber. The document also summarizes briefly the provisions of titles I and III.

Senator GLASS. That may be included in our record.

(The pamphlet entitled "The Proposed Banking Act of 1935, Analysis of Title II, and Summary of Other Provisions," will be found at the end of the day's proceedings.)

Mr. SWEET. The subsequent report of our special committee, entitled "Proposed changes in the Federal Reserve System", was sent to the members of your committee and widely distributed. I shall submit a copy now, for insertion in the record, if your committee should desire it.

Senator GLASS. That will be received for the record.

(The pamphlet entitled "Proposed changes in the Federal Reserve System: The provisions of Title II of the pending banking

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act of 1935, report of special committee", will be found at the end of the day's proceedings.)

Mr. SWEET. Based upon the committee's report and discussions of the pending banking bill at its annual meeting, the membership of the chamber adopted a statement of the chamber's position upon the bill. This statement is contained in a resolution adopted on May 2, a copy of which I shall submit for the record also if your committee desires.

Senator GLASS. We will be glad to have it for our record.

Mr. SWEET. I hand it to the committee reporter.

CHAMBER OF COMMERCE OF THE UNITED STATES—RESOLUTION ADOPTED AT THE TWENTY-THIRD ANNUAL MEETING, MAY 2, 1935

FEDERAL RESERVE SYSTEM

The Federal Reserve System from its inception has received the steadfast support of the Chamber of Commerce of the United States. We reaffirm our confidence in its fundamental principles. We urge that no change be made in the Federal Reserve Act except such as will supply further strength and usefulness to the present plan. It is vital that every necessary safeguard exist against partisanship in the control and operations of the System.

Proposals for substantial, even radical, changes in the Federal Reserve System are contained in title II of the pending banking legislation. These proposals are not based upon the collective judgment of the officials of the System or supported by a body of authoritative banking and business opinion. In the aggregate, the effects of their adoption in the form before the Senate or as reported to the House of Representatives would be to subject the operations of the System to a greatly increased danger of political domination. The measure provides for such concentration of power over reserve and commercial banking as would mean the establishment of a central bank mechanism that, under political control and influence, would necessarily destroy the present plan, which was approved by both political parties and the public and is based upon the maintenance of a system of regional reserve banks possessing a high degree of autonomy. The centralized control of credit resulting from such a fundamental change would amount to little short of political dictatorship over the individual deposits and credit of our people. The bill as drawn does not so much affect bankers as the depositors in banks.

Quickly conceived and hurriedly enacted changes of important features of our Federal Reserve System are profoundly disturbing. It is, therefore, urged that Congress at this session provide for a thoroughgoing consideration of the Federal Reserve System and for ascertainment of any changes which should be made for its improvement.

OTHER BANKING LEGISLATION

With the elimination from the pending bill of the provisions of title II, which we so earnestly believe should not be enacted, there would remain in the proposed Banking Act of 1935 the sections relating to insurance of bank deposits (contained in title I) and the sections that relate to a number of technical changes of banking law (contained in title III). The subject matter of the deposit-insurance provisions and of the technical amendments, having been evolved by officials of the Federal Deposit Insurance Corporation and the office of the Comptroller of the Currency in consultation with men of practical experience in banking and in business, are based upon demonstrated needs. The adoption of these provisions of the bill, with such minor modifications as congressional investigation may warrant, is reccommended.

Mr. SWEET. The chamber has been in receipt of many statements of opinion from business organizations and business men in support of its position and has received none in opposition to it.

With the permission of the committee, I should like now to introduce Mr. Frederic S. Snyder, of Boston, a member of the chamber's special committee on banking legislation, who will present our opin-

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ions and recommendations upon the more important provisions of title II.

I thank you.

Senator GLASS. All right, Mr. Sweet; we are glad to have had your views.

(Thereupon Mr. Sweet left the committee table.)

Senator GLASS. Mr. Snyder, will you come forward to the committee table and take a seat opposite the committee reporter?

STATEMENT OF FREDERIC S. SNYDER, BOSTON, MASS., A MEMBER OF THE SPECIAL COMMITTEE ON BANKING LEGISLATION OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. SNYDER. Mr. Chairman, I am Frederic S. Snyder, a resident of Boston, recently retired after 40 years of active business, mainly in food packing and processing. If it be of moment, I might mention that for 3 years I was chairman of the board of the Institute of American Meat Packers and for a similar period president of the Boston Chamber of Commerce. I have never been an officer of a bank, although I have held directorships and now am a trustee of two savings banks and of a few estates and trusts.

I appear here primarily as a member of the special committee of representatives of commerce, agriculture, and industry, which was appointed by the Chamber of Commerce of the United States to give consideration to the proposals in title II of the proposed Banking Act of 1935 in the form it was introduced and as now pending before your committee. I shall make some references, however, to the provisions of this title as passed by the House.

I desire to make it clear that I am a business man who happens to have given some thought to banking questions generally, with special attention to some of the main features of title II of this bill. In other words, I am not a technician in banking, a money theorist, nor an administrator of banking affairs. On the other hand, I have had many years of experience as a depositor, customer, and borrower of banks and have been called upon to consider with bankers and legislators at times the businessman's conception of good banking. While I profess no profound knowledge of the technique of the operations of Reserve banks, for more than 20 years I have followed the development of thought in business circles upon a number of phases of reserve banking.

My main presentation will be addressed to some of the principal features of title II. It will develop the inadvisability of approving them if the credit needs of commerce, agriculture, and industry are to be met in a proper manner, and if confidence in our monetary and credit mechanism is to be felt in business circles, and thus furnish the basis for decisions to venture in business enterprise in aid of economic recovery.

We have come to regard certain features of the structure, powers, policies, and practices of reserve banking as fundamentals. These would be seriously affected by more than 1 of the 10 sections of title II, many of the provisions of which are interrelated. For ease of reference, however, and with a minimum review of these features, my presentation will follow the order of the provisions of the bill.

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First, with reference to officers of Reserve banks: In section 201 the principal points to which we wish to address some attention concern the selection of the governors of the Reserve banks and the prohibition upon directors of these banks serving more than 6 consecutive years.

It is provided in the Senate bill that before taking office the governor of a Reserve bank, elected annually by the local board, must have the approval each year of the Federal Reserve Board. In the bill as passed by the House such approval would be required each 3 years.

The minor circumstances that the offices of governor and chairman in each bank would be combined and that the duties of the Federal Reserve agent would be assigned to a person designated by the Federal Reserve Board instead of placed with the present chairman and agent are insufficient justification, in our judgment, for bringing the governor and vice governor of each Reserve bank closely under the domination of the Board at Washington.

Any man worthy of the office of governor of a Reserve bank, particularly if a form of career service is to be developed, would be selected by the directors of a Reserve bank with a view to his fitness for serving for a period of years. If the governor is to be simply an agent of the Federal Reserve Board and his tenure of office depends upon his continuing to satisfy that Board, it will tend to make him supine and a mere subordinate.

With respect to district matters or questions affecting the Federal Reserve System generally, he would be looking over his shoulder at Washington in endeavoring to decide what effect his opinions and actions, during the year or during the 3-year period, would have upon his ability to retain his office. He would have two immediate groups of bosses, one the local board of directors which elects him annually, and the Washington board which would have the power each year or each 3 years to disapprove of his continuing in office.

This feature of the bill, combined with certain others which I shall mention later, would tend to interfere with or destroy the exercise of reasonable autonomy by the directors of the Reserve banks if, as would seem inevitable, the governor would become in fact the agent of the Federal Reserve Board.

We strongly urge that it would be preferable to make no change in the present set-up in this respect, than to adopt either the provisions as passed by the House or the one in the Senate bill. If the Congress, however, is determined upon a change, we recommend that the directors of the Reserve bank be permitted freedom to select the governor, as the chief executive officer, the vice governor, and subordinates, and any requirement that the governor and vice governor selected by such directors must be approved by the Federal Reserve Board at Washington should apply only to any new incumbents of those offices.

As to the limitation that directors of Reserve banks may serve only 6 consecutive years, in our judgment, it would operate as a practical matter, mainly to curtail effective representation in the Reserve banks of the commercial, agricultural, and industrial interests of the respective districts.

It has been asserted that some of the Reserve banks now limit the periods of service of the class B directors. We do not find that

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to be the case. It is true that in some of the districts the class A or banker directors are limited to one or two terms of 3 years. The class B or business directors, however, are no so limited and, in our judgment, should not be.

It will be recalled that under the law these men may not be officers, directors, or employees of any bank. Because of the nature of the operations of the Reserve banks and the complex business and credit situations in the Reserve districts, these representatives of business and agriculture require a considerable service upon the board of a Reserve bank to fit them to represent adequately the business and agricultural interests of their sections in a manner that will regard public welfare regionally and nationally.

Under the present arrangement of three classes of directors there is a balanced plan of representation in each Reserve bank. It requires substantial agreement between the appointees of the Federal Government, the locally elected representatives of commerce, agriculture, and industry, and the locally elected representatives of the member banks. We do not accept the reasoning that, since the Federal Reserve Board would relinquish the appointment of the chairman, and since the governor would be elected by the local board, this would in fact increase the autonomy of the regional Reserve banks. If the chief executive officers who are given control under the bill of all the bank's employees become in fact the agents of the Washington Board, and if the familiarity with System affairs and the independent spirit of the business directors as a class are lessened through relatively short periods of service, the whole regional bank could become in fact a mere subordinate agency of the Federal Reserve Board.

As will be developed later with reference to the power of the regional banks with respect to open-market operations, rediscount rates and other matters, the principal features of the bill would tend to make the System a central bank, in fact, with the regional Reserve banks relegated to the status of branches. It would be a central bank with a mere facade of a system of regional branches and subbranches.

We urge the Congress, even if it limits the service of class A directors, to permit the class B directors to serve without limitations on the number of terms they may be elected. It would seem that any necessary adjustments in the Reserve banks with respect to class B directors, or, for that matter, with respect to the class A directors, should and could be made without statutory limitation. In any event it is to be hoped that the experience and wise counsel of class B directors who have served most usefully over a period of years will not be sacrificed.

With reference to requirements for membership in the Reserve System: In section 202, the Federal Reserve Board would be granted discretion to waive in whole or in part the capital requirements of banks for membership in the Federal Reserve System, in the case of any nonmember bank with deposits insured by the Federal Deposit Insurance Corporation, provided the bank made application for membership prior to July 1, 1937. The bank, however, would be obliged to comply with the present capital requirements within such period after its admission as might be designated by the Federal Reserve Board.

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Under the bill as passed by the House complete discretion would be granted to the Federal Reserve Board to waive all requirements imposed by statute or otherwise as a condition to admitting insured nonmember banks to membership in the Federal Reserve System. The Board, however, would be authorized to require such a bank to increase its capital to such amount as the Board might deem necessary, but not to exceed the amount required by the National Banking Act, within such period as the Board might prescribe. The House bill, moreover, omits any requirement that all insured banks must become members of the Federal Reserve System.

It is to be recognized that many of the insured banks do not now possess sufficient capital to meet present requirements for admission into the Federal Reserve System. These requirements are that an applying bank must have paid-up, unimpaired capital sufficient to enable it to become a national bank in the place in which it is situated—the minimum being $50,000—except as to certain State banks and trust companies located in communities of 6,000 population or less, which possess capital of $25,000 or more. At the same time there is some demand in Congress and elsewhere that there be omitted any requirement that nonmember banks must joint the Federal Reserve System as a requirement for deposit insurance, or else that the time limit be extended somewhat beyond July 1, 1937. If such views should prevail in Congress, the urgency of changing the present requirements for admission into the Federal Reserve System would not exist.

We support the proposition that every bank doing a commercial business should ultimately become a member of the Federal Reserve System. It is believed that this would serve to produce desirable uniformity in commercial bank policies and practices and greater safety for depositors. As desirable as it may be, however, to have all commercial banks come into the membership of the Federal Reserve System, proper standards of membership must be maintained if the benefits of a uniform system are not to become illusory.

If banks are once admitted with no statutory provisions that they must reach specified standards as to capital and surplus within a reasonable period, it will be difficult to compel them to increase their capital funds after admission to the System. It is of considerable importance to note at this point that under another provision of the pending bill member banks of the Reserve System could be permitted to present for rediscount longer-term loans than allowed at present. If the assets of the member banks should more generally change in character to longer maturities, conservative practice would require that many banks increase their capital funds above the amounts now possessed.

We feel it to be advisable, therefore, that Congress insist upon the maintenance of the standards for admission to the System that are set out in the Federal Reserve Act. If some discretion be allowed for a period to admit insured banks without complying with these standards, the statute should prescribe that the standards be met within a reasonable period, say a few years.

With reference to membership of the Federal Reserve Board: In section 203 we desire to direct attention to four main provisions:

First, those affecting qualifications of appointive members of the Federal Reserve Board; second, the salaries of Board members;

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third, retirement allowances for Board members; and fourth, the term of offices of Governor and Vice Governor of the Federal Reserve Board.

MEMBERSHIP QUALIFICATIONS

As to the qualification provisions it is to be noted that the bill would replace the present requirement of law that the six appointive members of the Federal Reserve Board must be chosen with due regard to "fair representation of the financial, agricultural, and commercial interests, and geographical divisions of the country." In place of that such Board members must be "well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies."

This change would seem to be unwise. It tends to magnify the emphasis to be placed upon economic and monetary policies and to subordinate what obviously should be a principal concern of the Federal Reserve Board and Reserve banks, namely, desirable credit conditions. There should be even greater emphasis than under present law upon the requirement that Board members be men of ripe practical experience. The Board has adequate resources and authority to engage such economic, monetary, and statistical experts as it may require. Such men as a rule would lack practical knowledge of credit conditions, the operations of the banking system, and the needs of commerce, agriculture, and industry, and the needs of the various divisions of the country.

Under the proposed amendment a board of theorists could be appointed, a board composed of farmers could be appointed, or a board composed wholly of bankers could be appointed. While it is not to be supposed that this power would be abused to such an extent, there would appear to be no wisdom in providing the power.

Even if it be granted that it is advisable to place greater emphasis upon Board members being well qualified by education to participate in the formulation of national economic and monetary policies, it would seem that the present requirements of law would permit the application of judgment with respect to those matters, instead of, with other provisions of the bill, opening the door to overemphasis upon theoretical knowledge of monetary policy.

Salaries: As to increased salaries for future members of the Board, it is to be noted that the House bill omits any increase in the salaries. The Senate bill would provide that future appointive members be given compensation annually at the same rate as members of the President's Cabinet, which now is $15,000.

We represent the point of view that an increase in the salary of Board members is desirable and believe that such salaries should compare more favorably with those paid to the administrative officers of the Reserve banks, some of whom receive $25,000 per year or more. It is obvious, however, that if provision is made for liberal retirement allowances, the salary schedule should be in proportion thereto.

We see nothing urgent, however, in providing $3,000 a year additional salary for future members of the Reserve Board. That would accomplish little. It would be better to leave this question, together

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with the proposal as to the qualification for membership upon the Board, the size of the Board, the methods of selecting its members, and other important modifications of the Reserve Act, to study of a thoroughly representative and bipartisan agency established to give adequate consideration to all proposals for changes in the Federal Reserve System.

Senator GLASS. On that point let me ask you a question: Are not the Banking and Currency Committees of the respective Houses of Congress bipartisan committees?

Mr. SNYDER. To a degree they are, Senator Glass, but in view of the history of investigations of the past, those upon which the Federal Reserve Act was founded, and others, included a study by many agencies, all of which finally culminated in the Congress, and the result was the eventual Federal Reserve Act without being able to exactly trace it.

Senator GLASS. Well, do you think we could get a commission—but perhaps I ought not to ask you the question.

Mr. SNYDER. I shall be glad to try to answer any questions, Senator Glass, after I have finished my statement.

Senator GLASS. I was going to ask if you thought we could get a commission more competent to deal with these questions than the members of this committee, who have had contact with and observation of the Federal Reserve System since its foundation almost.

Mr. SNYDER. I think my answer to that question would be this: All the best minds of the country, using that term in its proper sense, are glad to contribute all they have upon this subject to your committee, and as you know our legislative procedure has been for many years to have committees that heard everybody who was competent to be heard, and some perhaps who were not competent to be heard, upon the subject, and sift the evidence thus secured, and add their own judgment, and thereupon to attempt to found sound financial policies. I conceive that to be practically the history of the Federal Reserve Act as it now exists.

Senator GLASS. And you think that ought to be done in this instance, do you?

Mr. SNYDER. I think we should take time enough, in view of the very radical proposals for a change in the Federal Reserve System, to assemble the views of the best minds of the country, and get the best judgment we have upon the entire subject, and then finally act upon it in the Congress. To the most of us who represent business it does not seem humanly possible to do this work properly in the time remaining of this session of Congress.

Senator GLASS. That is what I have been trying to do as far as this subcommittee is concerned up to the present time. I quite agree with you that it would take a longer time if full consideration were given to the subject.

Mr. SNYDER. It would seem that the present need is not great enough with respect to title II of the bill, Senator Glass and members of the subcommittee, to hurry the matter to the point of——

Senator GLASS (interposing). What is the need of it at all?

Mr. SNYDER. Do you mean of title II of the bill?

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Senator GLASS. Yes.

Mr. SNYDER. There does not at the moment appear to be an urgency that is great, but at the same time it has always seemed to me that after every 5- or 10-year period we should reexamine the structure and ascertain whether or not anything of importance should be done. I think there is general approval of titles I and III of the bill, but that so far as title II of the bill is concerned it should be given further consideration.

May I now proceed?

Senator GLASS. Yes.

Senator MCADOO. Is the suggestion that a special commission be appointed to examine this title and make a report on it?

Mr. SNYDER. I think the suggestions we have to make are completely embodied in the statement I am now reading to you, and that it will cover the entire situation if I may be permitted to continue.

Senator MCADOO. You mean that you will discuss that matter as you go along?

Mr. SNYDER. Yes; I think it is fully covered in this prepared statement. And I am afraid I will waste your time by a double discussion in trying to answer questions in this way.

Senator MCADOO. All right. Go ahead.

Mr. SNYDER. As to retirement allowances: We support in principle the idea of adequate retirement allowances. It is to be noted, however, that the provisions of the Senate bill would operate to permit or induce the retirement of some of the present Board members. Combined with other amendments, such as the proposed changes in the qualifications for appointment of Board members and the extensive increase that would be made in the powers of the Federal Reserve Board, it would probably operate to permit of the early selection of a Board composed mainly of members in avowed sympathy with present directions of policy. The original act carefully provided for a staggering of the terms of the members of the first Board and full terms for their successors, in contemplation of a majority, at least, holding office beyond the 4-year term of the Executive.

With reference to term of officers of the Federal Reserve Board: Under the present bill the Governor and Vice Governor of the Federal Reserve Board would be appointed with a definite provision that they could hold those offices only as long as would be permitted by the President of the United States. Upon the termination of his designation as Governor, the incumbent would be deemed to have served his full term as a Board member.

Under the provisions of the House bill, the Governor, after resigning or being removed from that office, would be given the option to complete his term as a member of the Board or to retire from the Board without being subjected to the limitation that he may not reenter the banking business within 2 years. It would seem that of these two methods the House provision is preferable.

We believe, however, that it is highly inadvisable to provide in the Federal Reserve Act that the Governor of the Federal Reserve Board shall hold office only at the pleasure of the President. It would be clearly a symbol, in fact almost a requirement, that during his incumbency of the position of Governor of the Federal Reserve Board the man must please the President of the United States. Since

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the System has been established it appears that every President has taken the position that the six appointive members of the Reserve Board, including the Governor, while naturally expected to regard the opinion of the President, are not compelled by any circumstance to follow that opinion with respect to Federal Reserve matters.

Senator GLASS. That has not always been the case at all. Mr. Wilson refused to discuss Federal Reserve matters with the Federal Reserve Board. He said he had appointed a Board that he thought capable of considering these matters, and he refused to have them bring to him any problem that they had to consider.

Mr. SNYDER. And we hope, Mr. Chairman, that will continue.

Senator MCADOO. Well, it has not continued, although it would be a good thing if it had.

Mr. SNYDER. May I resume my statement?

Senator GLASS. Yes.

Mr. SNYDER. It must be noted that in the Banking Act of 1933 there was omission of the previous provision of law that the appointive members of the Federal Reserve Board could be removed only for cause. We believe this provision should be restored.

Senator GLASS. Somebody slipped it through, but I do not know who it was.

Senator MCADOO. Oh, they were always removable anyway. The President could remove anybody.

Senator GLASS. I know; but the original act required that they should be removed for cause.

Senator MCADOO. Yes; but the case could be the judgment of the President as to competency.

Senator GLASS. Certainly. You may continue, Mr. Snyder.

Mr. SNYDER. We believe further that in the interest of the President, of the Federal Reserve Board, and of the Governor of that Board, the latter should not be given a status identical to that of a member of the President's Cabinet. If given that status he will come to be considered a political adviser and one amenable to other political advisers. He and the President may be subjected to greater pressure from political and sectional interests to have them favor or oppose the adoption of particular policies in the System.

As a matter of practice, the Governors of the Federal Reserve Board who have differed strongly or believed they might differ strongly with the general trend of policy of an incoming administration have been willing to make way for new appointees. There is no practical necessity for the amendment at this time, and its adoption could easily lead to grave abuses in the operations of the Federal Reserve System.

Senator GLASS. Some years ago, under an administration that I need not specify, the President undertook to designate a Federal Reserve agent at Federal Reserve banks. I do not know how many he would have undertaken to designate had he been permitted to proceed, but I do know that he undertook to designate the agent at one of the Federal Reserve banks. Under this bill I ask you, Mr. Snyder, if it would not be possible for the Federal Reserve Board to designate every employee of Federal Reserve banks? And might that not result in tremendous political pressure of a partisan nature to fill the banks with—well, with what you can guess?

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Mr. SNYDER. Senator Glass, we think the word is stronger than "might." We think the word is more nearly "would." And in that connection I should like to support that statement by citing something which occurred in Washington and that bears upon that point, when I finish reading my statement.

Senator GLASS. You may proceed.

Mr. SNYDER. We believe that the present method of selecting the Governor of the Federal Reserve Board from among the appointive members of the Board and giving him as a member of the Board a 12-year term of office should be continued.

As to delegation of duties: We are disposed to pass over the minor section 204 which would permit the Federal Reserve Board to assign to designated members of the Board, or its officers or representatives, the performance of specific duties or functions of the Board that do not include the determination of policy or the exercise of powers which the law requires be exercised by a specified number of members of the Board. We comment, however, that the Federal Reserve Board has been operating for more than 20 years without such an amendment in the law, and although the detail placed upon the Board may have increased somewhat in recent years, this amendment is not of sufficient importance in itself to justify the adoption of title II.

As to open-market committee: We come in section 205 to one of the major features of the bill. It proposes far-reaching changes in the structure and powers of the open-market committee. It provides a committee composed of the Governor of the Federal Reserve Board, two members of that Board selected annually by it, and 2 governors of the Reserve banks selected annually by the governors of the 12 banks, in accordance with procedure to be prescribed by the Federal Reserve Board. This committee would be empowered to state in resolutions the policies that in its judgment should be followed with respect to purchases and sales of Government securities, bankers' bills, and other eligible paper by the Reserve banks, and those banks would be required to conform with the proposals. Such a committee would be empowered also to make recommendations regarding the rediscount rates of the Reserve banks.

As questionable as we believe this proposal to be in the Senate bill, we remark in passing that the provisions of the House bill which would place in the Federal Reserve Board itself those and greater powers, not only with respect to the open-market operations of the Reserve banks but with respect to changes in the rediscount rates and changes in the reserves required of member banks, would be still more questionable.

The Under Secretary of the Treasury, who apparently is discharging the function of fiscal officer, indicated to the House committee his objections to placing control of open-market operations in the Federal Reserve Board. He called attention to the fact that the Reserve banks are responsible for the funds employed in the open market and stated that they should be represented effectively upon a controlling committee by governors of their choice. It appears that the Secretary of the Treasury has since made a qualified endorsement of the idea that the open-market powers should rest in an independent board.

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The proposed amendment provides one of the main grounds of controversy. In addition to making the decisions of such an open-markt committee, as proposed in the Senate bill, or of the Federal Reserve Board, as proposed in the House bill, mandatory upon the Reserve banks, rather than advisory to them, the amendment would omit the present requirement of law that the time, character, and volume of open-market transactions must be "governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country." In our judgment, the latter requirement should be maintained.

In view of official statements respecting the intent to control the volume of money and credit through open-market operations, respecting the advisability of more conscious central direction of monetary and credit policies, and especially the desire to assure support of the Government's borrowing, concern is being expressed in business and in other circles in regard to the proposed amendment upon a number of grounds.

Under the Senate bill a majority of the members of the open-market committee would be members of the Federal Reserve Board and the two governors of the Reserve banks would be men whose annual election as governors would be subject to the approval of that Board. In effect, the proposal would provide an additional means by which the views of a few men in Washington would control some of the principal operations of the Reserve banks. It could mean, in fact, governmental control of the policies and operations of those banks and therefore in a large measure over credit extensions throughout the country. It is widely accepted that outside domination of the System's operations by any agency of the Government would be detrimental to the general interest of the public.

If the two governors of the Reserve banks should consider themselves in effect delegates from all the Reserve banks with a duty to reflect the position of these institutions, they could be a minority upon the committee, or the Governor of the Federal Reserve Board with the two governors of the Federal Reserve banks could overturn the views of the Federal Reserve Board, or three members of the Federal Reserve Board could set at naught major policies agreed to by a majority of the Federal Reserve Board.

In our judgment the open-market operations should be mainly the concern of the Reserve banks, the funds of which make such operations possible. Beyond that, who owns these funds? They belong to the member banks, but in the last analysis they belong to the depositors of the member banks, namely, the business men, firms, and others who possess sufficient assets to be depositors in banks.

No arrangement with respect to open-market operations would be correct, in our judgment, that fails to regard the banking situation in the respective Reserve districts in relation to the national situation. The reposal of open-market powers in the Federal Reserve Board with the device of an advisory committee would serve to disfranchise the boards of the Reserve banks with respect to major policies that vitally concern the business of the country.

Senator GLASS. Let me ask you right there, if I may, if it will not interrupt the course of your remarks?

Mr. SNYDER. Certainly.

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Senator GLASS. Do you contend that the credit conditions, for example, in the regional Reserve district of Dallas, or of Minneapolis, or of Richmond, have any controlling influence on credit conditions of the entire country?

Mr. SNYDER. Yes; I do; and in this sense: These centers are subject to local conditions. For instance, we had an earthquake in San Francisco, and conditions were changed instantly in that region, and it affected the entire country. But the situation surrounding the Federal Reserve bank in that region was totally different for a period of time, at least, than that of any other Federal Reserve district of the country.

Senator GLASS. But I am not talking about earthquakes. I am talking about normal conditions. I have been unable to see how the credit conditions, the discount rate, for instance, in the Dallas Reserve district could affect credit conditions throughout the Nation.

Mr. SNYDER. Only in the broad sense, Senator Glass, that we are so closely interrelated that they affect them. We do know that there are different rediscount rates in different regions for reasons that seem to be good to Federal Reserve banks in those regions. While the weight of the effect is local, yet I suppose we must reason that the effect is transmitted eventually throughout the entire Nation, just as in the case of a stone falling into water and making a big splash at some point, it will make some effect upon the remote edges of the lake.

Senator GLASS. Yes; I suppose on the theory that if you drop a pebble into the ocean it has an effect over on the other side of the ocean.

Mr. SNYDER. Yes, sir; but you must remember that——

Senator GLASS (continuing). That is just about the effect these regional credits in the smaller regional Reserve districts have upon the general credit of the country.

Senator COUZENS. Might I ask the witness at this point if it is a fact that the rediscount rate may be very low in New York and very high in Dallas or Richmond, and therefore have an effect on competitive conditions of industry in those localities?

Mr. SNYDER. I think the effect of the difference in rates would be relatively slight so far as that is concerned, because the difference in any set of rates varies quite widely with conditions as to Federal Reserve banks. For instance, one concern with a high credit rating may borrow at a smaller rate. There is a wide variation in rates within any district itself.

Senator COUZENS. Then notwithstanding credit conditions of industry in Richmond or Dallas, it is your judgment that the rate should be higher there than in New York, where the credit conditions may be the same?

Mr. SNYDER. I should like to modify my answer by saying that conditions might be such as to make it wise to have a higher or lower rate, and if that is the judgment of the local board of nine, I should conclude that that is sound. Of course, the effect of their judgment is modified by the advice of the Federal Reserve Board, and taking the two together I should say the judgment of the combined group would be one that would be well to follow, even though there might be some differences.

Senator GLASS. You know perfectly well that the initial discount rate in the member banks varies, that in the various Federal Reserve

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districts it is materially different. For example, the current discount rate by statute in Michigan is 5 percent, but if you take some of the western States, it is as high as 8 and 9 percent.

Senator McADOO. You mean interest rate instead of discount rate, do you not?

Senator GLASS. No. I mean the discount rate but not the rediscount rate.

Senator McADOO. You mean in the member banks.

Senator GLASS. Yes.

Senator McADOO. Well, that is the interest rate.

Senator GLASS. In other words, the statute of Virginia prohibits any member bank or any bank at all from charging a higher discount rate, that is, interest rate on a note, than 6 percent.

Mr. SNYDER. Yes.

Senator GLASS. It prohibits any higher contract rate than 6 percent. But in some States the contract rate goes as high as 18 percent. In your own State, Mr. Snyder, the contract rate on small loans goes as high as 18 percent.

Mr. SNYDER. It does.

Senator COUZENS. But that was not what I particularly had reference to. I had reference to the fact that if money was much cheaper in New York than in Richmond or Dallas, there would be a natural inclination on the part of concerns with a high credit rating to go to New York to get their money rather than to get it in Dallas or Richmond.

Mr. SNYDER. Well, to a degree that is done, but it is very small in proportion to the total credits of the country. May I resume, Mr. Chairman?

Senator GLASS. Yes.

Mr. SNYDER. The test as to what is a correct national policy must rest upon effective representation of the views of all sections of the country and of the true interests of the country. The body in control should be large enough to avoid any provincialism and to insure that it is truly representative in a national way.

No evidence has been produced that the Reserve banks acting independently have failed to conform adequately to an open-market policy. We believe that no group should be given power to compel the Reserve banks to engage in specific open-market operations unless the program meets with the approval of a majority, at least, of the 12 Federal Reserve banks. We believe, further, that effective representation of the boards of directors of those banks, which are ultimately charged with the operations of the institutions, should be provided for in the determination of decisions to buy or not to buy Government securities or other eligible paper.

Senator GLASS. It has been suggested by some that a Federal Reserve bank might be exempted from participation in an open-market operation by a majority vote of Federal Reserve banks, and by others that by a two-thirds vote of the Federal Reserve banks that might be done. What would you have to say as to that?

Mr. SNYDER. Expressing my own personal view, and you will understand that this is the judgment of the committee for whom I am speaking, I should favor that exemption, because conditions do occur in different sections of the country from time to time in which

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they need all their funds and reserves, and may need help from other Federal Reserve banks.

Senator GLASS. And except for that one privilege open-market operations may be carried on only under rules and regulations adopted by the Federal Reserve Board, I mean under the existing statute.

Mr. SNYDER. Yes, sir.

Senator GLASS. That is the only remaining right to the Federal Reserve banks now. And the question will arise as to whether a limitation should be put upon that right by a majority or two-thirds of the banks agreeing to exempt Federal Reserve banks.

Mr. SNYDER. I think the judgment of the Federal Reserve banks with respect to a particular bank would be pretty acceptable to almost all interests.

Senator GLASS. All right. You may resume your statement.

Mr. SNYDER. Through permitting an inflationistic device that has wrecked other countries why run the risk of further unsettlement of confidence and unwillingness of people to apply their resources and energies, and I underscore that, in aid of economic recovery? We do not favor any method that could operate to permit the Government to force its debts into the central banking mechanism. That was the method which impoverished the people of Germany and of France. Evidence has been presented to this committee and the facts are plain in the laws of other countries that their central banking systems contain safeguards against the ability of the governments to compel the banks to carry the deficits of the Government. There is enough compulsion in this respect normally when the Government goes to the capital market for its funds.

Such theoretical views are current concerning monetary, credit, and governmental spending policies as to lead to the belief among many that the Federal Reserve Board, or the Open Market Committee provided in the Senate bill, would be subjected to pressure to assist in the execution of these theories.

Senator BULKLEY. Do you think the law as it exists today provides an adequate safeguard against pressure by way of forcing Government issues onto Federal Reserve banks?

Mr. SNYDER. I think if you maintain in essence the principle that the governing bodies of the banks and of the Federal Reserve Board shall be as independent of administrative influence or authority as the superior courts and the Supreme Court, we will then be on safe ground.

Senator BULKLEY. But do you think we are safe under existing law?

Mr. SNYDER. I think the existing law is vastly safer than the one proposed here.

Senator COUZENS. That does not quite answer Senator Bulkley's question. Could you answer his question directly?

Mr. SNYDER. I think if it could be improved as to just what would be reasonable, with the hope to proceed as we are by passing titles I and III, and without passing title II, we would get along very well indeed. But that does not mean that we should not progress. I think we should reexamine the situation carefully. I think we should reexamine it now to see what can be done to improve it.

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Senator GLASS. Well, you do not have to go very far to determine that it was never intended by the existing law that the Federal Reserve banking system should be compelled to finance the United States Government.

Mr. SNYDER. The weight of our entire argument is directed to that statement.

Senator GLASS. That does not admit of any argument. When the open-market provision of the bill was adopted there were less than 200 million dollars of United States bonds available for purchase.

Senator COUZENS. I still go back to Senator Bulkley's question, and should like to get an answer to it.

Senator BULKLEY. I should like to go back to it, too.

Senator COUZENS. Senator Bulkley, suppose you repeat your question.

Mr. SNYDER. I will be glad to try to answer it.

Senator BULKLEY. The question is whether you think the law as it exists today provides an adequate safeguard against the Treasury forcing Government issues into Federal Reserve banks.

Mr. SNYDER. I cannot answer that question as an expert, but expressing my own personal opinion I would state that if my view is correct that would be substantially true.

Senator BULKLEY. What would be substantially true?

Mr. SNYDER. That you could not force upon the Government the purchase of their securities.

Senator BULKLEY. You mean they could not force upon the banks the purchase of Government securities?

Mr. SNYDER. Yes, sir; force upon the banks the purchase of Government obligations.

Senator GLASS. I am not an expert either, but I think I could give a more definite answer than that to Senator Bulkley's question.

Senator COUZENS. We would like to have it in order to see if the witness agrees with you.

Senator GLASS. Well, I think you will agree with me, Senator Couzens. You do not always agree with me, but I think maybe you will agree with me this time: The fact is that there has been put upon the Federal Reserve banks the enormous sum of two and a quarter billion United States bonds for which they have no use. Is not that so?

Mr. SNYDER. Yes.

Senator COUZENS. Do you think that was done willingly or by governmental power or influence?

Mr. SNYDER. Well, it was done in effect willingly because they did not have other use for their funds. But they would have preferred commercial paper, naturally.

Senator COUZENS. So that your answer is, in effect, that those securities were not forced upon the banks by the Federal Government; is that it?

Mr. SNYDER. I should say they were not forced upon the banks, but I should think the pressure of the necessity for putting their funds into something was best answered at the time by taking that which was available; that with business knocked down about 50 percent at one stage, there was not sufficient commercial paper.

Senator GLASS. Well, I am not that charitable. But you may resume your statement.

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Mr. SNYDER. If so, there would be subordination of the true functions of the Federal Reserve System to the fiscal and other operations of the Government without independence of decision or means of protection short of such public disturbance as would shatter confidence.

We strongly urge that open-market policies should continue as at present to be formulated by a committee representing the 12 Federal Reserve banks. If the authority is given to any agency of the Federal Reserve System to enforce compliance by the Reserve banks with a stated open-market policy, the exercise of such authority should be made contingent upon its acceptance by at least a majority of the Reserve banks.

With respect to changes in rediscount rates: We record special objection to any proposal that an open-market committee be given power to compel changes in rediscount rates. It has been suggested that this power should be centralized as a means of controlling speculation. The record of reserve operation warrants the belief that the Reserve banks are fully as alert, if not more alert, than is the Federal Reserve Board in guarding against speculative excesses. The Reserve banks now have extraordinary powers under the Banking Act of 1935 to place effective checks upon speculation. Furthermore in the Act of May 12, 1933 (Thomas amendment to the Agricultural Adjustment Act), the Federal Reserve Board is given the power, to be exercised with approval of the Secretary of the Treasury, to "require the Federal Reserve banks to take such action as may be necessary, in the judgment of the Board and of the Secretary of the Treasury, to prevent undue credit expansion." In another provision of law the Federal Reserve Board with the approval of the President is given the power to raise or lower the reserves to be required of member banks. We believe that changes in the rediscount rates should continue to be initiated by the Federal Reserve banks and be subject to the approval of the Federal Reserve Board.

As to rediscounts and loans to member banks: Section 206 of the bill before the Senate provides that, subject to the regulation of the Federal Reserve Board as to maturities and other matters, any Federal Reserve bank would be permitted to rediscount for a member bank, upon its endorsement, any commercial, agricultural, or industrial paper and to make advances to a member bank on its promissory notes secured by any sound assets of such member bank.

This broad grant of power would destroy the careful limitations prescribed by the Federal Reserve Act with respect to the types of advances which may be made by Reserve banks to member banks and its meticulous provisions respecting the types and maturities of paper made eligible for rediscount which places preponderant emphasis upon short-term commercial paper.

This provision of the bill would mean a change in the fundamental conception of the Reserve System that has prevailed since its establishment and, in our judgment, should be continued.

It clearly is not the function of a central banking system to accept illiquid or long-term paper and proper safeguards against the acceptance of such paper should be specified by statute.

It may be recognized that the character of assets of member banks has undergone some changes in recent years and that an increasing percentage of such assets is represented by securities and

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advances upon collateral loans of types not generally considered suitable for rediscount. In our judgment, however, a substantial upturn in business activity will bring forth a greatly increased volume of eligible paper and certainly meanwhile the system should not be encouraged or permitted to load up with slow paper.

There would not appear at this time to be any great need of the amendment. It has been pointed out by the Federal Reserve Board in a recent annual report that the use made by the member banks of the emergency power to borrow upon assets not otherwise eligible for rediscount was availed of by relatively few banks. If the eligibility requirements for rediscounts and advances should be modified, it should be after a thorough examination and without a broad grant of authority to the Federal Reserve Board to determine these requirements.

Attention might be directed to the temporary restoration of the emergency provision of the Federal Reserve Act (sec. 10b) which lapsed March 3, 1935, and which provided that a member bank with no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations, through rediscounting at a Reserve bank or any other method provided by the Reserve Act, could secure advances from the Reserve bank on time and demand notes secured to the satisfaction of the Reserve bank, but at 1 percent higher rate of interest than the rediscount rate.

With respect to purchase and sale of guaranteed obligations: In section 207 all obligations guaranteed as to principal and interest by the Federal Government would be eligible for open-market purchases by the Reserve banks upon the same basis as direct obligations of the Government and without regard to maturities.

This proposal serves to focus attention upon the increasing number of Federal agencies which have access to the money markets and to the resources of the Reserve and member banks. We believe there should be resistance to the trend toward making the Reserve System the repository of innumerable types of securities which are not suitable for investment by Reserve banks. It is not a proper function of the Reserve System and it should not be called upon to provide the guaranteed obligations with greater attractiveness by supplying a market for them. As has been earlier stated, in well-conceived central banking systems, conservative policies are in force in relation to the amount of Government paper that they acquire. Considerable independence of decision is given to them with respect to extensions of credit to the primary banks upon the security of Government obligations. Such extensions may be required to bear higher rates of interest than are extensions on the security of commercial paper. We cannot bring ourselves to support the proposal that, without limit as to volume or maturity, the guaranteed obligations might be bought and sold by the Reserve banks, particularly in view of the opinions that we have presented concerning the open-market machinery that would be set up by the bill.

As to the basis for Federal Reserve notes: In section 208 the Federal Reserve banks would be permitted to issue currency—Federal Reserve notes—under the present requirement of law that they be secured by a first and paramount lien on all the assets of the Reserve banks. These notes, however, need have no specific cover except a

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minimum of 40 percent reserves in gold certificates for the notes in actual circulation.

Since we maintain that there would be considerable danger under other provisions that the assets of the Reserve banks would be changed from short-term to long-term or less liquid paper, we cannot but believe that the amendment would mean a deterioration of the quality of the Federal Reserve currency. If the assets of the Reserve banks should be composed more largely of Government securities and various kinds of long-term or illiquid paper, the Federal Reserve note would become less desirable. We would have neither an elastic Federal Reserve note nor a redeemable one.

It may be recognized that this proposal would be more acceptable if there were safeguards as to the quality and maturity of the assets of the Reserve banks and safeguards as to the independence of their management. If, however, the eligibility requirements for rediscounts and advances are left to the Federal Reserve Board and the holdings of Government and Government-guaranteed obligations are increased, disturbing questions will arise concerning the volume and quality of future Reserve note circulation.

The fear will appear that under the two proposed changes, namely, in the eligibility requirements for rediscounts and in the collateral requirements for Federal Reserve notes, practices would develop which are not generally recognized as being desirable in central banks.

The adoption of this provision of section 208, combined with the changes in the eligibility requirements for rediscounts and advances, would mark a set-back to the Nation's effort to evolve an elastic currency that would expand and contract in accordance with the flow of business. They would present to business men the likelihood of arbitrary determinations, subject to rapid change, as to the nature and quality of the assets that would be placed back of the currency and as to the volume of money permitted to be outstanding. The fear of currency debasement is one of the most positive forces that can operate against the employment of credit in a constructive manner.

With respect to reserves against deposits of Reserve banks: In section 208 there is a provision for the elimination of gold certificates as required reserves against deposits of the Reserve banks. Reserves of 35 percent in lawful money—other than Federal Reserve notes or Federal Reserve bank notes—would be the only requirement. This would constitute another step away from the principle that the structure of both the note issues and the deposits of a Reserve bank should be placed firmly upon a basis of gold reserves. There is no emergency which requires the passage of this amendment.

With respect to reserves of member banks: In section 209 there would be provided a new basis for the determination of the reserves to be required of member banks. The Federal Reserve Board would be permitted to change by regulation the requirements as to reserves to be maintained against demand or time deposits, or both, by member banks in any or all of the Reserve districts and in any or all of the three Reserve classes of cities.

Even the proponents of this amendment have believed it necessary to modify it and the House changed it to grant authority to the Federal Reserve Board to alter the reserves required of member

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banks by two classes, namely, one class to be composed of the member banks in the central Reserve and Reserve cities, and the other class to be composed of the banks in country areas.

This matter is of great importance not merely to the member banks of the Federal Reserve System but to commerce, agriculture, and industry as the Reserve requirements have a distinct bearing upon the availability of bank credit.

We take the position that, based upon recommendations of administrative officials of the Reserve System, there should be submitted to Congress a definite plan outlining the extent of change that could be permitted and presenting the method of computing the reserves to be required of member banks. We believe the legislation should state the definite percentage of deposits within which required reserves could be changed by action of an administrative authority. We perceive no immediate need for such legislation, and no change at all would be preferable to such a delegation of power to the Federal Reserve Board as would be provided by the amendment in the Senate bill or the amendment in the House bill. There is existing an emergency provision of the law which provides a sufficient power to change the reserve requirements. We cannot bring ourselves to accept the idea that the Federal Reserve Board should be permitted by such a power to force great changes in the banking system. Under this power the door would be open, for instance, to furthering a theory which a few persons have advanced, that a hundred-percent reserve should be established against demand deposits. Arbitrary decisions in such matters by a small group of persons with power to act would create considerable disturbance.

As to loans on real estate: In section 210, the last section of title II, there would be substantial modification of the powers of national banks to make loans upon improved real estate.

Briefly, we believe that member banks should be permitted to make 5-year unamortized loans; that the percentage of a loan in relation to the appraised value of the property, even though the loan be required to be amortized, should not be greater than 60 percent.

We believe that the aggregate volume of real-estate loans should bear a more conservative relationship to capital and surplus and to time and savings deposits than is proposed, that is, a more conservative relationship than 1 percent of the capital and surplus, in place of the present 25 percent, or than 60 percent of time and savings deposits, in place of the present 50 percent of savings deposits.

We believe the real-estate loans insured under the provisions of the National Housing Act should be restricted in the same manner as other loans upon the security of amortizable mortgages and that the existing territorial limitations upon real-estate loans, or somewhat similar limitations, should be retained in the law.

The banks in recent years have been severely criticized for tying up their deposits in what proved to be illiquid paper. The provisions of the bill before the Senate committee provide for the relaxation of statutory standards which in the past have not proved too high.

If the requirement of present law that insured banks must join the Federal Reserve System by a particular time is not maintained, or if the time is postponed, we believe the mortgage-loan limita-

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tion should be established with sole attention to the situation of the banks now in the membership of the Reserve System.

It must be recognized that if the idea back of the proposed change in the requirements is that the Reserve banks would increase the liquidity of the assets of the member banks by making them advances upon the security of real-estate loans, in the event of trouble arising, the Reserve banks will depart further from a proper sphere of operation of central reserve institutions. Their own assets would become less liquid and real estate mortgages could enter into the cover of Federal Reserve notes. Any such development would be more likely to intensify rather than to relieve the uneasiness of the country with respect to the credit situation.

Now, as a summation: In this presentation it is apparent that we see a mere modicum of possible benefit in the proposals in title II mixed into a very great deal of real and potential injury to our banking system and to business and agriculture.

Even those proposals for which some basis of merit may be discerned are not urgent. These are the possible combinations of offices of governor and chairman of the Reserve banks, possible increase in salaries of members of the Federal Reserve Board, the institution of a system of retirement allowances, the power to delegate routine duties to members or employees of the Board, the selection of the Governor of the Federal Reserve Board without a geographical limitation, and some powers to adjust the requirements for membership in the Federal Reserve System if the insured banks are compelled to become members by a stated time.

On the other hand, the requirement of the approval annually or triennially by the Federal Reserve Board of the governors of the Reserve banks, the limitations upon the length of service of the class B directors, the broad power to waive eligibility requirements for admission of banks into the System, the change in the eligibility qualifications of the appointive members of the Federal Reserve Board, the provision that the Governor of that Board should be permitted to hold office only during the pleasure of the President of the United States, the placing of the complete power over open market operations in the Federal Reserve Board or a committee composed of 3 of its members and 2 governors of Reserve banks, the power to change the reserves to be required of member banks without limitations as to percentages, the admission to open-market operations of guaranteed obligations without limit as to volume or maturity, the change in the basis of Federal Reserve notes, the change in the eligibility requirements for rediscounts and advances, the centralization of power over rediscount rates, and the undue liberalization of powers to make real-estate loans or the power given to the Federal Reserve Board to control the making of such loans, when taken together, raise very serious and disturbing questions that lead us to urge the elimination of title II from the bill and to urge that Congress in the present session provide for subsequent and thorough-going consideration of these and all other proposals for fundamental changes in the Federal Reserve System.

In conclusion, the aggregate effects, in our judgment, of the adoption of these provisions of title II, to which we have found serious objection, would be—

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It would mean the virtual creation of a central bank of an undesirable type, in violation of the established principle that the Federal Reserve System should consist of locally directed regional Reserve banks possessing a high degree of autonomy in relation to conditions in their own districts.

It would mean that the Congress would court the danger that accommodation of the real credit needs of commerce, agriculture, and industry would be subordinated to the spending plans of the Government, with departures from the established principle that the quality of credit extensions in the accommodation of short-term transactions should be the main guide to Federal Reserve credit policy.

It would mean that there would be constant fear that there would be disturbing, even misguided, efforts to control the level of production, prices, and employment through adjustments of the mere volume of money and credit by a Washington agency permitted to experiment with a most dangerous form of so-called "central planning."

It would mean that power would be granted to the Federal Reserve Board that would be broad enough to permit, if not encourage, the conversion of the resources of the Reserve banks into slow and illiquid assets.

It would mean that inflationistic influences could be given broader sway, and inflation or deflation or the expansion and contraction of credit could be largely determined by a few men in Washington, with less rather than more independence from outside pressure. They would possess the power to precipitate disastrous inflation or deflation, with no substantial safeguards against their mistakes or abuse of authority.

It would mean that there would be a setback to the Nation's efforts to evolve an elastic currency that, in fact, would expand and contract in accordance with the flow of business. Instead there could be arbitrary determinations, subject to rapid change, as to the nature and quality of the assets placed back of the currency and as to the volume of money permitted to be outstanding. There would be no real assurance that the debasement of the currency must be avoided.

It would mean that there would be great danger that our whole banking structure would be weakened rather than strengthened and that banking standards would be lowered rather than raised.

It would mean the development and continuation of such uncertainties in the minds of business men, concerning credit and money, as would interfere with the making of decisions and commitments to apply their resources and energies that must be applied constructively if we are to obtain economic recovery.

