BANKING ACT OF 1935

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

SEVENTY-FOURTH CONGRESS

FIRST SESSION

ON

S. 1715 and H. R. 7617

BILLS TO PROVIDE FOR THE SOUND, EFFECTIVE, AND UNINTERRUPTED OPERATION OF THE BANKING SYSTEM, AND FOR OTHER PURPOSES

[CONSOLIDATED]

APRIL 19 TO JUNE 3, 1935

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BANKING ACT OF 1935

FRIDAY, APRIL 19, 1935

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

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

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

Present also: Senator Fletcher.

Senator GLASS (chairman of the subcommittee). The committee will please come to order.

Senator FLETCHER. Mr. Chairman, it might be appropriate at the beginning of your hearings today to insert a letter which I received from the President on February 4, 1935; and following that, the bill. I think that is desirable.

Senator GLASS. I think that would be desirable.

Senator FLETCHER. So I will ask to have inserted this letter addressed to me.

THE WHITE HOUSE,
Washington, February 4, 1935.

Hon. DUNCAN U. FLETCHER,
Chairman Banking and Currency Committee,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: I have had a number of conferences regarding three banking matters which are to some extent interrelated and which affect the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Office of the Comptroller of the Currency. I have discussed these matters with Mr. Leo T. Cromley, Chairman of the Federal Deposit Insurance Corporation; Mr. Marriner S. Eccles, Governor of the Federal Reserve Board; and Mr. J. F. T. O'Connor, Comptroller of the Currency. I have asked the representatives of the various departments and agencies affected to give consideration to the matters discussed.

For the information of your committee they have prepared a tentative draft of legislation and I am asking the gentlemen named to give the benefit of the results of their discussions to you as Chairman of the Banking and Currency Committee of the Senate.

I shall be glad to have you call them before your committee for further information if you desire.

Very sincerely yours,

FRANKLIN D. ROOSEVELT.

Senator FLETCHER. I assume a similar communication was addressed to Mr. Steagall, chairman of the Banking and Currency Committee of the House; and on February 5 Mr. Steagall introduced the bill in the House. The Senate was in recess on that day, and on February 6 I introduced the bill in the Senate, which may be set forth in your record as the pending bill.

Senator GLASS. Yes.

(The bill, S. 1715, is made a part of the record, in full, as follows:)

[S. 1715, 74th Cong., 1st sess.]

A BILL To provide for the sound, effective, and uninterrupted operation of the banking system, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, This Act may be cited as the "Banking Act of 1935."

TITLE I

Section 12B of the Federal Reserve Act, as amended (U. S. C., Supp. VII, title 12, sec. 264), is further amended as follows:

1. By striking out subsection (a) and inserting in lieu thereof the following:

"(a) There is hereby created a Federal Deposit Insurance Corporation (hereinafter referred to as the 'Corporation'), which shall insure, as hereinafter provided, the deposits of all banks which are entitled to the benefits of insurance under this section, and which shall have the right to exercise all powers hereinafter granted."

2. By adding at the end of subsection (b) the following:

"In the event of a vacancy in the office of the Comptroller of the Currency, and pending the appointment of his successor, the Acting Comptroller of the Currency shall be a member of the board of directors in his place and stead In the absence of the Comptroller of the Currency any Deputy Comptroller of the Currency may, within the limits prescribed by the Comptroller, act as a member of the board of directors in his place and stead."

3. By inserting a new subsection to read as follows:

"(c) As used in this section—

"(1) The term 'State bank' means any bank, banking association, trust company, savings bank, or other banking institution which is engaged in the business of receiving deposits and which is incorporated under the laws of any State or the Territories of Hawaii or Alaska or which is operating under the Code of the District of Columbia (except a national bank).

"(2) The term 'State member bank' means any State bank which is a member of the Federal Reserve System, and the term 'State nonmember bank' means any other State bank.

"(3) The term 'District bank' means any State bank operating under the Code of the District of Columbia.

"(4) The term 'national member bank' means any national bank located in the States of the United States, the District of Columbia, or the Territories of Hawaii or Alaska, except a national nonmember bank as hereinafter defined.

"(5) The term 'national nonmember bank' means any national bank located in the Territories of Hawaii or Alaska which is not a member of the Federal Reserve System.

"(6) The term 'mutual savings bank' means a bank without capital stock transacting a savings bank business, the net earnings of which inure wholly to the benefit of its depositors after payment of obligations for any advances by its organizers.

"(7) The term 'insured bank' means any bank the deposits of which are insured in accordance with the provisions of this section, and the term 'noninsured bank' means any other bank.

"(8) The term 'new bank' means a new national banking association organized by the corporation to assume the insured deposits of an insured bank closed on account of inability to meet the demands of its depositors and otherwise to perform temporarily the functions provided in this section.

"(9) The term 'receiver' shall include a receiver, liquidating agent, conservator, commission, person, or other agency charged by law with the duty of winding up the affairs of a bank.

"(10) The term 'board of directors' means the board of directors of the corporation.

"(11) The term 'deposit' means 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 as provided in paragraph (5) of subsection (h) of this section, together with such other obligations of a bank as the board of directors shall find and shall prescribe by its regulations to be deposit liabilities by general usage: *Provided*, That any obligation of a bank which is payable only at an office of the bank located outside the States of the United States, the District of Columbia, and the Territories of Hawaii and Alaska shall not be a deposit for purposes of this section or be included as a part of total deposits or of an insured deposit. The board of directors may by regulation further define the terms used in this paragraph.

"(12) The term 'insured deposit' means such part of the net amount of money due to any depositor for deposits in an insured bank, after deducting offsets, as shall not exceed the maximum prescribed by paragraph (1) of subsection (l) of this section. Such amount shall be determined according to such regulations as the board of directors may prescribe. In determining the amount due to any depositor there shall be added together all deposits in the bank maintained in the same capacity and the same right for his benefit either in his own name or in the names of others, except trust funds which shall be insured as provided in paragraph (5) of subsection (h) of this section.

"(13) The term 'transferred deposit' means a deposit in a new bank or other insured bank made available to a depositor by the corporation as payment of the insured deposit of such depositor in a closed bank, and assumed by such new bank or other insured bank.

"(14) The term 'effective date' means the date of enactment of the title containing this amendment."

4. By striking out in subsection (c) the following: "(c)" and inserting "(d)"; by striking out in said subsection (c) that part of the third sentence following the words "Federal Reserve banks" in said sentence and inserting a period; by striking out in subsection (d) the following: "(d)" and the first four sentences of said subsection (d); and by striking out in the fifth sentence of said subsection the following: "class B"; and by inserting at the end of subsection "(d)" the following: "The capital stock of the corporation shall consist of the shares subscribed for prior to the effective date. Such stock shall be without nominal or par value, and shares issued prior to the effective date shall 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 the capital stock shall be allocated to capital and to surplus in such amounts as the board of directors shall prescribe. Such stock shall have no vote and shall not be entitled to the payment of dividends."

5. By striking out subsection (e) and inserting in lieu thereof the following:

"(e) (1) Every operating member bank, including a bank incorporated since March 10, 1933, licensed on or before the effective date by the Secretary of the Treasury shall be and continue without application or approval an insured bank and shall be subject to the provisions of this section.

"(2) After the effective date any national member bank authorized to commence or resume the business of banking, State bank converting into a national member bank, or State bank becoming a member of the Federal Reserve System shall be an insured bank from the time the certificate herein prescribed shall be issued to the Corporation by the Comptroller of the Currency in the case of such national member bank, or by the Federal Reserve Board in the case of such State member bank. *Provided*, That in the case of an insured bank admitted to membership in the Federal Reserve System or insured State bank converting into a national member bank, such certificate shall not be required, and the bank shall continue as an insured bank. Such certificate shall state that the bank is authorized to transact the business of banking in the case of a national member bank, or is a member of the Federal Reserve System in the case of a State member bank, and that consideration has been given to the factors enumerated in subsection (g) of this section."

6. By striking out subsection (f) and inserting in lieu thereof the following:

"(f) (1) Every bank not a member of the Federal Reserve System which on the effective date is a member of the Temporary Federal Deposit Insurance Fund or of the Fund for Mutuals created pursuant to the provisions of an Act approved June 16, 1933 (48 Stat. 168, ch. 89), as amended June 16, 1934 (48 Stat. 969, ch. 546), shall be and continue without application or approval an insured bank and shall be subject to the provisions of this section, unless in accordance with regulations to be prescribed by the board of directors such bank shall give to the corporation within thirty days after the effective date written notice of its election not to continue after June 30, 1935, as an insured bank and shall give to its depositors, by publication or by any reasonable means, as the board of directors may prescribe, not less than twenty days' notice prior to June 30, 1935, of such election: *Provided,* That any State nonmember bank which was admitted to said Temporary Federal Deposit Insurance Fund or Fund for Mutuals but which did not file on or before the effective date of October 1, 1934, certified statement and make the payment thereon required by law as it existed prior to the effective date, shall cease to be an insured bank on June 30, 1935: *Provided further,* That no bank admitted to the said Temporary Federal Deposit Insurance Fund or the Fund for Mutuals prior to the effective date shall, after June 30, 1935, be an insured bank or have its deposits insured by the corporation, if such bank shall have permanently discontinued its banking operations prior to the effective date. Deposits of the bank giving such notice shall continue to be insured until June 30, 1935, and the rights of the bank shall be as provided by law existing prior to the effective date, and such bank shall not be insured by the Corporation beyond June 30, 1935.

"(2) Until July 1, 1937, any national nonmember bank, on application by the bank and certification by the Comptroller of the Currency in the manner prescribed in subsection (e) of this section and until such date any State nonmember bank, upon application to and examination by the Corporation and approval by the board of directors, may become an insured bank. Before approving the application of any such State nonmember bank, the board of directors shall give consideration to the factors enumerated in subsection (g) of this section and shall determine, upon the basis of a thorough examination of such bank, that its assets in excess of its capital requirements are adequate to enable it to meet all of its liabilities as shown by the books of the bank to depositors and other creditors."

7. By striking out subsection (g) and inserting in lieu thereof the following:

"(g) The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors under subsection (f) shall be the following: 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."

8. 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 average determined from such total as of the close of business 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 provide for a refund or credit by a percentage upon the last annual assessment 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. 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.

"(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 amount of its liability for deposits as of the close of business on the 30th day of June last preceding 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 deposits on the date for which such statement is made. On or before the 15th day of January of each year each insured bank shall file a like statement showing the total amount of its liability for deposits as of the close of business on the 31st day of December last preceding, 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 deposits on the date for which such statement is made.

"(3) Every bank which becomes an insured bank after the effective date and on any date more than thirty days before the next succeeding last day of June or December of any year shall pay to the Corporation as an initial assessment the prorated portion for the period between the date such bank became an insured bank and the next succeeding last day of June or December, as the case may be, of an amount equal to one-half the annual assessment rate provided in this section multiplied by its total deposits at the close of business on the 15th day after it becomes an insured bank. In all other cases the initial assessment upon a bank which becomes an insured bank after the effective date shall be the assessment payable according to paragraphs (1) and (2) of this subsection.

"(4) Each bank which shall be and continue without application or approval an insured bank in accordance with the provisions of subsection (e) or (f) of this section, shall, in lieu of all right to refund, be credited with any balance to which such bank shall become entitled upon the termination of said Temporary Federal Deposit Insurance Fund or the Fund for Mutuals. The credit shall be applied by the corporation toward the payment of the assessment next becoming due from such bank and upon succeeding assessments until the credit is exhausted.

"(5) Trust funds held by an insured bank in a fiduciary capacity whether held in its trust or deposited in any other department or in another bank shall be insured subject to a $5,000 limit for each trust estate and when deposited by the fiduciary bank in another insured bank, shall be similarly insured to the fiduciary bank according to the trust estates represented. Notwithstanding any other provision of this section, such insurance shall be separate from and additional to that covering other deposits of the owners of such trust funds or beneficiaries of such trust estates: *Provided*, That where the fiduciary bank deposits any of such trust funds in other insured banks, the amount so held by other insured banks on deposit on the last day of the month preceding the filing of the certified statement required by paragraph (2) of subsection (h) of this section 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. The board of directors shall have power by regulation to prescribe the manner of reporting and of depositing such funds."

9. By striking out subsection (i) and inserting in lieu thereof the following:

"(i) (1) Any insured bank (except a national member bank or State member bank) may, upon not less than ninety days' written notice to the Corporation, terminate its status as an insured bank. Whenever the board of directors shall find that an insured bank or its directors or trustees have continued unsafe or unsound practices in conducting the business of such bank or have knowingly or negligently permitted any of its officers or agents to violate repeatedly any provision of this section or of any regulation made thereunder, or of any law or regulation made pursuant to law to which the insured bank is subject, the board of directors shall first give to the Comptroller of the Currency in the case of a national bank or district bank, to the authority having supervision in case of a State bank, and also to the Federal Reserve Board in case of a State member bank, a statement of such violation by the bank for the purpose of securing a correction of such practices or conditions. Unless such correction shall be made within such period of time not exceeding one hundred and twenty days as the Comptroller of the Currency, the State authority, or Federal Reserve Board, as the case may be, shall require, the board of directors, if it shall determine to proceed further, shall give to the bank not less than thirty days' written notice of intention to terminate the status of the bank as an insured bank, fixing a time and place for a hearing before the board of directors or before a person designated by it to conduct such hearing, at which evidence may be produced, and upon such evidence the board of directors shall make written findings which shall be conclusive. Unless the bank shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the termination of its status as an insured bank. If the board of directors shall find that any ground specified in such notice has been established, the board of directors may order that the insured status of the bank be terminated on a date subsequent to such finding and to the expiration of the time specified in such notice of intention. The Corporation may publish notice of such termination and the bank shall give notice of termination to its depositors in such manner and at such time as the board of directors may find necessary and may order for the protection of depositors. After termination of the insured status of any bank under the provisions of this paragraph, the insured deposits of each depositor in the bank on the date of such termination, less all subsequent withdrawals, shall continue for a period of two years to be insured and the bank shall continue to pay to the Corporation assessments as in the case of an insured bank for such period of two years from such termination, but no additions to any deposits or any new deposits shall be insured by the Corporation, and the bank shall not advertise or hold itself out as having insured deposits unless in the same connection it shall state with equal prominence that additions to deposits and new deposits made after the date of such termination, specifying such date, are not insured. Such bank shall in all other respects be subject to the duties and obligations of an insured bank for the period of two years from such termination and in the event of being closed on account of inability to meet the demands of its depositors within such period of two years, the Corporation shall have the same powers and rights with respect to such bank as in case of an insured bank.

"(2) Whenever the insured status of a member bank shall be terminated by action of the board of directors, the Federal Reserve Board in the case of a State member bank shall terminate its membership in the Federal Reserve System in accordance with the provisions of section 9 of the Federal Reserve Act and in the case of a national member bank the Comptroller of the Currency shall appoint a receiver for the bank (to be the Corporation whenever the bank shall be unable to meet the demands of its depositors). Whenever a member bank shall cease to be a member of the Federal Reserve System, its statute as an insured bank shall without notice or other action by the board of directors terminate on the date of the taking effect of the termination of membership of the bank in the Federal Reserve System, with like effect as if terminated on said date by the board of directors after proceedings under paragraph (1) of this subsection (i).

"(3) When the liabilities of an insured bank for deposits shall have been assumed by another bank or banks, the insured status of such insured bank shall terminate on the receipt by the Corporation of satisfactory evidence of such assumption with like effect as if terminated on said date by the board of directors after proceedings under paragraph (1) of this subsection (i): *Provided,* That if such bank gives notice of such assumption within thirty days after such assumption takes effect to its depositors, by publication or by any reasonable means, in accordance with regulations to be prescribed by the board of directors, the insurance of its deposits shall terminate at the end of six months from the date such assumption takes effect and such bank shall be relieved of all future obligations to the Corporation, including the obligation to pay future assessments."

10. By striking out the period at the end of paragraph "Fourth" of subsection (j) and inserting a colon and the following: "*Provided,* That, notwithstanding any other provision of law, all suits of a civil nature at common law or in equity to which the Federal Deposit Insurance Corporation shall be a party shall be deemed to arise under the laws of the United States, and the district courts of the United States shall have original jurisdiction of all such suits; and the Corporation as defendant in any such suit may, at any time before the trial thereof, remove such suit from a State court into the district court of the United States for the proper district by following the procedure for the removal of causes otherwise provided by law. No attachment or execution shall be issued against the Corporation or its property before final judgment in any suit, action, or proceeding in any State, county, municipal, or United States court."; and by inserting at the end of said subsection the following:

"Eighth. To make examinations of and to require information and reports from banks, as provided in this section.

"Ninth. To act as receiver.

"Tenth. To prescribe by its board of directors such rules and regulations as it may deem necessary to carry out the provisions of this section."

11. By striking out in subsection (k) "(k)" and inserting in lieu thereof "(k) (1)"; and by adding to said subsection 3 new paragraphs to read as follows:

"(2) The board of directors shall appoint examiners, who shall have power on behalf of the Corporation (except as to a District bank) to examine any insured State nonmember bank, State nonmember bank making application to become an insured bank, or closed insured bank, whenever considered necessary. Such examiners shall have like power to examine, with the written consent of the Comptroller of the Currency, any national bank, or District bank and, with the written consent of the Federal Reserve Board, any State member bank. Each examiner shall have power to make a thorough examination of all of the affairs of the bank and in doing so he shall have power to administer oaths and to examine and take and preserve the testimony of any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of the bank to the Corporation. The board of directors in like manner shall appoint claim agents who shall have power to investigate and examine all claims for insured deposits and transferred deposits. Each claim agent shall have power to administer oaths and to examine under oath and take and preserve testimony of any persons relating to such claims. Any such examiner or claim agent in relation to any such examination, investigation, or taking of testimony may apply to any judge or clerk of any court of the United States to issue subpenas and to compel the appearance of witnesses and the production and taking of any such testimony and to punish disobedience in like manner as provided in sections 184–186 of the Revised Statutes (U. S. C., title 5, secs. 94–96).

"(3) Each insured State nonmember bank (except a District bank) shall make to the Corporation reports of condition in such form and at such times as the board of directors may require of such bank. The board of directors may require such reports to be published in such manner, not inconsistent with any applicable law, as it may direct. Every such bank which fails to make or publish any such report within such time, not less than five days, as the board of directors may require, shall be subject to a penalty of $100 for each day of such failure recoverable by the Corporation for its use.

"(4) The Corporation shall have access to reports of examinations made by and reports of condition made to the Comptroller of the Currency or any Federal Reserve bank, and may accept any report made by or to any commission, board, or authority having supervision of a State nonmember bank (except a District bank), and may furnish to the Comptroller of the Currency, or any such Federal Reserve bank, commission, board, or authority reports of examinations made on behalf of and reports of condition made to the Corporation."

12. By striking out all of subsection (1) preceding the last paragraph thereof and inserting in lieu thereof the following:

"(1) (1) The Temporary Federal Deposit Insurance Fund and the Fund for Mutuals are hereby consolidated into the permanent insurance for deposits created by this section and the assets therein shall be held by the Corporation for the uses and purposes of the Corporation: *Provided*, That the obligations to and rights of the Corporation, depositors, banks, and other persons arising out of any event or transaction prior to the effective date shall remain unimpaired. From the effective date the Corporation shall insure the deposits of all insured banks as defined and provided in this section. The maximum amount of the insured deposit of any depositor shall be $5,000.

"(2) An insured bank shall for the purposes of this section, 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 its depositors.

"(3) Notwithstanding any other provision of law, whenever any insured national bank or insured District bank shall have been closed by action of its board of directors or the Comptroller of the Currency, as the case may be, on account of inability to meet the demands of its depositors, the Comptroller of the Currency shall appoint the Corporation receiver for such closed bank and no other person shall be appointed as receiver of such closed bank.

"(4) It shall be the duty of the Corporation as such receiver to realize upon the assets of such closed bank, having due regard to the condition of credit in the district in which such closed bank is located; to enforce the individual liability of the stockholders and directors thereof; and to wind up the affairs of such closed bank in conformity with the provisions of law relating to the liquidation of closed national banks, except as herein otherwise provided, retaining for its own account such portion of the amount realized from such liquidation as it shall be entitled to receive on account of its subrogation to the claims of depositors and paying to depositors and other creditors the net amount available for distribution to them. With respect to such closed bank, the Corporation as such receiver shall have all the rights, powers, and privileges now possessed by or hereafter given a receiver of an insolvent national bank.

"(5) Whenever any insured State bank, except a District bank, shall have been closed by action of its board of directors or by the authority having supervision of such bank, as the case may be, on account of inability to meet the demands of its depositors, the Corporation shall accept appointments as receiver thereof, if such appointment be tendered by the authority having supervision of such bank and be authorized or permitted by State law. With respect to such insured State bank, the Corporation shall possess the powers and privileges given by State law to a receiver of such State bank.

"(6) When an insured bank shall have been closed on account of inability to meet the demands of its depositors, payment of the insured deposits shall be made by the Corporation, subject to the provisions of paragraph (7) of this subsection (1), either (a) by making available to each depositor a transferred deposit in a new bank or in another insured bank in the same community in an amount equal to the insured deposit of such depositor and subject to withdrawal on demand, or (b) in accordance with any other procedure adopted by the board of directors: *Provided,* That the Corporation, in its discretion, may require proof of claims to be filed before paying the insured deposits, and that in any case where the Corporation is not satisfied as to the validity of a claim for an insured deposit, it may require the final determination of a court of competent jurisdiction before paying such claim.

"(7) In the case of a closed national bank or District bank the Corporation, upon payment of any depositor as provided in paragraph (6) of this subsection (1), shall become and be subrogated to all rights of the depositor to the extent of such payment. In the case of any other closed insured bank, the Corporation shall not pay any depositor until the right of the Corporation to be subrogated to the rights of such depositor on the same basis as provided in the case of a closed national bank under this section shall have been recognized, by express provisions of State law, by allowance of claims by the authority having supervision of such bank, by assignment of claims by depositors, or by any other effective method. Such subrogation in the case of any closed bank shall include the right to receive the same dividends from the proceeds of the assets of such closed bank as would have been payable to such depositor on a claim for the insured deposit, such depositor retaining his claim for any uninsured portion of his deposit

"(8) As soon as possible, the Corporation, if it finds that it is advisable and in the interest of the depositors of the closed bank or the public, shall organize a new bank to assume the insured deposits of such closed bank and otherwise to perform temporarily the functions provided for in this section. The new bank shall have its place of business in the same community as the closed bank.

"(9) The articles of association and the organization certificate of the new bank shall be executed by representatives designated by the Corporation. No capital stock need be paid in by the Corporation. The new bank shall not have a board of directors, but shall be managed by an executive officer appointed by the board of directors of the Corporation and who shall be subject to its directions. In other respects such bank shall be organized in accordance with the existing provisions of the law relating to the organization of national bank associations. The new bank may, with the approval of the Corporation, accept new deposits, which shall be subject to withdrawal on demand. The new bank, without application or approval, shall be an insured bank and shall maintain on deposit with the Federal Reserve bank of its district the reserves required by law for member banks, but shall not be required to subscribe for stock of the Federal Reserve bank. Funds of the new bank shall be kept on hand in cash, invested in securities of the Government of the United States, or in securities guaranteed as to principal and interest by the Government of the United States, or deposited with the corporation, or with a Federal Reserve bank, or with an insured bank. The new bank, unless otherwise authorized by the Comptroller of the Currency, shall transact no business except that authorized by this section and such business as may be incidental to its organization. Notwithstanding any other provision of law it, its franchise, property, and income shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority.

"(10) On the organization of a new bank, the Corporation shall promptly make available to the new bank an amount equal to the estimated insured deposit of such closed bank plus the amount of its estimated expenses of operation and shall determine as expeditiously as possible the amount due each depositor for his insured deposit in the closed bank, and the total expenses of operation of the new bank. Upon determination thereof, the amounts so estimated and made available shall be adjusted to conform to the amounts so determined. Earnings of the new bank shall be paid over or credited to the Corporation in such adjustment. The new bank shall assume as transferred deposits the payment of the insured deposits of such closed bank to each of its depositors. Of the amount so made available, the Corporation shall transfer to the new bank, in cash, such amount as is necessary to enable it to meet expenses and immediate cash demands on such transferred deposits and the remainder shall be subject to withdrawal by the new bank on demand.

"(11) When in the judgment of the board of directors it is desirable to do so, the Corporation shall cause capital stock of the new bank to be offered for sale on such terms and conditions as the board of directors shall deem advisable, in an amount sufficient, in the opinion of the board of directors, to make possible the conduct of the business of the new bank on a sound basis, but in no event less than that required by section 5138 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 51), for the organization of a national bank in the place where such new bank is located, giving the stockholders of the closed bank the first opportunity to purchase any shares of common stock so offered. Upon proof that an adequate amount of capital stock in the new bank has been subscribed and paid for in cash, the Comptroller of the Currency shall require the articles of association and the organization certificate to be amended to conform to the requirements for the organization of a national bank, and thereafter, when the requirements of law with respect to the organization of a national bank have been complied with, he shall issue a certificate of authority to commence business to the bank, which shall thereupon cease to have the status of a new bank and shall be managed by directors elected by its own shareholders and may exercise all the powers granted by law and shall be subject to all of the provisions of law relating to national banks. Such bank shall thereafter be an insured national bank, without certification to or approval by the Corporation.

"(12) If the capital stock of the new bank shall not be offered for sale, or if an adequate amount of capital for such new bank is not subscribed and paid in, the board of directors may offer to transfer its business to any insured bank in the same community which will take over its assets, assume its liabilities, and pay to the Corporation for such business such amount as the board of directors may deem adequate; or the board of directors in its discretion may change the location of the new bank to the office of the Corporation or to some other place or may at any time wind up its affairs as herein provided. Unless the capital stock of the new bank is sold or its assets acquired and its liabilities assumed by an insured bank, as provided above, within two years from the date of its organization, the Corporation shall wind up its affairs, after giving such notice, if any, as the Comptroller of the Currency may require, and shall certify to the Comptroller of the Currency the termination of the new bank and thenceforth the Corporation shall be liable for its obligations and be the owner of its assets. The provisions of sections 5220 and 5221 of the Revised Statutes (U. S. C., title 12, sec. 181 and 182) shall not apply to such new banks."

13. By inserting before the said last paragraph of subsection (l) the following: "(n) (1)"; and by striking out the comma after the words "United States" in the first sentence of said paragraph and inserting before the word "except" the following: "or in securities guaranteed as to principal and interest by the Government of the United States,"; and by transposing said paragraph to subsection (n) as amended, as paragraph (1) thereof.

14. By striking out in subsection (m) the following: "(m)"; and by striking out in said subsection the word "herein" and inserting in lieu thereof "in this section"; and by transposing said subsection to subsection (n), as amended, as paragraph (2) thereof.

15. By adding a new subsection to read as follows:

"(m) (1) The Corporation as receiver of a closed national bank or District bank shall not be required to furnish bond and shall have the right to appoint an agent or agents to assist it in its duties as such receiver, and all fees, compensation, and expenses of liquidation and administration thereof shall be fixed by the Corporation, subject to the approval of the Comptroller of the Currency, and may be paid by it out of funds coming into its possession as such receiver. The Comptroller of the Currency is authorized and empowered to waive and relieve the Corporation from complying with any regulations of the Comptroller of the Currency with respect to receiverships where in his discretion such action is deemed advisable to simplify administration.

"(2) Payment of an insured deposit to any person by the Corporation shall discharge the Corporation, and payment of a transferred deposit to any person by the new bank or the other insured bank shall discharge the Corporation and such new bank or other insured bank, to the same extent that payment to such person by the closed bank would have discharged it from liability for the insured deposit.

"(3) Except as otherwise prescribed by the board of directors, neither the Corporation, such new bank, nor such other insured bank, shall be required to recognize as the owner of any portion of a deposit appearing on the records of the closed bank under a name other than that of the claimant, any person whose name or interest as such owner is not disclosed on the records of such closed bank as part owner of said account, where such recognition would increase the aggregate amount of the insured deposits in such closed bank.

"(4) The Corporation may withhold payment of such portion of the insured deposit of any depositor in a closed bank as may be required to provide for the payment of any liability of such depositor as a stockholder of the bank, or of any liability of such 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 such depositor or any other person liable therefor.

"(5) 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 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-year period shall be refunded to the Corporation."

16. By striking out in subsection (n) the following: "(n)" and inserting "(3) "; and by retaining said subsection in paragraph (3) of subsection (n), as amended; and by striking out in said subsection (n) the words "member banks which are now or may hereafter become insolvent or suspended" and inserting in lieu thereof "insured banks closed on account of inability to meet the demands of depositors"; and by striking out "State member" and inserting in lieu thereof "insured State"; and by striking out the period at the end of the first sentence and inserting in lieu thereof "or District banks."; and by adding at the end of said subsection two new sentences to read: "The Corporation, in its discretion, may make loans on the security of or may purchase and liquidate or sell any part of the assets of an insured bank which is now or may hereafter be closed on account of inability to meet the demands of its depositors. In any case where the Corporation is acting as receiver of such insured bank such loan or purchase shall not be made without approval of a court of competent jurisdiction."; and by adding to subsection (n), as amended, a new paragraph to read as follows:

"(4) Until July 1, 1936, whenever in the judgment of the board of directors such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation, or facilitate the sale of the assets of an insured bank to and assumption of its liabilities by another insured bank, the Corporation may, upon such terms and conditions as it may determine, make loans secured by the assets of such insured bank in subordination to the rights of depositors or otherwise, or may purchase such assets, or may guarantee any other insured bank against loss by reason of assuming the liabilities and purchasing the assets of such insured bank. Any insured national bank or District bank or, with the approval of the Comptroller of the Currency, any conservator thereof is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans.

17. By striking out in subsection (o) the following: "(o)", and inserting in lieu thereof "(o) (1)"; and by inserting after the word "empowered" in the first sentence in subsection (o) the following: "with the approval of the Secretary of the Treasury"; by striking out in subsection (o) the words "of its capital" and inserting in lieu thereof "received by the Corporation in payment of its capital stock and of the first annual assessments"; and by adding at the end of subsection (o) two new paragraphs to read as follows:

"(2) The Secretary of the Treasury, in his discretion, is authorized to purchase any obligations of the corporation to be issued hereunder, and for such purpose the Secretary of the Treasury is authorized to use as a public-debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under the Second Liberty Bond Act, as amended, are extended to include any purchases of the Corporation's obligations hereunder. The Secretary of the Treasury may, at any time, sell any of the obligations of the Corporation acquired by him under this section. All redemptions, purchases, and sales by the Secretary of the Treasury of the obligations of the Corporation shall be treated as public-debt transactions of the United States.

"(3) No obligations, contingent or absolute, shall be incurred for the expenditure or other disposition of funds heretofore, hereby, or hereafter appropriated or otherwise obtained for the carrying out of functions of the Corporation unless within estimates of such obligations and expenditures approved by the Director of the Budget: and, to the extent that the Secretary of the Treasury may consider practicable and under such rules and regulations as he may prescribe, there shall be maintained on the books of the Treasury Department such accounts as may be necessary to give full force and effect to this provision: *Provided*, That this paragraph shall not apply to obligations of the Corporation to depositors of banks closed on account of inability to meet the demands of depositors, obligations for expenses of paying its obligations to depositors or expenses of operation of new banks, obligations connected with the powers and duties of the Corporation as receiver, or obligations incurred for the purposes provided in this subsection (n) of this section, or obligations to make the refund provided by law to any bank not a member of the Federal Reserve System electing as provided in subsection (f) of this section not to continue after June 30, 1935, as an insured bank."

18. 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 purposes of this section and fully providing for all of the obligations of the Corporation."

19. By inserting in subsection (s) following the words "purchase any assets" the following: "or for the purpose of obtaining the payment of any insured deposit or transferred deposit or the allowance, approval, or payment of any claim,".

20. By striking out in subsection (v) the following: "(v)" and inserting in lieu thereof "(v) (1)"; and by striking out in said subsection "class A stockholder of the Federal Deposit Insurance Corporation" and inserting in lieu thereof "insured bank."

21. By striking out the second paragraph of subsection (v) and inserting in lieu thereof the following:

"(2) Every insured bank shall display at each place of business maintained by it a sign or signs, and shall include in advertisements relating to deposits and in forms furnished for use of its depositors as specified by regulations of the board of directors, a statement to the effect that its deposits are insured by the Corporation. The board of directors shall prescribe by regulation the forms of such signs and the manner of display and the forms of such statements and the manner of use. For each day an insured bank continues to violate any provision of this paragraph or any lawful provision of said regulations, it shall be subject to a penalty of $100, which shall be recoverable by the Corporation for its use."

22. By adding to subsection (v) three new paragraphs to read as follows:

"(3) 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 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.

"(4) Unless, in addition to compliance with other provisions of law, it shall have the prior written consent of the corporation, no insured bank shall enter into any consolidation or merger with any noninsured bank, or assume liability to pay any deposits of any noninsured bank, or transfer assets to any noninsured bank in consideration of the assumption of liability for any portion of its deposits, and no insured State nonmember bank (except a district bank) without such consent shall reduce the amount or retire any part of its common or preferred capital stock, or retire any part of its capital notes or debentures.

"(5) Each insured bank shall provide such protection and indemnity against burglary, fidelity, and other similar insurable losses 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.

"(6) Whenever an insured bank, except a national bank or district bank, for a period of one hundred and twenty days after written notice of the recommendations of the Corporation, based on a report of examination of such bank by an examiner of the Corporation, shall fail to comply with such recommendations, the Corporation shall have the power, and is hereby authorized, to publish any part of such report of examination in such manner as it may determine: *Provided*, That such notice of intention to make such publication shall be given at the time such recommendations are made, or at any time thereafter and at least ninety days before such publication."

23. By striking out all of subsection (y) preceding the last paragraph thereof and inserting in lieu thereof the following:

"(y) (1) No State nonmember bank, other than (a) a mutual savings bank, or (b) a Morris Plan Bank, or (c) a bank located in the Territories of Hawaii or Alaska, shall become or continue an insured bank after July 1, 1937, and the insured status and insurance of the deposits of each State nonmember bank, other than (a) a mutual savings bank, or (b) a Morris Plan Bank, or (c) a bank located in the Territories of Hawaii or Alaska, shall terminate on July 1, 1937.

"(2) For the purposes of this section, and notwithstanding any other provision thereof, any unincorporated bank which continues to be an insured bank without application or approval under the provisions of paragraph (1) of subsection (f) of this section shall be included in the term 'State bank' and 'State nonmember bank'."

24. By inserting at the beginning of the last paragraph of subsection (y) the following: "(3)."

Title II—Amendments to the Federal Reserve Act

Section 201. (a) Section 4 of the Federal Reserve Act, as amended, is further amended by striking out the paragraph which commences with the words "Class C directors shall be appointed by the Federal Reserve Board" and the next succeeding paragraph, and inserting in lieu thereof the following:

"Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the districts for which they are appointed, except that this requirement shall not apply to the Governor and Vice Governor of the bank. Each class C director shall hold office for a term of three years except that the Governor's term as a class C director shall expire when he ceases to be Governor of the bank and, if the Vice Governor be designated as a class C director, his term as a class C director shall expire when he ceases to be Vice Governor. One of the directors of class C shall be appointed by the Federal Reserve Board as deputy chairman to exercise the powers of the chairman of the board when necessary. In the case of the absence of the chairman and deputy chairman, the third class C director shall preside at meetings of the Board.

"Effective ninety days after the enactment of the Act containing this amendment, the officers 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 until approved by the Federal Reserve Board and thereupon he shall be appointed by the Federal Reserve Board as one of the class C directors of the bank. He shall be ex officio chairman of the board of directors and chairman of the executive committee; and all other officers and employees of the bank shall be directly responsible to him. For each Federal Reserve bank there shall be appointed annually in the same manner as the Governor a Vice Governor, who shall, in the absence or disability of the Governor or during a vacancy in the office of Governor, serve as the chief executive officer of the bank and act as chairman of the executive committee of the bank. He may be appointed by the Federal Reserve Board as a class C director of the bank and in such case may be appointed as deputy chairman of the board of directors. Whenever a vacancy shall occur in the office of the Governor or Vice Governor of a Federal Reserve bank, it shall be filled in the manner provided for original appointments; and the person so appointed shall hold office until the expiration of the term of his predecessor.

"Effective ninety days after the enactment of the act containing this amendment, any Federal Reserve agent who shall not have been appointed Governor of the bank shall cease to be a class C director and chairman of the board of directors. All duties prescribed by law for the Federal Reserve agent shall be performed by such person as the Federal Reserve Board shall designate.

"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, but this shall not prevent the present incumbents from serving out the remainders of their present terms."

(b) The last paragraph of such section 4 is amended by striking out the words "Thereafter every director of a Federal Reserve bank chosen as hereinbefore provided shall hold office for a term of three years" and substituting the words "Thereafter each director of class A and each director of class B chosen as hereinbefore provided shall hold office for a term of three years."

SEC. 202. Section 9 of the Federal Reserve Act, as amended, is amended by changing the period at the end of the tenth paragraph thereof to a colon and adding the following: "*Provided further*, That upon application to the Federal Reserve Board at any time prior to July 1, 1937, by any nonmember bank which at the time of such application has been admitted to the benefits of insurance by the Federal Deposit Insurance Corporation under section 12B of this Act, the Federal Reserve Board, in its discretion, in order to facilitate the admission of such bank to membership in the Federal Reserve System, may waive in whole or in part the requirements of this section relating to the amount of capital required of such bank. Such bank shall comply with such requirements within such period or periods after admission as in the Board's judgment shall be reasonable in view of all the circumstances."

SEC. 203. Section 10 of the Federal Reserve Act, as amended, is further amended in the following respects:

(1) By striking out the second sentence of the first paragraph and substituting the following: "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 shall be selected from any one Federal Reserve district, except that this limitation shall not apply to the selection of the Governor."

(2) By adding at the end of such first paragraph the following: "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 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 this amendment: *Provided*, That if he shall not have served for as much as twelve years his retirement pay shall be at the rate of one-twelfth 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. 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."

(3) 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."

SEC. 204. Subsection (i) of section 11 of the Federal Reserve Act, as amended, is amended by adding the following at the end thereof: "The Board may assign to designated members of the Board or officers or representatives of the Board, under such rules and regulations, the performance of duties, functions, or services so specified, but any such assignment shall not include the determination of any national or system policy or any power to make rules and regulations or any power which under the terms of this act is required to be exercised by a specified number of members of the Board."

SEC. 205. Effective ninety days after the enactment of this Act, section 12A of the Federal Reserve Act, as amended, is amended to read as follows:

"SEC. 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 chairman of the Committee, two members of the Federal Reserve Board, selected by the Board, and two 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 The terms of the members of the Committee, other than the Governor of the Federal Reserve Board, shall expire at the end of each calendar year. Whenever a vacancy shall occur a successor shall be selected in the same manner as his predecessor was selected. Meetings of the Committee shall be 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, or upon his own initiative.

"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."

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."

SEC. 207. Subsection (b) of section 14 of the Federal Reserve Act, as amended, is further amended by changing the semicolon at the end thereof to a colon and adding the following: "*Provided*, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities."

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. 16. 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."

(2) By striking from the sixteenth paragraph the words "or Federal Reserve Agent" where they occur in three different places and also the words "or his" and the words "at the Treasury or at the Subtreasury of the United States nearest the place of business of such Federal Reserve bank or such Federal Reserve Agent."

SEC. 209. The sixth paragraph of section 19 of the Federal Reserve Act, as amended, is amended to read as follows:

"Notwithstanding the other provisions of this section, the Federal Reserve Board, 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 member banks in any or all Federal Reserve districts and/or any or all of the three classes of cities referred to above."

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. 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 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 years: *Provided*, That loans may be made in amounts not exceeding 75 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 twenty years by means of substantially equal monthly, quarterly, semiannual, or annual payments on principal with interest added or on principal and interest combined. 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 in computing such aggregate sum there shall be included all such loans on which the bank is liable as endorser, guarantor, or otherwise, and the book value of all real estate owned by the bank directly or indirectly except its banking premises. Nothing contained in this section shall prevent any national banking association from acquiring, as additional security for loans previously made in good faith, second or subsequent liens on real estate or shares or participations in such liens. In the case of loans secured by real estate which are insured under the provisions of title II of the National Housing Act, the restrictions of this section as to the amount of the loan in relation to the actual value of the real estate and as to the three-year limit on the terms of such loans shall not apply. All loans made hereunder shall be subject to the general limitations contained in section 5200 of the Revised Statutes of the United States. Such banks may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such banks may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State wherein such national banking association is located. State banks and trust companies which are members of the Federal Reserve System shall not hereafter make new loans secured by real estate except to the same extent and under the same terms and conditions as national banking associations are permitted to do so."

TITLE III—TECHNICAL AMENDMENTS

SECTION 301. Subsection (c) of section 2 of the Banking Act of 1933, as amended, is amended by adding at the end thereof the following paragraph:

"Notwithstanding the foregoing, the term 'holding company affiliate' shall not include 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, banking associations, savings banks, and/or trust companies."

SEC. 302. The first paragraph of section 20 of the Banking Act of 1933, as amended, is amended by inserting before the period at the end thereof a colon and the following: "*Provided*, That nothing in this paragraph shall apply to any such organization which shall have been placed in formal liquidation and which shall transact no business except such as may be incidental to the liquidation of its affairs."

SEC. 303. (a) Paragraph (1) of subsection (a) of section 21 of the Banking Act of 1933, as amended, is amended by adding before the semicolon at the end thereof a colon and the following: "*Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities to the extent permitted to national banking associations by the provisions of section 5136 of the Revised Statutes, as amended (U. S. C., title 12, sec. 24; Supp. VII, title 12, sec. 24): *Provided further*, That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate."

(b) Paragraph (2) of subsection (a) of such section 21 is amended by inserting after the words "to engage to any extent whatever" the words "with others than his or its officers, agents, or employees", and is further amended by adding the following sentence at the end of said paragraph: "The expense of the examinations required hereunder shall be assessed against, and paid by, the institution subject to examination in the manner and with the same effect as provided by section 5240 of the Revised Statutes, as amended (U. S. C., title 12, secs. 484, 485; Supp. VII, title 12, secs. 481–483)."

SEC. 304. Section 22 of the Banking Act of 1933, as amended, is amended by adding at the end thereof the following sentence: "Such additional liability shall cease on July 1, 1937, with respect to shares issued prior to June 17, 1933, by any association which shall be transacting the business of banking on July 1, 1937."

SEC. 305. Section 4 of the Act entitled "An Act to amend section 12B of the Federal Reserve Act so as to extend for one year the temporary plan for deposit insurance, and for other purposes" (48 Stat. 969), approved June 16, 1934, is amended to read as follows:

"SEC. 4. So much of section 31 of the Banking Act of 1933, as amended, as relates to stock ownership by directors, trustees, or members of similar governing bodies of any national banking association or of any State bank or trust company which is a member of the Federal Reserve System is hereby repealed."

SEC. 306. Effective January 1, 1936, section 32 of the Banking Act of 1933, as amended, is amended to read as follows:

"SEC. 32. No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve at the same time as an officer, director, or employee of any member bank 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 it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

SEC. 307. (a) The second sentence of paragraph seventh of section 5136 of the Revised Statutes, as amended (U. S. C., Supp VII, title 12, sec. 24), is amended to read as follows: "The business of dealing in investment securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe, but in no event shall the total amount of the investment securities of any one obligor or maker, purchased after this section, as amended, takes effect and held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund."

(b) The fourth sentence of such paragraph seventh is amended to read as follows: "Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation."

SEC. 308. Section 5138 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 51), is amended by adding the following sentence at the end thereof: "No such association shall hereafter be authorized to commence the business of banking until it shall have a paid-in surplus equal to 20 per centum of its capital: *Provided*, That the Comptroller of the Currency may waive this requirement as to a State bank converting into a national banking association."

SEC. 309. The last paragraph of section 5139 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 52), is amended to read as follows:

"After one year from the date of the enactment of the Banking Act of 1933, no certificate evidencing the stock of any such association shall bear any statement purporting to represent the stock of any other corporation, except a member bank or a corporation existing on the date this paragraph takes effect engaged primarily in holding the bank premises of such association, nor shall the ownership, sale, or transfer of any certificate representing the stock of any such association be conditioned in any manner whatsoever upon the ownership, sale, or transfer of a certificate representing the stock of any other corporation, except a member bank or a corporation existing on the date this paragraph takes effect engaged primarily in holding the bank premises of such association: *Provided*, That this section shall not operate to prevent the ownership, sale, or transfer of stock of any other corporation being conditioned upon the ownership, sale, or transfer of a certificate representing stock of a national banking association."

SEC. 310. (a) Section 5144 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 61), is amended by inserting before the period at the end of the first sentence thereof a semicolon and the following: "except that such holding company affiliate may without obtaining such permit vote in favor of placing the association in voluntary liquidation".

(b) Such section 5144 is further amended by adding at the end of the first paragraph thereof the following: "Whenever shares of stock cannot be voted by reason of being held by the bank as sole trustee, such shares shall be excluded in determining whether matters voted upon by the shareholders were adopted by the requisite percentage of shares."

(c) The first sentence of the third paragraph of such section 5144 is amended to read: "Any such holding company affiliate may make application to the Federal Reserve Board for a voting permit entitling it to vote the stock controlled by it at any or all meetings of shareholders of such bank or authorizing the trustee or trustees holding the stock for its benefit or for the benefit of its shareholders so to vote the same."

SEC. 311. Section 5154 of the Revised Statutes, as amended (U. S. C., title 12, sec. 35), is amended by adding at the end thereof the following paragraph:

"The Comptroller of the Currency may, in his discretion and subject to such conditions as he may prescribe, permit such converting bank to retain and carry at a value determined by the Comptroller such of the assets of such converting bank as do not conform to the legal requirements relative to assets acquired and held by national banking associations."

SEC. 312. Section 5162 of the Revised Statutes (U. S. C., title 12, sec. 170) is amended by adding at the end thereof the following paragraph:

"The Comptroller of the Currency may designate one or more persons to countersign in his name and on his behalf such assignments or transfers of bonds as require his countersignature."

SEC. 313. The first two sentences of section 5197 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 85), are amended to read as follows: "Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the association is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the association is located, whichever may be the greater, and no more, except that where, by the laws of any State, a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State, or Territory, or District, the association may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the association is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run: *Provided*, That the maximum amount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located."

SEC. 314. Section 5199 of the Revised Statutes (U. S. C., title 12, sec. 60), is amended 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."

SEC. 315. Section 5209 of the Revised Statutes (U. S. C., title 12, sec. 592), is hereby amended by inserting after the words, "known as the Federal Reserve Act", the words "or of any insured bank as defined in subsection (c) of section 12B of the Federal Reserve Act"; and by inserting after the words "such Federal Reserve bank or member bank", wherever they appear in such section, the words "or insured bank"; and by inserting after the words "or the Comptroller of the Currency", the words, "or the Federal Deposit Insurance Corporation,".

SEC. 316. Section 5220 of the Revised Statutes (U. S. C., title 12, sec. 181), is amended by adding at the end thereof the following paragraph:

"The shareholders shall designate one or more persons to act as liquidating agent or committee, who shall conduct the liquidation in accordance with law and under the supervision of the board of directors, who shall require a suitable bond to be given by said agent or committee. The liquidating agent or committee shall render annual reports to the Comptroller of the Currency on the 31st day of December of each year showing the progress of said liquidation until the same is completed. The liquidating agent or committee shall also make an annual report to a meeting of the shareholders to be held on the date fixed in the articles of association for the annual meeting, at which meeting the shareholders may, if they see fit, by a vote representing a majority of the entire stock of the bank, remove the liquidating agent or committee and appoint one or more others in place thereof. A special meeting of the shareholders may be called at any time in the same manner as if the bank continued an active bank and at said meeting the shareholders may, by vote of the majority of the stock, remove the liquidating agent or committee. The Comptroller of the Currency is authorized to have an examination made at any time into the affairs of the liquidating bank until the claims of all creditors have been satisfied, and the expense of making such examinations shall be assessed against such bank in the same manner as in the case of examinations made pursuant to section 5240 of the Revised Statutes, as amended (U. S. C., title 12, secs. 484, 485; Supp. VII, title 12, secs. 481–483)."

SEC. 317. Section 5243 of the Revised Statutes (U. S. C., title 12, sec. 583) is amended to read as follows:

"SEC. 5243. The use of the word 'national' either alone or in combination with other words or syllables, as part of the name or title used by any person, corporation, firm, partnership, business trust, association, or other business entity doing the business of bankers, brokers, or trust or savings institutions is prohibited except where such institution is organized under the laws of the United States or is otherwise permitted by the laws of the United States to use such name or title or is lawfully using such name or title on the date when this section, as amended, takes effect."

SEC. 318. Section 5 of the Federal Reserve Act, as amended, is amended by striking out the last two sentences thereof and inserting in lieu thereof the following: "When a member bank reduces its capital stock or surplus it shall surrender a proportionate amount of its holdings in the capital stock of said Federal Reserve bank. Any member bank which holds capital stock of a Federal Reserve bank in excess of the amount required on the basis of 6 per centum of its paid-up capital stock and surplus shall surrender such excess stock. When a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal Reserve bank and be released from its stock subscription not previously called. In any such case the shares surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash-paid subscriptions on the shares surrendered and one-half of 1 per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal Reserve bank."

SEC. 319. The fifth paragraph of section 9 of the Federal Reserve Act, as amended, is amended by adding at the end thereof the following sentence: "Such reports of condition shall be in such form and shall contain such information as the Federal Reserve Board may require and shall be published by the reporting banks in such manner and in accordance with such regulations as the said Board may prescribe."

SEC. 320. The first sentence of paragraph (m) of section 11 of the Federal Reserve Act, as amended, is amended by inserting before the period at the end thereof a colon and the following: "*Provided*, That with respect to loans represented by obligations in the form of notes secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, such limitation of 10 per centum on loans to any person shall not apply, but State member banks shall be subject to the same limitations and conditions as are applicable in the case of national banks under paragraph (8) of section 5200 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 84)."

SEC. 321. The third paragraph of section 13 of the Federal Reserve Act, as amended, is amended by changing the words "indorsed and otherwise secured to the satisfaction of the Federal Reserve bank" in that paragraph to read "indorsed and/or otherwise secured to the satisfaction of the Federal Reserve bank."

SEC. 322. Subsection (e) of section 13b of the Federal Reserve Act, as amended, is amended by striking out "upon the date this section takes effect", and inserting in lieu thereof "on and after June 19, 1934"; and by striking out "the par value of the holdings of each Federal Reserve bank of Federal Deposit Insurance Corporation stock" and inserting in lieu thereof "the amount paid by each Federal Reserve bank for Federal Deposit Insurance Corporation stock."

SEC. 323. (a) The first paragraph of section 19 of the Federal Reserve Act, as amended, is amended to read as follows:

"SEC. 19. The Federal Reserve Board is authorized, for the purposes of this section, to define the terms 'demand deposits', 'gross demand deposits', 'deposits payable on demand', 'time deposits', 'savings deposits', and 'trust funds', to determine what shall be deemed to be a payment of interest, and to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof."

(b) The tenth paragraph of such section 19 is amended to read as follows:

"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), including cash items with Federal Reserve banks and other banks in process of collection, checks on other banks in the same place, and exchanges for clearing houses."

(c) The last two paragraphs of such section 19 are amended to read as follows:

"No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand: *Provided*, That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract entered into in good faith which is in force on the date on which the bank becomes subject to the provisions of this paragraph; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this paragraph, and every member bank shall take such action as may be necessary to conform to this paragraph as soon as possible consistently with its contractual obligations: *Provided further*, That this paragraph shall not apply (1) to any deposit of such bank which is payable only at an office thereof located outside of the States of the United States and the District of Columbia; (2) to any deposit made by a mutual savings bank; (3) to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, or to any deposit of trust funds if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law; or (4) to any deposit of funds by the United States, and Territory, District, or possession thereof (including the Philippine Islands) or any public instrumentality or agency of the foregoing, with respect to which interest is required by law to be paid.

"The Federal Reserve Board shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits; may classify time and savings deposits according to maturities, locations of banks, conditions respecting receipt, withdrawal, or repayment, or otherwise as it may deem necessary in the public interest; and may prescribe different rates for deposits of different classes. No member bank shall pay any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Federal Reserve Board, or waive any requirements of notice before payment of any savings deposit except as to all savings deposits having the same requirement: *Provided*, That the provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia. Every bank whose deposits are insured under the provisions of section 12B of this Act (except mutual savings banks and Morris Plan banks which are not members of the Federal Reserve System) shall comply with the provisions of this paragraph and the paragraph immediately preceding and with the rules and regulations prescribed by the Federal Reserve Board pursuant thereto."

(d) At the end of such section 19 there is added the following new paragraph:

"Notwithstanding the provisions of section 7 of the First Liberty Bond Act, as amended, section 8 of the Second Liberty Bond Act, as amended, and section 8 of the Third Liberty Bond Act, as amended, member banks shall be required to maintain the same reserves against deposits of public moneys by the United States as they are required by this section to maintain against other deposits."

SEC. 324. Section 21 of the Federal Reserve Act, as amended, is amended by adding at the end thereof the following paragraph:

"Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of member banks are required to submit to examination, the Federal Reserve Board or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank."

SEC. 325. (a) Subsection (a) of section 22 of the Federal Reserve Act, as amended, is amended by inserting in the first paragraph thereof after "No member bank" the following: "and no insured bank is defined in subsection (c) of section 12B of this Act"; by inserting before the period at the end of the first sentence of such paragraph "or assistant examiner who examines or has authority to examine such bank"; and by inserting after "any member bank" in the second paragraph thereof "or insured bank"; by inserting before the period at the end thereof "or Federal Deposit Insurance Corporation examiner"; and by adding at the end of such subsection a new paragraph, as follows:

"The provisions of this subsection shall apply to all public examiners and assistant examiners who examine member banks of the Federal Reserve System or insured banks, whether appointed by the Comptroller of the Currency, by the Federal Reserve Board, by a Federal Reserve agent, by a Federal Reserve bank, or by the Federal Deposit Insurance Corporation, or appointed or elected under the laws of any State; but shall not apply to private examiners or assistant examiners employed only by a clearing-house association or by the directors of a bank."

(b) Subsection (b) of section 22 is amended by inserting therein after "no national bank examiner" the following: "and no Federal Deposit Insurance Corporation examiner"; and by inserting after "member bank" the following: "or insured bank"; and by inserting after "from the Comptroller of the Currency" the following "or from the Federal Deposit Insurance Corporation,".

(c) Subsection (g) of such section 22 is amended to read as follows:

"(g) No executive officer of any member bank shall borrow from or otherwise become indebted to any member bank of which he is an executive officer, and no member bank shall make any loan or extend credit in any other manner to any of its own executive officers: *Provided*, That loans made to any such officer prior to June 16, 1933, may be renewed or extended for periods expiring not more than five years from such date where the board of directors of the member bank shall have satisfied themselves that such extension or renewal is in the best interest of the bank and that the officer indebted has made reasonable effort to reduce his obligation, these findings to be evidenced by resolution of the board of directors spread upon the minute book of the bank. If any executive officer of any member bank borrow from or if he be or become indebted to any bank other than a member bank of which he is an executive officer, he shall make a written report to the board of directors of the member bank of which he is an executive officer, stating the date and amount of such loan or indebtedness, the security therefor. and the purpose for which the proceeds have been or are to be used. Borrowing by, or loaning to, a partnership in which one or more executive officers of a member bank are partners having either individually or together a majority interest in said partnership, shall be considered within the prohibition of this subsection. Nothing contained in this subsection shall prohibit any executive officer of a member bank from endorsing or guaranteeing for the protection of such bank any loan or other asset which shall have been previously acquired by such bank in good faith or from incurring any indebtedness to such bank for the purpose of protecting such bank against loss or giving financial assistance to it. The Federal Reserve Board is authorized to define the term 'executive officer', to determine what shall be deemed to be a borrowing, indebtedness, loan, or extension of credit, for the purpose of this subsection, and to prescribe such rules and regulations as it may deem necessary to effectuate the provisions of this subsection in accordance with its purposes and to prevent evasions of such provisions. Any executive officer of a member bank accepting a loan or extension of credit which is in violation of the provisions of this subsection shall be subject to removal from office in the manner prescribed in section 30 of the Banking Act of 1933: *Provided*, That for each day that a loan or extension of credit made in violation of this subsection exists, it shall be deemed to be a continuation of such violation within the meaning of said section 30."

SEC. 326. The third paragraph of section 23A of the Federal Reserve Act, as amended, is amended to read as follows:

"For the purpose of this section, the term 'affiliate' shall include holding company affiliates as well as other affiliates, and the provisions of this section shall not apply to any affiliate (1) engaged primarily in holding the bank premises of the member bank with which it is affiliated or in maintaining and operating properties acquired for banking purposes prior to the date this section, as amended, takes effect; (2) engaged solely in conducting a safe-deposit business or the business of an agricultural credit corporation or live-stock loan company; (3) in the capital stock of which a national banking association is authorized to invest pursuant to section 25 of the Federal Reserve Act, as amended, or a subsidiary of such affiliate, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (4) organized under section 25 (a) of the Federal Reserve Act, as amended, or a subsidiary of such affiliate, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (5) engaged solely in holding obligations of the United

States Government, the Federal intermediate credit banks, the Federal land banks, the Federal home-loan banks, or the Home Owners' Loan Corporation; (6) where the affiliate relationship has arisen out of a bona fide debt contracted prior to the date of the creation of such relationship; or (7) where the affiliate relationship exists by reason of the ownership or control of any voting shares thereof by a member bank as executor, administrator, trustee, receiver, agent, depositary, or in any other fiduciary capacity, except where such shares are held for the benefit of all or a majority of the stockholders of such member bank; but as to any such affiliate, member banks shall continue to be subject to other provisions of law applicable to loans by such banks and investments by such banks in stocks, bonds, debentures, or other such obligations. The provisions of this section shall likewise not apply to indebtedness of any affiliate for unpaid balances due a bank on assets purchased from such bank."

SEC. 327. Section 24 of the Federal Reserve Act, as amended, is amended by adding at the end thereof the following new paragraph:

"Loans made to establish industrial or commercial businesses (a) which are in whole or in part discounted or purchased or loaned against as security by a Federal Reserve bank under the provisions of section 13b of the Federal Reserve Act, (b) for any part of which a commitment shall have been made by a Federal Reserve bank under the provisions of said section, (c) in the making of which a Federal Reserve bank participates under the provisions of said section, or (d) in which the Reconstruction Finance Corporation cooperates or purchases a participation under the provision of section 5d of the Reconstruction Finance Corporation Act, shall not be subject to the restrictions or limitations of this section upon loans secured by real estate."

SEC. 328. Effective January 1, 1936, the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (38 Stat. 730), approved October 15, 1914, as amended, is further amended (a) by striking out section 8A thereof and (b) by substituting for the first three paragraphs of section 8 thereof the following:

"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."

SEC. 329. (a) Section 1 of the Act of November 7, 1918, as amended (U. S. C., title 12, sec. 33; Supp. VII, title 12, sec. 33), is amended by striking out the second proviso down to and including the words "to be ascertained" and inserting in lieu thereof the following: "*And provided further*, That if such consolidation shall be voted for at said meetings by the necessary majorities of the shareholders of each of the associations proposing to consolidate, any shareholder of any of the associations consolidated who has voted against such consolidation at the meeting of the association of which he is a shareholder and has given notice in writing thereat to the presiding officer that he dissents from the plan of consolidation, shall be entitled to receive the value of the shares so held by him if and when said consolidation shall be approved by the Comptroller of the Currency, such value to be ascertained as of the date of the Comptroller's approval."

(b) Such section 1 is further amended by adding at the end thereof the following paragraphs:

"Publication of notice and notification by registered mail of the meeting provided for in the foregoing paragraph may be waived by unanimous action of the shareholders of the respective associations. Where a dissenting shareholder has given notice as above provided to the association of which he is a shareholder of his dissent from the plan of consolidation, and the directors thereof fail for more than thirty days thereafter to appoint an appraiser of the value of his shares, said shareholder may request the Comptroller of the Currency to appoint such appraiser to act on the appraisal committee for and on behalf of such association.

"If shares, when sold at public auction in accordance with this section, realize a price greater than their final appraised value, the excess in such sale price shall be paid to the shareholder. The consolidated association shall be liable for all liabilities of the respective consolidating associations. In the event one of the appraisers fails to agree with the others as to the value of said shares, then the valuation of the remaining appraisers shall govern."

SEC. 330. (a) Section 3 of the Act of November 7, 1918, as amended (U. S. C., Supp. VII, title 12, sec. 34 (a)), is amended by striking out the first sentence following the proviso down to and including the words "to be ascertained" and inserting in lieu thereof the following: "If such consolidation shall be voted for at said meetings by the necessary majorities of the shareholders of the association and of the State or other bank proposing to consolidate, and thereafter the consolidation shall be approved by the Comptroller of the Currency, any shareholder of either the association or the State or other bank so consolidated, who has voted against such consolidation at the meeting of the association of which he is a stockholder, and has given notice in writing thereat to the presiding officer that he dissents from the plan of consolidation, shall be entitled to receive the value of the shares so held by him if and when said consolidation shall be approved by the Comptroller of the Currency, such value to be ascertained as of the date of the Comptroller's approval."

(b) Such section 3 is further amended by adding at the end thereof the following paragraph:

"Where a dissenting shareholder has given notice as provided in this section to the bank of which he is a shareholder of his dissent from the plan of consolidation, and the directors thereof fail for more than thirty days thereafter to appoint an appraiser of the value of his shares, said shareholder may request the Comptroller of the Currency to appoint such appraiser to act on the appraisal committee for and on behalf of such bank. In the event one of the appraisers fails to agree with the others as to the value of said shares, then the valuation of the remaining appraisers shall govern."

SEC. 331. The Act entitled "An Act to prohibit offering for sale as Federal farm loan bonds any securities not issued under the terms of the Farm Loan Act, to limit the use of the words 'Federal', 'United States', or 'reserve', or a combination of such words, to prohibit false advertising and for other purposes", approved May 24, 1926 (U. S. C., Supp. VII, title 12, secs. 584–588), is amended by inserting in section 2 thereof after "the words 'United States'", the following, "the words 'Deposit Insurance'"; and by inserting in said section after the words "the laws of the United States", the following, "nor to any new bank organized by the Federal Deposit Insurance Corporation as provided in section 12B of the Federal Reserve Act, as amended", and by striking out the period at the end of section 4 and inserting the following, "or the Federal Deposit Insurance Corporation."

SEC. 332. The Act entitled "An Act to provide punishment for certain offenses committed against banks organized or operating under laws of the United States or any member of the Federal Reserve System" (48 Stat. 783), approved May 18, 1934, is amended by striking out the period after "United States" in the first section thereof and inserting the following: "and any insured bank as defined in subsection (c) of section 12B of the Federal Reserve Act, as amended."

Senator FLETCHER. I thought I would make that statement, Mr. Chairman, as the foundation for the hearings.

Senator GLASS. Yes; thank you, Mr. Chairman.

In order that it may be understood that there has been no delay in the consideration of this bill, I desire to say that five members of the subcommittee having charge of the bill are members of the Senate Appropriations Committee, and all of them, more or less, and especially the chairman of the committee, were occupied with what is known as the "relief" and "works-relief bill"; hence it was impossible to give consideration to this bill before now.

Senator BULKLEY. In addition to that, Mr. Chairman, three members of this subcommittee are members of the Home Loan subcommittee and have given a good deal of time to the Home Loan bill.

Senator TOWNSEND. That is correct.

Senator GLASS. I just wanted it to appear in the record that we have gotten to the bill as soon as we could.

Mr. Crowley, will you be good enough to take a seat over there?

Mr. CROWLEY. Thank you, Mr. Chairman.

STATEMENT OF LEO T. CROWLEY, CHAIRMAN OF THE BOARD, FEDERAL DEPOSIT INSURANCE CORPORATION

Senator GLASS. Mr. Crowley, you have heard read the letter of the President to the Chairman of the Banking and Currency Committee of the Senate, stating that this bill, known as "S. 1715", is a tentative draft of the banking bill, and that the President desired that you and others supposed to be associated with the drafting of the bill be heard by the committee; and you have been requested to come and testify accordingly. We would be glad to have you say what you may desire.

Senator COUZENS. Is this testimony going to be confined to title I?

Senator GLASS. In support of title I.

Mr. CROWLEY. Thank you.

Senator GLASS. I have been told by you that you had part only in drafting title I of the bill.

Mr. CROWLEY. That is true; that is the part that I drew. The general counsel and I drafted title I, which is the part I am familiar with.

Senator GLASS. You had nothing to do with title III?

Mr. CROWLEY. Not the drafting of it; no, sir.

Senator GLASS. And it was not your suggestion that they be combined in one?

Mr. CROWLEY. No, sir; that was the suggestion of others—that they be combined in one.

Senator GLASS. Very well.

Mr. CROWLEY. Mr. Chairman, I have here an outline that I would like to present. It will take probably 30 or 40 minutes to go through with it. Do you object to that? It is a complete report of the changes in our bill.

Senator GLASS. No; I do not object to it.

Senator COUZENS. You mean changes in the law, and not changes in your bill?

Mr. CROWLEY. Changes in the bill; yes, sir.

With your permission, I would like to outline to you in detail the reasons which have motivated our suggestions for changes in the permanent-insurance plan. The charts and tables on the next few pages give a vivid picture of the commercial banking structures of the United States. These data cover all insured and noninsured banks, arranged according to total deposit liability size groupings. They do not include mutual savings banks or private banks.

Ninety percent by number of all of the licensed commercial banks in the United States have been admitted to the insurance fund. Over 98 percent of the total deposits in commercial banks and trust companies in the United States are in banks, the deposits of which are insured. On October 1, 1934, there were only 1,100 licensed commercial banks with deposits of slightly more than $500,000,000 which were not insured, while insured commercial banks numbered more than 14,000 on that date, and their deposits amounted to some $36,000,000,000. Mutual savings banks have been excluded from these figures. There are 68 out of the 576 mutual savings banks in the fund for mutuals.

The charts, we will just pass for the time. We will come back to those, Senator Bulkley, if you do not object.

Senator BULKLEY. I was wondering whether you wanted them printed in the record.

Senator COUZENS. Were they printed in the Record of the House?

Mr. CROWLEY. Yes, Senator.

Senator COUZENS. I do not think we need to duplicate them here.

Senator GLASS. No; I do not think we do. It would be a useless expense.

Mr. CROWLEY. Losses to depositors, 1864 to 1934: To arrive at a practical basis for estimating the amount of funds necessary to cover the insurance liability of the Corporation, our first consideration has been the volume of losses which depositors have borne during the past.

From July 1, 1864, the beginning of the national banking system, to June 30, 1934, about 16,000 commercial banks, with deposits of nearly 9 billion dollars, are known to have suspended operations. Losses to depositors in these banks are estimated at 3 billion dollars over and above all recoveries.

The estimates of losses to depositors in suspended commercial banks are based upon available data which clearly minimize the facts. The figures for national banks are fairly complete and reliable, and are taken from reports of the Comptroller of the Currency. The figures for other commercial banks, however, are incomplete, particularly for the period prior to 1920. All failures have not been reported. Bank depositors, therefore, have suffered losses which have not been recorded. Many records of voluntary liquidation by banks ignore the fact that depositors were not paid in full. Then, again, bank reorganizations, in late years, have been based upon the waiving of depositors' claims, while in other cases depositors have voluntarily reduced their claim or made contributions to capital as a means of absorbing losses.

The accompanying charts show, by years, from 1864 to 1934 the percentage of national and other commercial banks suspending, and the ratio of deposits in suspended banks to deposits in active banks. The ratio of deposits in suspended banks to total deposits in all active banks is smaller for national than for other commercial institutions.

Senator COUZENS. During the preparation of these figures did you obtain any amounts that might have been lost by stockholders?

Mr. FOX (accompanying Mr. Crowley). We have estimates that we can give you if you would like them.

Senator COUZENS. Yes; if it does not take up too much time. You can go on and you can put that in later.

Mr. CROWLEY. Our estimates indicate that about one billion dollars of the 9 billion dollars which was on deposit in commercial banks that failed during the 70-year period, were secured by pledge of collateral or otherwise. Of the remainder, some 6 billion dollars were in accounts of less than $5,000, or constituted the first $5,000 of large accounts. Two billion dollars represent the volume of these deposits which was in accounts with balances above $5,000.

For every $100 of deposits in the entire commercial banking system, about 32 cents a year was lost. Of this figure, it is estimated that 24 cents represents losses to depositors with balances not in excess of $5,000, while the remaining 8 cents represents losses to depositors having balances in excess of $5,000. For every $100 of deposits in the national banking system, 21 cents per year was lost, as against 42 cents per $100 per year in the State system. The table on the following page summarizes the estimates of losses to depositors in suspended national and other commercial banks during the 70 years ending June 30, 1934.

Losses to depositors in suspended commercial banks, July 1, 1864–June 30, 1934

	All commercial banks	National banks	Other commercial banks
Deposits in suspended banks (millions of dollars)	$8,778	$2,715	$6,063
Secured	1,033	184	849
Unsecured under $5,000	5,762	1,675	4,087
Unsecured over $5,000	1,983	856	1,127
Estimated losses (millions of dollars)	3,113	1,015	2,098
Secured deposits	(1)	(1)	(1)
Unsecured deposits under $5,000	2,301	667	1,634
Unsecured deposits over $5,000	812	348	464
Average loss per year for each $100 of deposits in active banks	0.32	0.21	0.42
Unsecured deposits under $5,000	.24	.14	.33
Unsecured deposits over $5,000	.08	.07	.09

1 Negligible.

Federal Deposit Insurance Corporation Division of Research and Statistics.

Losses to depositors have been most severe during the periods of business depression. Two-thirds of the losses during this entire 70-year period resulted from bank suspensions occurring during the 4 years ending June 30, 1934. For these 4 years, losses to depositors are estimated at $1.32 per year for each $100 of deposits in the commercial banking system. Comparable losses during the depression of the 1870's amounted to 35 cents, and during the depression of the 1890's amounted to 23 cents. The figures for the early periods understate the losses, but it is apparent that the losses in these earlier periods were not as great in proportion to total deposits as during the past 4 years. The data are summarized on the following tables. The first shows the losses in commercial banks which suspended and did not reopen during the three depression periods; the second compares losses during the 14 years included by the three critical periods, with the other 56 years since 1864.

Losses to depositors in commercial banks suspending during periods of crisis—Banks which did not reopen

	All commercial banks [1]		
	1873–78	1892–97	1931–34
Deposits in suspended banks (millions of dollars)	$85	$134	$5,356
Secured	10	13	637
Unsecured under $5,000	66	103	3,256
Unsecured over $5,000	9	18	1,473
Estimated losses in deposits (millions of dollars)	26	43	2,142
Secured deposits	(2)	(2)	(2)
Unsecured deposits under $5,000	23	36	1,478
Unsecured deposits over $5,000	3	7	664
Average loss per year for each $100 of deposits in active banks	0.35	0.23	[3] 1.28
Unsecured deposits under $5,000	.31	.19	.89
Unsecured deposits over $5,000	.04	.04	.40

[1] Periods beginning on July 1 and ending on June 30 of the years specified.
[2] Negligible.
[3] If losses of banks which subsequently reopened are included, the average loss per year for each $100 of deposits in active banks is raised to $1.32.

Source: Federal Deposit Insurance Corporation, Division of Research and Statistics

Losses to depositors in suspended banks, July 1, 1864–June 30, 1934—Three crisis periods contrasted with the remaining years—All commercial banks

	70 years 1864–1934	14 years during 3 crisis periods [1]	Remaining 56 years
Deposits in suspended banks (millions of dollars)	$8,778	$6,084	$2,694
Secured	1,033	716	317
Unsecured under $5,000	5,762	3,738	2,024
Unsecured over $5,000	1,983	1,630	353
Estimated losses (millions of dollars)	3,113	2,269	844
Unsecured deposits under $5,000	2,301	1,578	723
Unsecured deposits over $5,000	812	691	121
Average loss per year for each $100 of deposits in active banks	32	1.17	.11
Unsecured deposits under $5,000	.24	.82	.09
Unsecured deposits over $5,000	.08	.36	.02

[1] Includes figures for banks suspending during period July 1, 1930 to March 15, 1933 which subsequently reopened.