I thank you, gentlemen of the committee.

Senator COUZENS. Mr. Chairman, have you any more witnesses for today?

Senator GLASS. Not for today. Do any members of the subcommittee wish to ask Mr. Snyder any questions?

Senator COUZENS. Mr. Snyder, do you believe in the N. R. A.?

Mr. SNYDER. I believe in certain things about it and I should like to see them continued. Massachusetts led the way in the original movement, and but for the N. R. A. we would have been compelled to change our own State laws in regard to child labor, maximum hours of labor, minimum wages, and so forth.

Senator COUZENS. Is that all now, Mr. Chairman, for this morning?

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Senator GLASS. I should like to ask one question: If these things which you have so graphically described in the summary of your testimony should come to pass by reason of the enactment of this bill, what inducement would remain now that the circulation privilege is to be abolished for any bank to remain a member of the Federal Reserve System and subject itself to such subservience as is here proposed?

Mr. SNYDER. We have given that question consideration and it is a very important one. I think if banking legislation of the type now proposed should go through, it might force upon banking and business interests of the country to act under State powers and to develop independent action for the purpose of protecting their own interests and the business interests of the country. That is not impossible, and I think it a very important question to have in mind.

Senator GLASS. Of course it is not impossible. And I do not want to ask you to predict, but my own thought is that it is very probable.

Mr. SNYDER. Well, I am trying to be conservative in my statement. But I will add to that——

Senator GLASS (interposing). Well, I am rather radical instead of conservative. We are greatly indebted to you for your statement. To me it is a very illuminating statement.

Mr. SNYDER. Might I add just a word on that particular point?

Senator GLASS. Certainly.

Mr. SNYDER. I served as State chairman of the antihoarding committee in the State of Massachusetts, and we did a lot of work and spent a lot of money trying to educate the entire public to the evils of hoarding. And I woke up to the fact that 90 percent of all our business was based upon these expressions of confidence which we call checks, drafts, and bills of exchange, and that only 10 percent of the deposits we placed in banks were currency. I realized how enormously important it was that everything be done to maintain that confidence. I want to emphasize the statement that there is nothing that could possibly occur, at least according to my personal judgment, which would so retard recovery as to put ourselves in the position where, in view of the fact that 90 percent of our business is done now on trust and credit, that we had to have doubts in the minds of business interests of the country regarding the structure of our Federal Reserve System. It would have the effect in my opinion of keeping the energies and initiative and resources of our people locked up, because they would not dare invest their capital in new ventures in many fields. With a situation in which the very basis of the limited amount of currency available, only about forty-odd dollars per person, might be subject to great changes, and with the very deposits we have now, which are twice as great as required by statute in Reserve banks, might be required to remain at that figure, and the assets of the public might be required, and that of the banks, to absorb Government obligations, I cannot think of anything that would be so destructive in character. And if that should go through we would be nearer to Russia in the matter of our banking system than almost any other country on earth. There is only one State bank now, and that is in Sweden, and that is controlled by the King and the Rikstag, and then it remains as independent as we would like to see ours remain independent. In Japan one-half of the stock of the bank may be

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owned by the Government, but it is not. There is no embarrassment that would be equal to that.

Senator GLASS. Do you know of any central bank on earth that is arbitrarily authorized to spend other people's deposits and that would have no deposits of its own?

Mr. SNYDER. Of course, there is none. Even Germany after its experience set up a protective ordinance so that that thing could not happen there again. And so have most European countries.

Senator GLASS. Well, I think your statement made before this committee ought to be broadcast. I think every business man in the United States ought to have the opportunity to hear it.

Mr. SNYDER. Senator Glass, the fact is that business men trust the central government a great deal and give their time to attention to their own business. Therefore, they do not get at conditions quickly. But there is arising an opinion all over the country.

Senator GLASS. Oh! The banks are scared to death.

Mr. SNYDER. Of course they are scared to death, and business is scared to death, and we think our people are beginning to take a lively interest.

Senator GLASS. Business ought not to be afraid to express itself, and banks should not either, for that matter.

Mr. SNYDER. Business is not afraid to express itself but they rely more upon groups to express their views for them. But it is not news and is not studied by the average citizen, and these questions do not make the headlines as much as they should.

Senator GLASS. Well, it will become news.

Senator TOWNSEND. You said you would like to make a statement about something which occurred here in Washington.

Mr. SNYDER. Yes; there was something which occurred here in Washington within a very recent time and which illustrates my fear with reference to changes that might occur in the banking system. A very important department of the Government under a certain Cabinet member needed a new head, and one of the ablest men in the country, who is at the head of a very large accounting organization, who, because of his extreme ability as an analyst—that is, he is employed not merely as a certified public accountant but more as an economist and because his advice ranks high to important interests in this country—I say, he was asked if he would come down here to Washington and take charge of that particular department, where his talents would be very useful. He looked over the situation and replied, "Well, it will mean a very considerable financial loss to me, but will be an interesting experience, and I can perhaps perform a useful service." So he said he would accept the burden. Another member of the Cabinet stated to him that of course any changes in the personnel of his organization that other member of the Cabinet would expect to make. Thereupon this man immediately said, "My acceptance of the position is withdrawn." In other words, he could not run the department on the basis of having men whom he himself might nominate and have approved by the higher authority, but he was expected to have the higher authority nominate them for him.

Now, if that is what is sought to be done here with the Nation's banking system, where will our banking business be? And it will probably be just that.

Senator GLASS (chairman of the subcommittee). The subcommittee will now adjourn until 10:30 tomorrow morning.

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THE PROPOSED "BANKING ACT OF 1935"

ANALYSIS OF TITLE II AND SUMMARY OF OTHER PROVISIONS

(Chamber of Commerce of the United States, Washington, D. C., April 1935)

After an examination of the proposed Banking Act of 1935, the board of directors of the national chamber adopted on March 1, 1935, the following resolution:

"Official proposals for far-reaching changes in the basic and fundamental features of the Federal Reserve System were recently submitted to Congress. These are the suggested amendments to the Federal Reserve Act that are presented under title II of the proposed Banking Act of 1935.

"It does not appear too much to say that these proposals are of such serious import as to justify the deliberate and careful consideration that was given by the Congress and the country to the plan for the establishment of the Federal Reserve System.

"The proposed changes would affect the general public and the customers of banks even more than the banks themselves. The commercial and industrial elements of America, in the public interest as well as in their own protection, must ask that time be granted for thorough consideration of the proposals.

"It is recognized that timely modifications in the Federal Reserve Act and in the policies of the System will continue to be necessary. We believe, however, that there must be rigid resistance to proposals of a harmful nature and to well-meant but mistaken efforts to divert the System from its proper course. In particular, the country must weigh carefully the adequacy of safeguards against the political domination of the Federal Reserve Board, the Reserve banks and the member banks, and against undue centralization of credit control.

"It is understood that various banking groups are studying the pending proposals. This board urges that the commercial and industrial interests of America do the same without delay and be prepared to register their opinions upon the measure and upon the announced purposes underlying it.

"The chamber is appointing at once a committee of men drawn from industrial and commercial groups to report upon the pending proposals for modification of the Reserve System and cognate matters. Meanwhile it will distribute to the business community an analysis of the suggested amendments.

"It is hoped that early consideration will be given by the Congress to the amendments contained in title I of the proposed Banking Act of 1935, modifying the present plan of insurance of bank deposits, and to the provisions of title III that deal with some technical modifications of existing banking laws.

"It is urged, however, that Congress deal with the proposed amendments to the Federal Reserve Act, contained in title II, separate and apart from the other portions of the bill. Business asks reasonable time to determine its position upon the amendments to the Reserve Act that are contained in title II and to make known its views to Congress."

FOREWORD

There is pending in the Congress the proposed Banking Act of 1935.[1] It sets forth, under three titles, numerous amendments to the banking laws of the United States:

Title I presents amendments to the laws upon insurance of bank deposits. With a few exceptions, its provisions are likely to receive general support in business and banking circles. A brief summary of title I appears in the appendix to this pamphlet.

Title II presents the principal amendments affecting the Federal Reserve System. These amendments are being subjected to criticism by business and banking groups. An analysis of title II comprises the body of this pamphlet.

Title II presents a number of technical amendments which experience has indicated to be advisable. It seems probable that in the main these amendments will receive the support of banking and business elements. A brief summary of title III appears in the appendix to this pamphlet.

The following analysis is not to be construed as argument by the Chamber of Commerce of the United States for or against the amendments presented under

[1] In the House the measure is H. R. 5357, and in the Senate it is S. 1715.

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title II. A special committee of the chamber shortly will present a report upon the merits of these amendments.

The principal purpose of the analysis is to direct the attention of the business community to the aspects of each proposal that would seem to require careful consideration. It should be observed, however, that the full purport of the amendments can be realized only after consideration of the purposes and economic concepts underlying them.

The principal official statements concerning these purposes and concepts of money and credit and of general economy are those of the Governor of the Federal Reserve Board. They appear mainly in the hearings on the bill before the House Banking and Currency Committee between March 4 and 20, 1935.[2]

Commentators have found their main grounds of approval or disapproval of important features of the measure in these explanations of purpose and belief. It is now clear that these explanations challenge or differ with policies that many hold to be basic and fundamental.

The special committee appointed by the American Bankers Association to study the proposed legislation published on March 22, 1935, a number of recommendations concerning the bill. Its recommendations upon the provisions of title II only are presented in the following analysis. The committee states, however, that if changes substantially along the lines it recommends cannot be made it would be strongly opposed to the enactment of title II. It is indicated that the committee, after further study, may make additional recommendations upon title II.

Amendments to Federal Reserve Act

(As proposed under title II of pending Banking Act of 1935)

For ease of reference, the sequence of the analysis is that of the amendments in title II of the bill. In the case of each amendment there are presented: (1) The gist of the proposal; (2) the gist of the pertinent provisions of present law; (3) explanatory comment upon controversial aspects; and (4) modifications of the proposal that have been advanced by others than the national chamber.

GOVERNOR OF RESERVE BANK

Proposal.—The governor of each Reserve bank would be elected annually by the directors of the bank, but his election would be made subject to the approval of the Federal Reserve Board at Washington. After such approval he would become the chief executive officer of the bank and, while governor, would be a member and ex-officio chairman of its board and of its executive committee. He need not be a resident of the Reserve district. In case of a vacancy the position would be filled in the manner provided for the original appointment but only until expiration of the term of the predecessor. A governor would be eligible for successive 1-year terms indefinitely.

At present.—The office of governor is not mentioned in the act. It was created under the power given to boards of Reserve banks to engage necessary employees. The salary of the governor, but not his selection, is now subject to approval of the Federal Reserve Board. He is elected annually by the bank board; he is not a director of the bank.

Comment.—The principal questions surround the proposal that the Federal Reserve Board at Washington be given power to approve or disapprove annually of the governor selected by the board of a Reserve bank.

In support, it is stated that since the measure would enhance the prestige and influence of the governor, and abolish the present authority of the Federal Reserve Board to appoint a chairman of the board of the bank and Reserve agent, the Federal Reserve Board should be given power to pass upon the qualifications of the man locally selected. This is held to be important since it is the intent of the bill to centralize in the Washington board greater control of important operations of the Reserve banks, especially as regards the decisions upon rediscount policies and the purchase and sale of Government securities and acceptances.

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[2] Hearings on the proposed Banking Act of 1935, before the Banking and Currency Committee of the House, can be obtained from the Government Printing Office, Washington, D. C.

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Federal Reserve Bank of St. Louis

In opposition, it is stated that the grant of such power would make the governors of the 12 regional Reserve banks supine in relation to the Federal Reserve Board at Washington and to its governor; that every important decision that a governor of a bank would be compelled to make during the year would be influenced by his belief as to its acceptability to the Washington group. It is stated that the amendment would be certain to lower the efficiency of the management of Reserve banks, prevent reasonable regional autonomy, and increase the danger of political interference in the operations of the Reserve System as a whole.

Modification.—The Governor of the Federal Reserve Board has suggested that consideration be given to providing that the Federal Reserve Board should approve every 3 years, instead of annually, the selection of a governor of a Reserve bank, even if the governor be elected annually.

The special committee of the American Bankers' Association states that the term during which a governor may serve without having to be approved by the Federal Reserve Board should be as long as possible and this approval certainly should not be required more than every 3 years.

It has been suggested, by those who believe that approval every 3 years is open to the same objections as annual approval, that the Federal Reserve Board at Washington should be authorized to pass upon the first selection, but not thereafter, whether the election be annually or every 3 years. It also has been proposed that, if the Federal Reserve Board should be given greater influence with the reserve banks than it now possesses, it might be empowered to select four instead of three of the directors.

VICE GOVERNOR OF THE RESERVE BANK

Proposal.—A vice governor would be appointed annually in the same manner as governor. During absence or inability of the governor or a vacancy in that office, the vice governor would serve as the chief executive officer of the bank and act as chairman of its executive committee. He could be appointed a director of the bank by the Washington Board, and if so appointed could be made deputy chairman of the board of the bank. In case of a vacancy in the office of vice governor, a person would be appointed in the same manner as governor to hold office until expiration of the term of the predecessor. The vice governor would be eligible for successive 1-year terms indefinitely.

At present.—The office of vice governor is not mentioned in the act. The office of deputy governor, however, was created under power given to the board of directors of each bank to engage necessary employees. One or more deputy governors are serving in each bank. The title of vice governor does not exist.

Comment.—In substance the same as in the case of governor of a Reserve bank.

Modification.—Substantially the same as stated above in the case of governor of a Reserve bank.

CHAIRMAN OF BANK BOARD AND RESERVE AGENT

Proposal.—The offices of governor and chairman of the board would be combined, and the governor would become the ex-officio chairman of the board. If the vice governor is appointed a director of the bank by the Federal Reserve Board, it would be permissible to make him deputy chairman. In the absence of the governor and vice governor, the third of the three Reserve bank directors appointed by the Federal Reserve Board would preside at meetings of the board of the bank. A Federal Reserve agent who is not selected to be governor of a bank within 90 days after approval of the act would cease to be a director of the bank and chairman of its board. All duties now prescribed by law for the Federal Reserve agent would be performed by such person as the Federal Reserve Board designated.

At present.—The chairman of the board is appointed annually by the Federal Reserve Board from among the three directors of the bank whom it selects. He is also Federal Reserve agent. He must be a person of tested banking experience, must maintain in the Reserve bank a local office of the Federal Reserve Board, must make regular reports to the Federal Reserve Board, and must act as its official representative for performance of functions conferred on the Federal Reserve Board by the act. His salary is fixed by the Federal Reserve Board and must be paid by the bank.

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Federal Reserve Bank of St. Louis

Comment.—The suggestion that the offices of governor and of chairman be combined has often been advanced. Some assert that it was the expectation of the framers of the original act that the chairman would be the principal executive officer of the bank as well as the official representative of the Federal Reserve Board. In practice, however, in nearly every instance the governor is the active head. It is stated that the change would work for smoother cooperation between the Federal Reserve Board and the bank and greater unity of administrative control within the bank. Attention is also directed to the point that it would result in some saving through elimination of one of the high salaried officers in the bank and that it would give definite legal sanction to the position of governor.

On the other hand, it is asserted that the problem here again presented is the possibility that the Federal Reserve Board at Washington, through its power to approve or disapprove the selection of the governor and vice governor, as the chairman and possible vice chairman, respectively, could overbear the judgment and decisions of the directors of the regional bank and control the principal operations of the bank, especially in view of the large powers granted through other provisions to the Washington board.

Modification.—No proposal has been advanced as yet for retention of the office of Federal Reserve agent and no objection has been raised to combining the office of governor and chairman. It has been suggested, however, that if a chairman is not selected to be a governor a longer period than 90 days should be permitted him for readjustment.

DIRECTORS OF RESERVE BANKS

Proposal.—No member of the board of directors of a Reserve bank (other than the governor or vice governer) would be permitted to serve for more than 6 consecutive years, although a present incumbent could serve the remainder of his term.

At present.—Three-year terms are provided for 9 directors in the 3 classes, namely: 3 class A directors who must be elected by and be representative of the stockholding banks of the district; 3 class B directors, similarly elected, who must be actively engaged in the district in commerce, agriculture, or some other industrial pursuit and may not be officers, directors, or employees of any bank; and 3 class C directors, designated by the Federal Reserve Board at Washington, who may not be officers, directors, employees, or stockholders of any bank. There is no statutory limitation upon the number of terms that a director may serve.

Comment.—It is stated that the limitation upon the service of directors would prevent crystallization of any one interest in the management of the Reserve bank. A few of the Reserve banks now limit the terms of their class A, or banker, directors. In some districts directors are said to be kept on the boards largely as a matter of inertia.

As against the proposal, value is claimed for the present arrangement. Some of the class B, or nonbanker, directors who have served longest are said to be among the most valuable counselors in the System. It is said that the proposed arrangement would not be more successful, as men for the position of class B director who are well informed upon System operations, are not plentiful. It is stated that directors drawn from business pursuits other than banking have generally shown the longest average time of service, but that there is usually a sufficient turnover to assure new personnel and to distribute representation.

In most districts it is expected that the strongest resistance to undue Washington influences can be expected to come from the nonbanking directors, who are independent of political and banking interests, and who through long service have become familiar with the affairs of the System. The proposal is said to have a practical bearing upon the maintenance of regional autonomy, as early turnover of directors would be involved and the governors, as representatives of the Federal Reserve Board at Washington, would shortly be placed in a position to dominate decisions of the regional boards. Taken with other provisions of the bill, it is said to weaken the influence of the commercial and industrial representatives in the affairs of the System.

Modification.—No modification has been suggested by the Governor of the Federal Reserve Board or by the special committee of the American Bankers Association.

Others have suggested, however, that the 6-year limitation be applied to class A directors, but not to class B directors. Mention might here be made of the

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suggestion that the Federal Reserve Board be empowered to appoint 1 of the class B directors as well as the 3 class C directors, if it is deemed advisable for the Federal Reserve Board to have larger influence in selection of directors who elect the officers and pass upon their performance.

REQUIREMENT FOR MEMBERSHIP IN RESERVE SYSTEM

Proposal.—The Federal Reserve Board would be granted discretion to waive in whole or in part the capital requirements for membership in the Reserve system in the case of any nonmember bank admitted to the benefits of insurance by the Federal Deposit Insurance Corporation, if the bank makes application for membership in the Reserve System prior to July 1, 1937, but it must comply with the present capital requirements within such period after its admission as, in the judgment of the Federal Reserve Board, would be reasonable in view of all the circumstances.

At present.—To be admitted to membership in the Federal Reserve System an applying bank must have paid-up, unimpaired capital sufficient to enable it to become a national bank in the place where it is situated. This requirement, however, does not apply to a State bank or trust company organized prior to June 16, 1933, having a capital of $25,000 or more and situated in a place the population of which does not exceed 6,000, nor to such a bank which, while it is entitled to benefits of deposit insurance, increases its capital to $25,000 or more. No national bank may be organized with capital of less than $100,000 unless it is located in a city with a population which does not exceed 6,000, in which case its capital must be at least $50,000. A national bank organized in a city of more than 50,000 must have a capital of not less than $200,000, except in the outlying district of such a city when, with the approval of the Comptroller of the Currency, it may be permitted to organize with capital of not less than $100,000 if a State bank similarly located may be organized with capital of $100,000 or less.

Comment.—Since the law for insurance of bank deposits requires that State banks which are not now members of the Federal Reserve System must become members before July 1, 1937, if they are to continue in the insurance fund, it is maintained that it is necessary to lower the capital requirements for the admission of such banks to the Reserve System. If these banks cannot meet the present capital requirements and are compelled to withdraw from the insurance fund, much difficulty would result.

On the other hand, it is asserted that the capital requirements for admission to the national banking system and to the Federal Reserve System are not too high.

Modification.—The Governor of the Federal Reserve Board has suggested that the Board be given power to waive not only the capital requirements but all other requirements for admission of insured banks into the Federal Reserve System. He believes the Federal Reserve Board might be given full power in the matter, and while he would not require the present nonmembers to increase their capital he would require that they have adequate capital funds in relation to their deposits.

The special committee of the American Bankers Association recognizes that many nonmember banks advocate that the present requirement of the deposit-insurance law compelling all insured banks to join the Federal Reserve System by July 1, 1937, should be given further careful study by Congress before that date. The committee favors the admission of the insured banks to membership in the Reserve System without requiring an increase in capital, provided their capital is adequate in relation to their liabilities.

Others have pointed out that if no definite capital requirements are made of banks applying for membership it may be difficult to compel them to increase their capital after they are admitted to membership. In this connection attention is directed to the proposal in the bill that member banks be permitted to make and rediscount longer-term loans. If the assets of banks should more generally change in character to longer maturities, it has been suggested that conservative practice will require that many banks increase their capital funds above amounts now possessed.

MEMBERSHIP OF THE FEDERAL RESERVE BOARD

Proposal.—There would be repealed the present requirement that the six members of the Federal Reserve Board appointed by the President must be

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chosen with due regard to "fair representation of the financial, agricultural, industrial and commercial interests, and geographical divisions of the country." In place of that it would be required that such Board members be "well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies."

Not more than one of the appointed members could be selected from any one Federal Reserve district, except that this limitation would not apply to the selection of the Governor. The provisions would be continued that the Secretary of the Treasury be an ex-officio member of the Board, and preside at its meetings as chairman, as well as the designation of the Governor to preside at meetings of the Board in the absence of the Secretary of the Treasury. The Comptroller of the Currency would be continued as an ex-officio member of the Board.

There would also be continued the limitation that makes appointed members of the Board ineligible during the time they are in office and for 2 years thereafter to hold any office, position, or employment in any member bank excepting a member who has served the full term for which he was appointed.

At present.—Not more than one of the six appointed members of the Federal Reserve Board may be selected from any one Federal Reserve district and, as stated above, these members must be chosen with due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country.

Comment.—The main questions that have been raised concern the change in language as to the representative character of the appointed members of the Board and as to the continuance of the Secretary of the Treasury as presiding officer at Board meetings.

It is asserted that there is nothing inherently good about the present requirement concerning fair representation of various interests and geographical divisions. It would be inadvisable, for instance, for the member appointed as representative of agriculture to act solely as such representative and thus take too narrow a view of questions before the Board. Present requirements are said to be so broad and vague as to be meaningless. Apparently it is desired to place emphasis now upon the President appointing men who may be useful with respect to monetary policies in contrast to credit policies, even though they be without practical banking or business experience.

The introduction of the words "national economic and monetary policies" are said to be indicative of the struggle between those who would have the system operated with considerable, if not main, attention to monetary powers and control of the volume of money and those who would emphasize banking and credit functions with primary attention to the quality of credit extensions.

The view is expressed by some that the change in language is only important in connection with the intent back of it. Since official explanations have been made that there must be more emphasis upon conscious central control of monetary and credit policy and of economic conditions some apprehension has been created as to the real significance of the suggestion. Objections are stated to making the Federal Reserve Board a part of any planning bureaucracy of the Government or its agent.

The question is raised as to whether too much may not be expected of the Federal Reserve Board and of the System as a whole in connection with the application of monetary theories, changes in the character of banking operations, and the influencing of price levels and of business conditions.

No question has been raised concerning the proposal that the Governor of the Federal Reserve Board be appointed without relation to Federal Reserve districts.

Modification.—It has been suggested that the proposal be modified to provide that two members of the Federal Reserve Board be selected, when possible, from persons with experience as executives in the Federal Reserve System.

In place of the present Board of 6 appointed members and 2 ex-officio members, the special committee of the American Bankers Association has recommended that the Board be reduced to 5 members, by retiring its ex-officio members, namely, the Secretary of the Treasury and the Comptroller of the Currency, and by reducing the appointed members of the Board to 5 as soon as a vacancy occurs. The committee places emphasis upon the importance of making the Federal Reserve Board a body of such independence and prestige that it could be described as the supreme court of finance and banking.

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SALARIES AND RETIREMENT OF BOARD MEMBERS

Proposal.—The appointed members of the Federal Reserve Board taking office after July 1, 1935, would be given a salary at the same rate as the members of the President's Cabinet ($15,000) together with actual necessary traveling expenses. Each appointed member heretofore appointed could retire from active service upon reaching the age of 70 or at any time thereafter, and all members hereafter appointed must retire upon reaching 70. Each member so retired, who has served for at least 5 years, would receive retirement pay during the remainder of his life. Such retirement pay would be at the rate of one-twelfth of the present annual salary ($12,000) of appointed members for each year up to 12 years of service and full salary for longer service. Any member whose term expired while he was between the ages of 65 and 70, and who was not reappointed would receive retirement pay on the same basis. The salaries and retirement pay of the appointed members must be provided by the Federal Reserve banks. The term of appointment would be continued as 12 years.

At present.—The salary of an appointed member is $12,000 per annum, paid by the Reserve banks. There is no provision for compulsory retirement on account of age nor for retirement pay. The term is 12 years.

Comment.—Various students of the Federal Reserve System have long advocated that the salary of Board members be increased.

The retirement-pay idea is new. It is observed that a number of the present Board members would be eligible for retirement under the plan proposed. If retired there would be vacancies to be filled by the appointment of the President of men in sympathy with any new directions of policy. The proposals are said to assume real importance when considered in this light in connection with the other provisions of the bill. The retirement provisions are said to need safeguarding to avoid danger of political abuse.

Modification.—The Governor of the Federal Reserve Board has suggested that the proposal be modified to provide that any member of the Board who has served as long as 5 years and whose term has expired and who is not reappointed, be eligible for a pension upon the same basis as though he were retiring at the age of 70.

The special committee of the American Bankers Association approved the proposed increase in salaries but indicated that it would favor compensation at a somewhat higher figure than is proposed in the bill, so as to attract the very best talent available. It stated that a plan of providing suitable pensions is especially desirable because the security which such an arrangement assures would be a further help in inducing outstanding men to accept a call for service on the Board and would give them the financial independence which such a position requires.

It has been suggested by others that the salaries of Board members be made the same as that of the associate justices of the Supreme Court of the United States ($20,000) and that the compensation of the Governor be the same as that of the Chief Justice ($20,500).

TERMS OF OFFICE OF GOVERNOR AND VICE GOVERNOR

Proposal.—The appointed members of the Federal Reserve Board designated by the President as Governor and Vice Governor would hold these offices subject to the pleasure of the President of the United States. The term of the Governor would be limited to the period during which he is permitted by the President to serve as Governor, and upon the termination of his designation as Governor he would be deemed to have served his full term as a Board member.

At present.—The Governor and the Vice Governor are appointed by the President of the United States from among the six appointed members of the Board and have 12-year terms of office as Board members.

Comment.—It is stated that under the present arrangement it is sometimes difficult for a President to appoint to the governorship a man whom he desires to place in that office. The limitation that more than one appointed member may not come from a single Reserve district and the 12-year term of the Governor have occasionally presented embarrassments to new Presidents. It is asserted that if there is such difference of viewpoint between a Governor and a President as to cause the Governor to resign his office, he presumably would not care to stay as a member of the Board. It usually has happened

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that a man resigning from the office of Governor has not remained upon the Board and that a Governor has raised the question of his continuance in office with an incoming President. For such reasons the proposed change is said to be only realistic.

On the other hand, strong objection has been raised that to adopt the proposed amendment would place the Governor in substantially the same position as a member of the President's cabinet; that he would be considered a political adviser and amenable to other political advisers; that there would be increased pressure from political and sectional interests upon the President to use his influence with the Governor in favor of or opposed to particular policies; and that it would mean considerable political pressure at times not only upon the governor but upon the whole Board. Even some of the advocates of the proposal are recently quoted as believing it should be reconsidered.

Modification.—The Governor of the Federal Reserve Board has suggested that a Governor who is not redesignated as such should be permitted to continue as a member of the Federal Reserve Board if he chooses, and, if he resigns from the Board in the event that he is not redesignated as Governor, he should be considered to have served out his full term as a Board member and therefore should not be subject to the prohibition that for 2 years after resignation he may not hold any position with a member bank.

The special committee of the American Bankers Association has indicated its agreement with the modification just stated. It adds, however, that if it is deemed essential to give each incoming President the right to name a Governor of his own choosing, because of the fact that under another recommendation of the committee the incoming administration would no longer be represented on the Board by the Secretary of the Treasury or the Comptroller of the Currency, it might be desirable to give the incoming President the power to select the Governor of the Board and to provide that his term be the same as that of the President. It believes the act should provide that the members of the Federal Reserve Board, including the Governor, should be removable during their terms of office only for cause.

DELEGATION OF DUTIES

Proposal.—The Federal Reserve Board would be permitted to assign to designated members of the Board or officers or representatives of the Board, under its rules and regulations, the performance of specific duties or functions of the Board which do not include the determination of any national or system policy, nor the exercise of the power to make rules or regulations or of any power which the Federal Reserve Act requires be exercised by a specified number of members of the Board.

At present.—The law specifies a variety of routine duties which must be performed by the Board and does not authorize the delegation of them.

Comment.—The proposal is advocated on the ground that it would relieve the Board from many minutiae. It does not appear to have met with any objection.

Modification.—None was suggested.

OPEN-MARKET COMMITTEE

Proposal.—The Federal Open Market Committee would be composed of the Governor of the Federal Reserve Board (as its Chairman), 2 members of that Board selected annually by it and 2 governors of Reserve banks selected annually by the governors of the 12 banks in accordance with procedure to be prescribed by the Federal Reserve Board. Meetings of the committee would be held upon the call of the Governor, when requested by the Board or by any two members of the committee, or upon his own initiative.

The committee would be empowered to state in resolutions the policies that in its judgment should be followed with respect to the open-market operations of the Reserve banks and the banks would be required to conform to the proposals. The committee would be authorized to aid in the execution of such policies and to perform such other duties relating thereto as the Federal Reserve Board might prescribe. All open-market operations of the Reserve banks would be subject to regulations of the Federal Reserve Board.

The Committee would be empowered to make recommendations to the Federal Reserve Board regarding the discount rates of the Reserve banks. There would be omitted the present requirement of law that the time, character, and

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volume of open-market transactions must be governed with a view to accommodating commerce and business and with regard to the general credit situation of the country.

At present.—The Federal Open Market Committee consists of 12 members. The board of directors of each Reserve bank elects one member each year. The committee meets in Washington at least 4 times each year upon the call of the Governor of the Federal Reserve Board or upon the request of any 3 members of the committee. In the discretion of members of the Board they may attend its meetings.

No Reserve bank is permitted to engage in open-market operations except in accordance with regulations adopted by the Federal Reserve Board. The time, character, and volume of all open-market transactions must be "governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country." Any Reserve bank which decides not to participate in the open-market operations recommended by the committee must file with the chairman of the committee within 30 days a notice of its decision and transmit a copy thereof to the Federal Reserve Board.

Comment.—The proposed amendment appears to provide one of the main grounds of controversy. The open-market operations are believed by many to be the most important single instrument within Reserve control. These operations consist mainly of the buying or selling of obligations of the United States Government and bankers acceptances. Buying by the Reserve banks releases funds to the market and selling withdraws funds.

This amendment is advocated principally on the ground that the present committee arrangement and practice do not provide a good set-up from an administrative point of view; that the Federal Reserve Board, which is largely responsible for policy, does not formulate the open-market policy in the first instance; and that neither the committee which does formulate the policy nor the Board has power to compel its adoption by the Reserve banks. It has been emphasized that the amendment would contribute to the formulation and effectuation of a more truly national policy.

In view of the nature of official statements respecting the control of the volume of money and of credit through open-market operations, the need for more conscious central direction of monetary and credit policies to assist recovery, and especially the support of the Government's credit through purchase of its securities by the Reserve and member banks, there are objections to the proposed amendment upon a number of grounds.

These principally are that the open-market policy would not be determined by the Federal Reserve Board in consultation with the Reserve banks, but would be formulated by a small committee upon which those banks would have a minority representation, even if the two governors should consider themselves in effect delegates from the Reserve banks with the duty to reflect decisions of the banks rather than their own opinions. It is asserted that the proposed conditions under which the governor of a Reserve bank and the Governor of the Reserve Board would hold office would operate to make the latter a dominant figure with regard to one of the most important powers to be given a banking system. It is pointed out that any one of the three members of the Federal Reserve Board, such as the Governor, by agreeing with the two governors of Reserve banks, could overrule in effect basic policies that would have majority support in the Federal Reserve Board or, for that matter, in the Reserve banks.

It is asserted by some that this delegates to a small committee a great power which should be reposed in the Board if the present arrangement needs modification, and which should be exercised only in consultation with the Reserve banks without arbitrary imposition of policy upon them. It is maintained that the open-market operations should be mainly the concern of the Reserve banks and that no arrangement would be correct which fails to regard the banking situation in the respective Reserve districts in relation to the national situation as a whole. It is denied that the Reserve banks have interfered as a matter of fact with the formulation or effectuation of open-market policies in opposition to express views of the Federal Reserve Board.

The main question as to the composition of the Federal Open Market Committee concerns the number and representative character of people that should participate in the formulation of policy. Recognizing that the body should be broadly representative, it is asserted that the proposed amendment provides too small a number and is equivalent to giving one of the great powers of a legislative body to a small committee. It is maintained that the plan now in force

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brings to bear upon policy the opinions of competent groups of bankers and of nonbankers, and that the proposed plan would disfranchise the boards of the Reserve banks with respect to a policy that could be more important in its effects than many laws of Congress. It is asserted that to vest this power in the Federal Reserve Board would fail to recognize that the Board can be provincial and operate in a manner that is not truly representative in a national way.

It is maintained that open-market policies are not simply questions of general theory but involve problems of good administrative practice by the Reserve banks, and that the Reserve banks are in a better position to realize the probable effects of a policy than is the Federal Reserve Board.

Objection is raised to the omission of the present requirement that the time, character, and volume of open-market transactions must be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. Some appear to believe that this omission presents a prospect that dubious monetary theories, in contrast to qualitative credit considerations, would be preeminent in the policies adopted and that, in support of the deficit financing of the Government and of its spending programs, more extensive purchase of its securities would be engaged in than would prove desirable.

It is asserted that by means of this amendment the administration of the Federal Government could compel open-market operations to suit its particular purposes regardless of the principles of sound central banking and of the needs of commerce, agriculture, and industry. It is maintained that it is not the function of a central banking system to give Government credit a higher rating than it otherwise would have in the open market to which non-Government borrowers and lenders must go. It is emphasized that in view of the existing situation and of the monetary, credit, and governmental spending theories of the principal proponents of title II, the actions of the proposed open-market committee undoubtedly would be subjected to Government control and would mean the subordination of the true functions of the Federal Reserve System to the fiscal and other operations of the Government.

Objection has also been made to giving to the Federal Reserve Board or to the Open Market Committee any power to compel changes with respect to rediscount rates, preference being expressed for the present method under which changes in rediscount rates are initiated in the reserve banks but are subject to the approval of the Federal Reserve Board.

Modification.—The Governor of the Federal Reserve Board recently proposed that the open-market authority be vested in the whole Federal Reserve Board and that there be appointed a committee of 5 governors selected by the 12 governors of Reserve banks with the requirement that the Board consult this committee before changing the open-market policy, the rediscount rates, or the reserves required of member banks. He stated that the Board should have the responsibility and power to initiate changes and that the committee of governors should be entitled to make recommendations upon proposed changes. He favored a power to the Board to make rules and regulations with respect to the method of selecting the committee of governors, time of its meetings, and similar matters.

The special committee of the American Bankers Association has stated that neither the proposal in the original bill providing for a committee of 3 members of the Federal Reserve Board and 2 governors, nor the subsequent suggestion that authority over open-market operations be vested in the Federal Reserve Board with the requirement that it consult with a committee of 5 governors selected by the 12 governors before adopting an open-market policy, a change in discount rates, or a change in reserve requirements, constitutes a satisfactory solution of the open-market problem. It suggested that the open-market committee consist of the entire Federal Reserve Board (reduced to 5 members) and 4 governors selected by the 12 governors annually, with each member of the open-market committee having a vote in the deliberations of the committee with respect to the three subjects that might be entrusted to it, namely, open-market policy, consideration of rediscount rates, and changes in reserves required of member banks.

It is proposed by others that a slight modification of the present set-up of the open-market committee be adopted. They would have the 12 governors of the Reserve banks serve as the open-market committee and, in consultation with the Federal Reserve Board, determine the policy to be recommended to the Reserve banks, with a rule that after approval of the policy by a majority of the Reserve banks it would be binding upon all. They would limit the

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subjects to be dealt with by the committee to two, namely, open-market operations and changes in reserves required of member banks.

The Under Secretary of the Treasury has indicated objections to placing control of open-market operations in the Federal Reserve Board. Calling attention to the fact that the Reserve banks are responsible for the funds employed in the open market, he stated that they should be represented upon the open market committee by governors of their choice.

REDISCOUNTS AND LOANS TO MEMBER BANKS

Proposal.—Subject to Federal Reserve Board regulation as to maturities and other matters, any Federal Reserve bank would be permitted to rediscount for a member bank, upon its endorsement, "any commercial, agricultural, or industrial paper" and to make advances to a member bank "on its promissory notes secured by any sound assets of such member bank."

At present.—The Federal Reserve Act prescribes, with careful limitations, types of advances which may be made by Federal Reserve banks to member banks and, under exceptional circumstances, directly to individuals, partnerships, or corporations. There are also meticulous provisions respecting types and maturities of paper made eligible for rediscount, with major emphasis placed upon commercial loans. An emergency provision that the Reserve banks may come to the assistance of banks which have sound assets but are devoid of eligible paper lapsed in March 1935.

Comment.—These proposed broad grants of power to the Federal Reserve Board are advocated on the grounds that there has been considerable change in the character of the assets of the member banks, that narrow restrictions upon the types of bank loans and rediscounts are in accordance with an outgrown theory of Reserve banking, that more emphasis should be placed upon the soundness of assets rather than upon their commercial or liquid nature, and that since it is advisable to encourage the member banks to make loans of a character that may not now generally be made, the Federal Reserve Board should be empowered to permit discounting for any member bank of any type of asset that the Board might prescribe. Attention is also directed to the fact that if about 7,600 nonmember banks now in the deposit-insurance fund are compelled to become members of the Federal Reserve System, considerable flexibility should be allowed regarding eligibility requirements so that the Reserve banks may serve usefully these new members. The same line of reasoning is applied to the proposal that advances may be secured "by any sound assets" of a member bank.

The proposal has been objected to on the ground that it would mean a change in the fundamental conception of the Reserve System that has prevailed since its establishment and that should be continued. It is considered an exceptionally broad power to give the Federal Reserve Board which not only might seriously affect the kind and quality of assets held by the Reserve banks, but might permit the application of dubious monetary policy in connection with Federal Reserve notes. It is stated that the provision would open the door, for instance, to index currency, the commodity dollar, and a bond-secured or slow-asset currency. It is asserted also that the proposal is an indication of the desire that the force and direction of Reserve bank operations, and even member-bank lending policies, be subjected in the main to the views of a small Washington group. At the same time it is recognized that the changes in the economic situation have affected the volume of short-term, self-liquidating paper now eligible for rediscount and that it is necessary, in determining the advisability of a change in present requirements, to make a close estimate of the trends in the operations of member banks.

Taken in conjunction with other powers, particularly the open-market operations and the collateral requirements for Reserve notes and the centralizing of great authority in the Federal Reserve Board, the proposal is objected to as permitting the development of a kind of banking system in the United States that is not deliberately planned by the Congress, after consideration of the views of business and banking elements and other informed citizens as to the kind of banking system that is desirable. Attention has been directed to the fact that it is unusual in central bank practice anywhere to give the bank authorities entire discretion to determine the eligibility requirements for rediscounts and advances, and at the same time to provide that bank notes shall be a first lien upon the assets of the bank with no specific cover other than a specified percentage of gold or gold certificates.

Modification.—None has been officially proposed.

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Some are recommending, however, that the emergency provisions of the Federal Reserve Act (sec. 10b) which lapsed March 3, 1935, be restored for a period of 2 years, and that little or no change be made in other requirements concerning rediscounts and advances. According to the provisions of section 10b, a member bank with no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations, through rediscounting at a Reserve bank or any other method provided by the Reserve Act, could secure advances from the Reserve bank on time and demand notes secured to the satisfaction of the Reserve bank. The note was required to bear interest at a rate not less than 1 percent higher than the highest discount rate.

Some would require that advances to member banks, collateraled by Government bonds, bear a higher rate of interest than rediscounts, and some would more drastically curtail the use of Government securities by member banks in obtaining accommodations from the Reserve banks.

PURCHASE AND SALE OF GUARANTEED OBLIGATIONS

Proposal.—The Reserve banks would be permitted to purchase and sell direct obligations of the United States or those fully guaranteed, as to principal and interest, by the United States, without regard to maturities.

At present.—Direct obligations of the United States are now eligible for open-market operations. The Reserve banks have purchased principally the shorter-term securities. Other obligations, which may be guaranteed as to principal and interest by the United States, are not fully eligible in every instance for open-market operations. With the exception of bonds and notes of the United States, obligations which may be purchased by the Reserve banks normally must have maturities of not exceeding 6 months from the date of purchase.

Comment.—The amendment would make all obligations that are guaranteed both as to principal and interest by the United States eligible for open-market purchases upon the same basis as direct obligations of the Government, and both types could be purchased without regard to maturities. It is stated that this would help to support the market for such obligations.

The question has been raised, however, as to the advisability of permitting the Reserve banks to acquire such guaranteed obligations in any large volume, especially since this and other amendments could be used to set the stage for a large increase in Reserve bank purchases of Government obligations, direct or contingent.

It is asserted that the Reserve banks could be flooded with illiquid long-term securities and, under the system aimed at by the various provisions of title II, there would be danger of both unsound money and unsound credit conditions.

Modification.—None officially proposed.

NEW BASIS FOR FEDERAL RESERVE NOTES

Proposal.—Each Reserve bank would be permitted to issue Federal Reserve notes, which would be obligations of the United States, secured by a first and paramount lien on all of the assets of the Reserve bank, but there must be maintained reserves in gold certificates of not less than 40 percent against Federal Reserve notes in actual circulation. The notes would be issued and retired under such rules and regulations as the Federal Reserve Board would prescribe and would be legal tender for all purposes.

The present requirements that each Reserve bank maintain a retirement fund in gold certificates on deposit in the Treasury of the United States and the prohibition upon a Reserve bank paying out notes issued by another Reserve bank would be removed, as would the provisions for issuance and redemption of notes through Federal Reserve agents and the substitution of collateral behind notes. Detailed matters relating to printing, denomination and form of notes would be modified. All newly prepared notes would be held in the Treasury subject to the order of the Comptroller of the Currency for delivery to the Reserve banks instead of being deposited, as at present, in the Treasury, the subtreasury or mint nearest the Reserve bank.

At present.—Each Reserve bank must maintain a 100-percent cover for Federal Reserve notes of which cover a minimum of 40 percent must be in gold certificates and the balance in eligible paper or Government securities or both. The inclusion of Government securities as part of the cover for such

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notes is a temporary power. The amendment would remove permanently any specific cover except the minimum 40 percent in gold certificates, but would continue the present provision that the notes are a first and paramount lien upon the Reserve bank assets.

Comment.—The principal questions raised relate to the cover for Federal Reserve notes.

It is maintained that the Federal Reserve notes in fact are secured by all the assets of a Reserve bank and it is only realistic and proper to omit the requirement of specific cover beyond a reasonable reserve in gold certificates. It is stated that this would make more flexibility with respect to note issuance and, while providing a sufficient gold cover, would not necessitate the employment of gold certificates to an unreasonable amount as cover for the notes. If a Reserve bank has gold certificates in excess of the 40 percent, they still would be a part of its general assets.

The present absence of volume of eligible commercial paper is referred to as well as the probability that such paper is not likely to become available in any greatly increased volume for cover of notes. It is asserted that the new provisions would make for a better Federal Reserve note than the present one, especially in view of the existing power to collateral the notes with Government's, instead of eligible paper, to the extent that they are not covered by gold certificates.

On the other hand, it is asserted that the provisions would make for a less desirable note, particularly if, because of other amendments in the bill, the assets of the Reserve banks should become composed more largely of Government securities and longer-term and all manner of illiquid paper. In other words, this view holds that the proposal would be more acceptable if there were safeguards as to the quality and short maturity of the assets of Reserve banks and against political interference with their management. In view of the proposal that the eligibility requirements for rediscounts be greatly broadened and be left entirely to the Federal Reserve Board and of the possibility that holdings of Government securities and guaranteed obligations would be increased, it is asserted that disturbing questions would arise concerning the volume and quality of future Reserve-note circulation.

Attention should be directed to the fact that the present power to collateral the notes with Government securities is a temporary one to expire not later than March 1937, and it never has been considered desirable to increase more than necessary the volume of bond-secured currency.

It is stated that under the two proposed changes, namely, in the eligibility requirements for rediscounts and in the collateral requirements for Federal Reserve notes, practices would develop which are not generally recognized as being desirable in central banks. It is stated that in the principal central banks of the world, when collateral requirements for notes are minimized or omitted the eligibility requirements for rediscounts are maintained and vice versa. It is recalled that these changes taken together would emphasize the prospect of more central management and "conscious control" of money and credit and, combined with the deficit financing of the Government, would make for an increased opportunity for inflation.

Modification.—None officially proposed.

RESERVES AGAINST DEPOSITS OF RESERVE BANKS

Proposed.—Gold certificates would be eliminated as required reserve against deposits of Reserve banks. The reserve would be lawful money (other than Federal Reserve notes or Federal Reserve bank notes) of not less than 35 percent.

At present.—Each Reserve bank is required to maintain a 35-percent reserve in gold certificates or lawful money against deposits.

Comment.—It has been held at times that the stated percentage of required reserves against deposits is relatively unimportant in the case of a Reserve bank. Since under present law the present requirements could be met with lawful money, the omission of gold certificates is said to be only realistic and would permit of flexibility with respect to the use of gold certificates in relation to note circulation.

It has been observed that with no scarcity of gold or gold certificates the proposal might be favored as a permissive power, but that as a general policy it would be objected to by those who assert that both the credit and monetary systems should be placed and kept firmly upon a foundation of gold.

Modification.—None officially suggested.

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RESERVES OF MEMBER BANKS

Proposal.—"In order to prevent injurious credit expansion or contraction", the Federal Reserve Board would be permitted to change by regulation the requirements as to reserves to be maintained against demand or time deposits or both by member banks in any or all of the Reserve districts and/or in any or all of the three Reserve classes of cities.

At present.—The law now specifies definite minimum reserves that must be maintained by member banks, according to their locations. The highest reserves against deposits are required of the banks in the central reserve cities (New York and Chicago). The next highest reserves required are in the Reserve cities (now some 62 in number), and the lowest reserves required are in banks outside of these two classes of cities, namely, in the country districts. There is, however, an emergency provision that 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" the reserve balances required to be maintained by member banks against their deposits.

Comment.—Proposals for changes in the required reserves have been under discussion for many years. The subject is of great importance.

The amendment is advocated on the ground that it is proper to adopt as a permanent provision the intent of the present emergency provision of law and give to the Federal Reserve Board the power to change reserve requirements, without specifying that an emergency exists and without requiring the approval of the President. It is stated that this is a function of monetary control almost equal in importance to open-market operations, and the Federal Reserve Board should have the power in order to control any inflationary condition that might develop. It is asserted that the reserves of the member banks may be greatly in excess of the amount of Government bonds and paper held by the Reserve banks and that the sale of such securities in the market would not be sufficient to absorb the excess reserves. It might then be necessary to make an increase in reserve requirements as a means of controlling the inflation of credit. It is stated that the power would be used as a method secondary to open market operations, when such operations fail to meet the situation.

On the other hand, the proposal is objected to on the ground that it would be too great a power to give to the Washington board without any limitation, except a general provision that it be exercised in order to prevent injurious credit expansion or contraction. There are many who appear to support the proposition that the Federal Reserve authorities should propose a definite plan for changing the reserve requirements but that these requirements should be passed by Congress rather than left to the discretion of the Federal Reserve Board.

Some have asserted objections to the present proposal, not because there should not be power to control any such undue expansion of credit as could occur under the various laws that have been passed, but because they fear the amendment, combined with the other proposals in the bill, would open the door to policies more concerned with forced and harmful expansion of credit than with contraction. They point out that the power could be used as a weapon in any reserve district or in the larger cities to compel the banks to do or not to do particular things.

It is asserted that great changes in the banking system could be forced by altering the reserves required of banks according to Federal Reserve districts, central reserve or reserve cities, or rural areas. The door would be opened, for instance, to a requirement that a hundred percent reserve be established against demand deposits, in furtherance of a theory which a few persons have advanced. Arbitrary decisions in such matters by a small group of minds, with power to act, would create considerable disturbance.

Modification.—The Governor of the Federal Reserve Board has recently proposed a modification of the amendment to the effect that changes in member-bank reserve requirements might be applied to two classes, namely, to one class to be composed of the banks in central reserve and reserve cities, and to a second class to be composed of the banks in country areas.

The special committee of the American Bankers Association believes that the suggestion of the Governor of the Federal Reserve Board, above referred to, is more desirable than the amendment in the bill, but suggests that serious consideration also should be given to the desirability of fixing limits and

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percentages of deposit beyond which reserve requirements cannot be increased or decreased. In connection with its recommendation upon the Federal open market committee, earlier referred to, it believes that changes in reserve requirements should be subjected to the decision of an open market committee of the type it proposes.

LOANS ON IMPROVED REAL ESTATE BY MEMBER BANKS

Proposal.—State member banks would be required to conform to the limitations upon national banks in regard to new loans made upon the security of real estate.

A national bank would be authorized to make loans when secured by first liens upon improved real estate (farm, business, and residential properties) when the entire amount of the obligation is made or sold to the bank. Such a loan could not have a maturity in excess of 3 years nor be in an amount in excess of 60 percent of the actual value of the property, except that a loan, secured by a first lien, in an amount not exceeding 75 percent of the actual value of the property could be made if the loan is required to of substantially equal monthly, quarterly, semiannual or annual payments. be completely amortized within a period not exceeding 20 years by means The aggregate sum of such loans could not exceed the paid-in, unimpaired capital and unimpaired surplus, or 60 percent of the time and savings deposits of the bank, whichever is the greater. In computing such aggregate there must be included all the loans on which the bank is liable as an indorser, guarantor, or otherwise, and the book value of all real estate owned by the bank directly or indirectly except its banking premises.

In the case, however, of loans, secured by improved real estate and insured under the provisions of title II of the National Housing Act, the restrictions as to the amount of the loan in relation to the value of the real estate and as to the 3-year limit on the terms of the loans would not apply.

There is advanced a specific provision that the law would not prevent any national bank 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.

The geographical restrictions on real-estate loans would be removed.

At present.—State member banks must conform only to the requirements of their respective State laws, which in some instances grant them powers which differ from those of national banks in the matter of real-estate loans.

A national bank is authorized to make loans upon a mortgage for a period not exceeding 5 years, and in an amount not exceeding 50 percent of the actual value of the improved real estate. The aggregate amount of such loans may not exceed 25 percent of the bank's paid-in, unimpaired capital, and unimpaired surplus or one-half of its savings deposits, as it may elect.

There is no provision that a national bank may make an amortized loan without conforming with the limitation of 5 years maturity and 50 percent of the value of the property, except that in the case of a loan which is insured under the provisions of title II of the National Housing Act the restrictions as to the amount of the loan in relation to the value of the real estate and as to the 5-year limit on its term do not apply.

A national bank may make a loan only upon the security of a first lien upon property situated within the Reserve district in which it is located or within a radius of 100 miles of the location of the bank.

Comment.—With the decrease in commercial loans by commercial banks and the changed character of the financial operations of commercial and industrial customers, it is maintained that the proposed mortgage-loan powers would contribute to general recovery and to an increase in the earnings of banks, as well as assist in making mortgages more generally acceptable instruments and greatly support the operations under the National Housing Act.

It is asserted that the proposed changes would enable the banks better to supply the needs of their communities for mortgage loans and that they do not introduce a new character of loan but merely relax existing limitations on real-estate loans which national banks have made for years. It is stated that even if it be theoretically desirable to separate commercial banking from savings banking, it could not be accomplished in this country without disrupting existing machinery while there is urgent need for increased building activity. It is stated also that member banks are suffering from competition by Government and other agencies entering the field of real-estate loans, and that it is a

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matter of self-preservation for the banks to be able to hold and expand their activities in this field.

It is recognized by proponents of the amendment that some of its details may have to be modified, as at times in some regions even a 50-percent loan would be liberal. Attention is also directed to the fact that some of the State member banks and many of the nonmember banks already have in excess of 60 percent of their time funds in real-estate loans.

It is argued that there are no restrictions imposed upon banks with reference to their investments in long-term bonds in which they may engage not only their commercial funds but their savings funds, and it is as desirable to permit them to lend funds on improved real estate on an amortized basis in their local communities as to invest in long-term listed bonds. It is observed that the depression proved that a ready market for such bonds existed only at prices that weakened the banks which were forced to sell and that more banks became insolvent as a result of the depreciation of their bond accounts than as a result of their real-estate loans. It is asserted, however, that the banks should be permitted to invest funds in long-term bonds as well as to lend upon long-term amortized mortgages, especially their savings or time funds, otherwise they might find it difficult to employ such funds except in the purchase of Government bonds or securities guaranteed by the Government.

On the other hand, the proposed changes are objected to by those who believe that the powers of banks to lend upon mortgages should be curtailed rather than increased and by those who maintain that the experience with amortized loans, based upon insured or uninsured mortgages, has not been conspicuously superior to unamortized loans and by those who entertain considerable doubts as to the success of the insurance provisions of the National Housing Act.

Taken with other provisions, objection is made that mortgages could be made available for rediscount with Reserve banks and, thus with other slow assets, make their portfolios less liquid and dependable. There has been steady objection to the admission of mortgages to rediscount and to permitting them and other slow assets to become a basis for currency issues and for release of Reserve credit.

It is asserted that the problem of the banks concerning their listed bonds was not as great as their inability to realize upon their mortgages, but that in both instances the difficulties mainly arose because of examining policies which required the carrying of such assets on a basis of immediate market value instead of real intrinsic worth; further, that it is only reasonable to expect that carefully selected bonds as investments will prove more liquid than loans upon first mortgages whether amortized or unamortized.

Modification.—The Governor of the Federal Reserve Board has proposed that the conditions upon which loans upon the security of real estate might be made by member banks should be left to the discretion of the Federal Reserve Board to enforce by regulations and that some suitable geographical limitations as to the territory in which such loans might be made should be established.

The special committee of the American Bankers Association has indicated that it does not favor the amendment as contained in the bill to the extent of permitting advances against real estate up to 75 percent of value if amortized within 20 years or up to 60 percent of value for a term of not more than 3 years, in both instances without geographical limitations. It does favor, however, the suggestion subsequently advanced that all real-estate loans hereafter made should not exceed 60 percent of the appraised value of the property, and that the Federal Reserve Board be given discretion to make regulations governing real-estate loans held by banks at the present time. It further stated that the present geographical limitations or similar ones should be contained in the law and that unamortized real-estate loans should be permitted up to a period of 5 years.

BUSINESS STABILITY

Proposal.—While there is no amendment dealing specifically with this subject in the bill, the Governor of the Federal Reserve Board has indicated to the Banking and Currency Committee of the House approval of the insertion of a provision that "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."

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Comment.—In the past vigorous objections have been made to a specific requirement that the Federal Reserve Board or System or the Treasury or any combination of them be expected to use their powers specifically for such purposes as establishing stability of business, prices, or employment. The main grounds of objection have been that such a provision of law would raise public expectations that could not be realized through use of monetary or other powers and would subject the Federal Reserve Board or System, or the Treasury, or all of them, to severe criticisms because there will always be some, in and out of Congress, who would maintain that "proper" exercise of the monetary and other powers would produce more "desirable" conditions.

APPENDIX

There are presented below brief summaries of the provisions of title I and of title III.

TITLE I

(Summary of amendments to law upon insurance of bank deposits)

Title I of the proposed Banking Act of 1935 would practically rewrite the insurance-of-bank-deposits section of the Federal Reserve Act which now provides for a temporary Federal Deposit Insurance fund and a fund for mutuals to operate until July 1, 1935, and a so-called "permanent" plan to operate for an indeterminate period thereafter.

Effective date.—Upon the enactment of the measure the temporary Federal Deposit Insurance fund and the fund for mutuals would be consolidated, and a revised, permanent insurance plan would become operative.

Banks insured.—Every licensed operating bank which is a member of the Federal Reserve System would continue as an insured bank without application or approval. Every national bank established after the passage of the legislation, and every State bank becoming a national bank or becoming a State member bank of the Federal Reserve System would become an insured institution upon certification by the proper authority, except that an insured nonmember State bank which is converted into a national bank or into a State member bank would not have to be certified.

Every bank not a member of the Federal Reserve System which is insured in the temporary fund or the fund for mutuals would continue without application or approval to be an insured bank unless it should give written notice to the corporation within 30 days of its election not to continue after June 30, 1935, as an insured bank, and give notice to its depositors not less than 20 days prior to June 30.

Deposits of a bank giving such notice would continue to be insured until June 30, 1935, and the rights of the bank would be as provided under the present law.

Any State nonmember bank in the temporary fund or the fund for mutuals which did not file statements required on or before October 1, 1934, and did not make payments required thereon would cease to be an insured bank on June 30, 1935. An insured bank which has permanently discontinued its banking operations prior to the passage of the legislation would not be an insured bank after June 30, 1935.

Until July 1, 1937, any national nonmember bank, upon its application and certification by the Comptroller of the Currency or any State nonmember bank upon its application to and examination and approval by the Corporation, could become an insured bank.

Certification.—Before approving the application of any State nonmember bank for insurance, the board of directors of the Federal Deposit Insurance Corporation would be required to give consideration to the following factors: The financial history and condition of the bank, the adequacy of its capital structure, its future earning prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its coporate powers are consistent with the deposit insurance provisions.

The certificate required from the Comptroller of the Currency in the case of a national bank and from the Federal Reserve Board in the case of a State member bank entering the insurance fund after the passage of the bill,

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would have to state that the bank is authorized to transact the business of banking as such a bank and that consideration has been given to the factors enumerated above.

Size of insured accounts.—The maximum size of an insured deposit would be such part of the net amount of money due to any depositor for deposits in an insured bank, after deducting offsets, as would not exceed $5,000. This is the maximum amount now insured under the terms of the temporary fund and the fund for mutuals, and would be continued in place of the different amounts which would be insured under the so-called "permanent plan." In determining the amount due to any depositor there would be added together all deposits in the bank maintained in the same capacity and the same right for his benefit either in his name or in the name of others except trust funds.

Trust funds held by an insured bank in a fiduciary capacity would be insured up to $5,000 for each trust estate, and such insurance would be separate from and in addition to that covering other deposits of the owners of such trust funds or other beneficiaries of such trust estates.

Assessments upon insured banks.—Each insured bank would be assessed at the rate of one-twelfth of 1 percent per annum upon its total deposits without any deduction for indebtedness of depositors, based upon the average determined from such total as of the close of business on the last day of June and December of each year. This would be in lieu of the provisions of the present permanent fund which would allow the imposition of an unlimited number of assessments of one-fourth of 1 percent of the banks' total deposits.

The term "deposit" would be defined as the unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given or is obligated to give unconditional credit to a commercial checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, and trust funds held by a bank in a fiduciary capacity, whether held in its trust or deposited in any other department or in another bank. Where a fiduciary bank deposits trust funds in other insured banks, the amount so held by the other insured banks on deposit would not be considered to be a deposit liability of the fiduciary bank, but would be considered deposit liabilities of the banks in which the funds are deposited by the fiduciary institution. Such other obligations of a bank might be considered deposits as the directors of the Corporation might find and prescribe by regulations to be deposit liabilities by general usage. An obligation of a bank, however, payable only at an office which is located outside of the United States, the District of Columbia, Hawaii, or Alaska, would not be a deposit for the purpose of deposit insurance or be included as a part of total deposits or of an insured deposit. The directors of the Corporation could by regulation further define the terms used in connection with the definition of "deposit."

The directors of the Federal Deposit Insurance Corporation could fix a lower rate than one-twelfth of 1 percent, or provide for a refund or credit by a percentage upon the last annual assessment rate not exceeding 50 percent thereof. The same rate would apply to all insured banks except that the directors of the Corporation could provide a different rate that would be applicable only to mutual savings banks.

On or before July 15 and January 15 of each year each insured bank would be required to file with the Corporation a statement showing the total amount of its liability for deposits as of the close of business of the preceding June 30, or December 31, as the case might be, and would have to pay one-half of the annual assessment multiplied by its total deposits on the date for which the statement is made. Provision would be made for adjusting assessments of banks entering the insurance fund after the passage of the legislation, and on any date more than 30 days before the next succeeding last day of June or December of any year.

Each bank continuing without application or approval to be an insured bank would in lieu of all right to refund, be credited with any balance to which the bank might become entitled upon the termination of the temporary Federal Deposit Insurance fund for the fund for mutuals. The credit would be applied by the Corporation to the payment of the assessment next becoming due from such bank and upon succeeding assessments until exhausted.

Voluntary termination of insurance.—Any insured bank except a national or State member bank, upon not less than 90 days' written notice to the Corporation, could terminate its status as an insured bank. A member bank would be required to withdraw from the Federal Reserve System to terminate its status as an insured bank. Likewise, should a State member bank cease to be

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a member of the Federal Reserve System its status as an insured bank would also terminate and its insured deposits would be treated as described below.

After the voluntary termination of the insured status of any bank the insured deposits of each depositor in the bank from the date of such termination, less all subsequent withdrawals, would continue to be insured for 2 years, and the bank would have to continue to pay to the Corporation assessments as in the case of an insured bank for such period. No additions to any deposits, however, nor any new deposits would be insured and the bank could not advertise or hold itself out as having insured deposits unless it stated with equal prominence that additions to deposits and new deposits made after the date of the termination would not be insured. Such bank would in all other respects be subject to the duties and obligations of an insured bank for a period of 2 years from the termination of its insurance, and if closed on account of inability to meet the demands of its depositors within such period, the Federal Deposit Insurance Corporation would have the same powers and rights with respect to it as it would in the case of an insured bank.

Involuntary termination of insurance.—Whenever the directors of the Federal Deposit Insurance Corporation find that an insured bank or its directors or trustees have continued unsafe or unsound practices in conducting the business of the bank, or knowingly or negligently have permitted any of its officers or agents to violate repeatedly any provision of the insurance statutes or regulations made thereunder, or of any law or regulation pursuant thereto to which the bank is subject, the board of the Corporation would first give to the Comptroller of the Currency, in the case of a national bank or a bank in the District of Columbia, or to the authority having supervision over it in the case of a State bank, and also to the Federal Reserve Board in the case of a State member bank, a statement of such violation by the bank for the purpose of securing a correction of such practise or conditions.

Unless a correction were made within not more than 120 days as might be required by supervisory authorities, the directors of the Corporation, if determined to proceed further, would give to the bank not less than 30 days' written notice of intention to terminate its status as an insured bank, and would fix a time and place for a hearing before the directors of the Corporation or before a person designated to conduct such hearing, at which evidence might be produced. The directors of the Corporation would make written findings upon such evidence and these would be conclusive. Failure of the bank to appear by a duly authorized representative at the hearing would be deemed to be a consent to the termination of its status as an insured bank. Upon a finding by the directors of the Corporation that any ground specified in the notice has been established, they might order the insured status of the bank to be terminated on a date subsequent to the finding and to the expiration of the time specified in the notice of intention. The Corporation might publish notice of such termination and the bank would be required to give notice to its depositors in such manner and at such time as the directors of the Corporation might order.

If the directors of the Corporation should terminate the insured status of a member bank, the Federal Reserve Board, in the case of a State member bank, would terminate membership of the bank in the Federal Reserve System, and in the case of a national bank the Comptroller of the Currency would appoint a receiver for the bank, except that if such national bank were unable to meet the demands of its depositors the Federal Deposit Insurance Corporation would be the receiver.

After the involuntary termination of the insured status of any bank, the insured deposits would be treated as explained above in the case of banks whose insurance is terminated voluntarily.

Assumption of liabilities.—Upon the assumption of the liabilities of an insured bank by another bank, the insured status of such insured bank would terminate on receipt of notice by the Corporation of such assumption with the same effect as if terminated voluntarily (see above) except that should such a bank give notice of the assumption within 30 days thereafter to its depositors in accordance with regulations prescribed by the directors of the Corporation, the insurance of its deposits would terminate at the end of 6 months after the assumption of such deposits, and the bank would be relieved of all further obligations to the Corporation.

Corporation as receiver.—In the event of the closing of any insured national bank or bank in the District of Columbia on account of inability to meet the demands of the depositors, the Comptroller of the Currency would be required to appoint the Federal Deposit Insurance Corporation as receiver for the bank,

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with full power to wind up its affairs. Upon the closing of an insured State bank, the Corporation would be required to accept appointment as receiver if it were lawfully tendered by the proper State authority.

Payment to depositors in closed banks.—The bill would change in several respects the procedure to be followed in the event an insured bank is closed on account of inability to meet the demands of its depositors. It would permit the Corporation to pay insured depositors (1) by making deposits to their account in a new national bank set up to assume the insured liabilities of the closed bank; (2) by making deposits to their account in any insured bank that is active in the community; or (3) by adopting any other procedure that is approved by the directors of the Corporation.

Under the present law the only method available to the Corporation to pay off insured depositors is through the establishment of a new national bank with limited powers. The bill would permit such a new national bank, if organized, to keep deposit balances with another insured bank as well as with the Corporation, or with a Federal Reserve bank.

An insured bank would be deemed to have been closed on account of inability to meet the demands of its depositors in any case where it has been closed for the purpose of liquidation without adequate provision for payment of depositors.

Payment of an insured deposit either by the Corporation or by a bank designated to make such payment would discharge the liability of the Corporation and of such bank to the depositor to the same extent that payment by the closed bank would have been a discharge of liability. Unless otherwise prescribed by the Board of the Corporation, neither the Corporation nor a bank assuming the insured deposit liability of a closed bank would be required to recognize as the owner of any portion of a deposit, any person whose name or interest as such owner is not disclosed on the records of the closed bank as part owner of the account, if such recognition would increase the aggregate amount of insured deposits in the closed bank.

The Corporation might withhold payment of such portion of an insured deposit as might be required to meet any stockholder liability of the owner of the deposit, or any liability of the depositor to the bank or its receiver, not offset against a claim due from the bank, pending the determination and payment of such liability by the depositor or any other person liable therefor.

A depositor who fails to claim his insured deposit within 1 year or to arrange to continue it with such bank as may have assumed it, would have all his rights against such bank barred in respect to the deposit; and all rights of the depositor against the closed bank to which the Corporation may have become subrogated would revert to the depositor. The amount of any transferred deposits not claimed within 1 year would be refunded to the Corporation.

Subrogation to deposit.—Upon the payment of any depositor in a closed national bank or bank in the District of Columbia, the Corporation would become subrogated to all rights of the depositor to the extent of such payment. No payment could be made to a depositor in any insured bank, other than a national bank or a bank in the District of Columbia, until the right of the Corporation to be subrogated to the rights of such depositor to the extent described above becomes established.

Subrogation in the case of any closed bank would include the right to receive the same dividends from the proceeds of the assets of the bank as would have been payable to the depositor on a claim for the insured deposit, such depositor retaining his claim for any uninsured portion of his deposit. These provisions differ from the present law in that the Corporation is now required to become subrogated to all the rights of the depositor against the closed bank, and is entitled to receive the same liquidating dividends that would be payable to the depositor until such dividends equal the insured deposit liability to such depositor, whereupon further dividends would be payable to the depositor.

Compulsory membership in the Federal Reserve System.—The insurance of any bank which is not a member of the Federal Reserve System (other than a mutual savings or a Morris Plan bank or a bank in Hawaii or Alaska) would terminate July 1, 1937.

Purchase or loan upon bank assets.—Until July 1, 1936, the Corporation would be given the right to purchase or loan upon (in subordination of depositors' rights or otherwise) the assets of an open insured bank, or could agree to indemnify another insured bank assuming the liabilities of such open bank.

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The present power of the Corporation to purchase or lend upon the assets of a closed National or State member bank of the Federal Reserve System would be modified so as to embrace all insured banks.

Management of the corporation.—In the event of a vacancy in the office of the Comptroller of the Currency, the Acting Comptroller of the Currency would be a member of the board of directors of the Federal Deposit Insurance Corporation. In the absence of the Comptroller any deputy comptroller, within limits prescribed by the Comptroller, could act as a member of the board of directors in his place. At present the board consists of 3 members, 1 of whom is the Comptroller of the Currency, and 2 of whom are appointed by the President with the approval of the Senate.

Capital of Federal Deposit Insurance Corporation.—The capital stock of the Corporation would consist of the shares subscribed for prior to the passage of the bill. The shares would be without nominal or par value, and shares already issued would be exchanged and reissued at the rate of one share for each $100 paid into the Corporation for capital stock. The consideration received by the Corporation for its capital stock could be allocated to capital and surplus in such amounts as the board of directors might prescribe. Such stock would have no vote and would not be entitled to the payment of dividends.

The bill would repeal the present provision that requires insured banks to subscribe for class A stock of the Corporation; its stockholders would consist only of the Treasury of the United States and the Federal Reserve banks.

Corporation debentures.—The Corporation, with the approval of the Secretary of the Treasury, could issue and have outstanding at any one time its notes, debentures, bonds, or other such obligations in an amount not to exceed three times the amount received by it in payment for its caiptal stock plus the first annual assessments upon the insured banks.

The Secretary of the Treasury, in his discretion, would be authorized to purchase obligations of the Corporation. For such purpose he would be authorized to use as a public debt transaction the proceeds of the sale of any securities issued after the passage of the bill under the authority of the Second Liberty Bond Act, and the purposes for which securities may be issued under such act would be extended to include any purchase of the Corporation's obligations. The Secretary of the Treasury could sell obligations of the Corporation so acquired. All redemptions, purchases, and sales by him of such obligations would be treated as public-debt transactions of the United States.

Examination and reports.—The Corporation would appoint examiners who would have power to examine any insured State bank which is not a member of the Reserve System, any State nonmember bank applying for insurance, or any closed insured bank whenever considered necessary. Such examiners would have like power to examine, with the written consent of the Comptroller of the Currency or of the Federal Reserve Board, as the case might be, any National or State member bank. Each insured nonmember State bank, except a bank in the District of Columbia, would be required to make reports of conditions in such form and at such times as the board of the Corporation might require. The board might also require such reports to be published and could levy a penalty upon a bank which fails to make or publish a required report. The Corporation would be given access to reports of examination made by and reports of condition made to the Comptroller of the Currency or any Reserve bank and could accept any report made by or to any authority having supervision over a State nonmember bank except a bank in the District of Columbia.

Signs and advertisements.—Every insured bank would be required to display signs in all places of business maintained by it, and to include in its advertisements relating to deposits and in its forms furnished for the use of depositors' statements to the effect that its deposits are insured by the Corporation. The board of the Corporation would prescribe by regulation the form of such signs together with the manner of their display and the form of such statements and the manner of their use. A bank would be subject to a penalty of $100 per day for violation of these requirements.

Investigations.—The board of the Corporation would be specifically directed to investigate and report upon "the organization, operation, closing, reopening, reorganization and consolidation of banks, banking practices and management, and the security of depositors and adequacy of service to borrowers." Its findings and recommendations would be made in annual or special reports to Congress.

Dividends.—No insured bank could pay any dividends on its capital stock while it remains in default of any assessment due the Corporation, and penalties

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would be imposed upon officers or directors of a bank convicted of participating in a violation of this prohibition.

Mergers.—Prior written consent of the Corporation would be required before an insured bank could merge with or assume the deposit liability of a noninsured bank or transfer assets to any noninsured bank in consideration of the assumption of liability for any portion of its deposits.

Capital adjustments.—State banks which are not members of the Federal Reserve System would not be permitted to reduce the amount or retire any part of the common or preferred capital stock, or retire any part of their capital notes or debentures without the prior written consent of the Corporation.

Fidelity and other insurance.—Protection and indemnity against burglary, fidelity, and other similar insurable losses as the board of the Corporation by regulation might require would have to be provided by each insured bank.

TITLE III

(Summary of technical amendments)

The gist of the provisions is stated below in the order followed by the bill.

Definition of holding-company affiliate.—The term "holding-company affiliate" would be defined so as to exclude any organization which in the judgment of the Federal Reserve Board is not engaged directly or indirectly as a business in holding the stock of or managing or controlling banks (sec. 301).

Security affiliates in liquidation.—Security affiliates which have been placed in liquidation and transact no business except that incidental to their liquidation would be exempt from the provisions of the Banking Act of 1933 with regard to the divorce of such affiliates by member banks (sec. 302).

Security and real estate loan operations.—It would be specified that the Banking Act of 1933 does not prohibit banks, trust companies, and other financial institutions from engaging in transactions in securities to the extent that national banks are permitted to do so, and that the limitations upon the powers of banks to deal in securities do not affect their right to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate (sec. 303a).

Employee deposits.—The requirement that any banking or other type of firm which accepts deposits must submit to examination by the Comptroller of the Currency or by a Reserve bank and must publish reports of condition would not apply to firms which accept deposits only from their own officers, agents, and employees. The expenses of examination of firms receiving other deposits and required to be examined by the Comptroller of the Currency or a Reserve bank would be assessed against such firms (sec. 303b).

Double liability.—The additional liability upon shares of national bank stock issued prior to June 16, 1933, would be terminated as to active banks on July 1, 1937, thereby accomplishing on that date that elimination of additional liability upon the stock of active national banks (sec. 304).

Directors of national banks.—The share holdings required of directors of the national banks that are not members of the Reserve System (certain banks in Hawaii and Alaska) would be made the same as those required of directors of other national banks (sec. 305).

Bank and security dealer relationships.—After January 1, 1936, there would be elimination of the present provisions of law which, in the absence of a Federal Reserve Board permit therefor, prohibit correspondent relationships between a member bank and a securities firm and prohibit any such firm from holding on deposit any funds on behalf of a member bank.

Effective as of January 1, 1936, the Federal Reserve Board would be permitted to issue general regulations, in lieu of the present requirement that it grant a permit in each case, as to the conditions under which an individual might serve as an officer, director, or employee of both a member bank and of a firm primarily engaged in the issue, flotation, underwriting, sale, or distribution of securities. In limited classes of cases the general regulations could allow such service when, in the judgment of the Federal Reserve Board, it would not unduly influence the investment policies of the member bank or its advice to its customers regarding investments (sec. 306).

Purchase of stock; dealing in securities.—National banks (and, in view of existing provisions of law, State member banks) would be specifically authorized to buy and sell stock for the account of others; but the provision now in effect that they cannot buy stock on their own account would be continued. The limitations now fixed by law as to the amount of an investment issue that

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Federal Reserve Bank of St. Louis

may be taken by a bank as the obligation of any one party would be eliminated. As a substitute, it would be provided that the total amount of the investment securities (as defined by the Comptroller of the Currency) of any one obligor or maker that at any time could be purchased and held for its own account by a bank could not exceed 10 percent of the bank's capital and surplus (sec. 307).

Paid-in surplus.—No national bank hereafter would be authorized to commence business unless it has a paid-in surplus equal to 20 percent of its capital. The Comptroller of the Currency, however, could waive this requirement in the case of a State bank converting into a national bank (sec. 308).

Unification of stock.—Restrictions of present law as to the unification of national-bank stock with the shares of other corporations or with beneficial interest in such corporations would be broadened to provide that nothing would prevent the ownership, sale, or transfer of stock of other corporations being conditioned upon the ownership, sale, or transfer of the stock of a national bank and to permit the ownership, sale, or transfer of the stock of a national bank being conditioned upon the ownership, sale, or transfer of the stock of an existing corporation engaged primarily (instead of solely) in holding the bank's premises (sec. 309).

Voting by holding-company affiliates.—Holding-company affiliates would not be required to secure a permit from the Federal Reserve Board to vote in favor of placing a national bank (and consequently a State member bank) in voluntary liquidation. The right of a holding-company affiliate to accumulate votes upon shares of national banks owned by it would be made clear (sec. 310a and 310c).

Voting by bank as trustee.—Shares of its stock held by a national bank as sole trustee (which cannot be voted under present provisions of law) would be excluded in determining whether matters voted upon were adopted by the required majority of shares (sec. 310b).

Retention of assets.—The Comptroller of the Currency could allow State banks upon converting into national banks to retain, at values determined by him, assets which do not conform to the legal requirements as to the assets which may be acquired and held by national banks (sec. 311).

Comptroller's signature.—The Comptroller of the Currency could delegate the responsibility of countersigning assignments or transfers of bonds deposited by national banks with the Treasurer as security for circulating notes (sec. 312).

Interest charged by foreign branches.—A branch of a national bank outside of the continental United States could charge the rate of interest allowed by the laws of the place in which it is situated (sec. 313).

Earnings carried to surplus.—Before declaring a dividend, a national bank would be required to carry to surplus at least one-tenth of its net profits of the preceding half year until its surplus equaled the amount of its common capital, instead of equaling 20 percent of its capital as now provided (sec. 314).

Criminal provisions.—The criminal provisions of section 5209 of the Revised Statutes would be made applicable to the Federal Deposit Insurance Corporation and banks insured by it (sec. 315).

Voluntary liquidation of national banks.—In case liquidation of a national bank is voted by the holders of two-thirds of its stock, the shareholders could designate one or more persons to act as a liquidating agent or committee to conduct the liquidation according to law, under suitable bond and under supervision of the board of directors. The liquidating agency would be required to render annual reports to the Comptroller of the Currency and to the shareholders of the bank upon the progress being made. At an annual or special meeting a majority of the holders of the entire stock could remove the liquidating agent or committee and appoint one or more others as successors. The Comptroller could require an examination at any time in the affairs of the liquidating bank, with the expense assessed against it, until the claims of all creditors had been satisfied (sec. 316).

Use of the title "National."—Existing prohibitions upon the use of the word "national", as part of the business title of bankers, brokers, or trust or savings institutions—other than national banks and those concerns specifically authorized by the laws of the United States to employ it—would be extended to prevent its use in combination with other words or syllables in such titles (sec. 317).

Reduction of holdings of Reserve bank stock.—Provision would be made for the reduction of stock holdings of a member bank in a Federal Reserve bank

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in the event of a decrease in the surplus of the member bank. This would be in addition to the present requirement that in the event the capital of a member bank is decreased it must reduce its holdings of Reserve bank stock (sec. 318).

Reports of State member banks.—The Federal Reserve Board would be authorized to prescribe the contents, time, and manner of publication of reports of condition of State member banks (sec. 319).

Loans on United States securities.—State member banks would be made subject to the limitations imposed by paragraph (8) of section 5200, revised statutes, upon national banks as to the maximum extension of credit which may be made to one borrower upon the security of specified obligations of the United States (sec. 320).

Direct loans.—The requirement that a direct loan to a private concern by a Federal Reserve bank must be both secured and endorsed would be liberalized so as to permit a Reserve bank to make an advance with either security or endorsement or both (sec. 321).

Insurance Corporation stock.—Since under title I, the stock of the Federal Deposit Insurance Corporation would be changed from shares having par value to shares without par value, the reference to the par value of such stock that is made in the so-called "Loans to Industry Act" would be eliminated, and the amount paid by each Federal Reserve bank for such stock would be substituted (sec. 322).

Deposits of member banks.—In place of definitions in the Federal Reserve Act, authority would be given to the Federal Reserve Board to define the various classes of deposits for purposes of computing reserves, of determining what shall be deemed the payment of interest, of classifying time and savings deposits and of making rules regarding withdrawals (sec. 323a).

Reserves on bankers' balances.—In lieu of the present procedure for computing reserves required on bankers' balances, member banks could deduct from their gross demand deposits balances due from other banks (except Federal Reserve and foreign banks), including cash items in the process of collection with banks, checks on local banks, and exchanges for clearing houses (sec. 323b).

Interest on deposits.—In addition to the types of demand deposits upon which interest can now be paid would be added (1) all deposits payable only at offices of member banks located outside of the United States (instead of those payable only at offices in foreign countries), and (2) deposits of trust funds and deposits of the United States and of certain other public bodies where required by law.

The Federal Reserve Board could classify time and savings deposits as it might deem necessary and could prescribe different rates of interest for deposits of different classes. Time deposits in member banks could be paid prior to maturity under regulations prescribed by the Federal Reserve Board rather than as now prescribed by law. The provisions regarding the payment of interest on time and savings deposits by a member bank would not apply to deposits payable only at an office located outside of the United States.

All banks insured by the Federal Deposit Insurance Corporation, except mutual savings and Morris Plan banks that are not members of the Federal Reserve System, would be required to comply with the provisions of the Federal Reserve Act respecting the payment of interest on demand and time deposits (sec. 323c).

Reserves against United States deposits.—Member banks would be required to maintain the same reserves against deposit by the United States as must be maintained against other deposits (sec. 323d).

Reports of affiliates.—Supervisory officials could waive the requirements with respect to the examination of affiliates of a member bank and reports from them if it is deemed that such examination or reports are not necessary to disclose fully the relations between the bank and its affiliates (sec. 324).

Bank examiners.—Present prohibitions upon the making of loans or granting of gratuities to public examiners of banks, and penalties for theft or concealment by such examiners, would apply in the case of all banks insured by the Federal Deposit Insurance Corporation and the examiners and officers of such banks. The prohibition against the acceptance of outside compensation or disclosure of information by bank examiners would be made to include the Federal Deposit Insurance Corporation examiners and all insured banks (sec. 325 a and b).

Loans to bank officers.—The prohibition that an executive officer of a member bank may not borrow or otherwise become indebted to the bank is con-

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tinued, except that loans extended to such officer prior to June 16, 1933, could be renewed or extended until June 16, 1938 (the present limitation being June 16, 1935), provided that the board of directors of the bank evidences in its minutes that it is satisfied that it is in the best interest of the bank and that the officer has made reasonable effort to reduce his obligation.

The requirement that borrowings by an executive officer of a member bank from another bank must be reported to the chairman of the bank of which the borrower is an executive officer would be changed so that the report would have to be to the board of directors of such bank.

Borrowing by or lending to a partnership in which one or more executive officers of a member bank are partners having individually or together a majority interest in the partnership would be similarly restricted.

An officer could guarantee or endorse for the protection of the member bank of which he is an executive officer any loan or other asset previously acquired by the bank in good faith, or could incur indebtedness to the bank in order to protect it against loss or to give it financial assistance.

The Federal Reserve Board would be authorized to define "executive officer" and to determine what would constitute a borrowing or extension of credit to an officer.

The provisions of the Federal Reserve Act for the removal of bank officers or directors would be substituted for the present penalties attaching to violations of the prohibitions against loans to officers (sec. 325c).

Loans to affiliates.—Limitations upon loans to affiliates would not apply in situations, in addition to those now exempted, where (1) the affiliate relationship results from the operation of properties already acquired for banking purposes; (2) the affiliate is a subsidiary of an affiliate established under the terms of sections 25 and 25a of the Federal Reserve Act; (3) a bona fide debt already contracted was the cause of such relationship; (4) the ownership or control of voting shares in the affiliate by a member bank is in a fiduciary capacity, unless the fiduciary relationship exists for the benefit of a majority or more of the stockholders of the bank; or (5) the indebtedness of an affiliate is for unpaid balances due a bank on assets purchased from the bank (sec. 326).

Limitation on direct loans.—The restrictions upon real-estate loans that can be made by national banks would not apply to loans made under the "Loans to Industry Act" in those cases where there is an actual discount, agreement to purchase, or other commitment on the part of a Federal Reserve bank or the Reconstruction Finance Corporation (sec. 327).

Interlocking directorates.—The prohibitions upon interlocking directorates between banks and commercial or industrial firms which may make loans upon collateral would be eliminated, as would certain other provisions of the antitrust laws regarding interlocking directorates between banks. There would be substituted a provision that no director, officer, or employee of any member bank of the Federal Reserve System shall be at the same time a private banker or a director, officer or employee of any other bank (except a mutual savings bank) or trust company, except in limited classes of cases in which the Federal Reserve Board may allow such service by general regulation and in the judgment of that Board the classes of institutions are not in substantial competition (sec. 328).

Consolidation of banks.—The provisions for the consolidation of two or more national banks, or of a State bank and a national bank, would be changed as regards the procedure for the determination by appraisal of the value of the stock of shareholders who dissent, at the meeting of the shareholders, from the plan of consolidation. If a shareholder dissents at a shareholders' meeting and the board of directors fails to appoint appraisers to determine the value of his stock, he may request the Comptroller of the Currency to appoint an appraiser to act on an appraisal committee for and in behalf of the bank. In the case of the consolidation of two or more national banks, if shares, when sold at public auction, realize a price greater than their final appraised value, the excess in such sale price would be paid to the shareholder. Also, in the consolidation of national banks, the notice as to shareholders' meetings to vote upon consolidation matters could be waived by consent of all shareholders (secs. 329 and 330).

Use of term "deposit insurance."—Limitations now imposed by law upon the use of such words as "Federal", "United States", "reserves", or any combination of such words would be broadened to include the words "Deposit insurance." They would not apply, however, to the use of such words by any

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new bank organized by the Federal Deposit Insurance Corporation as provided in section 12 B of the Federal Reserve Act, nor to the Corporation (sec. 331).

Offenses against banks.—The act which provides punishment for certain offenses committed against banks organized or operating under the laws of the United States or any member bank of the Federal Reserve System would be amended to include any bank insured by the Federal Deposit Insurance Corporation (sec. 332).

PROPOSED ADDITIONAL SECTIONS

It is reported that the Comptroller of the Currency recommended to the House Banking and Currency Committee the inclusion of four additional sections in title III, to be numbered sections 333–336. It is understood that the gist of these proposals is substantially as follows:

Doubtful assets.—The Comptroller of the Currency would be given the right to retain doubtful assets of banks reducing their capital, such assets ultimately to be returned to the stockholders with permission of the Comptroller and a two-thirds vote of the shareholders.

Form of stock certificates.—A definite form of stock certificates for national banks would be provided to aid in national-bank procedure.

Authority of Comptroller over preferred stock.—The Comptroller of the Currency would be given the same authority over the issuance and retirement of preferred stock that he now has over common stock.

Clarification of District of Columbia law.—Certain minor points in he District of Columbia law, under which the Comptroller of the Currency has jurisdiction over State banks and trust companies located in the District with regard to stockholders' double liability, would be clarified. (The double liability feature would be eliminated after July 1, 1937.)

PROPOSED CHANGES IN THE FEDERAL RESERVE SYSTEM

THE PROVISIONS OF TITLE II OF THE PENDING "BANKING ACT OF 1935"

Committee on Banking Legislation: William L. Sweet, chairman, treasurer, Rumford Chemical Works, Rumford, R. I.; Samuel F. Clabaugh, president Protective Life Insurance Co., Birmingham, Ala.; John L. Dower, president Colorado Milling & Elevator Co., Denver, Colo.; August F. Hockenbeamer, president Pacific Gas & Electric Co., San Francisco, Calif.; C. T. Jaffray, president Minneapolis, St. Paul & Sault Ste. Marie Railway Co., Minneapolis, Minn.; Murray D. Lincoln, executive secretary Ohio Farm Bureau Federation, Columbus, Ohio; Frederic S. Snyder, trustee, Boston, Mass.; Charles John Whipple, president Hibbard, Spencer, Bartlett & Co., Chicago, Ill.

FOREWORD

This is a report upon certain proposals for far-reaching changes in the Federal Reserve System. These are the amendments contained in title II of the proposed "Banking Act of 1935."

The report does not deal with the other two titles of the proposed act, namely, title I, which contains amendments to the laws upon insurance of bank deposits, or title III, which contains a number of technical amendments to various banking statutes.

In view of the position taken by the report that most of the provisions of title II require considerable revision and should be dealt with separate and apart from the subject matter of the two other titles of the bill, the committee desires to make it clear that it is not suggesting that action be delayed upon the subject matter of title I or title III. On the contrary, it is the information of the committee that the provisions of title I and title III, with a few exceptions, meet with favor in the business community.

In the charter given to the committee by the board of directors of the national chamber it was specifically provided that the committee should be free to make its findings, concerning the subject matter of title II, independent of any existing policies of the chamber. The committee proceeded on that basis. Its report is to be understood as the expression of its members as individuals.

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PLAN OF REPORT

Part 1, pages 5 to 13, presents the general position of the committee.
Part 2, pages 13 to 43, presents the detailed comments of the committee.

PART ONE

The task has been assigned to this committee to present its findings upon certain official or semiofficial proposals for important amendments to the banking laws of the United States. The amendments in question affect the Federal Reserve System. They appear under title II of the proposed "Banking Act of 1935", which measure was submitted recently to the Congress as a "tentative draft" of legislation.

The nature of the proposed amendments contained in title II of the pending bill has led the committee to submit its report in two parts. The first part deals with the proposals as a whole in relation to the principal functions of the Federal Reserve System. The second part presents more detailed discussion of each major proposal.

ALTERATION OF THE SYSTEM

It is to be recognized that the changing requirements of our domestic and foreign business and of our general economic situation thrust new responsibilities from time to time upon the Federal Reserve Board, the regional reserve banks, and the member banks. Timely modifications, therefore, of the Federal Reserve Act and of the administrative policies of the System will continue to be necessary.

As a basic proposition, however, this committee expresses confidence in the established principles of the Federal Reserve System and believes that:

Only such changes should be made in the Federal Reserve Act and in the fundamental policies of the System as will supply further strength and usefulness to the present plan.

Except for minor adjustments to provide flexibility, any substantial change in the System should be based upon the collective judgment of its officials supported by a body of authoritative banking and business opinion.

Every necessary safeguard should be provided against partisanship in the control and operations of the System.

Measured by these tests, certain of the major proposals in title II, in the form originally introduced or as they would be altered by later suggestions of the Governor of the Federal Reserve Board or by the report of the House Banking and Currency Committee, do not recommend themselves. The committee is of the opinion that:

It should not be provided that before taking office the governors of the Reserve banks must have the approval each year of the Federal Reserve Board at Washington or, as was later suggested, every 3 years.

It should not be provided that the directors of the Reserve banks drawn from commercial and industrial pursuits must be limited by statute to 6 years of service on the boards of the banks.

It should not be provided that the Federal Reserve Board at Washington shall possess a broad grant of authority to waive entirely the statutory requirements of capital and other eligiblity provisions that govern the admission of nonmember banks to membership in the System.

It should not be provided that the present eligibility qualifications of appointive members of the Federal Reserve Board be changed in the manner proposed.

It should not be provided that the Governor of the Federal Reserve Board shall be permitted to hold office only during the pleasure of the President of the United States.

It should not be provided that the open-market policies of the System shall be determined by the Federal Reserve Board, or by a committee composed of the Governor and 2 members of the Board and 2 governors of Reserve banks, or that either such group shall possess broad powers to dominate the purchases and sales of Government securities and bankers' acceptances by the Reserve banks, to pass upon their discount policies or, as was later suggested, to modify from time to time the reserves required of member banks.

It should not be provided that obligations guaranteed by the Government shall be eligible for purchase and sale by the Reserve banks, without limits as to volume or maturity.

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It should not be provided that the only specific cover to be required for Federal Reserve notes shall be a minimum of 40 percent in gold certificates.

It should not be provided that the eligibility requirements for the rediscount of commercial and other paper and for advances to member banks shall be left to the discretion of the Federal Reserve Board.

It should not be provided that the reserves to be required of member banks from time to time shall be left to the discretion of the Federal Reserve Board, or, as was later suggested, to the proposed open-market committee.

It should not be provided that the powers of the member banks to make loans upon the security of real estate shall be changed in the manner originally proposed in the bill, or, as was later suggested, be left to the discretion of the Federal Reserve Board.

GENERAL CRITICISMS

The detailed criticisms of these unacceptable provisions, as well as favorable comment upon certain other provisions, are reserved for the second part of the report. We record at once the main general grounds of opposition to the proposals that we have thus far stated. In their aggregate effects we believe that—

The Federal Reserve Board, the Reserve banks, and the member banks would be subjected to a greatly increased danger of political domination of their operations; partisan or governmental dictation of banking would be likely to supplant desirable regulation.

Such concentration of power with respect to Reserve banking would be produced as to approach the creation of a central bank and to violate the established principle that the regional Reserve banks should possess considerable autonomy.

The Federal Reserve Board at Washington could be compelled to conform its policies with respect to money and credit to any financial program of the Government and to its dictation concerning the volume and kind of credit to be made available to commerce, agriculture, and industry.

The main features of the banking system that shall exist in this country could be determined by a small group of officials in Washington.

In the councils of the Federal Reserve System, especially in the Reserve banks, there would be a marked decrease in the influence of the independent representatives of commerce, agriculture, and industry, while the influence of bank officers and of a small group of officials in Washington would be increased to an undesirable extent.

The door would be opened to the immediate application of theories of money and banking which have been espoused by the few proponents of the amendments and which are fundamentally opposed to carefully developed standards in the Federal Reserve Act and to the best traditions of business and banking. In this direction policies concerned mainly with the volume of money and credit, rather than with the quality of the credit extensions of the primary and Reserve banks, apparently would be established.

Both the Reserve and member banks would be subjected to official and public expectations that their loan and investment policies must contemplate the possession of an indefinite volume of illiquid paper. Furthermore, they could be subjected to an increase of pressure to conform their operations to inflationistic policies.

We frankly record the opinion that our money and credit mechanism has failed in some respects to meet the real requirements of commerce, agriculture, and industry, and there have been harmful social and economic consequences. It would appear that wide swings of booms and depressions could be mitigated to a larger extent through public and voluntary efforts to obtain greater stability of production, price levels, employment, and purchasing power.

We recognize, however, that great care must be employed to avoid encouraging overly optimistic expectations concerning the extent to which economic conditions may be controlled by operations of a credit or monetary character. Decisions to seek and to employ credit must be made by borrowers who in the last analysis also control the manner of its use; such influence as the banking system or monetary control may possess is often of secondary importance.

So complex is the nature of the credit structure that adherence to sound policies by the Reserve and member banks nevertheless may be rendered ineffective for many reasons, including unwise governmental fiscal operations and the mistaken decisions of individuals. Such influence as may be exerted with respect to the volume and kind of currency issues and credit extensions

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cannot assure their constructive use nor avoid the effects of misdirections of enterprise.

It is to be emphasized that the direction of efforts to produce and maintain greater economic stability should not rest with a purely political body nor with interests concerned mainly with the production of profits. Since it is fundamental in the Federal Reserve Act that the Federal Reserve Board and the management of the Reserve banks shall not conduct their operations for the purpose of producing profit, it would appear that, with adequate safeguards against political domination, these authorities in cooperation with the member banks could make more definite contributions than thus far have been observable. In fact, within the limits of its powers, it is a proper function of a well-conceived Reserve System, as a form of central banking, to seek at all times to exert a steadying influence upon the money market and upon the course of industry.

With respect to these matters, however, we are of the opinion that the adoption of the provisions of title II would raise public expectations that cannot be realized within the practicable scope of the banking and monetary mechanism and thus would endanger the vital services that are usual and performable.

While recording our opinion that some changes in Federal statutes relating to money and banking are needed, we recall that within the charter of this committee it is expected to limit its recommendations to the provisions of title II. Indeed, it is to be observed that the committee has not approached these subjects as technicians in banking and that time has not permitted exhaustive study of numerous suggestions beyond the provisions of title II.

A summary of our general position with respect to these amendments is briefly that, in the aggregate, they would result in a greatly increased intrusion of political and governmental influences to the detriment of sound banking and business, the application of doubtful, if not indefensible, theories of money and credit, the subordination of practical experience, and the reversal of basic concepts now embodied in the Federal Reserve Act.

It is significant that these proposals in title II are being subjected to severe criticisms by others. Business and banking organizations of standing have urged that they not be adopted. Regarded from the viewpoints of depositors and customers of banks, and the board, legitimate interests of commerce, agriculture, labor, and industry, the adoption of the proposals to which we have referred would be harmful.

We believe that the following propositions with respect to these subjects are basic, and we recommend their continued application:

Independence from politics.—The banks of deposit should be privately owned and managed, under proper public supervision, and the day-to-day control of both primary and reserve credit should be independent of governmental domination and partisan influence.

Regional autonomy.—The authority of regional Reserve banks to exercise a high degree of autonomy should be maintained.

Credit accommodations.—The accommodation of the short-term credit requirements of commerce, agriculture, and industry should be a primary responsibility of the System definitely recognized as such in law and in the operations of the member banks and of the Reserve banks; the credit supply should be fitted to the volume of current production, increasing to the extent output expands and diminishing to the extent it recedes.

Government credit.—Aside from acting as fiscal agent for the government, the System's support of the fiscal program of the government should not require it to subordinate the needs of commerce, agriculture and industry; decisions of the reserve banks concerning the acquisition of government securities as investments or as collateral should be free of Treasury and other governmental domination.

Note issues.—The note issues of reserve banks should be on such a basis as will assure an elastic currency that will expand and contract in accordance with the volume of buiness transactions; by definite provision of law such issues should be tied to automatically liquidating commercial paper as well as to gold or gold certificates; it should be recognized as a major responsibility of the System to support both the currency and credit structures upon a firm and adequate foundation of gold, and it should be given the necessary powers to meet that responsibility as far as may be possible.

Capital of member banks.—Definite minimum requirements of capital should be made applicable to banks admitted to membership in the System; any discretionary authority that may be granted in this respect should be limited in

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time and contemplate the attainment within a reasonable period of the standards now set by the Federal Reserve Act for the admission of non-member banks.