Source: Federal Deposit Insurance Corporation Division of Research and Statistics.

The experience of the past 70 years indicates that to repay losses suffered by all depositors in our suspended commercial banks, an assessment of 33 cents per $100 of total deposits, or one-third of 1 percent of total deposits in all open commercial banks, would have been necessary. Excluding the losses incurred during the three depression periods (1873–78, 1892–97, 1931–34) and confining ourselves to losses occurring during the balance of the 70 years, an assessment of one-eighth of 1 percent would have been necessary.

Future losses: In the past, the number, timing, and geographic concentrations of bank suspensions have been chiefly due to fundamental weaknesses in banking structure and the course of economic events. Suspension of individual banks within the areas affected has reflected, in the main, the quality of bank management. In the future, the magnitude of losses which will result from bank failures will also depend upon the trend of economic events, the changes which may occur in the structure and functions of the commercial banking system, the caliber of the individual bank management, the extent to which the system is reinsured against defalcations, and the quality of the supervision exercised over these banking institutions.

Of course, the future trend of economic events cannot be forecast.

Changing tendencies are now apparent in the structure and functions of commercial banking. On the one hand, the drastic reduction in the number of banks during the past 14 years has greatly relieved the over-banked condition in many communities. On the other hand, new financial agencies, serving specialized needs have been created, and will compete, to some extent, with commercial banks. The types of credit which may be extended by commercial banks may be subject to varying degrees of risk.

The extent to which the caliber of bank management will improve in the future, over what it has been in the past, cannot be estimated. While it is hoped that a better quality of personnel will develop, it must be recognized that there will continue to be poorly managed banks and that such institutions will eventually succumb. We cannot foretell the extent to which the existence of deposit insurance will influence bank management.

Insurance premium: To establish a fair rate of assessment which the banks shall pay for Federal deposit insurance, the hopeful expectations for the future must be tempered by a consideration of the realities of the past. Let me repeat that a premium at the rate of one-third of 1 percent of total deposits would have been necessary to cover all losses to depositors during the past 70 years. A premium at the rate of one-eighth of 1 percent would have covered depositors' losses in all years except those of severe depression.

We are concerned next with the basis of assessment, and with the ability of the banks to pay the required amount.

The existing permanent insurance law provides that all insured banks may become liable for an uncertain number of successive assessments. It is not sound deliberately to subject an operating business to an unpredictable liability. The maximum rate and number of assessments should be fixed so that an insured bank may know in advance its potential liability to the Corporation. An annual premium of a known maximum amount constitutes a sound basis for insurance revenue, as it provides a specific payment to cover a clearly defined risk for a definite period of time.

We also believe that payments made by insured banks should be made in the form of premiums rather than through the purchase of stock. As in the case of other insurance companies, receipts from premiums should be added to the reserve funds of the Corporation. Such reserve funds should not be considered an earning asset of the insured banks. The interest received by the Corporation from the investment of reserve funds should not be made the basis of dividend payments.

It is recommended that assessments be based upon total deposits in insured banks, regardless of whether or not the insurance is limited to $5,000 per depositor. To base assessments solely on the first $5,000 of each depositor's account places an undue burden upon the small banks. The greatest risk to the Corporation does not necessarily lie in these institutions. On the contrary, it has been demonstrated frequently in recent years that the consequences of the failure of a large bank may be more disastrous than the failure of a number of small institutions. The closing of a large bank often brings in its wake the failure of correspondent institutions.

The benefits of deposit insurance are not limited solely to the protection of the individual depositor. The entire banking structure of the country is so intimately interwoven that a disturbance in any part of the system may cause repercussions of far-reaching proportions. The benefits which will accrue to the large city banks because of greater stability in the country banks, are real and tangible.

All banks, large and small, should be required to support the insurance system. Banking is no longer merely a private business proposition. It involves great social consequences. The stability of the banking system affects the economic prosperity of the country. The raising of a sufficient revenue, solely through the levying of premiums against the deposits of those receiving direct insurance benefits will not be a fair distribution of the burden.

Our analysis of the ability of the banks to pay assessments is confined solely to national banks, since adequate data for other institutions are not available. The figures for earnings, profits, and dividends of national banks since 1870, as published by the Comptroller of the Currency, have been used. If the operating results of national banks can be taken as criteria, the banking system as a whole could have paid its losses during the past 70 years without impairing its stability or the payment of reasonable dividends to stockholders.

Operating profits of the banks have been below normal during recent years. The condition is reflected not only in reductions in gross earnings but also in unusually heavy write-offs made necessary by shrinkage in values. As we come out of the depression, losses on existing credits will appear. Banks should charge off these losses currently as they develop. They should not allow them to accumulate as was frequently the case prior to the banking holiday of 1933. These losses may absorb a considerable part of the banks' earnings over the next few years. To ask the banks to bear the entire cost of insurance at a rate comparable to the experience of losses over the past 70 years, would subject them to a heavy burden at the present time.

Senator COUZENS. Do you mind an interruption there?

Mr. CROWLEY. No, sir.

Senator COUZENS. During the preparation of this statement and the gathering of data for it, have you computed the cost of eliminating interest on the savings deposits?

Mr. CROWLEY. We will come to that, Senator.

Senator COUZENS. Very well.

Mr. CROWLEY. It is probably true that after the period of adjustment has been completed, the banks' earnings will enable them to pay an assessment adequate to cover losses at the rate shown for the past 70 years. To ask them to do so, however, without making some effort to reduce the burden of losses seems to me to be unfair to the banks and to the public which must ultimately bear the cost. This factor prompts us to ask for specific powers which will reduce these losses so that the insurance plan can be operated upon a reasonable assessment basis.

The following table compares annual averages of earnings, expenses, losses, and profits of the national banks for the years 1918 to 1930 with similar figures for the 6 months' period ending December 31, 1933. If charge-offs during the last half of 1933 had been no heavier than the average for the years 1918 to 1930, the national banks would have shown net profits of more than $1 for each $100 of total deposits or more than $7 for each $100 of invested capital.

Earnings, expenses, losses, and profits of national banks' averages for 1918–30, compared with 6 months ending Dec. 31, 1933

Items	Amounts per year per $100 of total deposits		
	Average 1918–30	6 months ending Dec. 31, 1933 [1]	Change
Gross earnings, plus recoveries	$6.46	$5.18	−$1.28
Interest paid	1.92	1.05	−.87
Other expenses	2.44	2.18	−.26
Net earnings, plus recoveries	2.10	1.95	−.15
Losses on loans and investments	.81	3.76	−2.95
Net additions to profits	1.29	[2] 1.81	−3.10

[1] The figures for the 6 months have been adjusted to show a rate per year, rather than for 6 months only.
[2] Deficit.

Source Federal Deposit Insurance Corporation, Division of Research and Statistics.

It will be noted that the expenses of operating national banks were considerably lower in 1933 than during the period 1918 to 1930. Most of this reduction was due to a decline in the average rate of interest paid on deposits. About two-thirds of this reduction in interest occurred before the Banking Act of 1933 became effective and reflected the general decline in money rates. One-third of the reduction took place after the passage of the act, reflecting almost entirely the prohibition against the payment of interest on demand deposits. The savings in interest on account of this change in the law amounted to 26 cents for each $100 of total deposits or more than the premium necessary to cover losses on deposits insured up to $5,000, as indicated by the experience of the past 70 years.

The cost of insurance will not be disproportionately heavy in relation to earning power if paid by banks in proportion to their total deposits. If insurance be limited to $5,000 for each depositor and the cost is distributed among the banks in proportion to their insured deposits, the payments by smaller banks would be nearly double the assessments distributed on the basis of total deposits.

Reserve for losses: We have recommended not only that subscriptions by insured banks to capital stock of the Corporation be eliminated, but also that the Corporation be given the right to allocate to surplus any portion of the some $300,000,000 paid to it by the Treasury and the Federal Reserve banks. If the amounts paid in subscriptions to stock were to be carried in full on the books of the Corporation as capital stock, the Corporation would be unable to pay any losses except out of income, over and above operating expenses, without impairment of its capital. The Corporation would have no surplus and while it might legally be permitted to spend its capital in meeting its obligations, a substantial capital impairment shown in its published reports would have a most adverse effect upon public confidence. We are, therefore, recommending that the stock issued by the Corporation to the Federal Reserve Banks and the Treasury, be without par value and that the balance be placed in a surplus or reserve account.

Until such time as the resources of the Corporation may be adequate to handle the volume of anticipated losses, it would be very unwise for the Corporation to pay dividends. We, therefore, recommend that the payment of dividends be eliminated.

It is important that the Corporation be given adequate means for increasing the funds at its disposal during critical periods. It is doubtful, however, if at such times the Corporation could borrow from private sources. The United States Treasury is the logical purchaser of these obligations. The Government is vitally interested in the maintenance of the country's banking system. We recommend that the obligations of the Corporation be issued only with the approval of the Secretary of the Treasury so that any credit which the Corporation may require shall not conflict with the financial policies of the Government.

Standards of membership: During the past year the activities of the Corporation have been chiefly concerned with the problem of rebuilding the capital structures of insured banks. In the future, the Corporation should devote a large part of its efforts to the maintenance of sound conditions among the insured institutions.

To maintain sound conditions among all insured banks it is essential that the Corporation have the power to control the admission of banks to the insurance fund. We cannot return to the overbanked condition of 1920 if we wish to have a sound banking structure. The growth of excessive banking facilities was one of the most destructive influences which existed prior to the banking holiday of 1933.

Since the banking holiday much effort has been expended in reorganizing and relicensing banks in order that the frozen funds of the depositors might be released. The accompanying table indicates that more than 2,000 banks have been added to those which withstood the shock of the banking crisis.

Newly licensed[1] banks grouped according to volume of total deposits by class of bank—July 1, 1933, to Dec. 31, 1934

[Deposit figures in thousands]

	July 1, 1933, to Dec 31, 1934					
	Number of banks			Aggregate deposits[2]		
	National	State	Total	National	State	Total
Banks with deposits of—						
$100,000 or under	25	379	404	$2,070	$22,905	$24,975
$100,001 to $150,000	29	222	251	3,624	27,528	31,152
$150,001 to $250,000	131	268	399	25,862	50,956	76,818
$250,001 to $500,000	219	248	467	78,988	87,635	166,623
Subtotal	404	1,117	1,521	110,544	188,024	299,568
$500,001 to $750,000	110	90	200	67,346	55,735	123,081
$750,001 to $1,000,000	58	42	100	50,765	36,665	87,430
$1,000,001 to $2,000,000	76	65	141	104,282	88,732	193,014
$2,000,001 to $5,000,000	44	35	79	131,970	102,133	234,103
$5,000,001 to $10,000,000	16	6	22	113,573	35,067	148,640
$10,000,001 to $50,000,000	5	3	8	91,414	51,860	143,274
Not available	6	88	94			
Total	719	1,446	2,165	669,894	559,216	1,229,110

[1] By "newly licensed" is meant existing banks reopened, banks reorganized, and primary organizations.
[2] Deposit figures for the most part as reported in Rand-McNally Bankers' Directory for July 1934

Source Card records of newly licensed banks maintained by the division.
Federal Deposit Insurance Corporation Division of Research and Statistics

Under present conditions the Corporation insures all newly licensed banks which apply for insurance if they are found to be solvent. Approximately 90 percent of the newly licensed institutions have become insured. The Corporation should be granted the specific power to refuse the admission of new banks into the insurance fund where such admission would weaken the banking system. The Corporation should also be given the specific right to require a higher standard than mere solvency for admission to the insurance fund.

It is my firm belief that every community which can produce a sufficient volume of deposits to support a bank should receive the advantages of such facilities. There are many localities throughout the United States, however, which can support only one or two banks. To establish a second or third bank in such communities leads to speculative and destructive practices in an effort to earn sufficient income to pay expenses. For the protection of the insured institutions, the Corporation, and the public welfare, the admission of banks to the insurance fund should be carefully supervised.

It is for these reasons that we have recommended that the legislation incorporate specific standards to be met by future applicants before admission to the benefits of deposit insurance. These standards have already been recognized by Congress in other legislation.

Capital rehabilitation: In the latter part of 1933 banks were admitted to membership in the insurance fund under exceptional conditions. The situation existing at the close of 1933 was critical. The lack of real public confidence in banks was unsettling. Congress, therefore, provided that all solvent banks should be admitted to the insurance fund, even though their capital was impaired in a number of instances. However, the Corporation immediately undertook to assist all banks which needed it in rebuilding their capital structures and correcting capital impairments which our examinations had disclosed.

The capital rehabilitation of banks was to be effected either through local contributions or through the facilities of the Reconstruction Finance Corporation. The Insurance Corporation assisted State nonmember banks to rebuild their capital structure. The responsibility for the condition of National and State member banks rests with the Comptroller of the Currency and the Federal Reserve Board, respectively. The Comptroller of the Currency and the Federal Reserve Board had the right to insist that banks under their jurisdiction accept necessary aid. The Corporation, however, had no such power. To accomplish the task of rebuilding the capital of nonmember State banks which had been admitted to the benefits of insurance, the Corporation could only use the power of rational appeal to the board of directors or to the State banking authorities. Without the cooperation of the State banking authorities the capital structure of nonmember banks would not have been rebuilt.

State nonmember banks which could not obtain local capital contributions were assisted in securing aid from the Reconstruction Finance Corporation. Banks which had already made application were assisted in complying with the conditions laid down by the Reconstruction Finance Corporation. The accompanying table reveals the extent of the aid extended by the Reconstruction Finance Corporation to the various classes of banks in this country. While it is true that by the close of 1934 Federal Reserve member banks (State and national) had received almost three times as much Reconstruction Finance Corporation aid as had nonmember banks, in proportion to total deposit liability the aid given State nonmember banks was twice as great as the assistance extended member banks.

Reconstruction Finance Corporation purchases of capital obligations of insured banks

[In millions of dollars]

	National banks	State member banks	Insured nonmember banks (excluding mutuals)	Total insured banks (excluding mutuals)
1. Total deposits, June 30, 1934 [1]	$19,896	$11,116	$4,746	$35,814
2 Capital, surplus and undivided profits, June 30, 1934 [1]	2,843	1,886	1,005	5,752
3 Net Reconstruction Finance Corporation contribution to capital to June 30, 1934 [1]	384	202	184	773
4 Ratio Reconstruction Finance Corporation to total deposits ... percent	1 9	1 8	3.9	2.2
5 Ratio Reconstruction Finance Corporation to total capital ... percent	13 5	10 7	18 3	13.4
6 Reconstruction Finance Corporation cumulated disbursement to all banks, Feb 1, 1935 [2]	$465	$238	$256	$959
7 Ratio of item 6 to item 1 ... percent	2 3	2 1	5.4	2.7
8 Ratio of item 6 to item 2 ... do	16 4	12 6	25.5	16.7

[1] Call report of insured banks, no 1
[2] As reported by the Reconstruction Finance Corporation.

Source: Federal Deposit Insurance Corporation, Division of Research and Statistics.

In some instances the necessary capital reconstruction had hardly been accomplished when applications were made by the banks to retire the preferred stock or debentures purchased from the Reconstruction Finance Corporation. As has been indicated, the capital reconstruction program was carried out for the purpose of protecting not only the banks but the Insurance Corporation. The capital and surplus of banks constitute a guaranty fund to depositors. They represent a cushion for the liability of the Corporation. When this capital and surplus are exhausted through losses, the depositor must turn to the Insurance Corporation for the payment of his deposits. The Corporation is vitally concerned, therefore, with the amount and condition of the capital and surplus of insured institutions. The reduction of this cushion of safety should be permitted only after obtaining the approval of the Corporation. If banks are allowed to retire this new capital, the rehabilitation, which has been so tediously accomplished, would be of no avail. The Corporation should have the right to control any future reductions in capital by insured banks.

Mergers and consolidations: The Corporation should have the right to review all mergers and consolidations affecting insured banks. It is possible that banks which have been refused admission to the insurance fund may be absorbed by insured institutions, thus extending the liability of the Corporation to depositors of the absorbed bank. Under the existing conditions, there is no way by which such a subterfuge could be prevented.

In the interests of the depositor the Corporation should have the right to refuse to give its stamp of approval to inequitable or unsound reorganizations. Last year the Corporation was called upon to review more than 700 such plans. Many of those which we have seen are inequitable. The Corporation should have the right to pass upon the justice and soundness of reorganization plans. Depositors have often made tremendous sacrifices without the comparable sacrifice by stockholders and other special groups.

The Corporation now has the right to buy assets of closed Federal Reserve member banks. We have recommended that this right to purchase be extended to operating insured banks until July 1936 whenever such action will avert an impending loss and facilitate a merger or consolidation. It will be to the best interests of both depositors and the Corporation if, through the absorption by the Corporation of a comparatively small loss, a more serious loss will be averted. Furthermore, such a procedure will offer both an incentive and a method for completing the rehabilitation of all insured banks prior to July 1, 1936. The right to purchase assets from operating banks should not be exercised unless in conjunction with a merger or consolidation and only for the purpose of averting loss.

Fidelity and other protection: Bank failures are frequently precipitated by defalcations. We, therefore, recommend that the Corporation be given the right to require adequate fidelity and other insurance. Such insurance provides protection to depositors, to bank executives, and to the Corporation. Where a given institution does not carry sufficient insurance, the Corporation should be given the right to contract for such insurance and charge the bank therefor.

Termination of insurance: A method whereby nonmember banks may withdraw from the insurance fund should be included in the legislation. Banks leaving the insurance fund should give adequate notice to the Corporation and to their depositors. However, such withdrawals should not expose the depositors to a sudden cancelation of the protection afforded them, and the insurance benefits should be extended to the depositors for 2 years after the withdrawal of any bank.

We also believe that the Insurance Corporation should have the right to terminate the insurance of any bank if, after a hearing and after notice to depositors, such action is in the best interest of both depositors and the Corporation. In establishing deposit insurance Congress has assumed not only a definite responsibility to bank depositors, but also a moral obligation for the sound management of banks. If the Corporation finds that an insured bank is engaged in repeated practices detrimental to its depositors, the Corporation should not be placed in the position of sanctioning such practices but should be given the right to terminate the insurance of the bank's deposits without jeopardizing the depositors. For the protection of depositors we have recommended that in such cases insurance be extended for 2 years from the time that membership in the fund is terminated.

The right of dismissal may seem to be somewhat drastic, but it is hoped that the use of this power may seldom be necessary. As an intermediate step, and as a means of notifying the public, it is suggested that the Corporation be authorized to publish either all or such portions of examination reports as it deems necessary. The State supervisory authorities will be advised of the intention to publish all or part of the examination report and only after adequate notice has been served on the executives of the bank concerned will such action take place. This procedure is designed to allow sufficient time for the executives of the bank concerned to correct the practices which jeopardize the safety of the depositors' funds. The Comptroller of the Currency has this right in the case of national banks.

Senator COUZENS. May I ask a question at that point?

Mr. CROWLEY. Yes, sir, Senator.

Senator COUZENS. What would happen to a bank if it was known it had made an application for withdrawing from the Insurance Deposit Corporation or if the Corporation undertook to cancel the insurance? Wouldn't there be a run on the bank?

Mr. CROWLEY. Well, I would say this, that if a bank has been carrying on practices of this kind, that we have given them 90 days' time to correct them, and if they won't do it or haven't done so, that the depositors should be protected by notice that that bank is going to be put out of the system. Now, I presume it will be agreed that if a bank has been guilty of practices such as that, it should be put in liquidation, if it has been conducting its affairs along that line.

Senator COUZENS. Yes; but what am I getting at is this: Would not publicity of the fact that the bank is going to lose the insurance ordinarily cause a run? I am wondering if it would be better, when that necessity arose, to close the bank and save the depositors.

Mr. CROWLEY. Well, I should say this: If a bank has been carrying on unsound practices, and the Corporation has given the 120 days' notice in which to correct such practices, and then the bank either has failed or refused to make such corrections, then the depositors of that bank should be protected by a suitable notice that the bank is going to be dismissed. Now, I presume it is generally agreed that if a bank has been guilty of unsound practices it should be eliminated from the insurance fund, even though such elimination mean liquidation.

Senator COUZENS. You are asking power, however, to cancel the insurance and to permit a bank to withdraw from the fund, which is tantamount to a notice to the depositors that the bank is in trouble. It seems to me there ought to be some better device for handling that matter than has been suggested in your memorandum.

Mr. CROWLEY. As I understand it, the Congress does not have the right to give the Corporation the power to close State banks.

Senator COUZENS. Would you give notice to the State bank before you took any such action?

Mr. CROWLEY. Yes, and also notice to the State supervising authorities.

Senator COUZENS. Would you give the State officials any notice before you made public your action?

Mr. CROWLEY. Yes.

Senator BYRNES. Would the public get the information?

Mr. CROWLEY. Ultimately the public would get the information after the necessary notice had been given and the bank given an opportunity to appear before our Board to show cause why they should not be eliminated from the fund.

Senator BYRNES. On the face of that notice, practically every bank would have to close, they would feel that they would have to close in order to take advantage of the insurance.

Mr. CROWLEY. You mean the final notice?

Senator BYRNES. No; I mean just what Senator Couzens says, that once it becomes known to the depositors that you believe their practices are such as to justify you in taking such action, that depositors will immediately withdraw their funds, immediately the wise fellows will, and some of the officials will, on getting notice.

Mr. CROWLEY. The law will operate in this manner: Notice is first given to the officials of the bank and the State supervising authority, and the bank is given 120 days to make the necessary corrections. At the end of the 120 days, if the corrections have not been made, the bank will then have 30 days within which its representative may appear before the board of directors of our Corporation to answer the charges. At the expiration of the 30 days, if the corrections have not been made or the representative of the bank has not appeared, the bank is expelled from the fund. You understand, however, that we insure those who are depositors at the date of expulsion for a period of 2 years thereafter. We do not insure anyone who becomes a depositor after the date of expulsion. This, I think, Senator, covers the situation you have in mind.

Senator BYRNES. It should not accept them without the depositor having knowledge that the insurance has been removed.

Mr. CROWLEY. Yes; that is right.

Senator BYRNES. The only question is whether they should run at all.

Senator COUZENS. Let us say there was the 120-day and 30-day additional notice, yet all the directors and officials of that bank have the knowledge, what would happen to the insiders?

Mr. CROWLEY. The most the insiders could do would be to withdraw balances in excess of $5,000, realizing that if the bank should ultimately close, they, like everyone else, would be protected up to the $5,000 limit.

Senator COUZENS. They may even want the money in there, having in mind that the Deposit Insurance Corporation could pay it and then get the money out no matter whether it was below or above the $5,000 insurance. It seems to me there must be some better device for handling this situation than is outlined in your testimony.

Mr. CROWLEY. Well, we would be glad to talk with you about that.

Senator COUZENS. We can take that up later.

Senator BULKLEY. I would like to get clear the operation of your distinction between the old and the new deposits. Suppose I have a $4,000 deposit in a bank where you are going to terminate the insurance. Now, if I draw that money in the account down to $2,000 and then make a new deposit of $2,000, how much am I insured to?

Mr. CROWLEY. $2,000.

Senator BULKLEY. If I made a new deposit, savings deposit, up to $5,000, and then drew it down to $4,000, how much would I be insured for?

Mr. CROWLEY. You will be insured only for the amount of your balance at the day that we notify the bank that they are dismissed from the fund.

Senator BULKLEY. Exactly; but I may be changing the amount, depositing and checking out.

Mr. CROWLEY. No; as you check out of that, our liability goes down. Otherwise, there would be no incentive for putting the bank out of the fund because our liability would always remain the same.

Senator BULKLEY. So, by checking out and drawing out money, your liability would be reduced?

Mr. CROWLEY. Yes.

Senator BULKLEY. And any new deposits would have no effect whatever?

Mr. CROWLEY. This is the primary reason why depositors should know when their bank is no longer insured, so that any future deposits they may make will be made with full knowledge and at their own risk.

The CHAIRMAN. You have no legal right, nor has Congress the right to give you authority to close a State bank.

Mr. CROWLEY. That is right.

The CHAIRMAN. And when a bank gets in the condition you describe it ought to be closed by one method or another, it should not be allowed to continue business and receive deposits over the counter when it is an insolvent condition.

Mr. CROWLEY. That is right.

The CHAIRMAN. Most of the States have statutes making that a penitentiary offense to do that.

Mr. CROWLEY. But, Senator, we couldn't afford, with our liability here, to depend upon the State commissioners to close these banks.

The CHAIRMAN. I am saying that; yes. That is what I am saying.

Mr. CROWLEY. We have got to have some power.

The CHAIRMAN. I think when a bank gets into that condition it ought to be closed in the speediest way possible.

Mr. CROWLEY. That is right.

The CHAIRMAN. Inasmuch as you are not authorized by law and Congress cannot give you the right to close the bank, it seems to me that your method there is worthy of very serious consideration, at least.

Mr. CROWLEY. Reports of condition: Reports of condition now being issued to the public are confusing because of their inadequacy and lack of uniformity. Considerable effort has been expended in a study of this question. Conferences have been held with the State and Federal supervisory agencies in an effort to develop standard and uniform reports of condition. In order that the public may be informed as to the status of the institutions with which they do business, periodical statements of condition should be required of all banks.

Payment of claims: Revision of the provisions of the law reciting the obligation of the Corporation to pay the insured deposits of a closed insured bank is necessary. As it now stands, the law requires the Corporation to organize a new national bank to act as its instrumentality in paying the insured deposits of every closed insured bank. This procedure must be followed even though there is not the slightest possibility of the community being able to capitalize the new national bank. Fifteen insured banks have thus far closed but in only one instance were the local people in a position to capitalize the new bank.

This procedure for paying insured deposits has proved unsatisfactory since it involves needless expense and many unnecessary accounting problems which could be eliminated if the Corporation were permitted to pay its obligations in the same manner as other insurance companies engaged in the commercial field. Accordingly it is proposed that the organization of a new bank be at the discretion of the Corporation.

Under the present law, where it pays the insured portion of a deposit claim which is larger than $5,000, the Corporation becomes subrogated to the entire amount of the depositors' claim until it is reimbursed for the amount paid out to the depositor. This is manifestly inequitable to the larger depositors. We believe that the Corporation should be subrogated only to that portion of the claim which it pays, the depositor retaining his claim for any uninsured portion, and receiving all dividends payable thereon directly from the liquidating officer. In the case of every closed bank there are some depositors who can never be located by reason of death, disappearance, or change of residence. We believe claims which are not filed within 1 year after an insured bank is closed should not be paid by the Corporation. This suggestion finds ample precedent, and will enable the Corporation to close its books on each pay-off within a reasonable period.

The bill before you includes suggestions for clarification of provisions of the existing law about which some doubt has arisen. The adoption of these provisions will facilitate administration.

Five thousand dollars maximum: We recommend that the maximum limit of insurance to any one depositor be retained at the present figure of $5,000. Congress, in establishing deposit insurance, was presumably most concerned with the mass of depositors with small accounts. Our reports cover 51,000,000 accounts, of which over 98 percent are fully insured with the $5,000 limitation. Many of the accounts not fully covered are interbank accounts, public funds, deposits of corporations, institutions, and trust estates. The actual number of individuals with deposits in excess of $5,000 is probably less than 1 percent of the total number of depositors. Out of the 14,000 insured banks, over 9,600 have more than 80 percent of their deposits insured under the $5,000 limitation. To raise the limit of insurance above $5,000 would materially increase the maximum possible liability of the Corporation. If all the deposits were insured, this would be more than doubled. It would be increased from the present 16½ to nearly 30 billion dollars by the permanent plan which now exists in the statute. This tremendous increase in the maximum possible liability of the Corporation would benefit only one out of each hundred bank depositors.

The Insurance Corporation's interest in the sound operation of banks is more tangible and more vital than that of any supervisory authority. Deposits in practically all commercial banks and trust companies of the United States are insured by the Corporation. Bank supervisory agencies have a responsibility to the depositing public, and it is their duty to see to it that the bank laws are properly enforced. The Corporation, however, has a financial liability to these depositors. Its interest in the sound operation of these institutions is one of dollars and cents.

There are two courses open to the Insurance Corporation. It can be a charitable institution which will pay for the mistakes, bad banking, and dishonesty of bankers, in which case the cost of the insurance must be set so high that it will be an injustice to every sound bank. Or, by being placed on a sound basis, the Corporation may be used as an instrument to improve the standards of bank management and reduce the losses to depositors through bank failures. The latter course, which I prefer, requires that the standard of bank supervision throughout the country be improved, that the Corporation be given the right to protect itself against excessive risks, and, finally that the Corporation be not handicapped by taking into the fund banks which are unsound or by continuing in the fund banks which are mismanaged.

Senator COUZENS. Have you convenient what your experience has been with the banks that have closed?

Mr. CROWLEY. Yes, Senator; I have.

Senator COUZENS. Have you it summarized? You don't need to give each bank.

Mr. CROWLEY. Fourteen of the fifteen insured banks which have failed to date had total deposits of $3,392,000. The secured portion of these deposits, including deposits subject to offset, was $953,000. Our liability was $2,137,000 and deposits of $301,000 were neither insured or secured.

Senator COUZENS. How soon did they pay out after the closing of the bank?

Mr. CROWLEY. Why, we usually started every pay-off within 10 days from the time of the closing.

Senator TOWNSEND. Have you finished your statement, Mr. Crowley?

Mr. Crowley. Yes; I have finished the written statement.

Senator Townsend. What was the overhead of the Corporation up to July 1, 1934, as compared with the cost of operation in the last 6 months of 1934?

Mr. Crowley. The overhead from September 11, 1933, to January 31, 1934, was $1,702,000. From February 1, 1934 to June 30, 1934, it was $1,130,000. From July 1, 1934 to December 31, 1934, it was $1,512,000. Or, since the Corporation has been in operation, the actual overhead was $4,345,000. The budget that is being set up for 1935 estimates that the cost of operation will be about 2½ million dollars, or a reduction of about $800,000.

Senator Townsend. That is 1935 as compared with 1934?

Mr. Crowley. That is correct, Senator.

Senator Townsend. Yes.

The Chairman. In the event, Mr. Crowley, that the duties and the functions of the Corporation should at a later period be transferred to the Federal Reserve System, what do you estimate would be the reduction in the overhead?

Mr. Crowley. I don't think, Senator, such a change would bring about any appreciable reduction in overhead, for the reason that practically all the functions now being carried on by our Corporation would have to be carried on by some other agency for the protection of the insurance fund. It seems to me that when you consider the contribution made toward the rebuilding of the entire banking system, the restoration of confidence among depositors, and the efforts expended toward making banks more safe and sound, the expense of operation of the Corporation can well be considered very nominal.

The Chairman. Isn't that largely upon the assumption that if transferred to the Federal Reserve System there would be no examination of these banks?

Mr. Crowley. Senator, let me say this: If you take away from this Corporation its right to examine banks, you are destroying the greatest safeguard this Corporation has. We are now examining some 7,800 State banks which applied and were admitted to the insurance fund. If we must take the examination of State supervising authorities it means that the protection now afforded by the right to make examination cannot be maintained, and in my judgment you could not hope to keep the Corporation solvent. Now, we have many reasons for this belief, and I want to give one in confidence. I would like to have you read this memorandum, which shows the reasons why hundreds of banks were closed. It also gives you some idea of the hazard we would have if we did not have the examining right.

Senator Bulkley. Now, as to the banks which are members of the Federal Reserve System, you would rely on the Federal Reserve examination?

Mr. Crowley. We do that, Senator. We do not examine any national banks in the Federal Reserve System or members in the Federal Reserve System which are not national banks.

Senator Bulkley. You don't examine them at all?

Mr. Crowley. There is no occasion to.

Senator Couzens. May I point out to Mr. Crowley that he had better check the figures with respect to the banks that are closed. He read the figures and they were inaccurate as he read them in the report because the insured deposits were larger than the amount he read in the record, and the record ought to be corrected.

Mr. CROWLEY. $2,137,000.

Senator COUZENS. Yes; you read off 953.

Mr. CROWLEY. No; 953,000 was the secured.

Senator COUZENS. But you didn't read it off that way.

Mr. CROWLEY. I beg your pardon.

Senator TOWNSEND. What was the condition of the State banking system when you started to admit banks into your fund on January 1, 1934, and what has been done to correct the practice?

Mr. CROWLEY. When the Federal Deposit Insurance Corporation first examined banks applying for membership, it found that there were 732 banks, with deposits of about $690,000,000, which were wholly without net sound capital. In other words, the total——

Senator TOWNSEND. How many banks?

Mr. CROWLEY. Seven hundred and thirty-two. In other words, the total of the amounts of the assets which the examiners considered doubtful and loss was equal to or more than the book capital of these banks. There were 723 additional banks, with deposits of $860,000,000, which were in the danger class, since the net sound capital in those banks was less than 5 percent of the deposits. In other words, there were 1,450 nonmember State banks which the Corporation considered to be in an extraordinarily weak condition, since they showed practically no net sound capital. These banks showed approximately $155,000,000 of book capital.

Through the activities of the Corporation it has been possible to improve the net sound capital through the introduction of local and R. F. C. funds in over 1,250 of the 1,450 banks which were originally considered to be precariously weak. In place of having $1,550,-000,000 of deposits in weak banks, which was the case at the inauguration of deposit insurance, we now have only $310,000,000 of deposits in about 200 weak banks.

Considering all of the State nonmember banks together, we find that the net sound capital has increased from $484,000,000 to $812,000,000, an increase of over 60 percent. Upon first examination, the combined net sound capital of nonmember State banks constituted about 45 percent of the book capital. On our most recent examinations net sound capital constitutes about 70 percent of the book capital.

The increase in net sound capital has been brought about by the following developments:

(a) Improvement in the condition and value of certain assets originally criticized, between the time of the first and last examinations;

(b) The removal of bad assets from the banks by directors;

(c) The injection of new capital;

(d) Charge-off of further loss items; and, finally,

(e) The changed point of view of examiners.

We estimate that the State nonmember banks still have well over $300,000,000 of doubtful and loss assets on their books which should be written off. The current earnings, plus recoveries, but before write-offs were taken during the year 1934, amounted to $92,000,000. At this rate it will take the 7,700-odd State nonmember banks between 3 and 4 years to absorb all losses which at present stand on their books, assuming, of course, that no additional losses in the assets of the banks are incurred.

Senator TOWNSEND. Do you know how many banks have been reorganized and given a charter since you started?

Mr. CROWLEY. Yes; I have that, Senator.

The CHAIRMAN. Mr. Crowley, I note that you recommend that all dividends on the stock of a bank be eliminated. That, of course, would transform the Treasury contribution into a gift.

Mr. CROWLEY. Well, I presume that you might refer to it as that, Senator.

The CHAIRMAN. That is what I wanted it to be, from the first.

Mr. CROWLEY. There is no need of leaving the dividend provision in, because there will be no way we can pay dividends.

The CHAIRMAN. Well, there ought to be some dividend. I don't agree with you about that. There ought to be some way to pay dividends, but I agree that the contribution by the Treasury ought to be made in recompense for the enormous amount of money that the Treasury took from the banks and didn't earn a dollar of it. Now——

Senator BULKLEY. May I ask a question to clear up a matter?

The CHAIRMAN. Yes.

Senator BULKLEY. I am not quite clear in my own mind as to what banks the Federal Reserve System audits and checks. There are the State member banks?

Mr. CROWLEY. The State member banks; yes, sir.

Senator BULKLEY. That is their function?

Mr. CROWLEY. Yes, sir; as far as examination is concerned.

The CHAIRMAN. Member banks and State member banks?

Mr. CROWLEY. No; they do not examine national banks.

The CHAIRMAN. The Comptroller of the Currency does that, but they have authority to do it, to make the audit, too.

Senator BULKLEY. And I understand the practice of the Federal Reserve System is to examine member State banks, is that right?

Mr. CROWLEY. That is correct.

Senator BULKLEY. And how often do they do it?

Mr. CROWLEY. I think they do it at least once a year.

Senator BULKLEY. Is that all?

Mr. CROWLEY. Yes. The Federal Reserve Board examines State member banks about once a year.

Senator BULKLEY. And you find that examination adequate for your corporation?

Mr. CROWLEY. Well, under the law, we must accept that examination.

Senator BULKLEY. Under the law; well, I asked you if you found it adequate.

Mr. CROWLEY. I think that the Corporation should have the right to go into any bank, if it felt that it was necessary to protect itself, and we have asked that, with the consent of the Comptroller, we might go into any national bank to try to work out a merger, where we might be subjected to loss, and we are asking for the same right in the Federal Reserve member bank.

Senator BULKLEY. In the Federal Reserve Bank System you say you rely solely on the Comptroller's examination so far as national banks are concerned?

Mr. CROWLEY. We do.

Senator BULKLEY. Do you find that adequate?

Mr. CROWLEY. Yes, but there are instances where I think it necessary that we have the power, with the consent of the Comptroller and the Federal Reserve Board, to join in examinations of national banks and State member banks, particularly in proposed mergers and consolidations.

Senator BULKLEY. I see. Thank you.

The CHAIRMAN. Mr. Crowley, let me review a section from existing law, which prescribes that the Federal Reserve Board shall from time to time limit by regulation the rate of interest which may be paid by member banks on time deposits, and may prescribe different rates for such banks on time and savings deposits having different maturities or subject to different conditions respecting withdrawal or repayment or subject to different conditions by reason of different location. What did you take that to mean?

Mr. CROWLEY. Well, we assumed this, Senator, that it meant the Federal Reserve had the power to regulate the interest on time deposits of any member bank, and then we assumed that we had the power under our act to cooperate with them and fix the rate of interest on members of the fund.

The CHAIRMAN. I know that was the assumption, but with respect to the Federal Reserve Board, what do you think that language means? Doesn't it clearly imply that the proponents of this law and that the Congress thought there was a good reason why the rate of payment should be different according to different maturities or subject to different conditions respecting withdrawal or repayment or subject to different conditions by reason of different localities?

Mr. CROWLEY. I think that is what they intended.

The CHAIRMAN. Otherwise, we wouldn't have put that in.

Mr. CROWLEY. I think that is practical, too, Senator, because some parts of the country get a higher interest.

The CHAIRMAN. Senator Bulkley, who was a member of this committee as originally constituted, will recall that we discussed that very intently and for a long time. Do you think there is any more reason why a payment on time and savings deposits should be uniform throughout the country than there is a reason why discount rates should be uniform throughout the country?

Mr. CROWLEY. No; I think, Senator, the interest rate should be determined by regional districts, taking into consideration the interest charged on loans for that district.

The CHAIRMAN. Well, I am glad to hear you say that, because that has been my contention. In other words, a bank that is limited by State taxes in its current discount rate to 5 percent, as is the case in Michigan and in one other State, or to 6 percent, as is the case in Virginia and is the case in most of the eastern banks, ought not to be restricted in its payment of interest on these deposits, as the western banks and some southern banks which charge 8 and 10 and 12 percent for the use of the depositors' money.

Mr. CROWLEY. That is correct.

The CHAIRMAN. In other words, a bank that is restricted to 5 or 6 percent in its discount rate or, rather, a bank that is allowed 8 or 10 or 12 percent for the use of these depositors' money, can afford to pay more to those time and savings depositors than a bank that is restricted to 5 or 6 percent; isn't that true?

Mr. CROWLEY. That is right. Senator, you asked me a question about reorganizations.

Senator TOWNSEND. Yes. Do you think that the Corporation should have the right to combine the assets of closed banks?

Mr. CROWLEY. We have proposed that this power be extended to us until July 1, 1936, for these reasons: There are certain banks whose existence cannot be economically justified, that is to say, their size and location precludes the possibility of their making sufficient earnings. There are others whose distressing condition is such as to make it advisable for them to either close or consolidate with some other bank. It would be helpful to this Corporation if we had the authority to purchase the assets of some of these banks in order to bring about consolidations or mergers. Our liability would thereby be greatly reduced.

Senator BULKLEY. Why do you recommend the date of July 1, 1936?

Mr. CROWLEY. In order to give us an opportunity to observe the practical results of operation the date was arbitrarily chosen. I do think, however, there is danger of this power being abused, and that, therefore, it ought to be used only in extreme cases. The Corporation would gain nothing if it purchased the bad assets from banks that had been badly managed, and if State commissioners would later recharter another bank with the same old management.

The CHAIRMAN. Adverting to the payment of time and savings deposits.

Mr. CROWLEY. That was on open banks, Senator. Now, on the matter of closed banks, there may be instances where we have 90 percent of deposit liability, we may wish to do the same thing as with the closed bank, merging part of the assets. There are no limits to that.

Senator TOWNSEND. I think you were interrupted in answering my question about the number of banks there were reorganized and newly opened.

Mr. CROWLEY. Since July 1, 1933, there have been 404 newly licensed banks admitted to the fund with deposits of less than $100,000, 251 with deposits of less than $150,000, 399 with deposits of less than $250,000, and 467 with deposits of less than $500,000.

The CHAIRMAN. How many banks closed from 1920 to 1933?

Mr. CROWLEY. About 11,000, Senator, closed, excluding those which suspended and later reopened. I would like to show you the size of these banks.

The CHAIRMAN. Yes.

Mr. CROWLEY. Since 1920, in 1920 you had 6,548 banks, with loans and investments of under $150,000.

The CHAIRMAN. Do you call those banks?

Mr. CROWLEY. From 1921 to 1931, 3,504 of that size suspended. I would like at this point to call your attention to the fact that there is grave danger that we are traveling the same road that led to the wholesale licensing of banks and the appalling number of closings. In order to avert a repetition of the mistakes that have been made in the past, it seems to me that it is necessary to give this Corporation powers we are seeking so that we will not have to admit to membership in the fund, banks which cannot economically survive.

The CHAIRMAN. How many of the banks that failed, that closed, were State banks, and how many national banks? Have you stated that?

Mr. CROWLEY. We have that here, Senator. From 1921 to 1933, inclusive, about 1,800 national banks suspended and did not reopen. More than 9,000 State banks suspended and did not reopen.

The CHAIRMAN. What is the average size of the banks now in your fund?

Senator TOWNSEND. Pardon me, before you pass that. Does it give you the amount? What was the amount of the total deposits of the 11,000 State banks?

Mr. CROWLEY. They were very small, Senator, on an average. The total in suspended State banks was about $4,000,000,000. In the national banks, it was about $1,700,000,000. Deposits of banks which reopened are not included in these figures.

Now, the size of the banks in our fund. We have 1,502 banks with deposits of $100,000 and less. They are made up of 94——

The CHAIRMAN. With deposits of what?

Mr. CROWLEY. $100,000 and less. They are made up of 94 national, 22 State member banks, and 1,386 State banks. The insured liability of those banks is 91.67 percent. So you can see what our liability is in that particular group of 1,502 banks.

From $100,000 to $250,000, there are 3,580 banks; 834 of them are national, 119 are State members, and 2,627 are State nonmember banks. And we have an insured liability there of approximately 87 percent of all those banks.

From $250,000 to $500,000, there are 3,109 banks; 1,261 are national, 186 are State members, and 1,662 are State nonmember banks. We have an insured liability there of 83 percent.

From $500,000 to $750,000, there are 1,477 of them; 741 are national, 97 are State members, and 639 are State nonmember banks; with an insured liability of approximately 80 percent.

Or in 9,668 banks, 2,930 are national banks, 424 are State member banks, and 6,314 are State nonmembers. We have an insured liability of 80 percent or greater.

The CHAIRMAN. Well, how many of these banks do you think might be so small that they may not remain economically sound and that they will involve you in losses?

Mr. CROWLEY. Our figures show that all of the State nonmember banks, amounting to 7,700 banks, operated at a net loss of $115,000,000 for the year 1934. This is after taking into consideration their current net earnings of $54,000,000, their recoveries of $38,000,000, and their write-offs of $206,000,000.

As an example of what the banks' earnings were, let me call your attention to the 1,200 State nonmember banks that have total deposits of less than $100,000. These banks operated at a net loss of

$2,900,000, or about $2,400 per bank after taking into consideration recovery and write-off of losses. On the average, operating expenses of these banks were only $700 less per bank than operating earnings—in other words, I am not taking any losses at all. The operating income of the average bank of $100,000 and under was only $700 before they considered losses. After they took out their losses, they operated in the red.

The banks with total deposits of from $100,000 to $250,000 of which there are 2,500 showed a total loss for the year of almost $10,000,000, after taking into consideration recoveries and write-offs. On the average, each of these 2,500 banks had current earnings which were only $1,800 more than their current expenses.

In other words, this group of from $100,000 to $250,000 had average earnings before losses of $1,800 a year.

The CHAIRMAN. Isn't it conceivable, Mr. Crowley, that if that sort of thing should continue, the losses of your Corporation will be incredibly large?

Mr. CROWLEY. Senator, you cannot hope to keep this Corporation solvent unless you either give it tremendous income, or unless you give it supervisory powers and the right to correct unsound practices, because by the very nature of their earning capacity these banks cannot keep themselves clean because any kind of a loss which they will have will eat up any earnings they have and adversely affect their capital position.

The CHAIRMAN. Adverting to this payment on time and savings deposits, have you any provision in title I relating to that?

Mr. CROWLEY. No, Senator; after my conversation with you that time, I left that out.

The CHAIRMAN. You left that to the Federal Reserve?

Mr. CROWLEY. No; we haven't any provision at all for State banks. You recall, you and I discussed that. I think there should be a provision in our law, Senator, to apply to the State nonmember banks.

The CHAIRMAN. And have the rate of payment relating itself to the rate of discount?

Mr. CROWLEY. That is correct, sir.

The CHAIRMAN. Let me ask you this: It has been stated elsewhere that nonmember banks have been or will be exempted from the obligation of becoming members of the Federal Reserve Banking System by July 1, 1937. I think you very clearly recall the details of this provision of the existing law, and the President and the Secretary of the Treasury, then Mr. Woodin, were apparently irrevocably opposed to insurance of deposits. But they finally became convinced that it might be a desirable experiment, only because it seemed very probable that it would bring about approximately a unified banking system by compelling all insured banks to come into the Federal Reserve System. Do you alter that provision of the law in your title I?

Mr. CROWLEY. No, Senator; we leave that, as it was agreed last year to extend it until 1937.

The CHAIRMAN. Yes.

Mr. CROWLEY. And that is in your bill just as it was agreed last year.

The CHAIRMAN. What is your judgment as to the proposition of eliminating that requirement?

Mr. CROWLEY. I think this, Senator: If the Government is going to insure deposits, and really this is a Government fund because the money comes from the Government; if it is going to assume the responsibility, it should try to centralize the control of these banks, and that is one way you can centralize the control of all State nonmember banks.

The CHAIRMAN. But I don't agree that it is a Government fund. It is a fund derived from assessment on banks. Of course, a part of the fund——

Mr. CROWLEY. Senator, if we are going to have to pay the same proportion of losses in the future as the depositors suffered in the past, I don't think the banks can finance that fund themselves.

The CHAIRMAN. Well, I don't understand that anybody connected with this administration, or perhaps I might say, though it is a venture, that anybody connected with this committee now investigating this matter is in favor of Government guarantee of deposits. We have provided for a bank guarantee of deposits.

Mr. CROWLEY. Well, I think that is true.

The CHAIRMAN. Of course, the Government has made what some people call a contribution and what I call compensation, by the Treasury putting in some money, but that is all, that is all of the Government's liability. What I want to arrive at directly is whether or not you think we cannot ever have a unified banking system unless this requirement remains?

Mr. CROWLEY. I think that is the first step in a unified banking system, and I think in time to come, Senator, that you have got to come to a unified banking system if you are going to reduce these losses materially.

Senator BULKLEY. Mr. Crowley, I don't understand your statement that the banks cannot finance this insurance. Didn't you just testify that the saving in interest alone, the savings by the banks in the payment of interest at the bank and on accounts is about equivalent to the amount necessary to carry the whole thing?

Mr. CROWLEY. Yes; but of course it doesn't mean that you can take all that saving, Senator, from these banks, because some of that saving was brought about by their own voluntary act, since they could not employ these funds any more profitably, and naturally they had to reduce the amount they could afford to pay for them. In other words——

Senator BULKLEY. Are you testing the bank's ability to pay by their earnings in these very depressed times?

Mr. CROWLEY. No; we have gone over a period of a great many years' bank earnings. But what I say is this, Senator, that the first thing you must do is to avoid the losses of the past. Because, certainly, our banking system has demonstrated that it had many weaknesses in it. If we are going to have the same amount of losses in the future as we have in the past——

Senator BULKLEY. There is no doubt about that. There are many things that can be done.

Mr. CROWLEY. I think the banks can finance this plan provided the Corporation is given the power to protect itself, particularly in not permitting State supervising authorities to indiscriminately charter new banks and make the Corporation take them into the fund. If we are to assume the liability comparable to the one we are now carrying in 9,668 banks, we must have the right to protect ourselves.

Senator BULKLEY. Does the law now make you take them into the fund?

Mr. CROWLEY. Yes, sir; under the law we must admit a bank into the fund if its assets equal its deposit liabilities.

Senator BULKLEY. Now, I understand what you are driving at.

The CHAIRMAN. Mr. Crowley, speaking of the banks financing this insurance, it has been suggested, and for myself I can entirely concur in the suggestion, that instead of having an annual stated assessment from the banks, make an assessment on the banks until your fund reaches a given strength, say, a half billion dollars, and when that shall have been done that the assessments cease automatically until that fund shall become impaired, say, by 25 percent, and then automatically the assessments be resumed. What would you have to say about that?

Mr. CROWLEY. You mean our surplus shall be $500,000,000, or until we build a surplus of $500,000,000?

The CHAIRMAN. What do you call a surplus? What is the nearly $400,000,000 that you have now? What is it there for?

Mr. CROWLEY. A part of that will become capital, of course, and part of it will be used for surplus.

The CHAIRMAN. What do you need with capital?

Mr. CROWLEY. We don't particularly need it. As a matter of fact, I think most of our present funds should be transferred to surplus.

The CHAIRMAN. It was put there to pay losses, insure deposits. What I mean is that when that sum reaches a half billion dollars, that then the assessments upon the banks should automatically cease, and whenever it shall become impaired by 25 percent, the assessments automatically resumed.

Mr. CROWLEY. Now, that would depend upon this: If you would keep that building of the fund to $500,000,000, and then let us continue to assess or start to assess again when our fund was impaired, we will say, 20 percent, that it seems to me might be satisfactory.

The CHAIRMAN. Yes.

Mr. CROWLEY (continuing). Which would bring it to $400,000,000.

The CHAIRMAN. Yes.

Mr. CROWLEY. But, you see, if you had a 50-percent impairment, which will——

The CHAIRMAN. Nobody has suggested 50 percent.

Mr. CROWLEY. On the basis of the present proposed annual assessment of one-twelfth of 1 percent it will require a great many years to build the fund up to $500,000,000. I can see no great objection to putting a cap somewhere along the line to provide that the maximum amount of the fund may not go beyond a reasonable amount.

Senator BYRNES. Otherwise you would be accumulating a fund from which there is no immediate benefit. It does seem it would be unnecessary.

Mr. CROWLEY. It will be a long time before we get up to $500,000,000, Senator. Now, if you want to put a cap in there at that place, I don't see any great objection to that.

Senator BYRNES. You say a long time. What is your estimate?

Mr. CROWLEY. I would say it would be 10 years, Senator, before you got it up after deducting your losses.

The CHAIRMAN. Would not that largely depend upon what your losses would be?

Mr. CROWLEY. Yes, sir; that is right, Senator.

The CHAIRMAN. And if the banking business progresses, gets on a better, more expanded basis, why it wouldn't take so long, would it?

Mr. CROWLEY. No; that is correct, Senator. It will all depend on how successful you are in improving your banking system so as to eliminate losses.

The CHAIRMAN. It has been suggested, Mr. Crowley, that the bank examination agencies now in existence should be centralized in one agency. What have you to say about that?

Mr. CROWLEY. I think, Senator, there is much to be said in favor of a central examining system, however, I doubt if examinations can be centralized before 1937, when it is required that all State banks enter the Federal Reserve System. At present I think there would be much resentment toward any Federal examining agency other than the Insurance Corporation making the required examinations of the 7,800 nonmember State banks. Up to date our relations with the nonmember State banks which are members of the fund, as well as with the greater number of the State banking authorities, have been quite satisfactory. I feel very strongly that during the next year or two the Insurance Corporation must give the banks in the fund very close attention and supervision. I think that in the next 2 or 3 years there must be some changes in your banking laws, but that is a matter that should be given very careful study and consideration. I am opposed to the hasty passage of far-reaching changes in the banking laws without sufficient time and study being devoted to them. One important question is what should be done in order to give to small communities banking service, some of which are not in position to raise independent local capital.

The CHAIRMAN. How do you propose to eliminate the unsound and uneconomic banks? I believe you said you wanted authority to merge and consolidate.

Mr. CROWLEY. I think, Senator, that unsound and uneconomic banks should be eliminated through the process of merger or consolidation whenever possible. The Corporation is asking for the authority to purchase assets wherever advisable, in order to effect mergers and consolidations when in the best interests of the depositors and the Corporation. We are asking for certain powers which will give us some discretion and latitude in the matter of admitting newly chartered banks. This is in accord with the universal practice of insurance corporations generally, who have the right to pass on what risks they are going to assume. With the wide-spread acceptance of deposit insurance amongst bankers and the increased confidence of depositors in the plan, membership in the fund will tend to become more and more attractive and necessary. I think this will tend to eliminate the hasty and ill-advised chartering of new banks when it is realized that the Corporation does not have to admit indiscriminately any bank which applies for membership.

The CHAIRMAN. Would not that situation be very materially helped by a system of State-wide branch banking?

Mr. CROWLEY. I think so; there are certain communities that are entitled to certain banking service, but they can't support a bank with capital and keep it in a sound position.

The CHAIRMAN. Mr. Crowley, could you be back here at 10:30 Monday morning?

Mr. CROWLEY. Yes, Senator.

The CHAIRMAN. All right, please do that.

Mr. CROWLEY. Thank you.

(Whereupon, a recess was had at 12:25 p. m. to 10:30 a. m., Monday, Apr. 22, 1935.)

BANKING ACT OF 1935

MONDAY, APRIL 22, 1935

United States Senate,
Subcommittee of the Committee on Banking and Currency,
Washington, D. C.

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

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

Senator Glass. The committee will please come to order. Mr. Crowley, will you come forward and resume?

STATEMENT OF LEO T. CROWLEY, CHAIRMAN OF THE BOARD, FEDERAL DEPOSIT INSURANCE CORPORATION—Resumed

Senator Glass. Mr. Crowley, we were proceeding with your examination, and there are some few further questions that some of us would like answered. I, particularly, want to ask you what would be, in your judgment, the effect upon the insurance of deposits scheme if all State banks are to be permitted to join the Deposit Insurance Fund upon the mere payment of the assessment and not required to come into the Federal Reserve System and comply with the provisions of that System?

Mr. Crowley. Well, Senator, that's a very difficult question for me to answer on account of our limited experience with the plan of insurance of deposits. It seems to me that the answer depends upon a number of factors, which obviously cannot be determined at this time. For example, the manner in which the Corporation is administered, its relations with the various supervising authorities, the public's acceptance of the plan, and the attitude of bankers will all be determining influences.

Senator Glass. What was the purpose of this requirement that they become members of the Federal Reserve System after a given period of years?

Mr. Crowley. Well, my understanding of the purpose was this: That when this act was agreed upon, it was agreed upon to set up the insurance corporation with that provision in it that you were going to be able to strengthen your banking system by having new members in your Federal Reserve System.

Senator Glass. That we are going to be able to get approximately a unified banking system? Was it not your understanding that that is the real reason the President agreed to that provision in the law?

Mr. CROWLEY. I was not here at that time, Senator, but I understood, from what you have told me, that that is the reason that the President agreed to that provision.

Senator GLASS. That is the only reason that the President, and the then Secretary of the Treasury, Mr. Woodin, agreed to that provision of the law. As I understand it, we have approximately 7,000 State banks who are voluntary members of the Deposit Insurance Fund?

Mr. CROWLEY. That is correct, Senator.

Senator GLASS. Have those banks the right to withdraw from the fund at any time?

Mr. CROWLEY. They have the right to withdraw, Senator, by giving us 30 days notice prior to June 30 of this year. Under the law we give them the right to withdraw, but we are also asking that they notify their depositors when they are going to withdraw.

Now, the reason for that is this: When you have an unsound or a badly managed bank that requires supervision, and in order to evade your supervision they may attempt to withdraw from the fund, so that in order that those banks cannot withdraw we say to them that they must notify their depositors, and we will protect the old depositor for a period of 2 years. Now, the new depositor, after he is once put on notice, puts his money in the bank at his peril.

Senator GLASS. Well, would it not be reasonable to suppose that bank directors would have to call meetings of their stockholders to discuss the question of withdrawal?

Mr. CROWLEY. I do not think it is as necessary for them to discuss the question with the stockholders as to notify the depositors, because they have an interest in those banks by reason of assessment. I believe they should have knowledge before they withdraw from the fund.

Senator GLASS. Therefore, do you think it important for the bank to know the attitude of their stockholders and depositors at a reasonably early period?

Mr. CROWLEY. I do, Senator.

Senator GLASS. You think, then, do you, that there is occasion for the speedy enactment of title I of this bill?

Mr. CROWLEY. I do, because opportunity must be given to those banks now in the fund to withdraw if they so desire. If the proposed bill is not enacted the original permanent fund goes into effect July 1 of this year. Moreover, the Corporation should be given time to make administrative adjustments that will be necessary before the proposed bill takes effect. Since there is such a short period of time before the permanent fund provided in the existing law becomes effective, we find a great number of bankers are vitally interested in the passage of the proposed bill for the reason that they consider it inadvisable to continue as members of the Corporation unless the proposed changes are made. It is my opinion that unless the present bill is passed a great number of institutions will not avail themselves of the opportunity of membership in the permanent fund.

Mr. L. E. BIRDZELL (general counsel, Federal Deposit Insurance Corporation). At the beginning of that statement, Mr. Crowley said that under the law we are operating under now. That should be, under the proposed bill.

Senator GLASS. Do you recall how many banks the R. F. C. has propped up by loans?

Mr. CROWLEY. By loans and also preferred stock or a debenture——

Senator GLASS (interposing). Well, preferred stock is a loan, is it not? What else is it?

Senator COUZENS. Is there not a difference whether it is a preferential creditor over the preferred stock? So it is not preferred over a depositor, while a loan would perhaps come in there?

Senator GLASS. Well, I am told that nine tenths of the banks which have sold their preferred stock sold it upon their own volition and upon application to the R. F. C., and not upon request of the R. F. C., and they sold it in order to be propped up.

Mr. CROWLEY. Senator, I think that is correct. I do not think R. F. C. has ever asked any bank——

Senator GLASS (interposing). It has asked some few banks——

Mr. CROWLEY (interposing). What I mean, Senator, is the rank and file, to sell their preferred stock.

Senator BULKLEY. It has asked some.

Senator BYRNES. Are you connected with the R. F. C.?

Mr. CROWLEY. No; I am not, Senator.

Senator BYRNES. And yet you attempt to say what they have done?

Mr. CROWLEY. What I mean, is, that they have not asked it of the supervising agency.

Senator BYRNES. You mean they have not asked you?

Mr. CROWLEY. They have not asked us.

Senator BYRNES. Can you say they have not asked the others?

Mr. CROWLEY. I say, of the supervising agencies, that I have suggested.

Senator BYRNES. I thought you said they have not done it.

Mr. CROWLEY. No; we have all done it.

Senator BYRNES. Than you agree that all banks are propped up?

Senator GLASS. For what reason, Mr. Crowley?

Senator BYRNES. Answer the chairman's question first, and then I will take this up.

Senator GLASS. No; you go ahead.

Senator BYRNES. You agree that these banks have been propped up?

Mr. CROWLEY. Sure.

Senator BYRNES. How many of them?

Mr. CROWLEY. Five thousand four hundred and twelve.

Senator BYRNES. They all needed propping up?

Mr. CROWLEY. That is right, Senator.

Senator BYRNES. What would have happened if they had not been propped up?

Mr. CROWLEY. I do not know. It might have wrecked your banking system.

Senator BYRNES. And you talk about loans on preferred stock?

Mr. CROWLEY. The reason I say what I do about preferred stock, is, they sold preferred stock, and the owner had to take class B of the R. F. C., and maybe a loan for class C.

Senator GLASS. I suppose it would not have wrecked the entire banking system, because more than 85 percent of the banks resumed operations with licenses after the banking holiday.

Senator COUZENS. You do not take that seriously, do you?

Senator GLASS. I do not think that percentage of banks was sound, because the Secretary of the Treasury admitted to me that he had licensed at least 1,000 unsound national banks or insolvent national banks. But what I mean, is, banks that were properly conducted—and there were many thousands of banks that were properly conducted and would not have been very much affected by the failure of banks that were improperly conducted, for the reason that individual banks failed to create consternation among the depositors of the country anyhow. It was my theory—it is not particularly pertinent here—it was my theory that every rotten bank in the country should have been permitted to fail at the time we were having bank failures, and then we would not have any trouble now.

Mr. Crowley, I believe I understood you to say that you were a member of what was called this committee of experts to prepare banking legislation. You were a member of that committee?

Mr. CROWLEY. I was a member of the loan committee, if that is what you mean, Senator.

Senator GLASS. Yes. And, as I recall, you said you had nothing to do with any provision of this bill except title I?

Mr. CROWLEY. Our board of directors and the legal department drafted title I and submitted it to the committee.

Senator GLASS. Yes. And you hoped that would be acted upon separately from any other provision in the bill?

Mr. CROWLEY. Well, that was decided; that was our original thought, Senator, but the President decided that he wanted it kept together, and told us so.

Senator GLASS. Yes; and he afterwards decided that he was willing to have them separated, and then again decided that he would like to have them kept together.

How did you propose to eliminate the unsound and uneconomical banks hereafter?

Mr. CROWLEY. I think what has got to happen, Senator, on that is that the Corporation will have to make a survey of each State and try to determine the banks that, by their size, or for other reasons, cannot operate soundly, and try to bring about eliminations by the purchasing of assets and consolidations, and then, of course, by having power to restrict the rechartering of that same type of bank in the future.

Senator COUZENS. You mean the Federal Deposit Insurance Corporation has the power to charter?

Mr. CROWLEY. No; I mean that we have the power, Senator, with the banks that come into our fund. We have no power to charter a State bank.

Senator COUZENS. Or any national bank?

Mr. CROWLEY. That is right. But we ask for the power that if a State commissioner should charter a bank that we think is economically unsound, that we may not have to admit it to our fund. That is the protection we are asking for.

Senator GLASS. That is the protection the Corporation is seeking against the chartering of a lot of small and uneconomic banks hereafter?

Mr. CROWLEY. Well, the experience in the past, Senator, has been this: That not only in small banks, but in lots of communities they have had 2 or 3 or 5 banks where really the community could only support 2 banks, and it is a question of the banks having an earning capacity that they may keep themselves sound.

Senator GLASS. What has been your experience with State bank commissioners on the examination of State banks? Have they cooperated with you?

Mr. CROWLEY. May I answer that off the record for the time being?

Senator GLASS. Yes; off the record.

(There was discussion off the record.)

Senator GLASS. Now, then, what provision have you for the dismissal of banks from the membership of the fund that seem to your Board to be unworthy of insurance?

Mr. CROWLEY. I believe I have already outlined the procedure we desire, namely, the giving of notice to the bank and supervising authority.

Senator GLASS. What percentage of the State banks that are now in your fund could qualify for membership in the Federal Reserve Banking System, do you think?

Mr. CROWLEY. You mean the capital requirement, Senator?

Senator GLASS. Well, I mean the capital requirement—perhaps that is the only point upon which you are informed. But there are other requirements as well.

Mr. CROWLEY. There are 5,387, Senator, on June 30 that could have qualified; and 2,134 that could not.

Senator GLASS. They have from now until July 1, 1937, to be placed in position to qualify?

Mr. CROWLEY. For those 2,134 banks to qualify, it will take $55,583,000 to put them in condition to qualify. The deposits in those 2,134 banks are $502,000,000.

Senator GLASS. Well, do you think your fund would be entirely safe unless they should qualify and become members of the Federal Reserve System?

Mr. CROWLEY. Well, I think it all depends, Senator, on what power you give our corporation.

Senator TOWNSEND. You mean, whether or not we give you the power as designated in this bill?

Mr. CROWLEY. Well, I think you have got a problem all the way through your whole banking system that you have got to consider in the next few years, and that is how to give these communities banking service. There are a great many communities now that need banking service; they have none, and yet they are not able to raise sufficient capital. I think the whole principle of this thing goes back to a correction of your whole banking system and making certain changes that are going to give to your corporation better protection, and strengthening of the banking system.

Senator GLASS. Do you think a branch banking system, Statewide, would do that?

Mr. CROWLEY. It might. There are something like 17 States that have no branch banking, whereas 30 or 31 do permit it. In my opinion there must eventually be a thorough study of our entire banking system made, at which time the subject of branch banking ought to be impartially discussed.

Senator GLASS. Of course, that is an essential feature of branch banking, you have to determine those matters.

What provision have you in this bill to protect your Corporation against a reduction of capital in the banks which are now insured?

Mr. CROWLEY. We are asking for the authority, Senator, that no bank will reduce its capital without the consent of our Corporation. We are asking for that after some experience of going out and getting these banks to come into the R. F. C. to take some aid, only to find that in some of them we just get their capital rebuilt and they go out and confuse liquidity with capital and want to repay the R. F. C. before they are in position to do so.

Senator GLASS. Well, what provision have you against an insured bank merging with a noninsured bank?

Mr. CROWLEY. We are asking for the prevention of mergers, that where they are attempting to merge with a noninsured bank, that they will not do it without our consent. The reason we are asking that is this: We have permitted them to come in on occasions, and then they have merged without our consent. In other words, we took the liability that we formerly had refused.

Senator GLASS. I believe you provide in your title I that the temporary clause of the existing law as to the limitation upon insurance shall be permanent; that is to say, $5,000 insurance?

Mr. CROWLEY. Yes, Senator; we do.

Senator GLASS. Gentlemen, do you have any questions?

Senator BYRNES. I would like to ask him one question.

Mr. CROWLEY. Yes; Senator.

Senator BYRNES. What power is contained in this bill as to the determination of admission to the system of State banks? Exactly what power is contained in this bill?

Mr. CROWLEY. You mean admission to our fund, Senator?

Senator BYRNES. Yes.

Mr. CROWLEY. All the banks that are now members, Senator, we wash right into the permanent fund. They do not have to go through any formality to come in at all. Now, on a bank that is duly licensed—and there are some 1,100 outside our fund—we are asking that those banks have more than just enough capital and surplus to meet the solvency test. They must have a reasonable capital to provide a protective cushion for the deposits.

Senator BYRNES. You make an examination of those banks, do you not?

Mr. CROWLEY. Well, Senator, under the temporary law we have only the authority to determine whether they have sufficient to pay the deposits. We cannot ask that they have an excess. Do you get the point?

Senator BYRNES. Yes.

Mr. CROWLEY. Now, what we are asking for in this bill is that, in addition to the meeting of the deposits, that they also have sufficient capital to protect their depositors; and also, in the case of a new bank, that they be an economic necessity to that community.

Senator BYRNES. Do you remember the number of the section in which that is provided?

Mr. BIRDZELL. I will give you that reference, Senator.

Senator BYRNES. I do not want to read it at this time.

May I ask another question: You gave the number of banks that have bought preferred stock of the R. F. C.?

Mr. CROWLEY. Yes, Senator.

Senator BYRNES. Will you give me that figure again, of the total number of banks?

Mr. CROWLEY. Five thousand four hundred and twelve banks, Senator.

Mr. BIRDZELL. That reference you asked for, Senator, is on page 9 of the bill, paragraph 7.

Senator BYRNES. That number of banks, Mr. Crowley, is the number in which preferred stock was purchased?

Mr. CROWLEY. And debentures.

Senator BYRNES. Out of how many banks?

Mr. CROWLEY. Out of 14,200 insured banks, Senator, and the amount of money is $821,000,000.

Senator GLASS. You said to Senator Byrnes that you are washing in all of the banks that you have now insured; but you have a provision in here under which you could wash some of them out, have you not?

Mr. CROWLEY. If they do not conduct themselves properly, Senator.

Senator GLASS. Yes.

Mr. CROWLEY. In other words, they will not have to go through the qualifying stages again. They are already members of the fund and they stay members as long as they stay in good standing.

Mr. BIRDZELL. May I add one observation there. Under the terms of the existing law every bank that came in under the temporary fund was made eligible to subscribe for class A stock, so they would be automatically qualified for class A stock anyhow.

Senator GLASS. I understand, but they might very easily become disqualified.

Mr. BIRDZELL. Yes, sir.

Senator GLASS. Mr. Crowley, we are very much obliged to you.

Senator BYRNES. May I ask one other question?

Senator GLASS. Certainly.

Senator BYRNES. Really, the discretion that you seek in section 7 is practically the same discretion that is exercised by the Comptroller in chartering a national bank?

Mr. CROWLEY. That is right, Senator.

Senator BYRNES. Almost the same thing?

Mr. CROWLEY. That is right. Back in 1920 you had 30,000 banks. Now you are down to about 15,000 banks. And when you had 30,000 banks, you had too many for your country, and what we are trying to save is the growth back to the 30,000.

Is that all, Senator?

Senator GLASS. That is all.

Mr. CROWLEY. Thank you very much.

Senator GLASS. Thank you very much, Mr. Crowley.

(Supplemental data submitted by Leo T. Crowley is as follows:)

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, D. C., April 12, 1935.

Hon. DUNCAN U. FLETCHER,
United States Senate, Washington, D. C.

MY DEAR SENATOR: The attached summary of public opinion concerning the Federal Deposit Insurance Corporation has been submitted by the National

Emergency Council. We are calling it to your attention, feeling that you will share our pleasure in the almost universally favorable reaction it mirrors.

The report is based on current interviews conducted by State directors of the emergency council among banking, industrial, and businessmen so that it presents an accurate and concise estimate of the national opinion of deposit insurance.

Very truly yours,

LEO T. CROWLEY, *Chairman.*

SUMMARY OF PUBLIC OPINION CONCERNING FEDERAL DEPOSIT INSURANCE CORPORATION

Alabama.—Never any criticism of this activity. Stands highest in public opinion of all emergency measures; has restored confidence in banks and resulted in greatly increased deposits.

Arizona.—Apparently public very favorable to Federal Deposit Insurance Corporation. This agency has restored confidence in all banks and undoubtedly exerted considerable influence in abolishing hoarding on the part of the people who had previously felt that banks were unsafe and that they should keep their money in cash at home. Every bank in this State except one is a member. Information at hand indicates that the citizens of the district where this bank is located are very dissatisfied and are not depositing their funds in this bank due to the fact that it does not have deposit insurance. Considerable interest expressed by public in the announcement that deposits in building and loan associations might be insured. General summary would be that the public is very much interested in continuation of deposit insurance and that it is a very determining factor in restoring and maintaining confidence in the banking institutions.

Arkansas.—Representative bankers advise that public reaction to Federal Deposit Insurance Corporation is 100 percent favorable. Great majority of bankers also favorable, but believe present limit might wisely be reduced to $2,500. Two bankers state they are strongly opposed to plan in principle. None interviewed has ever heard criticism of insured deposits by customers.

California.—Public opinion strongly back of Federal Deposit Insurance Corporation, despite objections of some larger banks to paying premiums.

Colorado.—Public opinion here practically unanimous in favor of Federal Deposit Insurance Corporation.

Connecticut.—Public seems entirely indifferent to present Federal Deposit Insurance law. Some 12 or 13 banks in Connecticut have not subscribed to plan and their deposits have not been affected. Some depositors inquired of their banks about this insurance when it became effective, but none has mentioned it to the Hartford banks in months. There is no demand here for increasing amount of insurance above $5,000 as 95 percent of all accounts are fully protected under present law. No Connecticut savings banks subscribed to plan because of adverse opinion of State attorney general. I can find no objection by savings-bank depositors. State director personally feels that the present $5,000 limit is sufficient in Connecticut. This State has been particularly fortunate in having very few bank failures.