Rediscounts and open market requirements.—There should be definite statutory provisions controlling the kind and maturity of paper made eligible for rediscounts, for the collateraling of advances to member banks, and for open market operations. Reenactment of the emergency provision, which recently lapsed, permitting for a temporary period the rediscounting of good but now ineligible assets, would be preferable to a permanent change in the existing requirements.

Business representation.—There should be definite provisions of law for the effective participation of representatives of commerce, agriculture and industry in the councils of the System.

Reserves of member banks.—Reserves to be required of member banks should be specified in the statute, after System authorities have submitted to the Congress a plan which includes definite percentages of deposits as minimum and maximum reserve requirements and which includes a method of computation; the present emergency power (preferably limited in time) to change the reserve requirements would be more desirable than a permanent grant of full discretion in this respect to reserve authorities.

Terms of board members.—The Governor and other appointive members of the Federal Reserve Board should retain definite terms of office, and should be removable only for cause.

Governor of Reserve bank.—The directors of a Reserve bank should be left free to select annually the chief executive officer of the bank and his subordinates; a combination of the present offices of governor and chairman is desirable but not at the sacrifice of this freedom of selection.

Open-market committee.—All of the Reserve banks should be represented by officials of their own selection in any body that is charged with proposing an open-market policy; compulsory participation in open-market operations should be made obligatory upon the Reserve banks only when a majority of them have assented to the policy, but the policy should regard special situations in which a Reserve bank may be placed by reason of conditions peculiar to its district.

Rediscount rates.—The Federal Reserve Board or other central agency should not endeavor to obtain changes in the rediscount rates of a Reserve bank except after full consideration of the resulting influence upon the commerce, agriculture, and industry of the district.

Long-term and slow loans.—No policy of depending upon a percentage of estimated value of an asset rather than upon ability to discharge the loan obligation within a reasonable period should be permitted to endanger the liquidity of the assets of Reserve or member banks.

Sound credit.—Sound bank credit must be the consequence of the collective judgment of all who give and use such credit; it cannot be achieved through the dictates of the Federal Reserve Board or other central agency, but such agencies and the Government should avoid contributing to the creation of unsound credit conditions.

TIMELINESS OF THE AMENDMENTS

The amendments to which objection has been made in this report have nothing to recommend them from the point of view that they are urgent in the interest of economic recovery. Quite the contrary; this is not the time in which to make such controversial and experimental changes in commercial and Reserve banking policies.

It would be desirable to make definite provision by statute for periodical reviews of the terms of the Federal Reserve Act, of the National Banking Act, the laws controlling the operations of the special credit agencies of the Government, and related questions. In certain countries such reviews are required periodically and appropriate provision is made for competent scrutiny of all pertinent proposals. If our country is given adequate notice that by a certain time modifications of the banking laws will be contemplated, suitable endeavor can be made by the authorities, the business community, and the public generally to reach a satisfactory result.

Quickly conceived and hurriedly enacted changes of such important features of banking as are dealt with in the amendments we have thus far discussed are disturbing and lead to serious mistakes. Patchwork legislation under the sway

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of transitory influences should not characterize our national endeavor to evolve a more satisfactory credit and monetary mechanism.

Recommendations.—We recommend that—

Commerce, agriculture, labor, and industry should support a proposal that the Congress make provision for suitable review at definite intervals, of 5 to 10 years, of the basic laws relating to banking and money and the operations of the special credit agencies chartered by the Federal Government.

Representative national agencies of commerce, agriculture, labor, and industry should provide for continuing study of such laws.

PART TWO

It remains to state in a more detailed manner the terms of the amendments contained in title II of the pending banking measure.

There is presented below the gist of each proposal of moment, including the amendments that have been referred to in the first part of this report. While it is the belief of the committee that Congress should defer action upon title II, it appears advisable to deal in this part of the report with modifications that would make some of the amendments less objectionable.

OFFICERS OF THE RESERVE BANKS

Amendment.—The bill (sec. 201) provides for a combination of the offices of chairman of the board of directors and governor in each Federal Reserve bank and the annual election (as is now the practice) of the Governor of the Reserve bank by its directors, but before taking office the governor would be required to have the approval each year of the Federal Reserve Board. If so approved, the governor would become the chief executive officer of the bank and, while governor, would be a member and ex-officio chairman of the board and of its executive committee as well as a class C director.

The vice governor would be selected in the same manner and would perform the executive duties of the governor in his absence. In the discretion of the Federal Reserve Board the vice-governor might also be a class C director, and if so appointed might be made deputy chairman of the board of directors. The offices of Federal Reserve Agent and Assistant Federal Reserve Agent would be abolished and all duties prescribed by law for such agent would be performed by such person as the Federal Reserve Board designates.

At present.—The office of governor was created under the power given to boards of Reserve banks to engage necessary employees; the position is not mentioned in the Federal Reserve Act. The same is true of the office of deputy governor; the office of vice governor does not now exist. The salaries of the officers are provided by the banks but must be approved by the Federal Reserve Board.

The chairman of the board of a Reserve bank is appointed annually by the Federal Reserve Board from among the three class C directors of the bank; he is also the Federal Reserve agent. He is required to be a person of tested banking experience. He must maintain in the Reserve bank the local office of the Federal Reserve Board, make regular reports to that Board, and act as its official representative for performance of functions conferred upon that Board by the act. His salary is fixed by the Federal Reserve Board and must be paid by the bank.

Modifications.—The bill as reported by the House committee would make the selection of the governor subject to approval of the Federal Reserve Board every 3 years. It has been suggested that after the Federal Reserve Board has once passed favorably upon the selection of the governor, his selection in subsequent years should not be subject to Board approval. Still another proposal is that the governor not be made subject at all to the approval of the Federal Reserve Board, but if it be deemed advisable that the Board be given somewhat greater influence in the selection of officers of the Reserve banks, it might be empowered to name 4, instead of 3, of the 9 directors of a Reserve bank as well as to pass upon the salary to be paid the governor.

Comment.—It may be recognized as desirable that the offices of governor and chairman of the board be combined, even though this requires the surrender of the present power of the Federal Reserve Board to appoint the chairman, who in some instances actually is the executive officer of the Reserve bank. The benefit, however, to be gained from a combination of the offices does not appear to be a sufficient reason for empowering the Federal Reserve

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Board to approve or disapprove each year (or 3 years) of the governor and vice governor elected by the directors of the Reserve bank.

The principal objection to such proposal is that the governor as the executive in charge of the operations of the bank, and his subordinates, including the vice governor, would be brought too closely under the domination of the Federal Reserve Board at Washington. The arrangement would tend to make the chief executives of the banks supine, interfere with the maintenance of reasonable regional autonomy, and lower instead of increase the efficiency of the Reserve banks. As other provisions of the bill, in our judgment, would expose the Federal Reserve Board at Washington and its governor to great danger of political interference, the effects would reach to the Reserve banks to the detriment of the whole banking system.

It is much to be preferred that any advantages that might accrue from a combination of the present office of chairman of the board with the office of governor be sacrificed, rather than bring the officers of the Reserve banks so definitely under the control of a small Washington group unable sufficiently to avoid political domination.

Some of the Reserve districts cover areas greater than important European countries. The Reserve banks must operate with close attention to the commercial, agricultural, and industrial conditions peculiar to their districts. The responsibility must rest with the officers and directors of the Reserve banks to act quickly and efficiently, and no arrangement that would tend to make them subordinate their judgment on district affairs to the Washington Board would be in the interest of good banking.

Recommendation.—While not believing that it is urgent to make such changes in present law, our committee is of the opinion that it would be desirable to provide that—

The offices of governor and chairman should be combined and the governor should be made chief executive officer of the bank; the directors of a Reserve bank should be permitted freedom to select the chief executive officer and all of his subordinates; any requirement that the governor and vice governor selected must be approved by the Federal Reserve Board at Washington should apply only to selections of new incumbents of those offices.

DIRECTORS OF RESERVE BANKS

Amendment.—The bill (section 201) provides that no member of the board of directors of a Reserve bank (other than the governor or vice governor) would be permitted to serve for more than 6 consecutive years, although present incumbnets could serve the remainder of their terms.

At present.—The directors of Reserve banks are elected for 3-year terms with no statutory limitation upon the number of terms that they may serve. There are nine directors in each Reserve bank, divided into three classes. Three class A directors must be elected by and be representative of the member banks of the district. Three class B directors, also elected by the member banks of the district, must be actively engaged in the district in commerce, agriculture, or some other industrial pursuit and may not be officers, directors, or employees of any bank. Three class C directors must be designated by the Federal Reserve Board at Washington and may not be officers, directors, employees, or stockholders of any bank.

Modifications.—The suggestion has been made that the 6-year limitation be applied to class A directors, but not to class B directors. There has also been a suggestion that the Federal Reserve Board be empowered to appoint one of the class B directors as well as the three class C directors, if it is deemed advisable for the Federal Reserve Board to have larger influence in the selection of directors who elect the officers and pass upon their performance.

Comment.—The adoption of the amendment would soon require considerable tournover in the directors of the reserve banks. If the chief executive officer of the bank came closely under the domination of the Reserve Board and it in turn were more subjected to partisan direction, the amendment would operate to weaken the conservative influences of the commercial, agricultural, and industrial representatives in the affairs of the System, and otherwise injure the reserve banks.

The practice has developed in some of the reserve districts of limiting the class A (banker) directors to one or at most two terms of office. The class B directors (representative of enterprises other than banking) usually are not so limited. It is these class B directors who are generally most independent in

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their attitude in favor of reasonable autonomy. When they are permitted to serve for a sufficient number of years to become familiar with the affairs of the System they exert a valuable influence which should not be diminished or lost. On the average, directors of this type have served longest in the banks.

At the conclusion of their terms as class B directors, individuals who served most usefully have often been appointed class C directors by the Federal Reserve Board so that their experience and wise counsel would not be lost to the Reserve System. The proposed amendment would compel the retirement at the end of their present terms of several class C directors appointed because of their special qualifications and whose constructive influence is now felt in the System.

It would not seem that statutory limitations upon the number of terms that might be served by class B directors or, for that matter, by any of the directors are necessary. There certainly is no urgent need of a change in the present arrangement. It would appear that any reasonable adjustment that might be advisable in the boards of some Reserve banks could be made without injury to satisfactory arrangements that exist in the others.

Recommendation.—The committee is of the opinion that—

Any necessary adjustments respecting the number of terms that directors of Reserve banks may serve should be made without statutory limitation, and, as a class, the directors who are representative of commerce, agriculture, and other industrial pursuits should be eligible to serve in excess of 6 consecutive years.

REQUIREMENTS FOR MEMBERSHIP IN RESERVE SYSTEM

Amendment.—The bill (sec. 202) would grant discretion to the Federal Reserve Board to waive in whole or in part the capital requirements for membership in the Reserve System in the case of any nonmember bank admitted to the benefits of insurance by the Federal Deposit Insurance Corporation, if the bank makes application for membership in the Reserve System prior to July 1, 1937. Such bank, however, would be required to comply with the present capital requirements within such period after its admission as, in the judgment of the Federal Reserve Board, would be reasonable in view of all the circumstances.

At present.—To be admitted to membership in the Federal Reserve System an applying bank must have paid-up, unimpaired capital sufficient to enable it to become a national bank in the place in which it is situated, the minimum being $50,000, except as to certain State banks and trust companies, located in communities of 6,000 or less, which possess capital of $25,000 or more. The Federal Reserve Board is empowered to reject the application even if capital requirements are met, but the bank would not make a suitable member in other respects.

Modifications.—The bill as reported by the House Banking and Currency Committee would authorize the Federal Reserve Board, in its discretion, to waive any requirements imposed by statute or otherwise as a condition to admitting insured nonmember banks to membership in the Federal Reserve System. In the bill thus reported there is omission of any requirement that the nonmember banks admitted to the benefits of deposit insurance must become members of the Federal Reserve System.

Others have recommended the admission of insured banks to membership in the Reserve System without requiring an increase in capital, provided their capital is adequate in relation to their liabilities.

Comment.—This committee supports the proposition that every bank doing a commercial business should ultimately become a member of the Federal Reserve System. This would serve to produce desirable uniformity in commercial banking policies and practices and greater safety for depositors.

The committee is aware that the present law for insurance of bank deposits requires that the insured banks which are not now members of the Federal Reserve System must join it before July 1, 1937, if they desire to continue in the insurance fund. It is to be recognized that many of the insured banks do not now possess sufficient capital to meet present requirements for admission into the Federal Reserve System. At the same time there is a strong demand, which finds favor among many members of Congress, that there be omitted any requirement that such nonmember banks be compelled to join the Federal Reserve System or else that the time limit be extended 1 or 2 or more years beyond July 1, 1937. If such views should prevail in Congress, the urgency of changing

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the present requirements for admission into the Federal Reserve System would not exist.

If, on the other hand, Congress maintains the requirement that all insured banks must be members of the Federal Reserve System by July 1, 1937, or thereabouts, we would still feel it advisable that Congress insist upon the maintenance of the standards for capital requirements that are set in the Federal Reserve Act, allowing, however, a reasonable period of time to the banks thus compelled to join the System to meet those standards. If the practical necessities in some sections should require the extension of branch banking within county or somewhat wider areas, in order that by combination the banks might reach the minimum standards of capital, it would offer one remedy to difficulties resulting from banks being permitted to operate without capital and reserves sufficient to provide any real protection to depositors.

It is to be recognized that there are about 2,000 State banks and trust companies in the insurance fund which have insufficient capital to be eligible for membership in the Federal Reserve System under present requirements. About three-fourths of these banks are in towns of 3,000 population or less. It is to be noted also that during the depression many nonmember State banks issued certificates of beneficial interest to depositors who waived portions of their deposits, or sold preferred stock or capital notes or debentures or used various combinations of these devices. Many of these banks are in a position where they have no common capital beyond the minimum requirements of State laws that are more liberal than the present requirements of the Federal Reserve Act. These conditions are all pertinent only if the present provision of law be maintained that insured banks must become members of the Federal Reserve System by some stated time.

It is of considerable importance that another provision of the pending bill would permit member banks of the Reserve System to make and present for rediscount longer-term loans than allowed at present. If the assets of banks should more generally change in character to longer maturities, conservative practice would require that many banks increase their capital funds above the amounts now possessed. As desirable as it is to have all commercial banks come into the membership of the Federal Reserve System, proper standards of membership must be maintained if the benefits of a uniform system are not to become illusory. If banks are once admitted with no statutory provision that they must reach specified standards as to capital and surplus, within a reasonable period, it will be difficult to compel them to increase their capital funds after their admission to the system.

Recommendation.—Conditional upon the existence of a requirement that insured banks become members of the Federal Reserve System by a stated time if they are to continue in the insurance fund, we recommend that—

There be statutory specification of the capital that must be possessed by banks for admission into membership of the Federal Reserve System, with definite limitations of time within which admitted banks must conform to such requirements.

MEMBERSHIP OF THE FEDERAL RESERVE BOARD

Amendment.—The bill (sec. 203) would repeal the present requirement that the six members of the Federal Reserve Board appointed by the President must be chosen with due regard to "fair representation of the financial, agricultural, and commercial interests and geographical divisions of the country." In place of that it would be required that such Board members be "well qualified by education or experience or both to participate in the formulation of national economic and monetary policies."

The requirement that not more than one member of the Board shall be from any one Federal Reserve district is preserved, but it is made inapplicable to the Governor of the Board.

At present.—Present requirements are indicated above.

Modifications.—The modifications that have been proposed deal with the number of members composing the Federal Reserve Board. One suggestion is that two members of the Federal Reserve Board should be elected, if possible, from persons with experience as executives in the Federal Reserve System. Another is that the present Board of 6 appointive members and 2 ex-officio members be reduced to a total of 5 members, by retiring the ex-officio members (the Secretary of the Treasury and the Comptroller of the Currency) and by reducing the appointive members to 5 as soon as a vacancy occurs.

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It has also been proposed that there be maintained the present requirement that the appointive members be chosen with due regard to fair representation of financial, agricultural, and commercial interests and that there be added the requirement that the members be well qualified by experience to participate in the formulation of national credit and monetary policies.

Comment.—The proposed change in the qualification for membership which would omit the present requirement of fair representation of the financial, agricultural, and commercial interests of the country and provide that Board members be qualified by education or experience to participate in the formulation of "national economic and monetary policies" appears to be undesirable. It would tend to magnify economic and monetary policies and subordinate what should be the main concern of the Federal Reserve Board and Reserve banks, namely, desirable credit conditions.

Emphasis should be retained upon appointing men of ripe practical experience. The Board has adequate resources and authority to engage such monetary and statistical experts as it may need. These men as a rule would lack practical knowledge of the credit conditions of banks and the credit requirements of commerce, agriculture, and industry, and of the various divisions of the country. It must be recalled that those who urge this amendment have indicated their belief that the System should be operated with considerable, if not main, attention to monetary powers and planned economic development largely through controlling the supply of money and deposit credit.

It is established in the present law and in the practices that have proved most beneficial that a primary concern of the reserve banks should be the quality of credit extensions, and that considerations applying to the volume of money and credit should never disregard the quality of credit extensions and the constructive use of bank credit in the short-term operations of commerce, agriculture, and industry.

This proposal, combined with such of the other amendments as would operate to subordinate the Federal Reserve Board and banks to governmental influences, would tend to make the Federal Reserve Board a mere economic planning bureau of the Government and would be more conducive to undesirable, if not dangerous, operations in our banking system than to improvement.

The size of the Federal Reserve Board and method of selecting the members have been under frequent discussion. There are many who believe that some method other than Presidential appointment of the members of that Board should be established. The membership of the Chamber of Commerce of the United States has favored the elimination of the Secretary of the Treasury from a place upon the Board, and has indicated that a method should be found of placing the duties of the Comptroller of the Currency under the jurisdiction of the Federal Reserve Board so that this official, as such, might also be retired from its membership. The present composition of the Federal Reserve Board was the result of political compromise and was frankly recognized as a concession that had to be made to certain political leaders to secure the passage of the Federal Reserve Act.

It is not the intention of this committee to object at this time to Presidential appointment of the members of the Federal Reserve Board. We regard sympathetically the idea that ultimately the Secretary of the Treasury should be retired as a member and, if commercial banks by one means or another are brought within the membership of the Federal Reserve System, any need for the Comptroller's membership should pass.

Since the committee, however, finds so much of the substance of title II undesirable, it cannot bring itself to favoring an immediate readjustment in the composition of the Board. The whole question of the most desirable method of assuring political independence of the Board and adequate representation of financial, commercial, agricultural, and industrial influences upon that Board, and a closer tie-up between it and the member banks, should be subjected to review when there is less tendency toward the centralization of governmental power and less fear that the Reserve banks and member banks may be made mere adjuncts or agencies of the Government rather than its allies.

Recommendation.—We believe that the present qualifications for membership upon the Federal Reserve Board should be retained.

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SALARIES OF BOARD MEMBERS

Amendment.—The bill (sec. 203) would provide that future appointive members of the Federal Reserve Board be given annual compensation at the same rate as the members of the President's Cabinet, namely, $15,000 per annum.

At present.—The appointive members of the Board receive $12,000 per annum. The salaries are paid by the Reserve banks and not by the Government.

Modifications.—Most of the modifications that have been suggested would provide higher salaries. The report of the House Committee on Banking and Currency omits any provision for increased salary.

Comment.—It is to be noted that the amendment would apply to future appointive members. We favor the proposal in principle. In fact, we support the view that the Board members should be given salaries that compare more favorably with those paid to the administrative officers of the Reserve banks, some of whom receive $25,000 per annum or more. If a precedent of salaries paid in Government service must be controlling, the salaries received by the Associate Justices of the Supreme Court of the United States, namely, $20,000 per annum, would be a better standard than the salaries of Cabinet officers.

Such increase in compensation is favored to encourage the acceptance of Board membership by men of demonstrated ability in practical pursuits, to encourage long service and to develop the independence of the Board from any influence of a partisan nature.

To increase the salaries, however, from $12,000 to $15,000 for future members will accomplish little. It would be better to leave this question, together with the proposals that apply to the qualifications for membership upon he Board, the size of the Board, the methods of selecting its members, and other important modifications of the Federal Reserve Act to be dealt with in a study by a thoroughly representative and bipartisan agency established to give adequate consideration to all proposals for changes in the Reserve System.

Recommendation.—We favor in principle that:

The salaries of the members of the Federal Reserve Board should be increased to compare more favorably with the salaries paid the principal administrative officers of the Reserve banks.

RETIREMENT ALLOWANCE FOR BOARD MEMBERS

Amendment.—The bill (sec. 203) provides that each member of the Federal Reserve Board heretofore appointed could retire from active service upon reaching the age of 70 or at any later time, and that all members hereafter appointed must retire upon reaching the age of 70. Each retired member who has served for at least 5 years would receive retirement compensation for the remainder of his life. The retirement pay would be at one-twelfth of the present annual salary ($12,000) of appointive members for each year up to 12 years of service. A member whose term expired while he is between the age of 65 and 70, and who was not reappointed, would reecive retirement pay on the same basis. The retirement pay, as the salaries of the appointive members, must be provided by the Federal Reserve banks. The term of appointment would be continued as 12 years.

At present.—There is no provision for compulsory retirement on account of age nor for retirement pay.

Modifications.—A modification has been proposed by the Governor of the Federal Reserve Board to provide that a present or future member who has served as long as 5 years, whose term has expired, and who is not reappointed would be eligible for a pension upon the same basis as though he were retiring at the age of 70. This would mean that a present member of the Board, who had srved at least 5 years, upon completing his term would receive each year for life $1,000 for every year that he had served, but not to exceed $12,000 per year.

The report of the House Committee on Banking and Currency would maintain the amendment as first stated but would add a provision that if the term of a member expires before he reaches the age of 65 and he is offered and declines to accept reappointment, he would not be entitled to retirement pay.

Comment.—In principle the idea of adequate retirement allowance is supported by the committee. It is to be noted, however, that if now adopted it would operate to permit or induce the retirement of some of the present Board members. Combined with other amendments, such as the proposed

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changes in the qualifications for appointment of Board members and the extensive increase that would be made in the powers of the Federal Reserve Board it would probably operate to permit of the early selection of a Board composed mainly, if not entirely, of members in avowed sympathy with directions of governmental policy that would produce disturbing changes in the operations of the Reserve System.

We express the point of view concerning the retirement plan that has been stated above in connection with the proposed increase of salary, namely, that provision for retirement pay be deferred for the scrutiny of such an agency as we suggest be created to consider all proposals for modifications of the Reserve System.

Recommendation.—We favor in principle as a matter of future policy that: Retirement allowances should be provided for members of the Federal Reserve Board with adequate safeguards to prevent abuse.

TERM OF OFFICERS OF FEDERAL RESERVE BOARD

Amendment.—The bill (sec. 203) provides that the Governor and Vice Governor of the Federal Reserve Board would hold these offices subject to the pleasure of the President of the United States. The term of the Governor would be limited to the period during which he is permitted by the President to serve as Governor, and upon the termination of his designation as Governor he would be deemed to have served his full term as a Board member. The office of Governor would be exempted from the limitation that not more than one member of the Board may be selected from any one Federal Reserve district.

At present.—The Governor and Vice Governor are chosen by the President from among the 6 appointed members of the Board and have 12-year terms of office as board members.

Modifications.—One modification that has been suggested is that a Governor who is not redesignated as such be permitted to continue as a member of the Board if he chooses, and if he resigns from the Board in the event of not being redesignated, he should not be subject to the prohibition that for 2 years thereafter he may not hold any position with a member bank. Another suggestion is that each incoming President might be given the right to name a Governor of his own choosing, particularly if the ex officio members of the Board are dropped, in which case consideration should be given to providing that the term of office of the Governor of the Federal Reserve Board lapse with the term of the President, but that the Governor and other appointive members of the Board should be removable during their terms of office only for cause.

The report of the House Committee on Banking and Currency would change the amendment to provide that if the Governor of the Federal Reserve Board should resign from membership on that Board within 90 days after he ceases to be Governor, he could reenter the banking business without waiting 2 years, as now required by law; he would be permitted, however, to serve out his full term as a member of the Board if he should choose to do so.

Comment.—To provide in the Federal Reserve Act that the Governor of the Federal Reserve Board shall hold office only at the pleasure of the President of the United States would subject both the Governor and the President to great pressure from political and sectional interests to have them favor or oppose particular policies in the System. It would place the Governor of the Federal Reserve Board in a position almost identical to that of a member of the President's Cabinet in that he would come to be considered a political adviser and one amenable to other political advisers. It has been recognized by some advocates of the proposal that it is undesirable.

One of the reasons for providing in the Federal Reserve Act that members of the Federal Reserve Board shall have terms of 12 years was to remove them as far as possible from political influence. As a matter of practice the Governors of the Federal Reserve Board who have differed or believed they might differ with an incoming administration have been willing to make way for new appointees. There is no practical necessity for the amendment at this time and its adoption could easily lead to grave abuses in the operations of the Federal Reserve System. Just as the position of member of the Federal Reserve Board should be safeguarded in every possible manner from political influence, so also should the position of Governor.

The provision in the amendment that would remove the office of Governor of the Federal Reserve Board from the limitation that not more than one member of that Board may be selected from any one Federal Reserve district is approved in principle. There is, however, no urgency for its adoption.

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Recommendation.—The committee recommends:

That the present method of selecting the Governor of the Federal Reserve Board from among the appointive members of the Board and providing him with a 12-year term of office should be continued.

DELEGATION OF DUTIES

Amendment.—The bill (sec. 204) would provide that the Federal Reserve Board could assign to designated members of the Board or its officers or representatives, under rules and regulations, the performance of specific duties or functions of the Board that do not include the determination of any national or system policy, nor the exercise of the power to make rules or regulations of of any power which the law requires to be exercised by a specified number of the members of the Board.

At present.—The law specifies a variety of routine duties which must be performed by the Board without clear authorization that they may be delegated.

Modification.—None has been suggested.

Comment.—It is recognized that the Board is charged with a variety of routine duties and that questions have arisen concerning its power to delegate them. In the interest of reducing the amount of minutiae that must be attended to by the Board, the proposal is desirable. The Federal Reserve Board, however, has been operating for more than 20 years without such an amendment in the law, and although the detail placed upon the Board has increased in recent years, this amendment is not of sufficient importance to justify the adoption of title II.

Recommendation.—Without any belief that it is urgent, we approve in principle that:

Reasonable grant of authority should be given to the Federal Reserve Board to delegate to its officers or representatives duties of a routine nature.

OPEN-MARKET COMMITTEE

Amendment.—The bill (sec. 205) proposes far-reaching changes in the structure and powers of the open-market committee. It would provide for a committee composed of the Governor of the Federal Reserve Board as its chairman, 2 members of that Board selected annually by it, and 2 governors of the Reserve banks selected annually by the governors of the 12 banks, in accordance with procedure to be prescribed by the Federal Reserve Board. The committee would meet upon the call of the Governor, when requested by the Board or by any two members of the committee, or upon his own initiative.

The committee would be empowered to state in resolutions the policies that in its judgment should be followed with respect to the open-market operations of the Reserve banks, and the banks would be required to conform to the proposals. The committee would also be empowered to make recommendations to the Federal Reserve Board regarding the rediscount rates of the Reserve banks.

At present.—The open-market committee at present has only advisory powers. It consists of 12 members; the board of directors of each Federal Reserve bank elects 1 member annually. No Reserve bank is permitted to engage in open-market operations except in accordance with regulations adopted by the Federal Reserve Board. A Reserve bank which decides not to participate in the open-market operations recommended by the committee must file with the chairman of the committee, within 30 days, a notice of its decision and transmit a copy to the Federal Reserve Board.

Modification.—The Governor of the Federal Reserve Board recently proposed that the open-market authority be vested in the whole Federal Reserve Board, and that there be appointed a committee of 5 governors selected by the 12 governors of the Reserve banks, with the requirement that the Board consult this committee before changing the open-market policy, the rediscount rates, or the reserves required of member banks. He has stated that the Board should have the responsibility and power to initiate changes and that the committee of governors should be permitted to make recommendations upon proposed changes.

Another suggestion is that the open-market committee consist of the Federal Reserve Board and 4 governors selected by the 12 governors annually, each member to be given a vote in its deliberations with respect to 3 subjects, namely, open-market policy, consideration of rediscount rates, and changes in reserves required of member banks.

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The report of the House Committee on Banking and Currency modifies the amendment in a manner to support the suggestion of the Governor of the Federal Reserve Board. It recommends an open market advisory committee consisting of 5 representatives of the Federal Reserve banks elected annually by the governors of the 12 Federal Reserve banks. It would be the duty of the committee to consult and advise with, and make recommendations to the Federal Reserve Board from time to time with regard to the open-market policy of the Federal Reserve System and to aid in the execution of open-market policy. The Board would be required to consult the committee before making any changes in the open-market policy, in discount rates of Federal Reserve banks, or in the reserves required of member banks. After consulting with and considering the recommendations of the committee, however, the Federal Reserve Board would be empowered to prescribe the open-market policy of the Federal Reserve System and this policy would be binding on all reserve banks.

Comment.—The Under Secretary of the Treasury, in testifying before the Committee on Banking and Currency of the House of Representatives, indicated objections to placing control of open-market operations in the Federal Reserve Board. He called attention to the fact that the reserve banks are responsible for the funds employed in the open market and stated that they should be represented upon a controlling committee by governors of their choice.

The proposed amendment provides one of the main grounds of controversy. Open-market operations are considered by many to be the most important single instrument which the Federal Reserve System has for controlling credit and monetary conditions. These operations consist mainly of the buying or selling of obligations of the United States and bankers' acceptances. Buying by the Federal Reserve banks releases funds to the market and selling operations withdraw funds.

In addition to making the decisions of the open-market committee mandatory on the Reserve banks rather than advisory to them, the amendment and the proposed modifications would omit the present requirement of law that the time, character, and volume of open-market transactions must be "governed with a view to accommodating commerce and business and with regard to the general credit situation of the country." In our judgment that requirement should be maintained.

In view of official statements respecting the intent to control the volume of money and credit through open-market operations, the advisability of more conscious central direction of monetary and credit policies, and especially the desire to assure support of the Government's credit through the purchase of its securities by the Reserve and member banks, concern has been expressed in regard to the proposed amendment upon a number of grounds.

A majority of the members of the open-market committee would be members of the Federal Reserve Board and the two governors of the Reserve banks would be men whose annual election would be subject to the approval of that Board. In effect, the proposal would provide an additional means by which the Government control could be exerted over the policies of the Federal Reserve banks. The history of the System indicates that Treasury domination of Reserve policies has existed in the past and has been detrimental to the best interests of the System and the public.

If the two governors of the Reserve banks should consider themselves, in effect, delegates from all the Reserve banks with a duty to reflect the decision of those institutions, they would find themselves in the minority upon the committee.

It is not the function of a central banking system to give Government a higher credit rating than it otherwise would have in the open market to which nongovernmental borrowers and lenders must go. In view of the monetary, credit and governmental spending theories of the principal proponents of the amendment, action of the suggested open-market committee doubtless would be subjected to pressure to undertake the execution of these theories, with resulting subordination of the true functions of the Federal Reserve System to fiscal and other operations of the Government.

The open-market operations should be mainly the concern of the Reserve banks, the funds of which make such operations possible. No arrangement would be correct that fails to regard the banking situation in the respective Reserve districts in relation to the national situation.

The reposal of open-market powers in the Federal Reserve Board, with a device of an advisory committee, is especially objectionable. The open-market committee should be broadly representative and no plan should be supported which

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would disfranchise the boards of the Reserve banks with respect to a policy that vitally concerns the business of the country. To vest complete control of the open-market power in the Federal Reserve Board would fail to recognize that the Board can be provincial and operate in a manner that is not truly representative in a national way.

Special objection may be made to any proposal that the open market committee be given power to compel changes in respect to rediscount rates. It has been suggested that this power should be thus centralized as a means of controlling speculation. The record of reserve operations warrants the belief that the Reserve banks are more alert than is the Federal Reserve Board in guarding against speculative excesses. The Reserve banks now have extraordinary powers, under the Banking Act of 1933, to place effective checks upon speculation. The committee believes that the present method under which changes in rediscount rates are initiated in the reserve banks, but are subject to the approval of the Federal Reserve Board, is far superior to the proposed method.

The proposal that the open-market committee be given power to deal with the reserves to be required of member banks is discussed later in this report.

It is to be recognized that there are occasions upon which an open-market operation should be entered into by all of the banks. The committee believes that when these occasions arise the Reserve banks, acting independently, would conform voluntarily to any sound program that might be agreed upon. The committee strongly urges that no power be given to compel the Reserve banks to engage in specific open-market operations unless the program meets with the approval of a majority of the 12 Federal Reserve banks.

Recommendations.—The committee believes, therefore, that open-market policies should continue, as at present, to be formulated by a committee representing the 12 Federal Reserve banks. If authority is given to any agency of the system to enforce compliance by the banks with a stated open-market policy, such authority should be made contingent upon its acceptance by a majority of the banks.

Changes in the rediscount rate should continue, as at present, to be initiated by the Federal Reserve banks, subject to the approval of the Federal Reserve Board.

REDISCOUNTS AND LOANS TO MEMBER BANKS

Amendment.—The bill (sec. 206) would provide that, subject to Federal Reserve Board regulation as to maturities and other matters, any Federal Reserve bank would be permitted to rediscount for a member bank, upon its endorsement, any commercial, agricultural, or industrial paper and to make advances to a member bank on its promissory notes secured by any sound assets of such member bank.

At present.—The Federal Reserve Act prescribes, with careful limitations, the types of advances which may be made by Federal Reserve banks to member banks and, under exceptional circumstances, directly to individuals, partnerships, or corporations. There are also meticulous provisions respecting the types and maturities of paper made eligible for rediscount, with emphasis placed upon commercial loans. An emergency provision that a Reserve bank could come to the assistance of a bank which has sound assets but is devoid of eligible paper lapsed in March 1935.

Modifications.—It has been proposed that the emergency provision of the Federal Reserve Act (sec. 10–b, which lapsed Mar. 3, 1935) be restored for a limited period, and that little or no change be made in other requirements concerning rediscounts and advances. Section 10–b provided that a member bank with no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations, through rediscounting at a Reserve bank or any other method provided by the Reserve Act, could secure advances from the Reserve bank on time and demand notes secured to the satisfaction of the Reserve bank. The note was required to bear interest at a rate not less than 1 percent higher than the highest rediscount rate.

Others would require that advances to member banks, collateraled by Government bonds, bear a higher rate of interest than rediscounts, and some would curtail more drastically the use of Government securities by member banks in obtaining accommodations from the Reserve banks.

Comment.—Objection is found to the proposal that the Federal Reserve Banks be permitted to rediscount for the member banks any commercial, agricultural, or industrial paper, and to make advances to the member banks on

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their promissory notes secured by any sound assets of such banks because it would mean a change in the fundamental conception of the Reserve System that has prevailed since its establishment and that should be continued.

It is not the function of a central banking system to accept illiquid or long-term paper and proper safeguards against the acceptance of such paper should be specified by statute. The proposal would eliminate the carefully devised limitations now prescribed by the Federal Reserve Act as to the kinds and maturities of paper that may be taken by the Reserve banks.

The committee recognizes that the character of assets of the member banks has undergone some changes since the Federal Reserve System was established, and that an increasing percentage of such assets has been invested in securities and advanced upon collateral loans of types not generally considered suitable for rediscount. It is to be expected, however, that a substantial upturn in business activity will bring forth a greatly increased volume of eligible paper.

The total loans and discounts of the Federal Reserve banks now outstanding to member banks is less than $10,000,000, whereas the banks possess approximately $2,000,000,000 of eligible paper exclusive of Government obligations. In more normal periods the eligible paper possessed by the member banks always has been many times greater than the amount of rediscounts. Neither the prospective capital positions of the principal customers of the member banks nor their general credit practices warrant the assumption that eligible paper in large volume will not be possessed by the member banks.

There does not appear to be at this time any great need of the amendment. It has been pointed out by the Federal Reserve Board in a recent annual report that the use made by the member banks of the emergency power to borrow upon assets not otherwise eligible for rediscount was availed of by relatively few banks. The amounts involved in those loans were not large, the maximum outstanding at any one time being less than $100,000,000. The existence of these facilities, however, served a useful purpose in individual situations.

The committee recognizes the desirability of a reexamination of the eligibility requirements. It is convinced, however, that there should be no such broad grant of authority to the Federal Reserve Board to determine these requirements as is proposed in the bill. If legislation is to be passed at this session, it might be well to reenact the emergency provisions which lapsed last March, without making other changes in the eligibility requirements.

Recommendation.—The committee believes that—

Present requirements as to the eligibility of paper for rediscount with, or to secure advances from, the Federal Reserve banks should be retained, except that consideration should be given to the desirability of reenacting, for a limited period, the emergency provision of the Federal Reserve Act, known as "Section 10–b", which lapsed in March 1935.

PURCHASE AND SALE OF GUARANTEED OBLIGATIONS

Amendment.—The bill (sec. 207) would provide that all obligations that are guaranteed both as to principal and interest by the United States would be eligible for open-market purchases by the Federal Reserve banks upon the same basis as direct obligations of the Government and without regard to maturities.

At present.—Direct obligations of the United States are eligible for open-market operations. The Reserve banks have purchased principally the shorter term securities. Other obligations, which may be guaranteed as to principal and interest by the United States, are not fully eligible in every instance for open-market operations. With the exception of bonds and notes of the United States, obligations which may be purchased by the Reserve banks normally must have maturities of not exceeding 6 months from the date of purchase.

Modification.—None has been proposed.

Comment.—The proposed amendment serves to focus attention upon the increasing number of Federal agencies which have access to the money markets and to the resources of the Federal Reserve and the member banks. While it may be said that no distinction should be made in principle between direct obligations of the Government and those fully guaranteed by it, the committee believes that there should be resistance to the trend toward making the Reserve System the repository of innumerable types of securities which are not suitable for investment by Reserve banks. The Reserve banks, moreover, should not be expected or be called upon to provide the guaranteed obligations of the Government with greater attractiveness by supplying a market for them. The

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member banks already possess ample holdings of direct obligations of the Government with which to obtain reserve credit should occasion require.

In central banking systems that are most highly regarded conservative policies are in force in relation to the amount of Government paper that they acquire. It is to be noted that their extensions of credit to the primary banks upon the security of direct obligations of their governments may bear higher rates of interest than extensions on the security of commercial paper.

Recommendation.—The committee believes that—

The Federal Reserve banks should not be permitted to buy and sell, without limits as to volume or maturity, the obligations which are guaranteed by the Government but which are not its direct obligations.

NEW BASIS FOR FEDERAL RESERVE NOTES

Amendment.—The bill (sec. 208) provides that each Federal Reserve bank would be permitted to issue Federal Reserve notes, which would be obligations of the United States, secured by a first and paramount lien on all the assets of the Reserve bank. The banks would be required, however, to maintain reserves in gold certificates of not less than 40 percent against Federal Reserve notes in actual circulation. The notes would be issued and retired under such rules and regulations as the Federal Reserve Board would prescribe and would be legal tender for all purposes.

At present.—Under the present law each Federal Reserve bank must maintain a 100-percent cover for Federal Reserve notes, of which cover a minimum of 40 percent must be in gold certificates and the balance in eligible paper or Government securities, or both. The inclusion of Government securities as part of the cover for such notes has generally been regarded with doubt even as a temporary power.

Modification.—No material modification has been advanced.

Comment.—This proposal of the pending measure has attracted much unfavorable comment. Taken with other provisions of the bill, it would mean the virtual elimination from the Federal Reserve Act of what remains of the original purpose to establish a sound and elastic bank-note currency.

The amendment would remove permanently the requirement of any specific cover except the minimum 40 percent in gold certificates, but would retain the present provision that the notes are a first and paramount lien upon the Reserve bank assets. It would mean that Reserve notes in the future would deteriorate in quality as the assets of the banks changed from short term to long term or became less liquid. There would be neither an elastic nor a redeemable currency.

The proposed amendment would make for a less desirable Federal Reserve note, especially since other amendments would permit assets of the Reserve banks to be composed more largely of Government securities and all manner of long-term or illiquid paper.

The proposal would be more acceptable if there were safeguards as to the quality and maturity of the assets of the Reserve banks and against political interference with their management. In view, however, of the suggestion that the eligibility requirements for rediscounts be left entirely to the Federal Reserve Board and the possibility that holdings of Government securities and guaranteed obligations would be increased, disturbing questions would arise concerning the volume and quality of future Reserve note circulation.

The fear appears justified that under two proposed changes, namely, in the eligibility requirements for rediscounts and in the collateral requirements for Federal Reserve notes practices would develop which are not generally recognized as being desirable in central banks. These changes taken together would emphasize the prospect of more central management and "conscious control" of money and credit and, combined with the deficit financing of the Government, would make for an increased opportunity for inflation.

Recommendation.—The committee believes that:

Each Reserve bank, as at present, should be required to maintain a 100 percent cover for Federal Reserve notes of which cover a minimum of 40 percent should be in gold certificates and the balance in eligible paper, or, temporarily, Government securities, or both.

RESERVES AGAINST DEPOSITS OF RESERVE BANKS

Amendment.—The bill (sec. 208) would provide for the elimination of gold certificates as required reserves against deposits of Federal Reserve banks.

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The reserves would be lawful money (other than Federal Reserve notes or Federal Reserve bank notes) of not less than 35 percent.

At present.—Each Reserve bank is required to maintain a 35-percent reserve in gold certificates or lawful money against deposits.

Modification.—None has been officially proposed.

Comment.—No great objection has been raised to this proposal except that it would constitute another step away from the principle that the structure of both the note issues and the deposits of a Reserve bank should be placed upon a firm basis of gold reserves. There is no emergency which requires the passage of the amendment.

Recommendation.—We believe that:

It is desirable to maintain that required reserves against the deposits of Federal Reserve banks should consist of 35-percent reserve in gold certificates or lawful money.

RESERVES OF MEMBER BANKS

Amendment.—The bill (sec. 209) would provide a new basis for the determination of the reserves of member banks. In order to prevent injurious credit expansion or contraction, the Federal Reserve Board would be permitted to change by regulation the requirements as to reserves to be maintained against demand or time deposits, or both, by member banks in any or all of the reserve districts and/or in any or all of the three reserve classes of cities.

At present.—The law now specifies definite minimum reserves that must be maintained by member banks, according to their locations. The highest reserves against deposits are required of the banks in the central reserve cities (New York and Chicago). The next highest reserves are required in the reserve cities (now some 62 in number), and the lowest reserves are required of banks outside of these two classes of cities, namely, those in the country districts. There is, however, an emergency provision that 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 the reserve balances required to be maintained by member banks against their deposits.

Modification.—The Governor of the Federal Reserve Board has proposed a modification of the amendment to the effect that changes in member bank reserve requirements might be applied to two classes, namely, to one class to be composed of the banks in central reserve and reserve cities, and to a second class to be composed of the banks in country areas. The report of the House Committee on Banking and Currency supports this proposal.

It has also been proposed that there be provided fixed limits within which the reserve percentages could be raised or lowered and that the power to change the reserve requirements be reposed in an open market committee representative of the Reserve banks.

Comment.—Proposals for changes in the required reserves have been under discussion for many years. This subject is of great importance not only to the member banks of the Federal Reserve System, but to commerce, agriculture, and industry, as reserve requirements have an important bearing upon the availability of bank credit.

The committee takes the position that, based upon recommendations of administrative officials of the Reserve System outlining the extent of proposed changes and presenting a method of computing the reserves to be required of member banks, there should be legislative revision of the provisions of the Federal Reserve Act relating to such reserves. The legislation should state definite percentages of deposits within which required reserves could be changed by action of the Federal Reserve Board. There is no immediate need, however, for such legislation and no changes at all would be preferable to such delegation of power to the Federal Reserve Board as would be provided by the amendment or the later suggestion of the Governor of the Federal Reserve Board.

Since the law now provides sufficient power to meet an emergency there is no immediate need for additional legislation of this character to control possible inflation.

An important objection to the broad grant of power which the amendment would give to the Federal Reserve Board is that through the exercise of this power great changes in the banking system could be forced. The door would

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be opened, for instance, to furthering a theory which a few persons have advanced, that a 100 percent reserve should be established against demand deposits. Arbitrary decisions in such matters by a small group of persons, with power to act, would create considerable disturbance.

Recommendation.—The committee concludes, therefore, that—

"After the reserve authorities have submitted a plan for minimum and maximum reserves of member banks and a method of computing the reserves, it would be advisable for the Congress to consider modification of the present reserves required of member banks."

LOANS ON IMPROVED REAL ESTATE BY MEMBER BANKS

Amendment.—The bill (section 210) would provide that State member banks must conform to the limitations upon national banks in regard to new loans made upon the security of real estate.

The bill, however, would change substantially the powers of national banks to make loans upon improved real estate. Such a loan could not have a maturity in excess of 3 years nor be in an amount in excess of 60 percent of the actual value of the property, except that a loan, secured by a first lien in an amount not exceeding 75 percent of the actual value of the property, could be made if it is required to be completely amortized within a period not exceeding 20 years by means of substantially equal monthly, quarterly, semiannual, or annual payments. The aggregate sum of such loans could not exceed the paid-in unimpaired capital and unimpaired surplus, or 60 percent of the time and savings deposits of the bank, whichever is the greater. (The geographical restrictions on real-estate loans would be removed.)

In the case, however, of loans, secured by improved real estate and insured under the provisions of title II of the National Housing Act, the restrictions as to the amount of the loan in relation to the value of the real estate and as to the 3-year limit on the terms of the loans would not apply.

At present.—State member banks must conform only to the requirements of their respective State laws, which in some instances grant them powers different from those of national banks in the matter of real-estate loans.

A national bank is authorized to lend upon improved real estate for a period not exceeding 5 years, and in an amount not exceeding 50 percent of the actual value of the property. The aggregate amount of such loans may not exceed 25 percent of the bank's paid-in unimpaired capital and unimpaired surplus or one-half of its savings deposits, as it may elect.

There is no provision that a national bank may make an amortized loan without conforming with the limitation of 5 years maturity and 50 percent of the value of the property, except that in the case of a loan which is insured under the provisions of title II of the National Housing Act the restrictions as to the amount of the loan in relation to the value of the real estate and as to the 5-year limit on its term do not apply.

A national bank may make a loan only upon the security of a first lien upon property situated within the reserve district in which it is located or within a radius of 100 miles of the location of the bank.

Modification.—The Governor of the Federal Reserve Board has proposed that the conditions upon which loans upon the security of real estate might be made by member banks should be left to the discretion of the Federal Reserve Board to enforce by regulations and that some suitable geographical limitations as to the territory in which such loans might be made should be established.

It has also been suggested that all real-estate loans hereafter made should be limited to 60 percent of the appraised value of the property and that the Federal Reserve Board be given discretion to make regulations governing real-estate loans held by member banks at the present time, but that they be permitted to make unamortized real-state loans up to a period of 5 years.

The report of the House Committee on Banking and Currency would support the idea that the conditions under which real-estate loans may be made by national banks should be prescribed henceforth by regulations of the Federal Reserve Board, except that (1) the amount of any such loan hereafter made could not exceed 60 percent of the appraised value of the real estate at the time the loan is made; and (2) the aggregate amount of such loans which any bank might make would not be permitted to exceed the capital and surplus of the bank or 60 percent of its time and savings deposits, whichever is greater.

Comment.—The proposed amendment would disregard the results of the practical experience of commercial banks with long-term real-estate loans when made upon an over-liberal basis or in too large volume.

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It is recognized that member banks of the Reserve System should be permitted to invest at least a portion of their time and savings deposits in real-estate loans, if they are to continue to accept such deposits and our communities are to be supplied with adequate credit facilities.

The interests, however, of the depositors in such banks require that lending upon real estate be carefully circumscribed, both as to the amount that can be loaned upon a single property and the proportion of the bank assets which may be engaged in real-estate loans. It will be recalled that the banks in recent years have been severely criticized for tying up their deposits in illiquid paper. It is strange, therefore, to have it suggested by one with some responsibilities of bank supervision that there be a relaxation of standards which in the past have not proved too high.

If many State banks that are not now members of the Reserve System are compelled to join it, the greatest care will be necessary to permit them a sufficient but not undue authority to lend in the future upon the security of real estate, It would be a disservice to them and to their depositors to encourage loans upon the security of paper that may prove to be without a ready market, whether mortgages or bonds, or to invest in such paper to an extent that experience has not indicated to be desirable.

If it be expected that the Reserve banks should increase the liquidity of the member banks by making them advances upon the security of such assets, in the event of trouble arising, the reserve banks will depart further from a proper sphere of operation of central reserve institutions and thus be more likely to intensify rather than relieve the uneasiness of the country with respect to the credit situation.

Recommendations.—We believe that the power of member banks to make loans upon the security of improved real estate should be limited to 50, or at most 60, percent of the appraised value of the property, and the permissible volume of such loans should bear a conservative relation to capital and surplus, or to time and savings deposits.

If the application of the present provision of law that all banks in the insurance-deposit fund must be members of the Federal Reserve System after July 1, 1937, is postponed or if the provision is eliminated, the mortgage-loan limitations should be established with sole attention to the situation of the banks now in the membership of the Reserve System.

BUSINESS STABILITY

Amendment.—While there was no amendment dealing specifically with the subject of business stability in the bill as introduced, the Governor of the Federal Reserve Board later recommended the insertion of a provision that "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."

The bill (sec. 204–b) as reported by the House Banking and Currency Committee would require the Federal Reserve Board "to exercise such powers as it possessed in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

At present.—There is no requirement of law that the powers of the Federal Reserve System be exerted to produce business stability. As a matter of policy, however, it is recognized that, as a reserve or supplementary credit system, the Federal Reserve Board and Reserve banks must seek to exert a steadying influence upon the money market and upon the course of industry.

In 1933 a modification of the Federal Reserve Act was made to establish that, subject to the provisions of law and the orders of the Federal Reserve Board, the directors of a reserve bank *may* extend to each member bank such discounts, advances, and accommodations as may be safely and reasonably made with due regard to the claims and demands of other member banks, "the maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture." The italicized word "may" replaced the word "shall" and thus more clearly granted discretion. "The maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture" were added as tests to be applied.

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It was also required by the amendment of 1933 that each reserve bank must keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and to give consideration to such information in determining whether to grant or refuse advances, rediscounts, or other credit accommodations. Each reserve bank chairman is required to report to the Federal Reserve Board any such undue use of bank credit by any member bank, together with his recommendation. The Federal Reserve Board, after reasonable notice and opportunity for a hearing, may suspend the bank from the use of the credit facilities of the Federal Reserve System if the bank, in the Board's judgment, is making such undue use of bank credit. The suspension may be terminated, or it may be renewed from time to time.

If any member bank, during the life or continuance of an advance to it by a Reserve bank, and despite the official warning of the Reserve bank or of the Federal Reserve Board to the contrary, increases its outstanding loans secured by collateral in the form of stocks, bonds, debentures, or other such obligations, or in the form of loans made to members of any organized stock exchange, investment house, or dealer in securities, upon any obligation, note, or bill, secured or unsecured, for the purpose of purchasing and/or carrying stocks, bonds, or other investment securities, except obligations of the United States and except the temporary carrying and clearance loans made solely for the purpose of facilitating the purchase or delivery of securities offered for public subscription, the advance will become immediately due and payable and the member bank will be ineligible for such advances for such period as the Federal Reserve Board determines.

Comment.—This committee has indicated in the first part of its report that, as a matter of policy, the Federal Reserve Board and the Reserve banks, in cooperation with the member banks, should endeavor to promote business stability. It is to be noted, however, that difficulties may arise from a specific requirement of law that stability of business prices and employment shall be a required duty of the Federal Reserve System. Public expectations may be raised that cannot be realized through use of the powers that the System possesses and it is liable to be subjected to severe criticisms on the grounds that it has not made proper exercise of its powers in the event of conditions arising that any particular group deems to be unstable or undesirable.

It should be remembered that it is a primary obligation of the Federal Reserve System to provide for the custody, regulation, and protection of the central banking and currency reserves of the country. All of these reserves are not now possessed by the System. Under some of the amendments of the bill the assets of the Reserve banks themselves, which should be of the most liquid character possible, may become such as to interfere with the discharge of its primary duties.

So far as monetary action may be necessary to contribute to stability, it should be recalled that the Federal Reserve banks do not possess the exclusive right of note issue and that broad monetary powers are vested outside of the System. The management and policies of the System may be brought under Government control and the influence of politics. The Reserve banks are not today the bankers of all our banks, and cannot influence the credit policies of nonmembers nor of many other credit-granting institutions while their influence in relation to many of the present member banks is of a limited character.

All of these conditions have a direct bearing upon the advisability of enacting a requirement that may lead to the charge that business instability in the future will be the result of delinquencies or misdirections of policy of the Federal Reserve System, and especially of the Federal Reserve Board.

The conditions that have just been referred to and all proposals that would add further strength and usefulness to the Reserve System should be examined in a comprehensive inquiry by a competent body before fundamental changes in the structure, policy, or operations of the System are made. It would seem that better integration of the entire banking system of the country, more protection of the Reserve System itself from unwise actions by the Government, and greater resources and powers, with proper safeguards, will be necessary before our credit mechanism can contribute most usefully to the promotion of such stability as is the objective of the amendment in question.

(Thereupon, at 12:15 p. m., Tuesday, May 21, 1935, the subcommittee adjourned to meet at 10:30 o'clock the following morning.)

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BANKING ACT OF 1935

WEDNESDAY, MAY 22, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE
ON BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met, pursuant to adjournment on yesterday, at 10:30 a. m., in room 301, Senate Office Building, Senator Carter Glass presiding.

Present: Senators Glass (chairman of the subcommittee), Bulkley, McAdoo, Bankhead, and Townsend.

Senator GLASS. The subcommittee will come to order.

Mr. Byrne, if you will be good enough to come up to the committee table and take a seat opposite the committee reporter.

Mr. BYRNE. Thank you, Mr. Chairman.

Senator GLASS. I believe you are the president of the Hartford Trust Co.

Mr. BYRNE. Yes, Mr. Chairman, but the correct name is Hartford-Connecticut Trust Co.

STATEMENT OF JOHN B. BYRNE, HARTFORD, CONN., CHAIRMAN OF A SPECIAL COMMITTEE OF THE EXECUTIVE COMMITTEE OF THE CONNECTICUT BANKERS' ASSOCIATION

Senator GLASS. Mr. Byrne, we have under consideration the bill, S. 1715, and have understood that you wanted to be heard on the bill.

Mr. BYRNE. Yes, Mr. Chairman.

Senator GLASS. We will be glad to have any statement you care to make.

Mr. BYRNE. I might say, gentlemen of the committee, that I am chairman of a special committee which was appointed by the executive committee of the Connecticut Bankers' Association, which drew up a set of resolutions in regard to this bill. Those resolutions were forwarded to you and are now, I take it, in your possession. My purpose today is simply to amplify those resolutions in person. I might say by way of further explanation that for 9 years I was in the service of the banking department of the State of Connecticut and for the last 5 years was Commissioner of Banking of the State.

Senator GLASS. You may proceed with your statement.

Mr. BYRNE. Recently the executive committee of the Connecticut Bankers' Association adopted a resolution in opposition to certain provisions of the proposed banking act, and a copy of that resolu-

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tion has been sent to each member of your committee. I am here today with the authority of that committee to express its views as contained in that resolution.

In the first place, we believe that titles I, II, and III, into which the act is divided in the bill, are unrelated subjects and should not properly be combined in one measure. Title I deals with certain changes and amendments in the present deposit-insurance law, and title III contains modifications and clarifications of existing banking laws. Title II, however, proposes to bring about far-reaching and vital changes in the basic set-up of the Federal Reserve System. We feel that such radical changes should not have been combined with the technical and routine changes contained in titles I and III.

Now, as to title I: I have to say to you that the feeling against deposit insurance in principle is very strong in Connecticut. We do not regard it as a cure for bad banking. We feel very strongly that it may weaken and undermine good banking practice. Our feelings are based largely on the belief that such insurance is largely unnecessary in our State and that we are being assessed for the benefit of banks in other States. However, recognizing that there is a public demand for some form of insurance and that its continuance for the time being is expedient, we do not oppose it. We suggest, however, that the life of the corporation be limited to a definite period; that the maximum amount of the fund to be raised be fixed, that assessments be not mandatory; and that the rate be substantially less than that proposed in the House bill.

Many of he banks in our State, as well as others, are doing their utmost in the face of diminishing earnings to set up adequate reserves for slow and doubtful paper, but they are doing it only by setting aside each year a substantial part or all of their available earnings. If the assessment established is too heavy, it will seriously affect the ability of the individual bank to continue to put its house in order, and it may be that a great many banks will not be able to stand the assessment at the proposed rate and will be forced to withdraw and risk going it alone.

Senator GLASS. And you say risk going it alone?

Mr. BYRNE. Yes, sir.

Senator MCADOO. And the proposed rate of assessment you speak of is one-eighth of 1 percent?

Mr. BYRNE. Yes, sir. And I can report for 67 State banks in Connecticut, with total deposits of $464,947,000, the assessment at the rate would bring in the sum of around $580,000. The State bank commissioner reports to me that the net earnings of those banks last year were $4,000,000 and the losses were $5,000,000.

Senator TOWNSEND. In other words, they were in the red a million dollars?

Mr. BYRNE. Yes, sir.

Senator MCADOO. These are abnormal times, of course.

Mr. BYRNE. That is true, but if these abnormal times continue and this assessment rate is put at one-eighth of 1 percent it would mean——

Senator MCADOO (interposing). But they do not have to take the insurance, do they?

Mr. BYRNE. They do not have to unless they want to. And they may have to go it alone if they feel they cannot pay it.

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Senator TOWNSEND. Or they may close, either the one thing or the other. That is the feeling as I see it. There is no prospect that the banks can expect to make more money this year than in years past with the low rates of interest prevailing; is that your view of the situation?

Mr. BYRNE. As far as I can see, judging from your own situation, and the situation generally in Connecticut, with which I am more familiar than elsewhere, I think bank earnings this year will be substantially less than they were in 1934.

Senator MCADOO. Do you think that banks that do not take the insurance would have to close?

Mr. BYRNE. No. There are seven or eight banks that did not see fit to take the insurance and yet they seemed to go along very well.

Senator MCADOO. Of course the law is such that if they do not want to take the benefit of the insurance, if there is any benefit in it, that it is optional with them to do it or not.

Mr. BYRNE. That is true, but——

Senator MCADOO (continuing). They are free to join or not as they please.

Mr. BYRNE. Of course, that is very true, but one of the objects of the Federal Deposit Insurance was to get the most of the banks in that were eligible to join.

Senator MCADOO. I am not making an argument against reasonable treatment of the banks because I am strongly in favor of giving them reasonable treatment. What I meant to say was that they are not forced to join the system under the existing law.

Mr. BYRNE. No; but——

Senator BULKLEY (interposing). Just what are you arguing for now? Are you arguing that we ought to abolish the Federal Deposit Insurance Corporation?

Mr. BYRNE. No; but I am registering in principle our objection to it.

Senator BULKLEY. What is the point that you make?

Mr. BYRNE. That the rate should be fixed in this bill at substantially less than one-eighth of 1 percent.

Senator BULKLEY. And what should it be?

Mr. BYRNE. Well, that is a different proposition. This is not insurance but an assessment. There is no actuarial experience in this kind of thing from which to judge what is the proper amount to be set up in order to safeguard possible failures.

Senator BULKLEY. I realize that there is room there for a difference of opinion, but wanted to know what you thought it should be.

Mr. BYRNE. The Federal Deposit Insurance Corporation put it at one-twelfth. We feel that one-sixteenth is about the situation that we could hope to meet. That will raise about $22,000,000 a year in the Corporation.

Senator BULKLEY. And any amount fixed would be on top of the existing losses that the banks are suffering anyway.

Mr. BYRNE. It would have to be.

Senator MCADOO. You also want to have the life of the Federal Deposit Insurance Corporation limited, I understood you to say.

Mr. BYRNE. Yes, sir.

Senator MCADOO. Limited to how short a period of time?

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Mr. BYRNE. We suggest 5 years, although I am not too positive about that. And that the maximum amount of the fund to be raised be fixed. It seems to me there should be a goal set for the work.

Senator MCADOO. Do you mean a maximum amount of insurance reserve?

Mr. BYRNE. Yes, sir; and maintained at that figure unless further losses occur when assessments would be made to build it up again.

Senator MCADOO. What do you suggest as a maximum figure?

Mr. BYRNE. I would suggest half a billion dollars.

Senator MCADOO. And to what extent would you suggest that the reserve would have to be depleted in order to have the insurance premiums resumed?

Mr. BYRNE. I think it should be kept at that figure.

Senator MCADOO. Suppose the fund should become impaired by losses; to what extent do you think that impairment should be permitted to go before there should be a resumption of assessments?

Mr. BYRNE. I would not state any definite percentage. They should set about getting new assessments as soon as definite losses were established. I suppose if forty or fifty million dollars of losses occurred they should go ahead and build up the fund again.

Senator GLASS (chairman of the subcommittee). The Senator from California, I assume, is asking that question because it has been suggested that the assessment against banks, at whatever percentage it may be fixed, should be automatic until they have a fund of $500,000,000. Then the assessment should automatically cease until that fund is impaired to the extent of 25 percent, and then the assessments would be automatically resumed.

Mr. BYRNE. Exactly. Mr. Chairman, you have stated it much better than I could.

Senator MCADOO. Do you think that is a good plan?

Mr. BYRNE. That is a very good plan.

Senator GLASS (chairman of the subcommittee). You may proceed with your statement.

Mr. BYRNE. If I may go on to title III next, we feel that it contains changes for the most part technical but seem to us, on the whole, to be beneficial, and we believe that title III should be passed. We have no objection to that at all. As to title II, we oppose vigorously the whole of it and believe that it should be taken out of the bill. We regard as extremely dangerous the possibilities of the centralization of control over our money and credit in the hands of a small group supposedly under complete political domination.

Senator TOWNSEND. Are you authorized to represent all of the banks of Connecticut?

Mr. BYRNE. There has been no referendum on this subject, but this represents the views of the executive committee of the Connecticut Bankers' Association.

Senator GLASS (chairman of the subcommittee). You may proceed.

Mr. BYRNE. We are opposed to lowering the standards with respect to assets which would be eligible for rediscount and to the liberalization as contrary to the teachings of experience of the laws regulating real-estate loans. A large part of our dismal record of bank failures is due to the abuse of demand deposits; that is, too great a proportion of those deposits were put out on long-term, non-

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liquid loans, including loans on real estate. We feel that it is an experiment full of danger to open wide the requirements of assets eligible for rediscount. No amount of artificial liquidity and letting the Federal Reserve hold the bag is going to discourage bad-loaning practices on the part of banks, and it may have the effect of encouraging them.

We believe it to be essential to preserve the autonomy of the regional Federal Reserve banks and are, therefore, strongly opposed to the provisions of this title, which would take from the regional banks all independence of action—deprive them of their ability to truly represent their respective districts with some degree of authority.

We are in agreement with the statement of the Economics National Committee, which I believe has been filed with you, that—[reading]—

> Measures designed to correct weaknesses in the Federal Reserve System should seek to increase rather than destroy its independence of political influence. They should assure, not impair, its liquidity, and they should free it from Government financing rather than link it more closely to the fiscal needs of the Government.

However, whether opposed or in favor of the far-reaching changes contained in title II of the proposed bill, we think that all would agree that these changes are revolutionary, and there is no disputing the fact that they are controversial. We see no emergency existing at the present time which calls for drastic and hurried action and feel that no attempt, therefore, should be made to rush through such revolutionary and controversial legislation.

It was only after long and patient study that the Federal Reserve Act was evolved. It is the first real reserve banking system we ever had, and by and large, for 20 years, it has worked and worked exceedingly well. It seems to us the height of folly to overthrow some of the fundamental theories upon which it is based merely because the blame for some of the difficulties we have experienced is charged against it. If it has fallen down in some particulars, we believe that it has also contributed very materially to the development of sound banking along recognized lines and has rendered valuable service to the interests of commerce, trade, and agriculture as carried on under our American system of doing business.

Granted that the Federal Reserve System is not perfect and may need some modification after careful study, it is our opinion that the failure of the System to be very helpful in the time of crisis, and speaking more specifically, to check the speculation which led up to the crash in 1929, can be attributed largely to the human element in its management rather than any break-down of the principles upon which the System was founded.

Senator GLASS. Has not that been cured so far as legislation may cure it in the Banking Act of 1933?

Mr. BYRNE. Yes, sir.

Senator GLASS. You may proceed.

Mr. BYRNE. Strengthen the System, if possible, and make such changes as are necessary, but let us not in a spirit of discontent and in our eagerness for reform and the centralization of power pass in haste measures which we may later have cause to regret. We are in complete accord with the position taken by those members of the

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House committee in their minority report that title II be taken out of the proposed act and that further consideration of such radical and fundamental changes in our banking system be referred to some qualified, independent, and nonpartisan commission for thorough investigation and study.

I submit that statement for your record, Mr. Chairman.

Senator GLASS (chairman of the subcommittee). Have you gentlemen of the subcommittee any further questions? [A pause, without response.] Then we are very much obliged to you, Mr. Byrne.

We understood that there would be present this morning some bankers from West Virginia, but they do not seem to be present. The subcommittee will now stand adjourned until tomorrow morning at 10:30 o'clock.

(Thereupon, at 11:20 a. m., May 22, 1935, the subcommittee adjourned to meet at 10:30 o'clock the following morning.)

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BANKING ACT OF 1935

FRIDAY, MAY 24, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE
ON BANKING AND CURRENCY,
Washington, D. C.

The subcommittee met, pursuant to adjournment, on Wednesday at 10:30 a. m. in room 301, Senate Office Building, Senator Carter Glass presiding.

Present: Senators Glass (chairman of the subcommittee), Bulkley, McAdoo, Bankhead, Byrnes, Couzens, and Townsend.

Senator GLASS. The subcommittee will come to order.

Senator COUZENS. Mr. Chairman, before Dr. Miller begins his statement, may I have entered in the record a letter which I received from the Governor of the Federal Reserve Board, Mr. Eccles, dated May 21, 1935, in which he says, in part [reading]:

> You asked me the other day what procedure I would have followed in 1928 and 1929, had the banking bill of 1935 been in effect at that time and had I been Governor of the Federal Reserve Board. It is always difficult to state what one would have done in different circumstances, and I presume that what you meant was not what I myself would have done in the circumstances, but what powers this bill would confer on the Board that it did not have at that time. * * *

May I put this in the record, without reading all of it?

Senator GLASS. Yes.

(Letter, dated May 21, 1935, from M. S. Eccles, Governor Federal Reserve Board, to Senator Couzens, is here printed in full, as follows:)

FEDERAL RESERVE BOARD,
Washington, May 21, 1935.

Hon. JAMES COUZENS,
United States Senate, Washington, D. C.

DEAR SENATOR COUZENS: You asked me the other day what procedure I would have followed in 1928 and 1929 had the banking bill of 1935 been in effect at that time and had I been Governor of the Federal Reserve Board. It is always difficult to state what one would have done in different circumstances, and I presume that what you meant was not what I myself would have done in the circumstances, but what powers this bill would confer on the Board that it did not have at that time that would have been helpful in preventing the excesses of 1928 and 1929.

As I stated in the hearing, the banking bill of 1935 is not primarily proposed for the purpose of meeting a situation such as existed in 1928 and 1929. Provisions that would have strengthened the Board's power to meet such a situation are contained in the Banking Act of 1933, which was the direct outcome of a Senate resolution and investigation occasioned by the stock market excesses during that period. The Securities Act and the establishment of the Securities and Exchange Commission were also the results of investigations by the Senate committee into abuses in the capital market and on the stock exchange.

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Conditions in 1928 and 1929 represented the culmination of developments during the entire post-war period. Interest rates were falling steadily from 1920 to the end of 1927, owing partly to the great inflow of gold from abroad; business was generally active; there were large profits earned by certain corporations, particularly by the larger corporations with monopolistic advantages. Opportunities for floating securities at profitable rates were exceptionally good, with the consequence that many corporations built up large cash reserves beyond their immediate needs, and this money was available for temporary employment in the stock market when the demand for brokers' loans increased.

Speculative activity on the stock market had become pronounced in 1924 and had continued to be large with fluctuations from that time to the autumn of 1929. In 1927 an easy-money policy, adopted primarily for the purpose of helping England remain on the gold standard and helping France and other countries to return to the gold standard, was followed by an additional spurt in the stock market. During 1928 the Federal Reserve System raised discount rates and sold Government securities, but this had relatively little effect on speculation.

In 1929 the Federal Reserve System had only a small volume of Government securities left and member indebtedness was large. The question that arose was whether the discount rates should be raised. Some of the Reserve banks recommended such advances, but the Federal Reserve Board felt that there was nothing in the business situation that required restraint; that, in fact, there was a recession in building activity, and that advances in discount rates would be undesirable, because they would probably not deter speculators but would have a bad effect on business activity. The Board therefore adopted a policy of trying to reach member banks directly by curtailing Federal Reserve credit extended to banks that had a large volume of loans in the stock market. This policy was only partially successful in restraining speculation, partly because under the then existing law the Reserve banks could only deal with member banks who were actually in debt at the Federal Reserve banks. This enabled banks with large stock-exchange accounts to buy Federal funds from other banks and thus to acquire reserve funds without borrowing directly from the Reserve banks. Control of speculative loans was difficult under these conditions. Furthermore, there was little or no growth in the volume of bank credit in 1928 and 1929. Loans by member banks to brokers and member-bank deposits did not increase. The speculative demand for credit in the market was met largely by the loaning of surplus funds owned by corporations.

It is impossible at this time to say what could have been done to remedy the situation, certainly at so late a date as 1928 and 1929. It is to be hoped that with security issues and stock-exchange practices under regulation by the Securities and Exchange Commission, with authority in the Federal Reserve Board to regulate margin requirements on collateral loans, both for brokers and for banks, with loans by corporations to brokers prohibited, and with the additional powers of control over speculative activity by member banks contained in the Banking Act of 1933, the Federal Reserve System will be in a much stronger position to prevent the development of an unsound situation such as the one that culminated in the stock-market debacle of 1929.

The banking bill of 1935 is not directed toward preventing stock-market abuses, which, as has just been said, have been dealt with by other legislation. This bill is concerned with improving the machinery of the Federal Reserve System and with centralizing in the Federal Reserve Board responsibility for all the instruments of monetary policy, namely, discount rates, open-market operations, and changes in reserve requirements. It was not in 1929 that the powers contained in this bill would have been valuable but in 1931. At that time, when England went off the gold standard and there was a heavy drain on gold in this country and a drastic deflation in business and in bank credit, the System would have been in a much stronger position to adopt a vigorous open-market policy if this bill had been in effect. As things were at that time, the System could not buy Government securities freely because they were not eligible as collateral for Federal Reserve notes and the Reserve banks had an inadequate supply of commercial paper eligible for that purpose. It was not until the passage of the Glass-Steagall Act at the end of February 1932 that the System was able to pursue a vigorous open-market policy. This obstacle to an easing policy at a critical time will be removed by the proposed bill.

Moreover, if banks had been able to borrow on their sound assets from the Reserve banks during the depression, as they would have been had this bill been in effect, much liquidation would have been avoided.

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The bill would also increase the ability of the Federal Reserve Board to cope with such a situation by placing on it the full responsibility for open-market policy, so that it could adopt and carry out such a policy on the basis of its conception of the national interest without being delayed by negotiations with the individual Reserve banks, which under existing law not only have the sole power of initiating open-market policy but also have the power of refusing to participate in such a policy when it is adopted.

The situation in 1931 and the early part of 1932 illustrates how the present bill would have helped at a time when deflation was in progress. Another purpose of the bill is to strengthen the Federal Reserve System's power to counteract inflation, if it should get underway in the future. With the large volume of excess reserves at member banks at the preesnt time and the likelihood of further increases in these reserves through gold imports, silver purchases, the use of the stabilization fund, and through possible currency issues under the bonus bill, or otherwise, there are possibilities of further increases of the reserves of member banks without corresponding growth in security holdings of the Federal Reserve banks that would be available to sell in the market for the purpose of absorbing bank reserves.

The proposed bill would improve the position of the Federal Reserve System in such a situation by concentrating the open-market power in the hands of the Federal Reserve Board, which could act promptly and decisively without possibility of delay or inability to agree on a policy. It would also give the Board the power to increase member bank reserve requirements without the necessity of declaring an emergency or obtaining permission from the President, who ought not to have this responsibility.

The fact that the proposed bill prescribes as an objective of monetary policy the maintenance of business stability would also strengthen the Boards power to act because an inflationary boom is not consistent with business stability.

It is for these reasons that I feel that the proposed bill would strengthen the power of the Board to act promptly, both in a period of inflation and in a period of deflation. With the powers contained in this bill, together with the provisions of the Banking Act of 1933 and the Securities Exchange Act, I believe that the Federal Reserve System would be in a much stronger position to moderate booms and depressions and would be better able to contribute to business stability insofar as this can be done within the scope of monetary action.

I hope that this is a satisfactory answer to your question. I have not dwelt on other phases of the bill because these matters are not directly in line with your question and have been discussed in my testimony.

Very truly yours,

M. S. ECCLES, *Governor.*

STATEMENT OF ADOLPH C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD, WASHINGTON, D. C.

Senator GLASS. Doctor, please give the reporter your name and position.

Mr. MILLER. Adolph C. Miller, member of the Federal Reserve Board.

Senator GLASS. Dr. Miller, I believe you have been a member of the Federal Reserve Board since the establishment of the System?

Mr. MILLER. I must admit it, Senator.

Senator GLASS. We have under consideration Senate bill 1715, and also the bill which passed the House, and the subcommittee would be very glad to have you make any statement that you may care to make.

Mr. MILLER. Senators, I have not prepared any written statement. That does not, however, mean that I have not given a great deal of thought to both the Senate bill and the bill in its amended form as it passed the House. I am prepared to give to you informally a statement of my views and the problem as I conceive it, and I shall be

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very glad if you accord me a few moments to give a general outline of my position before going into questions.

I have brought with me some charts and other matter which, if the committee is interested, as I hope it will be, might illustrate the background against which some of these provisions I think should be judged in order to understand their full implications and their possible working and effects.

Senator TOWNSEND. Will you discuss the three titles of the bill?

Mr. MILLER. No; I am going to confine my observations to title II.

I think at the outset it is well to recall that it is now more than 20 years since the Federal Reserve Act was passed and that there have been profound changes both in the economic structure and dispositions and relationships of the leading countries of the world, profound changes in the monetary organization when you compare it against the condition that existed for a long period of time and which had been assumed as a condition that would probably continue to exist permanently at the time the Federal Reserve legislation was enacted.

At that time the gold standard, the historic gold standard as it has been understood in the past, was in full operation. Probably in the 15 years before the Federal Reserve Act was passed the gold standard, the sterling gold standard particularly, had never operated with a greater degree of effectiveness and satisfactoriness than it did at that time; and whether intentionally or consciously or not, the Federal Reserve System, like all other great banking systems of countries on the gold standard, was predicated upon the expectation that that which had been would continue to be in the future. The world has never seen, and I doubt whether in a generation it will ever see again, any scheme of monetary organism set up anywhere capable of producing the results that actually were achieved in the 15 or 25 years immediately prior to the enactment of the Federal Reserve System.

That was a balanced world. It was one that was well adapted to the operation of a gold standard; and the gold standard as it was operated at that time, from London, and under the general dispensation of the Bank of England, produced throughout the world and in every part of the world a condition of stability which we have not seen since.

Senator BULKLEY. What years do you regard as being the important ones in that period?

Mr. MILLER. I would regard the 15 years—and that is not to be taken with absolute literalness—but I think we can date it from the reestablishment or the reaffirmation of the gold standard in this country in the Currency Act of March 1900, right down to the outbreak of the war. I take that as marking the period because I think it shows in a very great degree the kind of results that were capable of being attained under the gold standard when conditions are favorable to its effective operation and where it is, if you please, under good management. That was the sterling gold standard; many other countries, practically all countries, had a gold standard. Actually the gold standard was operated from London.

One of the remarkable attributes of the gold standard that were displayed during that period was this—and that we have lacked since,

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and that, in my judgment, in part explains the intensity, the severity of the crisis through which the whole world has been passing during the past 6 years—one of the qualities of the gold standard, when conditions are suitable to its effective operation, is that everything is constantly in process of readjustment. The best analogy that I can give that will give you a conception of the gold standard as it operated in that time, is this. I do not know whether it is medically true, but I imagine it is, that a corpse cannot stand on its feet. I doubt whether a statue could stand on its feet. There is a repeated process of adjustment of minor, hardly discernible or perceptible changes going on in the human organism in the process of trying to maintain a fixed position, but they are so minor that one hardly is aware of it, much less is anyone who is looking on. Those readjustments might be described as petty, infinitesimally small crises, nevertheless coming along constantly, and keeping, therefore, the economic organism of any given country or of the world in balance, just as the human organism would be kept in balance. In other words, any slack is constantly taken up through a process of readjustment.

I might perhaps convey an inadequate picture of it by saying that there was a constant succession of minor, petty crises, so small as not to come to the consciousness of even the average man of business, when those who felt the financial pulse of the world constantly were aware of the fact that something was going on toward the reestablishment and maintenance of equilibrium. To that I attach great importance in explaining why break-downs, catastrophic break-downs of the whole world are infrequent under the gold standard, despite the fact that in the earlier periods since the Civil War the world itself had experienced a great variety of very severe and catastrophic shocks. Under the system which has followed we have had an accumulation of these stresses and strains. They have not been promptly readjusted but have accumulated, and when they have accumulated in a sufficient number of countries to seriously threaten the maintenance of the equilibrium, a catastrophic break-down results and has resulted in our own country and in other countries; and the problem then takes on colossal dimensions and very serious consequences.

Now the gold standard has gone. It broke down in 1914. We can date the end of the effective operation of the gold standard with the advent of the World War. Despite the efforts of Europe and other countries to put their monetary affairs on a gold basis in the twenties, beginning with the Dawes settlement in Germany in 1924, England's restoration of the gold standard in 1925, with France, Belgium, and other countries following in swift succession, it is my view that the world has had no gold standard.

Senator GLASS. Would you apply that statement to this country?

Mr. MILLER. I would, Senator, emphatically.

Senator GLASS. Would not that mean issuing notes redeemable on demand in gold?

Mr. MILLER. Well, we had that aspect to the gold standard, but our gold situation was so extravagantly comfortable, our excess reserves were so large, and the period one of such extraordinary character that the gold standard as we had it was a managed gold standard.

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Senator GLASS. You think, then, that an overabundance of gold minimizes the importance of the gold standard rather than a minimum amount of gold?

Mr. MILLER. I would say an overabundance of gold, or let me say a bad dislocation of the distribution of the monetary gold stocks of the world, indicates such a serious breach in the whole economic and financial organism of the world that the gold standard in those conditions just would not operate.

Senator GLASS. I am not talking about the gold standard of the world or of any other nation than this Nation.

Mr. MILLER. Well, my answer there, Senator, would be that no one country by itself can be on the gold standard in an effective economic sense. It can technically.

Senator GLASS. On what kind of a standard were we when we had 43 percent of the gold of the world?

Mr. MILLER. I would say, off-hand, that from the inception of the System, or I would certainly say from 1921 on, we were in this country, without knowing it, on a managed gold-standard basis.

Senator MCADOO. Prior to that and during the World War we certainly were constantly on a gold standard, were we not?

Mr. MILLER. There was no gold standard then.

Senator MCADOO. There was. I beg your pardon.

Mr. MILLER. You are talking of it legalistically.

Senator MCADOO. No; I am speaking of the fact. There was not a note or a dollar of any kind that was not redeemable in gold and was not redeemed in gold at presentation at the Treasury or at any agency of the Treasury.

Mr. MILLER. That is perfectly true; but I am thinking of it in an economic sense.

Senator MCADOO. That is an economic sense.

Mr. MILLER. No; I say it goes far further, Senator, than that.

Senator BULKLEY. What years are you talking about now?

Senator MCADOO. From the beginning of the World War. Of course, we were on the gold standard prior to that. I mean, it was maintained throughout the World War as far as this country was concerned.

Mr. MILLER. It was maintained until recently. If you take as the only test of the gold standard prompt convertibility and redemption of obligations payable in gold, in gold, of course, there has never been a time until the passage of the Gold Reserve Act, or shortly before that, when that was not true. But our experience and the experience of the world in the decade of the twenties has demonstrated that you can have redemption and yet not have the protective safeguards to the economic system that are supposed to go with the gold standard and that actually went with it to an extraordinary degree in the prior period.

Senator BULKLEY. Are you going to make clear what you mean by a managed gold standard?

Mr. MILLER. If you desire; yes. I will give you an immediate illustration.

Senator MCADOO. You gave it to us already by saying that the pound sterling was managed in such a way that it constituted a stabilizing influence so far as gold was concerned.

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Mr. MILLER. Prior to the war the sterling gold standard was one in which the wisdom of the London financial market and the Bank of England intervened at times to temper or anticipate the effect and action of the gold standard. That is, they would smooth out, as it were, or redress some of its more exaggerated movements. They would not wait until an actual movement of gold took place from New York to London or from Paris to New York, but they would anticipate and perhaps intervene and assist in order that there might not be produced too violent and too sudden a dislocation in exchange rates and in monetary values.

Senator BULKLEY. Is that what you would call a managed gold standard?

Mr. MILLER. No. I call that the sterling gold standard or the pre-war gold standard.

Senator MCADOO. It did not apply to us except indirectly, of course?

Mr. MILLER. It was all indirect.

Senator MCADOO. There do you not attribute, when you talk about a controlled gold standard, a degree of prescience to those gentlemen who controlled it or managed it that they did not possess?

Mr. MILLER. They did possess it.

Senator MCADOO. They had prescience?

Mr. MILLER. It did not require a great deal of prescience. One of the characteristics of the old gold standard was that it did not require great prescience.

Senator MCADOO. Do you think that the symptoms of the disease were so clearly defined in advance that they were susceptible of treatment?

Mr. MILLER. The limits within which there is room for the play of discretion were such that there was no liability of making serious error. The object of all countries was to maintain the internal and the external value of their currency at an identical point.

Senator MCADOO. I did not mean to interrupt you in your answer to Senator Bulkley's question, but I did interrupt you, so I would like you now to proceed.

Senator GLASS. What I would like to know right at this point is whether or not the doctor proposes to substitute the judgment of a small body of persons to establish a maintained standard rather than the existing statutory requirements of the Congress as approved by the President.

Mr. MILLER. I am not sure, Senator, that I take in the full import of your question.

Senator GLASS. You say we are not on a gold standard. What sort of standard does this proposed legislation put us on?

Mr. MILLER. This legislation assumes what at the moment is a fact, that we are not on the gold standard; that we are on a managed currency basis. There is no redemption of paper currency in this country. To put it frankly, we are on a paper-money standard.

Senator MCADOO. Precisely.

Senator GLASS. We are on a fiat-money standard.

Mr. MILLER. Whether you call it fiat money or not is a matter of verbiage; but we are on a paper-money standard.

Senator GLASS. It is a matter of fact; it is not a matter of verbiage.

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Mr. MILLER. We are on an irredeemable paper money standard.

Senator MCADOO. You mean, printing-press money?

Mr. MILLER. I mean money of which there is no conversion——

Senator MCADOO. It is printing-press money?

Mr. MILLER. Yes.

Senator GLASS. And you think we ought to remain on that standard?

Mr. MILLER. No. I would be perfectly willing to be interrogated on that if you desire to interrogate me, but I assume that we are there now, and for my own part I have no hesitation in saying that I see no early prospect in the world, highly as I esteem the gold standard and devoutly as I wish for the good of this country and everybody in it that we could get back to a monetary system that would compare in the excellence of its results with what we had at the time of the outbreak of the Great War. But I see no early prospect of it.

Senator GLASS. We cannot get back if we insist on maintaining an irredeemable currency basis.

Mr. MILLER. We cannot get back, in my judgment, Senator, until the badly warped balance of the world, as well as every country in the world, notably our own, is in some way corrected. We are moving away from it nearly every day by an acute mania of economic nationalism and by devices that were utterly undreamed of a few years ago.

Senator TOWNSEND. What will be the final outcome if we keep moving away? Illustrate that, will you, please?

Mr. MILLER. Yes. The gold standard in an economic sense is a device, the best that the world has ever known, for maintaining a condition of balance among the countries of the world, and among industries within any country, by accurately and quickly detecting and registering the slightest departure from that balance and setting in motion at once corrective forces.

Senator GLASS. Do you think that we should persist in getting away from the best system on earth in order to go to the worst system on earth?

Mr. MILLER. No; I think that we ought to use all of our endeavors to get back; but as long as the tide is running strongly in the other direction—I mean the economic tide—I see no prospect of it. This country is in a bad state of economic unbalance. It has been ever since the war. The world as a whole is unbalanced.

Senator MCADOO. Do you mean, since the end of the war or the beginning of it?

Mr. MILLER. I would say, the end of the war. The beginning of the war gave the impulse.

Senator MCADOO. It culminated at the end of the war?

Mr. MILLER. Yes.

Senator MCADOO. The situation was intensified by the various devices used that were not heard of before and which represent the inventive genius of man; but in view of those facts do you think it would be possible for this country to maintain a gold standard if it wanted to? I mean, if we wanted to readopt the gold standard could we not do that?

Mr. MILLER. I think in the sense in which you are using the term—in other words, the convertibility of currency and credits of the

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country into gold—yes; I do not think there would be any trouble about that. But I still think that if we do that there would have to be a degree of management exercised over the credit organism of the country that in the olden practice of the gold standard was not necessary.

Senator McAdoo. I think you are correct about that. At the same time, I think it is clear that so far as the usefulness of gold is concerned—at least, it seems to me clear—it relates in the present condition of the world to international transaction.

Mr. Miller. That is true.

Senator McAdoo. Its usefulness, I mean, is rather restricted to that for the time being, in view of the economic nationalism of other countries and the intensification of it seems to be going on all the time. I think we can carry on our operations regardless of the gold standard, without injury, and maintain a fairly stable situation in our domestic affairs.

Mr. Miller. Yes. Admitting that that is so, it doubtless can be done, looking at the matter purely as a theoretical proposition.

Senator McAdoo. We are doing it.

Mr. Miller. We are not doing very much, I would say, Senator.

Mr. McAdoo. I mean, we are on that basis now?

Mr. Miller. We are on that basis now. But I would say that the last few years have demonstrated how utterly impotent the financial mechanism is to produce an effect when the patient will not respond to the treatment. You can lead a horse to the trough, but it is doubtful whether you can make him drink when you want him to.

Senator McAdoo. Everybody said that the repeal of the eighteenth amendment would cure all of our ills. Do you think that in spite of that we are going to survive unless we restore the gold standard?

Mr. Miller. Oh, I think we will survive. My own expectation is that the gold standard in some form will be reestablished among the leading countries of the world, but I am doubtful whether there is any near prospect of that. I may be unduly pessimistic, but I see no near prospect of that. Yet modern history, national and economic history, is full of surprises. The thing that it seemed yesterday could not occur, tomorrow does occur; and it might well happen that after this period of monetary disorganization and chaos has gone on a while longer and its futility and failures are appreciated by enough leading men in different countries, and a more normal mental balance is restored in the statesmanship of the leading countries of the world, they will get together and proceed to review the whole monetary situation with a view of putting it on some sort of secure foundation. I think then will come some type—if not the old type, some type of an international or world currency in the form of a gold standard.

Senator McAdoo. Doctor, I do not want to lead you too far astray, but in view of what you have said about the stabilizing effects of adherence to the gold standard, I am wondering whether or not the many artificial remedies that we are now adopting which resulted in legislation of an extraordinary character during the past few years are going to avail. What do you think about that?

Mr. Miller. That is a pretty broad and general question.

Senator McAdoo. It is.

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Mr. MILLER. And also a bit vague, Senator. I do not know that I would want to express a curb opinion on that; and any opinion that I might express now would be that.

Senator MCADOO. Would you think that over and supplement your remarks in the record with a statement?

Mr. MILLER. If you will make your question a little more specific.

Senator MCADOO. I do not know that I can make it more specific. It is a general question, necessarily. I know that you are capable of answering it, and that is the reason I put it to you.

Mr. MILLER. You are giving me quite a commission. I would rather confine myself and be confined in this hearing to the bills that are before the committee, the original Senate bill and the House bill as passed.

Senator MCADOO. But these questions, after all, have relation to those bills.

Mr. MILLER. Yes, they have; but in my comments and certain suggestions—and I propose to offer suggestions for change in practically every provision in both the Senate bill and the House bill, because not one of them seems to me to be satisfactory, and some of them have very serious objections, and I would greatly regret seeing them written into the Federal Reserve Act as amended. In my thinking I have looked at the matter primarily in its monetary and banking aspects and in the light of my own experience on the Federal Reserve Board.

Senator MCADOO. I do not insist on my question, Doctor. That is all right.

Mr. MILLER. I am trying to find out what light I can throw upon these problems, not from the point of view of theory or logic, but from the point of view of observation and experience.

Senator GLASS. I should like to get to the provisions of the bill. It is rather embarrassing for me that I cannot follow the philosophizing of two experts on these things. I would rather get to the practical details of the bill and have it explained to me whether this bill proposes to take us farther away from the statutory gold standard; because we certainly have a statutory gold standard.

Mr. MILLER. Would you say so?

Senator GLASS. Yes; I would say so. I would say that the act of March 1900 puts us on a statutory gold standard requiring the maintenance of every species of currency issued on a gold basis.

Senator MCADOO. The parity of gold was established by that act, and it has not been repealed.

Senator GLASS. It has not been revealed. Gold has been devalued and demonetized, which makes me wonder what they want with the $8,000,000,000 of gold they have there. Why didn't they dump it all overboard somewhere? They fine a man and put him in jail if he gets hold of some of it.

Mr. MILLER. Would you not say, Senator, that the legislation of 2 years ago carried in the so-called "Thomas amendment" and certain other monetary and currency legislation, in effect at least suspended the gold standard?

Senator GLASS. The only defense made of that legislation was that it was emergency legislation, and the only expectation that it would be sustained by the Supreme Court was that it was emergency legislation and that it would be terminated as speedily as possible.

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Mr. MILLER. Well, of course, I do not know what is going to happen, but for the time being, at any rate, as a member of the Federal Reserve Board I feel that any suggestions or comments or advice that I have to give you must be predicated upon the assumption that we are going to continue upon this rather anomalous basis in which discretion is to play a bigger role than ever before in the monetary concerns of this or any leading country——

Senator GLASS. What I am afraid of is indiscretion rather than discretion.

Mr. MILLER. It might work out to be indiscretion. It has in the past. That is one of the difficulties that you get into when you leave the gold standard, which is a kind of device or mode of discipline for enforcing good behavior upon the banking and financial mechanism of the countries that are in the family that respect the gold standard.

Senator BANKHEAD. To act as a policeman?

Mr. MILLER. A quick detector, a monitor. It tells you when something is getting out of joint, and you are put on notice. We were not put on notice in this country of the impending disaster until the disaster broke, when the run on the banks in early months or weeks of 1933 began. That was an indication that the public faith was breaking down. They wanted gold instead of gold notes, and it at once put the whole country on notice that something of an extraordinary character had happened.

Senator GLASS. Do you think people generally wanted gold or gold notes?

Mr. MILLER. No.

Senator GLASS. Or do you think a few persons with large pecuniary interests wanted gold and gold notes?

Mr. MILLER. I think that is a part of it, Senator, a very important part; but I think also that where there is uncertainty, prolonged uncertainty, there will be anxiety and fears, and in a money-minded age people will seek to convert their credits, or enough of them will seek to convert their credits into something that has a permanent value to demoralize, disorganize, and eventually break down the gold monetary system.

Senator GLASS. Do you think that people generally who held the ordinary currency were demanding redemption?

Mr. MILLER. No; I do not.

Senator MCADOO. As a matter of fact, Doctor, what they wanted was to get currency out of the banks with Uncle Sam's name on the currency. As long as they had that they were satisfied.

Mr. MILLER. Most of them were.

Senator MCADOO. The average man never thinks of gold; he looks at his note and is satisfied. It has the imprint of the Government on it, and he knows that if he puts it in a strong box it is safe, whereas if he leaves it in the bank it might not be safe in times of anxiety and apprehension. That is one of the fundamental causes of runs on banks, is it not?

Mr. MILLER. That is right.

Senator GLASS. Vastly more fear and more wide-spread fear occurred by taking us off the statutory gold standard than would have prevailed had we remained on the statutory gold standard.

Mr. MILLER. I have no hesitation in saying that I agree with you 100 percent.

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Senator BANKHEAD. Was there not panic and alarm long before we went off the gold standard?

Mr. MILLER. There were growing concern and anxiety, of course.

Senator BANKHEAD. Had it not come to a climax?

Mr. MILLER. I think so.

Senator BANKHEAD. Then why do you think that going off the gold standard subsequently caused it?

Mr. MILLER. I think the most serious blunder that any country can make in the monetary field is voluntarily, by its own action, to suspend the gold standard. I think we would have been pushed off of the gold standard by the pressure of events, but there was no occasion for us voluntarily doing it. Events would have done it, and we would have been off the gold standard with, I think, a vastly better national prestige today than we have. I think wisdom, foresight, would have seen that and would have let the natural course of events take place. In other words, play the gold standard to a finish, even though it takes the last dollar of gold you have. We knew that we were in a creditor position and that the gold would come back here after that frantic fear had played itself to a finish.

Senator BULKLEY. If we had done that, those who were quick enough to get their money out of the banks would have had all the gold and would have made a profit rather than the Government.

Mr. MILLER. You are assuming that devaluation is a part of going off the gold standard.

Senator BULKLEY. I think so. Do you not assume that?

Mr. MILLER. No; I do not; not as a necessary sequel.

Senator MCADOO. You are assuming, too, a profit from such devaluation.

Senator BULKLEY. The profit is there in the Treasury.

Senator MCADOO. It is not a profit.

Mr. MILLER. If that was a part of the intent and plan, that is another thing. But I am talking of it now purely in its monetary aspects. We would have been pushed off the gold standard, and I am rather inclined to think that the dollar today, vis-a-vis the pound, would be about where it is today. With all that we have done in the interim, though it is not possible to speak, of course, with certainty on that, we might have found not only that it was the prudent course but that it was the necessary course to devalue the dollar to some point.

Senator GLASS. Were the runs on the bank occasioned by any question relating to the gold standard, or were the runs on the banks occasioned by the fact that the banks themselves had engaged in excessive speculation and had reached a point of nonliquidity which rendered it impossible to respond to the ordinary demands upon them, and the failures began because of that and not because of any question relating to the gold standard?

Mr. MILLER. I think so.

Senator GLASS. And as bank after bank was necessarily closed up because of such excess and mismanagement and speculation, that caused runs throughout the country?

Mr. MILLER. Undoubtedly. If you go back into the matter of causation, that is true. I think it was when the failures came along, when Michigan declared its bank holiday, and the thing spread very

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rapidly through other sections of the country, that people then began to wonder whether they should not take gold as well as notes and convert their notes into gold.

Senator BANKHEAD. Did you find much disposition on the part of depositors to demand gold or to get any sort of money that the bank would let them have?

Mr. MILLER. Toward the end of the critical panic weeks, the last of February and March, when we had the bank suspensions and holidays declared by various States, gold was going out in a very large stream. It would not have taken a great while longer before the gold reserves in the Federal Reserve banks would have been pretty thoroughly dissipated.

Senator TOWNSEND. That was because of the big fellows taking the gold at that time?

Mr. MILLER. All kinds. There were records kept at the banks indicating that. There were a great many that brought in notes for redemption in gold.

Senator BANKHEAD. But throughout the country, not counting the big fellows and the ones in the big centers, the depositors did not specify what kind of money they wanted; they just asked for any sort the banks would hand out to them, silver or notes or anything else, just so it was money?

Mr. MILLER. I think that is true; and I think most people's faith was satisfied when they got a note.

Senator GLASS. So far as my observation went, there was no raid upon the gold reserves; there was no demand for redemption in gold by people generally who held notes of the Federal Reserve banks; but, as a matter of fact, the responsibility, in my judgment, for any raid, if it reached the point of a raid, upon the gold reserves of this country was legislation that we enacted here practically running us to a bond-secured currency and alarming Europe and advising them that we were going off the gold standard. The greatest withdrawal of gold occurred right at that point. Is not that true?

Mr. MILLER. I rather think it would be borne out by the record that the greatest withdrawals were in October and November 1931.

Senator BANKHEAD. Was the gold withdrawn before March 4, 1933?

Mr. MILLER. Yes.

Senator BANKHEAD. What legislation had been passed at that time?

Senator GLASS. The so-called "Glass-Steagall bill" that practically returned us for the time to a bond-secured currency. And I want to say again for the record that from my individual records I never would have agreed to have reported that bill but for the fact that we were assured over and over again by men in authority that they did not expect to use it; that they wanted it for psychological purposes.

Mr. MILLER. I am sorry you feel that way, Senator, because we felt it was one of the things that enabled the Federal Reserve System to bolster up a situation that was beginning to collapse and might have come down with a worse——

Senator GLASS. You could cure a situation like that about as easily as you could cure a rotten egg.

Mr. MILLER. The rotten eggs were there, Senator. We wanted to prevent them from cracking over the heads of the country.

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Senator GLASS. I wanted to see every rottenly mismanaged bank put out of business while they were going out of business, and I wanted every rotten and mismanaged railroad put into the hands of receivers and readjusted on an honest basis. That is what we ought to have done. A lot of them are propped up now, and they are going to topple over as soon as the props are taken away.