Delaware.—Due to fact that no bank failures occurred in Delaware, the public has shown little interest in Federal Deposit Insurance Corporation. Contacts made are all favorable.

Florida.—Have contacted 20 various business houses. Everyone heartily endorses the Federal Deposit Insurance Corporation. Believes this sentiment universal in Florida.

Georgia.—Federal Deposit Insurance Corporation was welcomed by great mass of people. Has been important factor in restoring confidence in banks, particularly smaller institutions. Regarded by many as one of most constructive steps in present national administration. Increased savings deposits in many banks believed traceable to insurance plan. While activities not subject to general discussion now, individuals and business, especially smaller business, finding satisfaction in safety provided by its operation.

Idaho.—Deposit insurance remains the cornerstone of public confidence in banks. Bankers admit Federal Deposit Insurance Corporation has produced solid public confidence in banks. Public opinion overwhelmingly favorable and confidence in banks remains solid with deposits increasing.

Illinois.—Report not received up to April 12, 1935.

Indiana.—Has restored confidence in banks.

Iowa.—Public reaction to Federal Deposit Insurance Corporation definitely favorable. Small depositor, which includes savings depositor, is very favorable to insurance of deposits. Best evidence of this is literally hundreds of cases reported to us of money taken from postal savings, from hoardings, and from larger banks in border States and deposited in Iowa banks after inception of Federal Deposit Insurance Corporation. There is some disposition to the belief that insurance is so satisfactory to the depositor that he does not seek other investments. It tends to restore confidence in the bank and thereby stabilizes banking conditions and satisfies small depositor, who as a rule is the cause of runs on banks. Public is grateful and happy for benefits of Federal Deposit Insurance Corporation.

Kansas.—Banks now beginning to fully appreciate the value of this activity with the result that an increasing number are subscribing. It has greatly increased confidence in financial institutions. However, many banks still remain without insurance.

Kentucky.—Much appreciated by public generally. Resulted in growing increase of deposits in all banks. Smaller banks quite enthusiastic. Some larger institutions feel their independence, objecting to expense of operation. These objections made some months ago but little protest at present time. Unquestionable demand for retention of act.

Louisiana.—My opinion public reaction Federal Deposit Insurance Corporation present act should be made permanent. Adds stability and confidence in banks, decentralizes and distributes deposits and eliminates the chance of run on banks from small depositors. Some bankers indifferent and feel their institutions command confidence without insurance feature. Small banks in country generally favorable to deposit insurance.

Maine.—Public sentiment favorable to Federal Deposit Insurance Corporation. Maine commercial banks favor this. State savings banks have centrally managed liquidity fund.

Maryland.—Activities progressing quietly.

Massachusetts.—Report not received up to April 12, 1935.

Michigan.—From every source I get only favorable public reaction to Federal Deposit Insurance Corporation. Belief quite general that this agency is reestablishing faith in banks. Increased deposits in Michigan banks best proof of renewed confidence.

Minnesota.—Agency has done outstanding work and 95 percent of banks in this State are insured. Public well informed and very favorable toward this activity. Agency 100 percent efficient and popular with both public and banks. Exceedingly popular and has produced great public confidence in banks.

Mississippi.—Public opinion appears entirely favorable to Federal protection.

Missouri.—Reaction of public and State banking department to Federal Deposit Insurance Corporation is universally favorable. Deposits substantially increased. More than 500 State banks have voluntarily come under Federal Deposit Insurance Corporation, and only 40 have not. Most of these 40 are small or family banks and expense is deterring factor. The favorable public reaction is general over entire State and also the four-State area. It is recognized as an essential part of the bnking system.

Montana.—Has greatly restored confidence and receives almost unanimous acclaim.

Nebraska.—Agency has made a fine record in this State with a high percentage of deposits now insured.

Nevada.—After experience of last 3 years when banks were blowing up like firecrackers in Nevada, depositors unequivocally approve deposit insurance plan. They are not interested in howl of big banks who may have to carry premiums for some of their weaker brethren. They feel this latter will be an incentive to insist on good banking practices and will insure national supervision and inspection.

New Hampshire.—About 1 out of 50 know anything about it. New Hampshire Bankers Association reports public neither informed nor interested. Reaction nil.

New Jersey.—There is little comment concerning this agency, but it is believed that this activity has full public support.

New Mexico.—Have heard of no comments either pro or con in New Mexico.

New York—Public reaction to Federal Deposit Insurance Corporation not widespread but generally favorable. Larger banks in Manhattan protest method of assessments claiming only insurable amounts of deposits should be taxed. Otherwise not opposed, although unenthusiastic.

North Carolina.—General public reaction most favorable. Find in contacting number of bankers, who will eventually help mould public opinion, in vast majority think $5,000 coverage sufficient and favor definite premium sufficient to cover, but to be lowered if justified later. Majority favor premium on insured deposits only. Five thousand limit covers 95 percent depositors banks this State.

North Dakota.—Public attitude and editorial comment uniformly favorable.

Ohio.—Program has been exceptionally beneficial and remains least criticized of all emergency agencies.

Oklahoma.—Public reaction reveals this is one Government program with which general public will go all the way. No derogatory comment to Federal Deposit Insurance Corporation was made in interviews with large number of Oklahoma business men and individual depositors. Editors and newspaper clipping bureaus report State-wide approval of program as reflected in press. Increased deposits indicative of restored confidence. Group 4 of Oklahoma Bankers Association in convention at Ardmore yesterday passed resolution recommending titles 1 and 3, Congressional Banking Act of 1935, and commending work of Federal Deposit Insurance Corporation. Group 5 in Tulsa today expected to pass similar resolution according to secretary of association. These group meetings represent approximately 450 eastern Oklahoma bankers. State banking commission reports only two failures in State banks since inception of Federal Deposit Insurance Corporation. Continuance of Federal Deposit Insurance Corporation under competent management felt essential to continued faith in banking system.

Oregon.—Has produced desirable feeling of security of average citizen in his bank account.

Pennsylvania.—Has functioned very successfully and restored confidence. Has greatly strengthened banking system, although many small banks, due to limited capital, criticize the provision compelling them to join the Federal Reserve System by July 1, 1937, in order to maintain their insured status.

Rhode Island—Banking situation here unusually strong, therefore, except for added confidence due to Federal Deposit Insurance Corporation, difficult to determine public reaction.

South Carolina.—Has restored confidence in banks. Comment is frequently expressed that this program is one of most important in "new deal." Public has great faith in this activity.

South Dakota.—Comment wholly favorable, with the exception of a very few bankers who are opposed to the principle of this activity.

Tennessee.—Has restored public confidence in banks.

Texas.—Well staffed and functioning effectively.

Utah.—Public unanimously for Federal Deposit Insurance Corporation, although some bankers and financial interests remain skeptical.

Vermont.—Public reaction to Federal Deposit Insurance Corporation quiet but favorable. About half the banks use their participation in their advertising. Bank public apparently take it as an accomplished fact and rely upon it, although not particularly outspoken in their comment.

Virginia.—Report not received up to April 12, 1935.

Washington.—Has resulted in vastly improved banking conditions and a general increase in deposits, although need is seen for means to enforce provisions of Federal Deposit Insurance Corporation.

West Virginia.—Public reaction to Federal Deposit Insurance Corporation quite sympathetic and deposit insurance has stimulated confidence in banking institutions. Deposits have materially increased. Bankers, however, are opposed to proposed amendments to existing law now pending in Congress.

Wisconsin.—Don't hear about it. Deposits on increase. Only through restatement of fact that money is in circulation, do we know about its works. Banks favorable.

Wyoming.—Banks noncooperative toward this activity.

LOSSES IN THE COMMERCIAL BANKING SYSTEM FROM 1864 to 1934

It is estimated that losses sustained in the commercial banking system over the past 70 years by depositors and others have amounted to about $14,000,000,000. The figures are summarized in the following table:

Losses in commercial banks, 1864–1934

[Amounts in billions of dollars]

Losses	All commercial banks	National banks	Other commercial banks
To despitors in suspended banks	3.3	1.2	2.1
To stockholders in suspended banks	1.7	.6	1.1
Written off in active banks [1]	7.9	3.7	4.2
Not yet written off [1]	1.3	.6	.7
Total	14.2	6.1	8.1

[1] Less estimated recoveries.

The figures of losses to depositors in suspended banks were obtained from the study made by the Division of Research and Statistics of the Federal Deposit Insurance Corporation. The figures of losses to stockholders in suspended banks and of losses written off in active banks were computed in the case of national banks from data published in the reports of the Comptroller of the Currency. The data did not cover all of the years and in some cases estimates were necessary. The character of the figures were such that it is believed that the estimates contain relatively small errors. The corresponding figures for other commercial banks were estimated on the assumption that the experience of these banks was the same as that of national banks. This assumption has been justified by our study of suspended banks and by other fragmentary data available.

The figures of losses not yet written off were estimated, in the case of national banks, on the basis of the Comptroller's report on loss and doubtful loans, and of the relation of losses on securities to losses on loans over recent years. In the case of other commercial banks, the figures for State member banks were estimated on the assumption that the experience of these banks would be the same as that of the national banks. The figures for insured State nonmember banks were obtained from our examination reports. Figures for uninsured commercial banks were not included.

It is believed that these figures are probably correct to within 10 percent of the results shown.

Now, Mr. Comptroller, will you please come forward?

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY

Senator GLASS. Mr. O'Connor, you are Comptroller of the Currency, are you?

Mr. O'CONNOR. Yes, Senator.

Senator GLASS. And have been for how long?

Mr. O'CONNOR. Since May 11, 1933.

Senator GLASS. You are a member of the committee which was asked to prepare what was regarded as essential banking legislation, are you not?

Mr. O'CONNOR. No, sir.

Senator GLASS. You are not a member of that committee?

Mr. O'CONNOR. No, sir. But I was invited in by the Secretary of the Treasury and attended a number of the meetings, Senator.

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Senator GLASS. Yes. Well, then, you did not see this bill until it came up here, did you?

Mr. O'CONNOR. You mean the completed bill?

Senator GLASS. Yes.

Mr. O'CONNOR. Oh, yes; title III, I had all to do with—my office. And title I, dealing with Federal deposit, I am quite familiar with all of the provisions of that, Senator, but not title II. I know very little about title II.

Senator GLASS. You did not see that until it came up here?

Mr. O'CONNOR. No. I think probably the day before it came up there was some discussion of it.

Senator GLASS. Well, as to title III, are there any alterations in that title that you care to suggest now?

Mr. O'CONNOR. Yes, Senator; there are just a few. Senator, can I hand the committee a copy of the corrections in title III?

Senator TOWNSEND. That you desire?

Mr. O'CONNOR. Yes; in title III.

Senator GLASS. Yes. Well, without going into those matters in great detail, unless some member of the committee wants to do that, there are one or two major matters that I want to interrogate you about.

It has been suggested as extremely desirable, if not exactly essential, that the bank-examining agencies be consolidated into one agency. I should like to know what you think about that.

Mr. O'CONNOR. That same question, Senator, was asked before the Banking and Currency Committee of the House, of myself, and in view of the fact that it involved my office I did not think it was your question, I believe it would be highly desirable if we could have centralized examinations.

Senator GLASS. Well, what is there of an improper nature?

Mr. O'CONNOR. The fact that I happen to be Comptroller and proper to say where those examinations should be. But, to answer that I was asking that those functions be transferred.

Senator GLASS. Well, the Comptrollership is an office; it is not an individual. And I cannot discover momentarily anything of an improper nature in the question, and I cannot imagine that it would be at all improper for you to suggest where the consolidated agency should be located. Of course, we understand, without your answering the question—at least, I think I do—that you think it should be in the Comptroller's office; and that Mr. Crowley thinks it should be in the Federal Deposit Insurance Corporation; and, very likely, the Federal Reserve Board thinks it should be in the Federal Reserve Board. So, if it embarrasses you, I will not press the question.

Senator BYRNES. Mr. Chairman, I agree with you in your first request. Assuming it to be a fact, I should like to know his reasons for thinking it should be in the Comptroller's office.

Senator TOWNSEND. He might state the reasons why it should be in one agency, as he sees it.

Mr. O'CONNOR. The Comptroller is on all three boards, and, therefore, from that angle it is rather impersonal. He is on the Federal Reserve Board, and on the Federal Deposit Insurance Corporation Board, and also Comptroller of the Currency. But the longest experience in the Government in this connection has been in the Comptroller's office. For over 70 years they have built up the procedure. When the Federal Deposit Insurance Corporation came into existence and it was necessary to examine these nonmember State banks, that organization was set up in the Comptroller's office to begin with, before the actual organization of the Corporation—before the two members of the Board were named by the President—not officially, but the framework, because nothing could be done until the Board met and approved it. And that examination was conducted in this way, which seems to have been successful and met with the approval of Congress and the people: One of the best national-bank examiners was placed at the head of every State examining staff with as many assistants as we could give him, and then along with him and under him were placed men who knew the values of property in that State, and who had experience in banks, all working under the direction of the national-bank examiner in that State. The importance of that was that the State bank examiner had the contact with the officials here in Washington, and he knew who to call on for matters requiring attention here; and it was not necessary that he get in touch with us for instructions as to how banks should be examined. That was done in that way, and they were all brought within the fund, as you know, with very few exceptions in the country.

Now, the question I would like to clear up, Senator, is the question of the so-called "duplication of examinations." There is no such thing in the Government as duplication of examinations. There is no one who enters into a national bank, except an examiner who is duly appointed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury, as the law provides, except in one instance. If the bank makes a deal with the Reconstruction Finance Corporation, and the bank and the Reconstruction Finance Corporation go in as partners and provide for some kind of an examination, it is entirely a voluntary matter between the bank and the R. F. C. That is the only instance in which anyone goes into a bank except a duly accredited representative of the Comptroller's office.

The Federal Reserve Board examines State banks, and that work is done in cooperation with the examiners of the various States, making examinations, I believe, once a year. The law requires the Comptroller to make two examinations every year of national banks.

Now, the only other agency that makes examinations in Washington is the Federal Deposit Insurance Corporation, and they examine State nonmember banks which are members of the fund. And no other agency goes into those banks on the part of the Federal Government.

I want to say that I have not found any complaint, or none has been registered so far as I know as a member of the three offices or departments, that there has been any criticism on the part of the States directed against the Federal Deposit Insurance Corporation, or the Federal Reserve Board, in working together for the examinations of those State banks. I have not found any on the part of the States. And I want to be sure to clear up the question that there is no duplication of examinations. I have seen many statements made that examiners from two or three departments go into those banks, which is not true.

Senator GLASS. Well, while it is practically a fact that there may be no duplication of bank examinations, as a matter of law the Federal Reserve Board is authorized at any time it pleases to examine a member bank.

Mr. O'CONNOR. The law provides it may make special examinations, Senator.

Senator GLASS. Yes.

Mr. O'CONNOR. Yes; that is the wording of the law, which they have never exercised, because they have access to our records.

Senator GLASS. They have access to all your data?

Mr. O'CONNOR. Yes, sir.

Senator BYRNES. Your contention is, as a practical matter, then, there is no duplication?

Mr. O'CONNOR. There is no duplication. There are no two examiners that go into a bank representing the National Government, which is duplication of examination, Senator.

Senator GLASS. But when all of those State banks come into the Federal Reserve System, as they are required to do by July 1, 1937, will they be examined by the Comptroller's office or by the Federal Deposit Insurance Corporation?

Mr. O'CONNOR. Well, if they become members of the Federal Reserve System, then, of course, they would not, under present statutes of Congress, be examined at all by the Comptroller's office, under the present statute.

Senator GLASS. Well, they would be examined by the Federal Deposit Insurance Corporation examining board?

Mr. O'CONNOR. No, sir.

Senator GLASS. And then that would not constitute a duplication? You would not examine them?

Mr. O'CONNOR. No; I would not examine them.

Senator GLASS. And the Corporation would not examine them?

Mr. O'CONNOR. No; the Corporation would not examine them. There would be no necessity.

Senator GLASS. They would be examined under the authority of the Federal Reserve Board?

Mr. O'CONNOR. Yes; just as they accept their examinations now.

Senator BYRNES. So far as the banks are concerned, they are not annoyed by duplication of examinations?

Mr. O'CONNOR. No, sir.

Senator BYRNES. But the fact is the Government has two sets of examiners under the present organization?

Mr. O'CONNOR. Yes, sir.

Senator BYRNES. Making examinations?

Mr. O'CONNOR. Yes. Now, that is the proper way to state the whole problem that is so misunderstood.

Senator GLASS. Under the law the Corporations—I mean both the Federal Reserve Board and the Federal Deposit Insurance Corporation—have access to your data?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. Your examinations of banks?

Mr. O'CONNOR. Yes, Senator.

Now, here probably is the foundation for the criticism that sometimes comes with reference to those examinations, to be very pointed. If you have a town, which happens very often, where you have got a national bank, and you have got a member bank, and you have got a State nonmember bank in the town, you have got three sets of examiners from the Federal Government going into that town; you have got the national-bank examiner going in there with his assistants, and he has no authority to go into the others; you have the Federal Reserve Board examiner, with his assistants, going in there; and you have the Federal Deposit Insurance Corporation examiner going in there.

Senator BYRNES. From the standpoint of administration, what you have in mind is that if an examiner went there he should examine the three institutions on one trip, instead of sending him, and then another examiner, and then still a third examiner?

Mr. O'CONNOR. I am just pointing out, Senator——

Senator BYRNES (interposing). That is the criticism?

Mr. O'CONNOR. Yes; that is the one criticism, that we have a duplication. There is no duplication in the town.

Senator BYRNES. Would it tend to efficiency if it was concentrated in one force?

Mr. O'CONNOR. Well, there could be only one answer to that, Senator.

Senator BULKLEY. Well, would it not make a better examination and prevent the possibility of switching cash accounts?

Mr. O'CONNOR. That is very true.

Senator GLASS. Passing that for the time, let me ask you if it is not true that under title III there is in it a provision to extend the time when bank officials who are now indebted to their banks may pay off their indebtedness?

Mr. O'CONNOR. Yes; we have recommended, Senator——

Senator GLASS (interposing). I know there is a recommendation, but is it embodied in title III?

Mr. O'CONNOR. It is also in title III that we extend time for payment to 1938. And you have raised a very serious question, Senator. That was section 22 of the Federal Reserve Act, and it is section 12 of the printed act of the Federal Reserve Act. On June 16 of this year the provision that executive officers must no longer be indebted to their bank expires; you gave them until June 16 of this year, and Congress fixed extraordinarily heavy penalties for an executive officer to become indebted or to be indebted to his bank after that date. He shall not be indebted to the bank after that day under a penalty of 1-year prison sentence or a fine of $5,000, or both, and the bank may be fined $10,000 and a sum equal to the amount of the loan.

Senator GLASS. Well, contrasted with penalties provided for the N. R. A., do you regard that as very excessive penalties?

Mr. O'CONNOR. Well, I do not know what those penalties are, Senator. I have all the trouble I want taking care of my office.

Senator BYRNES. It would depend on the size of the loan, too, would it not?

Mr. O'CONNOR. Yes; it would, of course. And, reverting again to this section with these drastic provisions in it, I believe there is only one option for an executive officer who owes a bank on June 16 of this year, and that is to resign if title III is not passed, not by June 16, which is a very short time, but a considerable period before, because these men must be given an opportunity to arrange their indebtedness to do something, to either resign or——

Senator BYRNES. Let me ask you about that. When was he given notice to rearrange his loan?

Mr. O'CONNOR. Two years ago; in 1933.

Senator BYRNES. He will have 2 years on June 16?

Mr. O'CONNOR. That is right.

Senator BYRNES. During this time, as a general thing, have banks been in position to make loans?

Mr. O'CONNOR. Oh, yes.

Senator BYRNES. There is no statement today that the banks have not funds sufficient to make loans upon good security, is there?

Mr. O'CONNOR. Oh, no; they have the funds, we all know that.

Senator BYRNES. Do not you think in 2 years the bank officers have had fair notice to make arrangements for a loan other than their own banks?

Senator GLASS. That depends on the officers, does it not, and the facility to pay?

Mr. O'CONNOR. I think, Senator, you would have to go into each individual case.

Senator BYRNES. It means you have 2 years at a time when there is ample capital. It depends on the kind of security the officer has up with his bank?

Mr. O'CONNOR. That is right.

Senator BYRNES. And if the security is not adequate it is about time something is done, is it not?

Mr. O'CONNOR. They have done something, Senator. It may interest you to know that when you passed this bill the officers owed about 90 million dollars—that is from the records I have access to; and they have reduced that approximately 33 percent, getting ready for what Congress has asked them to do. They have reduced their indebtedness to that extent.

Senator BYRNES. I think it was responsible for a whole lot of our trouble, excessive loaning on the part of officers.

Senator TOWNSEND. Does that apply to the private loans, or to the companies that he might be associated with?

Mr. O'CONNOR. It is direct loans. And there is also the indirect loans to officers, which amounted in round figures to $40,000,000. That has been reduced about the same percentage.

Senator GLASS. You do not understand that Senator Byrnes is so well situated that he can pay off his loans on call, and some of the balance of us have to take longer than 2 years. I am not an executive officer of a bank, nor any other sort of an officer, even a director, but there have been times in my business career when I would not have liked a bank to call my loan within 2 years, because I could not pay it.

Senator BYRNES. It is a question of his arranging with some other bank to finance his loan instead of his own.

Senator GLASS. Then he has to go through a process of getting the consent of his board of directors and so on and so forth.

Senator BYRNES. Yes.

Senator BULKLEY. Mr. O'Connor, as those loans have been reduced from $90,000,000 to $60,000,000, has that resulted in a good many of them being cleaned up?

Mr. O'CONNOR. I was just trying to find that information by looking in the place where it would appear. I would say no. They have just liquidated out, trying to be able to reduce their indebtedness to carry out the wishes of Congress.

Senator BULKLEY. Do you know how many accounts are involved?

Mr. O'CONNOR. Individuals?

Senator BULKLEY. Yes.

Mr. O'CONNOR. I haven't that data.

Senator BULKLEY. Well, then, you probably could not express an opinion as to how badly it would disturb the banks if their executive officers that are in that predicament that they cannot pay their loans should resign on June 16?

Mr. O'CONNOR. No.

Senator BULKLEY. Could you look that up and give us an opinion about that tomorrow?

Senator TOWNSEND. The fact that a great number of them have not been paid, Mr. O'Connor, is not conclusive that they are not good, is it?

Mr. O'CONNOR. Oh, no. They are probably slow loans that under the instructions that are given to examiners by the Comptroller, that they are not to suggest to the bank how they shall handle slow loans, that a slow loan is a good loan. The bank has no reason to press that for payment. It is a sound loan; it has good security, and the taxes are paid and the interest is paid.

Senator TOWNSEND. And the bank wishes the loan——

Mr. O'CONNOR. Well, they certainly need it.

Senator TOWNSEND (continuing). In a great many cases?

Mr. O'CONNOR. They certainly need the loans in a great many cases.

Senator BULKLEY. On the other hand, if these loans were very good, they could be refunded somewhere else, could they not?

Senator TOWNSEND. Of course, they could be refunded somewhere else, but the bank wishes the loan.

Senator GLASS. The statute provides that they may borrow from other banks with the consent of their boards of directors and after due notice.

Senator BULKLEY. Yes.

Mr. O'CONNOR. Senator, may I read this section, because I have also incorporated as a suggestion in the bill that the matter of the extension of the loan must be passed on by the directors, so that we will get the full picture before the directors of the bank, in addition.

Senator GLASS. All loans have to be passed upon by the directors.

Mr. O'CONNOR. Usually by a committee, Senator.

Senator GLASS. But the directors have to confirm what the committee does.

Mr. O'CONNOR. That is right.

(g) No executive officer of any member bank shall borrow from or otherwise become indebted to any member bank of which he is an executive officer, and no member bank shall make any loan or extend credit in any other manner to any of its own executive officers: *Provided*, That loans made to any such officer prior to June 16, 1933, may be renewed or extended for periods expiring not more than five years from such date where the board of directors of the member bank shall have satisfied themselves that such extensio nor renewal is in the best interest of the bank and that the officer indebted has made reasonable effort to reduce his obligation, these findings to be evidenced by a resolution of the board of directors spread upon the minute book of the bank.

Senator TOWNSEND. What is the time of the extension?

Mr. O'CONNOR. 1938, that would be, Senator.

Senator BULKLEY. Is that your law?

Mr. O'CONNOR. That is in the law, Senator.

Senator BYRNES. That is in the bill.

Mr. O'CONNOR. That is in the bill.

Senator BULKLEY. Well, that is in this new bill we are considering now?

Mr. O'CONNOR. Yes.

Senator BULKLEY. Is that what you recommend?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. However, would it be practicable to require that the renewal shall be conditioned on some actual reduction being made in the loan in these last 2 years? The language in the bill is "that an effort shall be made."

Mr. O'CONNOR. Well, my answer, Senator, would be that the examiners look into these matters. In other words, these loans, if they are taken out of the bank and charged against the bank, if they are good loans and if the examiner finds that they have been making payments and reducing them and they are in good standing, I think it could be left safely to the examiner.

Senator BULKLEY. The question I am asking now is whether we ought not to put in this bill the requirement that there must have been some reduction of the loan.

Mr. O'CONNOR. Yes.

Senator BULKLEY. Understand, I am not arguing the matter; I am simply trying to find out.

Mr. O'CONNOR. I understand that. Well, with 30 percent paid, I assume that that would not be a necessary requirement.

Senator BULKLEY. It shows some of them can reduce their loans.

Mr. O'CONNOR. Because one-third has been paid?

Senator BULKLEY. Yes. And that third might have been distributed among almost all the accounts there are?

Mr. O'CONNOR. That is right.

Senator BYRNES. You are proposing to extend it until 1938?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. Mr. Comptroller, if there are no further questions on that point, you are a member of the Deposit Insurance Corporation, and the question has arisen as to the method of assessing banks. There are two suggestions—one of one-twelfth of 1 percent and another of one-eighth of 1 percent—and there is a suggestion that instead of an annual assessment upon the banks, which might result in the accumulation of a very great and unnecessary fund, that the banks be assessed until there is accumulated a fund of a half billion dollars and that then the assessment automatically ceases until that fund shall have been impaired to the extent of 25 percent, and the assessments automatically resumed when that shall have occurred. What would you say to that?

Mr. O'CONNOR. Well, I heard your question on Friday, Senator, to Mr. Crowley on that point, and Mr. Crowley's answer, and I have been giving it some study since Friday, assuming, although not knowing, that I might be asked that question.

I cannot see any objection, Senator, to providing that in the bill, for two reasons. First, because in going over a period from 1921 to date, I find that under an assessment of one-twelfth of 1 percent on the total deposits, that we would have had a surplus in our fund in 10 of those years, and they were quite bad years. In four of them we would have had a deficit. But two things must be kept in mind: First, with deposit insurance, I don't believe we would have had the critical condition because of the confidence that Federal deposit insurance has given. And, secondly, because of the borrowing power that is provided for in your 1933 act, we would be able to borrow the money to take us over the 4 bad years, and then pick up the assessments again, which to me, gives me the greatest optimism as to the future of the fund.

Senator GLASS. Well, you do not look for a repetition any time within the next 100 years of those 4 bad years, do you?

Mr. O'CONNOR. No; I would rather not be around if they are going to come. But, you see, in those 4 years, which were the worst in the history of banking of this Nation, while the bill provides that we might borrow three times the capital of the Corporation, it would not have been necessary to use the credit that you permitted us to use in the bill to more than one and a half of the capital structure in the very worst years and then to pick up the assessments, together with the liquidation of banks, which occurs very fast, especially during the first year after they are closed, and of course that is added to the fund.

Senator GLASS. It is very likely you could not have borrowed a cent in those 4 years, is it not?

Mr. O'CONNOR. I am assuming we were going to get it from the Government, which is provided for.

Senator GLASS. It has been suggested by Senator Townsend, and others who are absent, that we recess at 12 o'clock until tomorrow. Is there any objection to that?

Senator BYRNES. No objection.

Senator GLASS. Can you be here for a little while tomorrow?

Mr. O'CONNOR. Yes, sir.

(Thereupon, at 12 o'clock noon, a recess was had until 10:30 a. m., Apr. 23, 1935.)

BANKING ACT OF 1935

WEDNESDAY, APRIL 24, 1935

United States Senate,
Subcommittee of the Committee on
Banking and Currency,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in room 301, Senate Office Building (having been adjourned on Apr. 23, 1935, on account of a lack of a quorum), Senator Carter Glass presiding.

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

Senator Glass. The committee will come to order. We have a quorum. We are to hear this morning Mr. James P. Warburg. Mr. Warburg will please take a seat over there opposite the committee reporter. I am hearing Mr. Warburg this morning because he finds it necessary to go to Europe on Friday. I had not contemplated calling him until the officials of the Federal Reserve Board had first been heard; but, owing to his arrangements, it is desirable to hear him this morning.

STATEMENT OF JAMES P. WARBURG, VICE CHAIRMAN BANK OF THE MANHATTAN CO., NEW YORK

Senator Glass. Mr. Warburg, please give your name and your occupation to the committee reporter.

Mr. Warburg. My name is James P. Warburg; vice chairman Bank of the Manhattan Co., New York.

Senator Glass. You are the son, Mr. Warburg, of the late Paul M. Warburg, who was for many years a member of the Federal Reserve Board?

Mr. Warburg. Yes, sir.

Senator Glass. And also, he was a member of the Aldrich Commission to investigate banking matters?

Mr. Warburg. Yes, sir.

Senator Glass. I wanted to have that stated, so that the committee might understand your background.

Mr. Warburg, we have before us S. 1715. You have familiarized yourself with the provisions of the bill, have you?

Mr. Warburg. Yes, sir.

Senator Glass. We would be glad to have any comment that you might desire to make to the subcommittee.

Mr. Warburg. Mr. Chairman, I am grateful for this opportunity to come before you, particularly in view of the amazing reticence on the part of the banking profession to appear and discuss this bill. I speak for no group or institution, but I am very glad to state my own position without fear or favor, with as much clarity as I can muster, and to this end I have prepared a statement which I would like to present to you.

The proposed Banking Act of 1935 consists of three titles. I shall confine myself to a discussion of title II, which deals with the proposed amendments to the Federal Reserve Act. I shall do this for the same reason that if someone were to say to me, "I am going to do three things for you: Buy you a dinner, buy you a drink, and cut your throat", I would not waste very much time choosing my drink or ordering my dinner.

Let me state at the outset that I am unequivocally opposed to the present enactment of title II of the proposed bill, with or without modifications. I say this for three reasons: (1) Because I am convinced that no amount of changes which might be made in this section of the bill would in any way alter its fundamental purpose or materially alter the practical results of its enactment; (2) because I profoundly disagree with the fundamental purpose of this section of the bill; and (3) because there is no present emergency which necessitates hasty action, whereas there is every reason why a matter of such far-reaching effect upon the future economic welfare of the country should be given the most careful study by competent authorities.

The statement released to the press by Marriner S. Eccles, Governor of the Federal Reserve Board, on February 8 as well as subsequent testimony before the House committee, clearly defined the purposes which motivate the suggested enactment of the proposed measure.

Before dealing with the bill itself, it is therefore advisable to consider the statements of Governor Eccles. At the beginning of his statement of February 8, the Governor said:

> The chief purposes of the proposals for changes in our banking laws, insofar as they relate to the Federal Reserve System, are the following:
> 1. To accelerate the rate of economic recovery.
> 2. To make our banking and monetary system, which was designed under the conditions prevailing prior to the World War, more responsible to our present and future economic needs.
> 3. To prevent a recurrence of conditions that led to the collapse of our entire banking structure in the spring of 1933.

I have no quarrel with these three general purposes, but I emphatically disagree that the proposed measure will contribute toward their realization.

To begin with, I do not believe that the enactment of title II will in any accelerate the rate of economic recovery. I say this because if the present fiscal and monetary policies are designed to accelerate recovery—which I for one do not believe they are—these fiscal and monetary policies are certainly not being impeded today by any obstacles that would be removed through the enactment of the proposed measure. The Federal Reserve System is today the obedient servant of the Administration, even though by law it is intended to be an independent authority. I fail to see how the mere legalization of the present status would in any way accelerate recovery.

Now, as to the other two purposes:

I do not quarrel with Governor Eccles' statement that "the banking system of this country has not been able to stand up under the strain of the depression", but I disagree that our banking system failed, as the Governor implies, under circumstances in which another system, particularly the banking system now proposed, would not have failed.

It seems to me quite obvious that a phenomenon such as a world-wide economic depression has its origin in a multiplicity of causes—in the case of this depression causes which seem to me linked very largely to the waste. dislocations, and strains incident to the World War and to the failures of political governments everywhere. It seems to me quite obvious that in the face of what has happened in the world since August 1914 no banking system in this country could have been able "to stand the strain of the depression."

Governor Eccles goes on to say that the banking system of this country has been unable to lend effective support in the fight against the depression. If he is referring to 1932 and early 1933, I agree with him. If he is referring to the banking system as it is today, I must disagree. The banking system today is glutted with billions of idle dollars waiting for business and industry to come and borrow them.

It does not follow, however, that I consider our banking system a perfect system or even a good system; nor that I am opposed to making changes in it.

On the contrary, I testified over a year ago before this committee and before the House Committee on Coinage, Weights, and Measures as to the need for thorough-going reform of our banking system.

The point I wish to make is that even if we had had a better banking system we should at best have avoided the ultimate spasms of collapse—and then only if we had had better business and political leadership than that which guided the destinies of our Nation in the post-war decade.

The second point I wish to make is this:

Granting the need of banking reform—which no one admits more readily nor has urged more assiduously than I—it does not follow that what is now proposed is the right answer to our problem.

Governor Eccles says:

> The principal measures contemplated in the proposed legislation, therefore, are designed to remedy deficiencies now inherent in the banking structure itself.

Taken in connection with the rest of the Governor's statement, and in connection with the bill he proposes, it would seem that "the deficiencies now inherent in the banking structure" consist very largely in (1) a lack of complete control by the political administration over the operations of the Federal Reserve System. at least insofar as these operations affect the national interest; and (2) in the existence of certain superfluous restrictions upon the extension of credit by the Federal Reserve banks and by the commercial banks.

These, it would seem, are the deficiencies which the proposed bill seeks to remedy.

Leaving aside for the moment the question of other and perhaps more real deficiencies of our present system, let us examine the theoretical background upon which the present proposal rests.

Governor Eccles says:

Underlying the proposed changes in the banking laws are fundamental economic and monetary considerations, the wide-spread influence of which has not been adequately understood.

In fact, the lack of an adequate understanding of these fundamental considerations was an important factor in bringing about the disastrous collapse of our economy, which culminated in the closing of all the banks in the spring of 1933.

Fluctuations in production and employment, and in the national income, are conditioned upon changes in the available supply of cash and deposit currency, and upon the rate and character of monetary expenditures.

The effect of an increased rate of spending may be modified by decreasing the supply of money and intensified by increasing the supply of money. Experience shows that, without conscious control, the supply of money tends to expand when hte rate of spending increases and to contract when the rate of spending diminishes.

During the depression the supply of money did not expand and thus moderate the effect of decreased rates of spending, but contracted rapidly and intensified the depression.

I have quoted this passage at length because it seems to me to contain the kernel of the present proposal. This kernel I should describe as "Curried Keynes", for it is in fact a large half-cooked lump of J. Maynard Keynes—the well-known British economist whose theories find more support in this country than in his own—liberally seasoned with a sauce prepared by Prof. Laughlin Currie.

Senator GLASS. Has he found any in his own?

Mr. WARBURG. Not that I know of.

I do not pretend to be an economist, and I freely confess that a recent reading of Dr. Currie's book left me hopelessly confused. Being a plain ordinary practical banker, I have learned just enough about money to know that I don't know it all and to suspect that many who think they know don't know it all either.

I have listened to Mr. Keynes argue. I have read many of his writings. I do not question the brilliance of his intellect. But I profoundly distrust the practical value of some of his conclusions.

And of all the Keynesian conclusions, the one I distrust most is the one I find imbedded in the statement of Governor Eccles, even though, as I say, it is highly seasoned with "Currie sauce"; namely that the supply of cash and deposit currency and the rate and character of expenditure control the volume of business activity.

What little I know from practical experience, and what little I have learned from recognized authorities would lead me more nearly to the opposite conclusion; namely, that under our system the volume of business activity determines the available supply of cash and credit; and that the rate and character of expenditure have their effect upon the available supply of cash and credit chiefly via their effect upon business activity.

But I am not asking you to accept my opinion as against that of Governor Eccles—much less against that of the learned gentlemen who have supplied the theoretical background of his proposal. I ask you only, before you adopt this premise, to take into consideration that you are being asked to accept a proposal which is founded upon a theory for which there is very little support among the world's recognized authorities.

And now let me deal with the two basic deficiencies with which, based upon the assumption of the Keynes theory, the present proposal is largely concerned.

The first deficiency which it is sought to cure is the lack of control over the Federal Reserve System by the political administration. In order to accomplish this purpose it is proposed to make certain alterations, first, in the organization, and, second, in the operation of the Federal Reserve System.

I am prepared to discuss each of the various items composing this program of change if you desire me to do so, but for the purpose of this general discussion it is not necessary for me to take up your time with more than a few general observations.

1. The organic changes consist of (*a*) various steps designed to strengthen the control of the Federal Reserve Board over the Federal Reserve System; and (*b*) various steps designed to place the Federal Reserve Board under the control of the political administration.

The result of these changes, if adopted, would undoubtedly be to accomplish the desired purpose; the President would have complete control over the Board—whose Governor would hold office at the President's pleasure—and the Board would have complete control over the System through its veto over the appointment of Federal Reserve bank governors and the powers to be vested in its open-market committee.

2. The changes in operation are designed to implement the purpose of the organic changes. The power to raise and lower rediscount rates, the power to raise and lower reserve requirements—not necessarily to the same extent or at the same time in the 12 Federal Reserve regions—and the power to conduct open-market operations are all vested via the Federal Reserve Board and its open-market committee in the head of the political administration.

This is the avowed purpose of the proposed legislation, and, if the proposed bill is enacted, the purpose will undoubtedly be accomplished.

3. In addition, a number of far-reaching changes are proposed which would relax existing loan restrictions that now govern the member banks and the Federal Reserve banks themselves.

My comments upon these proposals are these:

As already stated, I do not believe in the Keynes theory upon which the bill is founded.

Apart from this theory, I do not believe that the country's best interests would be served by vesting the control over the people's money in the political administration.

I say " the people's money " because that is what it is. And I am certainly not pleading for a bankers' control of the people's money.

Let me illustrate what I mean.

Speaking of open-market operations, Governor Eccles says:

> By these operations reserves may be given to or taken away from member banks; and it is on these reserves that deposits are based.
>
> It is not too much to say that the power to control open-market operations is the power to control the expansion and contraction of bank credit, and thus, in large measure, to control the country's supply of money.

Let us see how this works out in practice.

Open-market operations are the purchase or sale by the Federal Reserve banks of United States Government securities. When they make such purchases the Federal Reserve banks use the money deposited with them by the member banks. These member bank deposits—called " reserves "—are a portion of the money deposited with the member banks by the people. The proportion so deposited is fixed by law.

That is why I say it is a question of the people's money.

That is why the existing law provides that open-market purchases shall be made by a committee on which the 12 member banks each have a voice in determining how much of the money of the people in their regions is to be invested in Government bonds.

Under the proposed modification all this is to be changed.

Under the proposed modification this is what could happen:

The New York Federal Reserve Bank accounts for about one-third of the System's holdings of Government bonds; it has about $2,108,914,000 of member-bank deposits.

Under the new scheme a committee consisting of three members of the Federal Reserve Board (one of them the Governor, who is subject to instant dismissal by the President) plus the Governors of, let us say, the Atlanta and San Francisco Federal banks, could have the sole right to determine how much of the $2,108,914,000 of money belonging to the people in the New York Federal Reserve district should be invested in Government bonds.

What is more, the Federal Reserve Board, under Governor Eccles' scheme, could willy-nilly, raise the Reserve requirements in the New York district and thus increase the proportion of the funds of that district subject to the orders of his open-market committee.

And that is not all.

Under the proposed system the same officers of political government who direct the borrowing and spending of the people's money are also to be the ones to determine how much of the people's money is to be theirs to borrow and spend.

I am not saying that it may not be wise to some extent to centralize control. I am not saying that the Federal Reserve Board does not need strengthening.

But if Governor Eccles only wants to strengthen the Federal Reserve Board as against the System, in order to bring it, so strengthened, under the control of political government, then I say better leave the present "deficiency" in our system.

All history is there, gentlemen, to show you what happens when the long arm of the Treasury reaches out into the control of the credit machinery. All history shows such proposals as this one before you to be the favorite device of spendthrift governments.

And recently they have become the favorite device of another and more dangerous group—the device of those who seek by subtle means to destroy the foundations of western civilization.

During the last year this country has been flooded with propaganda to "nationalize the banking system" to "socialize credit", and so forth. You have pending before your committee several bills whose avowed purpose is of this nature.

I am not one who sees a Communist under every bed, but I sometimes wonder if the authors of these bills realize whose game they are playing.

Listen to what Lenin, addressing the Bolshevik conference of April 1917, had to say:

> We are all agreed that the first step in this direction, i. e., toward communism, must be such measures as the nationalization of banks * * *.

We cannot at once either nationalize the small consumers' concerns, i. e., one or two wageworkers, or place them under a real workers' control. Through the nationalization of banks they may be tied hand and foot.

In his book, Preparing for Revolt, Lenin says:

It is essential to proceed immediately to the nationalization of the banks, insurance companies, and of the most important branches of industry * * *. One State bank as huge as possible with branches in every factory—this is already nine-tenths of the socialist apparatus.

And here is what Mr. G. D. H. Cole, the influential British Socialist, has to say:

Before a Labor Government nationalizes or any other productive industry industry it should nationalize the banks. With the banks in our hands we can take over other industries at our leisure.

I have more quotations from Mr. Cole, if you care to have them.

And finally, in Australia, where the proposal for nationalization has just been defeated, Mr. Lang, the Labor leader, said:

You must remember there are always first steps. You must socialize credit first. The other things will come later. If you want to go through a door you must have the key first. Socialization of credit is the key.

Not for one minute do I attribute to the authors of the bill anything but the highest motives of patriotism. Not for one minute do I suggest that they would willingly undermine the American order. But, proposals like these are charged with dynamite—no matter how innocent their origin.

Lest I be accused of opposing "nationalization" of the banking system for reasons of self-interest and in order to keep the control of the banking system in the hands of private bankers, permit me to draw your attention to two proposals I made to this committee when testifying on the Gold Reserve Act in January 1934.

One was to transfer the ownership of the Federal Reserve banks from the commercial banks to the general public. This is certainly not pleading for bankers' control of the Federal Reserve System. I believe that the Federal Reserve banks should belong to the people, but that is a very different thing from making them the tools of political government while leaving the ownership where it is in the commercial banks of the country.

Senator GLASS. You recall, Mr. Warburg—to interrupt you—that there was a serious proposal at the time the Federal Reserve bill was before Congress, to permit the people to subscribe for stock; in fact, that is embodied in the Federal Reserve bill contingent upon the failure of the banks to subscribe the stock, the people were authorized to make subscriptions to the stock.

Mr. WARBURG. Yes, sir.

Senator GLASS. That is a part of the existing Federal Reserve law. But the banks very quickly—although they said they would not—very quickly subscribed to the stock.

Mr. WARBURG. The second proposal, which I made to this committee over a year ago, concerned the reconstitution of the Federal Reserve Board with the idea of strengthening its authority over the System and providing a more harmonious working between the Board in Washington and the 12 regional banks.

So much for the first "deficiency", which Governor Eccles seeks to remedy.

As to the second "deficiency", namely, the existence of restrictions "that are now imposed on the Federal Reserve System by the Federal Reserve Act, but that experience has shown to be detrimental and impractical":

I realize that present-day thought tends away from automatic controls and in the direction of a managed currency and credit structure. Personally, I am opposed to this tendency on purely practical grounds.

As a matter of theory, I am quite prepared to admit with Mr. Keynes and his followers that it is perfectly possible to have a fiat currency secured by nothing and limited as to its issued by nothing except the principles of sound management. But, this theoretical admission leads me to no practical result, for as a practical matter, human nature being what it is, I cannot believe that any group of human beings will be wise enough and strong enough to be equal to such a task.

Least of all do I believe that the officials of a political Government who depend upon popular favor will ever do anything so intrinsically unpopular as to arrest a boom.

If private bankers with their own capital at stake were in the past unable to say "no" when they should have—were unable to arrest excessive speculation, and were themselves drawn into the whirlpool of public madness—if such warnings of the coming storm as were issued prior to the collapse of 1929 came as they did come, not from the Government but from a few courageous private bankers—why should we assume that in future a political bureaucracy, dependent upon popular favor, should be able to safeguard the public interest without any legal restrictions or automatic controls?

I do not hesitate to oppose the removal of automatic controls when such removal is combined as it is in the present proposal with a transference of management to the political Government; I am less sure of my ground when it comes to the intrinsic merit of the restrictions themselves.

It seems to me that the whole question of asset currency and the restrictions under which it should be issued is one that merits the most careful study by competent authorities, and that it is not one which should be determined by hasty legislation.

I am aware of the arguments for doing away with the orthodox ideas of a currency based on gold and commercial paper. My own feeling is that these arguments are not sound. My own feeling is that to say that we must loosen the restrictions because we have not sufficient commercial paper in the country is to put the cart before the horse. We could and should have sufficient commercial paper; and the cure lies, I think, in exactly the opposite direction.

Senator GLASS. Right on that point, Mr. Warburg, are you aware of the fact, as I am by an official document of the Federal Reserve Board itself, that there are only 21 banks in the Federal Reserve System that have any eligible paper for rediscount?

Mr. WARBURG. I know it is a small number.

The cure lies in a reorganization of our commercial banking structure and in the development of a real discount market.

To argue. as Governor Eccles argues, that since there is not sufficient commercial paper of a self-liquidating nature, we must issue our currency against any "sound" bank asset, including long-term real-estate loans, is to pile Pelion on Ossa in the structure of error. And, not only is it no cure, but it seems to me that to issue currency against long-term real-estate loans is almost to guarantee its loss of elasticity.

Senator GLASS. Are you aware of the fact, Mr. Warburg, that in our hearings on the exchange bill the representatives of the brokerage interests in the larger commercial centers demonstrated that there had been fewer losses on brokers' loans than on any other species of loans of which the bankers had any knowledge?

Mr. WARBURG. Yes, sir.

Senator GLASS. So that to make loans on any sound proposition would enable the open market committee under this bill to go into the open market and deal in any kind of security on the New York Stock Exchange?

Mr. WARBURG. I should think so.

Nevertheless, I am not one to dogmatize because I am only too aware of the complexities of the problem; and this leads me to the chief purpose of this statement.

I believe that the whole subject matter of title II of the Banking Act of 1935 is not ripe for legislation and should be referred to an appropriate body for expert study and analysis.

It is 20 years since our currency and banking system has been thoroughly studied. In those 20 years there have been drastic changes in the economic life not only of our country but of the entire world.

We have at present a currency system which is no currency system at all. We have discarded the gold standard of the past and adopted instead a currency dictatorship which, no matter how well it may be suited to an emergency, can in no sense be termed a system adequate to meet the needs of modern economic life.

We have no banking system. What we have is a hotchpotch of remnants of partially discarded systems, upon which there is superimposed the Federal Reserve System and, latterly, an emergency structure designed to meet the crisis that arose in 1933.

Senator GLASS. Well, you say that we have no banking system. I assume that you say that in view of the fact that we have a multiple banking system rather than a unified banking system; that we have 48 States with different banking laws.

Mr. WARBURG. Yes. In fact, my next sentence is this:

Underneath the Federal Reserve System we have 49 different banking systems, each with its own ideas of law and supervision.

We have some States in which it is possible to start a bank with a capital of $10,000.

We have many States in which there are no savings banks whatsoever.

It is possible in most States for anyone, irrespective of training or qualification, to start a bank and become a bank officer.

These are only some of the "deficiencies" that I see in our present-day banking and currency system. So far as I can see, they are not even recognized by the present proposal which is "designed to remedy the deficiencies now inherent in the banking structure."

If we want a money and credit structure such as will insure the safety and flexibility to which our people are entitled, we must rebuild it from the bottom and not content ourselves with anything so superficially conceived as the proposed legislation.

In view of the vast complexity of the problem, in view of the fact that there is no present emergency which makes necessary the adoption of the drastic and fundamental changes advocated by Governor Eccles, I therefore urge this committee to consider whether it would not be far wiser to appoint a commission to study the entire banking and currency problem thoroughly and at leisure before any basic legislation is attempted.

This is not a suggestion born of fear of what the present proposal contains. It is a suggestion which I have been urging for over a year and which is contained in considerable detail in a book published last September.

In conclusion, title II is a proposal (1) to make a centralized system out of a regional reserve system; (2) to bring the system so created under political domination and control; and (3) to remove almost entirely the automatic controls inherent in the existing law.

As to these three proposals:

A. Much can be said for a stronger centralized control of the Reserve System, but I believe that much can also be said in favor of greater decentralization and greater responsibility on the part of each regional reserve bank for the soundness of the member banks within its region. One does not necessarily preclude the other, if the measures of reform are properly worked out.

B. I am unalterably opposed to political control of either a central bank system or regional reserve system for three reasons: (1) Because I do not agree with the underlying theory upon which the proposal rests; (2) because as a practical matter, I believe that political control will result in more violent business cycles than we have ever had before, for the simple reason that a political government will neither recognize an incipient boom nor have the courage to counteract it; and (3) because the proposal for political control of the banking and credit machinery is in effect a proposal to take a step defined by the Communists as the most essential step toward communism.

C. As to the elimination of automatic controls, I believe that this proposal rests upon a fundamental misapprehension as to what are the real deficiencies of our present banking system. The Banking Act of 1933 proceeded on the theory—which I think was correct—that our commercial banking system must be purified; that demand deposits should not be loaned out to finance speculative loans nor capital expenditures, and should be loaned out to finance self-liquidating commercial transactions. In proceeding along these lines, the authors of the Banking Act of 1933 were following principles arrived at by generations of study and experience.

The present proposal contemplates a complete reversal of these principles and proceeds on the assumtion that what is wrong with our banking system is the existence of precisely the type of limitation that the act of 1933 sought to impose.

If we are to fly in the face of all past experience—if we are to reverse the course in which both Congress and the administration believed when the law of 1933 was enacted, then I think we should do so only after far more thoughtful consideration than has been given to the matter so far in the preparation of the proposal now before you.

Senator GLASS. You are aware of the fact, Mr. Warburg, that the Banking Act of 1933 was enacted only after 18 months of hearings and consideration, are you not?

Mr. WARBURG. Yes, sir.

Senator GLASS. I find you rather more progressive, if that is a correct use of that term, than I. You speak of the desirability of more centralized control. I recall your father took that view in the hearings before the Banking and Currency Committee of the House, in 1913.

But let me direct your attention to the fact that we have certain requirements in the existing law, which may have escaped your attention momentarily, which seem to me to offer a large degree of centralization. The Federal Reserve Board is authorized to remove any director of any one of the Federal Reserve banks for cause. Do you recall that?

Mr. WARBURG. Yes, sir.

Senator GLASS. The open-market committee of the existing system, composed of a representative of each one of the Federal Reserve banks, may operate only under rules and regulations adopted by the Federal Reserve Board. Do you understand that that is so?

Mr. WARBURG. Yes. I did not endorse it.

Senator GLASS. Well, that is a fact?

Mr. WARBURG. Yes, sir.

Senator GLASS. The only thing that involves local or regional action with respect to the open-market committee operations is the fact that any regional bank, by choice, may not participate in the open-market operations. In short, if the New York Federal Reserve Bank, which transacts the larger part of the open-market activities, should decide to invest in two or three million dollars of United States securities, it would ask each of the other 11 Federal Reserve banks if it desired to join in that operation, and each one of them may accept or decline the invitation, as it pleases; upon the assumption that the regional banks understand their own conditions better than the Federal Reserve Board here; that they understand the condition of their patrons, their habits, their thought, and their financial status better than a central board here; and that, therefore, the act as it exists and as it has existed for 20 years, recognizes the right of local self-government to that degree. Do you think that is not wise?

Mr. WARBURG. No, sir; I think it is wise. The only increase of centralization that I have suggested and would suggest tentatively again, is that the Federal Reserve Board consist of only 3 or 4 appointed members: and, in addition to those 4 appointed members, 4 out of the 12 Federal Reserve Bank Board members serve in rotation, that being designed merely to coordinate the 12 bodies so that you would not have the banks out of touch with the officials in Washington. I certainly do not believe they should tell them what to buy. If you want me to express an opinion on open-market operations, I will tell you that I do not believe in them at all. I think they are a one-way street.

Senator GLASS. That reminds me that your father did not believe in them for awhile, but his opposition arose out of the fact that he feared that it would put the Federal Reserve banks in direct competition with their member banks which owned the Federal Reserve banks.

Mr. WARBURG. Yes, sir.

Senator GLASS. You have spoken of the reticence of the banking community to express itself on the theories and the possible practical operations under this suggested bill. Why do you think they are reticent?

Mr. WARBURG. I would almost rather not express an opinion about that, Senator. I can only attribute it to a lack of understanding of what this bill proposes, or a lack of courage.

Senator GLASS. Well, may it not be a combination of both?

Mr. WARBURG. It is quite possible.

Senator GLASS. The Governor of the Federal Reserve Board, either before the Banking and Currency Committee of the other body or in addresses made before banking associations, warned the bankers that unless they accepted this bill, the likelihood was that the Government would seize the banks and operate them itself. Do you think that that might have anything to do with the reticence of the banking community to express its judgment upon this bill?

Mr. WARBURG. It is possible. It would not affect my willingness to express my opinion.

Senator GLASS. I know. We have already seen that you are quite ready to express your opinion. But I am talking about the entire banking community.

Adverting to your remarks about the Banking Act of 1933 as it relates to the centralization of control. You will recall that that act, for the first time, made it the duty of every Federal Reserve bank to keep itself intimately apprised of the operations of each member bank in its particular district, particularly with reference to speculative activities, and to report to the Federal Reserve Board whenever there should appear to be an excess of speculative credits, whereupon the Federal Reserve Board by the act is authorized to warn that bank to restrict its speculative activities, under penalty of being suspended or dismissed from the Federal Reserve System. You are aware of that?

Mr. WARBURG. Yes; thoroughly aware of it, and I think it is a good provision.

Senator GLASS. Well, is not that a large degree of central control?

Mr. WARBURG. Yes; that is both central and decentralized control, because the local bank is responsible in the first instance. I think that is desirable.

Senator GLASS. Yes. The Banking Act of 1933, enacted, as I have said, after 18 months of extensive hearings and considerations and consultations with banking experts, also provides a very strict limitation upon the use of Federal Reserve facilities for speculative purposes, in that it exacts an increased discount rate over the usual discount rate for 90-day paper—it used to be 15-day paper. I do not recall whether we made it 90-day paper. They wanted it made that.

Mr. WARBURG. Yes; I think it was made that under the act of 1933.

Senator GLASS. I was opposed to that but, as so frequently happens now, my sound opinions did not count for much. [Laughter.] And we made it 90-day paper. But, in all events, we gave the Federal Reserve Bank and the Federal Reserve Board the right to suspend the bank from the facilities of the System, or to dismiss it entirely from the System, which, after warning, persisted in speculative activities. You recall that?

Mr. WARBURG. Yes, sir. That whole philosophy, as I understand it, is only attempting to protect the banking system against making loans——

Senator GLASS (interposing). Against speculative loans.

Mr. WARBURG. Yes. And this philosophy is based upon the desirability of liquidity of assets, upon the theory that if you can make things liquid, then you can borrow on them.

Senator GLASS. In short, under this bill or proposal, the open-market committee can go on the stock exchange and gamble its eyebrows off, can it not?

Mr. WARBURG. I think it can.

Senator GLASS. It was proposed, when we had under consideration the Banking Act of 1933, that we use the conjunctive, the Federal Reserve bank and the Federal Reserve Board. The concealed purpose of that suggestion was that the Federal Reserve Board could not restrain member banks from speculative activities unless the Federal Reserve bank agreed. That was another and/or case; but I insisted that we insert "or" instead of "and", so that if a Federal Reserve bank, as the New York Bank had done in 1929, refused to put any restraint upon the gambling activities of member banks, the Federal Reserve Board, here at Washington, might do it. That is the law now. Would you not regard that as a large measure of centralization?

Mr. WARBURG. Yes, sir.

Senator GLASS. And, speaking of centralization, the Federal Reserve Act is not a haphazard piece of legislation. We discussed, for months and months, the question of centralization, the majority members of the Banking and Currency Committee of the House, as stated at the outset of the hearings by me, as chairman of the committee, were precluded from even considering a central-bank plan, because the political platform upon which Mr. Wilson was nominated and elected President of the United States definitely and textually declared against a central bank, responsive to the whole history and whole tradition of the Democratic Party, from the time of Andrew Jackson, when it declared in favor of abolishing the United States Bank. And nearly every Democratic platform since then has praised us for doing that. So that, when you speak of centralization, I think that we have determined that question, that this country does not want a central bank, even such central banks as they have in Europe.

Mr. WARBURG. Well, I agree, Senator. Nothing that I said indicates that I would not like to see a central bank established; but I said:

> Much can be said for a stronger centralized control of the Reserve System, but I believe that much can also be said in favor of greater decentralization and greater responsibility on the part of each regional Reserve bank for the soundness of the member banks within its region.

Senator GLASS. Now, then, it has been suggested—and I was surprised and disappointed that you apparently concur in the suggestion—that the existing banking system failed in this depression. Was it the system that failed or was it the administration of the system that failed?

Mr. WARBURG. Well, I do not think that is a question I can answer categorically. I think any system would have failed under the same conditions which prevailed in 1932. The reason——

Senator GLASS (interposing). Well, is it not the fact that both in text and by implication the existing Federal Reserve Act is dead set against speculation by banks, and is it not a fact that the Federal Reserve Bank of New York, for example, to mention but one case, week after week raised its rediscount rate in order, as it thought, to curb the speculative fever that resulted in disaster, and is it not a fact that the central board, week after week, declined to approve that?

Mr. WARBURG. I have been told that, sir; yes.

Senator GLASS. Well, but this bill proposes now to charge the very authority here at Washington with practically exclusive control of a situation of that sort.

Mr. WARBURG. But, again, I heartily disapprove of that.

Senator COUZENS. I understood you to say, Mr. Warburg, that no system could have stood up under the 1932 conditions. How do you account for the fact that they stood up in Canada and Great Britain, if no system could stand up under it?

Mr. WARBURG. I do not think the conditions in Canada were analogous to those here.

Senator COUZENS. What were the conditions that were different in Canada from this country?

Mr. WARBURG. In the first place, let me say that the British and Canadian systems both did stand up better than ours.

Senator COUZENS. Yes.

Mr. WARBURG. But they were not subjected to the same kind of strain ours was.

Senator COUZENS. Was it the system that was under a strain, or the men that operated the system?

Mr. WARBURG. Was the system under strain, or the men that operated the system?

Senator COUZENS. Yes.

Mr. WARBURG. Both. But I say, a greater strain on the system than on the men themselves.

Senator COUZENS. So that you believe that if we had had a better operation of the system, in 1932, that might have stood up?

Mr. WARBURG. Would it have stood up?

Senator COUZENS. Yes; in 1932?

Mr. WARBURG. Your practical operation would have, but it would have to go back farther than 1932.

Senator GLASS. Yes; I think you would have to go back, perhaps, to 1927, when this riot of speculation was inaugurated and encouraged by the use of Federal Reserve bank facilities.

Senator COUZENS. Well, there was something wrong in the banking system itself, if it did not curb that, was there not?

Senator GLASS. No; I did not say that. I say, there was something wrong with the administration of the banking system if they did not curb it. But we have cured that, I will say to the Senator from Michigan, in my judgment, we have cured that in the 1933 Banking Act, both in that provision which makes it the duty of the Federal Reserve bank to keep itself informed as to the speculative activities of member banks and to notify the Federal Reserve Board here when there is excess, and authorized the Federal Reserve Board to suspend or dismiss a bank which persisted in that; and in that other provision of the law which authorized an increased rate on what I term speculative paper, of at least 1 percent—it is not confined to 1 percent; it may be raised much above 1 percent. I think we cured that defect then.

Senator COUZENS. May I ask Mr. Warburg, if we had the British or Canadian systems during those periods we would have gotten away with less distress?

Mr. WARBURG. I cannot answer that, sir. I think yes, but I would have to see the British system in operation here. But I go further than Senator Glass in that I think much is to be done toward centralization, and I think you will agree that there is merit in a centralization, that our system would not have leaked as badly if we had one system, instead of all the State authorities.

Senator GLASS. I have said that a thousand times. You said you wanted to confine yourself to title II. Right on that point, I understand that this bank bill has been reported from the committee on the other side of the Capitol with the elimination of that provision which requires all insured banks, by 1937, to become members of the Federal Reserve Bank System. Do you think that should be done?

Mr. WARBURG. No, sir; I think the only possible excuse for the whole insurance business is that it produces a unified system.

Senator GLASS. Well, that is what I thought, and that the President thought, and that the then Secretary of the Treasury, Mr. Woodin, thought, and they were brought to agreement with the insurance of bank deposits only upon that theory, that it might result, and in all probability would result, in a unified banking system.

Senator COUZENS. Do you not think, Mr. Warburg, before the State banks should be encouraged to join the Federal Reserve System, that the State banks would be glad to join if they would perform a greater service to them?

Mr. WARBURG. I think that is largely a question of the hen and eggs. I do not think they can perform a greater service until they have a larger membership.

Senator COUZENS. I will ask you to what extent they can perform service so as to encourage banks to become members, banks that are not members at present?

Mr. WARBURG. As a practical banker, I would say that I would not want to run a bank today that was not a member of the Federal Reserve System.

Senator COUZENS. But there are still a lot of good banks that are not in the System and do not signify an intention of joining.

Mr. WARBURG. I do not deny that.

Senator COUZENS. But you have got to have an assurance of service before you join.

Senator GLASS. Let me ask you this question: As a matter of fact, is it not a fact that the existence of the Federal Reserve System, which for 20 years has prevented occurrence of panic in this country, has saved many of those banks that are outside of the Federal Reserve System?

Mr. WARBURG. As I say, they do not realize what they are getting, unless somebody else belongs to the System and there is a System. I think that explains the neutral character of the American Bankers' Association toward the System.

Senator COUZENS. Then we ought to have everybody join the labor unions because everybody outside gets the benefit from those who belong.

Senator GLASS. I would not say so.

Senator COUZENS. I was asking the witness that.

Mr. WARBURG. I will steal the chairman's answer.

Senator GLASS. It was futile for me to answer, because you knew what I thought about it.

Mr. Warburg, it has been suggested, and you remarked upon it in your direct testimony, that the proposed legislation would accelerate recovery. Just how would that occur?

Mr. WARBURG. I am the wrong witness to ask that, Senator. I do not see how it could occur, unless on this theory, which I do not subscribe to, that you can have recovery by the unlimited expenditure of money that is not based on income, and that this would provide a means of getting unlimited amounts of money. That does not produce recovery in my mind, but if you believe in that, that is recovery.

Senator GLASS. You say unlimited amounts of money. You do not mean unlimited amounts of money; you mean unlimited currency.

Mr. WARBURG. Yes, sir.

Senator GLASS. There is a vast deal of difference between the two, is there not?

Mr. WARBURG. Yes; there is.

Senator GLASS. Let me ask you this: Is it not a fact that at no period of this depression have the Federal Reserve banks been in a condition that rendered them incapable, by reason of their reserve facilities, to respond to the requirements of commerce, industry, and agriculture?

Mr. WARBURG. I should say that was correct, sir.

Senator COUZENS. Is there not a difference, however, between being in a position to do that and the willingness to do it?

Mr. WARBURG. Yes; but you do not alter the willingness to do it, but alter the mechanical set-up.

Senator COUZENS. No; you can do that, but we do not want to get away with the record that there is an entire difference of opinion with respect to whether we have adequate facilities in the Federal Reserve to do the job you just referred to, or whether we have the willingness to do it.

Senator GLASS. Let me ask the witness if he can conceive any reason why a Federal Reserve bank, under the permissible provisions of the law, would not desire to respond to the requirements of commerce, industry, and agriculture?

Mr. WARBURG. I cannot conceive of any reasonable reason.

Senator GLASS. What are they for? They are not conducted for profit.

Mr. WARBURG. No.

Senator GLASS. They are there to do this very thing.

Mr. WARBURG. Yes, sir.

Senator GLASS. Now, it may be that there were and are still member banks which are not willing to make loans that, in their judgment, they think are unsound; and other member banks which have conceived the notion that it is more important for them to be liquid than to do business. But ordinarily what is a bank in business for, except to do business?

Mr. WARBURG. I would not know why they stayed in the banking business, sir, unless it is in the way you indicate the answer.

Senator COUZENS. Has it ever come to your attention, Mr. Warburg, that it is within the range of possibility, and maybe of probability, that some of the managers of these Federal Reserve banks have private interests to serve?

Mr. WARBURG. I would say it is within the range of possibility; I would not say it is within the range of probability.

Senator COUZENS. Did you ever hear of a case?

Mr. WARBURG. No.

Senator GLASS. I did.

Senator COUZENS. So did I. And it is perhaps not curious if you find there are some with private interests to serve, who are, therefore, not very anxious to make loans.

Senator GLASS. Well, I would not say some of the members; I have never known but one, and when I stood on the Senate floor and advised that he be kicked out of his board of directors before the lunch hour, again my sound judgment seemed to have no effect.

Senator COUZENS. But you never lacked a sounding board, though, did you, Senator?

Senator GLASS. Sir?

Senator COUZENS. You never lacked a sounding board although you had a sound judgment?

Senator GLASS. I had some sounding board.

Senator COUZENS. Yes.

Senator GLASS. But he was not kicked out, all the same. And he was afterward indicted, and he ought to have been kicked out.

Well, I do not want to be the whole show, if you gentlemen desire to ask Mr. Warburg any questions, you are, of course, at liberty to do it.

Senator COUZENS. I would like to ask Mr. Warburg that question over again in another form, to illustrate in part, what the chairman said with respect to one banker. Outside of that particular incident, does the witness have any knowledge of that happening in any other Federal Reserve bank?

Mr. WARBURG. No, sir; I have no knowledge of that case, except just what I have heard.

Senator COUZENS. You would be surprised, then, I suppose, if it was called to your attention that some of these Federal Reserve banks, that is, the managers, have private interests which they prefer to conserve, rather than making some loans?

Mr. WARBURG. Yes; I would be more than surprised. I would be shocked.

Senator COUZENS. I cannot tell you here, but I will tell you at some other time.

Senator GLASS. Well, if there is any such person on a Federal Reserve Bank Board, the Federal Reserve Board here at Washington, under the law, has full power to dismiss him. Is there anything in this proposed legislation that would correct a situation like that?

Senator COUZENS. No. I am not dealing with that particular question, except that the centralization which we have been discussing might, in part, remedy that.

Senator GLASS. Well, how could it when the Board already has full authority to deal with a case of that sort?

Senator COUZENS. Well, when all of this happened, of course, we did not have the 1933 act, and maybe that has remedied some of these complaints I have in my mind.

Senator GLASS. Yes; if you look into it you will find that that is so.

Senator COUZENS. Yes; I understand that, but you still have difficulty, Mr. Chairman, in proving an implication or a motive. It may be quite demonstrable that a motive and prejudice exist, and yet be difficult to prove it so that the Federal Reserve Board——

Senator GLASS (interposing). I understand that, but the difficulty would be just as great under one system as under another.

Senator COUZENS. That may be so. But in that case that I just referred to, the Federal Reserve Board may have, when provided by law, some authority to determine the validity of an application for a loan, rather than determine the incapacity or unfitness for the board of directors of some member of the board of directors in a Federal Reserve bank.

Senator GLASS. Mr. Warburg, just one more question from me, and I apologize for asking you so many.

Mr. WARBURG. I am enjoying it, Senator.

Senator GLASS. If we are to have a central bank in this country, would you prefer to have a central bank conducted by experienced bankers, or a central bank conducted by a board inexperienced in the technique and philosophy of central banking?

Mr. WARBURG. I prefer the first alternative, sir.

Senator COUZENS. May I ask a question, Mr. Chairman?

Senator GLASS. As many as you please, Senator.

Senator COUZENS. The witness, Mr. Warburg, referred many times to a political control, during the reading of his testimony. What kind of control do you prefer?

Mr. WARBURG. To political control?

Senator COUZENS. You disposed of political control in your testimony. What kind of control do you prefer, if you do not want political control?

Mr. WARBURG. In the first place, I do not believe there is any such thing as conscious control of credit and monetary machinery. That is what this bill seeks. I do not believe it is possible to find any person who is omniscient and omnipresent enough to do that. But if you are going to set up a group of men and ask them to do what I think is an impossible job, then you want to try to get the best men you can get hold of and be sure they are divested of private interests and that they do the best job possible. I do not think it can be done at all in the sense they are trying to do it here.

Senator COUZENS. No; but I go back to the question—not with respect to the particular bill in front of us—but you talked about political control, which is, obviously, an admission there must be some control. What kind of control would you have?

Mr. WARBURG. I do not admit that that is an admission of control; not the kind you mean.

Senator COUZENS. Did you ever know of anything in your life that did not have some kind of control?

Mr. WARBURG. The kind of control I meant, is a large number of persons entering into transactions with the hope of profit. That gives a free economic order. Now the minute you inject into that the reshaping of credit and monetary machinery because you control factors, or of private interests, you increase the disparity in other factors. That is why I take issue with the necessity for control.

Senator COUZENS. Mr. Warburg, do you want this committee to understand, and the public, that those influences have happened without control?

Mr. WARBURG. Which influences, Senator?

Senator COUZENS. Why, the influences that you have been complaining about and that you want to get out of political control? There is certainly something in the atmosphere that inspires you to continue to repeat that you do not want political control. You must, of course, have had enough experience to know that there is always control in everything, and I would like to know if you do not admit there has been some control somewhere.

Mr. WARBURG. Yes; there has been control somewhere.

Senator COUZENS. All right. What has it been and where has it been?

Mr. WARBURG. In the Federal Reserve System has it been?

Senator COUZENS. No; anywhere. You are talking of political control. I suppose you mean political control of credits, and monetary control, and that sort of thing. And you have repeatedly said that you do not want political control. Now, you know that there is always control somewhere. I would like to know where it is, and where you would approve putting it. It has been hazy, I admit; it has been, perhaps, difficult to allocate, but it has existed.

Mr. WARBURG. I can only answer that by going rather deeply into the whole philosophy. I believe that it is the function of political government, in the field of economics, to do just about one thing, and that is to insure free and fair competition in order that there may be the greatest amount of goods produced at the lowest possible price. Now, the minute that you go beyond that, it is like a referee in a game when you have the referee running with the ball when one side is losing; and you get into a control that I do not believe in. I say no one should control. Now, if you want me to answer why I do not believe in political control, I can answer that.

Senator COUZENS. If you do not want political control, what control do you want?

Mr. WARBURG. I think you want to get as close as possible to an impartial, nonpolitical body that is not influenced by the desire for reelection, as you can.