Mr. MILLER. That is a debatable question; and perhaps the judgment of the historian of the future will be that it would have been far wiser—it is already the judgment of many economists that it would have been far wiser—for the United States to have gone through the fires of bitter experience and be purified, cleansed and cleaned up and to have made a start from a new beginning, and that by this time we would have been well on the way to wiping out our former losses through productivity, activity, and the making of wages, earnings, and so on.

Senator GLASS. God Almighty penalizes everybody who disobeys his law; and there is no reason why everybody should not be penalized who disobeys the laws of sound economics and the laws of the country.

Mr. MILLER. I am afraid, Senator, that you—and I say this with the greatest reverence and honor, for I regard you as one of my most-honored friends—forget that our natures have not all been cast in the same mold as yours. I am afraid our later generations are getting to be a bit soft-handed, soft-minded, and it is a question whether both the economic morale and the political morale of the country could have stood up against the sobering and chastening process of the old-fashioned deflation. I am inclined to think that it simply would not, and therefore could not. There are limits to what you can expect people to endure, though we know ourselves that we could go further and fare far better through going further.

Senator BANKHEAD. I hold the same view, sir.

Senator GLASS. Theology teaches that if you do not punish sin, a fellow is going to keep on sinning; and that is just as true applied to economics as it is to theology.

Mr. MILLER. I think that is very true, Senator. That is the reason that I am going to oppose some of the amendments that are contemplated in this bill—because I think they will encourage more sin of the kind that brought about our recent troubles.

If I may just state, after the colloquy we have had here, what I, as a member of the Federal Reserve Board, take as the predicate for legislation. It is that we are on, at any rate for the time being, a managed-currency basis in this country, and I have considered the proposed amendments and changes in the structure of the organization and the functions and powers of the Federal Reserve System and of the Federal Reserve Board from that point of view. The peculiarity of a managed currency as distinguished from an operated gold standard lies just here—that somebody has got to do the managing. In plain words, somebody has got to pull the strings, to manipulate the machinery. Your difficulties come from two things: First. What is your objective to be in the management of currency, credit, money control—whatever you want to call it? They are all more or less interchangeable phrases. What is your objective to be in a country as vast and as complex as this?

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Second. If you are agreed upon an objective, what is the mechanism that you are going to employ and what warrant is there for believing that that mechanism will work successfully to promote the objective?

Third. There comes the question of whom you are going to entrust these vast powers to. Who is to do the managing? Who is to pull the strings?

Now, approaching that question in a general way, first, and as the sine qua non under any scheme of Federal Reserve management and currency management, is the body that is to exercise these functions as independent in law and in fact as it is possible for it to be under the Constitution of the United States? To me, that is indispensable. I am not submitting that as a theoretical conclusion, but the record of the Federal Reserve System—and I think I know the record in and out pretty thoroughly—if it discloses one thing more clearly and more importantly in this connection than any other, it is that the misadventure and miscarriage in the Federal Reserve System has come through interference, sometimes the interference of Government, sometimes the interference of banks. My experience has led me to the conclusion that both forms of interference are most objectionable and may occasion some very serious consequences, and that this legislation ought never to be enacted until protective safeguards of the strongest character can be set up to protect and forfend us against any interference of that kind. It is immaterial to me whether it is so-called "banking control" or whether it is so-called "political control"; from my point of view both are objectionable, and the objections are a part of the records of the Federal Reserve System. If a history of that System is ever written—it will not be in our day—you will see that political interference, as it is called, and banking domination or interference, as it is called, have largely been responsible for the major errors of policy that have been made in the Federal Reserve System.

Senator GLASS. Is there anything in the existing Federal Reserve law that authorizes or suggests either political or banking domination of the System?

Mr. MILLER. I would say, when it comes to banking domination—I am using that now specifically in the sense of Federal Reserve bank domination—that there are certain obscurities in the Federal Reserve Act that give divided authority and divided responsibility. It is not clear who is the responsible agent.

Senator GLASS. Since the Banking Act of 1933 was passed?

Mr. MILLER. I would say so, Senator. I would say so particularly in the matter of the open market section of the act, the section of the act setting up the Federal open-market committee. I do not know whether you have looked at that very recently, but I am afraid that in the process of legislation it was pretty badly garbled and did not come out as perhaps you intended it should.

Senator GLASS. May the open-market committee under that statute do anything except under rules and regulations passed by the Federal Reserve Board?

Mr. MILLER. No; but the rules and regulations of course can only regulate and cannot enlarge the powers exercised by the open-market committee. The Board cannot subtract from those powers; it can-

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not assume the exercise of any of those powers on its own side. If the open-market committee and the Federal Reserve Board are agreed as to what is a wise open-market policy, there is nothing by which they can enforce their position as against any Federal Reserve bank.

Senator GLASS. Is not that the only reservation whatsoever in the act, that any Federal Reserve bank may decline to participate in a given open-market operation?

Mr. MILLER. I would say that is a very important reservation, and I should say that that is one that can nullify the open-market policy. An open-market policy, I think it ought not to be overlooked, is always conceived as a national policy from a very broad point of view. It at any rate should be.

Senator GLASS. Do you think the Dallas bank could nullify, in an important sense, open-market operations participated in by the 11 other Federal Reserve banks?

Mr. MILLER. I do not think that the Dallas bank could exercise very much effect there.

Senator BULKLEY. Do you think the New York bank could?

Mr. MILLER. The New York bank could do quite a good deal. It represents approximately 40 percent of the resources of the Federal Reserve System, and without its cooperation we might easily run into difficulties.

Senator GLASS. As a matter of fact, the New York bank seems easily to manage things, and how to prevent that is something that I would like somebody to suggest.

Senator MCADOO. As the action of each bank is voluntary, one small Federal Reserve bank perhaps could not influence or affect the general policy very much, but suppose that dividing on section lines, now, merely to illustrate my point, that all the banks west of the Mississippi River declined to go into some policy that might be recommended in an open-market operation, and that all the banks east of the Mississippi River favored it, to what extent would that nullify, do you think, or seriously impede the effectiveness of the operation?

Mr. MILLER. I would say it would seriously impede it. It would put us in the peculiar position of undertaking a managed currency on a local basis for a country that is a nation. There would be no method by which the Dallas district or the San Francisco district could escape the effects of an open-market operation if it were carried through, even though they did not participate in it.

Senator GLASS. Was it not intended, with respect to regional banks, that they should manage the credits of their respective regions?

Mr. MILLER. I think that was the intent, and very advisedly the intent, of the Federal Reserve System when it was set up, and I have called attention, and will again, to the fact that at that time there were a great many conditions that do not exist now. We had a gold standard in the full flower of its operation. We had a limited financial market in this country, with a paltry 200 millions of Government bonds, that at the uttermost would be regarded as being in the floating supply of bonds. We had institutions envisaged as institutions of rediscount. But an awful lot has happened since then.

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Senator GLASS. Do you think we have come to the point, then, that it is advisable to charge the Federal Reserve Board with authority to absorb all the assets of the 12 Federal Reserve banks?

Mr. MILLER. No.

Senator GLASS. And to use them under the direction of the Board?

Mr. MILLER. No; I do not. I had no such extreme thing in mind; but I reached the conclusion 10 years ago, after the first considerable adventure of the Federal Reserve System in the field of open-market operations by extensive purchases of Government securities and acceptances, and it is a matter of record in House hearings and, I think, in some earlier Senate hearings, that the consequences would be utterly disastrous to this country unless the Federal Reserve Board was clothed with the power to exercise the ultimate determination of such policies. I have here today and would be glad to exhibit charts to illustrate these matters, if you will go back to 1927 when the last great open-market blunder was made by the Federal Reserve System. That was under Federal Reserve bank leadership. I make it specific. It was an operation that was initiated, proposed, and developed by the Federal Reserve Bank of New York, accepted by most of the other Reserve banks who participated in the discussions, and, I regret to say, by the Federal Reserve Board. I have previously described it in these hearings as the most costly blunder that was ever made by the Federal Reserve System or by any banking system, I think. I doubt—though this is purely a conjectural opinion—that if there had been at that time a definite concentration of responsibility in the matter of the open-market powers of the Federal Reserve System in any one body, whether the operation would have been undertaken. I doubt whether, if the Federal Reserve Board at that time had been clothed with the exclusive power in that matter, the Board would have dared to venture upon that operation.

Senator BULKLEY. Was that the Government bond purchases?

Mr. MILLER. Yes; in the latter part of 1927, supplemented by reductions in rediscount rates, with a view of supporting foreign currencies at a time when sterling particularly was in a very delicate and sensitive position following the coal strike of the previous year.

Senator BULKLEY. That is the operation that you characterize as a blunder?

Mr. MILLER. Yes; I would say, engaging in an operation that had perhaps as its larger objective the maintenance from collapse of the international gold standard as it was at that time.

Senator MCADOO. It was chiefly designed to aid Great Britain, was it not?

Mr. MILLER. To aid Great Britain and to aid the world and ourselves through preventing and forestalling monetary collapse.

Senator MCADOO. Great Britain, of course, was the leading factor?

Mr. MILLER. Great Britain was in a very critical position at that time. It was also the time of heavy exports of cotton and wheat from this country. We were in 1927 in what was then described as a depression. It seems nothing as compared with what we have gone through in recent years.

Senator MCADOO. I thought it was described as the year of perpetual prosperity.

Senator GLASS. In other words, that was, in my judgment, a distinct departure from both the text and the spirit of the Federal

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Reserve Act, without one particle of lawful sanction, and it resulted from an attempt to adjust the difficulties of Europe instead of giving attention to our own difficulties here.

Mr. MILLER. I agree with you, Senator. I not only agree with you now, but that was my position at the time.

Senator MCADOO. You are absolutely correct about that.

Mr. MILLER. I was not surprised by the future effects. I refused to go along with the policy; I opposed it.

Senator MCADOO. Mr. Strong was then Governor of the Federal Reserve Bank of New York, was he not?

Mr. MILLER. Yes. I do not know, but my belief is that if the Federal Reserve Board had been charged with the responsibility, and particularly if it had been charged with the responsibility of not engaging in the operation except on the affirmative vote of a minimum number of the members of the Board, the operation would never have been undertaken and the position of the country ever since would have been vastly better.

Senator GLASS. The Board had full responsibility then. Why did it not prevent it?

Mr. MILLER. No; the Board never has had the full responsibility, Senator, to initiate an open-market operation.

Senator GLASS. No; but it had the responsibility of passing upon open-market operations.

Mr. MILLER. It can say no.

Senator GLASS. But it did not say no.

Mr. MILLER. No. My belief is that if it had been obliged to say yes on its own motion, it never would have said yes and there would have been no occasion to have said no.

Senator GLASS. Let me ask you this, Dr. Miller. It might seem personal, but it is not intended to be personal. You may not desire to answer it, and you need not answer it if you do not desire to.

Mr. MILLER. I will answer it, Senator.

Senator GLASS. From the beginning has the Federal Reserve Board in its personnel been constituted of men who were altogether capable of engaging in open-market operations?

Mr. MILLER. You are asking that as an objective question, and I will answer it objectively. I will say no, but I think the same thing is true of the heads of the Reserve banks.

Senator GLASS. I am inclined to agree with that.

Senator COUZENS. Have you a record of the extent of the operations that you have been referring to?

Mr. MILLER. I think so.

Senator COUZENS. I would like to have it go into the record, to see how extensive they were. Do you have a record here?

Mr. MILLER (exhibiting chart I). The bottom line reflects the holdings of United States Government securities.

Senator MCADOO. By the Federal Reserve banks?

Mr. MILLER. Yes; their purchase and sale. You will notice the first great purchase operation was in 1922. We were then coming out of the postwar depression. We had an enormous influx of gold. The member banks were taking down their rediscounts, getting out of debt, with the result that the Reserve banks were hard put to make earnings. They therefore began to enter the open market

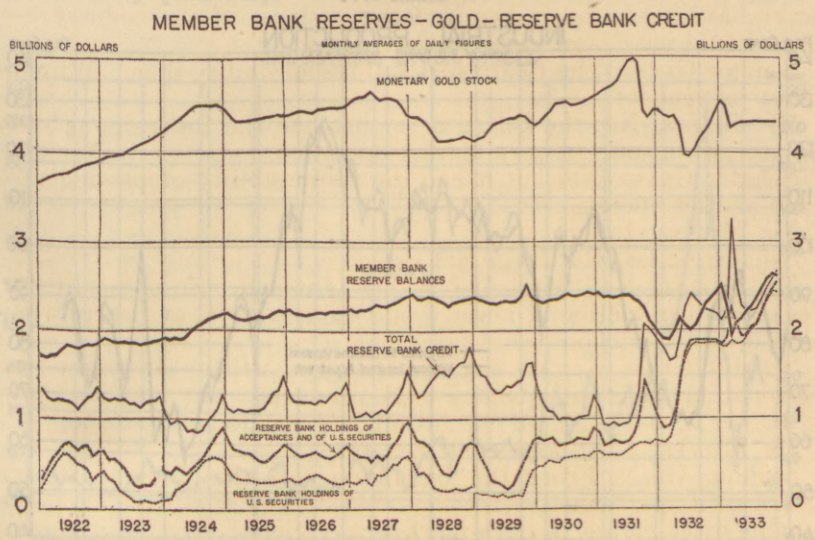
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to purchase United States Government securities. That is reflected in the bottom line on the chart.

Senator COUZENS. Then they fell off in 1923 again?

Mr. MILLER. Yes. You will recall that 1923 was the first active year we had after the crisis of the war. We had a considerable pick-up in business in the latter part of 1922, and that went on in 1923 to about the summer, and it was by many people regarded at the time as another inflation. It was about that time that the Federal Reserve Board set up its Division of Research in a more fully organized and competent form, and gathered systematically material bearing upon economic developments that were in process, and as a precautionary measure the System began to liquidate in part its portfolio of Government securities in order to serve as a resistant to the expan-

CHART I



sion of credit, the rise of prices and certain signs of perhaps too large activity in business, with the result, not shown on this chart, that the member banks that were extensively extending their loans were obliged to come in and borrow; and inasmuch as banks as a rule do not like to borrow, it put them under a certain pressure not to borrow unless they had to.

Toward the latter part of 1923 there is clearly disclosed on this chart the first return to health after the crisis, though not the beginning of a permanent and well-sustained recovery. In order to offset what you might call "deflationary influence", recession influences, the Federal Reserve System in 1924 again went into the open market and began to purchase securities. That was one of its greatest operations.

Senator COUZENS. Was that a sound operation, in your judgment?

Mr. MILLER. In my judgment, that was a sound operation.

Senator COUZENS. Those figures do not show in dollars and cents.

Mr. MILLER. No, sir. You can easily get them from the margins. The operation in 1924 amounted to about 500 million dollars. You notice [chart II] how this line, which indicates the movement of

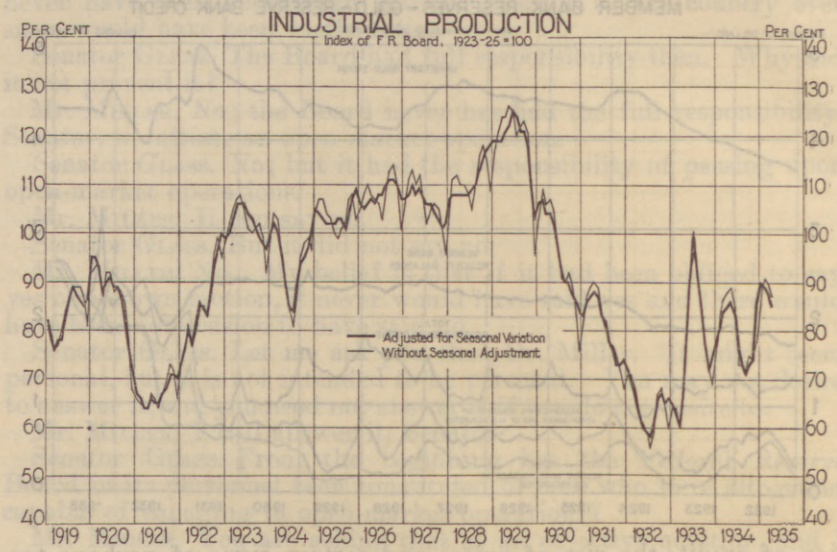
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the production index, shows a drop in 1924. We have all supposed that our purchase operation in that year, which is shown on this chart, was a resistant and had something to do with reversing the trend and sending the production curve upward. The error that I felt at the time was made and which I subsequently felt was pretty well demonstrated by the record, was that we did not liquidate rapidly enough in 1925, and this line, this volume [indicating on chart I] was kept too steady. It was in 1925 that most of the post-war inflationary developments date. That was, in my judgment, looking back now, a critical year, a very critical year.

Senator COUZENS. 1929, you say?

Mr. MILLER. 1925. That was the period when speculation began. You notice how in 1925 [chart III] stock prices suddenly began to rise and go on and go on.

CHART II



Senator COUZENS. If that appeared to you at the time, why did the Board not take any action?

Mr. MILLER. This did not appear at the time. We are looking back. We could only guess what was ahead.

Senator COUZENS. But was not that an actual fact, that it did occur in 1925, Doctor?

Mr. MILLER. My own feeling was that very energetic action ought to have been taken. That was my feeling at the time, and I have felt since that a great error was made by the Federal Reserve System in not having taken such action.

Senator COUZENS. That is, in 1925?

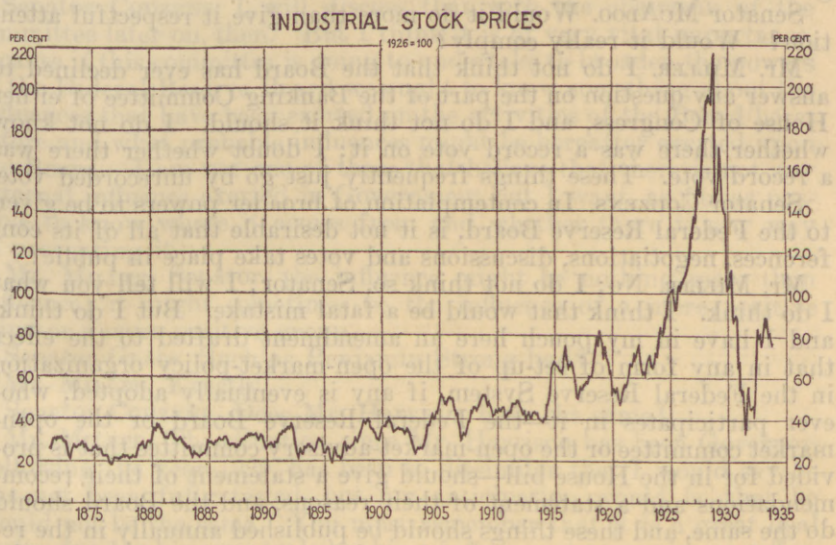
Mr. MILLER. Yes. I have always felt that that was a critical year, that we began to lose the fear of inflation, the fear of the previous experiences, and felt certain assurance and solidity that actually was not warranted by the later developments.

Senator COUZENS. Now, take it to 1927, if you please, when you performed these operations in behalf of international bankers.

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Mr. MILLER. You will notice in 1927 the production curve again begins to ascend [chart II]. That was described and is still described in some of the historical accounts of the Federal Reserve System as a year of mild recession. Of course you never know when recession begins whether it is going to run into a depression, whether it is going to be mild or serious. At any rate, this indicates a rather pronounced drop in the production curve, not so pronounced as in 1924, but pronounced. We had gotten down from the high level of 1925 and 1926. The Federal Reserve System then went into the market again to, as it were, fight or counter that tendency. It purchased securities very extensively, with the result that it purchased not only Government securities, but it purchased in the latter half of the year acceptances on a very extensive scale, with the result that the total volume of Reserve bank credit shot up very pronouncedly [chart I].

CHART III



Senator COUZENS. You said that that was largely due to the dropping off of production, and you previously said it had to do with the conditions in England.

Mr. MILLER. It had. The program was adopted on the 27th of July 1927.

Senator MCADOO. Would you permit an interruption? Did the Reserve Board at that time approve or disapprove the action of the Federal Reserve Bank of New York and of the banks of the Federal Reserve System in entering upon that policy?

Mr. MILLER. It approved it, Senator.

Senator MCADOO. Unanimously?

Mr. MILLER. No; it did not.

Senator MCADOO. What was the division?

Mr. MILLER. Well, I do not know exactly what the division was. I know I was opposed to it.

Senator MCADOO. Was the Secretary of the Treasury in favor of it?

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Mr. MILLER. I do not think so. I was not present at the meeting. I left when I saw what was going to happen. I went West. I knew that nothing that I could do would alter the outcome.

Senator MCADOO. You do not know whether the Secretary of the Treasury and the Comptroller of the Currency opposed it?

Mr. MILLER. My impression is that the Secretary of the Treasury had gone to Europe; but of that I am not sure.

Senator COUZENS. Do the records of the Board show who participated?

Mr. MILLER. Oh, yes.

Senator COUZENS. And how the vote stood?

Mr. MILLER. Yes.

Senator COUZENS. We would like to have that information.

Mr. MILLER. I do not know that it would show the vote by names. I think if you addressed that question to the Board, the Board would give it very respectful attention.

Senator MCADOO. Would it do more than give it respectful attention? Would it really comply?

Mr. MILLER. I do not think that the Board has ever declined to answer any question on the part of the Banking Committee of either House of Congress, and I do not think it should. I do not know whether there was a record vote on it; I doubt whether there was a record vote. These things frequently just go by unrecorded vote.

Senator COUZENS. In contemplation of broader powers to be given to the Federal Reserve Board, is it not desirable that all of its conferences, negotiations, discussions and votes take place in public?

Mr. MILLER. No; I do not think so, Senator; I will tell you what I do think. I think that would be a fatal mistake. But I do think, and I have in my pouch here an amendment drafted to the effect that in any form of set-up of the open-market-policy organization in the Federal Reserve System, if any is eventually adopted, whoever participates in it—the Federal Reserve Board or the open-market committee or the open-market-advisory committee that is provided for in the House bill—should give a statement of their recommendations and a statement of their reasons, and the Board should do the same, and these things should be published annually in the report of the Federal Reserve Board, so that the public can see what the action was, what the line of reasoning was that led to the action, and judge after a period of 5 or 6 or 7 years who has the best batting average. I think that should be done. But I do not think it should be done publicly at the time. I think that would be a great mistake. I think then you would have political control in the Federal Reserve System—not a political control as some people understand, but it would work out that influences other than those that were immediately appropriate and germane to the matters under discussion might influence the atmosphere in which the deliberations went on and the conclusions reached.

I am firmly of the opinion that if there is a record made at the time, a full record, and that record published as a matter of course in the annual report of the Federal Reserve Board, there will be more restraint, more circumspection, less indiscretion in the exercise of the open-market powers. Then you will get what I think some of you are very much concerned about here—a record also of when the

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Treasury becomes a factor. I think that type of publicity is respectable and proper, and I think from your point of view, Senator Couzens, it would be amply effective in securing the thing that you have in mind.

Senator COUZENS. What I have particularly in mind is related to your previous statement, that the Federal Reserve Board has been subject to external influences, both political and banking. I would like, if it is proper, to have you give us an example of that political or banking influence that has been exerted upon the Board. You must have, from your long association with the Board, some instance in mind where this external pressure has been exerted upon the Board to do certain things.

Mr. MILLER. I would suggest, if the committee really wants that, that it would be better to give the information in executive session. I doubt whether it would be advisable to enter it upon the record here. That is my feeling about it.

Senator COUZENS. I will discuss that with the chairman of the committee later on, then. But I think it is of very vital importance, because if this committee is going to undertake to broaden the powers of the Federal Reserve Board we ought to know something about the influences that have been exerted on the activities of the Board heretofore and what probable influences might be hereafter exerted upon the Board. I am not one of those that believe that there is not any external influence exerted in Government but I want, as far as possible to know where it comes from and whether there is any way of preventing it.

Mr. MILLER. Senator, the influence might be nothing more than influence; it might sometimes be the influence of a more positive mind or a more positive group.

Senator GLASS. Such as Benjamin Strong had?

Mr. MILLER. Exactly

Senator COUZENS. Does Mr. Harrison have the same?

Mr. MILLER. The situation since Mr. Harrison has been Governor, following the year 1929, has been so dissimilar that I would say he has not been fully tested, but my anticipation would be that he would not be the same. You must remember that it is a great deal easier for banking control, banking influence, to exercise an effective leadership in times of high prosperity and inflation; and New York, in the heydey of its ascendancy, was doing that. That was a period of inflationary developments, from 1924 right down to the crash.

But I might mention this, Senator. Perhaps it may content you to know that in the most serious position that the Federal Reserve Board ever found itself in, to wit, in the year 1929, when there was a pronounced difference of opinion as to whether the situation demanded Federal Reserve influence and control and what should be the form of that control, a majority in the Federal Reserve Board were confronted with what was a most serious kind of opposition, to wit, a combination of New York and Washington, between the Secretary of the Treasury and the dominant bank in the Federal Reserve System. That is a matter of record. I think the chairman knows that, and perhaps some other members of the committee know it.

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Senator COUZENS. Was that during the administration of the greatest Secretary of the Treasury since Hamilton, or was it during the administration of his successor?

Mr. MILLER. You know who the Secretary of the Treasury was in 1929; and there no reflection is intended by me upon the then Secretary of the Treasury. I want to tell you in a broad way that the two things to be guarded against in the operation of the Federal Reserve System are oscillation of outside influence, between the Treasury and New York; by the Treasury in times of strain; by New York in times of inflation. New York is our leading financial market and the greatest financial market in the world. It takes a positive position with respect to most financial matters. It has strong men to advocate its views and defend them, and in those times the Treasury is apt to be rather quiescent and passive, and frequently, I would say, very frequently, in the past the domination of New York on the Board has come through the channel of the Treasury.

Make no mistake; I do not think it will make very much difference in the future whether it happens to be a Republican Secretary of the Treasury or a Democratic Secretary of the Treasury. It will happen again!

Senator GLASS. Or a New York Secretary of the Treasury or a secretary from some other State?

Mr. MILLER. That is correct. I have noticed that when the Government itself has no strong position with respect to financial matters, in other words, when it has an open mind or, more frequently, an empty mind, New York will take possession; and I think that will be especially true in the future, with the enormous amount of public debt and financing and refinancing that we will have for a great many years to come; and the Secretary will have to contact New York. He will want to maintain a favorable attitude on the part of New York as well as the whole banking system of the country, and New York will have its important part in his success. The Federal Reserve Board does not know much about what is going on in the Treasury, except from the newspapers. The New York Reserve Bank knows far more. I repeat this, that I am of the opinion that I began to form 10 years ago, after the 1924 episode, that there will be no economic safety and financial safety for this country unless the ultimate responsibility for open-market operations is concentrated in one body definitely known to be responsible for the outcome.

Senator GLASS. It is definitely concentrated in one body now, except that the Board itself may control the whole situation by its rules and regulations under the law.

Mr. MILLER. Well, in other words, we might stop all open-market operations by refusing to issue regulations; yes. But there is no method, Senator, by which we could order any Reserve bank or all Reserve banks, let us say, to sell securities or buy securities, no matter how much we felt that it would be desirable in the interest of the preservation of a wholesome credit or financial situation or monetary situation that securities should be sold or should be bought.

Senator COUZENS. Does the public know through any source when you are engaged in open-market operations?

Mr. MILLER. If they are interested enough to follow our weekly statements they see. Usually we give a pretty faithful account in

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our monthly bulletin. The Federal Reserve Board has always laid its cards on the table. It makes a record of whatever it does. There are no secrets that we conceal; it is all open.

Senator GLASS. Is it not a fact that the commercial, industrial, and agricultural interests of this country have no contact with the open-market situation and have no knowledge of it and no understanding of it?

Mr. MILLER. I should say the latter is preeminently true.

Senator COUZENS. That is what I was trying to get at in my more obscure question.

Mr. MILLER. I think, Senator, that is true of even the great financial centers. I think there are comparatively few that really understand the true inwardness and the subtle workings of purchases and sales in the open market.

Senator GLASS. Do you think the open-market operations conducted, as you know, chiefly by the New York bank, very intimately affect the credit transactions of the remoter Federal Reserve bank districts?

Mr. MILLER. Very decidedly.

Senator GLASS. In what way?

Mr. MILLER. Money becomes easy, if securities are purchased in any considerable volume in the New York money market. Interior money may be, as a result of that, withdrawn from New York to get a better rate at home.

Senator GLASS. To get a better rate at home, yes; but it never reduces its standard rate at home, does it?

Mr. MILLER. Very frequently.

Senator GLASS. I have never known it to be done.

Mr. MILLER. I think very frequently the Federal Reserve System has entered the open market as a buyer of securities with a view of easing the money situation for the purpose of getting a reduction later on of discount rates which in turn would reflect itself——

Senator GLASS. Have you reached the conclusion that in the greater part of the country the individual banks have what they call their "standard discount rates" and that they rarely if ever depart from them, and that they always loan their money up to the statutory limit?

Mr. MILLER. I think that is true in large sections of the country, but I think it does not affect a very large proportion of total bank borrowings. I think there is a certain competition even in customer rates when you get far away from the great centers. Of course, in New York there is active competition; there is in all the large cities; and in recent years, Senator, with the development of large corporations which have access to financial markets anywhere in the country, it is not at all uncommon, in fact, it is very usual for Pacific coast business concerns to borrow in New York, Boston, Philadelphia, and their local banks have got to meet the rates they can get there or lose the business. There is a pretty competitive market. It does not follow that because the advantage goes to some customers it goes to all. We have very low rates at the present time. If anyone has got credit and wants to borrow, he will be able to get his money at a very attractive open-market rate. Market rates are so small that you have almost got to take a microscope to find out what they are. The acceptance rate is almost negligible.

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Senator GLASS. You know that is fictitious; it is not natural.

Mr. MILLER. We have figures for rates on customers' loans; they fluctuate considerably in New York and in southern and western cities show less fluctuation.

Senator GLASS. Much less; yes.

Mr. MILLER. Much less than it does in some other centers, but there is even there some fluctuation. At any rate, you have not as yet given the Federal Reserve System any control over customer rates. You may want to do that.

Senator GLASS. We will resume the hearing in the Appropriations Committee room in the Capitol at 2 o'clock this afternoon.

(Whereupon, at 12:20 p. m., a recess was taken until 2 p. m., to meet in the committee room of the Senate Committee on Appropriations, in the Capitol.)

AFTER RECESS

The subcommittee reconvened at 2 p. m. in the Capitol, at the expiration of the recess.

Senator GLASS (chairman of the subcommittee). The subcommittee will be in order.

Dr. Miller, you may go ahead and continue with your discussion of the bill we have under consideration, if you will.

STATEMENT OF ADOLPH C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD, WASHINGTON, D. C.—Resumed

Mr. MILLER. I think perhaps it will expedite the hearings if I take up the different groups or divisions of the proposed legislation and then comment upon them.

Senator GLASS. All right, you may do that.

Mr. MILLER. The provisions of the bill fall into three or four rather recognizable groups:

1. Changes in the organizational structure of the Federal Reserve banks. These concern particularly changes in provisions in respect of eligibility restrictions and the status of Federal Reserve notes. There are others that contemplate changes in the organizational structure of the Federal Reserve banks, such as—

(*a*) Abolition of the position of chairman and Federal Reserve agent.

(*b*) Statutory recognition of the office of Governor, and consolidation of it with chairman of the board of directors of Federal Reserve banks. Likewise the designation of the Governor as a member of the board of directors. At the present time the Governor has no statutory position as such, though there is nothing in the law to prevent his being elected as a member of the board of directors of a member bank.

(*c*) A change in the composition of class C directorate by the legal designation of Governor as a member of the board of directors of his bank; and the designation, optional with the Federal Reserve Board, of vice governor, which is also in the contemplated legislation made a statutory position; and

(*d*) A change in the tenure of office of the three classes of directors of Federal Reserve banks.

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2. Then there comes the important change that was discussed more or less this morning in the structure, functions, and powers of the Federal Open Market Committee as provided in the Senate bill.

The bill as originally introduced contemplated a change in the structure of the open market committee by reducing its membership from 12—that is, a representative from each of the 12 Federal Reserve banks—to a committee of 5, consisting of the Governor of the Federal Reserve Board, 2 members of the Board, and 2 governors of the Federal Reserve banks.

Now, the function of the open market committee is to——

Senator GLASS (interposing). Right there let me ask you a question: Is it not a fact that the transactions of the open market committee are practically conducted by an executive board of five?

Mr. MILLER. They operate within the general framework of a policy that is adopted by the committee of 12.

Senator GLASS. Yes.

Mr. MILLER. They hold meetings from time to time. The statute requires that they shall not meet less than four times a year, and the whole basis is thoroughly discussed in those conferences, which sometimes sit for 2 days. They reach a conclusion, and then in order that there shall be a certain flexibility of discretion in the application of the program they give certain instructions to the open market executive committee. That committee meets very frequently, and in recent years has met quite frequently, in consultation with the Secretary of the Treasury, at times when he wants to consult the open market executive committee with reference to open-market conditions.

Senator BULKLEY. How is that committee chosen?

Mr. MILLER. By full conference of the governors.

Senator BULKLEY. And it has on it five of their own members?

Mr. MILLER. Five of their own membership; yes. Of necessity the heads of the remoter banks cannot very well serve on that committee because it is to be subject to call on pretty short notice.

Now, under the Senate bill it will be the function of this new Open Market Committee, consisting of three members of the Federal Reserve Board and two governors, to formulate policies with respect to open-market operations of the Federal Reserve banks, their conclusions and recommendations to be binding upon the banks—that is not the case at the present time—and to be subject to the approval of the Federal Reserve Board.

This committee also, the bill contemplates, shall be vested with the responsibility of making recommendations to the Federal Reserve Board regarding discount rates and such changes in reserve requirements as the bill in another section proposes shall be given to the Federal Reserve System and shall be vested in the Federal Reserve Board.

The bill, as passed by the House, makes quite a change in the structure of the Federal Reserve System by a redistribution of powers as between the Federal Reserve banks and the Federal Reserve Board. Under the bill, as passed by the House, there is no Federal Open Market Committee, but there is an Open Market Advisory Committee of five members. Their function is to advise with the Federal Reserve Board, either, I think, on their own motion or when

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requested by the Federal Reserve Board; and I think the Board is obliged to consult with them whenever it contemplates a change in the scope of the open-market policy. But their function is advisory. The power of determining open-market policies rests with the entire membership of the Federal Reserve Board.

There are, therefore, considerable differences among the set-up of the present act, the Senate bill, and the bill as passed by the House.

Another group of changes relate to the powers or rather to a change in the status of the Governor of the Federal Reserve Board. There is a difference there between the Senate bill and the House bill. The Senate bill makes the term of office of the member of the Board who is designated as "Governor" by the President to run until the further order of the President. He is removable at the pleasure of the President. The House bill has left the existing law unchanged in this respect, with only this modification, that if the Governor should cease to be continued as Governor by the President he will still continue his membership on the Board. But if he resigns he is relieved from the disability now imposed upon him of not being able to enter upon the service of a member bank for a period of 2 years.

And, finally, there is the change in the power of member banks, national banks, in the matter of making mortgage loans. And there have been some changes there as between the Senate bill and the House bill.

Now, taking these up in order: There are, first, the eligibility provisions. And let me say in general that I think it inadvisable to make any sweeping changes in the eligibility provisions of the Federal Reserve Act. It is true that experience has demonstrated in the last few years that in a situation of acute and prolonged emergency, a depression such as we have had, it may become desirable and necessary to widen the eligibility provisions in order to be able to give the member banks all the assistance they need in resisting withdrawal of deposits, and similarly with respect to meeting requests for demand notes. But——

Senator TOWNSEND (interposing). You have that power now under the emergency clause.

Mr. MILLER. It has expired.

Senator TOWNSEND. You say it has expired?

Mr. MILLER. Not with respect to the Federal Reserve note, but with respect to the eligibility provisions, the Glass-Steagall Act has expired.

Senator TOWNSEND. That is the situation.

Mr. MILLER. I want to propose there that you consider—and I hope favorably consider—an amendment which I propose shall be tacked onto section 13 of the Federal Reserve Act. Shall I read the proposed amendment, Mr. Chairman?

Senator GLASS. Yes.

Mr. MILLER. My suggested amendment is as follows:

> Notwithstanding any other provision of law, when it deems it in the public interest and by affirmative vote of not less than ——— members—

And I suggest "not less than ——— members" because there have been many suggestions that the membership of the Federal Reserve Board be changed. Let us assume the present set-up to continue,

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where we have 8 members, I should say, on the affirmative vote of not less than 5 members. And it would suit me better if it were made not less than 5 of the appointed members of the Federal Reserve Board or certainly not less than 4 members. In other words, the invocation of these extraordinary powers, in order that they shall be used only to meet a genuine emergency, in my judgment should be surrounded with certain protective safeguards; and I can think of nothing better than the precedent contained in the Federal Reserve Act that the urgency and clearness of the need should be attested by making it possible for a certain minority of the Board to stop it.

In brief I would say that with a board of 6 members not less than the vote of 4 should be necessary in order to invoke this power to widen the eligibility requirements. Therefore, I continue reading my proposed amendment:

The Federal Reserve Board may authorize any Federal Reserve bank, for limited periods to be prescribed by the Board but which may be extended by the Board from time to time, to make advances to member banks which have no further eligible and acceptable assets available to enable them to obtain adequate credit accommodations through rediscounting at the Federal Reserve bank or by any other method provided by this Act. Such advances may be made on the promissory notes of such member banks secured to the satisfaction of the Federal Reserve bank and shall be subject to such regulations and shall bear such rates of interest as may be prescribed from time to time by the Federal Reserve Board.

Senator GLASS. That would be practically a reenactment of the emergency clause of the existing law which soon expires.

Mr. MILLER. Yes; except that it would be in operation only when the Board on the affirmative vote of a certain minimum number of its members decided that it should be put into operation. In other words, I vision is as a pistol in the hall closet which you do not expect to use but which you may use, and you have to get the key from the head of the house before you can go into the closet and get the pistol for use.

I think that would meet every emergency situation, and would not lead to the temptation to laxity in the administration of the Federal Reserve System. And let me say here that I think the great sin of the Federal Reserve System has been laxity of administration.

I think it would be a mistake to widen the eligibility provisions; for instance, such as proposed in either one of the bills, either that passed by the House or that which is here in the Senate. I think they are predicated upon too narrow a survey of banking developments in the experience of this country. I should say that that is one of those situations where you might well take the advice of Mark Twain when he said, "Never get out of experience more than there is in it."

In this connection you will remember the case of the cat that, having sat on a hot stove, was afraid after that to sit on a cold stove. I think we are more likely to have hot stoves if we have fire extinguishers around all the time than if we do not. On the other hand, if we get to a situation which needs treatment, there is the apparatus available. Or as a great statesman said at the end of the Civil War when he was charged with inconsistency for having voted for the Legal Tender Act, and after the war for having voted for the retirement of that currency, and paraphrasing his remarks,

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"Let not the medicine of emergency become the daily food of the banking system of the country."

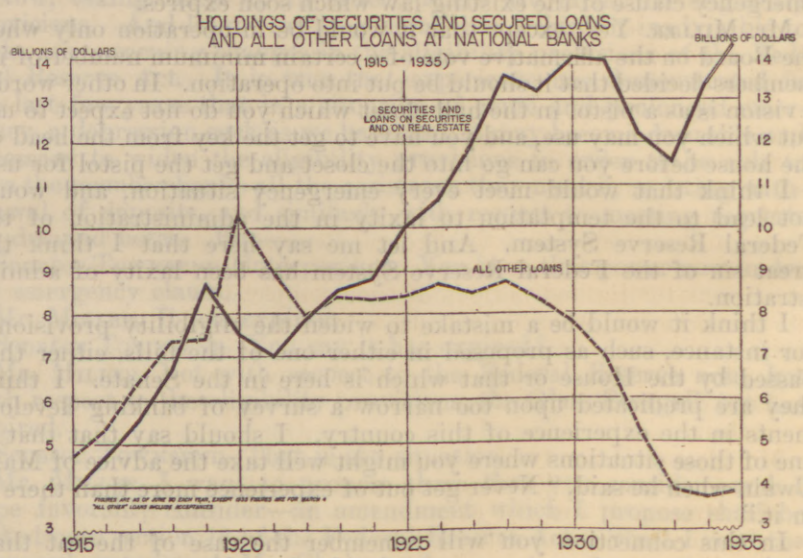
I think that is sound advice, and I hope you gentlemen will give it great thought before you throw down the eligibility provisions. It is true that eligibility is closely associated with liquidity of assets, but——

Senator GLASS (interposing). On the question of eligibility, Dr. Miller, has not the Federal Reserve Board very broad powers now? What restriction is there beyond the fact that eligible paper must relate itself to the commerce, industry, and agricultural interests of the country, and to the statutory maturity requirements, and the prohibition against defining as eligible paper investments in speculative stocks and bonds.

Mr. MILLER. Of course, that throws out the enormous category of paper that under the Glass-Steagall Act, or under the contemplated House bill, would be admissible to rediscount when offered to a reserve bank, or rather not rediscount but for an advance.

At this point let me exhibit to the members of the subcommittee a chart [chart IV] that may help us, and I shall draw a conclusion from it quite contrary to what you might expect. This chart shows two lines for the national banks, and they may be taken as fairly representative of the banking system of the country as a whole and as accurately representing the member banks.

CHART IV



And I might add at this point that these charts will all be numbered as they go into the record, so that they may be easily identified.

This heavy black line to which I now point represents the total of investments and of the so-called "loans" on securities and on real estate. The broken line represents all other loans, which are largely but not preponderantly commercial loans. Latterly we have estimated that 35 to 40 percent of these other loans are so-called "eligible paper" as defined in the act.

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Senator COUZENS. What other loans would be included?

Mr. MILLER. Personal loans, loans with ineligible maturities, anything of that character. This line also includes acceptances, anything that is of a definite commercial character.

Now, the most striking thing in this, I think, in trying to see what has been going on in the System, is that in the beginning commercial loans exceeded investments in securities, that that relation held until about 1922. There was the great speculative bulge in commodities, as you will recall in 1919 and 1920, which we had in silk and cotton, for example. It was then that commercial loans rose to a very high peak, and in the subsequent deflation they suffered most severely. The contraction got them particularly.

But when things began to clean up and the country started out on a new tack, say, about 1922—and this would be true if we carried our picture back to an earlier period—the most remarkable thing is the way banks began to become security-investment institutions. You will see that the line representing securities and secured loans ascends. You will note, Senator Couzens, how it began to rise rapidly after 1925 on up to 1929. At that time there was great stability in the line, which shows commercial loans and then from about 1928 they declined.

Now, I think those who are proposing that we shall strike down the eligibility test set up in the Federal Reserve Act are drawing too hasty a conclusion from this decline in commercial loans; and I think myself they are drawing an erroneous conclusion if you want to shape this legislation or retain the present features of legislation from a constructive point of view, to make the Banking Act not worse but better. My contention is that that is striking evidence of how banking was going wrong, until it finally became so wrong that an explosion was inevitable.

Senator GLASS. And if you strike out this restriction in the existing act, won't it go wrong again?

Mr. MILLER. I would leave exactly that restriction there, but I would add a proviso that the Federal Reserve Board, on the affirmative vote of a certain number of members, could widen the eligibility provisions for limited periods of time, subject to renewal, so that if we get into a jam we could act just as we have acted in the last 2 or 3 years.

Senator COUZENS. When the rise, as shown on that chart, began in 1925, did the Federal Reserve Board have any authority or power to curb it?

Mr. MILLER. I always felt that it had.

Senator COUZENS. But it never exerted that power.

Mr. MILLER. It did not exercise that power until 1929. There is no question in my mind that it had the power to exercise it, that that was clearly the intent of the act, and I think it was the responsibility particularly of the Federal Reserve Board.

Senator BULKLEY. You say now it was the intent of the act to prevent overinvestment in securities or in loans on securities?

Mr. MILLER. Yes; I think so; with Federal Reserve funds, either directly or indirectly.

Senator BULKLEY. There is a provision in the act against speculative loans.

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Mr. MILLER. Well, if you want to draw a fine distinction between these two——

Senator BULKLEY (interposing). I do not want to draw a fine distinction, but want to get your idea about it.

Senator GLASS. The language of the act, as you know, is a prohibition against notes, drafts, bills covering merely investments; or, as it reads here, issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities except bonds of the Government of the United States.

Mr. MILLER. Yes; that is pretty exclusive. There is no question of the intent.

Senator BULKLEY. What should the Federal Reserve Board have done, if it had adopted that view, in order to prevent that form of investment?

Mr. MILLER. Do you mean in 1925?

Senator BULKLEY. Yes.

Mr. MILLER. I should say it should have begun liquidating its portfolio of open-market investments with a good deal of energy; that it should have raised rediscount rates, as some banks were extremely desirous of doing. The Federal Reserve Bank of Boston was held back 6 weeks, under pressure, after they wanted to do it. And if that did not accomplish the thing, it should have invoked this power to withhold facilities from banks that were abusing their relationship to the Federal Reserve banks.

Senator BULKLEY. By withholding rather than rediscounting?

Mr. MILLER. Yes. And in that connection, let me quote from an address I made in Boston in November of 1925. I think it is of certain illustrative value as showing several things, but in this connection has application:

> We are in the midst of a very considerable industrial expansion with many of the factors that make for prosperity gaining in momentum. Production, trade, employment, and pay-roll disbursements are all in materially greater volume than a year ago. There can be no doubting that we are already in an era of prosperity.
>
> The outlook has never been so bright since the close of the war. Whether the prosperity which beckons is to be short-lived or of long duration will depend largely upon the wisdom and skill with which we handle ourselves in the United States.
>
> The floating supply of credit in the United States has never been so large as at the present time and never so much in excess of current and prospective requirements of commerce, agriculture, and industry.
>
> The great growth in the loan account of the banks of the country has not been in the commercial loan account but in the collateral loan account. And the great growth in this branch of banking operations is due mainly to the huge volume of credit absorbed by the call market in the country's great speculative center since the opening of the year 1925. This condition, along with the considerable volume of credit absorbed by land speculation in some parts of the country and speculative building operations, constitute the danger spots in our present situation. There is evidence that a section of the public is losing its bearings and being drawn into the arena of thoughtless speculation. Cheaper and more abundant credit than the country has ever known on so extensive a scale are giving them aid and encouragement. It is time for a halt lest a speculative frame of mind should be engendered which might in time invade the field of legitimate trade and industry.
>
> It is not the duty of the Federal Reserve System to undertake to regulate stock or other speculation or to interfere unnecessarily in the affairs of their member banks. But it is well to recall that the Federal Reserve System was not established to provide a life preserver for the speculator.

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Senator GLASS. It was not intended to have these facilities used for that purpose at all.

Mr. MILLER. No.

It was set up as an aid to industry, agriculture and commerce. It is a system of liquid productive credits. The use of Federal Reserve credit for speculative or investment purposes is precluded by specific provisions of the Federal Reserve Act.

That was my view at that time.

It is clear, therefore, that no bank has a proper status as an applicant for Reserve bank accommodation, which is supplying credit for speculative uses. It is the duty of the Federal Reserve banks to hold true to the course plotted for them in the fundamental provisions of the Federal Reserve Act.

Senator COUZENS. Might I inquire at that point: Did you ever come to Congress, or did the Federal Reserve Board ever come to Congress, to draw the attention of the Congress to that provision?

Mr. MILLER. Yes; I have been doing it for 10 years. The first opportunity I ever had was in 1926 in connection with the hearings on the stabilization bill, in the lower House of Congress, and I warned then against it. I particularly called attention to the fact that when the Federal Reserve System engaged in open-market operations, as they were doing by taking acceptances on a large scale, there was only one market. Therefore in the first instance the money goes into the New York market. If, as is usually the case except in periods of depression, you have got an active stock market that market will lap it up immediately, and the money goes into the New York banks. The banks have more money to lend. It is taken up by stock speculators or security investors or financiers, and then by process of indirection it gradually affects the open market, and then seeps out in one way or another into the back country; or by enhancing rates in New York it holds the money there, or by depressing them it leads the interior banks to withdraw their balances from New York and try to put them at work at home. But the theory that money is a fluid and that it rises promptly in every part of the country when you bore into it, is one of the metaphysical inventions.

Senator GLASS. That was one of the vices of the proposed Aldrich bill that we declined to adopt.

Mr. MILLER. Yes.

Senator GLASS. And not only did you bring the situation to the attention of the Congress but I brought it to the attention of the Congress repeatedly and perhaps rather severely criticized the Federal Reserve Board for not kicking a bank director out of his position who challenged the authority of the Board in a very offensive way. But the Congress did not pay any attention to that.

Senator COUZENS. Was any legislative effort made, or bill introduced at that time, to change that situation?

Senator GLASS. No. I was pretty nearly as much alone then as Mr. Miller was.