Senator GLASS. Well, is there not control in the law itself? In other words, the Federal Reserve Act, based upon 150 years of banking experience, provides for the automatic issuance of credits and currency. For what purpose? To respond to the requirements of commerce, industry, and agriculture. And it gives to the Federal Reserve Board freedom of action as to its definitions of eligible paper which relates itself to the business of the country, and prohibits the Federal Reserve Board from embracing in that definition speculative securities, only United States bonds being accepted, and United States bonds were accepted only because at the time of the adoption of the act there were less than $200,000,000 of United States bonds available for open-market operations. The law itself provides that when these business transactions shall have been terminated upon maturity the notes and credits would automatically terminate. The law itself provides, upon 150 years of banking experience, that there should be a 40-percent reserve upon the notes and a 35-percent reserve upon the credits. The Federal Reserve Board was set up as a controlling, supervisory authority to see that the law was carried out. Now, of course, there may be maladministration in any one of the Federal Reserve banks, as there seems to have been in one that I know of. There may be mistaken administration in the Federal Reserve Board; but as long as you have got human beings to do these things that is apt to occur.

Mr. WARBURG. That suggests, sir——

Senator GLASS (interposing). Let me interject there: As to the political aspect of the thing, the proponents of the original act conceived the idea that there should be a measure of political influence in the supervising board here in Washington, and for that reason they made the Secretary of the Treasury and the Comptroller of the Currency ex-officio members of the Board, with a view that in the event the Board should ever pursue a policy that was manifestly damaging to the public interests, and there should be a change of administration, there would certainly be a change in at least two members of the Board, then composed of only seven members, and that the President of the United States, elected by the people, could, for cause stated in writing, dismiss one or more members of the Board and change its policy. So that there is that measure of political control in the Board. It has been suggested, Mr. Warburg, that the Secretary of the Treasury ought not to be a member of the Board, and the Senate, 3 years ago, by a vote of 62 to 14, or 62 to 19, or 62 to 9—I do not recall which—Senator Couzens has a much more accurate memory than I and may remember——

Senator COUZENS (interposing). I do not remember that.

Senator GLASS. Sixty-two to a very small objecting vote, passed an act that removed the Secretary of the Treasury from the Board. I have always been in favor of that, and for the reason that when I was Secretary of the Treasury—I would not say in an offensive way that I dominated the Board, but I, at least, had considerable influence with the action of the Board, and I have suspected—being like Senator Couzens, naturally of a suspicious nature—I have suspected that frequently since the Secretary of the Treasury has had too much influence upon the Board, and I do not think he ought to be there.

Senator COUZENS. I am always in favor of influence, but I want to use it, that is all.

Senator GLASS. How is that?

Senator COUZENS. I am always in favor of influence, but I want to be the one that uses it, that is all.

Senator GLASS. So do I. But I do not want anybody to use it in a wrong direction.

Mr. Warburg, we are very much obliged to you.

Senator BYRNES. May I ask a question, Mr. Chairman?

Senator GLASS. Yes; as many as you want.

Senator BYRNES. What is the political control to which you refer? What have you in mind when you speak of "political control"?

Mr. WARBURG. I think it is the avowed purpose of this bill to bring the operation of the Federal Reserve Board, and through that the system, under the control of the administration.

Senator BYRNES. Of course, the bill has not been explained in full to the committee; in fact, you are the first witness. May I ask you to point out the language that you refer to, or the section which you think brings the administration of the system under political control?

Mr. WARBURG. Well, without going into the section, I can give you the items.

Senator BYRNES. All right.

Mr. WARBURG. That the Governor is appointed subject to the authority of the President.

Senator BYRNES. What is the existing law?

Mr. WARBURG. Well, I have got that right here.

Senator BYRNES. The present law, according to the House report, states that of the six persons, one shall be designated by the President as Governor.

Mr. WARBURG. Yes, sir.

Senator BYRNES. Therefore, under the existing law, the President designates the Governor.

Mr. WARBURG. Yes, sir.

Senator BYRNES. What is the change?

Mr. WARBURG. As I read the proposal, under the existing law he could not remove the Governor, except for cause, and then——

Senator BYRNES (interposing). The existing law says: "Of the 6 persons thus appointed, one shall be designated by the President as Governor", and so forth. Would you not, in construing that language, say that if the President designated Mr. Brown, instead of Mr. Jones, Mr. Brown would be Governor?

Mr. WARBURG. Yes, sir.

Senator BYRNES. I would think so. If that is the language of the House bill which you have reference to as giving political control, do you not then agree that there is no change from the existing law?

Mr. WARBURG. I cannot, Senator, go into a legal interpretation of the bill, because I am not a lawyer.

Senator BYRNES. But, without being a lawyer, you would agree, I think, that the President has the power not only to remove the Governor, but to remove any member of the Board.

Mr. WARBURG. I will say more than that. I will say that the present condition is very slightly changed by the proposal.

Senator BYRNES. Yes; but this——

Mr. WARBURG (interposing). But the rest of it shows me so much that there is in the present situation almost a usurpation of power; that is, a domination of something that is supposed to be independent. Now, what this proposal is, as I understand it, is to legalize that domination.

Senator BYRNES. To legalize it? Do you mean something that is done now that is not legal?

Mr. WARBURG. Not legal, but that is not the intention, as I understand the intention of the Federal Reserve Act.

Senator GLASS. The existing law has not been completely reported. The President may remove any member of the Board, for cause, in writing.

Senator BYRNES. May I ask these questions? I have not interrupted you when you were making your statement.

When you say "legalized", you do not mean to say that something is being done that is not legal?

Mr. WARBURG. I would not know, because I am not a lawyer, but it is certainly not according to my understanding of what the Federal Reserve Act intended to create.

Senator BYRNES. You were talking of the intent. As to the right to remove a man, you would not say that this right to remove an official is new, because you know that that is the law ever since the case of Myers, in Oregon, that the President has a right to remove a Government official. Do you not understand that?

Mr. WARBURG. I will take your word for that.

Senator BYRNES. Well, if you are not familiar with it I will not pursue it.

Now, as to the open-market operations and, again, because I am not as familiar with the detailed provisions of title II as I would like to be, not having had the opportunity to study it, I ask you what is the difference between the House bill as to the powers in the House bill governing open-market operations, and the provisions of the proposed bill here as to open-market operations?

Senator GLASS. Do you mean, what is the difference between the existing law and the proposed bill?

Senator BYRNES. The existing law and the proposed bill.

Mr. WARBURG. Under the existing law, the chairman outlined that a while ago, that the 12 Federal Reserve banks, each speak their own piece as to how much of Government bonds they will take. Under the proposal they can be told what to buy by the open-market committee.

Senator BYRNES. And not by the Federal Reserve Board?

Senator GLASS. They cannot only be told what to buy, but at what price to buy.

Senator BYRNES. Do you agree to that statement?

Mr. WARBURG. Yes, sir.

Senator BYRNES. That the open-market committee—I have been glancing at the House report while you have been testifying, and I am wondering if that is a correct statement of it, and that the Board has no power in the premises. I notice in subdivision (b) [reading]:

> The committee shall 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. The committee shall also aid in the execution of open-market policies adopted from time to time by the Federal Reserve Board and shall perform such other duties relating thereto as the Federal Reserve Board may prescribe.

What I want to know is whether the policy is fixed by the Board or is the policy of the committee.

Mr. WARBURG. Under the existing law?

Senator BYRNES. No; under the House bill.

Mr. WARBURG. That is, under the proposal?

Senator BYRNES. Yes.

Mr. WARBURG. I would say that the whole open-market policy was determined by the Federal Reserve Board, under that, and with such consultation.

Senator BYRNES. You mean, the Federal Reserve Board?

Mr. WARBURG. Yes, sir.

Senator BYRNES. Not by the Governor, but by the Board?

Mr. WARBURG. I think that would depend upon the personality.

Senator BYRNES. Of course, on the personality, always. It might be someone other than the Governor who might be the dominating influence on the Board.

Mr. WARBURG. Yes, sir.

Senator BYRNES. That is another question.

I think I heard made a statement by someone to the effect that if the bankers did not accept this bill, that their banks might be seized and, therefore, the bankers did not want to express an opinion.

Mr. WARBURG. I did not make that statement. That was a question.

Senator GLASS. I made the statement; but he did not make the statement. Do you want to question me about it?

Senator BYRNES. No. I wanted to ask the witness who made the statement, and when and where, just for my information. The witness did not make it?

Senator GLASS. No; the witness did not make it.

Let me ask you a concluding question, Mr. Warburg: If there is no difference between the existing law and the proposed bill, why make any alterations?

Mr. WARBURG. I did not know whether the witness was allowed to ask a question, but I wanted to ask that question myself.

Senator GLASS. Thank you, Mr. Warburg, very much for your statement.

Mr. WARBURG. Thank you, sir.

Senator GLASS. The meeting is recessed until 10:30 tomorrow morning.

(Whereupon, at 12:10 p. m., a recess was taken until tomorrow, Thursday, Apr. 25, 1935, at 10:30 a. m.)

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BANKING ACT OF 1935

THURSDAY, APRIL 25, 1935

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

The subcommittee met pursuant to adjournment 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, Bankhead, Townsend, and Couzens.

Senator GLASS. The committee will come to order.

Governor Winship, I understand you want briefly to address the committee.

Governor WINSHIP. Yes, Mr. Chairman. Thank you. May I sit right here?

Senator GLASS. Sit right there, and make such statement as you desire.

[Uncorrected copy of]

STATEMENT OF HON. BLANTON WINSHIP, GOVERNOR OF PUERTO RICO

Governor WINSHIP. I merely wanted to ask the committee to be good enough to recommend that the benefits of this act be extended to Puerto Rico, Mr. Chairman. I think this would be very helpful to Puerto Rico, and I think it might have been done before if it had been brought as fully to the attention of the committee as it is now.

Senator GLASS. You mean you want to be brought under the insurance of deposits provision of the bill?

Governor WINSHIP. Yes, sir. This matter has been discussed with Judge Birdzell; and Judge Rigby, who is our counsel for Puerto Rico, is very conversant with the situation.

I think this is stated as definitely as I might in a radiogram I have just had from Puerto Rico. It is from the Acting Governor, who is also very familiar with the situation. In answer to a telegram I sent him I have received this [reading]:

[Radiogram received Apr. 24, 1935]

DIVISION OF TERRITORIES AND ISLAND POSSESSIONS,
April 23 (No. 161).

Your No. 123. For Governor Winship from Domenech: "Nineteen hundred and thirty-three Banking Act provided no control of interest rates on loans, nor was such control included original draft of pending bank act, and as extension Puerto Rico legislation for insurance bank deposits would not affect insular statute fixing local interest rates, believe no limitation of interest bank loans or regulation of deposits is involved. Insurance of deposits should be extended to banks organized under laws of the United States, State, Territory, or insular possessions, but not to Canadian or any other foreign banks."

There are two Canadian banks there. [Continuing reading:]

Believe you should ask extension proposed insurance legislation to Puerto Rico despite New York banks opposition, two of which banks already enjoy insurance privilege. Failure to do so would mean great injustice our local banks.

HORTON, *Acting Governor*.

Senator GLASS. Why the opposition on the part of the New York banks?

Governor WINSHIP. The only opposition that was urged at that time, as I understand, was on account of the rate of interest; and that is not involved under the present extension. So, as I see it, there is no objection on the part of the New York banks now.

Senator TOWNSEND. What is the rate of interest?

Governor WINSHIP. The rates of interest were different. They thought they would have to charge a higher rate of interest.

Senator BANKHEAD. What is the rate of interest now?

Senator McADOO. The legal rate?

Governor WINSHIP. Nine percent, and under some conditions 8 percent—under certain conditions.

Senator TOWNSEND. They do not charge that now, do they?

Governor WINSHIP. Oh, yes.

Senator McADOO. They charge all they can get.

Governor WINSHIP. Puerto Rico is very peculiar in that respect——

Senator GLASS (interposing). Well, not in this respect, that all banks charge all they can get.

Governor WINSHIP. Yes; I think they do. But Puerto Rico was in a situation where 9 percent was nothing compared to what they had charged, and the fact that we are now getting interest rates at a reasonable rate is going to help the Puerto Ricans permanently.

Senator McADOO. Would it be wise to establish a lower rate than 9 percent?

Governor WINSHIP. It is questionable whether you can get back money if that was done. Of course, the Government has come in there through its different agencies and is letting us have money. The farm credit bank and other agencies have come in there and are letting us have money. It is surprising how much good that is doing. They are perfectly good loans that could be made, but they had grown up under that old system of people putting their money into mortgages, rather than other loans, if they could get them. And I think the rate now, and the money that is in there to be had, is going to give us more money and we will also have more local capital.

Senator McADOO. If the legal rate were, say, 6 percent, do you not think that the bankers under those circumstances would be willing to make loans at 6 percent rather than not make them?

Governor WINSHIP. Well, I hope so. We are considering that at the present time.

Senator McADOO. Nine percent seems to me to be a high rate.

Governor WINSHIP. It is 8 percent under certain circumstances. Political divisions, like St. George's, borrow money, under certain circumstances, and lend it to their people, and get a little spread.

Senator GLASS. Under existing laws national banks are permitted to charge that rate of interest which is authorized by the statutes of the different States. Where a State has no statute controlling the interest rates, the banks may charge in excess of 7 percent.

Governor WINSHIP. Well, that might be advisable, sir, to do that. We would have to take that into consideration.

Senator GLASS. That has been so for years.

Governor WINSHIP. Yes, sir.

Senator MCADOO. If Puerto Rico has established, through the proper authority, the rate of 9 percent, the national banks would be allowed to charge that rate.

Governor WINSHIP. Yes; that is the situation.

Senator BANKHEAD. How many banks do you have, and how many systems?

Governor WINSHIP. We have the two Canadian banks, and the National City Bank, and the Chase National Bank, and two local banks.

Senator BANKHEAD. Are the local banks organized under the laws of Puerto Rico?

Governor WINSHIP. The local laws of Puerto Rico.

Senator BANKHEAD. Do you have national banks there under our United States banking laws?

Governor WINSHIP. The land bank is down there.

Senator BANKHEAD. Yes; I know. But I mean commercial banks.

Governor WINSHIP. The National City Bank is there, and the Chase National Bank.

Senator MCADOO. No local national bank?

Governor WINSHIP. No, sir.

Senator BANKHEAD. Do they have an office there?

Governor WINSHIP. Yes; a branch office.

Senator BANKHEAD. A branch bank there?

Governor WINSHIP. Yes, sir.

Senator GLASS. Governor, we shall be very glad to consider the matter when we come to write the bill, sir.

Governor WINSHIP. Thank you very much. I think it would be very much to the interests of Puerto Rico to have this insurance of deposits extended there. I think it would be very helpful to do it. There are two letters from local banks that I think I will put into the record, to give you what they have to say, with your permission.

Senator GLASS. You have liberty to do that.

Governor WINSHIP. In fairness to the bankers I ask that the letters I have received from the Banco de Ponce be inserted in the record. I am handing you copies for your purpose.

Senator GLASS. Very well.

(The letters submitted by Governor Winship are printed in the record in full, as follows:)

BANCO DE PONCE,
Ponce, P. R., April 22, 1935.

GOV. BLANTON WINSHIP,
Care of Interior Department, Washington, D. C.

DEAR GOVERNOR WINSHIP: On the occasion when you sailed, local newspapers informed that among other matters which took you to Washington it was your intention to use your efforts to have Puerto Rico included in the new banking act which is at present under the consideration of Congress.

We wish to explain that when advertising of Government insurance was made compulsory to insured banks in the Bank Act of 1934, the question of the advisability of having the Federal Deposit Insurance Act made applicable to Puerto Rico was discussed by the Puerto Rico Bankers Association, and as we were apprehensive of the results which might develop through the advertising by insured banks of their special privilege, the Insular Banking Association went on record as desiring that the law should be made extensive to the island.

However, according to the terms of the new bank act the insurance of deposits is specficially omitted for branches of insured banks doing business in the island, so that under the circumstances it is the general feeling of the majority of the members of the association that the obtention of the Government insurance is no longer important to the native banks. The national banks presently operating branches in the island (the Chase National Bank and the National City Bank) would also prefer that their deposits should not be insured in order to avoid the expense involved.

With respect to native banks, the main difficulty in having the legislation made applicable to the island is the fact that we would be compelled to become members of the Federal Reserve System on or before July 1937. On the occasion when both Credito y Ahorro Ponceno and Banco de Ponce negotiated capital notes with the Reconstruction Finance Corporation a year ago, the Reconstruction Finance Corporation made it a condition that both banks should become members of the Federal Reserve System on the preliminary approval of the transaction, and in discussing matters with the majority of the members of the Federal Reserve Board we were advised that membership would be impracticable, inasmuch as native banks would not obtain any practical benefits because of the nature of their business, and the Federal Reserve Board at the time requested the Reconstruction Finance Corporation to withdraw the condition of membership prior to granting the loan, which condition was removed and substituted by one that whenever the Reconstruction Finance Corporation should so request it, both banks, Credito y Ahorro Ponceno and Banco de Ponce, would be compelled to make application for membership.

Unless the attitude of the Federal Reserve Board should have changed considerably, and it could be shown that through membership local banks could obtain adequate advantages, there is really no reason why we should request that the present bank act be made applicable to the island, as we shall then be forced to apply for membership in the Federal Reserve System, irrespective of the advantages, if any, which we would obtain thereby.

We are enclosing herewith copy of letter written by Mr. P. J. Rosaly, manager of Banco de Ponce, to the American Banking Association at Washington, D. C., and copy of their reply, in which it is confirmed that the deposits in branches in Puerto Rico of insured banks in the continental United States, will not be covered by Government insurance, so that there is no reason why we should ask for the law to be made applicable to the island until and unless the Federal Reserve Board should make membership attractive to native banks.

Under the circumstances we have thought it advisable to inform you of present attitude of the majority of native banks in respect to the proposed bank act now under consideration in Congress.

We beg to remain,

Yours very truly,

BANCO DE PONCE,
By P. J. ROSALY, *Manager*.
CREDITO Y AHORRO PONCENO,
By SANZ, *Manager*.

BANCO DE PONCE,
Ponce, P. R., April 3, 1935.

AMERICAN BANKERS ASSOCIATION,
Washington, D. C.

DEAR SIRS: We are in receipt of your letter of the 22d ultimo in reference to efforts of the association in respect to proposed bank legislation.

We should like to obtain your opinion with respect to whether deposits with branches of an insured bank in Puerto Rico are to be considered insurable. According to the definition of the term "deposit", page 4, lines 9 to 25, of H. R. 5347, it would appear that a deposit lodged with a branch of a national bank doing business in Puerto Rico could not be included as an insured deposit.

As the proposed legislation does not include Puerto Rico, it would be of interest to local or native banks whether deposits lodged with their competitors' branches of national banks, are subject to insurance.

As insured banks must necessarily apply for membership in the Federal Reserve System on or before July 1937 and as the benefits to be derived from native banks from membership in the Federal Reserve System are questionable, local banks have not come to a decision as to whether it would be convenient to have the law include Puerto Rico or leave the proposed legislation as presented, which specifically excludes the island, and for the purpose of further consideration of the matter, we would like to have your opinion of the point raised herein.

Will you be so kind as to render us your opinion at your very earliest opportunity and by air mail?

We thank you and beg to remain,

Yours very truly,

P. J. Rosaly, *Manager*.

Governor Winship. The representative of the Department of the Interior is here and wanted to speak just a moment for the Virgin Islands with reference to this same extension, Mr. Chairman.

Senator Glass. Very well. We will hear him.

STATEMENT OF F. B. WIENER, ASSISTANT SOLICITOR OF THE DEPARTMENT OF THE INTERIOR

Mr. Wiener. I do not want to take more than a moment of your time, Mr. Chairman. The Department of the Interior would like to see the insurance of deposits extended also to the Virgin Islands. In the Virgin Islands at the present time there is a national bank, which has been organized partly through local subscriptions and partly through subscriptions from the Reconstruction Finance Corporation. The only other bank there is a savings bank. The Department would like to see the insurance of deposits extended so that they can participate. The Department is agreeable to that. And the Reconstruction Finance Corporation is agreeable to it, and I understand from Judge Birdzell that the Federal Deposit Insurance Corporation does not object.

Thank you, Mr. Chairman.

Senator Glass. Thank you.

Now, Mr. Comptroller, you may resume.

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY—Resumed

Mr. O'Connor. Senator, at the conclusion of the last hearing I was asked about certain data bearing on loans of executive officers. Could I first give the figures Senator Bulkley requested?

Senator Glass. Yes, sir.

Mr. O'Connor. The Banking Act of 1933 prevented further loans to executive officers of member banks, but also gave the officers who had loans in the banks 2 years in which to liquidate their loans.

On June 30, 1933, in 4,902 national banks, with total assets of $20,860,491,000, those banks had a capital and surplus of $2,456,245,000 and they showed liability of executive officers as follows:

Amount of direct borrowings by officers, of $93,743,000.

The ratio of direct borrowings to total assets of all active banks was 0.45 percent.

The ratio of direct borrowings to capital and surplus of all active banks was 3.82 percent.

The amount of indirect borrowings by officers, $43,487,000.

The ratio of indirect borrowings to total assets of all active banks was less than a quarter of 1 percent, or 0.21 percent.

And the ratio of indirect borrowings to capital and surplus of all active banks was 1.77 percent.

Senator GLASS. What do you mean by indirect borrowings; endorsements?

Mr. O'CONNOR. Yes, Senator.

Now, the particular point that the Senator was interested in was what showing had been made with reference to carrying out the direction of Congress in reducing this indebtedness. I secured that data, Senator, as I felt the committee would probably ask for it, as we have proposed in the bill an extension of time for those officers to liquidate this indebtedness.

Senator COUZENS. Is your testimony all in relation to title III, Mr. Comptroller?

Mr. O'CONNOR. Well, the other day some questions were asked me on title I, and some on title III; and just as I was leaving, this question developed on title III. But the only ones I have testified about were title I and title III.

Senator GLASS. You had nothing to do with the drafting of title II?

Mr. O'CONNOR. Nothing whatever, Senator.

Now, on December 31, 1934—the figures heretofore given were all with reference to June 30, 1933, which was the nearest date we could get after the passage of your act of 1933. Now I am taking figures as of December 31, 1934, the last available call report.

This showed the direct obligations of executive officers to banks of $60,471,000; or a decrease of $33,272,000 in direct obligations.

And on December 31, 1934, the indirect liability of officers to banks was $30,281,000. That was a decrease of $13,206,000.

Unless there is some question, Senator, that is all I had on that particular point.

Senator GLASS. Well, you still adhere to your recommendation that they be given further time in which to discharge their indebtedness?

Mr. O'CONNOR. Yes; I do, Senator, in view of that showing.

Senator MCADOO. You requested further time?

Mr. O'CONNOR. The bill, Senator McAdoo, extends the time to 1938. It was extended for 2 years, which expires on the 13th of June, of this year, and the bill, if adopted in its present language, would extend that to 1938.

Senator MCADOO. For 3 years?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. Mr. Comptroller, tell the committee the policy followed in reopening banks after the banking holiday of 1933.

In this connection, one of the Washington newspapers reported the chairman of this subcommittee as having severely hit Secretary Morgenthau for licensing involvent banks. As a matter of fact, Mr.

Morgenthau was not Secretary of the Treasury when those banks were licensed, and I did not refer to Mr. Morgenthau at all. I referred to an admission which was made personally to me by the then Secretary of the Treasury, Mr. Woodin, and not to Mr. Morgenthau, the present Secretary of the Treasury.

Senator COUZENS. You were not Comptroller when those banks were opened up, were you, Mr. O'Connor?

Mr. O'CONNOR. Up to March 16, 4,522 national banks were licensed, leaving 1,417 banks under jurisdiction of Comptroller unlicensed. I took office May 11, 1933.

Senator GLASS. Under the law, who is authorized to close banks?

Mr. O'CONNOR. There is just a little question on that, Senator. Until the Emergency Banking Act, the matter was entirely in the hands of the Comptroller of the Currency; when he found a bank to be insolvent, then it was closed up.

Senator GLASS. Yes.

Mr. O'CONNOR. The question now is left with some little doubt, inasmuch as the law provides that the Secretary may license banks in addition to their being chartered by the Comptroller. And the Secretary may withdraw a license from a bank, and that would operate to close it.

Senator GLASS. What Federal official was ever authorized or could be authorized by any Federal statute to close State banks?

Mr. O'CONNOR. It is impossible, Senator. I do not know that we have any jurisdiction to close State banks at all.

Senator GLASS. Now you may proceed with your statement without further troublesome questions.

Mr. O'CONNOR. I am very glad to answer them, Senator.

At the date of the banking holiday, March 6, 1933, there were 5,939 national banks. On March 13 the first banks were licensed and all were licensed by March 16.

Senator TOWNSEND. All of that total number were licensed?

Mr. O'CONNOR. No; 4,522 of the number that were opened at that time. And then we did not relicense 1,417.

In other words, only 10 days elapsed between the closing of the banks and the reopening, during which time it was necessary to analyze and determine the condition of each bank on the available information.

Now, the information on which the Comptroller's office acted was the last report of the examination of the national banks, which was analyzed by the various chief examiners and their staffs in the field and considered, together with any other information which was available with respect to such banks. A like analysis was made in the office by the Comptroller of the Currency and, based upon such reports, all losses, market value depreciation, and doubtful assets were deducted from capital structure, and if the result of such deduction showed the bank to be solvent and otherwise in good condition, including adequate liquidity or borrowing power, the bank was recommended to the Secretary of the Treasury for a license. Each Federal Reserve bank made a similar analysis and submitted its recommendation on the national banks direct to the Secretary. In most instances the recommendations of the Federal Reserve banks and those of this office coincided.

If there was a variance in any case, that case was made a matter of special study and was discussed over long distance by members of the staff of the Comptroller's Office with the chief examiners in the field and with the Federal Reserve banks, in order to arrive at the proper decision. No bank that was considered unsound was recommended by the Comptroller's Office to the Secretary for licensing.

It was only natural that under this tremendous pressure and the short time available and with many examination reports not current, some errors occurred, but subsequent examinations have shown that they were few in number. In this connection it is well to call attention to the fact that in more than 2 years which have elapsed since the banking holiday only 11 national banks have suspended business. Five of these banks suspended business on account of defalcation on account of officers or employees. Seven of the banks were subsequently reorganized and three of that number paid creditors 100 cents on the dollar. One paid 80 percent and will pay a total of 90 percent; 1 paid 62½ percent and will pay a total of 77½ percent; 1 paid 60 percent and will pay a total of 70 percent; 1 paid 65 percent; 1 paid 50 percent and will pay a total of 70 percent; 1 paid 75 percent and will pay a total of 83 percent; and 2 were taken care of through the Federal deposit insurance.

I have a list and digest of each one of those 11 banks.

Senator TOWNSEND. Mr. Comptroller, you say there were 11 of those banks, but only 2 were members of the Federal Deposit Insurance?

Mr. O'CONNOR. Yes, sir.

Senator TOWNSEND. Why were they not members?

Mr. O'CONNOR. They closed before the law became effective. You see, the law did not become effective until the first of the year 1934. There was no insurance prior to that time.

In line with the policy of the office to require banks to maintain a proper ratio of sound capital to deposits, analyses were made of the condition of the licensed banks following their first examination after the holiday, by which all losses, bond depreciation, and doubtful assets were deducted from capital structure to arrive at the amount of sound capital.

Senator BYRNES. Mr. Chairman, may I ask a question at this point?

Senator GLASS. Just as many as you please.

Senator BYRNES. Mr. O'Connor, how many national banks have issued preferred stock, and for what amounts? Have you a statement showing that?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. I suggest to the Senator that we could get full information on that; but you may go ahead, Senator.

Mr. O'CONNOR. Up to the present date 2,170 national-banking associations have sold preferred stock in the total sum of $531,075,800. In addition there are pending in the office today 150 cases involving approximately $23,000,000.

Senator McADOO. What is the total number of active national banks now, as of the latest available date?

Mr. O'CONNOR. I can give you that in a second, Senator.

Senator GLASS. You can supply it.

Mr. O'CONNOR. I have it here, Senator, and would be glad to give it now. The number is 5,467.

Senator BYRNES. May I ask one further question on that preferred-stock feature?

Mr. O'CONNOR. Yes, sir.

Senator BYRNES. Have you any record showing how many national banks have retired their preferred stock, and the amount of stock which was retired?

Mr. O'CONNOR. Yes, sir. One hundred and ninety-three banks have retired their stock, in the sum of $11,496,982.

I might say, in passing, that not all these national banks really needed preferred stock. The preferred stock was issued for two purposes: First, to strengthen the capital structure of the bank; and, second, in many instances, where the banks wanted to carry slow paper and not crowd the debtors, they took in additional cash to enable them to do that. And, without giving the names, I happen to know of some national banks that did not need it for either purpose but did it because of the criticism that if the bank took additional stock it indicated a precarious condition; and they did it, they took the preferred stock, to help the weaker banks. That actually happened in some cases.

Senator GLASS. In some cases?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. But for general reasons, why did they issue preferred stock?

Mr. O'CONNOR. First, to strengthen the capital structure; and, secondly, while they had the opportunity to force the debtors to the wall, they took the preferred stock which was to enable them to carry those debtors. Those are the two reasons, Senator.

Senator MCADOO. The paper was simply slow paper?

Mr. O'CONNOR. Yes, sir.

Senator MCADOO. But not necessarily bad paper?

Mr. O'CONNOR. Sound, but slow.

Senator GLASS. Well, what is going to happen to the banks that were in a precarious condition by reason of mismanagement that took out preferred stock to try to recover their position? What is going to happen to them when they have to pay it?

Mr. O'CONNOR. Well, if the Government should call upon them, Senator, for repayment of the amounts of preferred stock, and the bank not be in shape to do it, there is only one thing that can happen; it has got to fold up.

Senator BULKLEY. Is there any agreement by which the Government could call on them for payment?

Mr. O'CONNOR. The Government requires from them that the bank set up a reserve out of their earnings over a period of 20 years.

Senator BULKLEY. But if no earnings, no reserve.

Mr. O'CONNOR. No earnings, no reserve.

Senator BULKLEY. Then the bank could not be forced at all?

Mr. O'CONNOR. I do not see how preferred stock could have a debt status.

Senator COUZENS. Were all these issuances uniform, of the preferred stock in all the banks? When they did subscribe for it, were the conditions uniform in all?

Mr. O'CONNOR. Senator, I am not in the best position to testify to that, that being an R. F. C. matter; but I am inclined to think there were some variations under some circumstances. For instance, this was a vital difference: When the R. F. C. found local interests were able to take some preferred stock, the R. F. C. took A stock, and the local interests took B stock.

Senator McAdoo. What Senator Couzens has in mind, I imagine, is whether the character of certificates was uniform in all cases.

Mr. O'Connor. It is my impression they were, Senator.

Senator McAdoo. They were necessarily so, were they not?

Senator Couzens. Did you ever pass on them before they issued them?

Mr. O'Connor. Yes; we passed on them.

Senator Couzens. Then you would know, would you not, whether they were uniform?

Mr. O'Connor. I do not want to pass on that without investigation, because there might be some differences in terms.

Senator McAdoo. But not in the form of the stock and the obligation incurred?

Mr. O'Connor. No. I would say, "Yes they were uniform", Senator McAdoo, but the difference between the bank and the R. F. C., the R. F. C. might ask the bank for a management clause.

Senator McAdoo. That would not vary the stock?

Mr. O'Connor. No; there was uniformity in the certificate.

Senator Couzens. I was talking about both.

Senator McAdoo. Were you?

Senator Couzens. Yes.

Senator Glass. As a matter of fact, you know the R. F. C. did demand the right of management of some banks?

Mr. O'Connor. That is correct, Senator.

Senator Glass. On the other hand, the R. F. C. persuaded some banks—I do not know how many; perhaps you do not know how many—to take this preferred stock that really did not want to take preferred stock, and there was no necessity for them to take preferred stock; is that not true?

Mr. O'Connor. That is true.

Senator McAdoo. But the preference that the R. F. C. acquired by the sale of these stocks was precisely the same. I am talking about the legal preference.

Mr. O'Connor. They always had the legal preference.

Senator McAdoo. Collateral management was not involved?

Mr. O'Connor. No.

Senator McAdoo. That was outside?

Mr. O'Connor. Yes.

Senator McAdoo. But the preference the Government got was the same in each instance?

Mr. O'Connor. Yes; that is true. The Government was in there first.

Senator Byrnes. If there was any difference between the character of certificate insisted upon, I think we ought to know it. What Senator McAdoo has asked is what I wanted to know: Whether the certificates of stock, A or B, issued by a bank differed by different banks or whether they were uniform?

Mr. O'Connor. Senator, we will let the record stand that they were all uniform, because that is my recollection at the present time. I will correct it if that is not correct.

Senator TOWNSEND. Were there variations in the local situations, Mr. Comptroller, of the different banks?

Mr. O'CONNOR. No; I think not.

Senator BULKLEY. I understand you are talking about national banks all the time?

Mr. O'CONNOR. That is all.

I think it would interest the committee to know how much of this preferred stock was purchased locally, because that has been my desire, and that of Mr. Jones—I should say of the Comptroller's office. We have all been desirous of having the local people purchased as much as possible.

Senator GLASS. You are speaking of the preferred stock of national banks?

Mr. O'CONNOR. Yes, sir.

Senator McADOO. And not State banks?

Mr. O'CONNOR. Not of State banks.

That sum was $359,365,445.

Senator McADOO. Out of a total of a little more than 459 million dollars?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. Mr. Comptroller, unless members of the committee want to ask you more questions on that particular point, I want to direct your attention to receiverships. There has been some discussion on the matter of receiverships, as to what bureau of the Government should handle receiverships. I believe the Federal Deposit Insurance Corporation wants to do it, and I believe the Comptroller's Office under the law was required to do it. What, if anything, do you have to say on that subject?

Mr. O'CONNOR. When the Federal Deposit Insurance Law was first drafted it was the plain intent of the law of Congress to insure deposits greatly in excess of $5,000, up to $10,000, and then, 75 percent up to $50,000 and 50 percent above $50,000; which, if it had become effective, would have practically taken all of the deposits in all banks under the insurable clause of the Federal Deposit Act.

Senator GLASS. That is the law now.

Mr. O'CONNOR. That is the law now, that is correct, Senator; it will be on July 1. It is the law, but not effective until July 1. Congress saw fit to put the temporary fund of $2,500 into effect, and then extended it to $5,000, which is now in effect.

Senator McADOO. You mean insurance, instead of fund?

Mr. O'CONNOR. Insurance of these deposits, and that meant that in national banks 42 percent of the total deposits in national banks are insured under the $5,000 provision, which leaves the Comptroller's office responsible for 60 percent of the deposits. In view of that particular effect, it rather occurred to me that inasmuch as the Comptroller's office now has 1,530 actual and active receiverships; and in view of the fact that there have been only two national bank failures and in receivership that are now being liquidated by the Federal Deposit Insurance Corporation as receiver, that it is a waste or duplication of effort to have two organizations acting as receivers set up and have an entirely different liquidating agency for just two national banks. I think until the 1,530 receiverships are gotten out of the way and until some appreciable number of national banks failed, that this waste should not occur and that the Federal Deposit Insurance Corporation should file its claim the same as any other claimant or debtor, and permit the Comptroller to liquidate the banks under the law.

Senator GLASS. What has been the cost of receiverships under the Comptroller?

Mr. O'CONNOR. Quoting from my annual report for the year closed on October 31 last:

Expenses incident to the administration of the 1,219 closed trusts, such as the receivers' salaries, legal and other expenses, amounted to $33,578,643, or 3.86 percent of the book value of the assets and stock assessments administered, or 7.39 percent of collections from assets and stock assessments. The assessments against shareholders averaged 68.25 percent of their holdings and total collections from such assessments as were levied amounted to 49.78 percent of the amount assessed.

A much better record than that, I might say, Senator, has been made in the larger banks, for instance, in Detroit, where we have the two largest receiverships. The expenses there have been less than 2 percent. In other words, out of every dollar collected we have made available for creditors 98 cents on the dollar.

Now, to complete the statement I made a few moments ago, because it is the other counterpart, we had, at the close of the banking holiday 1,417 unlicensed banks, with deposits of $1,971,960,000. That was a period of a little more than 2 years ago.

And it is of great interest, I think, to note just what has been done with those 1,417 national banks: 1,095 have been reorganized under old or new charters or absorbed by another national bank, with deposits of $1,807,334,000. And 31 of those national banks quit or left the banking system voluntarily, and paid their depositors in full the sum of $11,513,000.

And there were 291 of those banks placed in receivership that had deposits of $153,113,000; and of that sum—that is, the sum in receivership—we have already returned to the depositors $54,250,490.

And that indicates that of the approximately $2,000,000,000 of deposits that were frozen in the banks at the close of the banking holiday there now remains only 5 percent that is not available to the depositors. And I am very pleased to report to the committee that there is not a single conservatorship created during the banking holiday that is left in the system at present.

Senator GLASS. Can you tell us or conjecture why those 1,417 banks were not licensed when other banks that were insolvent were licensed?

Mr. O'CONNOR. Senator, my records do not show that any banks were licensed that were not solvent.

Senator GLASS. The Secretary of the Treasury told me positively that he licensed over 1,000 that were not solvent.

Mr. O'CONNOR. That is why I wanted to correct that statement. I do not know whether he referred to State banks or what he referred to, but certainly it was not correct as to national banks.

Senator GLASS. He said member banks. That included in all a thousand State banks?

Mr. O'CONNOR. Yes; 900 and something.

Senator GLASS. I cannot be mistaken about it.

Mr. O'CONNOR. No; I am not saying that you were.

Senator GLASS. I jocularly said to him that that was contrary to the Federal statute that made it a penal offense, and that 3 months theretofore we had sent man to the penitentiary from Danville, Va., for taking deposits over the counter when he knew his bank was insolvent. He laughed and said he hoped I would not send him there. I told him "No; I was personally too fond of him."

Senator BANKHEAD. You mentioned something about 5 percent. I did not get that.

Mr. O'CONNOR. Of the 1,417 we reorganized and reopened 1,095, with deposits of $1,807,334,000; 31 of the national banks decided to close up and go out of business, and pay their depositors in full, which they did, a total of $11,513,000. That left 291 of those banks that were not able to reorganize. In other words, they could not get the capital, or the banks were in such bad condition that they could not be reopened under any conditions. In those 291 banks there were total deposits of $153,113,000, and we paid to the depositors in those banks a total of $54,250,490.

Now, that leaves, roughly, $100,000,000, which is approximately 5 percent.

Senator BANKHEAD. Of the total deposits?

Mr. O'CONNOR. That is right. That was left after the banking holiday.

Senator BULKLEY. To what do you attribute the extraordinarily low cost of liquidation of the Detroit banks?

Mr. O'CONNOR. To the large sum involved. That always gives a low cost proportionately.

Senator BULKLEY. The rule is that in a large institution or bank, you can work out a better ratio?

Mr. O'CONNOR. Yes. To give you one illustration: One of those banks had deposits of about $415,000,000. We paid the receiver $14,000. There is no private institution that could get a man to go in there and do that work for $14,000.

Now, the proof of the fact that we can do it at low cost is that our receiver was offered a much higher salary and went to a concern that paid him a much higher salary, and then I was able to take that receivership and combine it with the other one in Detroit, so that instead of paying $28,000, I am paying one receiver out there $16,000.

Senator MCADOO. Under that practice, Mr. Comptroller, of the liquidation of insolvent banks, you do not permit the receivers to receive a commission? You pay them a salary, always, which is commensurate with the character of the work they have to do; is that not a fact?

Mr. O'CONNOR. Senator McAdoo, that is one of the most important distinctions between receiverships of national banks and other receiverships. There is no commission paid to anyone in a receivership. A receiver is paid a straight salary, and every attorney that is appointed to represent the trust signs an agreement allowing the Comptroller to fix his fee at a reasonable sum. He submits his bill to us, and then the lawyers here in my office go through it, item by item, and he agrees to accept their conclusions.

Senator MCADOO. Mr. Comptroller, it has been, as I recall the law, the historic right of the Comptroller of the Currency to appoint receivers and to liquidate insolvent banks.

Mr. O'CONNOR. For 70 years.

Senator McAdoo. During the whole period of years that that practice has existed in the Comptroller's office, a very fine organization has been built up of expert men who know how to handle such things, and that is why you get such a fine administration in those banks and at such a low cost; is that not a fact?

Mr. O'Connor. Yes, sir.

Senator McAdoo. Do you see any reason why the Comptroller's office should be deprived of that administration of receiverships and the work sent somewhere else?

Mr. O'Connor. No; I cannot see it.

And a second reason is that we are able to list all of the securities that we find in those banks and dispose of them at good rates. We send the securities to New York, which is the best market for sales. We have a very efficient staff there working with the Treasury. In other words, we do not permit the indiscriminate sale of securities, but require an orderly liquidation.

I might mention this one principle: We took in a great many Home Owners' bonds in exchange for real-estate mortgages which we had. And in discussing that with the liquidating department of my office, we gave orders that no bond was to be sold for less than par. That was specific orders. In other words, when the market got above par and investors wanted them we sold them. When they got below par we stopped selling them. For that reason we have not sold any below par.

Senator McAdoo. I want to get your view of this: In the administration of bankruptcies in the Federal courts, by a subcommittee of the Senate it was developed that the net returns to the beneficiaries was, in each instance, extraordinarily small; that not only applied to equity receiverships, but also to bankruptcies; and it was clearly shown that some more efficient method would have to be devised for the liquidation of those bankrupt assets, particularly. I would think, from my recollection of the testimony, that the figures were just the reverse from the figures that you have shown. In other words, instead of cost being 2 percent, the cost was probably 98 percent, and the beneficiaries got 2 percent, or in that neighborhood. Now, is it at all possible to enlarge your administrative force there on a national scale to administer bankruptcies in the Federal courts? I think it is perfectly clear that some more efficient organization must be effected to administer those bankruptcies. Equity receiverships is another class, but bankruptcies are quite different.

Mr. O'Connor. Senator, that would, of course, depend, first, on an analysis which I do not have, of the number and the amounts involved of all those receiverships, bankruptcy receiverships, and so forth, in the Federal courts, and then to determine just what it would require in the way of a national administration to administer them. I do think that some unified control should be exercised, and then developed to the extent that Congress desired it. I think that there ought to be some commencement or beginning of it, and then develop it as Congress would determine on the basis of what we are doing in the national banks.

Senator McAdoo. I want to say that I think it is an unfair question to ask you, with the idea that you could give me a response to it at this time, because it has not been brought to your attention. I would be glad if you would think of it, because it will become a live question in a little while.

Senator GLASS. I am glad the Comptroller's Office has gotten so efficient in the administration of receiverships because it has not always been so. I have known receiverships to extend over a period of 12 years.

Senator MCADOO. That was in the old days.

Senator GLASS. And there was not anything difficult about them, either.

Senator BYRNES. Mr. Chairman, may I ask a question along this line?

Senator GLASS. Certainly.

Senator BYRNES. I assume that the Federal Deposit Insurance Corporation should handle their receiverships, because of their interest in the insurance of deposits; is that right?

Mr. O'CONNOR. Yes; that's the present law Senator.

Senator BYRNES. Now, the receivership is to liquidate the trust for all creditors other than depositors?

Mr. O'CONNOR. That is right.

Senator BYRNES. If the Federal Deposit Insurance Corporation has charge of the receivership, and there be a stock liability, it would be to their interest to press that, because it would inure to the benefit of the deposits and, therefore, to their fund, and the Comptroller of the Currency, having the interest of all creditors, might not be as anxious to hurriedly collect the stock liability. Would that be true?

Mr. O'CONNOR. No, Senator; I think our record shows that we have gotton every dollar that is available out of stock liability and, frankly, it is not a pleasant task to have to sign these stock assessments, and Congress has released us of it.

Senator BYRNES. It is a very disagreeable task, I suppose.

Mr. O'CONNOR. Yes. And you will not have anything of that in the future, because you have eliminated it as to new banks and this bill will eliminate it as to all banks.

Senator MCADOO. It was a very brutal thing to do, and a brutal performance, in many instances.

Mr. O'CONNOR. Yes.

Senator GLASS. In the matter of consolidations, Mr. Comptroller, where do you think that authority ought to reside? I mean, the consolidation of smaller banks in order to meet the requirements?

Mr. O'CONNOR. You cannot localize that very well, Senator, for this reason: That the Comptroller's office is, of course, responsible and interested in the national banks, if it happens to be a national bank. If it is a member State bank, then the Federal Reserve is in the picture and should be consulted.

Senator GLASS. The Comptroller of the Currency is ex officio a member of the Federal Reserve Board?

Mr. O'CONNOR. Yes, Senator. Now, if you find a bank that is a State bank not a member of the Federal Deposit Insurance Corporation, you must have the Federal Deposit Insurance Corporation cooperating with the merger, because that is the only one that has any jurisdiction—either the Federal Deposit Insurance Corporation or the Federal Reserve Board.

Senator GLASS. Well, the law could make membership in the Federal Reserve a prerequisite to the right of being insured.

Mr. O'CONNOR. Yes; any condition that Congress may write in as a prerequisite to membership in the fund.

Senator GLASS. That is what I mean.

Mr. O'CONNOR. Yes, of course.

Senator GLASS. About the assessments on banks, I do not know whether I questioned you about that when you were here before.

Mr. O'CONNOR. You asked me for some figures.

Senator GLASS. There were differing views as to that. My own view and that of others has been that there should not be an annual assessment beyond a certain figure, and when that figure is reached the assessment should automatically cease, and be automatically resumed when the fund is impaired. What amount would be brought in by the one-eighth of 1 percent assessment and what amount by the one-twelfth of 1 percent assessment?

Mr. O'CONNOR. Senator, before I go to that, with your permission and the permission of the committee, could I just put in the record the figures showing unpaid deposits in these receiverships and the amount of deposits that we have paid?

Senator GLASS. Yes.

Mr. O'CONNOR. Of the 1,530 receiverships of banks, the deposits at closing were $1,871,681,991; and the deposits paid to date are $1,032,673,040. We have distributed to depositors, since March 16, 1933, $644,793,467. And if I have these figures correct in my mind, I think that is about 54 percent return.

Senator COUZENS. Does that include loans that you got from the R. F. C., when you talk about distributing to depositors?

Mr. O'CONNOR. Yes; that includes that.

Senator BYRNES. That made it possible?

Mr. O'CONNOR. Yes; in that amount. Now, Senator, to answer your question——

Senator MCADOO (interposing). If I may ask you this: What percentage of loans does that represent from the R. F. C.?

Mr. O'CONNOR. I have not those figures with me, Senator.

Senator GLASS. You may put them in.

Mr. O'CONNOR. I will be glad to. The figure is 59 percent but I might mention, however, that loans from the Corporation to receivers and conservators of national banks were not employed 100 percent in making distributions to depositors of such banks. That is to say, in certain instances portions of R. F. C. loans have been used as necessary to retire secured indebtedness of banks and to redeem pledged assets in order that such redeemed assets might thereafter be either liquidated or used as collateral to additional loans from the Corporation. As no analysis has been made in my office as to the proportion of R. F. C. loans employed exclusively in the payment of dividends and as to now do so would require many days of work upon the part of a number of men, I assume you will not require this exact data, which in any event would not give a materially different percentage from that quoted above based upon total loans.

Now, to answer your question, Senator:

An assessment for the 13-year period from 1921 to 1933, inclusive, of one-twelfth of 1 percent would amount to $545,454,077.

Senator GLASS. One-twelfth of 1 percent?

Mr. O'CONNOR. Yes, Senator.

Senator COUZENS. Over what period?
Mr. O'CONNOR. Thirteen years.
Senator COUZENS. Why do you fix 13 years?
Mr. O'CONNOR. I just go back to 1921.
Senator COUZENS. Oh!
Mr. O'CONNOR. For the same period, one-eighth of 1 percent would amount to $818,181,115.
Senator COUZENS. That is, collecting this assessment every year?
Mr. O'CONNOR. Yes, Senator.
One-sixth of 1 percent for the same period would amount to $1,090,908,154.
Senator TOWNSEND. Would that be allowing interest each year?
Mr. O'CONNOR. No. I will come to that, Senator.
Then, 1 percent for the same period the assessments would amount to $6,545,448,924.
Now, if we take one-twelfth of 1 percent on the total deposits for the 13-year period—and I will just pick out 2 or 3 years, just to give an idea: In 1921, with 30,812 banks, with total deposits of $38,-664,-987,000, the income at one-twelfth of 1 percent would be $32,220,823.
And while I have them for each year I will just go down to 1927: Total banks, 27,061; total deposits, of $56,751,307,000, with an assessment income of $47,292,756.
And then, coming down to 1933, with 14.624 banks, with total deposits of $41,533,470,000, we have an income of $34,611,225.
Now, I will just take two or three illustrations throughout that period of 13 years. On the one-twelfth of 1 percent the earnings, at 3½ percent, on the $325,000,000 of capital structure of the Corporation would be $7,875,000. And recoveries from advances made, $9,685,575. That would give us a total income of $49,781,398. Advances to pay insured deposits as of that date in that year 1921, $77,484,600. And the expenses of operation I have fixed through the entire period at $2,500,000 per annum, which would be a total disbursement of $79,984,600 for 1921.
There would be a loss that year if you had totaled your assessment of one-twelfth of 1 percent plus your earnings on your investment, plus your recoveries, of $30,203,202, which, of course, would come out of your capital, and which still leaves $294,796,798 of your capital. And during a period of 13 years, on your one-twelfth of 1 percent, we would be into the capital in 4 years of the entire 13—in 1931, 1932, 1933, and 1934—but under the bill we are permitted to borrow three times the capital; but it would only be necessary to borrow approximately one and one-half times the capital in the worst year of the 13-year period, which would be 1932. And then immediately we pick up in recoveries again from the closed banks, and from 1934 to 1937—and I am taking that period because we base it on a 5-year period of liquidation when we get into the recovery value of the assets—we would be into the red $99,662,818 on one-twelfth of 1 percent without any borrowing. We would only have to borrow, of course, that amount, and then after that the recoveries go on again for 1937.
Senator GLASS. Well, you are embracing the 13 years of the unprecedented period of bank failures, are you not?
Mr. O'CONNOR. Yes; I am.

Senator GLASS. Well, you do not think anything like that will ever happen again, do you?

Mr. O'CONNOR. Never.

Senator GLASS. It never happened before.

Mr. O'CONNOR. Now, let us take the figures on one-eighth of 1 percent. The assessment income would be $818,181,115 for the 13 years. The investment earnings would be $117,182,694. And the recoveries from advances made, $1,285,920,916, or a total income of $2,221,284,722. Less advances to pay insured deposits, $2,296,287,450. With expenses of operation of $35,000,000, or total disbursements of $2,331,287,450.

And during the 13-year period, the same period that I covered for the assessment of one-twelfth of 1 percent, we would be in the red the first year $14,092,791 instead of $30,203,202; and after that only three periods—in 1930, 1931, and 1932—would the corporation be in the red. And in 1932 the deficit would be $20,559,937 as against $39,472,549 under one-twelfth of 1 percent.

And then, in 1933, under the one-eighth of 1 percent, with our recoveries and our income we would be to the good again $157,904,593. And from 1934 to 1937 we would again have a surplus of $217,525,178.

Now, this is based on insured deposits over the period of 45 percent, which is the figure given by the Federal Deposit Insurance Corporation of 43.5, of total deposits in all banks, the national banks being insured 42.29 percent for $5,000 and the member State banks being insured 67.7 percent, and the State banks being insured 72.43 percent of their total deposits, or an average of 43.5 percent. So we take the figure, then, during that time of 43 percent, and the eventual losses of 44 percent, and the recoveries at 56 percent put back into the fund.

Now, of course, as Senator Glass has pointed out, with those figures we have got to keep in mind the very important fact that the number of bank suspensions in this period was 11,278, and nobody believes that we will ever have any such picture as that again. So, of course, it would make the figures here much more favorable to this assessment.

Senator GLASS. Without meaning to give it any suggestion of politics, the last year of Mr. Wilson's administration there was one national bank failure.

Senator COUZENS. What would happen, Mr. Chairman, to this situation if our loaning continued and our credit was wrecked, as you suggested?

Senator GLASS. I do not think it would have been continued and wrecked.

Senator COUZENS. I think you said, and the Comptroller said, that this condition that has existed in the last few years would not happen again.

Senator GLASS. Yes.

Senator COUZENS. And I asked you, in view of the fact that banks were so loaded with bonds, if it might not happen again if you continue to sell bonds.

Senator GLASS. If you continue to allocate them to banks, it might. The whole structure might be ruined, for that matter.

Senator COUZENS. How long will you continue, Senator?

Senator GLASS. As long as you gentlemen want to. I am sorry there are not more members of the subcommittee here.

Is there anything further you desire to discuss, Mr. Comptroller?

Mr. O'CONNOR. Senator, on title III which, you remember, largely becomes amendments to the banking act, I have prepared just a summary of each section that I should like to put into the record. It will save the members reading the entire bill.

Senator BULKLEY. I may want to ask some questions about that.

Mr. O'CONNOR. May I put this in, and also be subject to your call, Senator?

Senator GLASS. Yes; that may go into the record.

(The summary referred to is here printed in the record in full, as follows:)

EXPLANATION OF OBJECT OF PROPOSED AMENDMENTS CONTAINED IN TITLE III OF S. 1715

The majority of the amendments in question are based upon H. R. 9876 and S. 3748 submitted at the last session of Congress, which bills were mutually acceptable to the Federal Reserve Board and to the Comptroller's Office and were favorably reported by the Banking Committee of both Houses.

There has been placed before you copies of S. 1715 showing marked in red and by typed inserts certain eliminations and additions that have been suggested to the bill's original provisions in title III, which changes I will explain as each section is discussed.

A general statement of the object of the various amendments suggested in last year's bill and now resubmitted and those added thereto in title III of this bill are as follows (where these amendments were not embraced in last year's approved bills or are substantially different from those presented, the notation "new" appears in connection with this explanation):

Section 301: Amends section 2 (c) of the Banking Act of 1933 so as to exclude from the very broad definition of the term "holding-company affiliate", and hence from all provisions of law regarding such affiliates (except the provisions of section 23A of the Federal Reserve Act regarding loans to and investments in the securities of such affiliates), every corporation wholly owned by the United States and every 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, banking associations, savings banks, or trust companies."

Section 302: Amends section 20 of the Banking Act of 1933, which requires the divorcement of member banks from affiliated securities companies so as to make it clear that its requirements do not extend to a securities company which has been placed in formal liquidation and transacts no business except such as may be incidental to the liquidation of its affairs. This is in accord with rulings by the Federal Reserve Board and the Comptroller's Office as to a proper interpretation of the law.

Section 303 (a): Makes it clear that the provisions of section 21 (a) (1) of the Banking Act of 1933, prohibiting dealers in securities from engaging in the business of taking deposits, does not prevent banking institutions from dealing in, underwriting, purchasing, and selling investment securities to the extent expressly permitted to national banks under the National Banking Act and does not prevent banking institutions from selling mortgages without recourse. It will be observed that national banks are limited in dealing in and underwriting securities to doing so as to Government obligations, general obligations of States or political subdivisions, obligations issued under authority of the Federal Farm Loan Act, by the Federal Home Loan Board, or the Home Owners' Loan Corporation.

Section 303 (b): Makes it clear that section 21 (a) (2) of the Banking Act of 1933 does not require that business institutions which accept deposits only from their own officers, agents, or employees need submit to examination and publication of reports of condition. Hundreds of corporations, such as the Baltimore & Ohio Railroad, Chrysler Motors, Deere & Co., permit employees to leave part of their wages on deposit and in turn loan these funds to other employees so as to encourage thrift and be of assistance thereto.

This section also makes it clear that the expense of examining private banks by this office or by the Federal Reserve Board shall be paid by the institution examined as there are otherwise no funds available to bear the expense of such examination. I understand it is the sentiment of the House committee to repeal this subsection 21 (a) (2) entirely as it constitutionally is not only questionable, but no purpose is served by examining such banks when no power is given or can practically be given to force correction of dangerous conditions found. Also the public is misled from fact of Federal examination into assuming there is also actual Federal supervision with its attendant safeguards. I do not oppose repeal of the section.

Section 304 (new): Eliminates the double liability of shareholders of national banks on July 1, 1937. This provision considered desirable because of the fact that such liability has already been eliminated as to banks organized since June 16, 1933, and as to new capital issued since that date, with the result that at the present time many banks are in the awkward position of having outstanding some common stock with liability and other common stock without liability, resulting in needless confusion. Provision is being made in section 314 of this bill for banks gradually increasing their surplus out of earnings until same equals the bank's capital, thereby giving the creditors of the bank substantially the same additional protection which is now afforded by the assessment liability.

Section 305 (new): Corrects the accidental omission of national banks in Alaska and Hawaii from the benefits of an act passed last session repealing the requirement of section 31 of the Banking Act of 1933 that directors of national banks and member banks increase the amount of their shareholdings therein. This law was repealed incidentally because it was found physically impossible to enforce its requirement, with the result that many banks would have been forced to cease operation for lack of a qualified board of directors.

Section 306 (new): Gives the Federal Reserve Board power to control relationships of officers, directors, and employees of banks with securities companies through regulation, thereby saving the great burden involved in present procedure of issuing individual permits.

Section 307 (a) (new in part: Makes it clear that section 16 of the Banking Act of 1933 was not intended to prohibit national banks or member banks from buying or selling stocks solely for the account of their customers and as an accommodation thereto and not for their own account. Extremely important, particularly in communities remote from financial centers and since there is involved no investment by the bank of its own funds, no objection can be seen thereto. The amendment further limits national banks in purchasing investment securities for their own account to the purchase of same in an amount as to any one issue limited to 10 percent of the bank's unimpaired capital and surplus. The present law permits such investment in any one issue to an amount equal to 15 percent of the unimpaired capital and 25 percent of surplus, except where the total issue does not exceed $100,000 and does not exceed 50 percent of the capital of the association.

Section 307 (b): This section merely restates in clearer form the existing prohibition against national banks purchasing stock for their own account.

Section 308 (new): Section enacts into law present requirements of the Comptroller's office as a matter of policy that newly organized national banks have a paid-in surplus equal to 20 percent of capital before being authorized to do business, which requirements may be waived where necessary in connection with a State bank converting into a national bank.

Section 309 (new): Eliminates any possibility of section 18 of the Banking Act of 1933 being construed as preventing corporations other than a bank from conditioning transfer of their shares on the simultaneous transfer of shares of bank stock but preserving the unimpeded free and unconditional transfer of bank stock.

Section 310 (a): Permits holding company to vote on the question of placing a bank in voluntary liquidation without having to go through the expensive routine incidental to obtaining a voting permit, and section 310 (b). Under present law shares held by a bank as sole trustee cannot be voted. It consequently sometimes results where a large number of shares are so held in trust that it is impossible to obtain the requisite number of votes required by law to accomplish certain steps such as reduction in capital, amendments to articles, etc., or to vote to go into voluntary liquidation where such is necessary. Provision is accordingly made that the shares so held in trust shall be excluded in determining whether the resolution in question has been adopted by the requisite number of shares. For example, a bank has 1,000 shares outstanding. Four hundred of the shares, however, cannot be voted because held in trust by the bank as sole trustee. Consequently, in determining whether or not a resolution has been adopted by the required two-thirds vote, the 400 shares held in trust will be excluded, leaving a balance of 600 shares as the basis for determining whether a two-thirds vote has been obtained, in which case a vote of 400 shares in favor of the matter would be the requisite two-thirds majority of the shares entitled to vote.

It is suggested these two subsections be rewritten and combined as one section as per the draft before you and adding these additional changes: (1) To show clearly that present law does not limit extra voting rights of Reconstruction Finance Corporation or other holders of preferred stock in case of default on preferred dividends; (2) it permits stock held in trust by bank as sole trustee to be voted where donor or beneficiary directs or controls manner in which it shall be voted. This is desirable because the bank as trustee does not then in fact control such vote.

Section 310 (c) (new): Eliminates any doubt that a holding company which has met the requirements for obtaining a voting permit may cumulate its shares in the same manner as other shareholders are permitted to do. This is in conformity with the construction placed upon the present law by the Federal Reserve Board and by the Comptroller's office.

Section 311: Gives discretion to the Comptroller to permit a State bank converting into a national bank to carry over and retain, subject to certain conditions, such sound assets as a State bank may have which do not conform to the requirements as to assets held by national banks.

Section 312: Permits the Comptroller to delegate the manual labor of countersigning bond transfers in connection with substitution of securities held to secure circulation issued by national banks.

Section 313: Permits branches of national banks, which branches are located outside of the United States, to charge same interest rate permitted by local law to competing institutions.

Section 314 (new): Provides that before the declaration of dividends, national banks shall carry not less than one-tenth of their net profits of the preceeding half year to surplus until same is built up to an amount equal to the common capital instead of present requirement that same need only equal 20 per centum of capital. This change is deemed desirable in connection with the provision that assessment liability be eliminated from bank stock and is further desirable from the standpoint of building up a proper capital structure.

Section 315 (new): Extends the criminal provisions of existing law relative to embezzlement, false entry, etc., by officers and employees of member banks to include any insured bank.

Section 316: Gives the Comptroller closer supervision over national banks in voluntary liquidation as distinguished from those in receivership by requiring reports to him and to the shareholders and subjecting the bank to examination. Also enables shareholders to remove an incompetent liquidating agent.

Section 317 (new): Extends present prohibition on use of word, "national", by banks other than national banks, to include "Federal" or "United States", or any combination of such words.

Section 318. Amends section 5 of the Federal Reserve Act so as to require member banks to reduce their holdings of Federal Reserve bank stock upon a reduction in their own surplus, just as they are already required to do upon a reduction in their own capital. It would also repeal the provisions of sections 5 and 6 of the Federal Reserve Act which require the board of directors of a Federal Reserve bank to execute a certificate to the Comptroller of the Currency showing an increase or decrease in the capital stock of the Federal Reserve bank. Inasmuch as every adjustment in Federal Reserve bank stock is approved by the Federal Reserve Board before the stock is issued or canceled, the filing of such certificates with the Comptroller of the Currency is a useless formality involving duplication of work.

Section 319: Authorizes Federal Reserve Board to prescribe form and contents of reports of condition to be made by State member banks and prescribes manner in which such reports must be published.

Section 320 (a): Amends section 11 (m) of the Federal Reserve Act so as to place State member banks on a parity with national banks in lending on the security of bonds, notes, certificates of indebtedness, and Treasury bills of the United States, by changing the limitation on loans to one individual on such security, from 10 percent of the bank's unimpaired capital and surplus to 25 percent thereof, as provided for national banks in section 5200 of the Revised Statutes.

Section 320 (b): Amends section 5200 of the Revised Statutes so as to extend the eighth exception thereof, which pertains to loans secured by bonds, notes, and certificates of indebtedness of the United States, so as to apply also to loans secured by Treasury bills of the United States.

Section 321 (new): Present law permits Federal Reserve bank to make direct loans to private business on adequate endorsement and security. The amendment permits such loan on adequate endorsement or security.

Section 322: This section makes certain changes in the language of section 13b of the Federal Reserve Act, making it conform to the amendment in title I of the bill whereby stock of the Federal Deposit Insurance Corporation subscribed for by the Federal Reserve banks is changed to no par value. These changes are in form only and do not alter the effect of the existing law.

Section 323 (a) (partly new): Authorizes Federal Reserve Board to define "deposit" and related terms for reserve and interest requirements respecting deposits.

Section 323 (b): Amends section 19 of the Federal Reserve Act so that, for purposes of computing member bank reserves, amounts due from other banks (including checks in process of collection) may be deducted from gross demand deposits rather than from balances due to other banks, thus extending the benefit of this deduction to country banks which have no balances due to other banks.

Section 323 (c): Amends section 19 of the Federal Reserve Act so as to add to the classes of deposits exempted from the prohibition against the payment of interest on demand deposits the following: (1) Deposits payable outside the States of the United States and the District of Columbia (rather than merely those payable in foreign countries); (2) deposits of trust funds on which interest is required by State law; and (3) deposits of the United States, its Territories, districts, or possessions on which interest is required by law.

The section is also amended to make more flexible the Federal Reserve Board's power to classify time and savings deposits and limit the rates of interest to be paid thereon. The absolute prohibition against the payment of time deposits before maturity is relaxed to permit such payments under conditions prescribed by the Board; and deposits payable only at offices of member banks located outside the States of the United States, and the District of Columbia are exempted from all restrictions on payment before maturity and all restrictions on interest rates.

Section 323 (d) (new): Requires member banks to maintain same reserves against Government deposits as against other deposits.

Section 324: Permits the Federal Reserve Board or the Comptroller of the Currency, as the case may be, to permit waiver of report and examination of affiliates of a bank where such report and examination is not necessary in a particular case to disclose relationship existing between the bank and the affiliate. This eliminates the burden and expense now involved in hundreds of cases where there is no beneficial object to be gained in requiring submission and publication of such report, due to the fact that the affiliate is merely a technical accidental affiliate having no relationships whatsoever with the bank, such as for example, newspapers, clothing stores, lumber yards, etc., which become technical affiliates because of the accident that a majority of their directors happen to be directors of the bank.

Section 325 (a) (new): Extends the present provisions of the law prohibiting loans and gratuities to examiners of member banks to include examiners of all insured banks.

Section 325 (b) (new): Extends to Federal Deposit Insurance Corporation examiners the present prohibitions of law against disclosure of confidential information by examiners.

Section 325 (c) (partly new): Corrects impractical features of present law relative to loans to executive officers of banks by vesting certain discretions with the Federal Reserve Board to issue regulations governing same and substituting removal from office for present criminal provisions of the law. There is also a 3-year extension of time within which present loans must be retired, such extension, however, operative only if the board of directors adopt a resolution determining that it is to the best interest of the bank to make the extension and that the officer has made every proper effort to reduce his obligation.

Section 326 (partly new) : Under present law there are certain rigid requirements and limitations on loans to affiliates. Exception to these requirements is provided for where the affiliation arose out of foreclosure by the bank on collateral. It is often necessary to advance funds to an affiliate, control of which has been obtained through foreclosure in order to enable the bank to salvage the real value out of its assets and reduce the bank's loss. Under the circumstances, such affiliate manifestly cannot borrow elsewhere. There is also excluded the accidental type of affiliate, control of which is obtained by the bank in a fiduciary capacity, as for example, where the bank becomes executor and/or trustee of the deceased's estate, among the assets of which is a going business which must be operated by the bank as such trustee. There is also excluded an affiliate engaged solely in operating property acquired for bank purposes. An additional exception now recommended is to exclude from the limitations of the section, loans fully secured by obligations fully guaranteed by the United States and loans to affiliates engaged solely in holding such obligations, thus extending present law in that respect as to direct obligations of the United States to include obligations guaranteed by the United States.

Section 327 (new) : Exempts loans for industrial purposes made in cooperation with a Federal Reserve bank or the Reconstruction Finance Corporation from existing restrictions on real-estate loans by national banks, due to protection received by the banks from either the Federal Reserve bank or the Reconstruction Finance Corporation, where such loans are jointly made. As to such loans there is no need for such restrictions as are desirable for a real-estate loan made by the bank in its sole capacity. Furthermore, such existing restrictions have been found to seriously interfere with the scope and object of the Industrial Loan Act as they operate to prevent two or more banks cooperating with the Federal Reserve bank or the Reconstruction Finance Corporation in making a single industrial loan, prevents such loan where a substantial part of the security is real estate located outside of the restricted area in which national banks are limited in making real-estate loans, and for other reasons.

Section 328 (new) : Amends the Clayton Act to permit the Federal Reserve Board to supervise by regulation instead of by permit the matter of interlocking directorates.

Sections 329 and 330: Bring the law governing consolidation of national banks into conformity with that governing consolidations of a State and National bank, and offers additional protection to dissenting shareholders in the matter of obtaining the appraised value of their stock. Requirement is made that notice of discount be given by such shareholders when the vote to consolidate is had.

Sections 331 and 332 (new) : Extend to the Federal Deposit Insurance Corporation the protection now given by law to other Federal institutions against the misleading use of their name and extend to all insured banks present requirements of law making robbery of member banks a Federal offense.

Section 333: Amends section 5143 of the Revised Statutes so as to make it clear that, in approving reductions of capital stock by national banks, the Comptroller of the Currency, in order to conserve the assets for the protection of the banks, may specify that such banks shall not distribute a corresponding amount of their assets to their shareholders. The amendment would also strike out the words which make it necessary for capital-stock reductions to be approved by the Federal Reserve Board in addition to the Comptroller of the Currency, thus eliminating an unnecessary duplication of work.

Section 334: Amends section 5139 of the Revised Statutes by adding a paragraph specifying certain information to be stated on certificates hereafter issued representing shares of stock in national banks.

Section 335: Amends the last sentence of section 301 of the Emergency Banking Act of March 9, 1933, so as to require, in connection with the issuance of preferred stock, the same kind of a certificate by the Comptroller of the Currency as to the validity of such issue as is now required in the case of the issuance of common stock.

Section 336: Section 336 would terminate the liability of shareholders of banks and trust companies in the District of Columbia as of July 1, 1937, in a manner similar to that provided elsewhere in the bill for terminating the liability of shareholders of national banks.

Senator COUZENS. Does title III suggest anything more than was before us at the last session?

Senator BULKLEY. There are a few other matters; there are a few eliminations from it, and also some differences.

Senator GLASS. Mr. O'Connor, can you return in the morning at 10:30?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. We will recess until tomorrow morning at 10:30.

(Whereupon, at 12:05 p. m., a recess was taken until tomorrow, Friday, Apr. 26, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

FRIDAY, APRIL 26, 1935

United States Senate,
Subcommittee of the Committee on
Banking and Currency,
Washington, D. C.

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

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

Senator Glass. The committee will please come to order.

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY—Resumed

Senator Glass. Mr. Comptroller, I wanted to ask you, first, if you ever had any particular observations of branch banking.

Mr. O'Connor. No, sir; I have not. I have not made a study of it, either, Senator.

Senator Glass. You are not prepared to say what you think of branch banking?

Mr. O'Connor. No, sir.

Senator Glass. Well, we were talking yesterday, when we recessed, about receiverships. Have you any informative information, any available information with respect to banks and receiverships?

Mr. O'Connor. Yes, Senator. There has been some question raised with reference to information for the benefit of depositors with reference to the closed banks, and I think it is well to get that point cleared up. In all receivership banks at the end of every quarter we post up in the bank a complete statement of the condition of that trust, so that everybody that has any interest in that trust may go to that bank and find out its condition.

Senator Couzens. How long has that been the practice?

Mr. O'Connor. As long as I remember in the office, Senator, it has not been of recent adoption.

Now, that report, which is published quarterly, and usually the newspapers in the community publish that voluntarily for the benefit of the people, shows the following: Assets at date of suspension (book value as reported in receivers' first report); additional assets acquired since suspension (book value); stock assessment; total assets to be accounted for, cash collected from assets; cash collected from additional assets; cash collected from stock assessment; total cash collected from assets and stock assessments; offsets allowed on assets; losses charged off on assets and on stock assessment; remaining assets, consisting of uncollected assets, uncollected additional assets, and uncollected stock assessment; and also a recapitulation of remaining assets: book and estimated values, showing uncollected assets, uncollected additional assets, uncollected stock assessment, and a total of the remaining assets.

And then under liabilities we show secured liabilities at date of suspension; unsecured liabilities at date of suspension, additional liabilities established, total liabilities of this date; secured and preferred liabilities paid in cash (paid by conservator); unsecured liabilities offset; unsecured liabilities for which receiver's certificates have been issued; unpaid secured liabilities (both proved and unproved) unsecured liabilities not paid or proved, total liabilities accounted for.

And then we show collections and disbursements: Collections from all sources, showing cash collected from assets and stock assessment; cash collected from interest, premium, and rents; cash collected by receiver, and held as trustee for owners; Reconstruction Finance Corporation loans received (loan to conservator); total collections to be accounted for.

Disbursements of every character, showing secured and preferred liabilities paid (including dividends) (paid by conservator); collateral account (collections held by secured creditors and not yet applied); advances in protection of assets (taxes, insurance, etc.); expenses of receivership (expenses and advances by conservator); dividends paid to unsecured creditors (paid by conservator); Reconstruction Finance Corporation loans repaid; cash in hands of receiver and Comptroller; and total collections accounted for.

In addition to that, there is an annual report of the Comptroller published each year; the year terminates on October 31, and in that report several hundred pages are devoted to the administration of the liquidation of closed banks.

Senator COUZENS. Individually, or collectively?

Mr. O'CONNOR. Both. For instance, I will give you individually what we show.

All collections by receivers, collection and offsets allowed; collections from stock assessments.

This is for each bank, Senator.

Amounts borrowed——

Senator COUZENS (interposing). Let me understand it. Do I understand that you put in a detail of this trust in your report; of each trust?

Mr. O'CONNOR. Yes; of the 1,500. I am pleased you asked that, Senator.

Amounts borrowed from the Reconstruction Finance Corporation; dividends paid by receivers to secured and unsecured creditors; distributions by conservators, payments to secured and preferred creditors; offsets allowed and settled; disbursements for protection of assets; receivers' salaries, legal and other expenses; conservators' salaries, legal and other expenses; a table showing the status, progress, and results of liquidation of all national banks placed in hands of receivers from the date of the first national bank failure in 1865 to October 31, last, the end of the fiscal year in the Comptroller's Office; separate tables giving dates of appointment of receivers; capital at date of organization and at date of failure; dividends paid while solvent; total deposits, bills payable, and rediscounts at date of failure; also tables showing assets at date of failure, additional assets acquired subsequent to failure; offsets allowed; disposition of all collections and dividends paid to creditors of all insolvent national banks, this information being given in detail as to each and every national bank in liquidation.

Now, I have given you two methods of rather wide publicity, and the third method which we pursue is to call in a committee of the larger depositors of the trust—advising the receiver to do so, whenever he has the sale of some rather important asset of the trust. And the subcommittee knows that we cannot make a sale of property without a petition filed with the court setting forth the price, and the appraisement, and a hearing on it, and then the court, if he feels it fair and equitable to the trust, will permit it to be sold.

I can give you a good illustration right in this city. We have a rather large building; it is owned by one of the receivership banks in Washington, and we were offered $400,000 for it, cash. The receiver and representatives of the Comptroller's Office went into the matter rather carefully, and I, myself, went down to the building and went through the nine floors, and through the stores and the offices, and we declined the $400,000 offer, and within 30 days the offer was raised to $450,000. Before we accepted that we called in a committee of five or six representing the largest depositors in that bank. We asked them for their judgment of the matter and gave them all the information we had. They came up to my office. I talked to them personally about it. They all felt that we should accept it, felt it was a very good offer. And we had for their information the income from the building, the taxes, and the upkeep, and everything. That offer was filed with the court for approval, and the court has given 2 or 3 weeks of published notice to that petition, and it is in its file and it will be acted upon on the date fixed in that petition. That is an illustration of the way these receivership matters are handled.

Senator GLASS. Mr. Comptroller, while you have available for all interested parties and for the public information of the sort recited by you, you give out that information through your regular force, do you not? You do not employ an expert publicity agent?

Mr. O'CONNOR. No; I have no such agent.

Senator GLASS. That is contrary to law.

Mr. O'CONNOR. Yes, sir.

Senator GLASS. But it looks to me like every bureau in Washington has an expert publicity agent hired.

Mr. Comptroller, I note in the newspapers what is a mistake, and I assume an inadvertent mistake. Yesterday, or the day before, when you were testifying, you gave the amount of indebtedness of executive officers of national banks, and the reduction made. You did not mean to have anyone infer that there had been any loans to executive officers since the passage of the Bank Act of 1933, did you?

Mr. O'CONNOR. No, Senator; no loans have been made, according to the reports of examinations filed in the Comptroller's office, by any national bank to any executive officer since the passage of the Bank Act of 1933; and the figures that I gave showing the indebtedness of executive officers, both directly and indirectly, the two figures referred to the loans that were then in the national banks as of June 30, 1933. And then I followed that by showing the reduction that had been made. But no new loans to the executive officers have been made since the passage of that act.

Senator, might I clear up a matter that Senator Couzens asked about yesterday?

Senator GLASS. Yes.

Mr. O'CONNOR. I said I would bring the figures today. Senator Couzens, yesterday, when I gave the amount of dividends that had been distributed to depositors in closed banks since March 16, 1933, the total being $644,793,467, the Senator inquired whether I had a break-down showing how much of that sum had been borrowed from the Reconstruction Finance Corporation. I am prepared now, Senator, to give those figures.

Senator COUZENS. Very well.

Mr. O'CONNOR. The Office of the Comptroller of the Currency borrowed from the Reconstruction Finance Corporation, from March 16, 1933, to April 20, 1935, $275,181,347.

We have repaid to the Reconstruction Finance Corporation——

Senator BULKLEY (interposing). Is that the gross amount that has been loaned to the banks?

Mr. O'CONNOR. Yes; to closed banks.

Senator BULKLEY. To closed banks?

Mr. O'CONNOR. Yes; about a billion has been loaned to all bank, total.

Senator BULKLEY. You mean to closed banks?

Mr. O'CONNOR. Yes.

We have repaid to the Reconstruction Finance Corporation $160,125,692; not quite 50 percent has been repaid. As we would collect on these assets, of course, we make repayment at once to the Reconstruction Finance Corporation.

Senator BYRNES. You say you borrowed $275,181,347 and paid back $160,125,692?

Mr. O'CONNOR. That is right.

Senator BYRNES. That is more than 50 percent.

Mr. O'CONNOR. Yes. I deducted it. You are correct, Senator.

Now, all of this amount of $275,181,347 that was borrowed, of course, was not available for dividend purposes. I did not take the trouble to break that down, but I just want to call your attention to the fact that a large part of that sum—not intending to use the word "large" by more than 50 percent—but a large part of it was used for the payment of preferred claims.

Senator BANKHEAD. And to recapture collaterals?

Mr. O'CONNOR. Yes; and to recapture collaterals, to bring it back into the bank, of course. And a part of it was used to repay the Reconstruction Finance Corporation, and we made a new loan to take care of this and new matters. I have not a break-down of that. I would be glad to furnish it if the committee cares for it.

Now, Senator, for the information of the committee, I would like to put into the record a table I used yesterday with reference to the assessment for all purposes for thirteen years on one-eighth of 1 percent, if there is no objection.

Senator GLASS. That will be received.

(The table referred to is here printed in the record in full, as follows:)

Summary of hypothetical projection of a deposit insurance corporation's operating statements, period Jan. 1, 1921, to Mar. 15, 1933

Combined capital and surplus fund of Corporation as of Jan. 1	$325,000,000
Add:	
Assessment income (one-eighth of 1 percent)	818,181,112
Investment earnings for year (3½ percent)	117,182,694
Recoveries from advances made	1,285,920,916
Total income	2,221,284,722
Less:	
Advances to pay insured deposits	2,296,287,450
Expense of operation	35,000,000
Total disbursements	2,331,287,450
Net loss	110,002,728
Combined capital and surplus fund of Corporation at end of period	214,997,272
Number bank suspensions	11,278
Total deposits	$5,102,861,000
Insured deposits (45 percent)	$2,296,287,450
Losses (eventual, 44 percent)	$1,010,366,534
Recoveries (eventual, 56 percent)	$1,285,920,916

MEMORANDUM

Assessments, 13-year period:	
One-twelfth of 1 percent	$545,454,077
One-eighth of 1 percent	$818,181,115
One-sixth of 1 percent	$1,090,908,154
1 percent	$6,545,448,924
Total bank suspensions, period Jan. 1, 1921, to Mar. 15, 1933	11,278
Total nonlicensed banks placed in liquidation or receivership Mar. 16, 1933, to Dec. 31, 1934:	
National	860
State member	68
Nonmember	1,092
Total	2,020
Total insured banks in the United States as of Oct. 31, 1934, numbered	14,125
Total reporting banks in the United States as of June 30, 1934, numbered	15,894
Total insured deposits represented in the attached schedule have been predicated upon a percentage factor of currently insured deposits in active banks, of approximately ___ percent	45
The amounts of liquidation recoveries given in the attached schedule are predicated upon a total liquidation recovery, over a 5-year period of	*Percent* 56
Such recoveries have been further analyzed and found to occur at the approximate progressive annual rates of	25, 15, 8, 5, 3
Relative to the above-mentioned liquidation recovery rate of 56 percent, the records of my office indicate the average percentage of dividends paid in all national-bank receiverships liquidated and finally closed from 1865 to Oct. 31, 1934, to have been	66.51
The records of my office further indicate the average percentage of dividends paid in national-bank receiverships liquidated and finally closed during the 10-year period ended Oct. 31, 1934, to have been	56.82

The average liquidation recovery percentage of 56 percent used in the calculation herewith represents, therefore, some reduction in the rate apparent for national-bank liquidations on account of the assumed lower percentage of liquidation in banks other than national.

The records of my office indicate the average period of liquidation for national bank receiverships liquidated and finally closed during the 13-year period 1921 to 1934, to have been—5 years.

The issue of debentures to the Government in an amount substantially less than the total authorized by law would have adequately served to cover the deficits appearing in the attached schedule for the years 1931, 1932, and 1933, and such debentures could be repaid from earnings in subsequent years.

Annual investment income, period Jan. 1, 1921, to Dec. 31, 1933, predicated upon an average return of 3½ percent upon invested funds

Year	Invested funds	Earnings
1921	$225,000,000	$7,875,000
1922	210,907,209	7,381,752
1923	246,064,640	8,612,122
1924	265,863,872	9,305,235
1925	272,874,000	9,550,590
1926	311,419,966	10,899,699
1927	318,050,521	11,131,768
1928	360,708,376	12,624,793
1929	428,838,790	15,009,358
1930	458,118,802	16,034,158
1931	250,234,826	8,758,219
Total	[1] 257,544,692	117,182,694

[1] Average invested funds.

Annual assessment income, period Jan. 1, 1921, to Dec. 31, 1933, predicated upon an assessment rate of ⅛ of 1 percent of total deposits of active banks

Year	Total banks	Total deposits	Assessment income
June 30:			
1921	30,812	$38,664,987,000	$48,331,234
1922	30,389	41,128,352,000	51,410,440
1923	30,178	44,249,524,000	55,311,904
1924	29,348	47,709,028,000	59,636,284
1925	28,841	51,995,059,000	64,993,824
1926	28,146	54,069,257,000	67,586,571
1927	27,061	56,751,307,000	70,939,134
1928	26,213	58,431,061,000	73,038,826
1929	25,330	57,910,641,000	72,388,300
1930	24,079	59,847,195,000	74,808,993
1931	22,071	56,864,744,000	71,080,929
1932	19,163	45,390,269,000	56,737,836
1933	14,624	41,533,470,000	51,916,837
Total	----------	654,544,894,000	818,181,112

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A projection of hypothetical operating statements of a deposit insurance corporation by years for the period Jan. 1, 1921 to Mar. 15, 1933, predicated upon an initial combined capital and surplus fund of $325,000,000, an annual assessment rate of 1/8 of 1 percent of total deposits in active banks, a maximum insurance of $5,000, a liquidation period of 5 years, and the inclusion of liquidation operations to 1937 to give effect to total eventual recoveries upon all advances made

	1921	1922	1923	1924	1925	1926	1927
Combined capital and surplus fund of corporation as of Jan. 1	$325,000,000	$310,907,209	$346,060,640	$365,863,872	$372,874,000	$411,419,966	$418,050,521
Add:							
Assessment income, (1/8 of 1 percent)	48,331,234	51,410,440	55,311,904	59,636,284	64,993,824	67,586,571	70,939,134
Investment earnings for year (3½ percent)	7,875,000	7,381,752	8,612,122	9,305,235	9,550,590	10,899,699	11,131,768
Recoveries from advances made	9,685,575	20,730,589	25,699,656	35,136,559	41,901,302	47,814,385	52,785,003
Total income	65,891,809	79,522,781	89,623,682	104,078,078	116,445,716	126,300,655	134,855,905
Less:							
Advances to pay insured deposits	77,484,600	41,869,350	67,320,450	94,567,950	75,399,750	117,170,100	89,698,050
Expense of operation	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000
Total disbursements	79,984,600	44,369,350	69,820,450	97,067,950	77 899,750	119,670,100	92,198,050
Net income or loss	*14,092,791*	35,153,431	19,803,232	7,010,128	38,545,966	6,630,555	42,657,855
Combined capital and surplus fund of corporation as of Dec 31	310,907,209	346,060,640	365,863,872	372,874,000	411,419,966	418,050,521	460,708,376
Less cash reserve	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Available investment funds	210,907,209	246,060,640	265,863,872	272,874,000	311,419,966	318,050,521	360,708,376
Bank suspensions ... number	505	367	646	775	618	976	669
Total deposits	$172,188,000	$93,043,000	$149,601,000	$210,151,000	$167,555,000	$260,378,000	$199,329,000
Insured deposits (45 percent)	77,484,600	41,869,350	67,320,450	94,567,950	75,399,750	117,170,100	89,698,050
Losses (eventual, 44 percent)	34,093,224	18,422,514	29,620,998	41,609,898	33,175,890	51,554,900	39,467,142
Recoveries (eventual, 56 percent)	43,391,376	23,446,836	37,699,452	52,985,052	42,223,860	65,615,200	50,230,908

NOTE.—Italic indicates red figures.

A projection of hypothetical operating statements of a deposit insurance corporation by years for the period Jan. 1, 1921 to Mar. 15, 1933, predicated upon an initial combined capital and surplus fund of $325,000,000, an annual assessment rate of ⅛ of 1 percent of total deposits in active banks, a maximum insurance of $5,000, a liquidation period of 5 years, and the inclusion of liquidation operations to 1937 to give effect to total eventual recoveries upon all advances made—Continued

	1928	1929	1930	1931	1932	1933	1934-37
Combined capital and surplus fund of corporation as of Jan. 1	$460,708,376	$528,838,790	$558,118,802	$350,234,826	*$139,872,562*	*$160,432,499*	*$2,527,906*
Add:							
Assessment income, (⅛ of 1 percent)	73,038,826	72,388,300	74,808,993	71,080,929	56,737,836	51,916,837	
Investment earnings for year (3½ percent)	12,624,793	15,009,358	16,034,158	8,758,219			
Recoveries from advances made	49,127,795	48,171,704	87,786,223	193,354,514	247,233,927	206,468,506	220,025,178
Total income	134,791,414	135,569,362	178,629,374	273,193,662	303,971,763	258,385,343	220,025,178
Less:							
Advances to pay insured deposits	64,161,000	103,789,350	384,013,350	760,801,050	322,031,700	97,980,750	
Expense of operation	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000
Total disbursements	66,661,000	106,289,350	386,513,350	763,301,050	324,531,700	100,480,750	2,500,000
Net income or loss	68,130,414	29,280,012	*207,883,976*	*490,107,388*	*20,559,937*	157,904,593	217,525,178
Combined capital and surplus fund of corporation as of Dec 31	528,838,790	558,118,802	350,234,826	*139,872,562*	*160,432,499*	*2,527,906*	214,997,272
Less cash reserve	100,000,000	100,000,000	100,000,000				100,000,000
Available investment funds	428,838,790	458,118,802	250,234,826				114,997,272
Bank suspensions ... number	499	659	1,352	2,294	1,456	462	
Total deposits	$142,580,000	$230,643,000	$853,363,000	$1,690,669,000	$715,626,000	$217,735,000	
Insured deposits (45 percent)	64,161,000	103,789,350	384,013,350	760,801,050	322,031,700	97,980,750	
Losses (eventual, 44 percent)	28,230,840	45,667,314	168,965,874	334,752,462	141,693,948	43,111,530	
Recoveries (eventual, 56 percent)	35,930,160	58,122,036	215,047,476	426,048,588	180,337,752	54,869,220	

NOTE —Italic indicates red figures.

Senator BULKLEY. Are you putting in the other table, showing the assessment of one-twelfth of 1 percent?

Mr. O'CONNOR. Yes; that should be in. That is in the bill.

Senator GLASS. It may be received.

(The table referred to is here printed in the record, in full, as follows:)

A projection of hypothetical operating statements of a deposit insurance corporation by years for the period Jan. 1, 1921, to Mar. 15, 1933, predicated upon an initial combined capital and surplus fund of $325,000,000, an annual assessment rate of 1/12 of 1 percent of total deposits in active banks, a maximum insurance of $5,000, a liquidation period of 5 years, and the inclusion of liquidation operations to 1937 to give effect to total eventual recoveries upon all advances made

	1921	1922	1923	1924	1925	1926	1927
Combined capital and surplus fund of Corporation as of Jan 1	$325,000,000	$294,796,798	$312,249,552	$312,432,095	$297,693,350	$311,943,385	$292,563,412
Add:							
Assessment income (1/12 of 1 percent)	32,220,823	34,273,627	36,874,603	39,757,523	43,329,216	45,057,714	47,292,756
Investment earnings for year (3½ percent)	7,875,000	6,817,888	7,428,734	7,435,123	6,919,267	7,418,028	6,739,719
Recoveries from advances made	9,685,575	20,730,589	25,699,656	35,136,559	41,901,302	47,814,385	52,785,003
Total income	49,781,398	61,822,104	70,002,993	82,329,205	92,149,785	100,290,127	106,817,478
Less:							
Advances to pay insured deposits	77,484,600	41,869,350	67,320,450	94,567,950	75,399,750	117,170,100	89,698,050
Expense of operation	2,500,000	2,500,000	2,500,000	2,500,00	2,500,000	2,500,000	2,500,000
Total disbursements	79,984,600	44,369,350	69,820,450	97,067,950	77,899,750	119,670,100	92,198,050
Net income or loss	*30,203,202*	17,452,754	182,543	*14,738,745*	14,250,035	*19,379,973*	14,619,428
Combined capital and surplus fund of corporation as of Dec. 31	294,796,798	312,249,552	312,432,095	297,693,350	311,943,385	292,563,412	307,182,840
Less: Cash reserve	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Available investment funds	194,796,798	212,249,552	212,432,095	197,693,350	211,943,385	192,563,412	207,182,840
Bank suspensions ... number	505	367	646	775	618	976	669
Total deposits	$172,188,000	$93,043,000	$149,601,000	$210,151,000	$167,555,000	$260,378,000	$199,329,000
Insured deposits (45 percent)	77,484,600	41,869,350	67,320,450	94,567,950	75,399,750	117,170,100	89,698,050
Losses (eventual, 44 percent)	34,093,224	18,422,514	29,620,998	41,609,898	33,175,890	51,554,900	39,467,142
Recoveries (eventual, 56 percent)	43,391,376	23,446,836	37,699,452	52,958,052	42,223,860	65,615,200	50,230,908

NOTE.—Italics indicate red figures.

A projection of hypothetical operating statements of a deposit insurance corporation by years for the period Jan. 1, 1921, to Mar. 15, 1933, predicated upon an initial combined capital and surplus fund of $325,000,000, and annual assessment rate of 1/12 of 1 percent of total deposits in active banks, a maximum insurance of $5,000, a liquidation period of 5 years, and the inclusion of liquidation operations to 1937 to give effect to total eventual recoveries upon all advances made—Continued

	1928	1929	1930	1931	1932	1933	1934 to 1937
Combined capital and surplus fund of Corporation as of Jan. 1	$307, 182, 840	$345, 593, 585	$344, 361, 765	$104, 071, 147	*$418, 314, 428*	*$457, 786, 977*	*$317, 187, 996*
Add:							
Assessment income (1/12 of 1 percent)	48, 692, 551	48, 258, 867	49, 872, 662	47, 387, 286	37, 825, 224	34, 611, 245	
Investment earnings for year (3½ percent)	7, 251, 399	8, 6[illegible]6, 959	8, 563, 847	173, 675			
Recoveries from advances made	49, 127, 795	48, 171, 704	87, 786, 223	193. 354, 514	247, 233, 927	206, 468, 506	220, 025, 178
Total income	105, 071, 745	105, 057, 530	146, 222, 732	240, 915, 475	285, 059, 151	241, 079, 731	220, 025, 178
Less:							
Advances to pay insured deposits	64, 161, 000	103, 789, 350	384, 013, 350	760, 801, 050	322, 031, 700	97, 980, 750	
Expense of operation	2, 500, 000	2, 500, 000	2, 500, 000	2, 500, 000	2, 500, 000	2, 500, 000	2, 500, 000
Total disbursements	66, 661, 000	106, 289, 350	386, 513, 350	763, 301, 050	324, 531, 700	100, 480, 750	2, 500, 000
Net income or loss [1]	38, 410, 745	*1, 231, 820*	*240, 290, 618*	*522, 385, 575*	*39, 472, 549*	140, 958, 981	217, 525, 178
Combined capital and surplus fund of corporation as of Dec. 31	345, 593, 585	344, 361, 765	104, 071, 147	*418, 314, 428*	*457, 786, 977*	*317, 187, 996*	*99, 662, 818*
Less: Cash reserve	100, 000, 000	100, 000, 000	100, 000, 000				
Available investment funds	245, 593, 585	244, 361, 765	4, 071, 147				
Bank suspensions number	499	659	1, 352	2, 294	1, 456	462	
Total deposits	$142, 580, 000	$230, 643, 000	$853, 363, 000	$1, 690, 669, 000	$715, 626, 000	$217, 735, 000	
Insured deposits (45 percent)	64, 161, 000	103, 789, 350	384, 013. 350	760, 801, 050	322, 031, 700	97, 980, 750	
Losses (eventual, 44 percent)	28, 230, 840	45, 667, 314	168, 965, 874	334, 752, 462	141, 693, 948	43, 111, 530	
Recoveries (eventual, 56 percent)	35, 930, 160	58, 122, 036	215, 047, 476	426, 048, 588	180, 337, 752	54, 869, 220	

[1] Italics indicate red figures.

Mr. O'CONNOR. And yesterday, Senator, I also stated that there were 11 national banks which had been closed since the banking holiday of 1933, and only 2 of those were members of the insurance fund. And I have prepared a break-down for the information of the committee showing just why those banks failed—embezzlement, and other reasons, the 13—and that is all the national banks that have failed since the banking holiday of 1933. And with the permission of the chairman and the committee I would like to put that into the record.

Senator GLASS. That may go into the record.

(Table and information regarding disposition of licensed national banks which failed following the banking holiday, is here printed in the record in full, as follows:)

Memorandum for the Comptroller.

Information regarding disposition or present status of *licensed* national banks which failed following the banking holiday:

Licensed banks closed with immediate appointment of receivers

Name of bank	Date of suspension	Date receiver appointed
Rushville, Ind.: American National Bank	Apr. 22, 1933	Apr. 25, 1933
Bank still in receivership. Dividends aggregating 80 percent have been paid to creditors. Estimated future dividends approximately 10 percent		
Kingfisher, Okla. First National Bank	July 20, 1933	July 27, 1933
Cause of failure Defalcations Bank still in receivership Dividends aggregating 62½ percent paid to creditors. Estimated future dividends approximately 15 percent.		
West, Tex: National Bank of	Oct. 30, 1933	Oct. 30, 1933
Cause of failure. Defalcations. Returned to directors 11 a m, Oct. 9, 1934, for purpose of consummating sale of assets to the State National Bank of West, Tex. Meeting of stockholders held and bank voted into voluntary liquidation. Creditors paid 100 percent. Final report on Oct. 9, 1934.		
Lima, Mont.: First National Bank	July 19, 1934	July 19, 1934
Federal Deposit Insurance Corporation, receiver. Creditors paid in full by corporation.		
Herndon, Va National Bank of	Jan. 10, 1935	Jan 10, 1935
Cause of failure: Defalcations. Federal Deposit Insurance Corporation, receiver.		

Licensed banks closed through subsequent revocation of licenses and conservators appointed final disposition indicated

Name of bank	Date of suspension and appointment of conservator	Date receiver appointed
Albuquerque, N Mex.: First National Bank of	Apr. 17, 1933	------------
Cause of failure Defalcations. License issued to First National Bank in Albuquerque to succeed First National Bank of Albuquerque, and conservator of latter bank authorized to return bank to its board of directors, effective Oct 24, 1933. Creditors paid 100 percent.		
Camden, Ark · First National Bank	May 24, 1933	Apr. 16, 1934
Cause of failure Due to depreciation on large amounts Arkansas bonds, revenues on which were taken away by State law 60 percent distribution made to creditors by Spokane Sale while in conservatorship Estimated future dividends approximately 10 percent Bank still in receivership		
Battle Creek, Mich.: Old Merchants National Bank	June 13, 1933	------------
Conservatorship terminated and bank returned to board of directors, effective 12 noon, June 9, 1934, for the purpose of entering into a contract of sale with the Security National Bank of Battle Creek, which bank was licensed and authorized to commence business on June 9, 1934. Creditors paid 65 percent		
Boulder, Colo: Boulder National Bank	July 12, 1933	Mar. 28, 1934
50 percent distribution to creditors through Spokane sale while in conservatorship. Estimated future dividends approximately 20 percent. Bank still in receivership.		

Licensed banks closed through subsequent revocation of licenses and conservators appointed final disposition indicated—Continued

Name of bank	Date of suspension and appointment of conservator	Date receiver appointed
San Antonio, Tex: Commercial National Bank Cause of failure Defalcations Receivership terminated at 5 p m, Oct 16, 1934, and bank restored to solvency for purpose of completing reorganization plans and selling acceptable assets to Bexar County National Bank of San Antonio Old bank voted into voluntary liquidation. Creditors paid 100 percent Final report Oct. 16, 1934	July 31, 1933	Jan. 31, 1934
Waverly, N. Y: First National Bank 60-percent distribution paid to creditors by Spokane sale while bank in conservatorship. Second dividend of 15 percent paid by receiver. Estimated future dividends approximately 8 percent. Bank still in receivership	Sept. 1, 1933	Oct 24, 1933

Senator BULKLEY. Mr. Comptroller, what classification do your examiners report on loans?

Mr. O'CONNOR. We have three general classifications that the examiners classify the loans. The first is slow——

Senator BULKLEY (interposing). Now, this refers to all loans in all banks examined?

Mr. O'CONNOR. That is right, all national banks, Senator. The first classification is called the "slow loans," and that includes loans that are good, loans that are sound, but loans that could not be immediately liquidated but they are good and sound; and those are put in the slow column.

The next column is the doubtful column, and in that column is paper that the examiners say, "Well, it is not what I would call a sound loan, and yet there is no evidence at once that it is a loss; if business turns a little or some little thing happens in here, it is a good loan, but I will have to classify it as doubtful."

Senator GLASS. What does the examiner do in certain instances of that sort?

Mr. O'CONNOR. He puts it in the doubtful column.

Senator GLASS. I know, but what does he say to the bank officers?

Mr. O'CONNOR. In the doubtful column?

Senator GLASS. Yes.

Mr. O'CONNOR. He advises them to watch that loan until his next examination comes along, and to improve its condition, or get additional collateral, or get it in better shape.

Now, the loss column, the examiner finds just a straight loss, or the makers of the paper are bankrupt or people out of jobs entirely, or they just cannot pay, and he just calls it a loss and out they go.

Senator BULKLEY. And then you are required to write it off?

Mr. O'CONNOR. Yes; that is written off. And that is in the loss column.

Senator GLASS. I am asking you this question because I, at least, want to know whether the Comptroller's office is pursuing a different policy now from what was formerly pursued when the Comptroller of the Currency, some years ago, came before us and told us that if he would follow out the requirement of the law he would close one-half of the national banks of the country. If that was an accurate description of the situation it meant, of course, that the Comptroller's office had not been doing its duty for a number of years if he permitted the banks to get into that sort of a situation.

Now you authorize examiners to report derelictions of more or less a gross nature and suspend bank officers who do not comply with the report of your examiners, do you not?

Mr. O'CONNOR. Yes; Senator, that is correct. And we made a survey for, I believe, the first time in the history of the office——

Senator COUZENS (interposing). Before you go into that, may I ask you if you can clear up this situation: There have been articles in the press from time to time that the examiners of the Comptroller's office have adopted a deflationary attitude with respect to loans; while the Reconstruction Finance Corporation was urging banks to make more loans to industry and the bankers claimed they were in difficulty between two governmental agencies, one resisting loans that might not be A-1, and the other agency of the Government was urging them to make them. Have you any knowledge as to that?

Mr. O'CONNOR. Yes, Senator. I am glad you asked that question. I want to answer it in two ways. First——

Senator GLASS (interposing). Well, include in your answer an answer to this question: Is it not your business under your oath of office to protect the public interest and to protect the depositors in banks, and to require banks to make good loans, rather than bad or doubtful loans?

Mr. O'CONNOR. There is no question at all, Senator, about that being the policy of the office and the law that we must follow.

Senator GLASS. Yes.

Mr. O'CONNOR. Now, to answer Senator Couzens' question more directly: Some criticism such as that appeared, and in every instance I have inquired and run down the criticism to find out whether or not our examiners had acted fairly in the classification of assets of loans. And I want to give one very clear illustration. The Mid-West Banking Magazine published an editorial and stated that one of my examiners had required the charging off of a loan of $65,000 that had a two million dollar trust fund as security back of it, and criticized him very severely. I immediately wrote the editor, and I told the editor that if I had an examiner in the field doing that sort of thing I would discharge him. The editor took the matter up with the bank. The bank declined to give the name of the examiner and declined to give the asset that was criticized; the editor declined to give the name of the bank, and yet they published that false statement all over the country. It just was not true.

Now, to follow it up further: We made a survey of every examiner's report to find out the percentage of loans that had been placed in the three classifications that I have just given to Senator Bulkley, and we examined 5,275 reports of national banks. And the total amount of loans in those banks was $7,740,596,000. The examiners placed 2.88 percent of those loans in the loss column and 4.19 percent in the doubtful column and 27.05 percent in the slow column. Now, the slow column, of course, is the one that there is the most discussion about.

Senator BULKLEY. Do you require them to set up reserves against the slow and doubtful columns?

Mr. O'CONNOR. No; not against the slow.

Senator BULKLEY. But against the doubtful you do?

Mr. O'CONNOR. Sometimes or a portion of it.

Now, with reference to the slow column, we cannot just permit the slow column to go unchallenged. In other words, we cannot permit a bank to get overloaded with slow paper, and still we cannot run the banks, and if the taxes are paid and the interest is paid, and the only objection is that it is slow, we are not going to attempt to tell the banker how he shall deal with that particular piece of paper, provided he is not overloaded with it. So, here is the policy our office has adopted and the advice to examiners with reference to the slow column.

The examiners when classifying loans as slow should state briefly the reasons for such classification, but should bear in mind that the responsibility for determining and taking such action as may be necessary to place such slow loans in proper bankable shape rests entirely with the bankers. The examiners, therefore, should refrain from instructing the bankers as to what course they should pursue with their customers whose paper is classified as slow.

It is sound and good, and the only question is, it is slow.

Now, what we want——

Senator GLASS (interposing). What would happen to a bank that is overloaded with slow paper if a run should occur?

Mr. O'CONNOR. We do not permit it to get overloaded with it, Senator. I was careful to state that. And that is the reason we require these examiners to state the reasons for this classification, so that that can be developed.

Now the report is that 27 percent, which is safe—I do not believe anybody can challenge the fact that with 27 percent of the paper slow, which does not mean that it cannot be rediscounted——

Senator GLASS (interposing). You do not permit the bank to be overloaded with slow paper?

Mr. O'CONNOR. We do not.

Senator GLASS. Because you know very well in the event of a disturbance and a run on a bank of that type, it would be obliged to close its doors.

Mr. O'CONNOR. That is correct, Senator.

Senator BULKLEY. Twenty-seven percent is the average for all banks?

Mr. O'CONNOR. Yes, sir.

Senator GLASS. National banks?

Senator BULKLEY. I mean national banks.

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. What is the maximum?

Mr. O'CONNOR. Of course, some run lower and some higher. I have not checked that, Senator.

Senator BULKLEY. What maximum do you consider dangerous?

Mr. O'CONNOR. Well, you cannot just put it on a percentage basis, Senator, for this reason—just say a percentage, because that will depend on the other assets of the bank. If the balance is all cash, you could have a much higher percentage of slow paper. If you have cash and Governments and other slow paper, that is a different situation. So you have to see the whole picutre, and you have to sit back and examine it and see, as the Senator says, whether in the case of a run it could take care of it. That is our problem.

Senator COUZENS. May I ask what you do with under-collateralized loans?

Mr. O'CONNOR. Yes.

Senator COUZENS. Do you attempt to say what you think are good and what bad because of undercollateralization?

Mr. O'CONNOR. Yes; we attempt to do that also.

Senator COUZENS. So there may be a loan for $100,000 which you say is undercollateralized, because 75 percent slow and 25 percent doubtful?

Mr. O'CONNOR. Yes, sir.

Senator COUZENS. You would add it up before you make your estimate?

Mr. O'CONNOR. Yes, sir.

Senator COUZENS. Now, have you covered all that you have to say in regard to title I, Mr. Comptroller?

Mr. O'CONNOR. Yes; I am through with title I.

Senator COUZENS. I would like to ask, before you leave that—and you may have answered this before, and if you have you may ignore it. When Mr. Crowley was before the committee, some time ago, the question was raised as to the authority he asked for his this bill, as I understand it, to close banks that were improperly conducted or were not good risks for the Federal Deposit Insurance Corporation; and I raised some question as to the method that was to be used by Mr. Crowley for the Federal Deposit Insurance Corporation. Have you commented on that phase of it in your testimony?

Mr. O'CONNOR. No; I have not, Senator.

Senator COUZENS. Have you any views in connection with it?

Mr. O'CONNOR. Yes, sir. The Federal Reserve Board and the Comptroller of the Currency, of course, have wide powers with reference to the operation and management of member banks and national banks. We find ourselves in the Federal Deposit Insurance Corporation without any power at all; none——

Senator COUZENS (interposing). In that connection, is it practicable or does the policy exist of consulting these other agencies that do have great power over the closing and conduct of the banks? In other words, what I am trying to get at is that you say the Federal Deposit Insurance Corporation lacks power.

Mr. O'CONNOR. Yes; it has none at all.

Senator COUZENS. Now what I want to ask you is, if you can ask the other agencies that do have power.

Mr. O'CONNOR. No; they have none, either.

Senator COUZENS. They have none?

Mr. O'CONNOR. Not over the nonmember banks, at all.

Senator COUZENS. I was speaking of the member banks, as well as nonmember banks.

Mr. O'CONNOR. Whether the Federal Deposit Insurance Corporation can exercise its power?

Senator COUZENS. Yes.

Mr. O'CONNOR. Oh, yes; we all three work in harmony, when we find anything wrong, and also the Reconstruction Finance Corporation, if they have got any interest in it—all three departments sit down together then, and if it is an insured bank the Federal Deposit Insurance Corporation try to work out a program for that bank.

Now we are in this position, Senator, with reference to the insured nonmember banks, as I stated: We have these rather broad powers over State member banks, and then we find this great number of banks, 7,500, approximately, of small nonmember State banks insured. We must pay their losses; we have the responsibility to their depositors to that extent, but without any direction for that bank. We can examine them and we can find practices that would be condemend by everyone, I assume, and then not be able to make a suggestion—we can make a suggestion, but they do not have to do anything with it at all.

Senator BANKHEAD. Can you withdraw the insurance?

Mr. O'CONNOR. No; we cannot, Senator. Now we are asking this power, that when we find that condition in a bank, for the Federal Deposit Insurance Corporation, that we notify the bank and point out the things that ought to be corrected in that bank and give the bank 120 days to do it. At the end of that period the bank has the right to come before the Board and explain why it has not done it, or show that it has attempted to do it or made some progress toward it. Then we ask the power to cancel the insurance on future deposits in that bank, but we cannot, of course, walk away from the liability that we have incurred of insuring the deposits that were there on the day that we cancel the insurance. And we carry that insurance for a period of 2 years, so the bank thereafter is permitted to go along and work itself out, if it can. That is all we are asking, and we think it is fair enough power to ask over them, and we are going to protect the depositors whom we have insured and whose premium is paid, for 2 years.

Senator BULKLEY. You are talking about what you would do if you got the power in the law.

Mr. O'CONNOR. That is true, Senator.

Senator BULKLEY. Where is that in the bill?

Mr. O'CONNOR. Page 13.

Senator COUZENS. Before you go to that, is there any power in the bill that you refer to for you to take it up with the State bank commissioner?

Mr. O'CONNOR. Yes, sir.

Senator COUZENS. Where is that?

Mr. O'CONNOR. I will give it to you (reading):

Any insured bank (except a national member bank or State member bank) may, upon not less than ninety days' written notice to the Corporation, terminate its status as an insured bank. Wherever the board of directors shall find that an insured bank or its directors or trustees have continued unsafe or unsound practices in conducting the business of such bank or have knowingly or negligently permitted any of its officers or agents to violate repeatedly any provision of this section or of any regulation made thereunder, or of any law or regulation made pursuant to law to which the insured bank is subject, the board of directors shall first give to the Comptroller of the Currency in the case of a national bank or district bank, to the authority having supervision in case of a State bank, and also to the Federal Reserve Board in case of a State member bank, a statement of such violation by the bank for the purpose of securing a correction of such practices or conditions. Unless such correction shall be made within such period of time not exceeding one hundred and twenty days as the Comptroller of the Currency, the State authority, or Federal Reserve Board, as the case may be, shall require, the board of directors, if it shall determine to proceed further, shall give to the bank not less than thirty days' written notice of intention to terminate the status of the bank as an insured bank, fixing a time and place for a hearing before the board of directors or before a person designated by it to conduct such hearing, at which evidence may be produced, and upon such evidence the board of directors shall make written findings which shall be conclusive. Unless the bank shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the termination of its status as an insured bank. If the board of directors shall find that any ground specified in such notice has been established, the board of directors may order that the insured status of the bank be terminated on a date subsequent to such finding and to the expiration of the time specified in such notice of intention. The Corporation may publish notice of such termination and the bank shall give notice of termination to its depositors, in such manner and at such time as the board of directors may find necessary and may order for the protection of depositors After termination of the insured status of any bank under the provisions of this paragraph, the insured deposits of each depositor in the bank on the date of such termination, less all subsequent withdrawals, shall continue for a period of two years to be insured and the bank shall continue to pay to the Corporation assessments as in the case of an insured bank for such period of two years from such termination, but no additions to any deposits or any new deposits shall be insured by the Corporation, and the bank shall not advertise or hold itself out as having insured deposits unless in the same connection it shall state with equal prominence that additions to deposits and new deposits made after the date of such termination, specifying such date, are not insured. Such bank shall in all other respects be subject to the duties and obligations of an insured bank for the period of two years from such termination and in the event of being closed on account of inability to meet the demands of its depositors within such period of two years, the Corporation shall have the same powers and rights with respect to such bank as in case of an insured bank.

I think, Senator, that covers the question.

Senator COUZENS. Now is there a provision by which a bank that is insured may withdraw from the insurance?

Mr. O'CONNOR. Yes, sir.

Senator COUZENS. You need not read it.

Senator BULKLEY. Would not that make it very difficult for a bank to get any new deposits?

Mr. O'CONNOR. I think it would, Senator.

Senator BULKLEY. And would it not very nearly compel the depositors whose insurance was retained, to close their accounts within 2 years?

Mr. O'CONNOR. Oh, yes; they would have to close them within the 2 years if unwilling to continue in an uninsured bank.

Senator BULKLEY. They would have to withdraw all that money, then?

Mr. O'CONNOR. Yes; within 2 years.

Senator BULKLEY. It would very nearly put an end to the bank, then?

Mr. O'CONNOR. Well, if the bank is in the condition that the Corporation finds it to be——

Senator BULKLEY (interposing). It ought to be ended?

Mr. O'CONNOR. It ought to be ended; it ought not to be in business and ought not to take deposits.

Senator BYRNES. Let me ask you a question. Succeeding the bank holiday, in my State, there were opened a number of depositaries. They accept deposits, but make no loans, and I understand that they are insured in the Federal Deposit Insurance Corporation. Now, under the provisions of the Bank Act of 1933, if they do not become members of the Federal Reserve System, what will be the effect upon those institutions? Will it put them out of business?

Mr. O'CONNOR. No; the only thing is, they would not have insurance, because the bill, as it now stands, provides that in order to retain the benefit of insurance they must become members of the Federal Reserve System.

Senator BYRNES. What is the provision in the bill reported to the House?

Mr. O'CONNOR. They struck it out.

Senator BYRNES. Was that the reason that they struck it out, that they wanted to give such institutions the right to continue operations and to receive the benefits of the insurance fund?

Mr. O'CONNOR. Well, the House, Senator, made its report on the Banking Act of 1935——

Senator BYRNES (interposing). You do not know, then?

Mr. O'CONNOR (continuing). In considerable detail. I do not know whether they discussed that particular feature of it, or not.

Senator BYRNES. Were such institutions opened in many States merely for the purpose of receiving deposits?

Mr. O'CONNOR. I think your State is the only one, excepting Wisconsin. They amended the law and permitted the receiving of deposits at different stations, but those were branches of banks.

Judge Birdzell, do you know of any other State?

Mr. BIRDZELL. No; I do not think there is any other State, Senator. South Carolina is the only State, so far as we are aware, where cash depositaries are set up with a small capital and that function as banks. When the question of their eligibility for membership in the Federal Deposit Insurance Corporation temporary fund arose, the Corporation was doubtful as to their eligibility. The doubt, however, was resolved in favor of their membership. It seemed to the Corporation that there was very little reason why such institutions should seek insurance, in view of the contract rights of the depositors against the institution, among which is the right to share only in the investments which the depositary would make from any fund.

Senator BULKLEY. In other words, there was no promise made to him that he would get his money back at all?

Mr. BIRDZELL. No.

Senator BYRNES. Was it the hope on his part that, as a result of the insurance fund, he would get his money back?

Mr. BIRDZELL. Apparently these operating depositaries thought they could operate more successfully if they were insured.

Mr. O'CONNOR. I can answer your question now, Senator, with reference to the House attitude.

Senator BYRNES. I can take it up with you and get it later.

Mr. O'CONNOR. Let the record show that the House committee discussed it on page 3 of the majority report, and also on page 26 of the report.

Senator BULKLEY. Had you concluded what you were going to say about the request that you are making under title I?

Mr. O'CONNOR. Yes; Senator.

Mr. BIRDZELL. May I add one word? Our information is that a number of these cash depositories are intending to convert themselves into regular State banks.

Senator COUZENS. Are you going on to title III now, Mr. Comptroller?

Mr. O'CONNOR. I believe it would be well, for the information of the committee, in view of the figures that have been given, just to state the income of the corporation at this time, the Federal Deposit

Insurance Corporation. From our bond investment we have an annual income of $8,710,761.27. That is a daily income of $23,878.63.

Senator BULKLEY. Are those investments in Government bonds?

Mr. O'CONNOR. Yes; and we can only invest in Governments, under the law, Senator. I am glad you brought that out.

Senator COUZENS. Have you got some other income from the assets of banks whose deposits you have paid off?

Mr. O'CONNOR. Yes. We call it, really, recoveries. We have already 75 percent in one bank, and 49 percent in another, and 50 percent in another, in 3 of the banks of the total number of banks that have been closed, 15 banks in all.

Now, I am through with title I, Senator, unless you have some questions.

Senator BULKLEY. I do not think of anything more now.

Senator COUZENS. Before you start on the other title, may I ask you this: If you do not want to answer this, you do not need to. It appears from the low interest rate and the lack of opportunity for income in banks generally throughout the country, that they are having difficulty to make any money. Some are just getting by, some are in the red, and others make a small profit. Is that condition, if it prevails, going to affect the Federal Deposit Insurance Corporation materially?

Mr. O'CONNOR. Yes; of course, our banks, in order to be sound, must make profit, and, frankly, I look with considerable optimism to the future because of some of the benefits that the Banking Act of 1933 gave to the banks, and the most striking one is that by your act you eliminated the provision with reference to interest on demand deposits in national banks, and that saved the banks a very large sum of money.

Senator COUZENS. Have you an estimate of how much?

Mr. O'CONNOR. The total amount paid during the past 5 years, prior to the passage of the Bank Act of 1933 by member banks on demand deposits was $1,230,242,000, which was an average of $246,048,045 per annum. That was just for member banks.

Senator COUZENS. Have you estimated what that would have been in the calendar year 1934 if it had not been prohibited by the Banking Act of 1933?

Mr. O'CONNOR. Well, I would assume, Senator, that it would practically be the same as the average for the 5 years before.

Senator COUZENS. Well, no; because the deposits were much less. If you have not got it convenient, I would like to have, if you can compute it, what the interest would have been, or an estimate of what it would have been for the calendar year 1934 had the Banking Act of 1933 not prohibited the payment of interest.

Mr. O'CONNOR. Yes; we can get that.

Average demand deposits in all member banks calendar year 1934	$20, 566, 035, 000
Interest at 1.17 percent on average demand deposits in 1934	240, 623, 000

Senator COUZENS. But, in spite of that, I am still of the impression that with the investment rates low and the opportunities to lend money limited, that some of these banks are having, notwithstanding that elimination of interest, difficulty in getting by. Has that been your observation at all?

Mr. O'CONNOR. Oh, yes, Senator; there is no question about it. Their earning power has been greatly impaired since 1933.

Senator BULKLEY. Now, as for section 301, that is a new provision that was not in our omnibus bill last year. What was your experience that caused you to ask for this change in the law?

Mr. O'CONNOR. Well, the particular reason for that, Senator, is to permit the Reconstruction Finance Corporation not to come within the provision of a holding company, so that any wholly Government-owned corporation should be able to vote its stock and not have any of the inhibitions or viciousness that attach to other holding companies.

Senator BULKLEY. But the text goes a little farther than that. It says, "Any organization which, in the judgment of the Federal Reserve Board, is not engaged," and so forth. Have you any experience to base that on?

Mr. O'CONNOR. Yes; we have two or three, Senator. Here is one:

A corporation owning and operating large department stores in several cities in the United States owns the stock of a small member bank located on the premises of one of its stores, which bank is operated primarily for the convenience of its customers and employees.

An unincorporated labor union owns a majority of the stock of a member bank in New York City and a subsidiary organization of the labor union owns the stock of a member bank located in Chicago.

A corporation organized to hold real and personal property of a church owns or controls two member banks.

And a charitable foundation established for the purpose of aiding young men and women in obtaining an education owns the stock of a member bank.

Those are all illustrations.

Senator BULKLEY. Those are very good illustrations.

Now, there could be no discrimination in favor of those under the law.

Mr. O'CONNOR. No.

Senator BULKLEY. And the change you propose would permit the Federal Reserve Board to act in each specific case?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. And each case would have to be acted upon?

Mr. O'CONNOR. Yes, sir; by general regulation.

Senator COUZENS. That is, they would have to make the determination before they could vote?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. What is the significance of these words "as a business"?

Mr. O'CONNOR. That is which section?

Senator BULKLEY. Line 16, on page 51.

Mr. O'CONNOR. Well, that is just to distinguish the real holding company from the accidental affiliate. Those are not business, Senator; that is just to make that distinction.

Senator BULKLEY. Section 302 is as it was in the omnibus bill last year.

Mr. O'CONNOR. Yes. Senator, they are all the same in that bill as the Bulkley bill, except where we have indicated.

Senator BULKLEY. Section 303 seems a little broader than it was in last year's bill. You have included here, in lines 7, 8, and 9, "or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities", and so forth.

Mr. O'CONNOR. Section 303 (a) makes it clear that the provisions of section 21 (a) (1) of the Banking Act of 1933, prohibiting dealers in securities from engaging in the business of taking deposits, does not prevent banking institutions from dealing in, underwriting, purchasing, and selling investment securities to the extent expressly permitted to national banks under the National Banking Act and does not prevent banking institutions from selling mortgages without recourse. It will be observed that national banks are limited in dealing in and underwriting securities to doing so as to Government obligations, general obligations of State or political subdivisions, obligations issued under authority of the Federal Farm Loan Act, by the Federal Home Loan Board, or the Home Owners' Loan Corporation.

Those should be included.

Senator BULKLEY. This proviso, beginning in line 12 is new matter that was not in last year's bill, permitting banks to sell without recourse obligations evidencing loans on real estate.

Mr. O'CONNOR. This section makes it clear that section 21 (a) (2) of the Banking Act of 1933 does not require that business institutions which accept deposits only from their own officers, agents, or employees need submit to examination and publication of reports of conditions.

Oh, you are still on the other section?

Senator BULKLEY. Yes; the proviso beginning in line 12 is new matter that was not in last year's bill.

Mr. O'CONNOR. Yes, Senator. The question has been raised, Senator, in our office that banks might not have the right to sell mortgages, and this does not add anything to it, except it clarifies the fact that it does not interfere with what has been construed to be their right to do.

Senator BULKLEY. In other words, mortgages would not be construed as an investment security?

Mr. O'CONNOR. That is correct.

Senator BULKLEY. You do not consider them an investment security now?

Mr. O'CONNOR. No.

Senator BULKLEY. But you feel that this should be put in to make it more clear?

Mr. O'CONNOR. Yes; that is right.

Senator BULKLEY. It really does not change the effect at all?

Mr. O'CONNOR. No, sir.

Senator COUZENS. When a bank sells any of these real-estate securities, do they continue the contingent liability of the mortgagor?

Mr. O'CONNOR. No.

Senator BULKLEY. Now, my recollection is that the amendment was offered on the floor to that effect when we had the omnibus bill up, and it was quite troublesome, and, as I remember, Senator Couzens was opposed to this amendment.

Senator COUZENS. This amendment?

Senator BULKLEY. It was my idea it was this amendment, or to this effect.

Mr. F. G. AWALT (Deputy Comptroller of the Currency). It was much broader, Senator.

Senator COUZENS. Can you state what it was?

Mr. AWALT. Well, technically, it might have opened up to the banks the right, whether they had it then, to deal in mortgage securities, whereas this amendment confines it to the rights that they may have under the present law.

Senator BULKLEY. To the rights they may have under the present law?

Mr. AWALT. Yes; the way it is worded now. This is new. You see, the objection under the 1933 Banking Act was as to—it was a criminal provision, and the Attorney General says that a bank that sells a mortgage security, he has doubts whether or not they violate the terms of the act, and they may be criminally prosecuted; and this amendment is intended purely to give them a right to sell a mortgage, if they have it, without being criminally prosecuted.

Senator BULKLEY. This, as I understand you, is to make clear that the law means what you think it is, anyhow.

Mr. AWALT. That is it.

Mr. O'CONNOR. That is it, Senator, exactly.

Senator BULKLEY. We will look up that debate and see whether there is anything further to be inquired about here.

Now, this subsection (b) here raises a considerable question, because in your memorandum you said that perhaps the whole subsection which is here proposed to be amended ought to be repealed. Do you know whether the House proposed, in the bill as reported, to repeal it?

Mr. O'CONNOR. They struck it out, Senator.

Senator BULKLEY. The House struck out the subsection?

Mr. O'CONNOR. Yes. That is the examination of private banks. And here is the situation with reference to it——

Senator BYRNES (interposing). You cannot do anything about an examination, can you?

Mr. O'CONNOR. That is it. The Federal Government has no power over State banking institutions. You require that the Comptroller shall examine these private State institutions. And one of the Members of the House asked me whether I had examined those banks and institutions, and I said "yes." He said, "What did you do with the reports?" I said, "I filed them." He said, "Is that all you did?" I said, "Yes, because Congress told me to examine them."

Senator BULKLEY. Is there no provision for the publication of the report?

Mr. O'CONNOR. It might be required.

Senator BUCKLEY. Is it required under existing law?

Mr. O'CONNOR. Yes, as to reports of condition. And we have two difficulties. First, that they advertise that they are being examined by the Federal Government, and we have not one bit of power to go in and correct a bad situation.

Senator BYRNES. They get the benefit of the advertisement that you are examining them, and you may find practices that you could correct if you had the power.

Mr. O'CONNOR. That is correct.

Senator BULKLEY. However, that provision was put in the law as a result of very considerable discussion and debate, and I think that this discussion here ought to be continued with a little larger proportion of our membership present.

Senator BYRNES. I think so. It does seem that if it is to be continued we ought to make some provision for using the report of the examiner. If, as it now stands, the Comptroller is merely to file it and it accomplishes no purpose whatever, there is no reason for continuing it.

Senator BULKLEY. I must say that under the statement the Comptroller makes it does seem somewhat ridiculous, but at the time it was considered to have some importance.

Senator BYRNES. Yes; that impresses me. It was brought to my attention that the Comptroller did make a report, and nothing was done about it, and that the private bankers had the benefit of the advertising that they were examined by the United States Government. If he has no power I should not think he should have the responsibility.

Senator BULKLEY. If we should want some continuance of the supervision, would you recommend that there be a specific direction for publishing the reports, or do you think the whole thing is entirely impracticable?

Mr. O'CONNOR. I think it is, Senator, because the reports mean so little to the average person who goes into a bank and puts his money in there. You can publish a report, but readers do not understand it. It is so difficult to reach the people who are making these deposits, and who are dealing with these institutions. We have no power to close such banks or to compel them to do anything and, just as the Senator says, they advertise the advantage of being supervised by a Federal Government institution.

Senator BYRNES. And because they are not under a State institution, you cannot turn it over to a State official. There is nothing you can do but to file it.

Mr. O'CONNOR. That is all.

Senator BULKLEY. Your memorandum says you do not oppose the repeal of it. You really advocate the repeal of it, do you not?

Mr. O'CONNOR. Yes. It seems to me, Senator, that we ought to repeal it.

Senator BULKLEY (presiding). The committee will take a recess until Monday morning at 10:30 o'clock.

(Whereupon, at 12:05 p. m., the subcommittee recessed until Monday, Apr. 29, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

TUESDAY, APRIL 30, 1935

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

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

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

Senator GLASS. Proceed, Mr. Comptroller.

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY—Resumed

Mr. O'CONNOR. Are you going to take up title III?

Senator BULKLEY. Is that what you want to do?

Mr. O'CONNOR. There is a matter in title I that I would like to check up.

The Senate bill which is before us, S. 1715, on page 9, section 7, provides as follows [reading]:

By striking out subsection (a) and inserting in lieu thereof the following:

"(g) The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors under subsection (f) shall be the following: 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."

I have just read from the Senate bill; and the language that I have read is practically the rule followed by the Comptroller in chartering national banks.

Senator GLASS. You lay stress upon the requirement that the inquiry should be directed to the needs of the community, do you not?

Mr. O'CONNOR. Yes, Senator; that is one of the particular points that I would like to emphasize.

Senator GLASS. And you frequently refuse, as I know your predecessors have frequently refused, to charter a national bank in a community where the State banks met apparently all of the requirements of the banking business?

Mr. O'CONNOR. That is absolutely correct, Senator; and, in addition to that, not long ago a national bank made application for a branch. All branches of national banks, under the statute, must be approved by the Comptroller. We made the usual investigation in this particular community, by our examiners, to determine whether or not we felt there was need in that community for more banking facilities, and we found that the State had chartered a State bank some months before in that particular community. Its deposits at the time of our investigation were around $250,000. The bank was owned locally in that community, and I declined to permit a national bank to establish a branch in competition with that State bank because there seemed to be no need for it in that community.

I was rather surprised some weeks later to learn that the State itself had chartered a branch of a State bank in competition with its own institution in that community. I wanted to enlarge your suggestion, Senator Glass, that we also apply the same rule as to branches.

Senator GLASS. I very distinctly recall the latest instance in my own State, when I think Mr. Awalt was acting Comptroller of the Currency, or it may have been Mr. Pole, that application was made for the establishment of a national bank in Lancaster County, Va., at Cape Charles City, I think, in the third richest county in the State; and Mr. Pole, or Mr. Awalt, as the case might be, declined to charter the bank because he held that the two State banks there were affording ample banking facilities to the community.

Pardon me for interrupting you. You may proceed.

Mr. O'CONNOR. The House bill, H. R. 7617, on page 11, section 7, provides as follows [reading]:

By striking out subsection (g) and inserting in lieu thereof the following: "(g) The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors under subsection (f) shall be the financial condition of the bank and the adequacy of its capital structure."

Frankly, gentlemen, I regard this as one of the most important provisions in title I of the suggested bill, and I consider the amendment in the proposal of the House as most dangerous.

Senator GLASS. You mean, in the bill, or in title I of the bill?

Mr. O'CONNOR. Title I of the bill. Let us consider it for a moment, because of its great importance. If the section as suggested by the House is adopted, rather than the one that is in the Senate bill, it will mean that every State-chartered institution that applies to the board for insurance, and which has an adequate capital, will have to be admitted, because the financial condition of the bank is not very important, for the reason that practically all banks in the future will be new banks, and the financial condition of the institution being new would naturally be sound. What will happen? Over the past 10 or 11 years 12,000 banks in this country have closed. With deposit insurance in effect it will be the highest invitation to those who want to speculate in this country in the establishment of banks, because the promoters can say to the stockholders, "Your bank will be insured, so why not invest in this institution? You cannot be hurt." Secondly, because of the general move in the different States, as well as by the Federal Government, to eliminate the double assessment liability.

Senator BULKLEY. But you do not guarantee stockholders.

Senator TOWNSEND. He is using the argument that would be made to prospective investors.

Mr. O'CONNOR. I am trying to make this point, Senator: Under the old system when a bank was organized there would have been much greater care on the part of the investor going into the bank when first he was confronted with a double liability, which has been removed by Congress from new banks, and also some of the States are following the suggestion of Congress in this respect, and, secondly, to say to the man investing, "This bank will not close because it will be insured." So a man is more likely to invest his money as a stockholder because of the fact that the bank will be insured.

Senator BULKLEY. I do not see how that protects the stockholders. It certainly protects the depositors.

Mr. O'CONNOR. If you prevent runs on banks it will protect the stockholders.

Senator BULKLEY. The theory is that there will not be a run, and therefore the bank would be protected? There is something in that, of course.

Mr. O'CONNOR. Yes; that is it. It is simply an invitation and an encouragement in every State in the Union, because all that they would have to do, gentlemen, would be to secure a State charter and then come down here and be insured. If we had 11,000 or 12,000 failures in the past 10 years, I do not know what the situation will be in the next 10 or 12 years if that provision is permitted to become law.

The Senate bill I believe is very sound. The Senate bill provides as follows [reading]:

The financial history and condition of the bank—

Of course, that only applies to the remaining banks that are not members of the fund—

the adequacy of its capital structure, its future earnings prospects—

And we make a careful investigation of that in chartering a national bank—

the general character of its management—

And that is very important. The Comptroller's office cooperates with the Federal Reserve Board in a very careful check-up of the character and kind of men that are coming into the new banks. But particularly this section in the Senate bill:

the convenience and needs of the communtiy to be served by the bank.

To prevent, if we can, over-banking this country. I consider it of such importance, gentlemen, that I wanted particularly to call your attention to it this morning; and I thank the Senator for giving me an opportunity to point it out.

Senator GLASS. Mr. Comptroller, conceding that that is very important, do you think it more important than the provision in the existing law requiring all insured banks after July 1, 1937, to become members of the Federal Reserve System and comply with the law that applies to member banks and which appears to have been stricken out by the House bill? Do you think that is of any less importance? What do you think would happen to the insurance fund if that requirement should be expunged from the law? You are a member of the Insurance Deposit Board, are you not?

Mr. O'CONNOR. Yes, Senator; I am. My view is this. The ultimate aim of the legislation of 1933 was to establish one system in this country. The framers of the act had no objection to postponing the date of qualification to a future date when recovery was reached in the country, as well as giving an opportunity to banks to qualify for membership in the Federal Reserve System. That is a consummation devoutly to be wished. We cannot be unfair to these banks, and we must permit a reasonable time to elapse for the banks to be able to so rearrange their internal affairs, their capital structure, if they can, so as to qualify for membership in the Federal Reserve System. I believe we have made a step toward that, Senator, in title I, if it is adoped, permitting the Federal Insurance Corporation to purchase the assets of going banks, so that we can create mergers or bring about mergers all over the country, getting these banks in shape to qualify for membership in the Federal Reserve System. I think that was a wise provision of Congress, because I believe it would have been manifestly unfair on the part of Congress with respect to small banks to practically sign their death warrant because they could not qualify for membership in the Federal Reserve System; and in view of that, Congress wisely provided that it would give them an opportunity, a certain length of time in which to qualify for membership. It is the policy of the Federal Government as expressed in that law that at some future date all banks in the United States must become members of the Federal Reserve System.

Senator GLASS. As a matter of fact, in your capital fund there is $150,000,000 contributed by the Federal Government and also a fund contributed from the surplus funds of the Federal Reserve banks. Is there any reason why the Federal Reserve banks should contribute $150,000,000 toward insuring deposits of nonmember banks which refuse, after a period of 4 years, to become members of the Federal Reserve System?

Mr. O'CONNOR. My understanding is that the banks that are members of the insurance fund will all pay their proportionate share of the levy that is made by the Board.

Senator GLASS. But nonmember banks do not pay any part of the $150,000,000 taken from the surplus of the Reserve banks, do they?

Mr. O'CONNOR. No; but that is in lieu of their assessment, Senator. Is not that in lieu of their first assessment?

Senator TOWNSEND. You mean out of the $150,000,000?

Mr. O'CONNOR. Yes.

Senator TOWNSEND. I did not understand that.

Senator BULKLEY. They have to pay their assessment besides that, do they not?

Mr. O'CONNOR. But that was not out of the banks. That was taken out of the surplus of the Federal Reserve, was it not?

Senator GLASS. That is what I am saying. It was taken out of the surplus of the Federal Reserve, and it was put in the surplus of the Federal Reserve by member banks.

Mr. O'CONNOR. That is true.

Senator GLASS. That is what I am talking about.

Mr. O'CONNOR. I suggested some time ago that that be repaid.

Senator GLASS. I do not think it ought to be repaid. I do not think the $150,000,000 taken out of the Treasury, which never ought to have been in the Treasury, mulcted by law—there is such a thing as legal robbery, you know—ought to be repaid.

Mr. O'CONNOR. There is a very simple way to do it.

Senator GLASS. I just wanted to know what your opinion was of the proposition to relieve these banks, because I very distinctly recall—and I do not disclose any secret in saying so—that the President of the United States and the then Secretary of the Treasury, Mr. Woodin, brought acquiescence in the insurance provision of the bill only upon the ground that it would seem to bring about in what most people regarded as a constitutional way an approximately unified banking system.

Mr. O'CONNOR. The Federal Reserve System has been repaid that money. The money that they put in has been repaid them by the Treasury. The Treasury now owns the stock——

Senator GLASS. Owns what stock?

Mr. O'CONNOR. The money that the Federal Reserve Board put in.

Senator GLASS. The Federal Reserve Board has not been repaid.

Mr. O'CONNOR. The Treasury purchased that stock.

Senator GLASS. The Treasury put up $150,000,000 of its own.

Mr. O'CONNOR. And in addition to that it purchased the stock of the Federal Reserve banks.

Senator GLASS. They took $150,000.000 of the surplus of the Federal Reserve banks.

Mr. O'CONNOR. And they bought that stock and repaid it.

Senator BULKLEY. I did not know that. By what authority was it repaid?

Senator GLASS. It never was intended to be repaid.

Senator BULKLEY. But the Comptroller says it was. How was the authority given to repay that?

Mr. O'CONNOR. They bought that stock.

Senator BULKLEY. Out of what?

Mr. O'CONNOR. Treasury funds.

Senator BULKLEY. Under what authorization? Was that some of the relief money?

Mr. O'CONNOR. No; that is not relief money.

Mr. WOOD. I understand that under the industrial-loan bill last year it was provided that the Treasury would make an advance to the Federal Reserve banks in an amount equal to the amount that they had subscribed for stock in the Federal Deposit Insurance Corporation.

Senator GLASS. That was for a different purpose entirely.

Senator BULKLEY. It is very different from repurchasing the stock, too. If they made an advance of the same amount, it is only the amount that happens to be the same. It is not a repurchase of the stock.

Senator GLASS. It was to make direct loans to industry.

Senator BULKLEY. It does not constitute a purchase of the stock at all, as I understand it.

Mr. O'CONNOR. Let us read the section——

Senator GLASS. It was to make a contribution for direct loans to industry.

Mr. O'CONNOR. That is right.

Mr. BIRDZELL. The capital status of the Corporation has not been affected at all. We have $150,000,000 subscription; we have $139,000,000, in round numbers, from the surplus of the Federal Reserve banks for which stock has been issued, and it has not been altered a particle.

Senator GLASS. That was made the basis of the contribution of the Government to industry.

Senator BULKLEY. Was it not an advancement for another purpose than repayment of this amount?

Mr. WOOD. Yes. Our Corporation has not repaid any of that.

Mr. O'CONNOR. May I read the section? This is document no. 417, relating to direct loans for Federal Reserve banks [reading]:

In order to enable the Federal Reserve banks to make loans, discounts, advances, purchases, and commitments provided for in this section, the Secretary of the Treasury, upon the date this section takes effect, is authorized, under such rules and regulations as he shall prescribe, to pay each Federal Reserve bank not to exceed such portion of the sum of $139,299,557 as may be represented by the par value of the holdings of each Federal Reserve bank, all Federal Deposit Insurance Corporation stock upon the execution by each Federal Reserve bank of its agreement to be endorsed on the certificate of such stock, to hold such stock unencumbered and to pay to the United States all dividends, all payments on liquidation, and all other proceeds of such stock for which dividend payments and proceeds the United States shall be secured by such stock itself up to the total amount paid to each Federal Reserve bank by the Secretary of the Treasury under this section. Each Federal Reserve bank shall agree that in the event such dividend payments and other proceeds in any calendar year do not aggregate 2 percent of the total payment made by the Secretary of the Treasury under this section, it will pay to the United States in such year such further amount, if any, up to 2 percent of the said total payment as thereby covered by the net earnings of the bank for that year derived from the use of the sum so paid by the Secretary of the Treasury, and that for such amount so due the United States shall have a first claim against such earnings, and, further, that it will continue such payments until final liquidation of said stock by the Federal Deposit Insurance Corporation. The sum so paid to each Federal Reserve bank by the Secretary of the Treasury shall become a part of the surplus fund of such Federal Reserve bank within the meaning of this section. All amounts required to be expended by the Secretary of the Treasury in order to carry out the provisions of this section shall be paid out of the miscellaneous receipts of the Treasury created by the increment resulting from the reduction of the weight of the gold dollar under the President's proclamation of January 31, 1934; and there is hereby appropriated out of such receipts such sum as shall be required for such purposes.

That is what I had in mind.

Senator GLASS. We are entirely familiar with that. That was simply the basis for an additional contribution by the Treasury.

Senator TOWNSEND. Has the Treasury paid the Federal Reserve banks this money?

Mr. O'CONNOR. My recollection is, Senator Townsend, that they have. Whether it has been fully paid or not I do not know. I can look it up and let you know.

Senator TOWNSEND. Your first assertion, then, was correct?

Mr. O'CONNOR. That is what I had in mind.

Senator BULKLEY. It is rather a peculiar transaction. It looks different to me, however, from a purchase of the stock.

Senator TOWNSEND. They have received the money from the Treasury.

Senator BULKLEY. Yes; but not by way of purchase of the stock.

Senator TOWNSEND. It may be or may not be a purchase.

Senator BULKLEY. It is a most peculiar transaction.

Senator TOWNSEND. It certainly is.

Senator BYRNES. I think we should ask the Comptroller if he wants, after looking it up, to make a statement in the record as to what is the fact.

Senator BULKLEY. That would be very satisfactory; but I do not think it is very pertinent to what is before us.

Did you have something else to say?

Mr. O'CONNOR. Not on that section, Senator.

Senator BULKLEY. Do you want to go on with title III now?

Mr. O'CONNOR. Yes, senator. Section 304, page 53 of the bill, was where we left off.

Senator BULKLEY. That provides for eliminating double liability with respect to shares issued prior to June 17, 1933, by national banking associations. Have you considered whether we could in fairness to creditors of banks eliminate the liability?

Mr. O'CONNOR. I have given that rather careful consideration, Senator, and in my opinion you could not constitutionally destroy the rights that exist now between the debtors and creditors of banks. In other words, when a depositor places his money in a bank at the present time, with double liability on the stock, that becomes a part of his contract with the bank.

Senator BULKLEY. He is presumed to rely on only the security that the law gives?

Mr. O'CONNOR. That is correct. That is very well stated. Now, therefore, inasmuch as Congress has provided that as to new charters the double liability is eliminated, it would seem only fair to make provision at a convenient time in the future for the elimination of double liability on existing banks, and particularly because at the present time we have national banks with two kinds of stock, stock that has a double liability and new stock issued by the same bank that does not have a double liability.

Senator BULKLEY. I can see the confusion of it and the desirability of getting it ironed out, but I am thinking about the question of wiping out an obligation that actually exists in favor of existing creditors.

Mr. O'CONNOR. We do not go that far, Senator, because we provide here that this double liability shall be eliminated on July 1, 1937, and we feel that if the law is passed now with presumptive notice to all creditors that within that time they will all have had notice of the passage of the act, it will therefore not be subject to the constitutional objection. That is my argument on it. I believe that there is not anything more distressing than to call for stock assessments after a bank has closed, because usually it is the stockholders that have suffered greatly by the closing of the bank, and secondly, it is usually in a period when they are less able to respond to double liability, and the further fact that we have collected approximately 49 percent of the stock liability. I have suggested to this committee and to Congress that we should not weaken the financial structure of our banks too greatly. Just as soon as you take away this double liability we must concede that we have greatly weakened the structure of our national banks. So therefore I have suggested that the national banks shall be required to set aside out of their profits one-tenth each year until their surplus equals their capital. In other words, it will put into the bank this additional sum, rather than to attempt to collect afterward.

Senator BULKLEY. That provision about adding surplus is in section 314, is it not?

Mr. O'CONNOR. Yes, sir. The committee on that basis will be interested to know that in national banks we have a capital structure as of December 31, 1934, of $1,786,409,000.

Senator TOWNSEND. Do you mind an interruption there?

Mr. O'CONNOR. Certainly not, Senator.

Senator TOWNSEND. What percentage of the double liability assessment has been collected?

Mr. O'CONNOR. About 49 percent. The surplus in our national banks as of December 31 was $837,887,000, or, roughly, nearly one-half. Undivided profits amounted to $261,491,000. Of course, some banks have tremendous reserves and surplus. I have one bank in mind that has a capital of a million and a half and a surplus of 70 millions, and undivided profits of about a million and a half. I am just illustrating the great differences and gradations of banks, because you can hardly think off-hand of a bank that has a million and a half capital with 70 millions surplus.

May I further state, with reference to the constitutional objection that you are interested in, Senator Bulkley, that the House discussed that feature of it, and on page 60 of the House bill they inserted this provision to which we had no objection [reading]:

SEC. 304. Section 22 of the Banking Act of 1933, as amended, is amended by adding at the end thereof the following sentence: "Such additional liability shall cease on July 1, 1937, with respect to all shares issued by any association which shall be transacting the business of banking on July 1, 1937: *Provided*, That not less than six months prior to such date, such association shall have caused notice of such prospective termination of liability to be published in a newspaper published in the city, town, or county in which such association is located, and if no newspaper is published in such city, town, or county, then in a newspaper of general circulation therein. If the association fail to give such notice as and when above provided, a termination of such additional liability may thereafter be accomplished as of the date six months subsequent to publication, in the manner above provided."

Senator BYRNES. Let me ask you a question about that. If a bank becomes insolvent under the existing law, the depositor has the right to participate in any amounts that may be recovered from stock liability; that is right, is it not?

Mr. O'CONNOR. That is right.

Senator BYRNES. Under the insurance fund we have attempted to take care of that, so that if a bank becomes insolvent the depositors will receive payment from the insurance fund?

Senator TOWNSEND. Up to $5,000.

Senator BYRNES. Up to $5,000. Then what you have in mind is that while this insurance goes to the depositors, there shall be this additional fund added to surplus in order to protect depositors over $5,000, because the depositor who has no more than $5,000 is assured of payment out of the fund?

Mr. O'CONNOR. You just carry that one step further. It applies to the $5,000, too, because you have to keep in mind the fact the Federal Deposit Insurance——

Senator BYRNES. It is subrogated to the rights of the depositors against the stockholders?

Mr. O'CONNOR. Yes.

Senator BYRNES. Suppose you repealed it as to stockholders' liability, then there is no subrogation of the insurance fund. The depositor will have a remedy up to $5,000?

Mr. O'CONNOR. That is correct.