Mr. MILLER. I do not recall about that, but I was pretty much alone when I formulated the views and reached the conclusion I did in 1925. In fact, it was suggested that I was embarrassing, and that that was a very unwelcome statement.

Senator GLASS (chairman of the subcommittee). You may proceed.

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Mr. MILLER. This table shows in figures the movement [chart V]. You will see how this thing jumps up from 1924 to 1925 following open-market operations. These are total investments. These are total loans on securities and these on real estate. This shows how they began to move up, and they kept moving right up, at least when it comes to the matter of investments, to 1929–30. Loans on securities moved up interruptedly and at a very rapid pace. Loans on real estate moved upward, but not quite so rapidly.

CHART V

LOANS AND INVESTMENTS – ALL MEMBER BANKS

(IN MILLIONS OF DOLLARS)

JUNE 30	INVESTMENTS	LOANS ON SECURITIES	LOANS ON URBAN REAL ESTATE 2/	ALL OTHER LOANS	TOTAL LOANS AND INVESTMENTS
1921	6.002	1/ 4.400	1/ 875	12.844	24.121
1922	7.017	1/ 4.500	1/ 1.100	11.565	24.182
1923	7.757	1/ 4.950	1/ 1.350	12.450	26.507
1924	7.963	1/ 5.350	1/ 1.575	12.279	27.167
1925	8.863	6.718	1/ 1.875	12.062	29.518
1926	9.123	7.321	2.161	12.579	31.184
1927	9.818	8.156	2.449	12.333	32.756
1928	10.758	9.068	2.624	12.611	35.061
1929	10.052	1/ 10.094	2.760	12.804	35.711
1930	10.442	10.656	2.769	11.789	35.656
1931	12.106	8.563	2.830	10.423	33.923
1932	11.414	5.916	2.531	8.140	28.001
1933	11.928	4.884	2.064	5.910	24.786
1934	14.652	4.651	2.068	5.804	27.175
ACTUAL INCREASE 1921-1929	4.050	5.694	1.875	2/ 30	11.590
PERCENTAGE INCREASE 1921-1929	67%	129%	214%	—	48%

2/ REAL ESTATE LOANS OTHER THAN FARM LANDS
1/ PARTLY ESTIMATED
2/ DECREASES

Owing to so many conditions, partly induced by the tremendous influx of gold into the country, partly through a practice that member banks began to indulge in of shifting demand deposits to time deposits, which took reserve requirements of 3 percent as against 7, 10, and 13 percent for demand deposits, they put themselves in position to greatly expand their investments [see chart VI]. Investment of their resources in the purchase of securities, the figures as to which have been shown here, was mounting very rapidly. Chart VII shows brokers' loans or loans on call, which is a subdivision of

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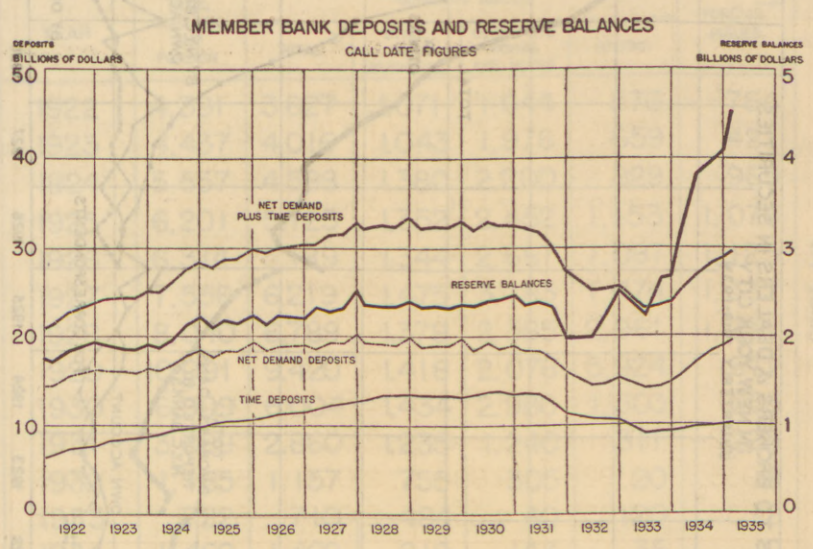
loans on securities, and which rose from about $3,000,000,000 at the end of 1925 to about $8,000,000,000 in 1929.

Senator GLASS. And that is something we do not want to return to, do we?

Mr. MILLER. Loans to brokers attained quite a height. That is an interesting thing. In 1926 they dropped. That drop was due to two things: One was the publication by the Board in the weekly member bank condition statement of loans to brokers; and also I think there was an adverse decision at that time by the Interstate Commerce Commission. At any rate, a reaction was produced in the stock market that rather produced a drop in loans for speculative purposes. But it assumed an upward course not long afterward and went on up without much interruption until late in 1929.

I am definitely of opinion that it is a hasty inference to assume

CHART VI



because we had this development in the past, which I would say was a development that indicated we were going sour during those years, that, therefore, we have to recognize it and admit as a fact and make it a base for extensive alteration of perhaps one of the most valuable safeguards of the whole Federal Reserve Act—the restrictions on that kind of paper admissible for rediscount or the making of advances.

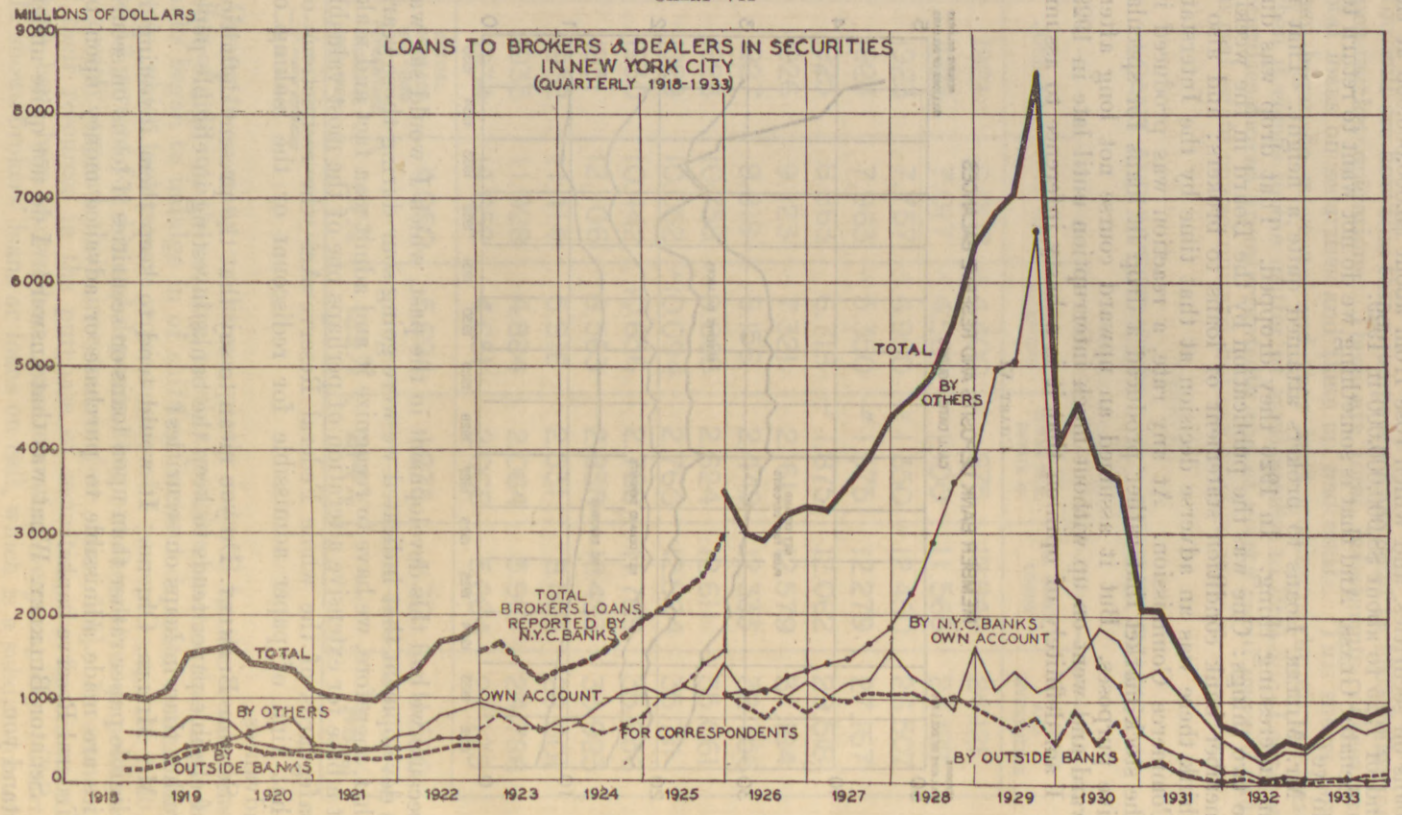
Senator BULKLEY. Do you mean to say that the present definition of eligible paper tends to keep the banks investing in eligible paper rather than in loans on securities?

Mr. MILLER. Oh, no. It would tend to keep them investing in eligible paper rather than upon loans on securities if loans on securities are made admissible to purchase or advance money upon by Federal Reserve banks.

Senator BULKLEY. What was that answer? I do not quite understand you.

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CHART VII



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Mr. MILLER. If you keep the present eligible requirements, which restrict rediscounts to certain types of paper, you are more likely to keep the banking system liquid than if you attempt to admit any type of security that the Board might describe as a sound asset.

Senator BULKLEY. Yes. That very right was in effect during those years, and it did not keep them out of it.

Mr. MILLER. I have tried to explain to you how that came about. It was through an enormous volume of easy money in this country, coming first from the excessive gold imports, amounting to 700 or 800 million dollars during this period; through the release of about 2 or 3

CHART VIII

CAPITAL ISSUES

(IN MILLIONS OF DOLLARS)

YEAR	TOTAL DOMESTIC AND FOREIGN	DOMESTIC ISSUES 2/				FOREIGN ISSUES 3/
		TOTAL 4/	STATE AND MUNICIPAL	CORPORATE BONDS AND NOTES	STOCKS	
1922	4,391	3,627	1,071	1,644	570	764
1923	4,437	4,016	1,043	1,976	659	421
1924	5,557	4,588	1,380	2,200	829	969
1925	6,201	5,125	1,352	2,452	1,153	1,076
1926	6,314	5,189	1,344	2,667	1,087	1,125
1927	7,556	6,219	1,475	3,183	1,474	1,337
1928	8,040	6,789	1,379	2,385	2,961	1,251
1929	10,091	9,420	1,418	2,078	5,924	671
1930	6,909	6,004	1,434	2,980	1,503	905
1931	3,089	2,860	1,235	1,240	311	229
1932	1,165	1,157	755	305	20	8
1933	722	710	484	40	120	12
1934	1,402	1,402	819	143	35	0

1/ THESE FIGURES EXCLUDE DIRECT REFUNDING ISSUES BUT INCLUDE ISSUES SUCH AS INVESTMENT TRUST ISSUES, THE PROCEEDS OF WHICH MAY BE REINVESTED IN OUTSTANDING SECURITIES.

2/ FIGURES FROM COMMERCIAL AND FINANCIAL CHRONICLE.

3/ FIGURES FROM DEPARTMENT OF COMMERCE.

4/ INCLUDES ISSUES OF FEDERAL LAND BANKS AND FEDERAL INTERMEDIATE CREDIT BANKS NOT SHOWN SEPARATELY.

hundred million dollars from the reserves of member banks by shifting from demand deposits to time deposits, which required a 3-percent reserve as against 10 or 13 or 7 percent; through a desire on the part of corporations that had been caught in the 1920–21 debacle to free themselves from banking control by selling securities in the market and providing themselves with working capital in that way [see chart VIII]; through the growth of great corporations, by reason of mergers and otherwise, which were in better position to avail themselves of the investment mechanism of the country through the sale of securities to banks and private investors.

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Senator BULKLEY. Those are all causes that tend to build up the account of investments on loans on securities.

Mr. MILLER. Yes; and to keep down commercial loans.

Senator BULKLEY. The point I am making is: That as against those causes the provision of the Federal Reserve Act was totally ineffective.

Mr. MILLER. There is no provision in terms of eligibility, or any other specification, as to what kind of paper a member bank might buy or make advances against.

Senator BULKLEY. Of course, the restriction is only on rediscounts.

Mr. MILLER. On rediscounts.

Senator BULKLEY. And that is not effective to accomplish the purpose, is it?

Mr. MILLER. It is not effective when you get such overwhelming money ease as we had then.

Senator GLASS. We had no penalty attached to the law, either.

Mr. MILLER. No; there was no penalty. The only power that could have coped with that situation would have been one to raise the required reserves.

Senator BULKLEY. Is that what you are advocating now?

Mr. MILLER. I will advocate it later on, but——

Senator BULKLEY (interposing). My question is directed to this: What I feel is that you are seeking a means to prevent something that a provision utterly failed to accomplish what you thought it ought to have accomplished at that time.

Mr. MILLER. Exactly; or perhaps I would put it this way: That provision should not be stricken out in the act because it failed to accomplish in those unusual conditions what it was intended to accomplish and what in my judgment it will accomplish in the future in more usual conditions. And in my judgment it will accomplish it in the future.

Senator BULKLEY. Well, have we not removed the inducement to bankers to keep their investments entirely in eligible paper when we permit the borrowing on and rediscounting on Government securities?

Mr. MILLER. They should not keep them entirely in eligible paper, but they should not shift them preponderantly to securities.

Senator BULKLEY. Have we not destroyed the incentive to keep it in commercial securities when you shift to Government securities?

Mr. MILLER. You have done something, but I think there is ample power under the act as it is now, without any amendment. We have 30 billion dollars of Government securities outstanding.

Senator GLASS. Yes; and considerably more.

Mr. MILLER. It is 28 billion dollars, and will soon be 30 billion dollars.

Senator GLASS. When you take into consideration the contingent liability of the Government making itself responsible for principal and interest on all these other loans, it is nearer 40 billion dollars than 28 billion dollars.

Mr. MILLER. At any rate it is a huge sum, and it will be so for a long time to come. So that even taking the low level of commercial paper at this time and adding to that approximately 10 billion dollars of Government paper that is in the member banks of the Federal Reserve System, and you have an enormous amount of paper in the portfolios of the member banks that is admissible to the Federal Reserve banks either for rediscount or for advances.

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Senator BULKLEY. You mean by adding eligible paper under the existing law to the Government securities.

Mr. MILLER. Under the existing law Government securities are eligible for banks that want advances against them. That is true now of the so-called "15-day" paper.

Senator BULKLEY. But my point is that as long as you have eligible paper for these advances then the banker does not have to have other eligible paper at all. He can always supply his need by borrowing against Government securities.

Mr. MILLER. The Board can regulate that if it wants to. It can easily do that by means of a discriminatory rate on regular discounts if it thought it desirable as against a rate on 15-day member bank advances. It has the power to do that.

Senator BULKLEY. But practically speaking it will never do it when the banks have such a small amount of eligible paper.

Mr. MILLER. You are accepting as a fact that banks have a small amount of eligible paper.

Senator BULKLEY. Well, you show it on the chart.

Mr. MILLER. And I am trying to show why. The small amount of their eligible paper is evidence of the disease that affected the body economic in those years.

Senator BULKLEY. I am not arguing against you on that but accept your statement that it is a disease, and am trying to find out about the effectiveness of your remedy.

Mr. MILLER. The effectiveness of my remedy lies elsewhere. On this position I simply want to say that the remedy is not to accept the disease as a visitation of Providence and encourage it by striking down the eligibility restrictions in the Federal Reserve Act. I would let those stand.

Senator BULKLEY. Yes; but what else are you going to use?

Mr. MILLER. You will see presently. The bill contemplates certain things here——

Senator GLASS (interposing). There are certain provisions.

Mr. MILLER. The modification I have suggested is to put the system in a position where an emergency of cataclysmic proportions would mean that it could deal with it by making it possible to accept anything a bank might have that is a satisfactory asset, as a basis of advance to it.

Senator COUZENS. Have you not left out one of the other factors in the disease you have been describing?

Mr. MILLER. Yes; several of them.

Senator COUZENS. I was going to ask you if you have not left out the fact that a great many of these industries have made excessive profits.

Mr. MILLER. That is correct.

Senator COUZENS. And did not pay them out in dividends.

Mr. MILLER. That is correct.

Senator COUZENS. And thereby created a surplus.

Mr. MILLER. Yes.

Senator COUZENS. Which in itself curtailed the use of commercial paper.

Mr. MILLER. Yes.

Senator GLASS. And that was reflected in loans to others on the stock market.

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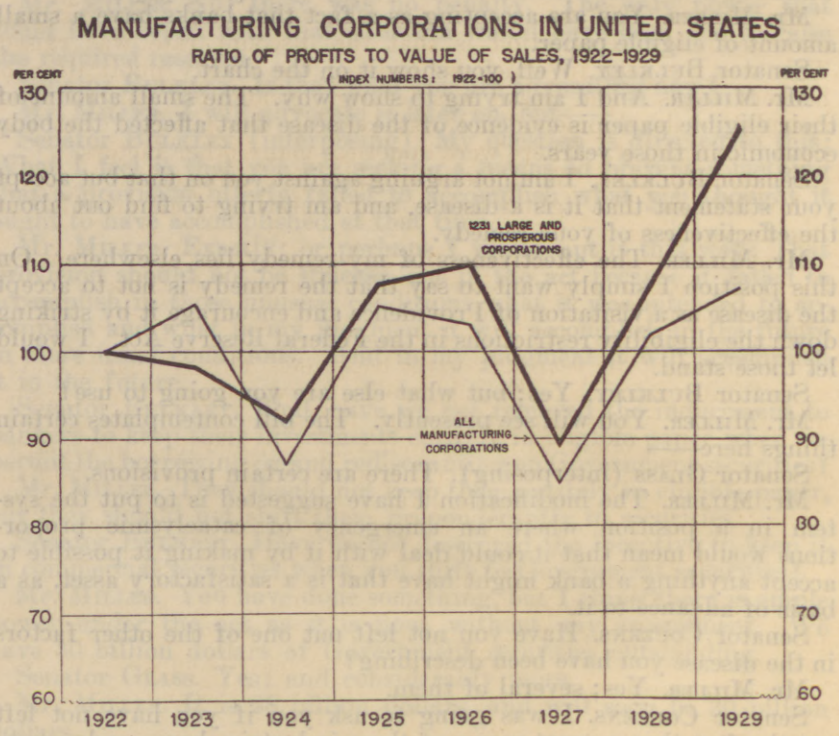
Senator COUZENS. Yes; and it is not mentioned.

Mr. MILLER. It will come into the picture very vigorously later on. I will say at this point that the mere fact that there were certain industries which were so excessively prosperous during this period was itself a byproduct of the inflation that we had during that period. I mean from 1922 to 1929, and I think that period will distinctly go down in the economic and financial history of the country as the great era of unchecked inflation.

Presently, if the hearings go far enough, I will point to some of the things that mislead people, and particularly mislead scholars and professors, and the pundits in their reading of this period.

You will be interested in this at this juncture, Senator Couzens [chart IX]. There is a chart I have had prepared, based upon a

CHART IX



study by Prof. Frederick Mills, of Columbia University, a member of the National Bureau of Economic Research in New York, a privately endowed organization, and, in my judgment, one of the most competent economists in the country. The figures are taken from the Bureau of Internal Revenue. This is based on a volume that he published 2 or 3 years ago entitled "Economic Tendencies", which I commend to anyone who wants to see what has been going on in this period.

Senator COUZENS. What is this heavy black line? What does that represent?

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Mr. MILLER. The heavy black line represents the ratio of profits to value of sales of 1231 large and prosperous corporations. These corporations represent industries that constitute about 85 percent of the total manufacturing enterprise in the United States, and these particular corporations represent about 37 percent of their sales. That is, they are the most successful, and the ones that have done the largest amount of business.

Senator COUZENS. What caused that terrific drop from 1926 to 1927 in their ratio of profits to sales?

Mr. MILLER. We had some reaction there.

Senator COUZENS. That is when you started in to operate the open market.

Mr. MILLER. Yes.

Senator COUZENS. The big operation was in 1927, you testified this morning.

Mr. MILLER. 1926 was the year in which there was some restraint exercised. My recollection is that the discount rate was raised. This was the year in which we ordered the weekly publication of brokers' loans. The Board was feeling considerable concern about speculative developments and was keeping closer tab. That may have influenced it. There were doubtless many other factors.

Senator COUZENS. What does the lighter line indicate?

Mr. MILLER. The lighter line is representative of all manufacturing corporations.

Senator BULKLEY. I do not quite understand that chart. How can the profits be more than 100 percent of the value of the sales?

Mr. MILLER. This is an index.

Senator BULKLEY. What does it mean?

Mr. MILLER. The year 1922 is the base line. This is what is known as an "index curve"—not actual profits, but variation. You see, Senator Couzens, when you get down to 1927—you recall this morning we looked at a chart which showed very considerable open-market operations on the part of Federal Reserve banks [chart I], and the lowering of the discount rates in aid of export trade and the support of European currencies. We saw what it did in the way of stimulating stock-exchange speculation. This curve we just had here showed what it did in the increase of security loans and brokers' loans [chart VII], and this shows what happened as regards the profit ratio of these 1,231 largest and most prosperous corporations.

Senator COUZENS. They jumped enormously from 1927 to 1929.

Mr. MILLER. Yes.

Senator COUZENS. What is the lighter line?

Mr. MILLER. The lighter line simply means a larger number of corporations—several thousand. They follow in general, except at one or two points. The heavy line indicates the largest, and those that most influenced the course of stock speculation. It represents the leaders, the big earners, the exceptional instances that rivet the attention of the speculating public, and influence the general trend. Many corporations had not any earnings to speak of, and some showed deficits. The packing business was in a difficult position at times during this period.

Senator COUZENS. You have no chart showing the relation of dividends to earnings during that period, have you?

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Mr. MILLER. We have no chart, but I think we may have facts, or can give them to you. I think I recall that from 1922 to 1929, including stock dividends, as well as cash dividends——

Senator COUZENS. Stock dividends are not dividends at all.

Mr. MILLER. They had a great deal to do with these speculative excesses.

Senator COUZENS. But I mean so far as actual values are concerned. They may have an influence as to speculation, but as to actual values they did not have any. What I was talking about, and what I was trying to get at particularly, was this: If it is demonstrated that there was a great falling off in the relation of dividends to earnings during that period of time, what, if any, effect would the income taxes have had upon it?

Mr. MILLER. You are at least as competent as I am to answer that question—probably more competent.

Senator COUZENS. It is a matter that the Board has not considered in any of its studies, is it?

Mr. MILLER. We have not regarded that as within our province. Whether, under the House bill, it would become within our province, along with the tariff, railroad rates, and so forth, I do not know. I suspect that everything would come, not within the province or scope of action of the Federal Reserve Board, but certainly if we were to study how to promote conditions conducive to business stability, I think everything would become grist for our mill.

Senator GLASS. The Board would know, of course, how to run railroads and to set up tariff schedules, would it not?

Mr. MILLER. What I am hoping, Senator, is that we shall not get situations of this kind that need extraordinary forms of correction. I hope we can avoid, through good administration in the future, periods of profits inflation. I shall have something to say later in connection with this profits inflation during this period, and the persistently advocated inclusion in the Federal Reserve Act in the past of an instruction to use the influence of the Federal Reserve System, and to use every influence, in order to stabilize the price level.

Senator GLASS. Who did that?

Mr. MILLER. I say there has been a persistent movement in the past to include such formula in the Federal Reserve Act.

Suppose we look at that right away, Mr. Thomas. Bring out the price curve, will you? This is the fruit of it, or the byproduct, in my judgment.

Senator COUZENS. I suppose if you had the figures that have been accumulated, or could be accumulated since the adoption of the N. R. A., it would show quite a startling situation, would it not?

Mr. MILLER. Yes; it would show a repetition of 1922–29 in form. It would show an analogy to this.

Senator COUZENS. That is what I was suspecting.

Mr. MILLER. Yes.

Notice, please, the period we have under review [chart X]—1922 to 1929.

Senator BULKLEY. Is this the American price level?

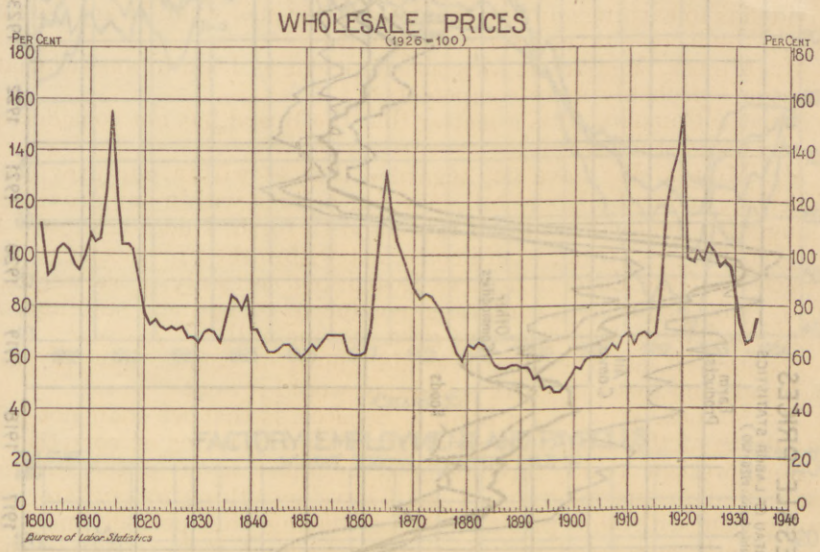
Mr. MILLER. Yes; the wholesale price level based on the Bureau of Labor Statistics index of wholesale prices. The 1922–29 period is,

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perhaps, in the 135 years covered by this chart the nearest approach that we have over such an interval of time to a so-called "stable" price level. You get something of it here just before the war. Then you have to go back here to the decade of 1820 to 1830, just 100 years before, and again the decade that followed the debacle of the War of 1812 and the financial demoralization that followed in the years of cleanup.

If you look at this profits chart, Senator, this does not go back very far. Otherwise it would show that this whole level has been

CHART X



lifted by comparison with the pre-war period. In the pre-war period the ratio of profits was declining. The ratio of wages was declining. Profits were not rising. At any rate, you have a very near approach to as near as you can get, practically speaking, a stable level of prices, from 1924 to 1929, and even earlier, with what circumstances and consequences? Declining costs of production. That was the period of the introduction of new technique on a very rapid scale into American industry, improved organizational methods, and more systematic sales policies, all of which showed themselves in a great increase of profits. [See chart XI.]

Senator COUZENS. That was particularly pronounced from 1927 to the "bust" in 1929?

Mr. MILLER. It was.

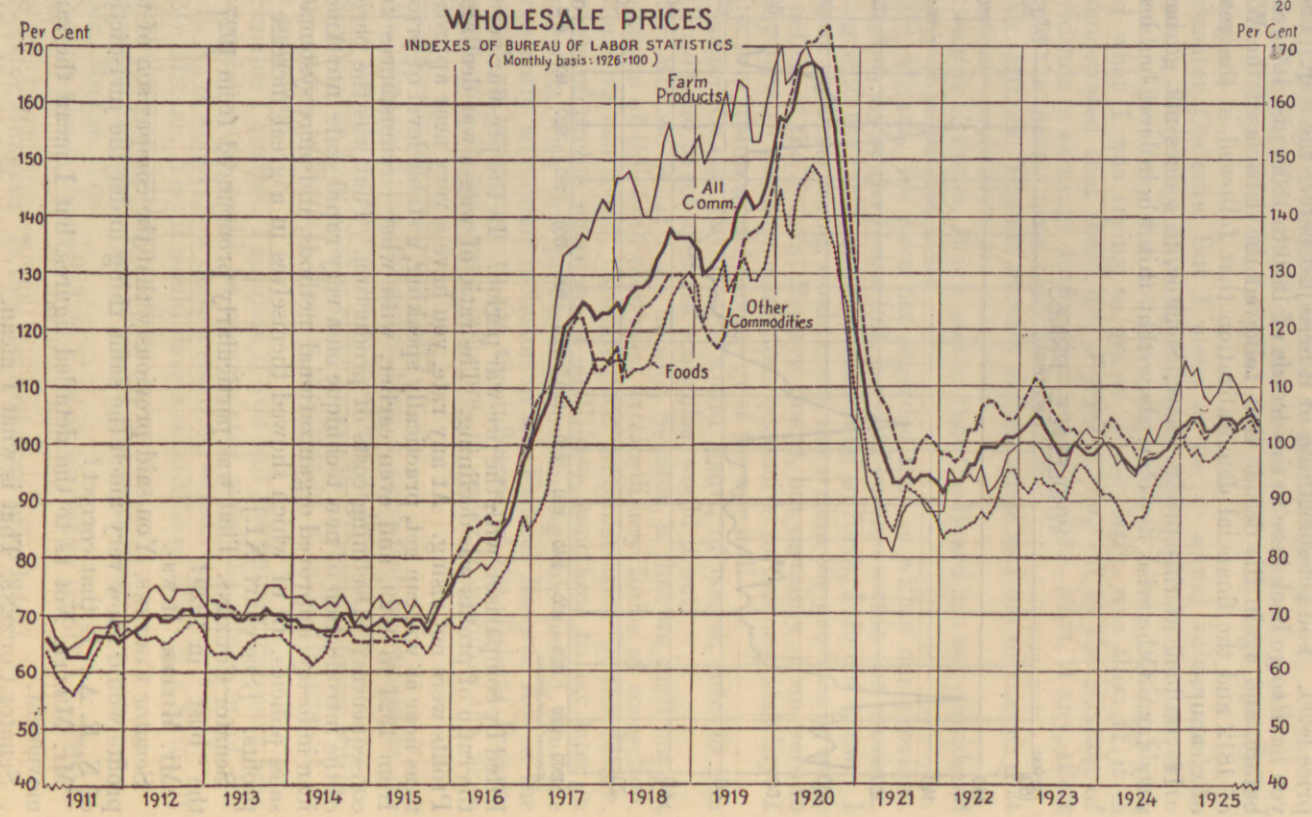
Senator COUZENS. You said previously that the comparison of the profits would show very much the same thing under the jurisdiction of N. R. A. is that correct?

Mr. MILLER. Not as to the detailed figures, but I mean the same movement.

Senator COUZENS. That is what I mean.

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CHART Xa



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Mr. MILLER. If you are interested, I will read you a conclusion from a very recent study on that. Here is a study entitled "Aspects of Manufacturing Operations During Recovery."

CHART Xb

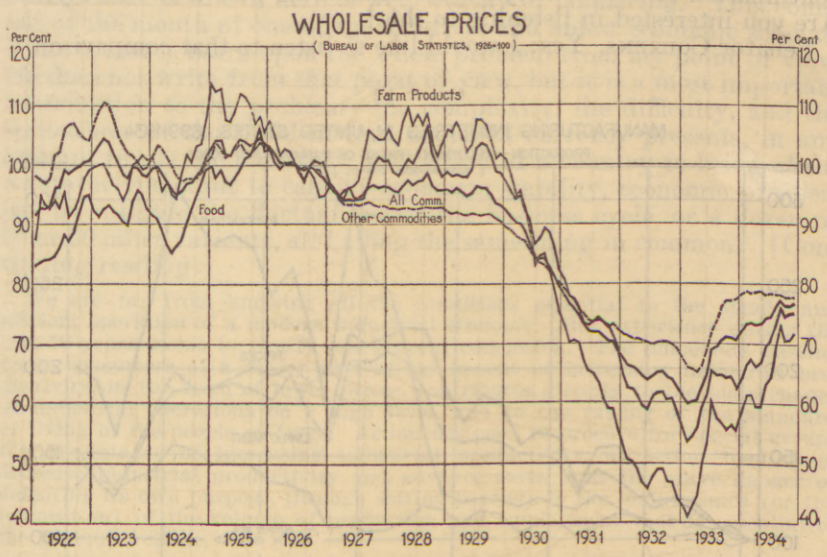
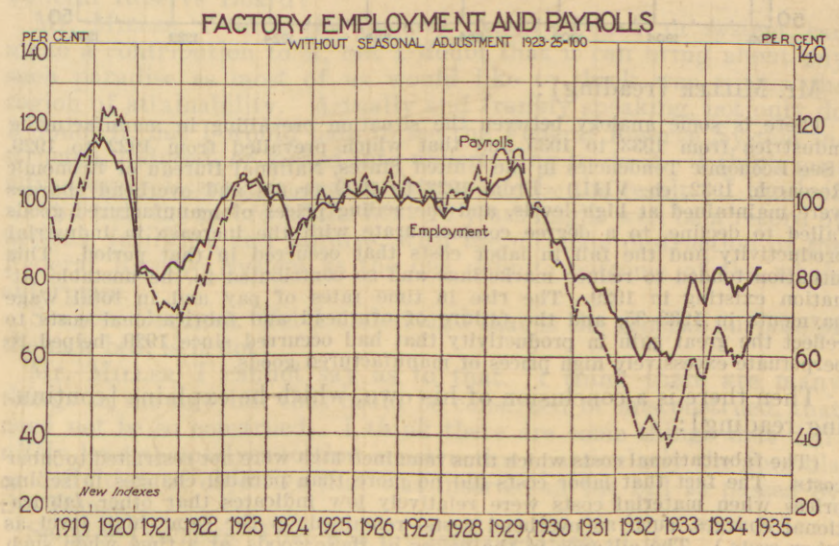


CHART Xc



Senator COUZENS. That is issued by whom?

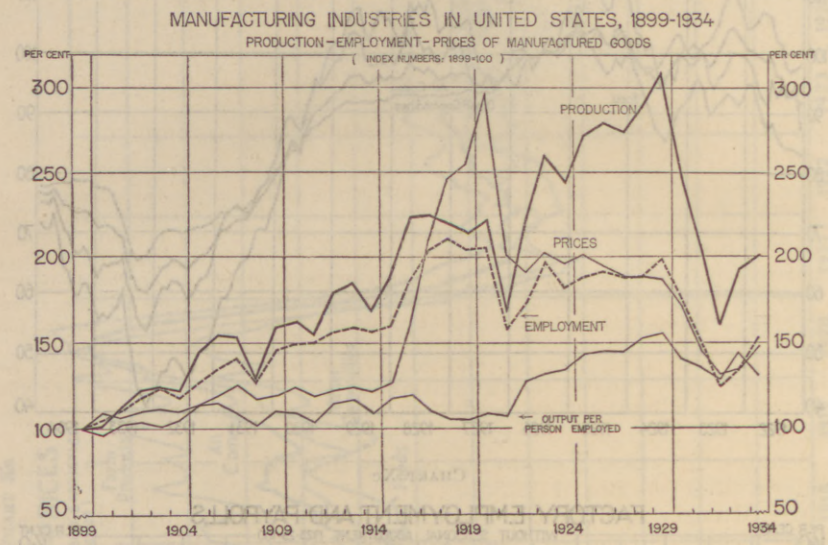
Mr. MILLER. By the National Bureau of Economic Research. That, by the way, I regard as perhaps the most competent research organization not only in our own country but in the world today,

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including the most carefully selected scholars and investigators, who are absolutely independent, and who are, I think, more nearly up to the minute in their interpretations than any other such agency. They are building on the broadest foundations. This is merely in continuation of studies they have been making over a series of years. Are you interested in listening to this?

Senator COUZENS. Yes; I would like to listen to that comparison.

CHART XI



Mr. MILLER (reading):

There is some analogy between the situation prevailing in manufacturing industries from 1933 to 1935 and that which prevailed from 1922 to 1929. (See Economic Tendencies in the United States, National Bureau of Economic Research, 1932, ch. VIII.) From 1922 to 1929 profits and overhead charges were maintained at high levels, and the selling prices of manufactured goods failed to decline, to a degree commensurate with the increase in industrial productivity and the fall in labor costs that occurred in that period. This situation tended to reduce marketings and so contributed to the unstable situation existing in 1929. The rise in time rates of pay and in total wage payments in 1933–35, and the failure of overhead and fabricational costs to reflect the great gain in productivity that had occurred since 1929, helped to perpetuate excessively high prices of manufactured goods.

Then there is a conclusion of his own, which he explains [continuing reading]:

(The fabricational costs which thus remained high were not restricted to labor costs. The fact that labor costs did no more than parallel changes in selling prices when material costs were relatively low indicates that other fabricational charges, such as overhead costs, remained on the same high level as labor costs.) The advance in the prices of these goods, at a time when such goods were already overvalued, retarded a needed expansion in the volume of sales. During the decade of the 'twenties a high manufacturing differential (profits are here included with the differential) was a factor in preventing the *maintenance* of a large volume of production and sales. From 1933 to 1935 a high manufacturing differential was a factor in preventing the *restoration* of a large volume of production and sales.

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Senator COUZENS. That is assumed to be as a result of the codes? It came in that period.

Mr. MILLER. It comes in that period, whatever the causation may be, and whatever the codes may have contributed. I think the conclusion that is drawn here is well worthy of pondering. This comes out of the mouth of one of the maturest and ablest economic scholars I know, and it bears upon the whole problem from my point of view. He does not write from that point of view, but it is a most important contribution to the problem—the complexity, the difficulty, and the seriousness of the problem that managed currency presents, in any attempt to use the monetary mechanism of a country to bring about whatever you want to call it—economic stability, economic prosperity, to mitigate the fluctuations of the business cycle, or a dozen or 20 or 50 other variants, all having the same thing in common. [Continuing reading:]

We are far from knowing all the conditions essential to the steady and efficient operation of a modern industrial economy. But experience during the last 10 years seems to justify one general conclusion. The immediate passing on to consumers of a major part of the benefit of increasing industrial productivity, in the form of lower prices, contributes directly to the maintenance of industrial operations on a high level, and to the raising of the standard of living of the people at large. Action designed to procure for special groups the advantages of increasing industrial productivity, or action tending to decrease industrial productivity and advance costs, runs the grave danger of defeating its own purpose, through setting barriers to the maintenance (or the restoration) of the volume of production and employment that is essential to the general welfare.

Senator COUZENS. You do not believe that can be controlled by the Federal Reserve Board?

Mr. MILLER. I think the Federal Reserve Board, or system, can make a contribution to it, but I doubt that it can bring about any such paradise as most of us would like to think was within the region of attainability. Actually and frankly speaking, not only do I doubt it, but I would hate to see the Federal Reserve System instructed, induced, or kicked into undertaking to do it. I think misadventure, miscarriage, and futility would be the result. I think if we did that the record of the next 10 years might well be a record of fictions, futilities, and failures, with the ultimate destruction of the Federal Reserve System as the one definite outcome of the whole enterprise.

Senator COUZENS. Yet I understand that is the general purpose of the new bill, is it not?

Mr. MILLER. I cannot say as to that. I think there are many things in the new bill that could be construed or misconstrued, that need not be so construed. I think there are some things that definitely lend themselves to that construction, particularly the formula or definition of objective that was inserted in the bill as passed by the House.

Senator COUZENS. That was my interpretation of it.

Mr. MILLER. Referring again to the price chart [chart IX], in my judgment, the persistent propaganda that went on in the twenties to try to amend the Federal Reserve Act so as to write into it a price commodity index formula did more than anything else to divert the attention of the mind of the Federal Reserve System from its true

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function. There was enough of flirtation with that theory in the Federal Reserve System that some of the leading minds of the System were pretty thoroughly infected with the price stabilization philosophy, and I think they were led into believing that so long as the price commodity index was all right, everything was all right.

Senator BULKLEY. Do you think the Federal Reserve Board should have nothing to do with prices at all?

Mr. MILLER. I think it should keep its eye on prices as one of the strategic factors in the interpretation of the condition of health of the body economic, but I think that if it should take that alone as a guide, or should take that as the main guide, nothing could more definitely insure that we would bump from one crisis or depression into the next one. I want to read you some evidence here.

Senator GLASS. Had the war not occurred, necessitating the issue of an enormous amount of bonded indebtedness, making it either desirable or necessary for the banks to undertake to finance the Government, and had the Federal Reserve System been free, as I contend it was intended to be free, to respond to the requirements of commerce, industry, and agriculture, automatically issuing its notes and affording its credits when either form of business transaction was desirable, and automatically canceling its credits and retiring its notes at the maturity of business transactions, do you think there could have been any reasonable criticism of the Federal Reserve System?

Mr. MILLER. I think there would have been, Senator, but that there should not have been. I think it is pretty safe to say that whatever the Federal Reserve System does or does not do, it would be subjected to criticism.

Senator GLASS. Oh, of course.

Mr. MILLER. But I am sure of this, speaking from the point of view of an older member of the Board, and one who has made service on the Federal Reserve Board, so to speak, a career, that there will be less to regret under what you have just portrayed than there will be under any of these other modes that are content to look forward 6 months or, at best, 2 or 3 years. I have found that troubles and mistakes come back to plague us later. The Federal Reserve Board is here now—and has been for some time—a system defending itself against the things that, in my judgment, men of clarity ought to have seen must be the inevitable byproduct of enterprises, policies, and attitudes that developed in the course of the middle twenties. I do not mean to imply by that that this country and the world would not have had to go through a searching depression in order to rectify all the breaches in the economic system that were occasioned by the war and intensified by the sudden shift in the position of the United States as a result of the war, financially, industrially, and economically; but I think the whole thing might have been kept in proportions that would have made it, instead of a depression of 6 years or more, one, perhaps, of 3 years at the utmost. A great deal of rectification has been necessary in this instance that could have been avoided if we had built a less lofty and a less insecure structure upon the flimsy foundation of credit.

Any excessive credit, any inflation, demands its toll, and we are paying for the inflation that we indulged in unrecognizedly in the

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period of 5 years preceding the climax in 1929. I sometimes think that one of your colleagues, Senator Glass, at the time the Reserve Act was passed, Senator Root, of New York, came pretty near the truth when he opposed the act on the ground that we are all optimists in this country. That means that we are all inflationists. The directors of the Reserve banks, he said, will be optimists. They will be inflationists. The members of the Federal Reserve Board will be optimists. They will be inflationists, he said. I would say that the cardinal thing to beware of on the part of any member of the Federal Reserve System is the insidious poison of inflation.

Senator GLASS. Senator Root was so far wrong about the Federal Reserve notes being fiat money that I never have paid much attention to what he has to say.

Mr. MILLER. Yes; that is true.

Senator COUZENS. That is one other factor I want to take up with you, and that is your evident optimism that this eligible paper is going to return. I do not feel that optimism that you do, in view of several factors, the primary one being the taxing policy of the Government.

Mr. MILLER. That will make it come all the quicker.

Senator COUZENS. No.

Mr. MILLER. Yes; I think so, Senator.

Senator COUZENS. I have a reverse view then. The taxing policy of the Government contributes to a very large degree to the accumulation of profits and the failure to distribte them among stockholders. I think that that, in itself, will impel many of these industries to keep exceedingly liquid unless it is taken away from them through some excess-profits system. Otherwise you might be right—that unless we adopt a very vigorous excess-profits tax we are going to keep these surpluses.

Senator GLASS. My pessimism in that respect is intensified by the fact that the Government is going into every conceivable sort of loaning business itself and practically undermining the commercial banking business.

Mr. MILLER. Senator, a very interesting study has recently been made, just in the last few weeks, by another one of the investigators for the Bureau of Economic Research, on changes in the capital assets and earnings of corporations in the period since the crisis of 1929. I have a quotation here of his conclusion. The study is not a very long one, but it would be too long to introduce in the record here. May I read the conclusion?

Senator COUZENS. I should be glad to have it.

Mr. MILLER. This is a statement that affects all reporting corporations in the United States. [Reading:]

> Working capital, taken as the difference between current assets (cash, notes, and accounts receivable, inventories, and tax-exempt investments) and current liabilities (notes and accounts payable), declined considerably (34 percent from 1929 to 1932). * * *

The decline in working capital from 1929 to 1932 was 12 billion.

> * * * working capital, in the form of liquid assets, was insufficient to finance the requirements that an upturn would bring. The major portion of new working capital lay nascent in the fixed assets of all corporations; the credit-making mechanism of our banking system was needed to quicken it into

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life. (Solomon Fabricant's "Profits, losses, and business assets, 1929–34", National Bureau of Economic Research Bulletin 55, Apr. 11, 1935, pp. 10–11.)

In brief, the very fact that these corporations have dissipated their surpluses in paying out dividends, in meeting their continuing overhead costs, and in the expenses for upkeep that cannot be postponed, has so reduced their own independent capital assets that when activity comes again and expansion, particularly in the heavy industries, I am satisfied that they will have to go into the market to borrow, and then your other loans, commercial loans, will begin to increase.

Senator GLASS. Will they borrow from the Government or from the banks?

Mr. MILLER. That is for Congress to determine, not for the Federal Reserve Board.

Senator COUZENS. In that connection may I say that with the easy money market there is no reason for these industries financing through short-term paper with the bankers. It seems to me that there is an ample security market for them, and at a much lower rate, and with much more assured capital, than through borrowing, short-time, from commercial banks.

Mr. MILLER. We have not had much new financing as yet.

Senator COUZENS. We have not had much borrowing from the banks as yet, either.

Mr. MILLER. No; but I fancy that even if we have an ultimate increase in security financing it will, in its initial phases, take the form of bank loans. I do not think you can have such a stupendous decline as $12,000,000,000 in the resources of the corporations of this country, in their working capital, without obliging them to lean on the commercial banks to a very considerable extent. At any rate, I repeat that it is a hasty inference, if you draw it, to say that because commercial loans, as a result of the depression and of this extraordinarily foul inflationary development that we had in the years 1922 to 1929 have declined, that that is to be taken as indicating that commercial paper and commercial borrowing have disappeared from the banking scene in America. I do not believe they have, and I think it would be going on a false predicate if the Federal Reserve Act were amended so as to recognize, hallmark, approve, and commend that situation.

Senator GLASS. There are only 21 banks in the whole System now that have no commercial paper.

Mr. MILLER. I know; but it is the total volume of it that is sometimes complained of as presenting a menacing situation. I should say if it does, and the act were amended along the lines I have suggested, you could open the door if it proves necessary; but I am far from being convinced that liquidity is an old-fashioned virtue in banking, any more than I believe that chastity is an old-fashioned virtue in womanhood.

Senator BULKLEY. What does liquidity consist of? Is it the ability to pay out promptly on demand? Liquidity consists in the ability to pay out promptly on demand, does it not?

Mr. MILLER. I would say, in economic terms, the ability to readjust your position in accordance with changes and shifts in economic circumstances—the ability, in other words, to walk a pretty

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steady course without someone putting a crutch under you or lifting you into an automobile or baby carriage and carrying you along.

I called attention this morning, in connection with the discussion of the gold standard prior to the war, to the constant readjustments that were going on under its operation. Liquidity is one of the most wholesome forms of discipline that the economic system has. You have it wherever you attach value and importance to liquidity. Our banking troubles, our economic troubles, have been enormously exaggerated in the last few years by reason of the fact that we had a frozen condition and did not know it. It was freezing long before the boom broke, and we did not know it, so it has been impossible to readjust.

Senator COUZENS. Do you think that the prominence of liquidity is as pronounced now under the bank-deposit insurance?

Mr. MILLER. No; I do not. I think a great deal is happening and has happened, and probably will happen, to look askance at, critically, but, to my mind, Senator, most good conduct is a question of degree. There can be such a thing as extreme liquidity, and there are certain bankers who are foolish enough to think that they are good bankers when they can liquidate every dollar of obligations to their depositors at the close of any day. That would put us back on a cash basis, virtually. But there are those others who think that they are liquid as long as there is a place in which they can park their assets—to wit, the Federal Reserve Board. It does not matter how long, or of what character, so long as you can go there and get money for it, it is a liquid asset. I maintain that is not a liquid asset. That is a means of postponing, for the most part, the evil day; and if enough get into the position where they are postponing the evil day, you have the evil day raised to the 'nth degree. That is one of the things we have had in this recent trouble, though there are many adventitious causes to explain it, such as the uncontrolable influx of gold, but that is the price for not having maintained in some degree a liquid position—at any rate, a far more liquid position than actually was maintained. The result was that in 1929 and 1930 there could be no readjustment.

Senator BULKLEY. Is any fixed investment a liquid asset?

Mr. MILLER. It is in an individual case. It is not for a country as a whole.

Senator BULKLEY. For a bank?

Mr. MILLER. For an individual bank?

Senator BULKLEY. Yes.

Mr. MILLER. It may be vicarious liquidity. The only genuine liquidity for a country as a whole is paper based on goods that are moving into consumption. It does not matter how good an investment may ultimately be, if there are too many people that want to realize on it at the same time it cannot be done. It implies a free market, a market in which there is actually buying and selling.

Senator COUZENS. Have you any evidence of the attitude of mind of the bankers as to the desirability of liquidity as a result of the bank insurance of deposits?