Senator BYRNES. What you are seeking to do, then, is to protect the depositors whose deposits are in excess of $5,000, by adding to the surplus and thereby improving the capital structure. Is that it?

Senator TOWNSEND. If you repeal the law you increase the hazard of the F. D. I. C., of course.

Senator BYRNES. If the Senator's statement is correct, the F. D. I. C. would be in a better situation, because the structure of the bank would be improved.

Mr. O'CONNOR. That is exactly correct, Senator.

Senator BULKLEY. Have you finished with section 304, Mr. O'Connor?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. Section 305 amends the Banking Act of 1933 in a very peculiar way by amending an amendatory clause. What is the idea of going around the bush in that way?

Mr. AWALT. It is just a simple way to do it.

Senator BULKLEY. Do you call that a simple way?

Mr. AWALT. Much simpler than the other way, Senator.

Mr. O'CONNOR. I suppose that sometimes the longest way round is the shortest way home. They have advised me that this is the simplest way to accomplish it.

Mr. AWALT. It is purely a question of draftsmanship.

Senator BULKLEY. I think the merit of the section is very easy to understand.

As to section 306, Mr. O'Connor, do you wish to give a little more explanation of that than is contained in the statement?

Mr. O'CONNOR. Yes, Senator. This is recommended by the Federal Reserve Board and also by myself. The burden upon the Board of investigating and examining each individual permit—thousands of them—has become so great that it is practically impossible for the Board to properly carry it out, but under the present law it must be done individually. The Board would like the authority to prescribe general regulations and then to be able to grant permits, if they come within those general regulations. We feel that this amendment will accomplish that.

Senator BULKLEY. Can you state just what happens under the existing law and how it would be changed by this amendment?

Mr. O'CONNOR. At the present time we have a complete summary of the relationship between the officers, directors, and employees of the banks and the security companies, and then each individual name comes up and he is investigated; whereas, if we could prescribe general regulations, general questions to each one of these individuals, as soon as it was looked over by one of the staff, he could see whether there was any possible conflict with the provisions of the act or the intent of Congress, and we would just pass them instead of going into each one individually. The Board would not have to go into each case individually. We would just pass them because they had complied.

Senator BULKLEY. Are there many such cases to be passed on?

Mr. O'CONNOR. Oh, a great many, Senator.

Senator BULKLEY. How does it run in figures?

Mr. O'CONNOR. I have not the figures so much in mind as I have a stack of instruments in front of us on the table in the board room.

Senator BULKLEY. And each one at present has to have a separate resolution of the Board?

Mr. O'CONNOR. Yes.

Senator BULKLEY. And there are so many that the Board cannot physically consider them?

Mr. O'CONNOR. It is very difficult to do it. It is practically an impossible burden on the Board.

Senator BULKLEY. This section, as I understand it, does another very important thing. Do you want to discuss that?

Mr. O'CONNOR. Yes. The section would revise section 32 of the Banking Act of 1933, which prohibits interlocking relations between member banks and securities companies, so as to extend the provisions thereof to employees as well as officers and directors, and so as to include individuals engaged in the securities business as well as officers, directors, and managers of organizations connected with such business. The description of this type of business can be revised so as to meet the other provisions of the Banking Act of 1933. The prohibition against correspondent relationships between member banks and securities companies would be eliminated. Whereas the existing law authorizes the Federal Reserve Board to make exceptions by granting permits in individual cases. the revised section would authorize the Board to make exceptions only by general regulations dealing with limited classes of cases, when in the judgment of the Board such relationship would not unduly influence the investment policies of such member banks or the advice they give their customers regarding investments.

Senator BULKLEY. You are reading from the House report?

Mr. O'CONNOR. Yes, sir; on the Banking Act of 1935, page 17.

Senator BULKLEY. I do not see that there is anything in this section now to prohibit correspondent bank relationships at all. Do you not simply eliminate that prohibition altogether?

Mr. O'CONNOR. That is right.

Senator BULKLEY. It is not a question, then, of licensing under general regulations?

Mr. O'CONNOR. Not that part of it.

Senator BULKLEY. It is simply pitched out?

Mr. O'CONNOR. That part goes out.

Senator BULKLEY. What was your thought in that?

Mr. O'CONNOR. It is the judgment of the Board, Senator, that there is no abuse there; or, if there was any abuse, the attention of Congress or the Board had—

Senator BULKLEY. You think that that was just an ill-advised provision of the law in the first place, do you?

Mr. O'CONNOR. Well, from the way it worked out practically, that was the result. I do not know that it was ill-advised, but that is the way it worked out.

Senator BULKLEY. Let us go on with section 307.

Mr. O'CONNOR. Section 307 is largely the same as was in the bill, Senator, a year ago, with some additions. It makes it clear that section 16 of the Banking Act of 1933 was not intended to prohibit national banks or member banks from buying or selling stock solely for the account of their customers and as accommodation thereto and not for their own account. It is extremely important, particularly in communities remote from financial centers, and since there is involved no investment by the bank of its own funds, no objection can be seen thereto. The amendment further limits national banks in purchasing investment securities for their own account to the purchase of same in an amount as to any one issue limited to 10 percent of the bank's unimpaired capital and surplus. The present law permits such investment in any one issue to an amount equal to 15 percent of the unimpaired capital and 25 percent of the surplus, except where the total issue does not exceed $100,000 and does not exceed 50 percent of the capital of the association.

Senator BULKLEY. I notice on page 54 you suggest striking out the word " investment " in the phrase " investment securities." Is there any significance in that?

Mr. O'CONNOR. Customers might want to buy something besides investment securities, and they would be prohibited from buying even for their customers securities other than investment securities.

Senator BULKLEY. I thought there was a prohibition against buying investment securities. I see no objection to eliminating the word.

Senator GLASS. There is a distinction between securities and investment securities.

Mr. O'CONNOR. Yes; a very wide distinction.

Senator GLASS. As a matter of fact, most of the things that are gambled on on the stock exchange are securities and not investment securities.

Senator BULKLEY. However, if you do eliminate it there, you should also eliminate it at the top of page 55, should you not?

Mr. AWALT. No, sir; because that is where the bank is buying for its own account.

Senator BULKLEY. That was intended to mean a different thing there, was it?

Mr. AWALT. Yes, sir.

Mr. O'CONNOR. Senator Bulkley, at the end of section 307, which we are discussing, we are suggesting adding to the end of the sentence the words "except that this limitation shall not require any association to dispose of any securities lawfully held by it on the date of the enactment of the Banking Act of 1935."

In other words, we do not want them to dump their securities on the market.

Senator BULKLEY. That is quite correct; and you have improved that sentence by inserting that proviso. That is a very good technical correction. But it seems to me that the sentence is still in some difficulty, because it says—

> But in no event shall the total amount of the investment securities of any one obligor or maker, purchased after this section, as amended, takes effect and held by the association for its own account, exceed at any time 10 percent of its capital stock—

And so forth.

Does that word "its" refer to the association?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. Did we not have some percentage of the proportion of the obligation——

Mr. O'CONNOR. Except where the total issued does not exceed $100,000.

Senator BULKLEY. Where are you reading from now?

Mr. O'CONNOR. The present law.

Senator BULKLEY. That remains unchanged?

Mr. O'CONNOR. No.

Senator BULKLEY. You are sure that this does not have the effect of striking that out?

Mr. O'CONNOR. I will check it in a second. That is the present law, Senator. The present law provides for an amount equal to 15 percent of the unimpaired capital of the association, 25 percent of its surplus except where the total issued does not exceed $100,000 and does not exceed 50 percent of the capital of the association. That is in the present law.

Senator BULKLEY. Is that in section 5136?

Mr. O'CONNOR. It is cut out.

Senator BULKLEY. I still think you are taking that out.

Mr. O'CONNOR. It is the present law that we are eliminating.

Senator BULKLEY. You just said you did not intend to eliminate it.

Mr. O'CONNOR. I meant, we are eliminating that section of it in view of the suggestion we make here as to the limitation of investments.

Mr. AWALT. We are tightening up on the law. Instead of leaving it 15 to 25 percent, as it was before, we are tightening it down to 10 percent of the capital and surplus.

Senator BULKLEY. And in view of that, you think you do not need any limitation with respect to what proportion it may be of the obligation of the obligor?

Mr. AWALT. No; we do not need that.

Senator BULKLEY. So that you are intending to eliminate that restriction?

Mr. AWALT. Yes, sir.

Senator BULKLEY. What is the next?

Mr. O'CONNOR. Section 307 (b). This section restates in clearer form the existing prohibition against national banks purchasing stock for their own account.

Senator GLASS. What do you do with that?

Mr. O'CONNOR. We just make it clear, Senator. It is a question of rewording it.

Senator GLASS. Sometimes people reword a thing and emasculate the meaning of it.

Senator BULKLEY. Is there any significance in using the word "hereinafter" instead of "herein"? The word "hereinafter" appears in the existing law, but in the bill that we proposed last year we changed it to "herein." My recollection is that it was for some good purpose, but I cannot remember now what it was.

Mr. O'CONNOR. We see no objection to it at all. I do not recall the purpose either, but that will be satisfactory.

Senator BULKLEY. The only change that you propose in the existing law is the insertion of these words "for its own account" in lines 11 and 12? Is that right?

Mr. O'CONNOR. I have not the section before me, Senator, but it is very easy to check it. It is only one sentence. Yes; "for its own account."

Senator GLASS. That is what it was intended to mean?

Mr. O'CONNOR. Yes, sir.

Senator BULKLEY. I think that is a clarification of the law. I think that is good. What is the next one?

Mr. O'CONNOR. Section 308, Senator. This is a new section which was not in your bill last year. It enacts into law present requirements of the Comptroller's office as a matter of policy that newly organized national banks have a paid-in surplus equal to 20 percent of capital before being authorized to do business, which requirements may be waived where necessary in connection with a State bank converting into a national bank. Whenever we charter a national bank we require not only the capital that is required under the statute, because of the population, and so forth, of a city—and as you know, it varies—but we also require a 20-percent surplus which we have no right to require. We are just asking for that authorization in the statute because we think it ought to be there. For the first 6 months that a bank operates it has got rent, salaries, and expenses with no earnings, practically; and we feel that there ought to be a surplus in there so that the capital remains unimpaired. We are asking Congress to affirm the policy that we have adopted for many years in the Comptroller's office, which we think is sound.

Senator BULKLEY. Have you made no exceptions to it?

Mr. O'CONNOR. No, sir.

Senator TOWNSEND. What is your reason for exempting that requirement in converted State banks?

Mr. O'CONNOR. Because if the State bank has a sound capital, Senator, and it is in good shape otherwise, and it is an operating bank and it can be determined, the Comptroller can look into it and see whether or not it should be permitted to convert. Leave that to the Comptroller, but do not require him, in addition to the capital which might be far in excess of their actual needs, if their investments are in good shape, to say, "You must have 20 percent also."

Senator BULKLEY. Section 309?

Mr. O'CONNOR. That eliminates any possibility of section 18 of the Banking Act of 1933 being construed as preventing corporations other than a bank from conditioning transfer of their shares on the simultaneous transfer of shares of bank stock, but preserving the unimpeded free and unconditional transfer of bank stock.

Senator BULKLEY. I wish you would explain that. It seems to me that we prohibit a thing and then say that if you want to do it backward you can go ahead and do it.

Mr. O'CONNOR. The Glass report on the Banking Act of 1933, page 16, section 18, provides for separating the certificates representing ownership in national banks and ownership in the affiliates, other than member banks or existing corporations engaged solely in holding the bank premises of the affiliated national bank, so that in the future they will not be written upon a single certificate of ownership.

This corresponds to the provisions contained in section 5, which is applicable to State member banks.

Mr. AWALT. The question arose, due to the language of the section, whether or not it went further than that. But what we are trying to do is to bring it back just to accomplish this particular thing.

As I understand it, what this report of the Senator Glass Committee was trying to do was to hit, for instance, the National City Bank and the National City Co., where the stock of the company was trusteed and was evidenced on the back of the National City Bank certificate. We have interpreted that section to mean exactly that—that you cannot have that on the back of the certificate of any sort of a corporation; but some people claim it might go further than that, so that where you have an irrevocable trust which is evidenced in some cases by companies that are not knocked out under the affiliate section that company would have to be dissolved in addition to having the name taken off of the certificate. We had one case in Chicago something like that. Have I made it clear?

Senator BULKLEY. No; I really do not understand it.

Mr. O'CONNOR. Let Mr. McGrath try it.

Mr. MCGRATH. Some of them have construed this section as being another provision requiring divorcement of an affiliate. In section 20 of the Banking Act of 1933 it is provided that certain types of affiliates are to be divorced from a bank. That is the divorcement section. This section is thought to be limited, as Mr. Awalt said, to taking the provisions off the stock certificates when full compliance is had by taking them off; but some say that since it provides that no stock of another corporation can be conditioned on the transfer of bank stock, the mere taking it off of the certificate is insufficient.

Senator BULKLEY. That is what I would think, myself.

Mr. MCGRATH. That is all right if it is an objectionable type of affiliate, but we have a case in Chicago where the bank has transferred charged off real estate and other assets to a corporation, the stock of which corporation is trusteed for the benefit of the shareholders of the bank. It is very desirable that the bank should hold that close control over the charged-off real estate. If you are going to require them to break up that trust agreement, then you would permit a bank shareholder gradually to sell his interest in that corporation, and in the course of time we would not have any relationship whatsoever between the bank and that affiliated corporation. But it is a desirable relationship to maintain.

We had another case in the South where a national bank had an interest in State banks in this way. The stock of the State banks was trusteed for the benefit of the shareholders of the national bank. They want to continue that relationship because there is a branch banking law being passed in that State, and they want to convert those State banks into branches of the national bank.

Senator BULKLEY. What is the significance of trusteeing it for the benefit of the shareholders? Does that simply take it out from under the rights of creditors of the bank?

Mr. MCGRATH. Well, in a sense it does.

Senator BULKLEY. What is the advantage of that relationship? Why should it not simply be owned by the bank?

Mr. McGRATH. The bank cannot own the stock itself. It is prohibited from owning the stock. A national bank can only own stock for a debt previously contracted.

Senator BULKLEY. I thought you said this was for a debt previously contracted.

Mr. McGRATH. No; this would be a case where a corporation has been organized to take over and liquidate bad assets of the bank, to get them out of the bank entirely.

Senator BULKLEY. That relates to debts previously contracted.

Mr. McGRATH. No; because that corporation does not owe the bank any debt.

Senator BULKLEY. But the transaction relates to dealing with debts that are owed to the bank.

Mr. McGRATH. That is true; but it is not a preexisting debt. It is a debt that it created simultaneously with the issuance of stock. In other words, the stock is issued in payment for the assets; and that would be the same thing as going out and buying stock as an initial transaction.

Senator BULKLEY. The bank in that case does not pay anything for it, does it?

Mr. McGRATH. It transfers the assets to the other corporation.

Senator BULKLEY. Does it not simply take it as the measure of liquidating a debt which was previously owed to the bank?

Mr. McGRATH. A debt of another party to the bank.

Senator BULKLEY. A party which is purely fictitious. It is set up for the purpose of liquidation, is it not?

Mr. McGRATH. That is true; but the transaction is with the bank——

Senator BULKLEY. I cannot see any advantage to the voluntary creation of a needless legal complication. Unless the purpose of it is to take that asset out so that it does not have to respond to the creditors of the bank, I do not see that it does anything. I do not think that is a good purpose. I should think that was a bad purpose.

Mr. McGRATH. These corporations are already set up. It is not a case of letting them do it in the future. You have got them now and you have got them under this irrevocable trust agreement that you cannot break up; and they feel that they are in a position possibly of violating the law.

Senator TOWNSEND. You are simply making this amendment to cure a situation that now exists?

Mr. McGRATH. That is it, and to express directly in the law what our purpose is and what the Federal Reserve Board has been doing. These companies come to us and say, "What must we do to comply?" We say, "Take it off your stock certificates." We cannot order them to break up the arrangement, because they physically cannot do it.

Senator GLASS. Let me ask you this question, please. Have you undertaken in title III to clarify your definition of "affiliates"? For example, this case was brought to my attention. A newspaper in Harrisburg, Pa., three of whose stockholders or directors were on the board of a local bank, was declared a bank affiliate. That just seems idiotic, to me.

Senator BULKLEY. There is a provision in the bill relating to that.

Senator GLASS. It ought to be clarified. It means banking affiliates, and it does not mean that a newspaper is an affiliate of a bank and that that newspaper is required, under the law, to make a complete statement of all of its business, its circulation, its advertising, its contracts and everything of that sort. No such thing was ever intended.

Mr. O'CONNOR. We have a church in the same position.

Senator GLASS. Well, it ought to be clarified.

Mr. O'CONNOR. Section 324, page 67, provides [reading]:

Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of members banks are required to submit to examination, the Federal Reserve Board or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank.

That would clear it, Senator.

Mr. AWALT. That gives us discretion.

Senator GLASS. The idea of calling a newspaper an affiliate of a bank is absurd.

Mr. O'CONNOR. How about a church?

Senator GLASS. Or a church, either.

It is 12 o'clock. The subcommittee will adjourn until tomorrow morning at 10:30.

(Whereupon, at 12 m., the subcommittee adjourned until tomorrow, Wednesday, May 1, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

WEDNESDAY, MAY 1, 1935

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

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

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

Senator GLASS. The committee will come to order, and Mr. O'Connor will proceed with his statement.

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY—Resumed

Mr. O'CONNOR. Were we on section 310, Senator?

Senator BULKLEY. I think so.

Mr. O'CONNOR. That section permits holding companies to vote on the question of placing a bank in voluntary liquidation without having to go through the expensive routine incidental to obtaining a voting permit and section 310 (b). Under present law, shares held by a bank as sole trustee cannot be voted. It consequently sometimes results, where a large number of shares are so held in trust, that it is impossible to obtain the requisite number of votes required by law to accomplish certain steps such as reduction in capital, amendments to articles, and so forth, or to vote to go into voluntary liquidation where such is necessary.

Provision is accordingly made that the shares so held in trust shall be excluded in determining whether the resolution in question has been adopted by the requisite number of shares. For example, a bank has 1,000 shares outstanding. Four hundred of the shares, however, cannot be voted because held in trust by the bank as sole trustee. Consequently, in determining whether or not a resolution has been adopted by the required two-thirds vote, the 400 shares held in trust will be excluded, leaving a balance of 600 shares as the basis for determining whether a two-thirds vote has been obtained, in which case a vote of 400 shares in favor of the matter would be the requisite two-thirds majority of the shares entitled to vote.

Senator BULKLEY. It seems to me that your examination is not on the printed text of the bill; I judge that you have submitted a new draft of the section here.

Is that for the same purpose?

Mr. O'CONNOR. Yes; that is explained as follows, Senator:

It is suggested that these two subsections be rewritten and combined as one section, as per the draft before you, and add these additional changes: First, to show clearly that present law does not limit extra voting rights of Reconstruction Finance Corporation or other holders of preferred stock in case of default on preferred dividends; two, it permits stock held in trust by the bank, as sole trustee, to be voted where donor or beneficiary directs or controls the manner in which it shall be voted. This is desirable because the bank as trustee does not then in fact control such votes.

Senator TOWNSEND. Your amendment, as outlined there, takes care of the proposition to your satisfaction?

Mr. O'CONNOR. Yes, Senator Townsend.

Senator BULKLEY. All right; I do not have anything more to say about that.

Mr. O'CONNOR. Section 310 (c) is new, Senator, and is not included in your bill of last year.

It eliminates any doubt that a holding company which has set the requirements for obtaining a voting permit may cumulate its shares in the same manner as other shareholders are permitted to do. This is in conformity with the construction placed upon the present law by the Federal Reserve Board and by the Comptroller's office.

That is just a clarifying section.

Senator BULKLEY. Is that the only effect of it?

Mr. O'CONNOR. That is all.

Senator BULKLEY. All right.

Mr. O'CONNOR. Section 311 gives discretion to the Comptroller to permit a State bank converting into a national bank to carry over and retain, subject to certain conditions, such sound assets as a State bank may have which do not conform to the requirements as to assets held by national banks.

Senator BULKLEY. That proposition was approved by the committee a year ago.

Mr. O'CONNOR. Yes, sir.

Section 312 permits the Comptroller to delegate the manual labor of countersigning bond transfers in connection with substitution of securities held to secure circulation issued by national banks.

Senator BULKLEY. That was also approved last year.

Mr. O'CONNOR. That is right.

Section 313 permits branches of national banks, which banks are located outside of the United States, to charge the same interest rates permitted by local law to competing institutions.

Senator BULKLEY. That proposition was approved last year, but I notice that you have considerably shortened the form of the amendment.

Senator GLASS. Read that again, Mr. O'Connor.

Mr. O'CONNOR. It permits branches of national banks, which branches are located outside of the United States, to charge the same interest rate permitted by local law to competing institutions.

Senator, the parts omitted are the present law; and we feel that it is not necessary to reenact the present law, and we just add the proviso. That is the reason we shortened it.

Senator BULKLEY. Was there any change embodied by that paragraph?

Mr. O'CONNOR. Not down to line 10.

Senator BULKLEY. All right.

Mr. O'CONNOR. Section 314 is new. It provides that before the declaration of dividends, national banks shall carry not less than one-tenth part of their net profits of the preceding half year to surplus until the same is built up to an amount equal to the common capital instead of the present requirement that same need only equal 20 percent of capital. This change is deemed desirable in connection with the provision that assessment liability be eliminated from bank stock, and is further desirable from the standpoint of building up a proper capital structure.

I fully explained that yesterday, Senator.

Senator BULKLEY. Yes; I felt quite satisfied with what you said yesterday.

Mr. O'CONNOR. Section 315 is new. It extends the criminal provisions of existing law relative to embezzlement, false entry, and so forth, by officers and employees of member banks, to include any insured bank.

Senator TOWNSEND. Did not that apply to the insured banks under the old law?

Mr. O'CONNOR. No; not to nonmember banks.

Senator GLASS. Do you make that a prerequisite to entrance into the insurance fund? Otherwise, it does not seem to me that you have any right to do it.

Mr. O'CONNOR. Let us read the section and see if it is broad enough. With the permission of the committee, I should like to insert a short statement showing just what the Attorney General has done since the passage of the act of May 18, 1934. It is a remarkable record, since we have been giving the Attorney General jurisdiction in these cases, under the new law you passed a year ago.

It is just a paragraph or two, and I should like to insert it.

Senator BULKLEY. You want to read it to us?

Mr. O'CONNOR. I do not have it with me. I just thought of it, as I was reading the section.

Senator GLASS. How do you mean it is a remarkable record?

Mr. O'CONNOR. In two ways: First, the number of convictions, the number of arrests; and also as indicated by a statement of one member of a gang of bank robbers. I have a statement from one of them, in which he said that they were very careful not to violate, or not to commit any act which is punishable by the Federal authorities, because the Federal Government would get them. But under the State they could get away with it.

Senator GLASS. Yes.

Mr. O'CONNOR. And then I have the summary of what has been done by the Attorney General's office since you passed the last act.

Senator GLASS. You mean, in convictions of persons who have been guilty of offenses against nonmember State banks?

Mr. O'CONNOR. Member State banks.

Senator GLASS. Well, there is no question about the right to do that.

But I am talking about nonmember banks. It seems to me that the only way you can apply the penalty to nonmember banks is to make it a condition of entry into the insurance fund.

Here is a provision, in title II, that would authorize the Federal Reserve Board to wipe out every single solitary requirement that might be made for entrance into the Federal Reserve System of a nonmember State bank, except the capital requirement. It practically waives everything.

Senator BULKLEY. Yes; that proviso is in the discretion of the Federal Reserve Board.

Senator GLASS. Yes; it is.

Senator BULKLEY. But it only applies to banks that have already been admitted to the insurance provisions.

Senator GLASS. That is very true. But it might mean this—and my conjecture is that it primarily means this: The Federal Reserve Act, in its very beginning, while it did not completely abolish exchange charges on check collections, it required that the banks could collect only actual costs, and it provides that now.

The actual cost is so infinitesimal that no statistician has ever been able to define it—meaning that the actual cost does not amount to anything. It has saved the business men of this country an average of $250,000,000 a year.

Under this provision of the bill that requirement could be abolished.

The thing was fought out in the courts over a period of 5 or 6 years. Cases were handled by Newton D. Baker, advisory counsel of the Federal Reserve Board, and carried to the Supreme Court; and the Board was sustained all the way through.

Now, here is a proposition that would enable the Board to abolish every requirement of membership in the Federal Reserve System.

Senator COUZENS. Mr. Comptroller, your Department has nothing to do with part II of the bill?

Senator GLASS. No; I understand that. But with respect to imposing penalties on offenses perpetrated by the officials of nonmember banks, I am no lawyer; and it seems presumptuous of me to raise a legal point.

But it seems to me that you could not sustain a proposition of that sort unless you make it a prerequisite of membership in the insurance fund.

Senator COUZENS. Can we not take care of that when we come to revise the bill?

Senator GLASS. I hope so. We may not revise the bill, you know.

Senator COUZENS. Let us go ahead.

Senator GLASS. All right; go ahead.

Mr. O'CONNOR. Section 316 gives the Comptroller closer supervision over national banks in voluntary liquidation, as distinguished from those in receivership, by requiring reports to him and to the shareholders, and subjecting the bank to examination. It also enables shareholders to remove an incompetent liquidating agent.

Senator BULKLEY. That was agreed to.

Mr. O'CONNOR. Yes, sir; and it is a rather important provision.

Section 317 is new, and extends present prohibition on use of the word "national" by banks other than national banks to include "Federal" or "United States", or any combination of such words.

We are trying to prohibit the use of any of those words in anything but a national bank.

Senator BULKLEY. As I understand it, this is an amendment to the provision of law that already prohibits the use of the word "national "; and the purpose of the amendment is to preclude the use of these other phrases.

Mr. O'CONNOR. That is right. For instance, we have a State bank in North Dakota called the " International Bank."

Senator BULKLEY. That would not be prohibited here?

Mr. O'CONNOR. Any combination of the word " national."

Senator COUZENS. I think that is highly desirable.

Senator BULKLEY. Oh, yes; it would cover that.

Mr. O'CONNOR. It is very important to prohibit any use of the words " United States " or " Federal."

Senator BYRNES. Do you have the use of the words " United States "?

Mr. O'CONNOR. We did have in New York—which I hope we shall never have again.

Section 318 amends section 5 of the Federal Reserve Act so as to require member banks to reduce their holdings of Federal Reserve bank stock upon a reduction in their own surplus, just as they are already required to do upon a reduction in their own capital. It would also repeal the provisions of sections 5 and 6 of the Federal Reserve Act, which require the board of directors of a Federal Reserve bank to execute a certificate to the Comptroller of the Currency showing an increase or decrease in the capital stock of the Federal Reserve bank. Inasmuch as every adjustment in Federal Reserve bank stock is approved by the Federal Reserve Board before the stock is issued or canceled, the filing of such certificates with the Comptroller of the Currency is a useless formality involving duplication of work.

That is entirely a matter of the Federal Reserve Board.

Senator BULKLEY. Here is a new proposal, to strike out the last paragraph of section 6 of the Federal Reserve Act. What is that? It is a proposed addition to section 318.

Mr. O'CONNOR. This is what goes out, Senator:

> Whenever the capital stock of a Federal Reserve bank is reduced either on account of a reduction in capital stock of any member bank, or of the liquidation or insolvency of such bank, or on account of the appointment of receivers for a national bank, following discontinuance of its banking operations, as provided by this section, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of the capital stock and the amount repaid to such bank.

It is just useless and is entirely a duplication of work with the Federal Reserve Board.

Senator BULKLEY. All right.

Senator GLASS. The Comptroller of the Currency is a member of the Federal Reserve Board and ordinarily would be apprised of the fact, anyhow, would he not?

Mr. O'CONNOR. Yes; that is very pertinent.

Section 319 authorizes the Federal Reserve Board to prescribe form and contents of reports of conditions to be made by State member banks, and prescribes the manner in which such reports must be published.

Senator TOWNSEND. Does that refer to new State member banks or the old ones? Do you not already have a form for the present member banks?

Mr. O'CONNOR. There is no authority in the act to require publication of these reports unless the State law happens to require it.

Senator TOWNSEND. Even though they are members?

Mr. O'CONNOR. Even though they are members.

Senator TOWNSEND. All right.

Senator GLASS. The Federal Reserve Board is authorized to accept the examination of the State authority, and to conform to the requirements of the State law, as to publicity.

Mr. O'CONNOR. That is right; that is the way it stands.

Senator COUZENS. Is there any uniformity between the reports required of the State boards, and the reports required of the Comptroller of the Currency, of these State member banks?

Mr. O'CONNOR. They are identical.

Senator COUZENS. It seems to me, in my observation, that there is a great deal of confusion existing, with respect to the form of these published bank statements. I have had considerable correspondence with the Comptroller and his staff about that. It seems, for example, that after the Comptroller has made a call, a certain form is published, under the requirements of law; and about that same date, another kind of report is published by the banks, giving a different set of figures, and which is not required by the Comptroller of the Currency. And the comparison of the two reports by that part of the country that does not belong to the banking fraternity cannot be understood.

It seems to me that there ought to be some provision requiring a uniformity of publication of these reports. I think the Comptroller recognizes—and at least his staff ought to—that this has created confusion. I do not know whether it can be covered by law, or not; I just raise the question.

Senator GLASS. As a matter of fact, not one person in ten understands the published reports.

Senator COUZENS. That indicates the perfect uselessness of publishing the reports.

Senator GLASS. Do you not agree with that statement?

Senator COUZENS. I think that is true, where there are two kinds of reports issued—one by the bank, on its own initiative, and another by order of the Comptroller of the Currency; I think that is true.

But if there were a uniformity of published reports, from time to time, so that some comparison could be made, they would be of benefit to the public, especially to large industries and large businesses.

Now, the trouble is that the published statement ordered by the Comptroller of the Currency, cannot be discerned, from reading the press, from a report that is published by the directors of a bank itself. And when you pick up one of these reports, you do not know whether it is a report published by order of the Government or a report published by order of the directors.

And in many of those cases a comparison is made, and no human being can get an understanding of what it says—just as the Senator from Virginia has said.

I brought this point up, because I thought the confusion should be stopped.

Mr. O'CONNOR. I can clear it up.

Senator COUZENS. You can clear it up, but you cannot clear it up by a statement for the record.

Mr. O'Connor. I should like to suggest this clarification: The Senator has in mind banks that make further publication of statements and figures.

I can clear that up; I can make the regulation that the report that I require the banks to publish, shall state at the head, that it is the report that is required by the Comptroller of the Currency; I can require the banks to publish that statement right under the bank's title.

Senator Glass. Does not this happen, Mr. Comptroller: The reports that are required by the Comptroller's Office to be published are technical?

Mr. O'Connor. Yes; very.

Senator Glass. My observation has led me to the conclusion that not 1 patron of the bank in 10, unless he be an expert accountant as is the Senator from Michigan, or a large depositor, as is the Senator from Michigan—I am conjecturing, but I do not think that anybody would contest the accuracy of the conjecture—understands this technical report.

Therefore, many of the banks, in order to advertise their position so that the ordinary business man may understand it, print advertisements in the newspapers, and emphasize what they regard as the strength of the bank in particular items.

Of those reports, the Comptroller has no jurisdiction.

Senator Couzens. The question is, Is it good judgment to have jurisdiction?

Senator Glass. As a newspaper publisher, I am opposed to a regulation which would prohibit a bank from advertising its business.

Mr. O'Connor. But, Senator, I do think that Senator Couzen's point is well taken—just to show the report is one that is required by the Comptroller. When the forms are sent out, we can place, right under the bank's name, that this is a report that is required by the Comptroller of the Currency.

Senator Couzens. That simplifies that particular part of it. But anyone who has been a banker, or who has had any experience in banking, knows that one of the best tests of the growth or falling off of a bank's responsibility and management, is caused by a comparison of the total deposits, and the character of resources, as they have changed from one report to another.

Now, if I take up a report published under the requirements of the Comptroller of the Currency today, and if the Comptroller of the Currency calls for another report in 6 months, and that is published, I have to go back to the newspaper of 6 months previous, and find out, by comparative figures, whether the bank is making progress or whether it is slipping back, or not.

So, in their effect, these reports published at the request of the Comptroller, are absolutely useless, except for the benefit of the newspaper publishers. And I do not see the benefit of requiring them, unless a more thorough analysis of the bank's condition is required when the report is published.

Senator Glass. Would you stop all publications of reports, just because the newspaper gets an inconsequential fee out of the advertising charge?

Senator COUZENS. No; what I am trying to bring out is the necessity for more understandable reports.

The reports are absolutely nonunderstandable, because you can make no comparison. And the only way by which you can judge the development of a bank, and the only way you can determine whether it is slipping or going forward, is by a comparison of the reports published from time to time.

Senator GLASS. I am one of the very modest depositors in a bank; and the only way I can get any idea of what the bank is doing, is whether I get my dividends, or do not get my dividends.

Senator COUZENS. I am not so much concerned about that as I am with the welfare of the depositors.

Senator TOWNSEND. Unless you had a comparative statement of the bank's business for a 6-month period, or for a year previous, how would you benefit?

Senator COUZENS. You would not, except that the reports published close together, one at the direction of the directors and one at the direction of the Comptroller of the Currency, are confusing. And I can bring in numerous records to show that the reports, where they come close together, are confusing to the public, and they are very useless.

And it does seem to me that the situation is such that the administrative department of the Government, either by administrative order or by legislative requirement, should demand a different kind of report than is now published.

I do not care how many reports are published, and I want to give the newspapers all the ads they can get, because I think that the more the public knows about the condition of the banks, the better it is.

Senator GLASS. Of course, I tried to be amusing, in my reference about newspaper advertising.

Mr. O'CONNOR. Section 320 (a) amends section 11 (m) of the Federal Reserve Act, so as to place State member banks on a parity with national banks in lending on the security of bonds, notes, certificates of indebtedness and Treasury bills of the United States, by changing the limitation on loans to one individual on such security, from 10 percent of the bank's unimpaired capital and surplus to 25 percent thereof, as provided by national banks in section 5200 of the Revised Statutes.

That was approved by the committee last year.

Section 320 (b) amends section 5200 of the Revised Statutes so as to extend the eighth exception thereof, which pertains to loans secured by bonds, notes, and certificates of indebtedness of the United States, so as to apply also to loans secured by Treasury bills of the United States.

That was approved by the committee last year.

Senator BULKLEY. I do not find it so, Mr. O'Connor.

Senator COUZENS. I do not see any section 320 (b) in the bill.

Mr. F. G. AWALT. No; that is our recommendation.

Senator TOWNSEND. I do not find it in the bill.

Senator BULKLEY. I do not find the subject matter of section 320 (b) in last year's bill.

Mr. O'CONNOR. That is right, Senator. That is in the bill that I handed to the committee, with those additional changes we suggested.

It should be the bill, Senator, that I gave the first day.

Senator BULKLEY. This year?

Mr. O'CONNOR. Yes; with the additional changes suggested.

Senator GLASS. I do not recall that the Banking Act of 1933, or any banking act, advances a limitatio nof 10 percent on loans to individuals, partnerships, associations, or corporations. It was changed to 25 percent.

Senator COUZENS. Is not that a development along the lines that you have been talking about of requiring the banks to load up with Government securities?

Senator GLASS. You mean that I have been advocating the loading up with Government securities?

Senator COUZENS. No; I merely said that you have been talking about it; I did not say that you have been advocating it or opposing it.

But that would accomplish this purpose if they were allowed up to 25 percent?

Senator GLASS. Yes; I think so.

Senator TOWNSEND. That liberalizes the provisions of the State member banks.

Is that what you are trying to do, Mr. Comptroller?

Mr. O'CONNOR. That is correct.

The old section reads:

> Obligations of any person, copartnership association, or corporation in the form of notes secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

Senator BULKLEY. Were you reading from the Federal Reserve Act?

Mr. AWALT. Reading from the National Banking Act, section 5200, Revised Statutes, as amended.

Senator GLASS. Proceed.

Mr. O'CONNOR. Section 321 is new. The present law permits the Federal Reserve bank to make direct loans to private business on adequate endorsement and security. The amendment permits such loan on adequate endorsement or security.

Senator GLASS. Why do you not make it "and/or"?

Senator COUZENS. It is in the bill, in that way.

Mr. O'CONNOR. Section 322. This section makes certain changes in the language of section 13 (b) of the Federal Reserve Act, making it conform to the amendment in title I of the bill, whereby stock of the Federal Deposit Insurance Corporation subscribed for by the Federal Reserve banks is changed to no par value. These changes are in form only, and do not alter the effect of the existing law.

Senator COUZENS. What were your reasons for changing it to "no par value"?

Mr. O'CONNOR. I do not know that it makes a great deal of difference, except that I believe the suggestion of the chairman, on that point, was that there would not be the impairment of the capital, if it were "no par."

Senator GLASS. Which chairman?

Mr. O'CONNOR. The chairman of the Federal Deposit Insurance Corporation; Mr. Crowley.

Section 323 (a) is partly new, and authorizes the Federal Reserve Board to define "deposit" and related terms for reserve and interest requirements respecting deposits.

Senator TOWNSEND. Who defines those deposits?

Mr. O'CONNOR. The Federal Reserve Board.

Senator BULKLEY. I think we ought to have a more full explanation of that. I am frank to say that I do not see what that is driving at.

Senator COUZENS. Was that new over last year's act?

Senator BULKLEY. Yes.

Mr. O'CONNOR. Yes; part of it is new.

Senator BULKLEY. It is all new in the sense that it was not contained in our omnibus bill last year.

Mr. O'CONNOR. I am reading from the report of the House, page 21:

> Section 323 (a) amends section 19 of the Federal Reserve Act so as to repeal the rigid statutory definitions of "demand deposits" and "time deposits" and authorizes the Federal Reserve Board to define for the purposes of the section the terms: "Demand deposits", "gross demand deposits", "deposits payable on demand", "time deposits", "savings deposits", and "trust funds", to determine what is to be deemed a payment of interest and to prescribe regulations to effectuate the purposes of the section.

Oh, yes: it comes back to me now: We had a number of discussions in the Federal Reserve Board, gentlemen, after the passage of the 1933 act, when you eliminated the interest on demand deposits, as to what constituted a demand deposit, a time deposit, or a savings deposit. We found great difficulty in applying the definitions that were in the act, and we found some of the banks attempting to circumscribe the prohibitions; and we wanted, when we found those evasions, to keep correcting the definition until they could not evade it.

Senator COUZENS. Why was that not brought up in the omnibus bill last year? You had not had the experience; is that it?

Mr. O'CONNOR. No. It was in the bill last year although the language may have been slightly different.

Senator BULKLEY. I think there was a slight error in the marking of my copy and that the Comptroller is right. That part of this was in the omnibus bill last year.

Senator TOWNSEND. At the present time member banks are not permitted, in estimating their reserve balances, to deduct the amount of their gross demand deposits, are they? And this gives them that privilege—due from other banks?

Mr. O'CONNOR. Due from other banks; oh, yes.

Senator TOWNSEND. Well, I think they should have that privilege.

Senator GLASS. We shall have to take that up when we come to it.

Senator BULKLEY. Yes; there was a different arrangement of it in the omnibus bill last year, and I should have to give it further study to see what this change is.

Mr. O'CONNOR. Section 323 (b) amends section 19 of the Federal Reserve Act so that, for purposes of computing member bank reserves, amounts due from other banks (including checks in process of collection) may be deducted from gross demand deposits rather than from balances due to other banks, thus extending the benefit of this deduction to country banks which have no balances due to other banks.

Senator BULKLEY. I think that is new matter.

Mr. O'CONNOR. Yes; that is new matter. It is not marked "new" on my notes, Senator.

Senator BULKLEY. Have you anything to say about subsection (b)?

Mr. O'CONNOR. No, sir.

Senator BULKLEY. Now, subsection (c), in a slightly different form, was in the omnibus bill last year?

Mr. O'CONNOR. That is correct.

Senator BULKLEY. What is the change in that?

Mr. AWALT. I do not know exactly, now.

Mr. O'CONNOR. I can tell you, Senator, exactly what the present section provides for.

Section 323 (c) amends section 19 of the Federal Reserve Act so as to add to the classes of deposits exempted from the prohibition against the payment of interest on demand deposits the following: First, deposits payable outside the States of the United States and the District of Columbia (rather than merely those payable in foreign countries); second, deposits of trust funds on which interest is required by State law; and, third, deposits of the United States, its Territories, Districts, or possessions on which interest is required by Federal law.

Senator BULKLEY. In the corresponding section of the omnibus bill last year, there is a rather important sentence that seems to be omitted here; and I am wondering if you recall that, which is as follows:

> Any director or officer of any bank who shall have continued to violate the provisions of this or the preceding paragraph or the rules or regulations issued pursuant thereto after having been warned to desist therefrom may be removed from office in accordance with the provisions of section 30 of the Banking Act of 1933: *Provided,* That in the case of a director or officer of a nonmember bank, the warning and certification provided for therein shall be given by the Federal Deposit Insurance Corporation.

Mr. O'CONNOR. We have the general removal clause of the Banking Act; and they felt that that was sufficient, Senator, under the general removal clause of the Banking Act of 1933 to cover this situation.

Senator BULKLEY. You really did not intend to leave out the power, but simply felt that it was provided for elsewhere?

Mr. O'CONNOR. That is correct.

Senator BULKLEY. We shall have to look into that further.

Mr. O'CONNOR. Section 323 (c) is also amended to make more flexible the Federal Reserve Board's power to classify time and savings deposits and limit the rates of interest to be paid thereon. The absolute prohibition against the payment of time deposits before maturity is relaxed to permit such payments under conditions prescribed by the Board; and deposits payable only at offices of member banks located outside the States of the United States, and the District of Columbia are exempted from all restrictions on payment before maturity and all restrictions on interest rates.

Section 323 (d) is new. It requires member banks to maintain the same reserves against the Government deposits as against other deposits.

Section 324 permits the Federal Reserve Board or the Comptroller of the Currency, as the case may be, to permit waiver of report and examination of affiliates of a bank where such report and examination is not necessary in a particular case to disclose relationship existing between the bank and the affiliate. This eliminates the burden and expense now involved in hundreds of cases where there is no beneficial object to be gained in requiring submission and publication of such report, due to the fact that the affiliate is merely a technical, accidental affiliate, having no relationships whatsoever with the bank—such, for example, as newspapers, clothing stores, lumberyards, and so forth, which become technical affiliates because of the accident that a majority of their directors happen to be directors of the bank.

We discussed that yesterday.

Senator GLASS. Oh, yes; that is a mere technical opinion, for which your office is not at all responsible. It gave people infinite, senseless trouble.

Mr. O'CONNOR. Section 325 (a) is new. It extends the present provisions of the law prohibiting loans and gratuities to examiners of member banks to include examiners of all insured banks.

Senator BULKLEY. Is that all that section 325 does?

Mr. O'CONNOR. I am coming to subsection (b) now.

Section 325 (b) is new. It extends to the Federal Deposit Insurance Corporation examiners the present prohibitions of law against the disclosure of confidential information by examiners.

And section 325 (c) is partly new. It corrects impractical features of present law relative to loans to executive officers of banks by vesting certain discretions with the Federal Reserve Board to issue regulations governing same and substituting removal from office for present criminal provisions of the law. There is also a 3-year extension of time within which present loans must be retired—such extension, however, operative only if the board of directors adopt a resolution determining that it is to the best interest of the bank to make the extension, and that the officer has made every proper effort to reduce his obligation.

We have already covered that very fully, and it is all in the record.

Section 326 is partly new. Under present law there are certain rigid requirements and limitations on loans to affiliates. Exception to these requirements is provided for where the affiliation arose out of foreclosure by the bank on collateral. It is often necessary to advance funds to an affiliate, control of which has been obtained through foreclosure in order to enable the bank to salvage the real value out of its assets and reduce the bank's loss. Under the circumstances such affiliate manifestly cannot borrow elsewhere. There is also excluded the accidental type of affiliate, control of which is obtained by the bank in a fiduciary capacity, as, for example, where the bank becomes executor and/or trustee of the deceased's estate, among the assets of which is a going business which must be operated by the bank as such trustee. There is also excluded an affiliate engaged solely in operating property acquired for bank purposes. An additional exception now recommended is to exclude from the limitations of the section loans fully secured by obligations fully guaranteed by the United States and loans to affiliates engaged solely in holding such obligations, thus extending present law in that respect as to direct obligations of the United States, to include obligations guaranteed by the United States.

I am not quite going to finish this, Senator. And since we are closing at 12 o'clock, I should like to call the attention of the committee to another suggested amendment I have to title III.

Senator BULKLEY. Why do you not go right ahead; we may sit a little after 12 o'clock.

Mr. O'CONNOR. Very well.

Section 327 is new. It exempts loans for industrial purposes made in cooperation with a Federal Reserve bank or the Reconstruction Finance Corporation from existing restrictions on real-estate loans by national banks, due to protection received by the banks from either the Federal Reserve bank or the Reconstruction Finance Corporation, where such loans are jointly made. As to such loans, there is no need for such restrictions as are desirable for a real-estate loan made by the bank in its sole capacity. Furthermore, such existing restrictions have been found to seriously interfere with the scope and object of the Industrial Loan Act as they operate to prevent two or more banks cooperating with the Federal Reserve bank or the Reconstruction Finance Corporation in making a single industrial loan, prevent such loan where a substatial part of the security is real estate located outside of the restricted area in which national banks are limited in making real-estate loans, and for other reasons.

Section 328 is new. It amends the Clayton Act to permit the Federal Reserve Board to supervise, by regulation instead of by permit, the matter of interlocking directorates which we discussed the other day.

Sections 329 and 330 bring the law governing consolidation of national banks into conformity with that governing consolidations of a State and National bank, and offer additional protection to dissenting shareholders in the matter of obtaining the appraised value of their stock. Requirement is made that notice of dissent be given by such shareholders when the vote to consolidate is had.

That was approved.

Sections 331 and 332 are new. They extend to the Federal Deposit Insurance Corporation the protection now given by law to other Federal institutions against the misleading use of their name, and extend to all insured banks the present requirements of law making robbery of member banks a Federal offense.

Section 333 amends section 5143 of the Revised Statutes——

Senator BULKLEY. You are now going beyond the bill, as introduced?

Mr. O'CONNOR. Yes; that is right.

Section 333 amends section 5143 of the Revised Statutes, so as to make it clear that, in approving reductions of capital stock by national banks, the Comptroller of the Currency, in order to conserve the assets for the protection of the banks, may specify that such banks shall not distribute a corresponding amount of their assets due their shareholders. The amendment would also trike out the words which make it necessary for capital stock reductions to be approved by the Federal Reserve Board, in addition to the Comptroller of the Currency, thus eliminating an unnecessary duplication of work.

Section 334 amends section 5139 of the Revised Statutes by adding a paragraph specifying certain information to be stated on certificates hereafter issued, representing shares of stock in national banks.

Section 335 amends the last sentence of section 301 of the Emergency Banking Act of March 9, 1933, so as to require, in connection with the issuance of preferred stock, the same kind of a certificate by the Comptroller of the Currency as to the validity of such issue, as is now required in the case of the issuance of common stock.

Section 336 would terminate——

Senator GLASS. Does that interfere with any of the operations of the R. F. C.?

Mr. O'CONNOR. No, sir. They have asked it, because it protects them as well as other holders of preferred stock.

Section 336 would terminate the liability of shareholders of banks and trust companies in the District of Columbia, as of July 1, 1937, in a manner similar to that provided elsewhere in the bill for terminating the liability of shareholders of national banks.

In other words, they are under the jurisdiction of the Comptroller, entirely; and we feel that they should be entitled to the same consideration that we extend to national banks.

I should like to call to the committee's attention an amendment which we are proposing, and which we are asking to be incorporated in the bill, which would permit the Comptroller's office to provide a fund for pensions for examiners, similar to those now provided for by the Federal Reserve examiners. There is no cost to the Government, of course; and there is only a very small charge to the banks.

And in that connection, I should like to submit for the record the technical amendment, and also a letter.

Senator GLASS. What is the existing provision of law with respect to pensions of Federal Reserve examiners?

Mr. O'CONNOR. It is not a provision of law, Senator, in the Federal Reserve, that being quite a different set-up than we have in the Comptroller's office.

Senator GLASS. The reason I am asking the question is that I know that the matter of pensions came before Congress some 8 or 10 years ago. The Federal Reserve Board made a recommendation to Congress, in respect to pensions; and it was not agreed to. And I wondered what sort of a pensions system the Federal Reserve Board is now authorized to have, without sanction of law.

Mr. O'CONNOR. Well, they do it by a joint contribution of the Federal Reserve banks—the Federal Reserve banks seemed anxious to do it—on the theory of additional compensation.

Senator GLASS. Well, I am not questioning the desirability of the matter; I am just wondering what sanction of law they have for anything of the kind.

Mr. O'CONNOR. Well, there is no direct provision of law, Senator, as I am informed.

Senator GLASS. There are so many matters that are not under lawful sanction, that I am not pressing the question.

Mr. O'CONNOR. That is why I am asking the consideration of the committee to this authority so there will not be any question of the authority.

Senator GLASS. That is right. That is the way that the branches of the Federal Government should do; they should ask authority for things they do, and not just do them.

Mr. O'CONNOR. For the record, I should like to submit the suggested amendment, and the letter which gives, a little more in detail, for the information of the committee, just how we propose to handle it.

The letter is on the letterhead of George B. Buck, consulting actuary, New York City; and it is dated April 29, 1935.

It is addressed to Mr. J. F. T. O'Connor, Comptroller of the Currency, Treasury Building, Washington, D. C.; attention, Mr. George P. Barse, counsel, and reads as follows:

DEAR SIR: On April 27 I had a conference with Messrs. George P. Barse and M. M. Washburn, of your office, at which time I was requested to send you a letter outlining certain actuarial work which I should be happy to perform for your Department.

As I understand the situation, there are approximately 700 bank examiners and associated employees, whom you desire to cover under a retirement system with benefits similar to those of the retirement system of the Federal Reserve banks, if the same is practicable. I am advised that you have complete service and salary records of all those to be covered, which you can supply to me, which records give the essential data on the basis of which, together with suitable mortality and service tables such as are used in the retirement system of the Federal Reserve banks, all needed actuarial calculations can be made.

Upon receipt of these records, we will undertake to test the practicability of the plan, which now appears entirely practical, and to make a valuation of the liabilities involved should these employees be covered by provisions the same as those of the retirement system of the Federal Reserve banks. The percentage rates of contribution required to be paid on account of such members in order to provide for the liquidation of the liability will also be determined. The results of the valuation and the rates would be submitted to you within 30 days after the date the data are received complete.

In addition to making the valuation above mentioned, I would review the deed of trust and the rules and regulations covering the operation of the system which you prepare. These documents would, I understand, follow closely those used by the Federal Reserve banks, which rules were drafted originally by this office.

With the results of the valuation, the deed of trust, and the rules and regulations, you will have all you need for the final approval and the adoption of the system. The work outlined above could be performed by my office at a fee to be determined on the basis of the time required to complete the work, but with a fixed maximum of $1,000 for all work enumerated. This fee would include the cost of two conferences. Additional conferences would be charged for at the rate of $35 per day and expenses if outside of New York. Probably not more than one conference will be needed for the work described, so that the cost of the other will be saved.

In addition to the above work there would be certain work required in connection with setting up the proper forms and records for the operation of the system after the system is authorized. Also for most of our clients we act as regular consultants, making an annual actuarial valuation of the assets and liabilities of the system, recommending the necessary adjustments in mortality tables required to offset unfavorable experience, auditing each retirement allowance granted, and certifying the reserve to be set up at retirement, and helping with miscellaneous technical questions which arise when the system is operating. I should be very happy to have this office perform similar services for your Department. The cost of this work can best be estimated when the terms of the final plan are determined upon just prior to its adoption.

With the completion of the work described above, you will have everything done that was done by the Governor's Committee of the Federal Reserve banks before the plan was finally approved by the banks and the Federal Reserve Board. The other work described has to do with the details of administration of the system after its approval in order that it may be accommodated to your existing personnel and pay-roll records with the minimum of effort and expense. If you proceed with the work, I understand that the record cards will be delivered to my office, at which time the final details as to the valuation will be arranged.

Trusting that you will find our services entirely satisfactory in every respect, I am,

Very truly yours,

GEORGE B. BUCK, *Actuary*.

The amendment is as follows:

SEC. —. The second sentence of the third proviso of section 5240 of the Revised Statutes, as amended (U. S. C., Supp. VII, title 12, sec. 481 and 482), is amended by striking out the word "is" after the words "whose compensation" and inserting in lieu thereof, a comma and the following: "including retirement annuities to be fixed by the Comptroller of the Currency, is and shall be", and said section is further amended by striking out the words, "The Federal Reserve Board, upon the recommendation of."

That concludes my remarks.

Senator BULKLEY. Those several additions, from section 333 on, are substantially what we reported to the House, are they not?

Mr. AWALT. They were reported by the House.

Senator BULKLEY. In the House report I find three additional sections.

Have you any comment to make on those?

Mr. AWALT. They were added by the House committee itself; we had nothing to do with them.

Senator BULKLEY. Do you have anything to say about them?

Mr. AWALT. No, sir.

Senator GLASS. Do you want to have anything to do with them?

Mr. AWALT. As I understand it, Judge Birdzell handled all three of those amendments.

Mr. O'CONNOR. I talked to the chairman, Mr. Crowley, this morning; and he said he was preparing a letter for the committee, that would be sent up this morning, approving the position I took yesterday with reference to the admission of banks to the fund. No doubt that letter should be here this morning.

Senator GLASS. I had word from Mr. Crowley, and he was expected to follow you this morning. He said that he would like to come up for a few minutes tomorrow morning, and very likely he will present it then.

STATEMENT OF L. E. BIRDZELL, GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, D. C.

Mr. BIRDZELL. There are three provisions here. Two of them deal with security which banks are required to give: One, for deposits of bankruptcy funds; the other, for deposits of receivership funds; and the third amendment deals with the matter of postal savings.

In the Banking Act of 1933, express provision was made for relieving the banks of the necessity of giving security for postal-savings funds, to the extent that they would be insured by the insurance of our Corporation. And following the principle of that, the

Corporation has thought that it would be well to relieve the banks of the burden of giving other security for some other types of deposits, where it is more or less of a nuisance.

In the case of bankruptcy funds, for instance, the banks, under existing law, would be required to give security, notwithstanding the fact that the deposit would be insured.

The same is true in regard to funds that may be deposited in a bank authorized to receive the deposits of receivers. Those two matters are taken care of in sections 338 and 339, in the same way that the Banking Act of 1933 took care of the deposits of postal-savings funds.

Senator GLASS. You suggested those?

Mr. BIRDZELL. We suggested those to the committee, and they incorporated them in the House bill.

The other is the Postal Savings matter, raising a question of competition between the Postal Savings Department and savings banks. With prohibitions existing against the payment of interest on demand deposits, and the limitation of the interest rate payable on savings deposits, banks are feeling, to some extent, the competition with the Postal Savings.

Under the law and the regulations of the Postal Department, prospective depositors are given the assurance that if they put their funds in the Postal Savings bank, they can withdraw them any time they want, and receive interest substantially down to the date of withdrawal.

The banks feel that this is a species of unfair competition.

The provisions of the existing law, on that subject, have been restated, here in section 340, on pages 90 and 91 of the House bill, with a view to requiring the forfeiture of interest for a definite period, in the event of the withdrawal of Postal Savings funds without giving the normal 60-day notice. The definite period provided for, in this act, is 3 months—in other words, one can withdraw his funds from the Postal Savings bank, now, without giving a 60-day notice, under the terms of this law. But he will forfeit interest on the amount withdrawn, for the period of 3 months. The reason a definite period is put in there is because there is no regular interest-crediting date in the Postal Savings. If you put in your fund today, it will begin drawing interest on the 1st of the following month; and your interest will be credited at stated intervals thereafter.

Senator GLASS. Have you discussed that with the Post Office Department?

Mr. BIRDZELL. We have from time to time discussed the general question with the Post Office Department.

As a matter of fact, under the existing law it is difficult to see how interest can be allowed on funds that are allowed to be withdrawn without giving the 60-day notice, because the existing law provides that where funds are withdrawn, without giving the 60 days' notice, no interest shall be allowed that has accrued subsequent to the passing of the Banking Act of 1933.

But somehow they think that is ambiguous, and they have been paying interest.

Senator GLASS (reading):

Any depositor may withdraw the whole or any part of the funds deposited to his or her credit, with accrued interest on them, on notice given 60 days in advance, and under such regulations as the Postmaster General may prescribe; but withdrawal of any part of such funds may be made upon demand, but no interest shall be paid on any funds so withdrawn, except interest accrued to the date of enactment of the Banking Act of 1933.

Mr. BIRDZELL. Now, that would seem to me not to be ambiguous; but under the regulations and the practice, I understand that they are paying interest where funds are withdrawn without giving 60 days' notice, and they are paying interest accruing subsequent to the passage of the banking act.

This particular provision was put in at the suggestion of the House Members. I simply acted as their agent in drafting it.

But this particular provision has not been taken up with the Postal Department, so far as I know, because it was not proposed, originally, by us.

Senator GLASS. Well, I think that perhaps it should be done by this committee.

I am told, Judge, that you are an exceptionally able lawyer; and I should like to get your judgment upon this requirement as to the payment of interest on deposits:

The Federal Reserve Board shall from time to time limit by regulation the rate of interest which may be paid by member banks on time deposits.

And now, note this, please:

And may prescribe different rates for the payment on time and savings deposits having different maturities or subject to different conditions respecting withdrawal for repayment.

And now, note this, particularly:

Or subject to different conditions by reason of different locations.

Would you, or would you not, imagine that whoever is responsible for drafting that provision of law, had in mind that that should be done? In other words, do you think that they had in mind that there should not be a uniform rate of interest on deposits, but a differentiating rate, according to circumstances?

Mr. BIRDZELL. According to the business transacted and the location of the bank and the terms under which deposits may be made?

Senator GLASS. Yes.

Mr. BIRDZELL. I would say that it clearly contemplated that a differentiation might be made, taking into consideration those different elements.

Senator GLASS. It contemplated it would be made, because we discussed it for hours and hours, in our committee.

Mr. BIRDZELL. It may be doubtful whether a uniform rate could be prescribed, unless it were found that the conditions justifying a uniform rate were likewise uniform.

Senator GLASS. Of course, it should not be—and there is no more reason why there should be a uniform rate of interest payment on deposits than that there should be a uniform rate of discount throughout the United States. A bank that is limiated by State statute to a 5-percent current rate, or a 6-percent current rate, ought not to be expected to pay the same rate on deposits as a bank that is authorized by State statute to pay 8, 10, or 12 percent, or to charge 8, 10, or 12 percent on the use of its deposits.

Does not that seem reasonable?

Mr. BIRDZELL. Yes; it does.

I do not like to edit the Senator's remarks, but that complimentary portion, in referring to me, Senator, will be just as well omitted.

Senator GLASS. No; no.

STATEMENT OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY—Resumed

Mr. O'CONNOR. Senator, I have the record, now, of work done by the Department of Justice, under the act passed by Congress and signed by the President, May 16, 1934—a Federal statute making robbery of national banks and member banks of the Federal Reserve System, a Federal offense—and a statement of the work thereunder; and I would ask permission to place in the record extracts dealing with the Department of Justice, on pages 3 to 6.

Senator GLASS. There is no issue raised about the right of the Federal Government to deal with those questions with respect to national banks and State member banks; the question is whether the Federal Government has any right to deal with them in cases of nonmember banks, unless you make it a prerequisite to the right of insurance.

Mr. O'CONNOR. I am rather inclined to agree with that, Senator.

But the object was to show the work that had been done under the laws passed by Congress. That is the reason why I wanted those statistics put in the record.

Senator GLASS. You wanted that put into the record?

Mr. O'CONNOR. Yes; if you please.

Senator GLASS. All right; put it in the record.

(The statement of activities of the Department of Justice is as follows:)

The Department of Justice, under the direction of Attorney General Homer Cummings, has initiated an intensive move against organized crime; against those crimes of violence that appear as an accompaniment of modern civilization, at least in its American manifestations. What Attorney General Cummings has had in mind, and what he now has in mind, is an unrelenting, persistent, sustained effort to deal with crimes of outlaw individuals and desperate gangs who arm themselves with lethal weapons of offense, and who avail themselves of all the resources of modern transportation and communication to commit their depredations upon the social, economic, and moral welfare of the Nation. Coupled with this well-defined group are individual or gang kidnapers and extortionists who have committed and are committing odious crimes against private citizens and their families.

During the 73rd Congress, the Attorney General advocated the passage of certain Federal criminal statutes, the object of which was to lend Federal assistance in a movement to protect our social organization against specified crimes of violence. He felt that between State and Federal jurisdiction there existed a kind of twilight zone—a gap through which criminals of the most dangerous description were escaping. The recent broadening of Federal power was designed to illuminate that twilight and fill that gap. Most of the legislation enacted extends to the Federal Government jurisdiction in crimes of an interstate character in which roving criminals are the principal offenders. The object of such legislation is to enable Federal authorities to deal with crime in its interstate aspects, to assist in the administration of justice at the point where State jurisdiction ends, or where, in the nature of an interstate crime committed under modern conditions, the existence of an interstate enforcement unit to cooperate with State and local agencies is desirable for the prompt detection and apprehension of the criminal.

Attorney General Cummings called a conference on crime last winter in Washington to consider this problem. This conference was for the purpose of appealing to the public for its thoughtful advice, for its sustained interest, and for its active help in a national movement to meet a common peril. In attendance there were the representatives of Federal, State, Territorial, and local Governments, as well as representatives of more than 75 private and quasi-public agencies the interests and activities of which were pertinent to this problem. In all there were about 600 delegates present from all parts of the United States, who heard from the lips of practical experts a discussion of crime in its principal aspects.

The short time which has elapsed since the passage of the series of crime bills sponsored by the Attorney General does not permit a comprehensive analysis of the assistance which the Federal Government can render to State and local agencies in dealing with interstate crimes or the effect which the enlarged jurisdiction of the Federal Government will have in decreasing such crimes. However, experience has shown certain facts that may be of interest.

The Lindbergh kidnaping case occurred on March 1, 1932. The commission of this crime resulted in the passage and approval of the Federal kidnaping statute on June 22, 1932, which gave the Federal Government jurisdiction in cases involving kidnapings wherein interstate features were present. Since the passage of this statute the Federal Bureau of Investigation of the United States Department of Justice has participated in the investigation of 35 cases involving actual kidnaping and plots to kidnap. In all of these cases the identities of the kidnapers are known. In the cases handled 81 persons have been convicted and 41 persons are now in custody awaiting trial. Sentences totaling 1,231 years 11 months and 2 days, suspended sentences totaling 32 years and probationary sentences totaling 22 years have been imposed, in addition to 16 life sentences and 4 death sentences. In addition 2 kidnapers were lynched, 3 committed suicide, 3 were murdered, and 4 were killed by officers.

The Federal bank robbery statute, making robberies of national banks and member banks of the Federal Reserve System a Federal offense, was approved by the President on May 16, 1934. Since that date there have been 116 robberies of national banks and member banks of the Federal Reserve System, with losses totaling $509,000, which have been reported to the Federal Bureau of Investigation.

As the result of investigations conducted there are at the present time 72 individuals in custody awaiting further prosecutive action in connection with these robberies and 47 individuals have been convicted in Federal court in connection with these robberies. Two received life sentences and others have received sentences totaling 1,095 years, suspended sentences totaling 120 years, probationary sentences totaling 38 years, and $33,206 in fines. One person has been acquitted. In addition trials in State courts have resulted in 22 convictions, with 2 life sentences, 13 indeterminate sentences, and other sentences totaling 136 years. During this period 6 bank robbers have been killed by State officers and 1 adjudged insane.

Mr. O'Connor. And there is one other matter which I shall ask Mr. Awalt to present.

STATEMENT OF F. G. AWALT, DEPUTY COMPTROLLER OF THE CURRENCY, WASHINGTON, D. C.

Mr. Awalt. Senator, you remember that under 11 (k) of the Federal Reserve Act, national banks that exercised fiduciary powers are required to keep a separate set of books and records showing, in detail, all transactions engaged in.

Then the law provides:

Such books and records shall be open to inspection by the State authorities, to the same extent as the books and records of corporations organized under State law which exercise fiduciary powers; but nothing in this act shall be construed as authorizing the State authorities to examine the books, records, and assets of the national bank which are not held in trust under the authority of this subsection.

Now, under that a great many of the States have for a long time accepted the examinations made of the national banks by us.

Recently some of them have started to examine—which means a duplication of examination. We examine, and they examine.

And it has been suggested for consideration—and we should like to suggest this for the consideration of the committee—that the committee amend that particular provision by providing that the State banking authorities may have access to the reports of examinations made by the Comptroller of the Currency, insofar as such reports relate to the trust department of such banks, instead of having a duplicate examination.

(The above-mentioned proposed amendment relative to examination of trust departments of national banks is as follows:)

SEC. —. The last sentence of the third paragraph of subsection (k) of section 11 of the Federal Reserve Act, as amended (U. S. C., title 12, sec. 248 (k)), is amended to read as follows: "The State banking authorities may have access to reports of examination made by the Comptroller of the Currency insofar as such reports relate to the trust department of such bank, but nothing in this Act shall be construed as authorizing the State banking authorities to examine the books, records, and assets of such bank."

Senator GLASS. That is all for this morning, gentlemen. We shall adjourn until tomorrow morning at 10:30.

(Thereupon, at 12:30 p. m., an adjournment was taken until tomorrow, Thursday, May 2, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

THURSDAY, MAY 2, 1935

United States Senate,
Subcommittee of the Committee on
Banking and Currency,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in room 301, Senate Office Building, Senator Robert J. Bulkley presiding.

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

Also present: Senators Barbour and Moore.

Senator Bulkley. Senator Glass says he will be here in a few minutes; and in the meantime Mr. Crowley wants to supplement his testimony.

STATEMENT OF LEO T. CROWLEY, CHAIRMAN FEDERAL DEPOSIT INSURANCE CORPORATION—Resumed

Mr. Crowley. Senator Bulkley, there are three particular problems of the Federal Deposit Insurance Corporation which I should like to have included in the record in my remarks. One of those is the question of admission of banks to the fund.

The House, in its bill, has taken out that part of subsection 7; and I should particularly like to call your committee's attention to that section which gives us the right to investigate 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 purpose of this section.

Senator Bulkley. From what were you reading?

Mr. Crowley. This is the wording of the subsection that the House took out.

Senator Bulkley. That was the subsection that was in the draft of the bill as originally introduced, and the House committee struck it out?

Mr. Crowley. That is correct, Senator.

Senator Bulkley. And you want it in again?

Mr. Crowley. It is in your bill now; and we want to keep it in if we possibly can.

Senator Bulkley. And you want now to have printed in the record a memorandum in support of that addition?

Mr. CROWLEY. That is correct.

Senator BULKLEY. Very well; it will go in.

(The memorandum is as follows:)

MEMORANDUM CONCERNING TITLE I, BANKING ACT OF 1935, AS INTRODUCED IN THE HOUSE (H. R. 7617)

As originally introduced, the section on admissions read as follows (that portion which is italicized has been deleted in the House bill):

"SUBSECTION 7. (g) The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors under subsection (f) shall be the following: 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 purpose of this section.*"

The Federal Deposit Insurance Corporation believes that the clauses in this section which were deleted in the House bill are of vital importance and should be retained. The Corporation was obliged under the original Deposit Insurance Act to take in a considerable number of banks which were certified by State commissioners to be solvent but which had very slight prospects of making sufficient earnings to maintain their solvency. Some of these banks had virtually no net sound capital; that is, the assets exceeded only slightly, if at all, the deposit liability. The Federal Deposit Insurance Corporation and the Reconstruction Finance Corporation assisted these banks to build up their capital structure. It is highly important that these banks be protected against the adverse effects that would result from the organization and insurance of new banks in the same communities. In many of these communities a new bank would be certain to take away business from existing insured banks which are already not very strong and thus weaken both the insured banks and the insurance fund.

There are 10 States in which the minimum capital requirement for a new bank is as low as $15,000 and in some of the States there is already an obvious tendency to permit banks to be organized which have no prospects of permanent success. Unless the Corporation is enabled to take future earning prospects into consideration it may be required to insure a constant succession of banks which operate for a short time and close with substantial losses to the Corporation.

It is also highly desirable that the Corporation have power to take into consideration the convenience and needs of the community to be served by the bank. Changing conditions, such as improvements in transportation, shifting of industries and business concerns from one locality to another, and changes in the population and in the income of communities, may make the organization of new banks superfluous. Yet the constant attempt of individuals to enter the banking business is likely to result in the granting of corporate charters in such communities, particularly those in which a part or all of the banks in existence a few years ago have disappeared. To give the Corporation power to consider the convenience and needs of the communities will be of material aid in preventing a return to the overbanked condition of the 1920's.

The purpose of the last clause in the section on admissions, as originally introduced, is to enable the Corporation to refuse membership to institutions which are not in reality banks of deposit but which are primarily engaged in other types of business enterprise and receive deposits in connection with those enterprises.

Mr. CROWLEY. I should like also to include in the record a statement regarding examinations and liquidations. It is my judgment that if the Corporation is to be successful, then, where they have 70 percent of the deposited liability in the 13,300 banks out of 14,200, it is utterly useless for our Corporation to go into a bank after it has once been involved; that we should have the right to be called in, and to keep the banks sound, and not merely be called in to pay the losses.

Also, on the matter of liquidations of the banks that have closed today, we are the largest creditor, to the extent of 85 percent of the banks closed up to this time.

Senator BULKLEY. Do I understand that you want to have the power to take over a bank, without closing it?

Mr. CROWLEY. We want the power of buying assets in an open bank, and we want also to have the power—which is given to us in the temporary act, and also in the present, permanent act—to liquidate assets of the closed banks that we pay off, in order that we may control the assets of the closed banks.

Senator BULKLEY. That was in the draft of the bill?

Mr. CROWLEY. That is correct; and I simply just wish to add my testimony as to why that should be left as it is.

Senator BULKLEY. That was not stricken out in the House bill?

Mr. CROWLEY. No, sir.

Senator TOWNSEND. The Comptroller rather favored that in his testimony. And I think that if these men are to pay the bills, there is a strong argument in favor of their controlling the assets.

Senator BULKLEY. The question, then, is whether you should control it, or whether the Comptroller's office should control it?

Mr. CROWLEY. Under the temporary act and under the bill which is before you, the Comptroller, in the case of a closed national bank, must appoint the Federal Deposit Insurance Corporation as receiver.

Senator BULKLEY. I see.

Mr. CROWLEY. Also, we have requested the various State legislatures to pass legislation providing that their State banking departments may appoint us receivers; and I believe that in some 30 States, we have had favorable response.

Our argument is that we have the liability, and consequently those assets should be handled by us because we are the ones who must get the recovery from them; and in practically every instance, we are liable for at least 70 percent of the deposits of these banks.

I should like to include that statement in the record, if there is no objection.

Senator BULKLEY. All right; that may go in the record.

Mr. CROWLEY. That is all I have, Senator Bulkley; and I appreciate your courtesy.

Senator BULKLEY. Very well; thank you, Mr. Crowley.

(The above-mentioned statement is as follows:)

There are three powers which we consider to be indispensible to the ultimate success of deposit insurance: The first is the power to refuse to admit banks into the insurance fund which are fundamentally unsound and, therefore, certain to develop into losses; the second is the power to examine insured banks; and the third is the power to liquidate insured banks which become insolvent.

During the period of 18 months ending December 31, 1934, over 2,200 banks were licensed to do business. About 1,500 of these banks had less than $500,000 in deposits and about 400 had less than $100,000 in deposits. The country as a whole would have been much better off had many of these banks not been licensed. It indicates a tendency to return to the overbanked condition of former years. Of the banks licensed in 1934, well over a hundred were primary organizations having no previous existence as distinguished from institutions which took over the business of other banks.

The indiscriminate rechartering of banks which have no economic justification will again return the country to the overbanked condition which existed in 1920. Unless checked, the security of the insurance fund as well as the banking system at large will be seriously jeopardized. The board of directors of the Insurance Corporation should be given the power to refuse the benefits of insurance to banks which are not now in the fund where the applying bank cannot ever develop a volume of deposits sufficient to permit earnings which will cover expenses and current losses.

We recommend that before a bank is admitted to the insurance fund thorough consideration be given to the history, future prospects, and management of the bank and the economic needs of the community where it proposes to engage in business. We believe these to be the determining factors in the ultimate success of a bank as an economically sound institution. In the interest of protecting the funds of the Corporation, these important factors should be given consideration and the board should be permitted to accept or reject an application for insurance depending upon the result of its analysis of the facts in this respect.

The next power which we consider to be necessary to safeguard the solvency of the Corporation is the power to examine insured banks.

Seventy percent or more of the total deposit liabilities in over 13,300 of the 14,200 insured banks are now protected by insurance. In other words, in over 94 percent of all insured banks the Corporation's risk is at least equal to 70 percent of the total deposit liabilities of these banks and in a large majority the Corporation's liability as compared to the total deposit liability of the banks is even greater.

Included in these banks, each of which is 70 percent or more insured, are 92 percent of all national banks, 81 percent of all State member banks and 98 percent of all State nonmember banks. The liability of the Corporation in all insured banks is estimated to be well in excess of $17,000,000,000. The direct liability of the Corporation to the depositors in these banks is more tangible than any responsibility which has heretofore existed in any Federal or State supervisory authority. Bank supervisory officials are charged with the duty of enforcing compliance by banks with the statutory requirements imposed by the laws. It is the duty of these officials to require banks to correct impairments of capital, to place in liquidation insolvent institutions, and, in many instances, to supervise liquidation in the interest of depositors. With the performance of these functions their responsibility ceases. No supervisory official is required to make good dollar losess.

The Federal Deposit Insurance Corporation, on the other hand, is in the position of a guarantor for every insured bank. Since the Corporation must supply to every depositor in a closed insured bank the amount of his insured deposit, it must be concerned (in the interest of conserving its funds) with protecting itself against bank failures. The most important instrument available for effectuating this protection is the right of examining insured banks. Only by giving the Corporation the free exercise of the right to examine banks can the directors of the Corporation hope adequately to discharge their responsibilities.

We have recently concluded a period of unprecedented bank failures. It is of singular importance that of the 13,500 banks which failed during the 14-year period ending December 31, 1934, over 11,000 were State banks. There are many reasons inherent in the system which operate toward the lowering of standards of the bank supervision which State supervisors exercise. We are not concerned with this aspect of the problem. However, we believe it would be a serious mistake to jeopardize the solvency of the Insurance Corporation by obliging it to accept the examinations made by State agencies, many of the interests of which are at times inconsistent with those of the Insurance Corporation. It is the Corporation which ultimately bears the losses which may often be the consequence of inadequate examinations. It would seem administratively unsound, therefore, to separate from the Corporation the right of examination. To oblige the Corporation to depend upon examinations performed by State supervisory authorities will not be in the interest of preserving the solvency of the fund.

Included by law as insured banks are all national banks and all State banks which are members of the Federal Reserve System. National banks are examined by the Comptroller of the Currency, while State member banks are examined by the Federal Reserve Board. However, as to insured State banks which are not members of the Federal Reserve System, Congress provided that the Corporation should have the right of examination. As a consequence of these provisions the Corporation has been engaged during the past 18 months in examining State nonmember banks in every State in the Union. On December 31, 1934, there were 5,462 national banks, 980 State banks members of the

Federal Reserve System, and 7,699 State banks not members of the Federal Reserve System. The Corporation now examines more banks, therefore, than does either the Federal Reserve Board or the Comptroller of the Currency, or both together.

The Corporation has now formulated a working program for the conduct of its examinations in cooperation with State supervising authorities. It is an established practice for the examinations of the Corporation to be conducted jointly with examinations by the State officials. In some States State officials accept these examinations of the Corporation in lieu of their own examinations. Copies of examination reports made by the Corporation are furnished to the bank and the State supervising authority, and to the Reconstruction Finance Corporation where the latter corporation has a capital investment. Constant contacts have been maintained with State authorities and the insured banks, with the result that a vast amount of constructive work in improving the condition of these banks has been achieved. In some instances examiners are detailed to confer with the officers of the bank in a friendly capacity for the purpose of offering constructive and intelligent assistance to the bank in disposing of any problems which may exist. This has enabled the Corporation greatly to strengthen the position of many banks. The figures evidencing the vast amount of progress which has been made as a result of the examinations of the Corporation are given elsewhere in the testimony. They give striking evidence of the constructive potentialities of examinations and of the importance of this activity to the Corporation.

Constructive results which may follow from a thorough and competent examination constitute the most potent single instrument which might be given the Corporation to reduce loss through bank failures. Examinations of sound and well-managed banks accomplish much toward the continuance of these banks in good condition. The examination of banks which are on the border line of bad management or insolvency is essential in order that weaknesses may be pointed out to the officers and in order that their attention may be directed to approaching trouble. Examination of banks which have already become insolvent is essential in order that supervising authorities may be advised and in order that they may be persuaded to close such institutions before the assets are depleted, and, consequently, before the losses which the Corporation will be obliged to assume are magnified. The practical supervisory powers which are implied in and which follow from examinations are essential to the continued success of the Federal Deposit Insurance Corporation.

In addition, it should be pointed out that through deposit insurance over 90 percent of all commercial banks are now embraced in one Nation-wide system. The insurance fund is in many ways a mutual undertaking. All insured banks contribute assessments in proportion to their deposit obligations, and to this extent all insured banks are concerned with the losses which the Corporation will be obliged to assume. It is only fitting, therefore, that all insured banks should be subjected to the same standards of examination. Examinations conducted by 50 different examining authorities preclude the possibility of uniform standards.

Since it is not practicable to assess banks at varying rates for the benefits of insurance, which rates presumably bear some relation to the degree of risk involved, it is important that all banks be subjected to uniform standards of examination, in order that an effort may be made to keep all banks on a uniformly sound basis. This is the only way in which the Insurance Corporation may undertake to prevent what may otherwise be discrimination against those banks which operate most soundly. In order to minimize discrimination against the better-managed banks (those in which the Corporation's ultimate risk factor is at a minimum), the Corporation should do everything within its power to improve the condition of those banks which are badly managed (or in which the Corporation has a high degree of risk). The Corporation can only undertake to improve the standards of management of the weaker institutions, if it is given the right of examination.

Federal deposit insurance is a new development. It is still in an experimental stage. We have had a mere 18 months of experience. That experience has shown us that the right of examination is the most useful and most constructive activity upon which the Corporation has engaged in order that it might preserve its funds and keep losses through bank failures at a minimum. Much remains to be done toward the improvement of the banking situation. It is singularly true that progress has been made. We will continue to make progress, if the right of examination is left with the Corporation.

The right of the Federal Deposit Insurance Corporation to act as receiver of insured banks where it is compelled to pay off the depositors is a right of major importance. Congress recognized this in the original law by requiring the Comptroller of the Currency to appoint the Corporation receiver of every insured national bank which closed.

It also authorized the Corporation to act as receiver or liquidating agent of any insured State bank which closed, if the appointment is tendered by the State authority having charge of the liquidation.

It is now possible for the Corporation to act as receiver or liquidating agent of closed insured State banks in 30 States. In 13 of these States the right is accorded by express provisions of a legislative act, and in the remaining 17 the existing law was interpreted as permitting the appointment.

The Corporation has submitted to the responsible authorities of every State a bill to permit it to act as receiver or liquidating agent for consideration of its legislature and has urged the passage thereof by the State legislatures.

The right of the Corporation to act as receiver of national banks should not be changed back to the old system of allowing the Comptroller of the Currency to appoint individual receivers who are to be responsible only to him. If this is done, it will cause the States to go back to the old system also. The States cannot consistently be asked to appoint the Corporation receiver where this right is taken away in respect to national banks.

On December 31 insured national banks had total deposits of $21,600,000,000. Insured State banks (Federal Reserve member and nonmember banks) had total deposits of $17,400,000,000. Or, in other words, all State banks had approximately 45 percent of the total deposits in all commercial banks. As has already been shown, the present maximum limit of insurance fully covers 70 percent or more of the deposits in 94 percent of all insured banks. More than 43 percent of the deposits of all insured banks are protected. Thus when the Corporation pays out the insured deposits of these banks, it will become the largest creditor by an overwhelming margin in approximately 9 cases out of 10, and in the remaining 1 case out of the 10 will be the largest single creditor, with from 30 percent to 40 percent of the bank's liabilities owing to it.

In view of its tremendous investment in these closed insured banks, the Corporation must have the right to supervise the liquidation of their assets.

In the preinsurance era the interest of local people who had their deposits tied up in these assets supplied the necessary check on the receivers in charge of the liquidations and the debtors who owed the trust money. Now, that is changed, and unless the Corporation is given charge of the liquidations it will be compelled to stand by while receivers do the job to suit themselves. Protracted receiverships will result because the receivers will not have any incentive to work themselves out of jobs. Unnecessary delay not only increases the expense of liquidation but cuts down the returns because of the well-known fact that the older a claim becomes the more difficult it is to collect.

That the creditors primarily interested in the outcome of a liquidation should have the first voice in conducting it is a well-established principle of law. The bankruptcy law provides for the election of a trustee to liquidate the assets of bankrupt estates by a majority in number and amount of the bankrupt's creditors.

Furthermore, the courts, in appointing receivers, frequently appoint the nominee of the principal creditors or set a time for hearing at which creditors may present their recommendations.

As already stated, the laws of 13 States expressly authorize the appointment of the Corporation as receiver of insured State banks. These States recognize this principle.

The selection of the Corporation as receiver will tend to reduce the expense of liquidation. The Corporation will be primarily interested in an economical liquidation because its average interest out of every dollar collected in the majority of cases will be 70 cents, which it will receive by way of dividends on the claims of depositors paid by it. Protracted receiverships will be avoided because of the expense involved. On the other hand, owing to the wide-spread interest of the Corporation as insurer of banks in every community in the country, the Corporation will liquidate in such manner as not to damage the credit structure of the community. The Corporation is gradually building its liquidating staff by training its own liquidators and will gradually absorb available men of experience and ability now engaged in liquidation work with National or State banking departments.

A large portion of the work preliminary to actual liquidation must be done by the Corporation, whether it acts as receiver or not. This work is done in preparing for paying off the insured depositors. The Corporation prepares a complete record of all of the deposit liabilities of the bank and secures claims from the depositors covering the amounts of their respective balances. In several cases where this Corporation has paid the insured deposits of closed State banks the State law did not permit the Corporation to act as receiver or liquidating agent. The result was that all work of the foregoing character was duplicated by State officials, and the depositors were compelled to prove their claims, not only with the Corporation but with the State officials also.

In addition, in order that it may be properly informed as to the progress of the liquidation under the supervision of the State receiver, the Corporation makes an inventory of all of the bank's assets, determines the valuation thereof, and estimates its loss, in accordance with the requirements of the Banking Act of 1933. In national banks, the Corporation now acts as receiver and in such cases all of the foregoing records are available for use of its liquidating agents, thereby eliminating a vast amount of preliminary work and expense.

Senator BULKLEY. Senator Barbour and Senator Moore are here, with some gentlemen from New Jersey.

Senator BARBOUR. Mr. Chairman and members of the committee, in conjunction with my colleague Senator Moore and the New Jersey delegation in the House, we have had a number of conferences with bankers from the State of New Jersey; and the banking fraternity of our State has designated the following committee to come before you gentlemen and to discuss our ideas with respect to the pending bill.

The committee consists of the following gentlemen: Mr. William J. Field, Commercial Trust Co. of New Jersey, of Jersey City; Mr. F. C. Ferguson, Hudson County National Bank, of Jersey City; Hon. Edward C. Stokes, of Trenton, former Governor of the State; Mr. Harry H. Pond, of Plainfield; Mr. F. Morse Archer, of Camden; and Mr. Spencer S. Marsh, of Newark.

Mr. Field would like to testify on titles I and III, and Mr. Ferguson would like to testify regarding title II. So we should be pleased if the chairman would call either one of these two gentlemen.

Senator BULKLEY. Do they represent the State Bankers' Association?

Senator BARBOUR. Yes; they do.

Senator BULKLEY. Very well. It does not matter who speaks first; we shall leave that to their preference.

Senator BARBOUR. I would suggest, then, Mr. Chairman, that Mr. Fields speak first, and then have Mr. Ferguson follow, if that is agreeable to you.

STATEMENT OF WILLIAM J. FIELD, PRESIDENT OF THE COMMERCIAL TRUST CO. OF NEW JERSEY, JERSEY CITY, N. J.

Mr. FIELD. Mr. Chairman and gentlemen, I represent the New Jersey Bankers' Association, and my job is to ask you to reconsider some of the suggestions in title I and III of the bill.

Senator TOWNSEND. As written in the Senate or the House bill as passed?

Mr. FIELD. The original bill and some of the proposed amendments of the House.

Senator BANKHEAD. With what bank are you connected?

Mr. FIELD. The Commercial Trust Co., of Jersey City.

Senator BANKHEAD. You are the president of that bank?

Mr. FIELD. Yes; the president of it.

Presuming the probability of titles I and III of the Banking Act of 1935 being enacted at the present session, and also the possibility of the Congress enacting title II, we wish to take this opportunity of bringing to your attention several sections of the bill which we believe should either be modified or clarified.

The following suggestions apply to title I of the proposed law.

Section 12B of the Federal Reserve Act is further amended, paragraph 23Y, to provide that all State nonmember banks must become members of the Federal Reserve System by July 1, 1937, or discontinue membership in the Federal Deposit Insurance Corporation.

One of the requirements at such time is assets, in excess of capital requirements, adequate to meet liabilities to depositors and other creditors.

The rule adopted by Government financial authorities—Federal Reserve bank, Federal Deposit Insurance Corporation, and Reconstruction Finance Corporation—for adequate capital is the 10-to-1 rule; that for every $10 of deposits there must be $1 of capital assets.

Section 308 is amended to require banks to have a surplus of 20 percent before opening for business.

These sections may mean rulings to the effect that nonmember State institutions, when joining the Federal Reserve System, in order to qualify for insurance with the Federal Deposit Insurance Corporation, must have good capital assets of at least 10 percent of deposits, of which the surplus fund shall be at least 20 percent of the capital.

Our fear under this situation is that when we consider the unreasonable value of assets by some of our banking supervisors, many of the present nonmember State institutions will be unable to meet these requirements.

To refuse them membership in the Federal Reserve System, and thus place them in a position where they would be obliged to advise their depositors they were no longer an insured bank, would, under existing conditions, result in many such banks closing their doors. Again, to start closing banks would undoubtedly cause serious trouble in the general banking situation.

We believe this situation has been considered by the House, and the bill amended to eliminate compulsory membership in the Federal Reserve System, leaving qualifications for membership in the Federal Deposit Insurance Corporation to the discretion of the Federal Deposit Insurance Corporation. While membership in the Federal Reserve System may eventually be highly desirable for all insured banks, it is our opinion that for the next few years many State banking institutions will be unable to make the grade for such membership.

Under this same section, 12-B, in paragraph 8-H 1 and 2, it is provided "that each insured bank shall be assessed at not to exceed one-twelfth of 1 percent—since increased to one-eighth of 1 percent—of its total deposits based on the average, determined from such total as of the close of business on the last day of June and the last day of December of each year."

Further on in this section, it is provided that 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 amount of its liability for deposits as of the close of business on the 30th day of June last preceding, and shall pay to the Corporation the portion of the annual assessment equal to one-half of the annual rate. This same wording applies to the assessment for the last half of each year.

Our presumption is that the intent of this wording is to assess banks on their average deposits for each 6 months, according to statements prepared of such average as of June 30 and December 31 of each year, and we ask that this part of the bill be clarified so there will be no question that the assessment will be made against such average deposits.

It would not be fair or reasonable to the banks to assess them on total deposits as shown on these particular days, and disregard average deposits, for the reason that many banks pay dividends and interest for depositors on July 1 and January 1 from deposits made a few days prior to such dates by corporations, counties, cities, and so forth, and really have no investment use of such funds. The cost of premiums for insurance of such deposits would be prohibitive. It would be necessary for banks to refuse such deposits, and such refusal would case much disturbance in the orderly distribution of income.

The House amendment has endeavored to clarify this section by showing it is clearly the intent to make premium assessments on average deposits. However, the method of determining such average, as suggested by the House amendment, is neither fair nor equitable. They suggest the amount to be assessed for each 6 months, be determined by selecting three arbitrary dates during such period, and averaging the deposits of such dates. How the dates are to be selected is not determined and they may well be selected from a hat. Should January 1, March 30, and June 30 be selected, the banks would show deposits much in excess of their true average.

A simple and true method of determining average deposits would be to average the daily deposits for 6 months' periods ending June 30 and December 31. This method would give the average of actual deposits; and as each bank has records so prepared, this would simplify the work for the banks.

When figuring these deposits, to arrive at the basis of assessment, it would appear fair and reasonable to permit a deduction of all deposits that are otherwise insured or secured: Bankruptcy funds, deposits by a trust department of the depository bank, postal savings funds, Federal Reserve moneys, and other Government moneys. These moneys are all secured by insurance or by the bank's securities, and the Federal Deposit Insurance Corporation would not have to be considered for payment. If you will consider, for instance, the deposits of postal savings: Banks now have to secure such moneys with a deposit of securities and at the same time pay a prohibitive rate of interest on them. If such deposits had to be included in the average the Government would soon be without a depository bank.

It is further provided in this section that a separate rate of assessment may be fixed for mutual-savings banks.

We ask your consideration of this situation, as we believe that if any different rate of assessment is made on deposits of savings banks, such rate should apply to time or savings deposits in National and State bank and trust companies. Deposits should be classified as to insurance rates rather than the kind of banks having such deposits. Savings banks are all State institutions, and each State has different laws governing savings.

All of the several kinds of banking institutions are in competition for savings deposits, but many savings banks are not insured by the Federal Deposit Insurance Corporation; and as time elapses comparatively few savings banks will be insured. In New Jersey we have a savings institution with capital stock. This institution is organized under a special charter and is partly mutual. It would be difficult to classify such a bank under the proposed law.

The assessment of the Federal Deposit Insurance Corporation at the maximum rate permitted is a very serious charge on the earnings of a bank, especially in these times of exceptionally low interest returns from proper investments. And if this rate should be assessed on savings or time deposits of all commercial banks, the result would be a higher cost for such money and a consequent lessening of the safety of investments in order to obtain additional income or a reduction of interest rates on such deposits.

Senator GLASS. Do you think that all mutual-savings banks go into the insurance-deposit fund?

Mr. FIELD. Not if they are well located. If they are located near banks that are on the verge of being upset it might be reasonable for them to go in.

Senator GLASS. As a matter of fact, have they not, almost en bloc, determined not to go in?

Mr. FIELD. Yes; many of them have. And I think that as time goes on many of them will get out.

Senator TOWNSEND. Are you speaking of the insurance or of the Federal Reserve?

Mr. FIELD. Insurance.

Senator GLASS. Yes; insurance.

I say that the mutual-savings banks, almost en bloc, have declined to go into the insurance fund. And they ought to have declined, and they ought to stay out.

Mr. FIELD. If the deposits of a savings bank are not insured, or, if insured, are assessed at a lower rate than similar deposits in commercial banks, such savings bank can naturally pay more interest than commercial banks, and thus enter into unfair and unwise competition.

The House has endeavored to make a distinction between "savings banks" and "mutual-savings banks." In some States, there may possibly be a slight distinction, but there is very little difference. And when you consider the savings departments of national and State banks and trust companies, the very little difference still applies. This endeavor to make these fine distinctions, will only lead to confusion and unfairness.

We ask that all such deposits, regardless of the kind of depository, be assessed at the same rate.

Now in regard to an assessment of the limit permitted; that is, one-twelfth of 1 percent per annum, and now increased to one-eighth of 1 percent, it will undoubtedly be found that this rate is excessive insofar as the general funds of the Federal Deposit Insurance Corporation are concerned, and will be prohibitive insofar as many banking institutions are concerned. For instance, as to the funds of the Federal Deposit Insurance Corporation, there should be practically no loss or depletion of the amounts contributed, and consequently there should be a limit to the proposed accumulation of surplus.

When an insured bank fails and the Federal Deposit Insurance Corporation is called upon to pay insured deposits, the Federal Deposit Insurance Corporation takes over all assets of such closed bank and is reimbursed from the liquidation of such assets.

It would be difficult to find many banks whose total deposit liability would be insured, because of all its deposits being for $5,000 or less. Consequently, the margin of assets covering deposits over $5,000 per depositor, plus capital and surplus liabilities, or what is left of them, should always insure the Federal Deposit Insurance Corporation against ultimate loss.

The House suggests that depositors having on deposit, in a closed, insured bank, an amount in excess of $5,000, should share pro rata in recovery from the assets of the closed bank. This, of course, will somewhat reduce the margin of safety of the Federal Deposit Insurance Corporation, but is certainly an equitable arrangement.

An investigation of assessments already made on insured banks will disclose that most good banks paid such assessment from reserves and did not accrue the amount as a charge against current income. Many other banks—and there are many—are carrying the amount as an asset, which, of course, is a doubtful and unsafe procedure. Subsequent assessments should naturally be paid from earnings; and earnings will show, in many cases, an inability to meet the assessments.

The Government, through the R. F. C., has endeavored to safeguard many banks by increasing their capital with preferred stock. Many find it difficult to service such preferred stock with present earnings. Where such banks will obtain money to meet Federal Deposit Insurance Corporation assessments is a very serious question and one to which you gentlemen should give your earnest consideration.

The House has changed this rate of assessment from one-twelfth of 1 percent to one-eighth of 1 percent, or from $833.33 per $1,000,000 of deposits to $1,250 per $1,000,000, and has eliminated the provision that assessments shall not be less than such rate. It would seem reasonable to give the Federal Deposit Insurance Corporation power to assess at a smaller rate, if, in their judgment, the circumstances warrant such action.

In this same section of the bill, paragraph 22–6, there is provided that the Federal Deposit Insurance Corporation, after the examination of a member bank, may make certain recommendations to such member; and failure to comply with such recommendations gives the Corporation power to publish any part of the report of such examination of any bank other than a national bank.

We cannot see why all banks should not be considered on a like basis in this contingency, and why there should be an exception in the case of a national bank. But we further believe that even if there were no exceptions, the publication provided for might work material harm, and should be eliminated. A proper system of fines might be much wiser in such cases, and would avoid publicity.

A situation to be considered under title I is the question of insuring deposits of beneficiaries of trust estates. Under the present law banks are required to report all insured deposits; and each beneficiary is safeguarded to the insured limit.

Under the proposed law a trust estate, as such, is insured to $5,000, regardless of the number of beneficiaries, although banks are required to pay an assessment on total deposits.

It is impractical for executors and trustees to break up an estate so as to deposit separate amounts according to the number of beneficiaries interested. It is our suggestion that this situation be modified so that each beneficiary will be protected up to the insured limit.

We are firmly of the opinion that insurance should be based on the amount insured, and that each bank should pay for the insurance benefits which it receives; in other words, we believe that the larger and better banks should not be asked to pay for insurance on deposits in smaller institutions. This result is not accomplished when total deposits are assessed instead of actual insured deposits. This charge is a socialistic principle with which we are not in accord and against which we enter our sincere protest.

Title II of the act provides mostly for a clarification of many moot questions, and insofar as we have been able to study it we believe it should be favorably considered.

There is one paragraph which should be further considered from the standpoint of the time limit imposed. We refer to the matter of loans made prior to June 16, 1933, to executive officers. The act permits the extension of such loans to 5 years from June 16, 1933.

This situation would be better safeguarded if such loans might be extended for 5 years beyond the date of enactment of the proposed law. Many of these loans to executives are secured by bank stock and mortgages which in all probability will take at least 5 years to show any substantial recovery. Such loans cannot be removed to other banks, and the time allotted is too short to permit orderly liquidation without damage to the borrower and the lending bank. As new loans of this kind are prohibited, it is only reasonable to grant ample time to clean up the present situation.

Gentlemen, we hope that you will give heed to the request of the New Jersey bankers. We think that we are practical people. We want to help this new legislation, and we should like very much to see titles I and III passed—of course, with the modifications we have suggested.

We think it is very important to the country that title I, especially—the Federal Deposit Insurance Corporation—should be set up properly, and the amounts limited so that they are within reason, and are within reach of the banks.

Under the R. F. C. the banks have been taking much preferred stock. I am a member of the New York advisory committee of the R. F. C., and I have seen many cases where they cannot service the preferred stock. This large assessment—and the assessment coming regularly every year—will put many of those banks out of business. They cannot stand the pressure. It must be either a lenient assessment, or they will be put out of business.

Senator BANKEAD. I notice that you are especially interested in titles I and III.

In the event that title II is not retained in the bill, do you advocate defeating the bill?

Mr. FIELD. No.

Senator BANKHEAD. Then, if title II is put in, you oppose the whole bill?

Mr. FIELD. I think that title II should be eliminated. If title II is retained, we oppose the whole bill. Title II is so radically out of order that we do not stand for it for a minute.

STATEMENT OF FRANK C. FERGUSON, PRESIDENT HUDSON COUNTY NATIONAL BANK, JERSEY CITY, N. J.

Mr. FERGUSON. My name is Frank C. Ferguson. I am president of the Hudson County National Bank, Jersey City, N. J., and chairman of the committee on Federal legislation of the New Jersey Bankers' Association, in which capacity I appear before this committee to speak on title II of the proposed act.

Senator GLASS. On title II?

Mr. FERGUSON. On title II.

I approach this subject with a considerable amount of trepidation, because I want to say at the outset that I do not pose as an expert on money or credit currency. The views that I am going to express in this memorandum, which has also been submitted to the executive committee of the New Jersey Bankers' Association, are based on the theories which I learned in school 25 years ago, and which 25 years of active commercial banking experience have not caused me to change.

I might also add, before I start on the memorandum, that the views which I am going to express in this memorandum are much better expressed in the writings and teachings of such men as Dr. Kemmerer. of Princeton; H. Parker Willis, of Columbia; Walter E Spahr, of New York University; and Dr. Sprague, of Harvard.

With your permission, I shall proceed with my memorandum.

Title II of the proposed banking bill of 1935 contemplates fundamental changes in our money and banking systems and is the most important division of the bill.

There are, unquestionably, serious weaknesses in our money and banking structures, as our experiences during the past years have shown us. Legislative steps should be taken to eliminate the known defects and to provide the Nation with the proper type of money and banking systems. However, such legislation, affecting the most vital and important cog of our economic system—our money and banking mechanism—should be the outgrowth of a careful, deliberate, and impartial study, and analysis of our money and banking problems should be conducted by our most competent experts.

The last great banking legislative step undertaken by this Nation was the present Federal Reserve System. The Federal Reserve Act was the result of years of study—conducted by Congress, banking associations, industry, economists, and others—of the banking systems of the world and of our money and banking problems.

The present situation may well be compared to the situation which existed before the passage of the Federal Reserve Act. Then, as now, we knew that our monetary and credit machinery was in need of overhauling and reconstruction, but how to accomplish this and to make the changes fit the needs of business and commerce was and is the problem. Any meddling with our monetary and credit systems may have serious effects on our business life and may aggravate the present evils. Changes in our monetary and credit systems, such as may be accomplished by title II of the Banking Act of 1935, should be made only after the most careful and painstaking inquiry conducted by a nonpartisan monetary commission—composed, as suggested by Dr. Walter E. Spahr:

> First, of those members of the Senate and House Committees on Banking and Currency who have devoted years to the study of problems of money and banking;
> Second, of the most outstanding and experienced economists and professors of money and banking in our leading universities—men whose reputation, intellectual integrity, and capacity are beyond question;
> Third, of outstanding bankers who are men of experience, maturity, and social vision; and
> Fourth, other students of money and banking, drawn from other fields of activity, if they are recognized as thorough students of money and banking problems.

An impartial analysis of title II reveals most conclusively that it does not contain the solution for our problems. Title III would make possible political control and consequent possible manipulation of the banking mechanism of the Nation. The bill, in this title, also provides for drastic changes in the basis of issuance of Federal Reserve notes, throws wide open the rediscounting and advancing powers of the reserve banks, increases the emergency powers of the Federal Reserve Board with respect to required reserves, and lets down the bars considerably with respect to the mortgage-loan powers of national banks.

aragraph 3 of section 203, because of its provisions will inevitably—despite all protestations to the contrary—bring about political control of the Federal Reserve Board. It states—

> that 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 * * *. 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."

Under the provisions of this paragraph the Governor of the Federal Reserve Board would hold office only at the pleasure of the President. He would, in effect, take office only by submitting an undated letter of resignation to the President. This provision would enable a President to advance any member of the Board to the governorship, remove him, and thus in a short time completely turn over the appointive personnel of the Board, despite the fact that the four appointive members, other than the Governor and the Vice Governor, are chosen for a term of 12 years.

Because of these provisions, the Federal Reserve Board will at all times be subject to residential control.

Paragraph 1 of section 203 provides that the President—

> shall choose persons well qualified by education or experience or both to participate in the formulation of national economic and monetary policies.

The result, as a consequence of paragraphs 1 and 3, may be that political expediency will be the prime consideration in the selection of the appointive members of the Board. These political appointees may be men of wide experience in banking and finance; nevertheless, they may have been appointed because their beliefs are compatible with those of the administration. The power of removal being at the disposal of the President, independent action by the Federal Reserve Board will not be possible, and thus membership in the Board will be restricted to those men who will fully comply with the wishes of the administration.

This section is the most dangerous section in the entire bill. It gives the political party in power the power to dictate the policies of the Federal Reserve Board—which Board, once appointed, should be absolutely free of political domination. The Federal Reserve System constitutes the central banking organism of the country. The governing body of the System, the Federal Reserve Board, has a position of the utmost importance in influencing the economic life of the Nation. Therefore, the independence of the Board should, if possible, be strengthened, and not weakened. It should be the main function of the Board to conduct the Federal Reserve System as "a neutral agent to finance commerce, agriculture, and industry" to the mutual benefit of all concerned. Since title II provides for a Federal Reserve Board which might become a political instrument, it is obvious that the independence of the Board is in jeopardy.

Senator BANKHEAD. Let me ask you, there, if there has ever been a time when they were not subject to the influence of the administration in power?

Mr. FERGUSON. They certainly have been subject to the influence in the last 10 years.

Senator GLASS. Yes; I can name a time when they were not: During the 8 years of the administration of Woodrow Wilson, he would not even have social contact with the members of the Federal Reserve Board for fear that it might be suggested that he was undertaking to influence the Board.

Senator BANKHEAD. My question, if the Senator will note, was not if there has ever been a time when they were not influenced, but when they were not subject to the influence.

Senator GLASS. Well, there were other times when they were not influenced in a political way, in any sense, as I recall. President Coolidge reappointed two of the Democratic members of the Federal Reserve Board during the term of his service as President; and although my contact with the Board may not have been as intimate as that of some others, I do not recall any instance in which President Coolidge ever sought to control the action of the Board, or to influence it in any respect.

Mr. FERGUSON. Section 201 provides the means by which the Federal Reserve banks would be brought under the control of the Federal Reserve Board. The most important feature of this section relates to the office of governor of the Reserve bank. It provides that the present offices of governor and chairman of the board of directors of each Federal Reserve bank should be combined. The governor, under the new act, shall be appointed annually by the board of directors of the Reserve bank, subject to the approval of the Federal

Reserve Board. He shall not take office until approved by the Board, and upon approval, he is to be designated by the Board as one of the class C directors of the Reserve bank. The governor is to be the chief executive officer of the bank, chairman of the executive committee, and "all other officers and employees of the bank shall be directly responsible to him."

The appointment of a vice governor for each Federal Reserve bank is to be made in the same manner as the governor. The vice governor may be appointed by the Federal Reserve Board as a class C director and, in such cases, he may be appointed deputy chairman of the board of directors. Class C directors, appointed by the Federal Reserve Board, shall hold office for a term of 3 years; but this does not apply to the governor's term, or to the vice governor's term if he is appointed a class C director. As stated before, these officers are to be appointed annually. Another requirement that class C directors must have been residents of their districts for at least 2 years, likewise does not apply to the offices of governor and vice governor. A class C director, other than the vice governor, may be appointed deputy chairman of the board of directors. The duties of the present Federal Reserve agent are to be performed by "such person as the Federal Reserve Board may designate."

The provisions of section 201, therefore, would bring the Federal Reserve banks under the complete control of the Federal Reserve Board, which, under the provisions of section 203, might become politically controlled. The executive offices of governor and vice governor will come under the direct control of the Federal Reserve Board because their tenure of office will depend upon the Board's approval. The powers and status of the board of directors of each Federal Reserve bank will be practically nil, because the senior officers of the bank will not be responsible to them. These boards will lose still more of their power, in that the rank and file of the Reserve banks will be directly responsible to the various governors. As a result, any political party in power, through the medium of setting up a subservient Federal Reserve Board—and which it would be able to accomplish without any difficulty—would not only be in a position to control the filling of the executive offices of the Reserve banks, but also the rank and file positions in these banks. In this manner the political party in power could use the Federal Reserve System and the Federal Reserve banks to its own advantage. It is evident, therefore, that better banking cannot and will not result from the provisions of sections 201 and 203.

Section 205, title II, proposes to create a new type of a Federal open-market committee. The new committee would consist of the Governor of the Federal Reserve, who is to be chairman of this committee; 2 members of the Federal Reserve Board, selected by the Board; and 2 governors of the Federal Reserve banks, selected by the governors of the Federal Reserve banks. With the exception of the Governor of the Federal Reserve Board, the terms of the members of this committee would expire annually. The two important duties of the committee would be:

First: "To consider, adopt, and to 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, Second: To " make recommendations to the Federal Reserve Board regarding the discount rates of the Federal Reserve banks."

Another important provision in this section is that the Federal Reserve banks would be required to conform their open-market operations to the recommendations of the committee.

The changes contemplated in this section can be better appreciated when one realizes that the present Federal open-market committee is composed of 12 members, 1 from each Federal Reserve district, and selected by the Reserve bank in such district. The present committee performs the same functions as proposed for the new committee, but its open-market recommendations are not mandatory, in that a Federal Reserve bank not wishing to participate in the open-market operations recommended may refuse to do so by filing notice with the Federal Reserve Board within 30 days of its decision.

This section would bring under the absolute control of the new committee the open-market operations of all the Federal Reserve banks. The committee, in turn, would come under the complete control of the Federal Reserve Board, because 3 of its members would be Board members and the remaining 2 members would hold office as Governors of their Reserve banks subject to the approval of the Board. If the Federal Reserve Board were to be an independent body, free from political influence, this section would be desirable, for it is highly desirable that a central banking system respond in its entirety to actions involving the adjustment of the rediscount rate or open-market operations.

Senator GLASS. But do we have a central banking system? My recollection of the history of banking legislation is that Congress very definitely rejected a central-banking system, and created a regional-banking system with the central-supervisory power here at Washington.

Mr. FERGUSON. That is so. But, of course, we approach that central-banking system through the regional banks.

Senator GLASS. Yes; but we have no central banking system. We have a regional-banking system with supervisory control by a central body, altruistic in its character, with no acquisitive considerations, whatsoever.

Mr. FERGUSON. You have a central-banking system under this proposed 1935 bill.

Senator GLASS. But I am talking about the existing system.

Of course, we have a central-banking system here, wherein the Government would control a central bank, and yet not own one dollar of proprietary interest in the banks that it proposes to manage.

There have been propositions for central banks to be owned by the Government; and that is one thing. But do you not observe that this bill sets up a central bank, to be managed by the Government, without the Government owning a dollar of proprietary interest in the banks?

Mr. FERGUSON. Yes; the member banks own the Reserve banks. May I go ahead?

Senator GLASS. Oh, yes.

Mr. FERGUSON. It is the function of a central banking system, such as the Federal Reserve System, through its open-market operations and the discount rate, to control the monetary and credit mechanisms of the Nation for the mutual benefit of commerce, industry, and agriculture.

It is not the function of a central banking system to concern itself primarily with Government financing, as now exists and will be further encouraged by the provisions of this section and of the bill. This section provides the means whereby any administration, through a controlled Federal Reserve Board, can initiate such open-market operations as will suit its purposes. At the present time, through pressure from the Treasury, the Federal Reserve System is maintaining an easy money-market condition of an extremely artificial nature, to aid the financing of Government expenditures through the banks. Excess reserves have skyrocketed to record levels and, if this bill is passed, is there any reason to believe that an open-market committee, which might be subject to political influence, would undertake open-market operations to counteract the inflationary potentialities of the excess reserves?

Section 206 provides that, subject to regulations as to maturity and such other matters as the Federal Reserve Board may prescribe, any Federal Reserve bank may discount for any member bank, upon its endorsement, "any commercial, agricultural, or industrial paper", and may make advances to any such member bank secured by "any sound assets" of such member bank. This amendment would open the way toward converting our commercial banking system into a nonliquid noncommercial system. As this provision is intended to be permanent, it would in time make the Federal Reserve System a nonliquid system, when by all means it should maintain its liquidity if it is to properly function as a depository of the Nation's reserves.

Section 207 of the bill proposes to widen the scope of the System's open-market operations so that obligations fully guaranteed by the United States as to principal and interest may be purchased by the Federal Reserve banks without regard to maturities. Keeping in mind the proposed reorganization of the open-market committee, this section would enable the committee, possibly dominated by factors of political expediency, to force the Federal Reserve banks to increase their scope of purchases of "governments" and thus tend to become nonliquid. The import of this amendment and of section 206 will be more fully discussed in that section of this statement dealing with the proposed issuance of Federal Reserve notes under section 208 of the bill.

By means of section 208 the bill proposes, first, to issue Federal Reserve notes under such rules and regulations as a possibly politically controlled Federal Reserve Board may prescribe; second, to maintain the present reserve requirements of at least 35 percent against deposits in lawful money and at least 40 percent in gold certificates against Federal Reserve notes; third, to abolish the 5-percent redemption fund now maintained with the Treasurer of the United States; and, fourth, to permit one Reserve bank to pay out the notes of other Reserve banks, without any penalties. In general, this section would permit the issuance of Federal Reserve notes against the general assets of the Federal Reserve banks, which, under the provisions of title II, may well consist of mortgage paper, bonds, Government securities, and so forth.

Prior to the enactment of the Federal Reserve Act, the Nation's bank note and deposit currency did not meet the required needs of industry, commerce, and agriculture, and, as a matter of fact, proved to be detrimental. Bank notes, as represented by national bank notes, backed by certain issues of United States Government bonds purchased by national banks and deposited with the United States Treasury, did not permit elasticity of contraction or expansion insofar as the needs of business were concerned. The issuance of these notes was dependent upon the price of "governments" and the profitability of their use on the part of the national banks. Then, again, as the National Government reduced its funded debt, as it did between 1881 and 1891, the supply of bonds available for note-circulation purposes was seriously reduced. Because of these factors, national-bank-note circulation did not expand or contract as necessary. During periods of stress, when expansion of note circulation would be desirable to ease the currency strain, national-bank-note circulation would decline, because the price of "governments" would be so prohibitive as to make note issue unprofitable. And during periods of easy money conditions, when additional note circulation was not needed or warranted, national-bank-note circulation would increase because of the favorable price of "governments."

Senator GLASS. Even if the price of "governments" were not prohibitive, the extent to which bank notes might be issued was less than a billion dollars.

Mr. FERGUSON. Yes, sir; limited to the amount of "governments" out.

The failure of national-bank notes to expand and contract as needed, during the period prior to the passage of the Federal Reserve Act, tended to add to the inelasticity of our deposit currency. Other major factors tending to make the deposit currency inelastic were the prevailing system of scattered reserves and the lack of central banking facilities. The country was urgently in need of an elastic note and deposit currency which would prevent the money panics occurring with more or less certain regularity.

The enactment of the Federal Reserve Act remedied these defects in that it provided for the issuance of an elastic bank note—the Federal Reserve note—and, through a system of mobilized reserves and of rediscounting facilities, elasticity was imparted to our deposit currency.

The act provided for a note issue subject to both automatic and manipulative control. The automatic control asserts itself in the retirement of Federal Reserve notes through the maturing of the short-term self-liquidating eligible paper used as collateral for purposes of note issue. The manipulative check is operated through the medium of open-market operations by means of which the Federal Reserve System can expand or contract the supply of money outstanding. Deposit currency likewise became subject to these checks. So long as both note and deposit currency are issued against reserves and self-liquidating paper, which in turn, are based upon transactions that will by their nature pay off the loans which gave rise to the deposit or note currency, redeemability and elasticity are provided and inflation is avoided.

Senator GLASS. Right there, Mr. Ferguson, let me say to you that the manipulative aspect of Federal Reserve transactions was never contemplated by the proponents of the Federal Reserve Act. In the first place, at that time there were less than $200,000,000 of United States bonds available for purchase on the open market. I venture to say that there was less than $100,000,000 of United States bonds available for purchase in the open market. Therefore, any manipulative practice that might have ensued would have been accordingly circumscribed.

Mr. FERGUSON. Yes; limited to the buying of bills, and so forth.

Senator GLASS. Yes; but it was never intended that the open-market transactions of a Federal Reserve bank were to be made with a view to controlling credit. It was intended that it should be used to enable the Federal Reserve bank—any Federal Reserve bank—analogous to the transactions of the Bank of England; to enforce its rediscount rate, or to enable any given Federal Reserve bank, if it had a surplus of funds on hand, to make money enough to pay its overhead charges. For a long period of time some of the banks were not able to pay their overhead charges and to pay their interest to the member banks.

So that this manipulative aspect of the Federal Reserve banking activities was never contemplated.

Mr. FERGUSON. As a matter of fact, you framers of the Federal Reserve Act never contemplated Government financing, except where taxes failed to come in, and you temporarily loaned the Government money.

Senator GLASS. Oh, of course, we never did.

Mr. FERGUSON. May I go ahead?

Senator GLASS. Yes, sir.

Mr. FERGUSON. In the following passages Dr. Walter E. Spahr, the economist who predicts that inflation may be the result of a change in the rediscount base, has very ably described the economic consequences of issuing Federal Reserve notes against Government securities, mortgage paper, or nonliquid paper, which would be possible under title II:

> Inflation is always to be avoided because it is an extension of purchasing power, either in the form of paper money or credit, which is not secured by reserves or commodities that will liquidate it at the proper time; and this, of course, means losses for someone.
>
> Therefore when Federal Reserve notes are issued against bonds, the desired and appropriate feature of elasticity is destroyed, and the inflationary procedure is being followed. Elasticity is destroyed because there is nothing in the nature of the bond security which automatically liquidates the notes after the exchange transaction is completed. When such notes are issued against commercial paper they are an advance to business men who will, in 30, 60, or 90 days, sell goods, retire the paper lying behind the notes, and, consequently, retire the notes. Thus the notes effect the exchanges, which could not be completed for 30, 60, or 90 days, and then they disappear. When, on the other hand, such notes are issued against bonds, the exchange is completed, the notes remain outstanding, there is nothing in the nature of the transaction that remains to be completed, and there is nothing to take place which will retire the notes.
>
> Thus there is a net addition to the currency, the price level tends to be disturbed, the currency goes into circulation without any new wealth being produced to liquidate the notes, and the procedure, therefore, is inflationary. Bonds should represent a transfer of savings from the bond buyer to the bond seller, and the currency supply should remain undisturbed. But the issuance

of currency against the bonds has the effect of creating an additional supply of currency with no new creation of wealth.

As the Federal Reserve banks purchase bonds, by creating a deposit to the credit of the Government, a deposit currency is created which is inelastic and inflationary in nature. The banks receive the bonds and the Government receives the deposit. But the currency supply does not remain unchanged; it is increased by the amount of the deposit, less any reserve which might be needed. If there is a surplus of reserves, then there is a full net increase in currency, equal to the value of the bonds. If the withdrawal of deposits gives rise to the withdrawal of Federal Reserve notes, the effect is the same. There is a net increase in the Reserve notes without any additional reserves or commodities being created to liquidate them. This is an inflationary procedure and one that can continue as bonds are purchased until the reserves of the Federal Reserve banks are reduced to the legal limit. Thus the price level tends to rise against the available wealth.

Senator GLASS. Of what account is a reserve that is irredeemable in itself?

Mr. FERGUSON. Well, my old boss used to tell me that a reserve was something that you should use when you needed it.

"What is it for, otherwise?" he used to say.

Senator GLASS. But I am asking you, of what account is an irredeemable reserve? What is it for?

Mr. FERGUSON. It is used to create confidence in the depositors.

Senator GLASS. Under existing circumstances, it is merely psychological, is it not?

Mr. FERGUSON. Yes.

The assets held by the banks against these notes will not retire the notes automatically, and it is doubtful if any management group would force such a retirement. People pay higher prices for things not because there has been an increased production and a resulting increase in income but because of a defect in the currency itself. It is a depreciating currency, and the general public loses in the form of trading the existing goods at the higher prices because of a defect in the currency.

If an effort is made later to retire such a currency, it will be necessary for the Government to raise taxes to pay off the bonds. Taxes are a burden to all people and have a depressing effect. Thus additional burdens must be incurred as a means of retiring the currency which in itself caused the public losses.

The same line of reasoning is applicable to the creation of a currency against mortgage paper as an asset. Such paper should represent a transfer of savings from one group to another so that the currency supply will remain unchanged. And when the mortgage is paid off, it should be paid out of savings. Hence it is proper, within certain limits, to use savings deposits for investment in such paper. But if a commercial bank creates deposit currency against such investment paper, it is deflating the currency, because the currency is not self-liquidating, and it is inelastic for the same reason. When Federal Reserve notes are drawn into circulation as a consequence of the creation of deposits against such assets, the note currency becomes inflated and inelastic.

In connection with these considerations, especially when considering the relations of currencies to rising prices, it is very important to remember that there are two types of rising prices—the sound and the unsound. The causal factors in each case are different; the reactions of people to them are different; and the economic effects are different.

The sound rise in the price level is caused by business men, especially in the heavy industries, who find it profitable to expand their productive activities; the unsound rise in the price level is caused by the act of inflating, or of threatening to inflate, the currency. The sound rise in prices generates confidence because it is pulled up by a confident buying, which, in turn, rests upon an increased purchasing power derived from the increased production. The unsound rise in prices generates fears, and people rush to purchase—not because they have more income, or because there is more production or more employment—but because of fear of a depreciating currency. The sound price level leads to economic equilibrium and widespread prosperity. The unsound, caused by inflation, leads to disasters.

Section 208 would permit the Federal Reserve Board to change reserve requirements as it sees fit during periods of "injurious credit expansion and contraction." The question arises as to whether or not this power would be exercised wisely by a potentially politically controlled Federal Reserve Board, or if it would be used to aid the carrying out of administration policies. In the hands of an independent Board, this power to change reserve requirements would be desirable—as they would, theoretically, during periods of "injurious credit expansions", increase the reserve requirements; and, during periods of "injurious credit contraction", decrease the reserve requirements. However, this section does not satisfactorily solve the problem of reserves, in that the question would still exist as to whether or not the distinction between time and demand deposits should be maintained and as to whether or not the distinction between central reserve cities, reserve cities, and others, should be maintained.

Finally, title II proposes to eliminate geographical limitations on mortgage loans made by national banks, to increase the amount of such loans up to 75 percent of the property value, if the loan is to be amortized within 20 years, or up to 60 percent of the property value for a 3-year period, and to increase the aggregate amount of such loans to an amount equal to the capital and surplus of the bank, or 60 percent of the time and savings deposits, whichever is greater. In view of the fact that during the past years real-estate loans of a far more restricted nature have caused great losses for the commercial banks of the country, this section entirely disregards the disastrous experiences of the past with respect to such loans.

Haste should not prevail in the passage of title II. Under the Federal Reserve Act at the present time any emergency can be met. In the meanwhile a National Monetary Commission, as proposed earlier in this statement, should be formed to study our problems of money and banking; and then a bill should be drafted, based upon its conclusions as a result of its findings and observations. Such a commission may well include in its agenda the following:

First. How and why has the Federal Reserve System failed to function as a properly managed central bank should, and how can this situation be corrected?

Second. Why, if it is so, have the present reserve requirements proved to be inadequate, and how can this be corrected?

Third. The Nation has approximately 15,000 banks and 49 different State banking systems. Has our banking and monetary structure been weakened because of this; and, if so, what is the best practical solution?

Fourth. How can the complex and confusing money system of the Nation be simplified?

Fifth. Is there a need for a central mortgage bank?

Sixth. To what extent has business financing changed, and how can the commercial banks meet this change, if any, without sacrificing their soundness and liquidity?

Seventh. Consider the advisability of the creation of a permanent institution, along the lines of the present R. F. C., to make loans to banks on a long-term basis on their secondary reserves during periods of emergencies.

Title II of the proposed banking bill of 1935 does not supply the solution to these fundamental problems, and therein lies its defects. The title provides for Government control of the currency and credit mechanism. So it would not help to promote a sound business recovery because of its potentially inflationary provisions, and it will not tend to strengthen fundamentally the banking structure of the country.

Senator COUZENS. I was absent when you started your statement, Mr. Ferguson and, if you have answered this question, you do not need to repeat.

Have you expressed any views as to why the Federal Reserve System broke down or fell down in the late twenties?

Mr. FERGUSON. No; I have not. And I prefer not to.

Senator COUZENS. You prefer not to what?

Mr. FERGUSON. Express my views.

Senator COUZENS. Oh, I thought you said you did not have any?

Mr. FERGUSON. You asked me if I had expressed my views, and I said that I had not; no one had asked me.

Senator COUZENS. Do you have in mind what kind of a monetary commission ought to be set-up?

Mr. FERGUSON. Yes, sir; I shall read it again to you if you wish.

Senator COUZENS. No; I have to go to the Finance Committee.

Senator GLASS. Of course, there is a very serious question as to whether the Federal Reserve System broke down or has broken down at any period in its existence. There may be a question as to whether it was maladministered, but in my personal view, the System itself has never broken down. I think it has been badly administered at times.

Senator COUZENS. I recognize the fact that the Senator from Virginia is not on the witness stand. But I was wondering if the witness, Mr. Ferguson, could tell us in what manner he had observed this maladministration.

Mr. FERGUSON. No; I ducked the question, Senator.

Senator GLASS. I am not going to duck it, when it comes to the time to discuss this bill.

Senator COUZENS. That only raises the question in my mind; and it does not seem to be answered by the statement of this witness, or by anybody else whom I have heard so far: That, no matter what system you set up, how are you going to assure the proper administration, or the avoidance of maladministration?

Mr. FERGUSON. I think that a great deal of our trouble could have been avoided had we—at the outset of the panic—had some place where the banks could lay down their secondary reserves—what we call "secondary reserves"—which consist of bonds for which there was no market because of the condition of the exchanges; and also a place where, upon the exhaustion of those secondary reserves, we could lay down our mortgages. But we were obsolutely stumped; we had no place to go. Our available commercial paper was lower than it had ever been because business did not require any; and the Federal Reserve, until the passage of the Glass-Steagall Act, was helpless to help us out in an emergency.

Senator BULKLEY. Do you mean borrowing against assets, when you refer to "laying them down"?

Mr. FERGUSON. Yes, sir.

Senator GLASS. May I ask if there was no way in which the crash could have been prevented? I ask that question because Mr. Ferguson seems to suggest a remedy for the conditions after the crash and not before.

Mr. FERGUSON. Well, I think that it could have been very much mitigated, so far as the banks were concerned, if we had had some place where we could borrow on our assets which were not eligible at the Federal Reserve banks.

Senator BULKLEY. Those borrowings would have been at the then market price, would they not?

Mr. FERGUSON. I think they should have been very liberal in their allowance to the banks on those assets.

Senator BULKLEY. In an effort to maintain the prices that then existed?

Senator COUZENS. And that without regard to how much the banks had discounted for the Wall Street brokers?

Mr. FERGUSON. I hold no brief for the Wall Street brokers.

Senator COUZENS. No; they are not to blame. It is the banks which made the loans. And I am wondering whether, in view of that, the Government should provide some reserve on which you could unload your secondary securities.

Mr. FERGUSON. I do not know how to answer you, Senator. I had no loans to Wall Street brokers in my institution; but yet I would have been very glad to have a place, when they were running our institutions, where I could go and lay down my bonds or mortgages. But I had no place to go.

Senator GLASS. It seems to me that the question could be answered by taking the simple facts: That the banks should not have engaged in this riot of speculation; and, particularly, the Federal Reserve banks should not have permitted the facilities of the Federal Reserve banks to be used to encourage this riot of speculation.

And that difficulty—as it seems to me, at least—was cured by the Banking Act of 1933.

Senator COUZENS. May I suggest to the witness, if he can answer this question: That the Senator from Virginia says he thinks the difficulty was cured by the Banking Act of 1933. And may I ask—and not in any desire to go into the personal portfolio of the witness' bank—but could you enumerate the class of securities that you would have liked to have disposed of, or borrowed on, at the time of the crash?

Mr. FERGUSON. Yes.

Senator COUZENS. Will you please do so?

Mr. FERGUSON. Bonds of railroads, industrials, and public-utility corporations of the United States.

Senator COUZENS. What do you mean?

Mr. FERGUSON. Those listed on the stock exchange.

Senator TOWNSEND. You are speaking of bonds, now, are you?

Mr. FERGUSON. Yes; I am speaking of bonds.

And obligations of municipalities, created in financing tax payments.

After those had been exhausted, then we should have liked to have had an advance on our first mortgages, which we took under the National Banking Act, and in strict conformity with the National

Banking Act, but on which it was not possible to borrow a 5-cent piece.

Senator COUZENS. Could that occur again?

Mr. FERGUSON. My understanding is that the R. F. C. is a temporary institution.

Senator COUZENS. No; but I meant with respect to your discounting of the high-class first mortgage.

Is it likely that you would encounter that condition again, where you would want to borrow on them?

Mr. FERGUSON. Surely.

Senator COUZENS. Does not the Eccles bill provide that?

Mr. FERGUSON. I admit that there should be an agency—and I have stated it in the last paragraph of my letter suggesting a central mortgage bank—or a permanent R. F. C. where a bank can borrow on its bonds and can borrow on its mortgages.

But where I differ from the Eccles bill is that under the Eccles bill those loans on bonds and on mortgages can be made the basis of deposit currency or note currency.

Senator BANKHEAD. Under your suggestion, where would the R. F. C. or the central bank get the money to make the loans?

Mr. FERGUSON. My idea is that the R. F. C., a permanent institution, would sell its obligations, guaranteed by the United States Government, in the open market; and I would further provide that those bonds of the R. F. C., guaranteed by the United States Government, could not be purchased by any bank or by any Federal Reserve bank.

Senator GLASS. Let me ask you this question: What would you have done with your money if you could have borrowed on those notes?

Mr. FERGUSON. Paid it out over the counter to the throngs of depositors who came.

Senator GLASS. And would they have loaned it to brokers to increase the unprecedented brokerage loans—to gamble on Wall Street?

Mr. FERGUSON. No; I am talking about the days of the gold rush, when they took it home and put it in the old sock.

Senator GLASS. But I am talking about the days when the Federal Reserve System was supposed to have broken down, but when it had not been broken down, but its facilities were used for stock-gambling purposes.

Mr. FERGUSON. I am talking about a different time; and I thought the Senator was asking me about the days of the calls on the banks.

Senator GLASS. Yes; that was partly in my question.

But I am shocked that you want a politically controlled R. F. C., but do not want a politically controlled Federal Reserve Board.

Mr. FERGUSON. But I do not want a politically controlled R. F. C.

Senator GLASS. But the R. F. C., under the theory of you gentlemen, is a politically controlled body. So it shocks me that you want a politically controlled R. F. C.

And it also shocks me that the Government wants to run things that the Government does not own.

Mr. FERGUSON. I recognize the fact, Senator, that it is necessary that there be an appointing power.

Senator COUZENS. Yes.

Mr. FERGUSON. And that has to be in the President.

What I should like to see, with respect to the Federal Reserve Board, is a bipartisan board appointed for a term of, let us say, 15 years, and the members of the Board removable only upon charges to be preferred for malfeasance, misfeasance, or nonfeasance, and heard on those charges.

And under those circumstances I do not care where you get your men; you can get them from any source. They feel secure in their office.

And, following your argument, I would make my proposed R. F. C. the same way.

Senator GLASS. What is the matter with the existing law?

Mr. FERGUSON. I am not kicking about the existing law.

Senator GLASS. As to the appointment of the Federal Reserve Board, has any member of the Board ever been removed by a President of the United States?

Mr. FERGUSON. Well, perhaps you will not think it impertinent of me if I ask you whether, under the existing law, in the past 10 years the Federal Reserve Board has been brought under the domination of the political party in control.

Senator GLASS. Of course, it has been brought. It has been absolutely dominated by the political party in control. But the law does not make it so. It is the violation of the whole spirit and intent of the law that has made it so.

Mr. FERGUSON. Well, Senator, under my plan, I want to remove it from politics, if I can—recognizing the fact that the President of the United States must "start the ball rolling" by making the appointments.

I want to keep these men in there, secure in their positions, regardless of what they do—provided they are not guilty of malfeasance, misfeasance, or nonfeasance—in the same manner that the members of the Supreme Court of the United States are kept secure in their positions.

Senator GLASS. Under the existing law the President of the United States cannot remove a member of the Board except for cause, in writing to the Senate.

Mr. FERGUSON. It seems to me that, within the last several weeks, I have read that it is contended that the President of the United States has the power of removal of Federal Reserve Board members.

Senator GLASS. Well, he has the power of removal for cause, in writing, to the Senate.

Mr. FERGUSON. I did not know that the President had to prefer charges against them.

Senator GLASS. Well, he does not necessarily have to prefer charges against them; he has to give his reason for the removal.

Senator COUZENS. Both the chairman, the Senator from Virginia, and the witness admit that the Federal Reserve Board has, in the past, been politically controlled; at least, the record so shows.

Mr. FERGUSON. I did not say that; that is going too far.

Senator COUZENS. Well, the question you asked the Senator from Virginia inferred that, at least.

Senator GLASS. I do not mean that it has been politically controlled; and I doubt if Mr. Ferguson means that it has been politically controlled, in the sense of party politics.

Mr. FERGUSON. No; I did not mean that, at all.

Senator GLASS. And I did not mean that, at all.

I mean that there have been times when there has been gross maladministration of the act.

Senator COUZENS. Due to political influence.

Senator GLASS. Well, I would not call it political influence.

Senator COUZENS. I do not know what you call the Secretary of the Treasury, or any other publicly appointed officer—whether he is not a politically appointed man.

Senator GLASS. The Secretary of the Treasury and the Comptroller of the Currency were intended, by the proponents of the act, to represent in a broad sense, and not in the sense which you employed.

Senator COUZENS. How do you know my implication?

Senator GLASS. Well, because I have some sense.

Senator COUZENS. Of course, we cannot very well repeat private conversations that take place.

Senator GLASS. You can repeat anything that I have said to you.

Senator COUZENS. You do not recall condemning the greatest Secretary of the Treasury since Hamilton's time?

Senator GLASS. Yes; I do.

Senator COUZENS. Do you recall condemning him for his influence on the Federal Reserve?

Senator GLASS. Yes; certainly.

Senator COUZENS. Is not that political control?

Senator GLASS. It is maladministration.

Senator COUZENS. It was due to political control by party politics.

Senator GLASS. No; it was due to governmental control, and not to party politics, at all.

It was due to the desire of the Secretary of the Treasury to facilitate the issuance of Government credit; that is what it was.

It was not due to party politics at all. It was a maladministration of the text and the intent of the Federal Reserve Act; that is what it was.

Senator COUZENS. Of course, I cannot agree to such a limited degree of control, as defined by the Senator from Virginia.

But, then, we are supposed to hear witnesses, and not hear ourselves.

Senator GLASS. Well, we can have that out among ourselves.

Senator COUZENS. Are you stopping for the day now?

Senator BULKLEY. Have you finished, Mr. Ferguson?

Mr. FERGUSON. Yes.

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

I will say this, Mr. Ferguson: That I had not supposed you wished to discuss title II, or I should have familiarized myself, perhaps, more definitely with the provisions of that title of the bill. I had been told by Senator Barbour that you gentlemen wanted to discuss titles I and III.

Senator BARBOUR. Senator Glass, I know that the fault must be mine.

Senator GLASS. It was not any great fault.

Senator BARBOUR. I sent you a memorandum, and we spoke about it on the telephone. In the memorandum there was an inadvertence—that one gentleman was going to speak on titles I and III and that the other gentleman was to speak on title III.

But we spoke on the telephone, and I thought I corrected that and that you understood it.

I know that Senator Moore and myself are very grateful to the chairman and to the committee for their attention and interest.

Senator GLASS. We are very much obliged to the gentlemen for their testimony.

(Thereupon, at 12:15 p. m., an adjournment was taken until tomorrow, Friday, May 3, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

FRIDAY, MAY 3, 1935

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

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

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

Senator GLASS. We have Dr. Sprague with us this morning.

We wanted to hear from you on title II of the impending banking bill, S. 1715; and we should be glad to have you make any statement that you may care to, in connection with it.

STATEMENT OF DR. OLIVER M. W. SPRAGUE, PROFESSOR OF BANKING AND FINANCE, HARVARD UNIVERSITY, CAMBRIDGE, MASS.

Dr. SPRAGUE. I shall confine what I have to say to title II; and the first matter that I should wish to bring up is as to whether the passage of that part of this bill may be regarded as an emergency or recovery measure.

In my opinion, it has little value from that point of view. There is practically nothing that the Federal Reserve System might not do under existing law, as a contribution to trade recovery, that it will be able to do if title II becomes law.

I look upon title II primarily, then, as a means of improving the Federal Reserve System over the years. There are only two features ing title II that, as far as I can judge, might have a bearing upon the immediate situation: The first is that which will empower the Federal Reserve banks to lend to member banks on sound assets, rather than exclusively on eligible paper. That change, in its immediate effects, does not seem to me to be of any importance whatever, partly because the banks are not borrowing at the present time, except to an insignificant extent; and secondly, because, as a matter of fact, the Reserve System has always loaned to member banks on the basis of sound assets. Wherever the eligible paper of a member bank, when offered, was not regarded as a good asset, the member banks have taken additional collateral—sometimes styled "excess collateral"—because the particular bits of eligible paper offered for rediscount were not regarded as a very good asset.

It does not, therefore, seem to me that the immediate effect of this change will be very great.

Senator BULKLEY. But suppose they do not have sufficient eligible paper: They cannot borrow, under present law, on sound assets, can they?

Dr. SPRAGUE. If they had no paper that, by any stretch of the imagination, could be styled "eligible", then you are quite right, sir.

Senator BULKLEY. Or if they did not have enough for their needs?

Dr. SPRAGUE. Yes.

Senator MCADOO. They could borrow on Government bonds, of course—if they had Government bonds.

Dr. SPRAGUE. They are eligible.

I am not saying that it is an undesirable change; I am simply saying that it does not appear to me that, at the moment, it will contribute very much.

Now, on the whole, I am inclined to think that it is a desirable change—for the reason that I do not believe that there is any close relationship between the eligible paper that a bank may have and the safe or desirable limits of borrowing, for the individual bank. Nor do I believe that there is any close relationship between the amount of eligible paper that may be offered and the desirable amount of credit to be extended by Federal Reserve banks.

Senator GLASS. Under the existing statute, the Federal Reserve Board has very broad powers in defining the eligibility of paper.

Dr. SPRAGUE. Yes; that is so.

Senator GLASS. It is only restricted by statute, when it comes to speculative matters; is not that true?

Dr. SPRAGUE. Well, the eligible paper may be broadly defined as loans which serve to provide funds for immediate working capital requirements of a business concern.

Senator GLASS. That I understand.

But the only restriction upon the Board, in its definition of eligible paper—which must relate itself to commerce, industry, and agriculture—is that it shall not accept speculative investment paper.

Dr. SPRAGUE. It cannot accept a real-estate mortgage, as such, for rediscount.

Senator GLASS. Under the existing law, Doctor, it is not allowed to accept any paper that is presented for discount for speculative purposes.

Dr. SPRAGUE. No; that is another restriction; and that might be put into the sound assets, if you wish to include the purpose.

Well, I look at this sound asset proposition mainly with reference to those activities of the Federal Reserve banks that have to do with their lending to the individual member. And the problem has not yet been solved, to determine the wise limits within which to lend to a particular member bank. If a member bank's loans were entirely liquid—all gilt-edge commercial paper of the open-market type—it would then be reasonable and safe to lend that bank a very large amount, by way of rediscount.

On the other hand, if a bank is not very liquid, and if its loans are purely local, then to rediscount the assets that it has may weaken that bank, leaving very little for the shareholders or depositors, in the event of failure.

I do not think we solve the problem of the proper use for Federal Reserve credit, in relation to the member bank, by any method of definition. You can rediscount an undesirably large amount, for a member bank, whether it be that you rediscount its eligible paper or whether you grant it advances on the basis of its sound assets. And it is one of the things which the Federal Reserve authorities need to work out far more than they have yet, on the basis of past experience—what amount, in the varying situations of different banks, it is helpful and desirable to lend to the particular institution.

Therefore, on the whole, I am inclined to favor this change, which emphasizes the sound assets and recognizes that it must be through management that you determine what the wise limit of advances to a particular member bank may be.

Senator GLASS. Do not the brokers on the stock exchange claim that their loans are the soundest and the best loans that are made, at all?

Senator GLASS. And yet the existing law prohibits those loans—and, I think, very wisely.

Dr. SPRAGUE. I think so, too.

And that relates very much more to the other activities of our Federal Reserve banks—their operations in the money market.

Senator GLASS. But does not this proposed change textually authorize the Federal Reserve bank to make discounts on brokers' loans, or anything else it pleases, that it may regard as sound?

If it accepts the brokers' views that the brokers' loans are the soundest loans that may be made, and involve the fewest losses of any loans that may be made, would it not be authorized to engage in speculative transactions?

Dr. SPRAGUE. It is possible that you are right. even though there are provisions in the Glass-Steagall bill which I had supposed covered that point.

Senator GLASS. Well, they do cover that point, but this uncovers it.

Senator TOWNSEND. The only question to be considered here is whether it is considered sound or not; is that it?

Dr. SPRAGUE. Yes.

Senator MCADOO. Doctor, let me ask you this question: There are many banks of the United States where the opportunity for making what we call self-liquidating loans—that is, I mean eligible commercial paper—does not exist to such an extent that those banks can employ a sufficiently large part of their assets in such loans.

On the other hand, they can make many loans that are perfectly sound, that are not commercial or self-liquidating loans; for instance, the loans to a customer who can secure them, let us say, by municipal or State bonds, or other security which is perfectly satisfactory and which makes the loan perfectly safe.

Now, that bank, also, may not have any Government bonds in its portfolio.

In such a condition as that, the banker needs to rediscount but has an insufficient amount of eligible paper, for the reasons that I have stated, and has no Government bonds; and the other paper that he has, that might be perfectly good—as I have described it—would not be available for rediscount.

Dr. SPRAGUE. That illustrates my point that there are banks in every sort of position and that a given amount of accommodation that may be quite appropriate and desirable for one bank may not be for another.

For example, there is a very interesting document prepared on the banks in Arkansas and their failures. And it is quite clear, from that analysis, that the banks that failed—to a rather large extent—were banks that had borrowed extensively, whether from city correspondents or from the Federal Reserve.

It is very clear, on the basis of the experience of the last 15 years, that it would have been better for the people of Arkansas if their banks had not borrowed quite as much as they did borrow. And it is not a question of the kind of assets that they used for borrowing; the trouble was that they exhausted their more liquid assets in the process of borrowing and had very little margin left to take care of the situation of deposit withdrawals.

Now, you can either leave the matter to the intelligence of the Federal Reserve or you can attempt to describe, by the law, a sufficient variety of situations to cover the varying situations of different banks.

But I am clear in this: That eligibility, as we have it, has not been a satisfactory safeguard. It has led a great many banks—or, at least, made it possible for a great many banks—to borrow more than it was desirable that they should borrow, given their entire situation.

Senator McAdoo. But if you widen the field for borrowing, by extending it to cover sound assets, do you not increase the temptation to overborrow instead of decreasing it?

Dr. Sprague. You do, unless the public and the management of the Reserve banks recognize the necessity of restraint varying with regard to the situation of the various banks.

Senator Glass. Doctor, I can call your attention to the fact—which I am sure you know—that the existing law charges the Federal Reserve Board with the exclusive right to determine or define the character of paper eligible for discount, always relating it to business transactions of a commercial, industrial, or agricultural nature.

Dr. Sprague. Yes.

Senator Glass. And that the only restriction on the Board, in making its definition, is in this language:

> but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying on trade in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.

That is the only restriction upon the Board, in its definition of eligible business paper.

Now, what I am asking you is that if we substitute for that the words that you have had under discussion, we would simply supersede this restriction, as it seems to me, and the bank could go in the open market and gamble to its heart's content, in any security on the stock exchange that it might desire.

Dr. Sprague. Well, I would suggest that you substitute the sound assets for the first part of that provision, and then add the limitation which is there contained.

Senator Glass. But therein—according to the brokers, who have repeatedly testified before our committee—you preclude the most liquid assets, and the soundest assets known to banking.

Dr. SPRAGUE. You are precluding them from a general reason: That is, because it is thought that they foment undesirable speculation; it is not with regard to the safety and appropriate amount of borrowing to which a particular bank may resort.

They seem to me to be two fairly distinct problems: That there are banks that do not have very much of the paper of the sort included in the regulations of the Federal Reserve Board.

Senator GLASS. Is that not largely due to the fact that we have gone back to a bond-secured currency, instead of a commercial currency?

Dr. SPRAGUE. Well, if you have 60 billions of deposits, you simply do not have available an evenly and sufficiently well-distributed mass of these business loans, to provide all banks with a variable amount of material for rediscount at the Federal Reserve banks.

Senator GLASS. How many banks would you guess, as of this date, that there are without eligible paper for discount?

Dr. SPRAGUE. Well, if you include the United States Government bonds—not very many.

But, again, I would say that I regard this feature primarily with reference to the years ahead. And anything that will emphasize the responsibility of the Federal Reserve to limit borrowings to what is safe—from the viewpoint of the particular borrowing bank—is desirable.

If, however, you take the view that a bank has a right to secure accommodation, because what it offers is good, then the more restrictions you have upon what it may offer for rediscount, the better.

But I do not feel that it is wise, if you feel that the bank is not very well managed or if you feel that 75 percent of its assets are slow and doubtful, for the bank in that condition to secure accommodation, ordinarily, from the Federal Reserve or from anywhere else.

But I repeat that I do not say that it is likely to have very much effect, immediately, on what the banks are prepared to do. It is like many other provisions of this bill, that may be wise, or that may not be wise, but are unimportant as regards what the banks are going to be doing in the next 6 or 12 months.

Senator McADOO. Outside of brokers' loans—which can easily be defined and can easily be excluded from that which is available for rediscount at Federal Reserve banks—there is, of course, a wide field of individually good loans secured by collateral that is absolutely sound.

Dr. SPRAGUE. Yes.

Senator McADOO. Some of it may be stock exchange securities, or other bonds or stocks—first class, and always finding a ready market.

Now, with respect to that large field of loans, there is no provision under existing law by which they can be used even as a supplement to commercial loans, by a bank which wants to borrow from a member bank.

Dr. SPRAGUE. Yes.

Senator McADOO. It seems to me that if we can draft this provision in such a way that paper of that character would not be denied eligibility, it would extend the field of operations for many of these banks which, as you have just stated, do not find, in the area of purely commercial loans or self-liquidating paper, as you denominate it, a sufficient opportunity to rediscount their funds.

Is that correct?

Dr. SPRAGUE. Yes.

Senator GLASS. Under existing law, is not the Board authorized to make such definitions?

Dr. SPRAGUE. I do not think so, except in view of the temporary definition made in view of the emergency?