Mr. MILLER. I have not talked with any banker on the subject. I have not talked with a banker for several weeks on this subject, if

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not several months, but I think you have had testimony here on that subject. I think that with a great many of the bankers liquidity is merely a phrase. I think they pay lip service to it and do not really know what is involved in the whole conception. I think there are others—some of the large bankers and some of the smaller bankers—who know what liquidity means and why it is a good test of the good conduct of the banking business. There are others who make a fetish of "liquidity."

(At this point followed informal discussion which the reporter was directed not to record, at the conclusion of which the following occurred:)

Senator GLASS. Very well. Proceed with your comments on the bill.

Mr. MILLER. I thought while we had the profits curves here and the price curve, I would like to read you, in part, an explanation of a rather severe condemnation of the so-called "price-index formula" for Federal Reserve guidance. I have been rereading this winter the writings, notably the two volumes on Money, of John Maynard Keynes.

Senator GLASS. A good deal of that is in the bill, is it not?

Mr. MILLER. I mention this because Mr. Keynes is well known as perhaps the leading proponent in the world of the managed-currency theory. In fact, I think he is the inventor of the phrase "managed currency." I regard him as one of the most brilliant writers, one of the most interesting writers, upon all monetary subjects. Let me also say that I regard him as one of the most candid writers. I would say that he stands in singular contrast to many American economists in that respect, and does not hesitate to admit a blunder when he has made one. I have often even suspected that he makes blunders sometimes so as to have occasion to admit and recant.

Senator GLASS. He has made a good many of that sort. I do not know whether he has intended to make them or not.

Mr. MILLER. At any rate, in a review of what took place in the United States from 1925 to 1930, this is what he has to say [reading]:

> This period is interesting, in that it provides (up to the spring of 1928) an example rare in monetary history, namely, one in which high rates of productive activity and of investment were developed without the rate of savings falling behind. By the middle of 1928, however, there is evidence that a profit inflation had commenced, culminating in boom conditions by the spring of 1929 and rapidly terminated by a collapse in the autumn of 1929.

He then gives a table, which, for better presentation, has been put into the form of a chart [chart XII].

This black line [indicating on right-hand chart] represents the course of industrial production. Those, I think, are the Standard Statistics Co. figures. The bottom line represents the course of wholesale commodity prices, according to the Bureau of Labor Statistics. The top line represents the prices of common stocks. The left-hand chart shows the movement of time deposits, and this median line here [indicating] represents loans and investments. The bottom line represents demand deposits.

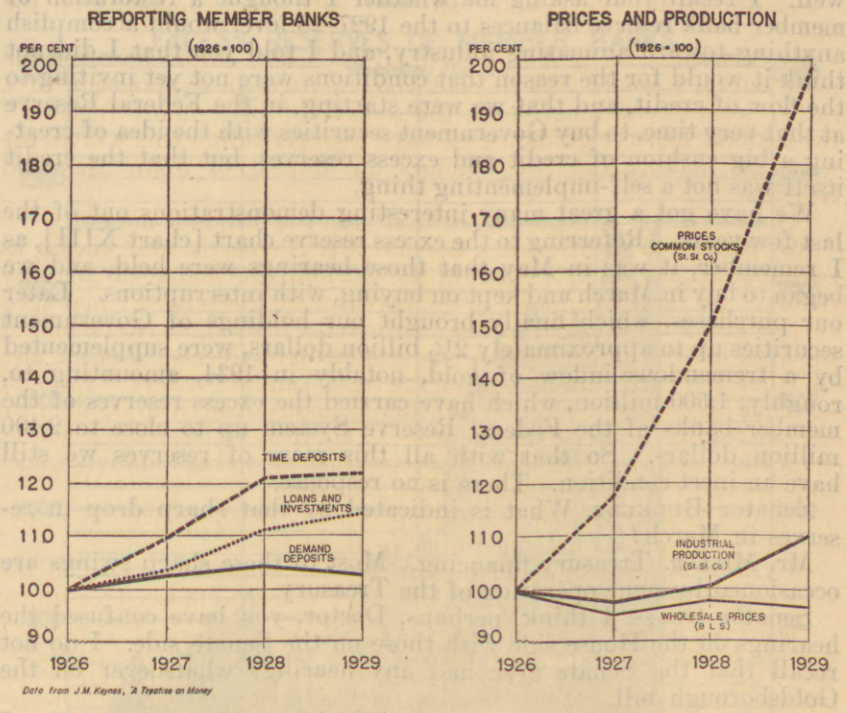
The principal thing to bear in mind here is the movement of the line representing loans and investments, that representing wholesale commodity prices, and that for stock prices.

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Now comes his comment [reading]:

Now for two reasons these statistics were peculiarly difficult to interpret. Anyone who looked only at the index of prices would see no reason to suspect any material degree of inflation; whilst anyone who looked only at the total volume of bank credit and the prices of common stocks would have been convinced of the presence of an inflation actual or impending. For my own part, I took the view at the time that there was no inflation in the sense in which I use this term. Looking back in the light of fuller statistical information than was then available, I believe that, whilst there was probably no material inflation up to the end of 1927, a genuine profit inflation developed sometime between that date and the summer of 1929.

CHART XII



Data from J.M. Keynes, 'A Treatise on Money'

That was the line you called attention to, Senator Couzens. You had, during that period, a stable, or a relatively stable price level, and if one were of the school of thought that regards the price level as the one thing that you must keep your eye on in order to interpret the proper course of Federal Reserve policy, there was no occasion to take any alarm at all. I have already cited the statement of my own in 1925, in which, while I was not neglecting the price factor, I had come to the conclusion that there was something going on that was not reflected adequately in the movement of prices, and that was reflected in the movement of credit, and in the movement particularly of credit that was flowing into security financing and stock-exchange speculation.

I do not know how much interested you are, but I have taken the trouble to canvass the best of the recent literature of the last 3 or 4

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years, dealing with the interpretation of the developments up to 1929, both of English and American writers. I have yet to find one that does not agree in the interpretation that I have given here of the connection between price stability and profits instability or inflation and economic instability. I think, Senator Couzens, you may possibly recall—though I am not sure that you had not left the hearing before I was through—in 1932, when the Goldsborough bill, I think, was before the committee——

Senator COUZENS. I was not at the committee at that time.

Mr. MILLER. You were at the hearing at the inception of the hearing, I remember. You asked me certain questions, I remember very well. I recall your asking me whether I thought a restoration of member bank reserve balances to the 1927–28 level would accomplish anything toward animating industry, and I told you that I did not think it would for the reason that conditions were not yet inviting to the flow of credit, and that we were starting, in the Federal Reserve at that very time, to buy Government securities with the idea of creating a big cushion of credit and excess reserves, but that the credit itself was not a self-implementing thing.

We have got a great many interesting demonstrations out of the last few years. Referring to the excess reserve chart [chart XIII], as I remember, it was in May that those hearings were held, and we began to buy in March and kept on buying, with interruptions. Later our purchases, which finally brought our holdings of Government securities up to approximately 2½ billion dollars, were supplemented by a tremendous inflow of gold, notably in 1934, amounting to, roughly, 1,500 million, which have carried the excess reserves of the member banks of the Federal Reserve System up to close to 2,400 million dollars. So that with all this mass of reserves we still have an inert condition. There is no response.

Senator BULKLEY. What is indicated by that sharp drop in reserves in March?

Mr. MILLER. Treasury financing. Most of these sharp swings are occasioned by some operation of the Treasury.

Senator GLASS. I think, perhaps, Doctor, you have confused the hearings on the House side with those on the Senate side. I do not recall that the Senate ever had any hearings whatsoever on the Goldsborough bill.

Mr. MILLER. I think it was the Fletcher-Goldsborough bill. I think a bill was introduced simultaneously in both Houses.

Senator COUZENS. It was not the Glass-Goldsborough bill? [Laughter.]

Mr. MILLER. At any rate, I have an excerpt here.

Testifying before the Banking and Currency Committee of the Senate in 1932 on a bill to restore and maintain the average purchasing power of the dollar, I called attention to the fact that some of the powerful shaping influences in the Federal Reserve System were thoroughly infected at that time with the idea of a stable commodity price level. "They believe," I then said, "that as long as prices of commodities were behaving all right things must be all right. As a matter of fact, the commodity price level, with the stability that it showed during those years, was a cover for one of the most vicious and costly, disastrous and destructive inflations that this country or

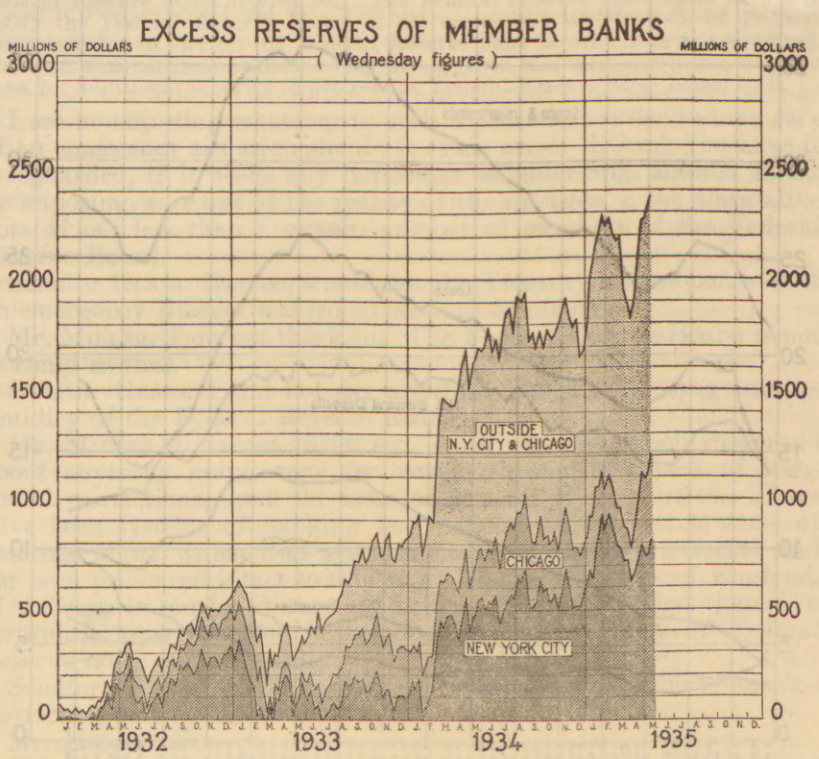
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any country in a state of solvency has ever experienced." I emphasized my belief that that kind of result was to be expected. I stated that inflations might be expected if we operate the Federal Reserve System under a stabilization philosophy. Continuing, I said:

A stable price level in a progressive economic society may frequently result in a profit inflation. Progress in technical organization, more efficient production methods, such as we usually have, all mean that costs of production keep going down.

How do production costs ordinarily run in a progressive society? They run down, do they not? That is what we mean by progress—technological improvement; more efficient production. Unless wage payments increase enough to absorb all of the savings made possible by more efficient methods, the proceeds

CHART XIII



of the sale of goods at stable prices are going to go somewhere else. Where do they go? Into profits. And what do profits do? When conditions favor a profit inflation, the stage is set for a speculative boom. And most of the stabilizationists in this country * * * are really unconscious inflationists. What they want is rising profits insured by a stable price level. I would say that in the long run a piece of legislation of this kind might be expected to insure that the country from time to time will have profit inflation, speculative booms, and speculative collapses.

That was stated in a rather crude way at a hearing, and I find, in going over the best recent literature, that that view finds complete vindication and endorsement, and likewise in the history of this period.

Senator GLASS. I approve the view, but to save my life I cannot recall that the Senate committee ever had any Goldsborough bill.

Senator COUZENS. I think the full committee did.

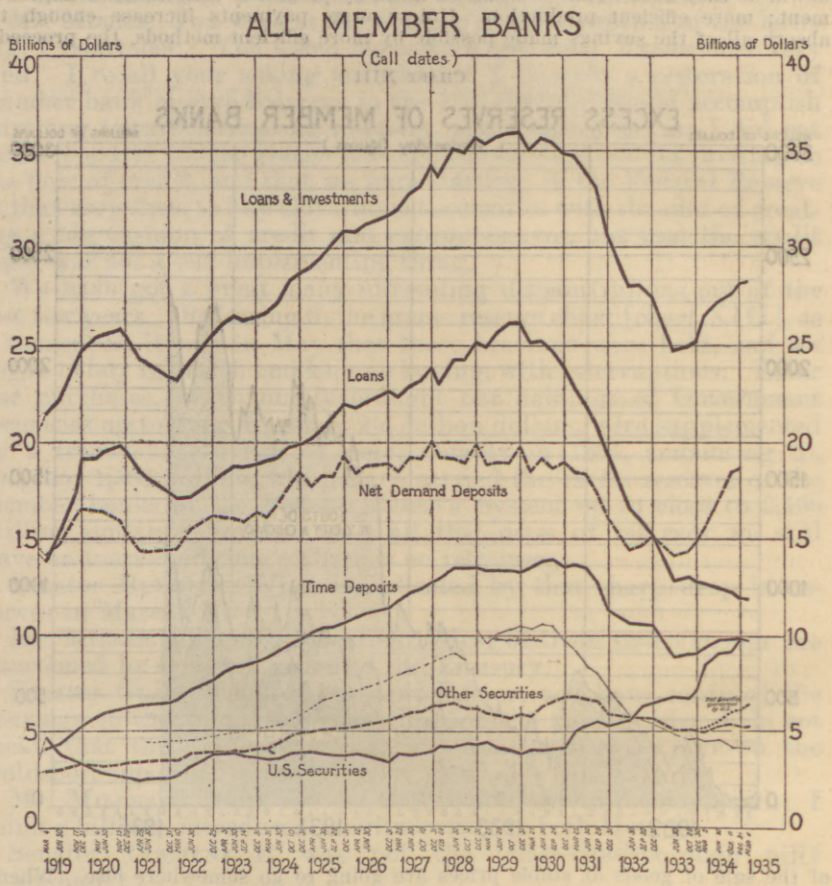
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Mr. MILLER. It was the full committee.

Senator COUZENS. I have some recollection of what the doctor is talking about now.

Mr. MILLER. It was the full committee, and I recall that Representative Goldsborough was permitted to question me, and I think it might have been in response to one of his questions, or in the colloquy with him, that I made the statement of which I quoted the substance to you here.

CHART XIV



Senator COUZENS. Are you going to propose some amendments now?

Mr. MILLER. Yes.

Senator COUZENS. You have proposed one.

Mr. MILLER. Yes. Are we through with eligibility?

Senator COUZENS. We are about through with it, but perhaps you are not.

Mr. MILLER. I mean are you through with me on it?

Senator COUZENS. Yes; I am.

Mr. MILLER. I propose, with respect to section 208 of the Senate bill, that a proviso be added to section 16 of the Federal Reserve Act, as amended, reading as follows [reading]:

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Provided, however, That the Federal Reserve Board, should it deem it necessary to safeguard the public interest, upon the affirmative vote of not less than —— of its appointive members, may authorize the Federal Reserve banks to offer, and the Federal Reserve agents to accept, as such collateral security, direct obligations of the United States.

Senator COUZENS. Without limit?

Mr. MILLER. Without limit. [Continuing reading:]

Such authorization shall be granted only in exceptional and exigent circumstances and only for limited periods but may be extended from time to time upon the affirmative vote of not less than — appointive members of the Federal Reserve Board. Upon the expiration of such authorization, such obligations of the United States shall be retired as security for Federal Reserve notes. In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it.

I see no objection whatever to such a proviso in order to take care of an emergency situation should it again arise. I think you have it safeguarded, if it needs any particular safeguarding, against abuse, by imposing, as a test of the reality of the emergency, the affirmative vote of not less than a certain number of members of the Federal Reserve Board.

Senator GLASS. Doctor, would not the Treasury always consider it an emergency when it wanted to do some financing?

Mr. MILLER. I do not think so. The Federal Reserve Board is not as timid as that.

Senator GLASS. I did not say anything about the courage or the timidity of the Federal Reserve Board.

Mr. MILLER. I do not think so. I am not very much concerned about anything going very far wrong through the lack of iron-bound restrictions, upon the issue of Federal Reserve notes. There have been systems of banking and policies of the best systems of banking under which that position has been thought essential and has been preserved intact to this day. That is the Bank of England. If we were in more ordinary conditions, I would say that there is a certain protective virtue in hedging around the issue of Federal Reserve notes very carefully.

Senator GLASS. There have been instances when there was no restriction and no limitation.

Mr. MILLER. Yes.

Senator COUZENS. Do you agree with Secretary Morgenthau that the Government ought to buy the Federal Reserve stock?

Mr. MILLER. No; I do not see any advantage. I do not think it makes any difference who owns it, from my point of view, Senator. It depends on who is going to administer it. If I thought that the ownership of the Federal Reserve System by the Government would give us a perfect administration I should assent to it at once. I think probably the reverse would be true.

Senator BULKLEY. Why would the reverse be true?

Mr. MILLER. I think, on the whole, the quality of mind and character that is required in a body that has to administer a managed currency in the country is not going to be found in ordinary servants of the Government. They have got to be more independent. They have to be stronger in intellect than the ordinary public servant and

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more responsible in their attitude of mind toward the people of the country.

Senator COUZENS. Certainly Senators would not qualify, then, would they?

Mr. MILLER. You know the Senate better than I do.

Senator GLASS. Let the Senator from Michigan make his own confession if he wants to.

Mr. MILLER. I would not hesitate to entrust the future of the Federal Reserve System, whether Government owned or otherwise owned, to you gentlemen; but it requires a different quality of mind, a different quality of interest; and if we are ever going to get a Federal Reserve System that fulfills its function, I am convinced that it must come through men being put on the Federal Reserve Board who are willing to undertake responsibility as a great public responsibility which runs to the public rather than to an official of the administration of the day.

Senator BULKLEY. You mean that they must, at the same time, be interested as bankers?

Mr. MILLER. Not at all.

Senator BULKLEY. Then I do not quite follow why it is not possible to get them in the Government service.

Mr. MILLER. Some men do not like to. I do not want to wear a Government collar. I do not want to be in a position where any member of the Cabinet, or even the President, can command me. I want to be a free man. I feel my responsibility to the people of the United States for doing my best to preserve, establish, and maintain as good a financial and economic situation in this country as the Federal Reserve System posibly can help bring about.

Senator BULKLEY. Is there anything in that that is inconsistent with the Government ownership of stock?

Mr. MILLER. I think you will get better men.

Senator GLASS. The Government owning the stock would not mean the Government owning the System. There is something more to the Federal Reserve System than the mere stock of the member banks in the Federal Reserve System.

Mr. MILLER. Yes. I say, if I thought owning the banks would give you better men, I would want it.

Senator BULKLEY. I want to get at why you think the reverse would be true.

Mr. MILLER. What is the reverse?

Senator BULKLEY. That is what I am asking you. You said a few moments ago that you thought the reverse would be true, and I am asking you why?

Mr. MILLER. I do not recall the exact connection in which I used the term.

Senator BULKLEY. If you do not mean to stand by the opinion——

Mr. MILLER. I want to stand by anything I have said.

Senator BULKLEY. I do not care. We sometimes misstate what we mean, and I do not mean to get you into a corner at all.

Mr. MILLER. Senator, the conception, as I view it, of the Federal Reserve Act is that the Federal Reserve Board is what, in the technical description of the Government vocabulary, is called an "independent Government establishment." I think the intent and purpose was to make it as nearly independent as possible.

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Senator COUZENS. Then you would not like to see the Secretary of the Treasury or the Comptroller of the Currency on the Board.

Mr. MILLER. I think they ought to be eliminated. I think it is a question of which should go first, and how to make the adjustment, but I am of the opinion that there should be no ex officio members of the Board.

Senator GLASS. The Senate thought that 2 years ago, by a vote of 62 to 14.

Senator COUZENS. Of course, their quality of mind does not equal others, and they should not be confused.

Mr. MILLER. I do not care anything about quality of mind. It is the quality of performance you get from the same mind.

Senator GLASS. I can very readily distinguish what Dr. Miller means and is reluctant to say, and I do not hesitate to say. I think Government employees, in the broad sense, are vastly less independent than an independent board set up for central supervisory purposes and paid by the agencies which they are called upon to supervise.

Mr. MILLER. I think the influences that enter the windows of a man's mind, even when they are supposedly closed and the shades down, are sometimes hard to detect, and he is frequently not aware of them. I have found, in keeping myself fit for the best discharge of my duties as a member of the Federal Reserve Board, that I have to devote an enormous amount of time to real study and research. I do not seek contacts with bankers and I do not have to. I keep myself out of the atmosphere of the administration of the day, whatever it happens to be, as much as possible, so as to maintain an objectivity of mind and a clear perspective. I think that gives a man, if he pursues it, a certain strength of conviction which, if he has the necessary elements of character and courage, insures a pretty good and a pretty straight performance.

Senator BULKLEY. I find myself very much in agreement with that, but I do not quite see to what extent it is promoted by the fact that the stock in the Federal Reserve banks is owned by the banks instead of by the Government.

Mr. MILLER. What advantage do you get? I will put it this way. You use the expression "own the stock." Who owns the men? I do not want to serve on a Federal Reserve Board in which there is the slightest ground for feeling that the men are owned by anybody.

Senator BULKLEY. That is exactly the objective I think we all ought to try for, but I am still puzzled as to why you think that objective is interfered with by the Government owning the stock.

Mr. MILLER. It becomes a department of the Government. It is an executive department.

Senator BULKLEY. What is that?

Mr. MILLER. It will be an executive department of the Government. It will be subject to influence.

Senator BULKLEY. The ownership of the stock would make you more subject to influence?

Mr. MILLER. Even though the Government undertakes to exercise no influence, the men who administer it will feel that they are direct agents of the Government and that they are primarily responsible not to the people of the country for a good performance, but to the administration of the day, for a satisfactory performance to it. There is no method by which you can escape that.

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Senator GLASS. The ownership of the stock, it seems to me, is not of primary importance.

Mr. MILLER. I do not think it is important.

Senator GLASS. The ownership of the reserves of the country and the ownership of the deposits in the banks, which primarily afford the profits that enable the banks to make reserves and deposit reserves, is important.

Mr. MILLER. Senator, even that does not strike me as the all-important thing. The important thing, it seems to me, is: Who are the men and by what process can they be selected so that they will guarantee as good a performance as we can provide in America in the administration of the Federal Reserve System? If the Government owns the stock and elects the directors, and I could be shown that that would give a better result, I would have no objection to Government ownership. I am convinced it would give an atrociously worse result.

Senator BULKLEY. Why?

Mr. MILLER. Whom is the Government going to elect as its directors?

Senator BULKLEY. Does not the Government select the members of the Board now?

Mr. MILLER. I suggest, Senator, that you just go back in your own mind, in your own State, 10 or 15 years, and vision what men might have been appointed as directors of the Federal Reserve Bank of Cleveland. Go back to 1921, 1922, and 1923.

Senator BULKLEY. That is pretty difficult.

Mr. MILLER. We have had some pretty poor material on the rolls of the Government and we have had some appointments on the Federal Reserve Board not of the most desirable character. It has been some effort, even as the set-up is now, to keep the Presidential hand from time to time from thrusting itself into the Federal Reserve Board to reward political adherents.

Senator GLASS. Under the proposal of this bill you convert the Federal Reserve System into a spoils system—nothing else on earth.

Mr. MILLER. I would hope not.

Senator GLASS. You are much more hopeful than I am.

Mr. MILLER. I am not so cynical as to expect it; but I would like to see the bill, before it is enacted, with those possibilities entirely closed.

Senator GLASS. Yes; but under this bill, from the janitor to the governor of the Federal Reserve bank—oh, well.

Mr. MILLER. You mean the appointment could be influenced from the Federal Reserve Board here in Washington?

Senator GLASS. Of course, it could.

Mr. MILLER. Does it not all come down to this, that men, after all, are the stuff of which Government, and particularly administrative organizations, are made? It does not matter how perfect a law you have; if you have men who are either intellectually or morally incapable of fulfilling those functions, you will not get the result.

Senator GLASS. But you need not, by statute, invite them to do that.

Mr. MILLER. No; I quite agree with you; and I am in full sympathy with any attempt to protect the system against that type of danger, unless it can be clearly shown that the advantages clearly outweigh the risks of danger.

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Senator GLASS. Doctor, we have a Pennsylvania banker here who is obliged to return home tonight. Would it inconvenience you to come back on Monday morning?

Mr. MILLER. No. I am at the service of the committee. There is nothing more important that I have to do than to do anything which you feel that I can helpfully do here.

Senator GLASS. If that is agreeable to you, then, we will hear Mr. Zimmerman at this time.

STATEMENT OF CHARLES F. ZIMMERMAN, PRESIDENT FIRST NATIONAL BANK, HUNTINGDON, PA.

Senator GLASS. Give your name, please, and your position to the official reporter.

Mr. ZIMMERMAN. My name is Charles F. Zimmerman. I am president of the First National Bank, Huntingdon, Pa.

Senator COUZENS. Are you appearing in your own behalf?

Mr. ZIMMERMAN. Yes.

Senator GLASS. I understood you to voice the action of group 6 of the Pennsylvania Bankers Association.

Mr. ZIMMERMAN. Well, I indirectly do that, Senator, but I am here not as an official representative of group 6.

Senator GLASS. Simply as a country banker?

Mr. ZIMMERMAN. I should like to be classed a mere country banker; yes.

Senator GLASS. Very well, sir. We will be glad to hear you. You may make any statement with respect to the pending bills that you care to make.

Mr. ZIMMERMAN. First of all, I feel that I owe an expression of gratitude to you men for making this concession. I hesitated very much to request the appearance, but you have been very kind.

My comment is not intended especially to deal with presenting any consideration of the administrative features of what is proposed in the Banking Act of 1935, because I have read the statements made by Mr. Aldrich of New York, and they seem to me to be sound and dependable so far as working within the Federal Reserve System is concerned.

With regard to title I of the bill, which has to do with the Federal insurance of deposits, I should like to present an impression that I gained in my contacts with bankers generally, to the effect that the provision now contained in the Senate bill of a discretionary assessment of one-twelfth of 1 percent would be acceptable to the rank and file of the smaller banks. I happen to be able to get around quite a bit in my contacts, since I am also secretary of the Pennsylvania Bankers Association, and I find that there is a good deal of disquiet over the idea that the rate might possibly be fixed at one-eighth of 1 percent.

With that in mind we have in Pennsylvania collected data directly from 67 banks, which I would like to leave with the committee, showing the percentage of earnings during recent years that an assessment of one-eighth of 1 percent would mean to the banks in the various classes to which I have referred. The name of each bank can be readily obtained, but we have classified them with just a number under various classifications.

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For instance, banks with resources under $1,000,000 show losses for each of the years that are presented here, 6 years, from 1929 to 1934, inclusive.

Banks with resources of $1,000,000 to $2,000,000 show loss in at least half the years, and the variation in the percentage of an assessment of one-eighth of 1 percent runs from 2.6 percent of the net earnings of the bank to 100 percent of the net earnings. That has to do with eight banks.

In the third classification we have records of 26 banks with resources of over $2,000,000 and less than $5,000,000, and there the variation runs from a percentage of 1.5 to 329 percent.

Then, in the fourth class, banks with resources over $5,000,000, taking into account 13 banks, it is shown that the variation runs from 6.3 percent to 100 percent of their net earnings during this period.

Senator COUZENS. This is based on one-eighth of 1 percent?

Mr. ZIMMERMAN. Yes. In country banks we have a record of four banks with resources under $2,000,000, which show a variation from 2.26 percent to 52.15 percent.

We have 12 banks with resources of over $2,000,000 and less than $5,000,000, showing a variation from 2.33 percent to 50 percent.

We have three banks with resources over $5,000,000, showing a variation from 6.07 percent to 86.8 percent.

If the names of the banks should be desired, we could very readily supply them to the committee. I would like to have the data inserted in the record.

Senator GLASS. That may be done.

(The statement referred to and submitted by the witness is here printed in full, as follows:)

On basis of one-eighth of 1 percent Federal Deposit Insurance Corporation assessment per year

1. Banks with resources under $1,000,000 (no. 4 shows loss every year except 1929)	1
2. Banks with resources from 1 to 2 million (no. C, 26, 29, 32 show losses in at least half the years and variation of percent in all runs from 2.6 to 100 percent)	8
3. Banks with resources over 2 million but less than 5 (nos. 3, 5, 10, 15, 7, L, 25, 27, 30, 31, 33, 38, show loss from 1 to 3 years and variation in percentage runs from 1.5 to 329 percent)	26
4. Banks with resources over 5 million (all but no. I show losses from 1 to 4 years and variations in percentage runs from 6.3 to 100 percent)	13
Total	48
Country banks only:	
1. Banks with resources under 2 million (no. C shows loss 3 years variation in percentage from 2.26 to 52.15 percent)	4
2. Banks with resources over 2 million but less than 5 (nos. 7 and L show loss 3 years and 1 year and variation in percentage from 2.33 to 50 percent)	12
3. Banks with resources over 5 million (nos. 22 and M show loss 1 year and 2 years and variation in percentage from 6.7 to 86.8 percent)	3
Total	19

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Resources and earnings required for Federal Deposit Insurance Corporation Assessment

	Year	Resources	Earnings
			Percent
3	1929	$4,267,000	11.3
	1930	4,146,000	14.6
	1931	3,077,000	17.1
	1932	2,696,000	(1)
	1933	2,390,000	(1)
	1934	2,477,000	57
4	1929	955,000	19
	1930	980,000	(2)
	1931	730,000	(2)
	1932	642,000	(2)
	1933	606,000	(2)
	1934	501,000	(2)
5	1929	3,809,515	27
	1930	3,365,068	(2)
	1931	3,016,961	(2)
	1932	2,535,524	(2)
	1933	2,422,245	22
	1934	2,507,955	22
6	1929	2,099,289	10
	1930	2,057,742	96
	1931	1,719,040	75
	1932	1,496,424	(2)
	1933	1,409,910	(2)
	1934	1,405,176	(2)
8	1929	5,805,272	9.2
	1930	5,374,651	15.2
	1931	4,793,556	12.4
	1932	4,007,890	30.1
	1933	3,880,569	11
	1934	4,382,199	21.6
9	1929	9,027,634	21.14
	1930	9,199,728	28.56
	1931	7,204,532	(2)
	1932	6,781,217	(2)
	1933	6,506,143	(2)
	1934	6,554,932	(2)
10	1929	5,199,000	4.6
	1930	4,966,000	7.6
	1931	4,099,000	14.0
	1932	3,709,000	(2)
	1933	3,242,000	(2)
	1934	3,668,000	(2)
13	1929	3,004,000	8.3
	1930	3,580,000	17.57
	1931	3,348,600	10.75
	1932	2,597,200	16.7
	1933	2,580,200	12.51
	1934	2,595,000	7.8
15	1929	5,996,548	10.7
	1930	5,747,776	329
	1931	4,925,504	(2)
	1932	4,127,223	(2)
	1933	3,629,184	(2)
	1934	3,654,529	32.3
17	1929	7,600,000	7.3
	1930	7,200,000	43
	1931	6,000,000	(2)
	1932	4,900,000	(2)
	1933	4,371,000	(2)
	1934	1,576,000	(2)
18	1929	2,745,529	12.6
	1930	2,525,639	24.1
	1931	1,818,538	3.8
	1932	1,251,514	1.5
	1933	899,325	3.7
	1934	813,727	22.3
17	1929	2,833,000	3.9
	1930	2,690,000	6.3
	1931	2,418,000	14.6
	1932	2,079,000	(2)
	1933	1,962,000	(2)
	1934	1,630,000	(2)
14	1929	2,787,000	6
	1930	2,823,000	9
	1931	3,404,000	12
	1932	2,942,000	11.5
	1933	2,899,000	11.5
	1934	2,776,000	8

	Year	Resources	Earnings
			Percent
16	1929	$3,272,383	16
	1930	3,108,157	37
	1931	2,909,573	.3
	1932	2,717,582	50
	1933	2,615,425	48
	1934	3,079,848	22
22	1929	8,087,789	9.16
	1930	7,402,625	10.83
	1931	6,499,935	10.13
	1932	6,015,937	(2)
	1933	6,067,187	86.8
	1934	6,778,107	47.8
1	1934	3,210,630	20.8
2	1933	890,727	44
	1934	1,273,792	8
12	1934	1,497,438	5
A	1929	1,928,852	2.26
	1930	1,831,784	52.15
	1931	1,394,500	14.45
	1932	1,117,700	43.7
	1933	1,065,773	9.44
	1934	1,196,123	9.29
B	1929	5,623,795	9.4
	1930	5,399,203	10.8
	1931	4,710,483	9.1
	1932	4,068,595	14.3
	1933	3,750,135	12.6
	1934	3,515,012	10.57
C	1929	1,677,042	4.6
	1930	1,531,234	2.6
	1931	1,386,234	4.3
	1932	1,348,947	(2)
	1933	1,236,542	(2)
	1934	1,208,874	(2)
D	1929	3,233,914	9
	1930	3,244,171	9.2
	1931	2,651,148	9
	1932	2,414,113	9.8
	1933	2,190,440	9.7
	1934	2,233,740	11.6
F	1929	2,928,374	3.9
	1930	2,914,211	4.4
	1931	2,772,742	4.9
	1932	2,391,158	4.7
	1933	2,400,538	5.6
	1934	2,667,730	8.8
G	1929	2,407,603	11.3
	1930	2,298,390	8.6
	1931	2,208,690	12.3
	1932	2,124,072	21.7
	1933	1,760,160	22.1
	1934	2,051,235	16.8
H	1929	2,056,090	6.1
	1930	2,007,516	10.2
	1931	1,822,493	8.4
	1932	2,523,787	15.6
	1933	2,441,420	28.3
	1934	2,496,427	7.5
I	1929	5,364,547	6.8
	1930	5,821,015	6.7
	1931	6,400,858	8.5
	1932	5,990,256	13.7
	1933	6,250,469	10.5
	1934	7,174,370	8
J	1929	4,858,981	7.6
	1930	4,798,928	7
	1931	4,933,641	13.9
	1932	4,302,550	9.5
	1933	4,365,891	14.5
	1934	3,584,843	11.3
K	1929	3,312,712	4.2
	1930	3,291,445	6
	1931	3,022,923	5.8
	1932	2,851,766	5.3
	1933	2,703,781	6.3
	1934	2,767,077	5.9
L	1929	4,155,875	2.33
	1930	4,214,224	7.33
	1931	3,790,159	6

Footnotes bottom of table.

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Resources and earnings required for Federal Deposit Insurance Corporation Assessment—Continued

	Year	Resources	Earnings		Year	Resources	Earnings
			Percent				*Percent*
14	1932	$3,106,951	20	29	1934	$1,437,000	(2)
	1933	3,055,439	(2)	30	1933	2,971,000	(2)
	1934	3,123,474	8.33		1934	2,805,000	35.3
M	1929	6,520,294	9.13	31	1933	3,575,000	(2)
	1930	7,010,703	12.95		1934	3,638,000	(2)
	1931	7,703,708	(2)	32	1933	1,617,000	22.5
	1932	7,338,035	23.8		1934	3,650,000	(2)
	1933	7,765,523	(2)	33	1932	3,689,000	12.9
	1934	7,683,983	28.4		1933	3,505,000	(2)
23	1930	15,891,000	12.6		1934	4,017,000	21.7
	1931	13,678,000	(2)	34	1930	5,247,000	16.4
	1932	11,527,000	(2)		1931	5,946,000	100
	1933	11,725,000	(2)		1932	5,429,000	(2)
	1934	11,860,000	(2)		1933	5,826,000	(2)
24	1930	10,814,000	100		1934	7,056,000	(2)
	1931	10,521,000	61.5	35	1933	2,210,000	(2)
	1932	9,835,000	80		1934	2,238,000	7.1
	1933	10,176,000	(2)	36	1930	8,169,000	22.7
	1934	10,813,000	(2)		1931	8,550,000	39.5
25	1932	3,892,000	16.7		1932	7,436,000	(2)
	1933	3,752,000	100		1933	7,454,000	(2)
	1934	3,866,000	(2)		1934	6,894,000	(2)
26	1930	639,000	(2)	37	1930	14,107,000	10.7
	1931	1,053,000	16.6		1931	15,053,000	10.9
	1932	1,119,000	22.9		1932	13,473,000	(2)
	1933	1,599,000	(1)		1933	12,632,000	(2)
	1934	1,727,000	12		1934	12,919,000	(2)
27	1932	3,204,000	(2)	38	1933	2,765,000	(2)
	1933	3,075,000	78.2		1934	2,611,000	50.2
	1934	2,909,000	48.8	39	1930	7,017,000	15.7
28	1930	6,074,000	7.9		1931	6,854,000	(2)
	1931	5,407,000	7.5		1932	5,199,000	(2)
	1932	4,726,000	(2)		1933	5,176,000	(2)
	1933	4,851,000	11.7		1934	5,118,000	(2)
	1934	4,531,000	(2)	40	1930	5,793,000	6.3
29	1930	1,493,000	100		1931	4,833,000	10.1
	1931	1,397,000	(2)		1932	4,868,000	34.5
	1932	1,264,000	(2)		1933	4,998,000	(2)
	1933	1,192,000	(2)		1934	5,262,000	(2)

[1] All. [2] Loss.

Mr. ZIMMERMAN. I feel that that might be helpful to the committee in attempting to arrive at the right percentage from the standpoint of operating banks.

We, of course, realize that the permanent insurance of deposits is a most desirable result to accomplish. I find that bankers everywhere are desirous of doing what they reasonably can to help make the permanent insurance of deposits stand up. At the same time, there is quite a good deal of concern as to how much money those banks would have involved in the way of an insurance payment from year to year. I have the idea that one-twelfth of 1 percent which, as I understand, has been developed on the basis of reasonable actuarial figures by the F. D. I. C. itself, would meet the situation very well, and I believe that it would have the support of banks, both State and national everywhere.

With regard to the relationship of the Federal Deposit Insurance Corporation to the other coordinated agencies of the Federal Government, it seems to me that there is a situation that requires special study and further investigation before the exact status of the F. D. I. C. in respect to banks in receivership can reasonably well be determined.

As I sat here today listening to Dr. Miller's presentation I have been impressed very deeply with this thought, that in the changes

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that are contemplated now in the set-up of the Federal Reserve System, as set forth in title II, we have so many issues running out of the Federal Government where there are loose ends that need tying together before the procedure can really be effective from the standpoint of assurance that country banks would have in adjusting the business of their particular institutions to an entirely new set-up in the Federal Reserve System, that without question I feel that it would be wise and prudent for this whole question of title II to be resolved into a study commission, which would be directed, for instance, by the Senate Banking and Currency Committee.

I would like to speak just for a moment of some of the considerations which I realize are moving in the mind of country bankers in their attempt to adjust themselves to all of the new conditions. I have just finished reading in detail a statement of Governor Eccles, and I find many things in it that stimulate my own thinking as indicated by marginal notes; but the conclusion that my mind inevitably reached as I have gone through these details and realized the tremendous readjustments that would have to be made all along the line in respect to the business of small banks was that time ought to be taken for a comprehensive survey of the ability with which the smaller bank may be able to readjust itself to these proposals in title II. For instance, some of the thoughts that have come up in that connection have to do with reserves. It is a very grave question in the mind of the small banker as to his ability to accommodate his business to a constantly shifted requirement for reserves for his own institution.

Another subject that it seems to me requires very careful consideration is the rate that might be authorized under title II as applied to mortgage loans of various classes; for instance, in contrasting centrally located city real estate with agricultural properties in the West.

Senator GLASS. You would prefer a statutory reserve to varying and changing reserves by a Federal board?

Mr. ZIMMERMAN. Senator, I feel that the statement of Mr. Aldrich on that subject is just about the last word from the standpoint of the dependability of the regulation.

Another feature that appeals to me as being exceedingly grave in this whole situation, particularly with regard to the country bank, is the question of a proper coordination of supervisory policies. We have seen the evidence of that coming out of Washington because of the new instrumentalities that have been set up in the banking field with regard to one or another type of control over the banking business. I need not cite those. They are just as familiar to you as to me. But when the smaller bank and the smaller sized banker, so to speak, finds that his institution is to be put upon the business end of differences in viewpoints as to supervisory authority, it is rather disquieting to him; and I feel that that is one of the situations that require the utmost of study and of common understanding before the new provisions of title II shall be put into effect.

And then, of course, dovetailing with the question of fixing the rights of these various governmental agencies where banks are in receivership, and particularly as that relates itself to the work and the field of the country bank.

I do not wish to take unduly of your time, but I just happened to make a little memorandum, and it occurred to me as being in my

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papers when Dr. Miller was speaking about his viewpoint as to the ability of promoting business prosperity, let us say, by what apparently is contemplated in title II through a shifting of reserves or the handling of what is meant to benefit monetary assets in the banks.

It has already been demonstrated conclusively that inflation of credit and expansion of credit have very little, if any, effect on business recovery. In order for business to recover an entirely different set of forces is necessary. These forces grow out of the confidence of each individual business man, and such confidence is much more likely to be drawn in even to the point of entire disappearance because of artificial control of the processes of business and credit at Washington than because of all other economic and social forces combined. I believe, of course, that the growth of speculation in business can be shifted, even stopped, by fixing the rates for credit.

It is somewhat the same procedure as applying the brakes on an automobile. Brakes, however applied, will not start the car, nor will they keep it in motion. This requires a different force entirely, and this force is not so much a question of confidence on the part of big business as it is the confidence on the part of the rank and file of smaller business men in every city, town, and hamlet from one end of the country to the other. Interference of Government with private businesses kills the goose that laid the golden eggs. When confidence is abroad, credit and currency are sure to be put to work—in other words, employment. When it is not abroad, there is nothing that can be found that will open up a prosperity period.

That may seem a gratuity, and yet it grows out of my observations in a rather limited field as to just what are some of the essential elements with respect to this business recovery which we so greatly desire in every section of the United States.

I think that is all I care to say with reference to title II.

With respect to title III, I need not remind this committee that there is a very great anxiety on the part of country bankers everywhere in respect to the effective date, namely, June 16, of the prohibition against loans to executive officers of banks in the portfolio of the banks with which they are associated. I have been receiving quite a good many letters indicating the gravity of that situation. I am told that the Comptroller's office is thoroughly aware of the need for that provision being made noneffective at least at this time, and I hope that the postponement at least until 1938 may be made effective.

In that connection I should like to say that while undoubtedly in some of the banks there probably have been abuses in connection with an executive officer making use of the funds of the bank, I am also convinced that in the vast majority of what we call the "ordinary banks", the loans to executive officers have been made by and with the approval, the full approval, of the board of directors at the time such loans were placed on the books of the bank; and therefore I feel that it is entirely fair not to draw too quick or too strong a line of discrimination as against honest-hearted and honest-purposed men in respect to the assuming of personal obligations within the bank. I sincerely hope that title III may be agreed upon and put through in time to save so many bankers who are fine, upstanding men from being classified as criminals, because they have

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been expecting this postponement to come through in time to relieve them of that liability.

That is all I have to say, Senator; and I again wish to thank you.

Senator GLASS. Yours is a national bank, is it?

Mr. ZIMMERMAN. Yes, sir.

Senator GLASS. What particular advantage is there in a national-bank charter with the rate of circulation eliminated?

Mr. ZIMMERMAN. As a matter of fact, we have regarded that as a purely negligible privilege. Recently we have anticipated that it might be ended at any time, so that the fact has not brought any reaction, so far as I know, at all, on the part of the country banker.

Senator GLASS. What particular advantage has your bank over a competing State bank because of your national charter?

Mr. ZIMMERMAN. From the standpoint of earnings, perhaps none; and I am rather disposed to feel that for the sake of uniform practices in banking we do not deserve any.

Senator GLASS. What I have in mind is this. If, as is proposed, thousands of nonmember State banks are to be permitted to enjoy the privilege of the insurance of deposit provisions of the law, without subjecting themselves to the restrictions and supervision of the Federal Reserve authorities and the Comptroller of the Currency, what particular inducement is there to a national bank to remain in the system and subject itself to such supervision and, as under this bill, subservience to a Washington board?

Mr. ZIMMERMAN. I think that all bank directors feel that for their particular institution there is a very splendid anchor to windward in the F. D. I. C. I believe that experience will guide the State-chartered institution within a reasonable time to accept membership in the Federal Reserve System when they can feel that these various supervisory agencies have been coordinated and their activities regulated by law so that they do not have to come on the business end of difficulty from which they would naturally recoil.

There are, for instance, duplicate examinations. I cannot see how a State-chartered bank would voluntarily wish to subject itself to duplicate examinations, and I think there is no practical reason why methods might not be devised whereby a uniform single examination could be set up for direct State-chartered institutions.

Senator GLASS. That has been proposed, but that is one of the many activities of the controlling authority, the question of examinations. I just do not understand why a national bank in the circumstances should care to remain a national bank if it may operate under a State charter and avail itself of all of the privileges and facilities that are afforded a State bank greater than those of a national bank in many respects. Why should a bank want to remain a national bank?

Mr. ZIMMERMAN. Senator, I think that all bankers realize that there is a tendency which is likely to be a growing tendency toward uniformity, at least, in banking practices in this country. I think that every national bank officer and every national bank director today would hestitate, except under convictions of extreme danger, to leave the national banking system—I mean, danger in respect to the undermining of its earning power through an inordinate levy for F. D. I. C. or the requirement of setting up excessive reserves as

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now would be possible under title II as proposed. I believe there has never been a time in my career when there was as much general allegiance felt toward the national banking system as there is at this time.

Senator GLASS. And I do not want to see that impaired.

Mr. ZIMMERMAN. I think you will not have to impair it if these questions that are now pressing for attention are not resolved too much to the disadvantage of the national banks.

I might say to you that I received a letter just the other day from a banker whose bank is quite liquid, a national bank, and he said:

> I do not like to see the idea of our institution misused either on the basis of Federal Deposit Insurance Corporation assessment—

And he meant up to one-eighth of 1 percent—

> or on the basis of having, under title II, as proposed, an excessive amount of idle money to be going into the Federal Reserve System.

And he expressed himself in a way that I felt he meant just that.

Sentiment, so far as I can understand it—and I think I have a fair right to speak of that—will thoroughly sustain an assessment which does not need to be arbitrary, but according to the needs of the system, up to one-twelfth of 1 percent of deposits.

I say, however, that there is a problem that needs a good deal of study in this respect. Where you have a bank in which a large proportion of the deposits run excessively beyond $5,000 so that the insured coverage is only a small percentage of such deposits, you have to consider this practical question in the mind of the banker as to whether or not he can justify an inordinate amount of payment every year to the Federal Deposit Insurance Corporation, if at the same time he does not feel that the deposit insurance is either necessary or dependent to any great extent either upon his stockholders or his depositors. There is a very sympathetic desire to establish a permanent insurance of deposits, but I think the Federal Reserve System and the national banking system can carry that through very successfully if they will be modest in respect to the amounts that are exacted in order to keep the banks in operation.

Senator GLASS. I think our committee—of course, I do not know—is rather disposed to deal with that question in a liberal way. But what I have in mind is to refrain from doing anything that might cause many national banks to leave the Federal Reserve System.

Mr. ZIMMERMAN. May I add this thought to what I have already said, that there is no sentiment abroad that I can detect calling for any immediate need of these rather radical changes in the present set-up of the Federal Reserve System. I have been quite shocked to think that such proposals, at a time like this, should be advanced, with the pressure that apparently is behind them. It seems to me that we have a banking temper in the country today that would very much prefer to see the Federal Reserve System carrying on for the time being, at least, just about on the same basis as it has been heretofore.

Senator GLASS. What do you think is the pressure behind it?

Mr. ZIMMERMAN. Senator, I have a very deeply founded conviction that we are suffering in Washington from, to put it plainly, a greed for power. I do not like to cast aspersions against any indi-

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vidual or upon any group of individuals, but I have deplored more than I can say the thought that our processes of government should, so to speak, be reaching out in autocratic ways, which seem to me to be characteristic somewhat of what is provided in title II of this bill.

Senator GLASS. This bill has been spoken of as an administration bill. I call attention to the fact that in the letter of the President forwarding this bill to the respective Banking and Currency Committees, he spoke of it simply as the tentative draft of a bill, and merely asked that those who were responsible for it might be heard. So far, with the exception of Governor Eccles, there has been no witness before the Banking and Currency Committee of either House of Congress to advocate this bill in an unqualified way. So I wondered what you imagined the pressure was.

Mr. ZIMMERMAN. Well, I, of course, happen to be a Republican, and I think perhaps it would be more becoming in me not to say anything more about my impressions in that respect.

Senator GLASS. I will not press you any further.

Mr. ZIMMERMAN. I do not feel that I am or ever shall be narrowly partisan.

Senator GLASS. I do not think politics ought to have a thing in the world to do with it.

Mr. ZIMMERMAN. I wish to thank you very much for your kind consideration.

Senator GLASS. We are obliged to you.

The subcommittee will adjourn until next Monday morning at 10:30.

(Whereupon, at 4:50 p. m., the subcommittee adjourned until Monday, May 27, 1935, at 10:30 a. m.)

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