Now, if I may go on to the next matter that has a bearing upon the immediate situation—the provision regarding real-estate loans; and I am taking, for purposes of discussion, not the original draft presented to the Senate but rather the modified House bill, which, so far as real-estate loans are concerned, has made a change which renders the provision far more satisfactory from my point of view. I think it highly desirable that we develop in this country the practice of borrowing on real estate for longish terms rather than for the 3- or 5-year period that has been so customary, and with an amortization feature.

Senator McADOO. Doctor, may I interrupt you for a moment?

Dr. SPRAGUE. Yes.

Senator McADOO. I should like to ask to what particular provision, page, and line you are referring in House bill 7617?

Dr. SPRAGUE. That is almost at the end of title II.

Senator McADOO. Section 24, on page 57, I presume, is it not?

Dr. SPRAGUE. Yes.

Senator McADOO. Let us look at that and see if that is the provision to which you have reference.

Dr. SPRAGUE. Yes.

Senator McADOO. All right.

Dr. SPRAGUE. Now, that is now set out in very broad terms, with authority in the Federal Reserve Board to issue regulations; and it seems to me that it might be used for the purpose of improving the practice in the matter of real-estate loans, whether they be of urban or agricultural character.

Senator McADOO. You are not expressing approval of that section of the House bill?

Dr. SPRAGUE. I am expressing approval of that section, on the whole.

Senator McADOO. Yes.

Dr. SPRAGUE. But also, I am pointing out that it does not seem to me, again, to be a feature that is going to contribute very much to change the present situation.

As with the case of most of the features of this bill, I am looking at it primarily from a long-run point of view.

Senator GLASS. You have already stated that you do not think they contribute to the present recovery from the depression?

Dr. SPRAGUE. Yes.

Senator GLASS. And you have already stated that they are not emergency requirements at all?

Dr. SPRAGUE. Yes. And they are the only features of the bill that, by any stretch of the imagination, so far as I can see, can be regarded as affecting the immediate situation.

Senator GLASS. Do you see any disadvantage in banks' investing demand deposits in long-term real-estate loans?

Dr. SPRAGUE. It depends upon the situation of the bank, and upon the proportion thereof. It is largely a matter of proportion.

A well-managed bank will continue in operation indefinitely. It must have a good proportion of assets that are near cash—which proportion will vary with all sorts of situations.

But in this particular proposal, it only has to do with the investment of a proportion of the time deposits, in real-estate loans.

Senator McADOO. You insist, of course, upon the essential element that such loans, including the amortization, be soundly secured?

Dr. SPRAGUE. I think that is highly important.

Senator McADOO. It is essential, is it not?

Dr. SPRAGUE. I think so.

Senator GLASS. Do you think it important to combine commercial banking with investment banking? Is not a reserve system intended to meet, at all times and promptly, the requirements of commerce, industry, and agriculture?

Dr. SPRAGUE. It seems almost unavoidable that there be some interrelation or fusion, because the banks have far more funds than can possibly be employed commercially.

Senator GLASS. Right now?

Dr. SPRAGUE. Or at any time.

They had far more funds in 1928 than could be employed in that fashion.

It is possible to reduce that total sum, under the influence of those provisions that empower the Reserve Board to fix the maximum rate of interest that a bank may pay upon deposits; and that should tend to force people to do more of their own investing—which would be all to the good.

In the 1920's banks were paying 4 and 5 percent for the time deposits—giving us a call on dollars, and paying us 5 percent, or so, for those funds.

And they had such a volume of funds that they could not possibly employ, even in a liquid fashion.

It would have been far better for the community, if ten or twenty billions of those funds had been invested by their owners, thus taking out of the situation ten or twenty billions of a call on dollars.

Senator GLASS. Do you think it at all feasible to establish a uniform rate of payment on time and savings deposits throughout the United States?

Dr. SPRAGUE. I think it might better be by districts than for the entire country; just as I feel that it is a desirable feature of the Federal Reserve Act, that we may have differential rates of discount in different parts of the country.

Senator GLASS. Precisely; and there is no more reason why there should be a uniform rate of payment on time deposits than on other deposits.

Dr. SPRAGUE. Precisely; and the modification of variation by districts might be a desirable addition to the Federal Reserve Act.

Senator GLASS. The Federal Reserve Act provides that now, Doctor.

Dr. SPRAGUE. By districts?

Senator GLASS. But it has not been followed.

Dr. SPRAGUE. It has been done generally.

Well, there we come to something that I want to take up a little later—that there is not much use giving powers to an agency if those powers are unlikely to be used because of the character or personality of the people making up that agency.

You can very easily give people powers that are so great that they are terrified when they come to use them.

But that is at the end of my story.

Senator GLASS. It is easy enough to give them powers that will terrify everybody else, if they are used, is it not?

Dr. SPRAGUE. Yes.

Senator McADOO. Quite right.

Doctor, let me take you back for a moment, to this question of rates of interest in different districts of the country.

There are many of our States which have a legal rate of interest, established more than 100 years ago, and the same rate prevails today.

Dr. SPRAGUE. Yes.

Senator McADOO. Those rates are fixed without any reference whatever to the economic conditions prevailing in the different States. And they are purely arbitrary prices established by law for the use of money. Some have legal rates as high as 7 percent.

Senator GLASS. Some are as high as 10 percent.

Senator McADOO.Well, I do not recall, at the moment, any as high as 10 percent.

But they are as high as 10 percent, by contract.

Senator GLASS. Well, they are as high as 18 percent, by contract.

Senator McADOO. In some States; yes.

Now, I think that constitutes a real abuse, and I think that is a field for reasonable reformation.

Of course, the Federal Government would have the power to establish the legal rate only as respects national banks. But would you consider it wise, for instance, for the Federal Government to legislate with respect to the legal rate of interest to be charged by the national banks throughout the United States?

Before you answer, I should like to say that, of course, this suggestion presents this situation: The State banks, you may say, would of course be able to charge a higher rate, and therefore they would be having an advantage over the national banks. But as a matter of fact, the national banks would have the advantage, because they would be charging a reasonable rate for money; and the State banks would have to come to it.

So I think it is advisable to establish a reasonable charge, here, provided we do not go so low as to be beneath a reasonable price for money.

Senator GLASS. The existing law provides that a national bank may prescribe the same rate as the State bank.

Senator McADOO. Yes.

But, as it stands today, if a State has a legal rate of interest which is excessive, or unjustified, rather, by the economic situation—either the established legal rate, or a rate which may be made by contract between the parties—why, the national bank is permitted to charge the same rate as that established in that State.

If, on the other hand, there were a Federal law restricting the national banks to charging a reasonable interest charge, regardless of the State law, then the question is whether or not, in your opinion, that would be a desirable reform?

Dr. SPRAGUE. I should hesitate to answer that question, Senator, without a good deal of reflection. It is something about which I have not thought.

Senator MCADOO. It requires study, of course.

Senator GLASS. Before answering, let me point out to the Senator from California, just one difficulty with a suggestion of that sort:

The State capital requirements vary greatly among the States, and afford such a departure from Federal capital requirements, that there are hundreds, if not thousands, of communities which cannot afford a national bank. And in those communities, the State law will prevail.

Senator MCADOO. That is true in any case, of course.

But the question is whether or not an effective measure of that kind would not benefit the general economy to such an extent that it would be justified.

Now, I am not proposing this; I am merely suggesting it as a subject for exploration.

Dr. SPRAGUE. I should not wish to answer it at the moment.

However, I am prepared to say that interest rates are undesirably rigid, and that a lowering of interest rates, very generally, would, I think, be a contribution to a trade recovery, if it could be brought about.

But I should look for it to be brought about, more, through the moderate rate of interest that the banks may pay on deposits, and through the accumulation of funds seeking investment.

Whereas, a change such as you suggest, although it might prove desirable, I should suppose would be very difficult to carry out. And I should suppose that it might affect public sentiment rather unfavorably, during its early stages of operation.

So that I would not regard it—though I am speaking quite offhand—as very helpful.

Senator MCADOO. You reserve judgment?

Dr. SPRAGUE. Yes.

Senator MCADOO. May I say, Doctor, with reference to your statement, that you know that Congress has, by law, prohibited the national banks and the member banks of the Federal Reserve System, from paying interest on demand deposits. I think that was a very effective reform.

Dr. SPRAGUE. Yes.

Senator MCADOO. And I think that has relieved them from heavy charges, and has stopped abuses of a very grave character in our banking system.

Dr. SPRAGUE. Yes.

Senator MCADOO. Now, in consideration of that, they might very well reduce the price of money to borrowers. But wherever a high legal rate of interest prevails—as in most of the States, regardless of economic considerations or situations—the legal rate is always required.

Dr. SPRAGUE. I think it might be desirable for some of the States to lower their usury rate, which was established many years ago. But that is something about which I do not feel qualified to express a definite opinion.

Senator GLASS. Here is a very simple question that you ought to feel qualified to answer: If we should persist in the original purpose of the Banking Act of 1933, and require all State banks, the deposits of which are insured, to become members of the Federal Reserve Banking System, could not that matter be better adjusted in that way, if at all?

Dr. SPRAGUE. That would affect at least a very large amount of funds—those funds that are employed by banks.

It would not affect all funds that are lent, of course. But it would go a long way in that direction.

Senator GLASS. In other words, would it not be within the power of the Federal Reserve Board to make regulations with respect to interest charges of member banks?

Dr. SPRAGUE. Not unless the power were given. I do not think it exists, under the existing law. At present, their power relates entirely to the rate of interest that the banks may pay to depositors.

Senator MCADOO. On time deposits?

Dr. SPRAGUE. On time deposits.

Senator MCADOO. There is no provision, as I understand it, by which the Federal Reserve Board could regulate the rates of interest charged to borrowers.

Senator GLASS. I understand that thoroughly.

But if you wished to authorize all the banks of the Federal Reserve System to do that, that would undoubtedly be a constitutional act.

Senator MCADOO. You are quite right. It could be reached through that method, and effectively.

Dr. SPRAGUE. I wish to make one suggestion about the section relating to real-estate loans: I think that real-estate loans ought to be limited to loans within the district, or at least within 100 miles of the district, in which a member bank is situated.

I do not believe that a member bank in Massachusetts is ordinarily in a position intelligently to make real-estate loans in Kansas or in Idaho; nor do I believe that a bank in those States is in a position intelligently to make them in Massachusetts.

Senator MCADOO. But do you think that they could intelligently make them in California?

Dr. SPRAGUE. I picked my States.

Senator GLASS. Do you think that any bank could intelligently make a real-estate loan under existing conditions, when the Government, itself, has gone into the real-estate business?

Dr. SPRAGUE. I take it that that is a rhetorical question.

Senator GLASS. No; it is a very practical question.

Senator TOWNSEND. May I ask if you would put any limitation to the character of real-estate loans? Is there not a great deal of difference, in real-estate loans, as to whether the loan is on a theater or on a hotel, or on a house, where the loan runs more or less in perpetuity?

Dr. SPRAGUE. There is; but you must leave something to the judgment of the lender.

And I should despair of attempting to safeguard, by legislative provisions, the particular type of loans that might be regarded as fairly safe, and those that might not be so regarded.

Senator McAdoo. You do not believe that, by legislative action, you can invest the human being with intelligence?

Dr. Sprague. Only in a very broad fashion.

Senator Glass. Under the decision of the Supreme Court, in the *Minnesota case*, do you think any real-estate loan of a bank, or anybody else, is very secure?

Dr. Sprague. Oh, they are in business, and will make loans of one sort or another, in any event.

So far, I have considered only changes in the statute, that may have some effect on the immediate situation. That influence is so slight that legislation along the lines of title II does not seem to me to be urgently needed at this session of Congress. Now, I come to provisions of title II that are significant only in the long run.

The first of these about which I should like to say a few words, is that relating to collateral behind Federal Reserve notes.

Senator McAdoo. Will you state the page and line, Doctor, if you have it? Are you dealing with the House bill or with the Senate bill?

Dr. Sprague. Well, the two bills are similar, as regards the changes regarding Federal Reserve notes.

Senator McAdoo. Yes.

Senator Glass. Page 46.

Senator McAdoo. In the Senate bill, or in the House bill?

Senator Glass. In the Senate bill, page 46.

Senator McAdoo. Very well.

Dr. Sprague. The provisions of the Federal Reserve Act relating to Federal Reserve notes were apparently designed to limit, in certain ways, the total amount of credit that might be extended by the Federal Reserve banks. There was the general limitation, which is retained in this new bill, of a 40-percent gold reserve; and then there was the additional provision that the remaining 60 percent must consist of rediscounted paper, or in its absence, the place must be taken by gold.

Now, there is not any particular relationship between the amount of rediscounts granted by Federal Reserve banks and the desirable amount of notes in circulation. Under our system of the use of checks, the amount of notes in circulation, or the total amount of money in circulation, is an incidental result of the level of prices, the activity of trade, and our habits in making payments, whether by check or by actual currency.

It does not seem to me that in the operation of the Federal Reserve System these special restrictions on note issue have had any practical effect, whatever.

They finally were modified to permit Government bonds to be used as collateral back of the Federal Reserve notes, because it became clearly evident that the total requirements for currency could not very well be met if the original restrictions were maintained. We would practically have been in the situation of meeting the increased currency requirements by the issue of what would have been little more than a gold certificate—virtually the situation we were in before the Federal Reserve Act was established.

On the whole, I am inclined to think that a large proportion of the total circulating medium of the country can be issued against the Government securities, as backing—always provided you do not attempt to use the note-issuing power as a means of financing Government requirements.

Obviously and quite clearly, there is need in this country for 4 or 5 billions of currency. It is inconceivable that we should ever drop down to 2 billions of currency in use.

Senator McAdoo. Doctor, just at that point. How do you establish in your mind the desirable amount of circulating notes required to meet the needs of business?

Dr. Sprague. In just about the same way that you determine the amount of subsidiary silver. If there is more subsidiary silver than is required under given circumstances, it comes drifting into the banks. They find that they have more on hand. They ship it to the Federal Reserve. And the Federal Reserve ships it to Washington.

The same is true of currency?

Senator McAdoo. They get currency for it?

Dr. Sprague. No; they get deposits, rather than currency.

Senator McAdoo. Yes.

Dr. Sprague. Similarly, in the matter of currency. If there is an excess, outstanding, relative to the activity of trade, and all the rest, the banks all over the country will find that they are receiving more currency over the counter than they are paying out over the counter; and it will be shipped to the Federal Reserve, to strengthen the balances of the shipping banks.

The active factor in determining the circulation or the total of the purchasing medium comes through the demand for loans which, initially, will take the form of deposits.

If business becomes more active and borrows more from the banks, in the first instance, that will take the form of balances against which checks are drawn. And then, as more labor and materials are employed, there may be increased requirements for more currency.

But the initiating force or process is through bank loans—taking, initially, the form of checking balances.

Senator McAdoo. Of course, Doctor, we all realize that, under our system in this country, the bank check constitutes the largest part of our circulating medium. The great bulk of the business of this country is done on bank checks. And, of course, when you get a contraction of credit in banks, you get a contraction of the bank-check circulation.

Dr. Sprague. That is followed by the contraction of the currency circulation, after a bit.

Senator McAdoo. Exactly; it has a relation.

Now, this is a theoretical question. We have outstanding in the country today, I think, about 4½ billion dollars in circulation—in notes of all kinds; that is, bank circulating medium.

Dr. Sprague. Yes.

Senator McAdoo. I am asking a hypothetical question, merely because I have an object in view. Would you say it would be inflationary to add a billion dollars to our circulating medium today?

Dr. Sprague. It would depend upon the reaction of the community thereto.

Senator McAdoo. You mean, of the country?

Dr. Sprague. Of the country.

If in the future, it did not at all affect confidence in the money of the counrty, that additional currency, after making 1 or 2 payments, would drift into the banks, and then to the Federal Reserve, increasing the balances of the member banks.

If it excited a fear of inflation, then the outcome would be different; because people all over the country might then begin to fly from currency, to buy tangible things—5 acres and a mule, or what not; and you would get an upward movement of prices, through fear.

There are two kinds of inflation, as I see it: A business inflation and a fear inflation. You cannot get a business inflation except when that is initiated by the process of securing loans.

Senator Bulkley. Are you ready to predict what would happen, right now, if we should put out a couple of billion dollars of currency, to pay the bonus?

Dr. Sprague. Why, no.

I might be willing to put it in this way: That if it were done grudgingly by the administration, and if everyone knew that it was distasteful to the administration, and that the administration was disposed to offset it, to some extent, then no fear inflation would follow.

Senator McAdoo. Suppose an amortization provision were made that would retire it, over a period of years?

Dr. Sprague. There, again, that is in the same line.

On the other hand, if a bonus were paid in currency, as just one of a succession of devices designed to force, through expansion, an upward movement of prices, then I think a fear inflation would develop.

Senator McAdoo. Do you think a people, as a whole, would be concerned, one way or the other, about an addition of 2 billion dollars to the currency? Do you think that would create apprehension among the people of the country?

Dr. Sprague. As I said a moment ago, if it were regarded as a succession of steps, so that if that does not work in the direction of price increase, some other payments will be made for some other purposes, then I think that you—again at some stage which is difficult to predict—induce a fear of inflation.

Up to the present time, our policy has been that of endeavoring, by one means or another, to induce a more active business demand for credit. It has not come yet; and when it will come, I do not pretend to know.

Senator McAdoo. We are just issuing 4 to 5 billion dollars of bonds—which, of course, have a decided inflationary tendency, and are bound to create inflation, eventually.

Dr. Sprague. I do not agree to that, Senator.

Senator McAdoo. Don't you?

Dr. Sprague. No, sir.

Senator McAdoo. I should think that we would get a very large measure of inflation.

Dr. Sprague. I am afraid that I differ from my sound-money friends, on that point. You can increase the Government debt, without inflation, so long as the increase does do no more than absorb current savings. You can increase the Government debt to the point at which the people begin to be doubtful of the credit of the country. But that is a point that is far away, of course.

But the mere increase of $4,000,000,000 of Government debt, in itself, is no more inflationary than a similar increase of private investments arising out of an increase in the bonds and shares of stock of industrial companies all over the country.

Senator McAdoo. I am inclined to agree with you on that point. I put the question that way because I wanted to get your view.

And I want to say that that is in line with the same doctrine which you have just expressed—about an increase in circulating medium; that is, the fear that something more might be done.

The same kind of fear might be induced by increased governmental indebtedness; and the same consequences might follow.

Dr. Sprague. I am willing to say that if a year hence the situation is such that you need to borrow even more than was borrowed this year for work relief and other purposes, and if at that time we see no light at the end of the tunnel and no date at which these needs will diminish, then I think you get into a situation in which Government credit may be weakened and in which a fear inflation might start.

In other words, while you might go up to $50,000,000,000 of Government debt, it seems to me that the process will be very different if, for example, next year you had to increase the debt a billion dollars over the debt increase this year, and the year after that, two billions more than this year.

Whereas if you have by next year evidence of an improvement, so that the deficit will naturally decline somewhat, then you can go on with that deficit for quite some longer time. Because it will be at a diminishing rate of increase.

Senator McAdoo. Doctor, I was interested in your observations that if we created a fear inflation by the issuance of a billion or more of ·rrency the people would be disposed to take their savings and invest ·em in 40 acres of land and a mule.

Now, that is one of the things that some people here are anxious to see done. Would that not have a generally stimulating effect upon the real-estate situation of the country that might be of value in rendering liquid a vast mass of stuff which is now hopelessly frozen?

Dr. Sprague. It is the same kind of liquidity which, it seems to me, was present in brokers' loan and stock-exchange securities in 1928 and 1929—a liquidity which presupposes an indefinite continuance of the upward movement.

I do not believe that that kind of fear inflation would land us in a condition under which we could go forward in a sound and healthy fashion.

Senator McAdoo. Of course, you understand that, for the purpose of discussion, I am merely putting hypothetical questions; I am not expressing views.

Senator Bulkley. Do I understand you to say that to put out, say, a quarter of a billion dollars of Treasury notes to pay the bonus would not necessarily result in an increase of the price level?

Dr. Sprague. Not much more than resulted in the previous bonus.

Senator BULKLEY. What do you mean by "the previous bonus"?

Dr. SPRAGUE. That of 1930 or 1931.

Senator BULKLEY. That was simply an increase in the loan value.

Dr. SPRAGUE. Well, it created a large amount of additional funds.

Senator BULKLEY. But not any new Treasury notes; there was no new issue as a result of it.

Dr. SPRAGUE. But it does not seem to me that the new issues promise anything permanent in the way of a price change. They either do or do not induce a fear inflation. If they do not, and do not induce a business inflation of a continuing sort, then the Treasury notes drift back to the banks and increase excess reserves of member banks.

So that you might have, as a result, 3 billions or more of excess reserves rather than the 2½ or 2¼ that we now have. But if it were simply regarded as the first of a series of measures that were going to be pursued until there was some action in the line of a price advance, then I think you could have the fear inflation begin, with a more or less early collapse.

I do not know that I need to go further into this change in Federal Reserve notes. For I do not believe that it would make any great practical difference in the functioning of the Federal Reserve System.

Now we come to open-market operations.

Senator GLASS. Before you start to discuss open-market operations, Doctor, I have a question about the increased currency medium.

What is the existing capacity of the Federal Reserve banks to afford credits in new issues for legitimate business transactions?

Dr. SPRAGUE. Why, they can, I should say, increase by something like three billions of dollars, in granting credit to member banks, or in buying bills or in buying "governments."

They have plenty of funds. And that is true, whether the existing arrangements about Federal Reserve notes are retained, or not.

If, however, you eliminate, or wish to lessen, the power of the Federal to grant credit, you could do so by eliminating the provision allowing them to use "governments" as cover for Federal Reserve notes. That would absorb quite a tidy portion of the gold certificates that the banks now hold.

Senator GLASS. And that are not worth more than the paper they are printed on, so far as redemption is concerned.

I am not talking about limiting the powers of the Federal Reserve System to meet the requirements of business. What I am trying to bring out, for the record, is that the Federal Reserve banks have ample facilities to meet all of the requirements of legitimate business.

Dr. SPRAGUE. Quite.

Senator GLASS. Is that not so?

Dr. SPRAGUE. That is true. They have them, with or without this change in Federal Reserve notes.

Senator GLASS. It may be a matter of interest to the record hereafter to state that the authority to loan on United States "governments", instead of on commercial paper, was granted upon the distinct understanding and repeated assertion that it never would be utilized.

Dr. SPRAGUE. Now, going on to the matter of open-market operations: They obviously are of no consequence at the present time for the purpose of extending credit, for the reason that we have in the United States Treasury a situation which is unique, so far as I am aware, in the history of governments—since our Treasury has honest-to-goodness physical cash available for use amounting to something like 3 billion dollars.

The ordinary position of a government treasury is that it has a moderate working balance, and is obliged to go into the market and borrow if its needs increase over and above current revenue.

Our situation is unique, and will continue, I suppose, for a good many years, until the Treasury gradually has transferred to the Federal, in the form of gold certificates, the equivalent of the gold which it now holds.

But that places the responsibility for the conduct of our affairs, more largely than is normally the case, with the Treasury Department.

Since the revaluation of the dollar, a year or more ago, the Federal has been quiescent in the matter of open-market operations, the increase in member-bank reserves being brought about as a result of gold imports and the deposit of gold certificates by the Treasury with the Federal Reserve banks.

Senator McAdoo. This 3-billion balance, Doctor, in the Treasury, to which you now refer, consists largely of the results of the devaluation of gold, does it not?

Dr. Sprague. Yes; quite.

Senator McAdoo. Almost wholly, is it not?

Dr. Sprague. Almost wholly, two billion eight.

Senator McAdoo. That was my recollection.

Dr. Sprague. Some of it is being employed in connection with the retirement of the national-bank notes.

Senator Glass. I am glad that you did not make the mistake of calling it profit; you called it the result of the devaluation and not profit.

Senator McAdoo. I wished to be meticulous about it.

Dr. Sprague. The time may come when there will be general agreement that expansion has been such that restraint may be desirable. And with our existing set-up it will be necessary, if restraint is to be exercised, that it be through close cooperation between the administration, the Treasury Department, and the Federal Reserve System. I think that it is possible to prevent the development of an excessive business demand for credit, if there should be close cooperation between those two agencies—but hardly otherwise.

Senator Glass. Do you know of any failure on the part of the banks to cooperate?

Dr. Sprague. I do not. But I simply bring out this point to emphasize the point that the open-market changes are not of a type, under existing circumstances, that possibly could have any important bearing upon the situation.

Senator McAdoo. How about the future? We are talking about this from a long-range standpoint, as you expressed it.

Dr. Sprague. That is what I am constantly trying to emphasize: That I am judging this bill from the long-range point of view.

Senator McAdoo. From the long-distance point of view, do you think that change is desirable, or not?

Dr. SPRAGUE. Now, that brings us to the real heart of the problem. All of these changes—that relating to the open market, and those relating, I should say, to real-estate loans, and the provision relating to the power of the Federal Reserve Board to change reserve requirements of member banks—all enormously increase the power of the Federal Reserve Board. There has been a decided tendency for the power of the Federal Reserve Board to be increased—certainly ever since the death of Governor Strong. It is probably inevitable, and for this reason: The major function of a central banking organization is to influence the supply and cost of credit.

Now, 11 of the Federal Reserve banks cannot greatly increase the cost and supply of credit. Their business, in the main, is that of meeting, or not meeting, the requests for accommodation, on the part of the individual member bank.

The activities of the Dallas Reserve Bank, or the Minneapolis Reserve Bank, are not different, in essence, from those which were performed, before the Federal Reserve System was established, by certain city banks with numerous country correspondents—banks like the First National and the Continental in Chicago. The Federal very likely does it better; but in essence, the business is similar in character.

If you are going to influence the cost and supply of credit throughout the country, it can only be done through open-market operations; and those open-market operations must necessarily be executed almost entirely to New York.

All over the world the tendency is for central banks to make use, more and more, of open-market operations in the execution of their policies. Now, this is the reason why the New York bank has been far more important than all the other Federal Reserve banks put together.

One of the hopes of some of the proponents of the original Federal Reserve Act was that the System would serve to decentralize many things.

Well, it has not and cannot. It is inevitable that there be a central money market in every country, the place where idle funds go and where business goes, that is susceptible of contraction or expansion under the impact of changes in interest rates.

Now, the Federal Reserve Board has tended—and I think will tend—to receive more power and more authority, because, apparently, the people of this country are not willing that the central banking business be conducted primarily by a New York institution.

I think, then, on the whole, that it is probably inevitable that the Federal Reserve Board acquire more and more power in the conduct of the Federal Reserve System.

If one admits that, it would seem to me to follow that it is of vital consequence that the Congress establish a Federal Reserve Board that shall have independence of the administration in a large degree—as large a degree as is practicable.

It cannot be expected that it shall have that degree of independence that is possessed by the United States Supreme Court. The final decision must necessarily be made by the government that is in authority, on matters of monetary policy. That is true in every country. The Bank of England, for example—which, perhaps, enjoys greater independence and prestige than any other central bank—cannot veto a definite decision reached by the British Cabinet, and supported by the British Parliament; but it is unthinkable that any important monetary action could be taken, in that country, without thorough-going consideration of the matter with the authorities at the Bank of England.

Now that, we do not have. Decisions have been made in this country, without anything that you can style thorough-going discussion of the proposal or the policy with either the Federal Reserve Board or with governors of the Federal Reserve banks. And that, as it seems to me, is the central question raised by this bill.

Senator McAdoo. You speak of its independence, Doctor. How would you make it independent to the degree that you have in mind, as against the way in which the Board is now constituted?

Dr. Sprague. In the first instance, I would not include the Secretary of the Treasury as a member of the Board. The Secretary of the Treasury will always be in position to exert an influence and to secure cooperation from the Federal Reserve Board.

This is not a new thought of mine; I have been urging it for a great many years.

Senator McAdoo. My recollection is that you were opposed to the inclusion of the Secretary of the Treasury, in the original Federal Reserve set-up.

Dr. Sprague. I was, sir.

Senator Glass. Oh, yes; I had considerable correspondence with you on that subject.

Dr. Sprague. I do not know of any specific instance in which the Treasury influence has been exerted to secure action of a desirable sort, that would not have been taken by the Reserve Board, of its own initiative.

I do know of a number of instances in which the Treasury influence has been exerted in directions which seem to me to have been shown, by what happened, to have been regrettable.

I also believe that you can secure better men, as members of the Board, if the Secretary of the Treasury is not included in the membership.

I would also take the Comptroller's office out from the Treasury Department, and make the duties of the Comptroller of the Currency the duties of one designated member of the Board.

Those changes would seem to me to be calculated to give the Board somewhat of a more independent status than it now has.

Senator McAdoo. Am I correct in understanding your suggestion to be that the Comptroller of the Currency, as such, and his office, as such, should be taken out of the Treasury?

Dr. Sprague. Yes.

Senator McAdoo. And should become a bureau—so to speak—or a department of the Federal Reserve Board?

Dr. Sprague. Yes.

Senator McAdoo. And the Comptroller to sit as a member of the Board, in that capacity?

Dr. Sprague. Yes; and in no sense be a subordinate of the Secretary of the Treasury.

Senator Glass. As a matter of fact, Doctor, the Comptroller of the Currency is not, in the sense that you indicate, subordinate to the

Secretary of the Treasury. He does not even have to make a report to the Secretary of the Treasury; he is required, by law, to make his report to the Congress of the United States. And his term usually overlaps that of the Secretary of the Treasury.

Senator McAdoo. As a matter of fact, Mr. Chairman, if you will permit me to interject this thought here: He is a pure subordinate of the Secretary of the Treasury because no Comptroller of the Currency can hold his office against the wish of the Secretary of the Treasury and the President of the United States.

Senator Glass. Neither can any member of the Federal Reserve Board.

Senator McAdoo. I think that the Comptroller of the Currency is perhaps more subordinate to them.

Senator Glass. I think that the present Comptroller of the Currency has been less subject to that domination.

Senator McAdoo. I think that is true. We are not speaking of it from the viewpoint of domination, but from the aspect of influence.

Senator Glass. You are a little more diplomatic than I am.

Dr. Sprague. I am not thinking of it with respect to its effect on the Comptroller, but with regard to the influence on the public: That we need to establish a board that has such prestige and status that it will be regarded by the public, as the appropriate agency with which the administration will consult, in taking any important monetary action.

And that, it seems to me, would be somewhat improved if the board ceased to have any direct relations with the Treasury Department.

Senator Glass. Doctor, for the last half hour, you have proceeded upon the theory that the Federal Reserve System is a central banking system, and that the New York Federal Reserve Bank is the whole thing.

If we must have a central bank, to be owned by the Government and managed by the Government, that is one thing; I can readily understand how one might advocate that. Many persons regarded as experts in the banking business, have advocated that.

But why should we have a central bank, not managed by bankers, in which the Government owns not a dollar of proprietary interest, and assumes no single dollar of responsibility, but is managed by the Government?

Dr. Sprague. Well, it does not seem to me that that is in the essence of the problem.

Senator Glass. That is the problem that we have, right now.

Dr. Sprague. It seems to me that the fact that the banks provide the capital, is a minor factor in the functioning of the System.

The capital is reasonably secure. It has a limited dividend; and the surplus, practically speaking, is available for proper public use, and is in no sense available to shareholders, on liquidation.

I prefer to consider it a type of institution that will have the confidence of the public and which may be expected to be managed with a fair measure of efficiency.

My first point is that even if no further powers are granted the Federal Reserve Board than those which they now possess, their power has increased so largely since 1914 that we need, even more than ever before, a body composed of independent-minded people—capable of cooperating, of course, with the Government—but with a standing with the public that will make their opinions weighty with the Government, as well as with the people outside.

Now I come to the specific provisions of the bill relating to the Board and to the Reserve banks.

And in this connection, I should like to call to your minds something that was said by the President in his fireside chat last Sunday—to the effect that it was very difficult for people stationed in Washington to sense public opinion and really to know what was going on all over the country.

Well, that is a difficulty that is bound to present itself if we place more and more power with the Federal Reserve Board situated here in Washington. It would be different if the capital of this country were in New York.

We do need a very close relationship between the Federal Reserve banks and the Federal Reserve Board; and in the Federal Reserve banks we need competence and also status, lest the management of the Federal Reserve banks become nothing more than branch managers. For in that event you will not secure the same quality of person as those who have been secured in the past in the service of numbers of the Federal Reserve banks.

It is from that viewpoint that I think the change proposed about the governor and chairman of the respective Federal Reserve banks should be considered: Will the governor, under the new proposal, have a sufficiently independent status and sufficient authority so that you can attract to those posts first-rate men?

Now, as the bill was originally introduced, I should say that the answer was clearly in the negative, for it provided that the governor of each Federal Reserve bank should be subject to approval, or renewed approval, or disapproval, by the Federal Reserve Board every year. That has been changed in the draft of the bill that is now before the House, and it now provides that after the initial approval of the governor selected by the directors of a Federal Reserve bank the board may not have a chance to say anything definite about it for a period of 3 years. On the whole, that seems to me to be a desirable change. Whether that period should be lengthened to 5 years——

Senator GLASS. Or 12 years.

Dr. SPRAGUE. Or 12 years is, I think, an important question for you to consider.

But the object should be that of giving that post sufficient influence and power so that it shall be attractive to first-rate men.

It is suggested that in concentrating the powers of the chairman with that of the Governor, something is done to make the post more attractive. I do not think that that carries very far. What will be important is whether the Governor of a Reserve bank is "his own man", or whether he is completely subordinate to the Federal Reserve Board.

Now, much has been said, in hearings before the House, about the need of securing cooperation. But I do not think the best way to secure cooperation is to have people constantly under your control, as your docile subordinates.

Senator GLASS. Is not that what this bill provides, for the governor of the Federal Reserve banks?

Dr. SPRAGUE. That is what I fear, as the bill is set up; and as I read the hearings of Governor Eccles, he seemed to me to think of securing results, to an unduly great extent, by means of control. Whereas I do not know of very many instances, in the functioning of the Federal Reserve System, in which there has been an undesirable lack of cooperation. There have been some differences of opinion; and people frequently speak of the Chicago case. But whether the Chicago bank participated in open market operations, or not, did not greatly matter. All that it meant was that the other 11 banks would have slightly more of the open-market purchases of "governments."

The powers that the Federal Reserve System has—and the even greater powers that it will have, if this measure is passed—lead me to feel that it is desirable that there be a necessity for a certain amount of give and take, and meeting of minds, and cooperation. Smooth working, without friction, is not nearly so important as that these matters of great moment be thoroughly threshed out, and that the various people doing the threshing out, shall be independent people, and not mere subordinates.

Senator McADOO. May I interrupt you there, for an observation? As I understand your testimony thus far, you believe that greater power should be concentrated in the Federal Reserve Board, but that it should be free, as much as possible, from governmental interferences, and from the exercise by the Government itself of any powerful influence on the Board.

Dr. SPRAGUE. That is not my view at all. I would say: Do not give the Reserve Board more power unless you can make certain that it will possess greater independence than in the past.

Senator McADOO. Now, conceding that that power is given to the Board, do you not necessarily make the governors of the various banks subordinate to the Board and really subject to the compulsion of the Board in carrying out the policies which may be determined to be wise?

Dr. SPRAGUE. In the final show-down; yes. But there is a great deal of difference between dealing with a person who is your subordinate and whom you may fire tomorrow morning, if you are so inclined, as contrasted with people whose opinions you must respect, and who will be there even though you have overruled them on an important matter.

Senator McADOO. Suppose you fix the time as 3 years: He has a sword of Damocles hanging over his head.

Dr. SPRAGUE. That is why I think a longer period of time is desirable, and why I say—quite categorically—that no evidence has been introduced, so far as I know, to show that the system has functioned badly in important matters, because it is somewhat cumbersome, and because of a lack of cooperation.

Senator McADOO. Is not that statement of yours a negation of what you are advocating in the way of extending powers to the Board?

Dr. SPRAGUE. I extend the powers, partly because the public seems to demand it, and because—as I said before—the Board here in Washington, in a bit of a backwater in respect to the details and the atmosphere and how things may be developing around the country, except as you get them from statistics and from people who come in.

Senator GLASS. How do you arrive at the conclusion that the public is advocating it? The whole press of the country has been against it.

Dr. SPRAGUE. Yes.

Senator MCADOO. That would make the public for it!

Senator GLASS. Probably so.

Not only that, but 65 of the outstanding economists of the country signed a protest against it. If my correspondence is any index at all, thousands of bankers are against it.

Senator MCADOO. They were against the original Federal Reserve Act.

Senator GLASS. So I am rather unable to see how you determine that the public is in favor of it.

Dr. SPRAGUE. Well, because of the successive changes in the act, made from time to time, which have tended to give more power to the Reserve Board.

I do not think that this measure is urgent, but I am inclined to think that, owing to the status of the New York bank as the operating factor in the system, it is likely to come about that more power will be given to the Board, sooner or later.

And I am trying to set out—somewhat academically, I fear—the conditions under which it seems to me reasonable that the Board have more power, if it is concluded that a change in the system is desirable.

Senator GLASS. Adding to the difficulty pointed out by the Senator from California, this bill not only makes the Governor of each Federal Reserve bank subordinate to the Board but it makes the banks absolutely subordinate to the Board, in the matter of open-market operations.

Under existing law, any one of the 12 banks may decline to participate in an open-market operation.

Dr. SPRAGUE. Yes.

Senator GLASS. Under this proposal, they will be compelled, by the Board and in the judgment of the Board, to participate in any open-market operation in which the Board wants them to participate.

Dr. SPRAGUE. I do not think that is necessary, because I know of no instance in which the policy of the System has been unfavorably affected because of the unwillingness of a particular bank to participate.

As I recall, the Boston bank at one time was indisposed to buy either bills or "governments", whichever it was. Well, that was that. So some of the other banks bought rather more; it did not affect the situation.

Senator GLASS. But let us assume that any one of the 12 banks—the Boston bank, or the Chicago bank, or the Kansas City bank—through its very carefully selected board, with 3 of the members representing the banks of the district; 3 of the members actively representing the commerce, industry, and agriculture of the district; and 3 of the members appointed by the Federal Reserve Board, here, to represent the Government——

Dr. SPRAGUE. Yes.

Senator GLASS. And suppose the board of any Federal Reserve district should determine that, in its judgment, it would not be warranted in participating in an open-market transaction—initiated, say, by the New York Federal Reserve Bank. Why should it be compelled to do so?

Dr. SPRAGUE. That is another case where I believe that cooperation is what one should aim at rather than absolute control. I do not think it is necessary for the functioning of the System. The general policy might well be determined by the Board; but whether every one of the banks shall come along I think might well be left to those banks. Because if it is at all a reasonable policy, you may be pretty certain that most, if not all, of the banks, in any given instance, will join in as they have done in the past.

Senator McADOO. Doctor, is it not conceivable, too, that in some particular district prevailing conditions at the time may make it unwise for that bank to participate in an open-market operation, as ordered by the Board here?

Dr. SPRAGUE. Yes.

Senator McADOO. And is it not a larger measure of protection to the System and to the general purposes for which it is designed to serve, to allow a bank so situated to determine for itself whether or not it shall participate?

Dr. SPRAGUE. I think it is wise to do that; and those who make this proposal ought to be able to present clear and definite situations in which the lack of cooperation has been a serious matter in the functioning of the System.

Senator GLASS. In any event, how may it reasonably be conceived that a board here in Washington, may be better acquainted with the requirements of any given Federal Reserve district, than the board of directors of the bank of that district, who are in intimate contact with all the business and banking interests of the district?

Dr. SPRAGUE. I suppose the answer would be made that these open-market operations are largely handled through New York, and that it comes up to the individual bank, mainly as an investment proposition.

I should rather put it on the ground that it is desirable, in view of the size of this country, to endure a little friction, if you please, and shoulder a little lack of cooperation at times, in order to make certain that you are going to have competent governors and directors.

Because if the Reserve banks become nothing but the branches of the Federal Reserve Board you will not get the same interest among directors.

Senator GLASS. That is precisely what this bill makes.

Dr. SPRAGUE. And that is why I think it is desirable to modify the open-market provision, with reference to taking out that " control or compel " feature.

Senator GLASS. Let me interpose there: The existing law authorizes the Board to adopt rules and regulations for the general policy of open-market operations. And speaking of the New York bank: The Banking Act of 1933 was designed to strip it of a great deal of the authority that it had assumed without sanction of law.

Dr. SPRAGUE. Yes.

Senator GLASS. In fact, no governor of a Federal Reserve bank may even negotiate with a foreign bank, without the express authority of the Federal Reserve Board.

Dr. SPRAGUE. Yes.

Senator GLASS. You know perfectly well that, theretofore, the governor of the Federal Reserve bank did as he pleased, in such matters.

Dr. SPRAGUE. Yes.

Senator GLASS. And went ahead and not only had conferences, but negotiated contracts and underwrote the indebtedness of foreign banks.

Dr. SPRAGUE. Yes.

Senator GLASS. And the Banking Act of 1933 stripped the Federal Reserve banks of that authority; and they may not do any of that sort of thing, without the sanction of the Federal Reserve Board.

Dr. SPRAGUE. Now, there is one further feature about the local banks, that I should like to mention: It is proposed to eliminate the chairman as a separate office, entirely, transferring his functions entirely to the governor. On the whole, I think the transfer of the functions is unobjectionable. I should like to suggest, however, that instead of making the governor the chairman of the board, that one of the class C directors be designated, who, then, would have no routine duties.

I think it would be highly desirable if, in each one of the Federal Reserve districts, a man were to be secured as chairman of the board, who drew no salary other than director's fees, but who—occupying an independent position and becoming, through being chairman, fairly familiar with the functions and activities of his Reserve bank—could make representations to the administration, to the Federal Reserve Board, and to the appropriate committees in Congress, far more satisfactorily than any one else coming from the various districts could be likely to do.

In fact, I should be quite willing that such a group of these chairmen take the place of the Federal Advisory Council, which is composed mainly of bankers who do not have any very direct familiarity with what is taking place in their respective Reserve banks.

In each one of the 12 districts, I think, you could find an outstanding person to occupy the post of chairman.

Senator BULKLEY. Do you think that the governor of a Federal Reserve bank ought to be a resident of the Federal Reserve district?

Dr. SPRAGUE. I do not think it is necessary. In the case of Boston, two governors of the Board have become governors of the Reserve Bank of Boston—one coming from Alabama and the other from Minnesota—with excellent results, in both instances.

I do not think that it is desirable that a sort of civil service of governors be developed, making the governorship of Reserve banks a career, with the governors moved about from one Reserve bank to another. However, I do not know that that is implied in this title II.

Senator MCADOO. As I understand, your suggestion about the present chairman of the Board and the Federal Reserve agent who does exercise quite limited functions, and is more or less a clerk, and has no authority or cuts no figure in the management of the bank, unless he is a strong man and, therefore, does exert the powers which the law confers upon him; I mean that, in operation, it has been just about what I described—at least it was while I was Secretary of the Treasury. He is not a strong man, as a rule, and he does not exercise a useful function to the extent that the law contemplated.

Dr. SPRAGUE. Yes.

Senator McADOO. Now, if I understand your suggestion, you would change that?

He now draws a salary, and is appointed by the Federal Reserve Board, is he not?

Dr. SPRAGUE. Yes.

Senator McADOO. Your suggestion is that there be an independent chairman—one of the class C directors, and therefore a Federal Reserve Board appointee?

Dr. SPRAGUE. Yes.

Senator McADOO. That he draw no salary, and that he serve purely for the honor of the position, is that your idea?

Dr. SPRAGUE. Yes. And then you could get the sort of men who, for example, now are serving as chairmen of the various industrial loan committees in each district.

Senator GLASS. Dr. Sprague is an idealist if he thinks that anything like that may be attained.

In the first place, the chairman—and the agent appointed by the Federal Reserve Board—is assumed, under the law, to be a man of capable banking experience, who is obliged to know what is going on in the Federal Reserve bank, because he has to pass upon all the paper presented for discount.

And not only that, but he is charged with issuing to the bank the notes that the bank may demand and the credits that the bank may desire.

Dr. SPRAGUE. I am not suggesting that the existing chairmen are not good men. But they are salaried men, giving all of their time to their respective Reserve banks.

If the duties of the governor and the chairman are merged, then there is no occasion for a salaried chairman. But I think it would still be desirable that there be a chairman other than the governor to bring into the bank one of the more distinguished men of affairs in each district.

Senator McADOO. Dr. Sprague, do you not think that there is something in the fact that the Chairman of the Board and the Federal Reserve agent, who is the Government's representative, has been subordinated, in the public mind, to a position of inferiority, because we permit the title of "governor" to be assumed by the man who is selected by the board of directors to be the executive officer of the bank?

I have always felt that if we had a governor of these banks, then the present chairman of the Board, who is the Federal representative, should get the designation of "governor", and the present Governor of the bank should get some other title, say President, for instance, because if you call a man "governor", he sometimes begins to swell a little.

Would it not be better to call the chairman of the Board—equivalent to the executive officer of the bank—its "president"?

Then you would give him the dignity that I think he should have. In the eyes of the public, he would have the position he ought to occupy with reference to the bank: In other words, he is "carrying the flag", so to speak.

Dr. SPRAGUE. With the governor simply serving in the fashion that I have indicated.

Senator McADOO. Yes. He would have no salary, but he would have a title. And then he would really occupy a commanding position, in the public mind, and he would be the governor's representative.

As it is now, you call him a "Federal Reserve agent, and chairman", and the other man is called the "governor." And I think that that is psychologically very bad.

Senator GLASS. You will recall, Senator, that the proponents of the act, in the beginning, had expected that the chairman—designated by the Board, here—would be the chief executive officer of the bank. But we also authorized the bank, without designating any such officer as a governor, to select such officers as it thought were required to carry on its business. And each bank selected a man, and called him "Governor." And for a while, the governors of the 12 Federal Reserve banks undertook to usurp the authority of the Board, here in Washington. They had meetings when and where they pleased; and but for Governor Harding calling a halt on that sort of thing, and prohibiting them from assembling anywhere, except upon authority of the Board, they would have usurped the authority of the Board here.

But the Board had sat here for 20 years—now going on 21 years—and permitted that system to prevail.

Senator McADOO. Governor Harding took that action upon my suggestion, when I was Secretary of the Treasury; and I think it was done after consultation with you, as I recall.

Senator GLASS. Yes; but it has been going on for 21 years.

And I do not think that any of the governors of the Federal Reserve banks have been discredited. If they have been, the Board has lawful authority to remove them at any time. But it has never removed one yet, that I know of.

So why interfere with a thing which has worked satisfactorily for nearly 21 years? It will be 21 years this June.

Dr. SPRAGUE. Well, apparently, those who proposed this measure are designing it to give the Board, or to restore to the Board, in part, the power which you, Senator, suggest the Board had originally.

Senator GLASS. I did say so; yes.

Dr. SPRAGUE. I am in favor of the maintenance of as high a degree of autonomy in the existing Federal Reserve banks as is consistent with a reasonable measure of efficiency in the conduct of business and the determination of policy.

Senator GLASS. But under the pending bill they have no independence whatsoever. They are mere branches of a central bank, which amounts to a central bank not conducted by bankers.

Dr. SPRAGUE. I am prepared to suggest lengthening out of the term of the Governor to 5 years, and modifying the open-market provision in the direction of not compelling a member bank to participate.

Senator GLASS. That is a very material alteration in the proposition that confronts us.

Dr. SPRAGUE. I attach even more importance to this matter of giving the Board, in the mind of the public, in the mind of the administration, and in the mind of Congress, a high degree of dignity, status, and independence.

Senator GLASS. Well, Doctor, we are greatly obliged to you for coming here and giving us the benefit of your advice, some of which I am altogether disposed to take; and other parts of which I shall try to consider fairly, as all of us shall.

As I have said, you are an idealist and I am an extremely practical man, and perhaps I cannot reach up to your level in considering these matters. Do you care to say anything further?

Dr. SPRAGUE. Well, I should like to conclude my remarks about the status of the Board.

Senator GLASS. I apologize for interrupting.

Dr. SPRAGUE. Perhaps I have said it already: There is not much use in giving this Board—or any other agency—power, unless the members of the Board are the type of people who will use it. Take just one instance. There is a provision, in existing law, which is greatly improved in this bill—about making changes in the reserve requirements of member banks; for this proposed measure allows the Board to make changes—not uniformly all over the country—but by classes of banks. That is a desirable change, I think.

But you can well imagine a Board that would be afraid to exercise that power; and it would be purely a dead letter.

Senator GLASS. But could you imagine a Board that would abuse it?

Dr. SPRAGUE. I can. But I can also imagine a Board which would use it very seldom—but also use it on occasions when it would be highly desirable.

It would have been a very desirable thing in 1928.

Senator McADOO. It did not exist at that time.

Dr. SPRAGUE. No; but had it existed, what would have been the result? They did not use, in any effective fashion, the powers which they then had. They did not adequately advance the discount rate.

Senator GLASS. They did not advance it at all for 7 successive weeks, and they turned down the New York board's moves for advancing the discount rate. And yet that is the board which we propose to charge with the entire responsibility and power.

Dr. SPRAGUE. If the Board would not advance the discount rate, I cannot imagine it would jack up the reserve requirements of member banks.

Senator McADOO. You are getting down to the basic difficulty: That you cannot always be sure of the responsibility or political independence of any board, and therefore you have to take the chance that the President will appoint men to this board of the character and stamina to execute the law. Otherwise we should have to stop legislating.

Now, have you any suggestion to make whereby we can secure men of the right stamina?

Dr. SPRAGUE. Well, write me a note when someone is up for confirmation.

Senator GLASS. And you write him back that the Senate, under the Constitution, is charged with just as much responsibility as the

President of the United States in the selection of these people and it never exercises it.

Dr. SPRAGUE. But it is the most important board—given all these powers—next to the Supreme Court of the United States, I would say.

(Dr. Sprague in reading over his testimony, amended his reply to the following effect:)

It is only in the event that it is possible to secure a Board that is not subordinate to constant political control that I am prepared to favor such changes in the Federal Reserve Act as are embodied in title II. And I may further add that even on the assumption of an independent Board, I believe that title II goes too far in subordinating the reserve banks to the Board.

Senator McADOO. After all, it gets back to the matter of the men who occupy public office—and that applies to the President, as well as to the members of this board and the Members of the House and the Senate. Under our democracy, we take the chance of sending the best men, and you have to take the results as they come out of the hopper.

Senator GLASS. We have gotten pretty good results.

Senator McADOO. I think we have. The fact that the United States has endured this long, is, I think, a tribute to the system.

Senator GLASS. Well, we are obliged to you, Dr. Sprague, for coming down and speaking to us; and we wish to thank you.

(Thereupon, at 12:45 p. m., an adjournment was taken until Monday, May 6, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

MONDAY, MAY 6, 1935

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

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

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

Senator GLASS. Mr. Graettinger, will you please take the witness stand?

The legislative committee of the American Bankers Association requested us to hear you gentlemen on titles I and III of the bill.

Mr. GRAETTINGER. Yes, sir.

Senator GLASS. Will you be good enough to give your name and position to the reporter, and then proceed to make any statement that you desire.

STATEMENT OF M. A. GRAETTINGER, EXECUTIVE VICE PRESIDENT ILLINOIS BANKERS ASSOCIATION, CHICAGO, ILL.

Mr. GRAETTINGER. I shall make my statement brief, since the two gentlemen who follow me, being practical bank officers, will go into more detail.

I am appearing before you as a representative of the American Bankers Association, as well as in my capacity as executive vice president of the Illinois Bankers Association. In the latter position I am a member of the Central States Conference, an organization consisting of the presidents, vice presidents, and secretaries of the State bankers' associations in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, and Wisconsin. This conference some time ago appointed a committee on banking legislation, and I have the honor to serve as chairman, together with the president of the Missouri Bankers Association, Mr. W. W. Alexander, Trenton, Mo.; the president of the Minnesota Bankers Association, Mr. Dan J. Fouquette, St. Cloud, Minn.; the president of the Indiana Bankers Association, Mr. M. J. Kreisle, Tell City, Ind.; and the executive manager of the Michigan Bankers Association, Mr. Ray O. Brundage, Lansing, Mich. There are more than 8,000 banks located in the territory represented by this conference, and this number is somewhat more than half of all of the banks in the United States.

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In general, these banks are in accord with titles I and III of the bill, which your honorable committee has under consideration; and we desire to see that much of the bill represented by titles I and III enacted into law in order that there may be a certainty as to the statutes under which the Federal Deposit Insurance Corporation shall function. We favor the maximum amount of insurance on each depositor's account being limited to $5,000, and that the temporary plan now in effect become the permanent plan by June 30; otherwise the permanent plan in the act of 1933 will become operative at that time.

Senator GLASS. You would like to see that done promptly, would you not?

Mr. GRAETTINGER. I would.

Senator GLASS. In order that due notice may be given to the banks?

Mr. GRAETTINGER. Yes; and that the banks may know that they are going to proceed with the plan that is now practicaly in effect.

We realize that, in order that the Insurance Corporation may properly carry on its functions and be placed on a sound basis, it must be clothed with authority to protect itself against excessive risks and have some discretion as to extending the insurance feature to the banks now covered and those later applying for coverage.

We agree to the general plan of having each bank pay an annual assessment on its total deposits to augment the funds of the Insurance Corporation and to provide a reserve. But, considering that the earnings of the banks as a whole are now at a very low mark and, in fact, that the losses and charge-offs more than take up these earnings, we believe that this assessment rate should be made as low as can be reasonably done.

The bill before this committee provides a rate of one-twelfth of 1 percent upon total deposits, although the board of directors of the Insurance Corporation may from time to time fix a lower rate, but not below 50 percent thereof. In the bill now being considered by the House, which was reported by the House committee, it is provided that this rate shall be one-eighth of 1 percent on the total deposits, definite or mandatory.

If it is desired that a definite rate be made effective, we believe that it might be better to start with one-sixteenth of 1 percent, which would mean approximately $25,000,000 a year, so that the banks in general would be able to conserve their earnings and contribute toward reserves which will help them to take care of such losses as occur, make the banks stronger and, consequently, better insurance risks for the Corporation.

Senator GLASS. What would you say about the suggestion to have the assessment, whatever it may be, stop after the $500,000,000 that is required in the fund, and automatically resume when the fund shall have been impaired by 25 percent?

Mr. GRAETTINGER. I should say, of course, that there should be a limit as to the amount that might be collected as a reserve, although it may be that—I do not imagine it will happen, but it is conceivable—there might be a year when the fund would be drawn on quite heavily, and it would take some time to bring it back.

Senator GLASS. Well, the assessments would automatically be resumed, to bring it back.

Mr. GRAETTINGER. Yes.

By one method, they may be assessed beyond their ability to pay—which would contribute to their weakness, thus making them charges on the Corporation; while the other method, by calling for a reasonable assessment, would be helpful under present circumstances and permit the banks to build up their strength for the benefit of the Corporation. While the experience over the past years might justify a higher rate of assessment, it is quite conceivable that with proper supervision and authority lodged in and exercised by the Federal Deposit Insurance Corporation, the rate suggested may be sufficient to carry on its purposes. No actuarial basis can be provided until an experience over a number of years and under varying conditions has been had; and until then, and because of the circumstances cited, we feel that the statutory provisions should call for the rate suggested until such time as a correct assessment basis may be determined.

There is one other provision in title I in the bill before this committee with which the nonmember State banks are particularly concerned, and that is section 23, page 37, which requires all banks to become members of the Federal Reserve System before July 1, 1937, in order to continue as insured banks.

And on this point I wish to say that the banks in the territory already referred to, whether large or small, national or State, are practically unanimous in asking that this provision be eliminated from the bill. It would seem that State banks having the qualifications for insurance by the Insurance Corporation under subparagraph 2 of section 6, page 9 of the bill, having the capital requirements under the laws of the respective States in which located, being acceptable to the Insurance Corporation as qualified insured banks and being under supervision and authority of the Insurance Corporation as well as of the several State governments, should not also be compelled to become members of the Federal Reserve System and put under additional supervisory power and authority. Banks in these States want to see the dual system and the right of States to charter banks, in accordance with localized sentiment and conditions, retained, for they fear that the effect of the provision in the bill will be the possible centralization of banking to which compulsory membership may lead. After all, the management is the measure of success of any banking institution or of any kind or form of banking, and, without question, there is just as efficient management in the smaller unit banks as in the larger institutions, which fact has been very definitely demonstrated during the recent years.

Banks under State supervision have gone along year after year serving not only their own communities but the country as a whole and are responsible to a great extent for the development of this country. The unit country bank, whether national or State, owned and officered by men who have their homes in the community where the bank is located, has been the greatest factor in building up that community. It has prospered with the people and suffered with them. These so-called "country banks" have gathered together the savings of their communities and used them in a large measure to build up their home towns and the country thereabouts. It has been an ideal financial set-up both for the banker and the customer.

True, unit country banking has had its share of failures, but in no greater degree than was experienced in metropolitan centers, because people who owed the bank could not pay their obligations on account of the world-wide economic conditions over which neither they nor the bank had any control. All that is wanted by the State banks is the opportunity to continue to be of service in their particular field. A closer adjustment to local problems can be had under State laws. Therefore, there should be the alternative opportunities that now exist from which banking institutions and local business interests may choose, so that they can function or conduct their business relationships under that banking code which best meets the conditions of the times and of the place, as they see them.

There are a number of these State nonmember banks which do not have sufficient capital to meet the requirements for admission into the Federal Reserve System; but in many instances the capital structure is large enough in proportion to the liabilities to adequately take care of the business entrusted to them, and these banks could not profitably employ or meet the necessary capitalization increase which would be required for membership. Is it not possible that, with the changing trend of economic conditions in the smaller communities, this situation will take care of itself by the natural process of evolution and adjustment, without the requirement of compulsory membership, which appears rather repugnant to these smaller banks? It is on behalf of all of the banks in the 14 States mentioned for which I speak that we earnestly hope you will give favorable consideration to the request for the elimination of this one provision in the bill.

As to title III, I wish to say that we are in substantial accord with the provisions as printed in the bill and ask for your approval of the same.

Senator TOWNSEND. I came in late. What 14 States do you represent, Mr. Graettinger?

Mr. GRAETTINGER. Arkansas, Indiana, Iowa, Illinois, Kansas, Missouri, Michigan, Minnesota, Nebraska, Ohio, Oklahoma, North Dakota, South Dakota, and Wisconsin.

Senator TOWNSEND. You feel that those States are in accord with the statement which you have made?

Mr. GRAETTINGER. I do.

Senator GLASS. One critical difficulty that I may mention, is that the President and then the Secretary of the Treasury, Mr. Woodin, agreed to the insurance of the deposit provisions of the bill, only upon representations that it would tend to bring about approximately a unified banking system. And the President has twice said to me that he would be disposed to disapprove any repeal of that provision.

So we must take that into account, in considering the problem.

Mr. GRAETTINGER. I understand, Senator.

Senator GLASS. The President may be induced to change his mind. Such things have occurred.

Mr. GRAETTINGER. It is my idea that with perhaps a liberalization of the requirements, and with a campaign of education, on the part of the Federal Reserve Board, perhaps these banks could be induced and encouraged to go into the Federal Reserve System.

It is just a question of their being compelled to go into the Federal Reserve System. And I think that, during the years, that may transpire.

Senator TOWNSEND. Do you have in mind any liberalization of the Federal Reserve that you think would be helpful?

Mr. GRAETTINGER. Of course, there is the question of capital requirements. In these smaller communities, there are many banks that have sufficient capital to carry on their business. But it is not enough to enable them to qualify as members of the Federal Reserve System.

Senator GLASS. The Governor of the Federal Reserve Board, in his testimony before the House committee, was quite unmistakable in his advocacy of the provision.

Mr. GRAETTINGER. Yes; I understand that.

Senator GLASS. But we shall be very glad to give due consideration to the representation that you have made.

Mr. GRAETTINGER. Thank you.

Nevertheless, we should like to present our statement in regard to that, and have you consider that.

Senator GLASS. Oh, yes; you are not obliged to agree with the Governor of the Federal Reserve Board.

Mr. GRAETTINGER. Thank you, gentlemen.

Senator GLASS. Mr. Allendoerfer, we shall be glad to hear from you. I recall very pleasantly that you attempted the impossible task of giving us an acceptable definition of these banking auxiliaries in 1933. We did not accept your definition, and the result is that we have had a good deal of confusion in the administration of the law.

We shall be very glad to hear from you, Mr. Allendoerfer, on such subjects of the bill as you may care to discuss.

STATEMENT OF CARL ALLENDOERFER, VICE PRESIDENT, FIRST NATIONAL BANK, KANSAS CITY, MO.

Mr. ALLENDOERFER. My name is Carl W. Allendoerfer. I am vice president of the First National Bank, at Kansas City, Mo.

I wish to touch on titles I and III, and to discuss some things of importance and some that are not so important, but perhaps are worthy of some little discussion.

Senator TOWNSEND. Are you confining your remarks to titles I and III?

Mr. ALLENDOERFER. Yes, sir.

Senator TOWNSEND. All right.

Mr. ALLENDOERFER. I have written what I have to say, with the idea of saving the time of the committee. In my memorandum, I have referred to certain pages and lines of the House bill 5357, which I think is identical with the Senate bill, of which I had no copy.

Senator TOWNSEND. Well, it was originally identical.

Mr. ALLENDOERFER. That is what I mean.

Having lived for many years in a State neighbor to Nebraska, Kansas, and Oklahoma where the guaranty of deposits has been tried, I cannot help having reservations and even doubts as to the successful outcome of an attempt to insure bank deposits. But one must readily admit the actualities of the case, which are that conditions practically demanded that the public be reassured as to their deposits in banks. This could only be done by some form of insurance fund.

We have not yet had enough experience with the temporary fund on which to base the formation of a permanent fund, but it is possibly necessary to relieve the uncertainty and anxiety of all banks as to their assessments and make it possible for them to come to definite decisions as to becoming or remaining members. Therefore, some permanent fund should be established, even though it be with a realization that it is experimental and may require change, as a result of operating history.

Let me say first that I have a pet theory that under any insurance principle the assessment should not be based on deposits, but on the assets of the bank which expose the fund to risk; that is, loans, investments, real estate, and so forth; and secondly, that assessments on total deposits, instead of on insured deposits, is at least a debatable proposition. But I recognize that legislation should not be muddied by consideration of pet theories, even though they might be found sound; and that if the Corporation is to be carried on at all, the base on which assessments are levied must be very broad or the rate will be so high as to put many banks out of business. However, there are some proposals in the bill which may be susceptible of adjustment, and which I shall mention.

In the order as they appear in the bill and not in order of importance, may I refer to items which seem to me worthy of consideration.

Page 4, line 9, and following, gives a definition as follows:

> The term "deposit" means 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, * * *.

It seems to me that this definition is not particularly clear. The reference to unconditional credit given, or which the bank is obligated to give sometimes, does not specify when the bank is obligated to give it. It may be that those who drew that definition, have in mind the same point that I have; but it just is not clear to me.

In any event, I venture to suggest a substitute. Section 323 of title III authorizes the Federal Reserve Board to define "demand deposits", "time deposits", and so forth, and while the definition there is for a different purpose, it would, of course, be well to attempt to see that there is no conflict in definitions, and that the meaning of the words "deposit" or "net deposit", used with reference to one section, is not different from that when used in connection with a different section.

However, for the purposes of this section, I should like to substitute this wording:

> The term "deposit" means the credit balance in any commercial, checking, savings, time, or thrift account held by a bank in the usual course of business, less deposited items in process of collection, and so forth.

There is more to this definition, about certificates of deposit, and so forth, in the same sentence, and in which I am not suggesting any change. It may be that that is what is meant by items for which it has given, or is obligated to give, unconditional credit; I am not sure.

My thought is this: The unpaid balance on the books to the credit of a customer may be a conditional balance in whole or in part, unless the amount of items in process of collection is deducted. Items in process of collection do not represent funds which could be employed to earn the insurance assessment. Depositors may protect themselves, in case of the closing of the bank, by having payment stopped on items in process of collection. If the items are returned unpaid, they are charged back to the customer's account, and the liabilities which must be met by the receiver are reduced by that amount. If the items are paid, they provide the receiver with additions to the funds available when he took charge.

The principle of deducting from ledger balances, items in process of collection, is recognized when computing reserve requirements with the Federal Reserve bank. If the proportion of uncollected funds to total ledger balances were the same in all banks, this would not be an important point, as the inclusion or exclusion of these items would merely mean a change of the base and, consequently, of the rate of assessment. However, the proportions are not the same in different banks or classes of banks. It is therefore respectfully suggested that consideration should be given to basing the assessments on net realized deposits, as contemplated in computing Federal Reserve requirements, rather than on total ledger balances. It may be that that is what this means; I just cannot tell what is meant by the paragraph, as now drawn.

It may not be convenient to adjust it, but it seems to me that there is an inequality in requiring the payment of the assessment levied on secured deposits. I recognize that this is a subject which might be discussed at very great length; but it seems to me to be particularly apparent that the trust funds deposited by a national bank with its own commercial department and secured under Federal statute by collateral deposited with the trust department, constitute funds for which complete security already has been provided under law, and without the need of any additional insurance fund for which an insurance premium or assessment should be paid.

Senator GLASS. That is true of the deposit of Federal funds in a depository bank.

Mr. ALLENDOERFER. I do not want to take too much time on that point. It seemed to me that there was a particularly outstanding case where it was not necessary to provide insurance and to pay assessments to take care of them.

Page 9, line 17 and following: This paragraph reads:

> The factors to be enumerated in the certificate required under subsection (e) and to be considered by the board of directors under subsection (f) shall be the following: 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.

The new House bill, no. 7617, strikes out several of these factors. They make it read:

> The factors shall be the financial condition of the bank and the adequacy of its capital structure.

I believe that some of these things which are stricken out are considerations which the Corporation should have the power to pass on, before admitting additional members to the fund; and I believe that the original language should be restored. The safety of the fund must be safeguarded by the fullest care in the acquisition of new risks.

Senator Couzens. Then, you favor the new language?

Mr. Allendoerfer. The old language. I favor the original language of bill no. 5357.

Senator Glass. Which is also the language of the Senate bill; they have altered it in the House.

Senator Couzens. Yes; but the Senate language is the same as the old language. That is right.

Mr. Allendoerfer. Page 10, section 8 (h), line 3, rate of assessment. I have had the pleasure of reading the brief prepared for the benefit of this committee by Hon. Leo T. Crowley, chairman of the Board of the Federal Deposit Insurance Corporation. Mr. Crowley and his organization have done a superb job in creating the machinery through which the temporary insurance fund was set up and now operates. Their statistical department has made available information not previously compiled with reference to many points relating to the condition, earnings, expenses, and so forth, of banks, members of the Corporation, and particularly with reference to those banks which are members of the insurance fund but not members of the Federal Reserve Bank.

Senator Glass. Is that altogether true? Have not the statistics been constantly compiled by the Comptroller of the Currency and the Federal Reserve Board, and they have simply been made available now, or made public, by the Federal Deposit Insurance Corporation?

Mr. Allendoerfer. Senator, so far as I have been able to find, the reports of the Comptroller and of the Federal Reserve Board have included data with reference to member banks of the Federal Reserve System. The Federal Deposit Insurance Corporation now has available only the recent data, and not the historical data, as to all of the banks, members of the Federal Deposit Insurance Corporation, these being the former nonmember banks. And this information is quite helpful in many considerations.

However, even with their excellent work in the matter of data, it must be admitted that the statistics are of relatively little help in determining the losses which may be expected hereafter, and that the total of future losses must be largely a guess. What these losses will actually be, is very greatly influenced by further supervision under other additional powers granted by the Board of the Federal Deposit Insurance Corporation under sections of this bill. No one can say with any certainty that an annual assessment of one-sixteenth of 1 percent, or one-twelfth of 1 percent, or one-eighth of 1 percent of total deposits is the amount which will be required. Actuarial computations are dependable only on the assumption that facts which have prevailed in the past will continue in the future. It is not reasonable to believe that the facts with reference to losses, in recent years at least, will be continued. It seems to me, therefore, that we should recognize that whatever rate of assessment is established at this time is purely experimental, and that it will take a number of years to determine, with any degree of accuracy, the required income to the insurance fund. Since this is true, we must then have in mind, in fixing the rate of assessment for the immediate future, the capacity of the banks to pay that assessment; and this should be the determining factor in arriving at the maximum levy. If it is placed above the ability to earn and pay, the very liability for such assessment will tend to reduce, and perhaps impair, the solvency of many of the institutions, themselves.

Senator COUZENS. Could we determine that, with any degree of uniformity?

Mr. ALLENDOERFER. No; not on any data that I have been able to find.

Senator COUZENS. So that, in fact, you cannot determine, when you draft this bill, whether the banks are going to be able to afford this?

Mr. ALLENDOERFER. That is true; so that I feel that it should be at a minimum. I cannot support my position by statistics, Senator. But I do know it to be a fact that during the period since any statistics have been compiled and published, the earnings of banks have continued to decline abruptly.

Senator COUZENS. But they have also had substantial amounts of money deposits.

Mr. ALLENDOERFER. I have a paragraph which I should like to present on that, if I may, a little later in the hearing.

Senator COUZENS. Very well; proceed.

Mr. ALLENDOERFER. What is the capacity to pay, as it appears at this time? We are in a period of unequaled low earnings for banks. There are no indications of an improvement in these earnings for some time to come. The expenses of banks will be further increased by the contributions to social-security funds which will be called for by State or national legislation now under consideration, and which, I believe, in some States is already enacted into law. No saving in expense, which would impair proper banking service to the public, in order that the insurance assessment can be paid, should be permitted.

On page 23 of Mr. Crowley's brief he indicates a deficit in net earnings of all national banks, reduced to an annual basis by computing from the results of the 6 months ending December 31, 1933. This he shows to be $1.81 per $100 of total deposits.

The table on page 112 of the Federal Reserve Bulletin for February 1935 would indicate a still greater deficit for all banks, members of the Federal Reserve System. I have not been able to find similar figures on all banks, members of the insurance fund; but it is very doubtful whether the deficit for all such banks would have been less than that just quoted. It has been stated by public officials that there are additional charge-offs which must be made, representing losses already recognized. In addition to this, there will be the inevitable current losses. The income of banks has been reduced acutely and increasingly since the period on which Mr. Crowley's figures are based. And in that situation, when we add the additional expenses which have been referred to, it must be inevitable that the wisest course for the present is to make the assessment rate at a low maximum and with some power in the board of the Federal

Deposit Insurance Corporation to give recognition to prevailing conditions and adjust the rate below the maximum.

Senator TOWNSEND. Would you care to suggest the rate which you think would be proper?

Mr. ALLENDOERFER. May I have just a minute? I do not mind being interrupted, but perhaps that is better referred to a little later.

Senator TOWNSEND. All right; proceed.

Mr. ALLENDOERFER. Whenever by reason of experience with a permanent fund, a higher rate of assessment is indicated as proper and the earnings of banks have increased so that they can pay more, the board of directors of the Federal Deposit Insurance Corporation will, without doubt, present these facts to Congress and ask for an increase in the maximum. The original bill fixed the amount of the annual assessment at such part of one-twelfth of 1 percent as the board of directors of the Federal Deposit Insurance Corporation should consider necessary. The new House bill, no. 7617, fixes the assessment of one-eighth of 1 percent, mandatory. Personally, I believe the lower of these two figures will make it very difficult for many banks; and I am in favor of making the rate as low as one-sixteenth of 1 percent, if it must be mandatory. Certainly, the mandatory rate of one-eighth of 1 percent is clearly excessive.

Answering your question, Senator Townsend, I think that one-twelfth of 1 percent, as the maximum, is the limit, on the maximum side. If there must be a mandatory minimum expressed, instead of leaving it entirely to the judgment of the directors of the Federal Deposit Insurance Corporation, within the maximum, I should say one-sixteenth of 1 percent mandatory, and up to one-twelfth of 1 percent maximum, in the discretion of the Board.

While referring to Mr. Crowley's brief, I should like to make a comment on an incidental matter which I believe should be of interest. Without doubt, Congress had in mind, when the Banking Act of 1933 was enacted, that by a provision eliminating interest on demand deposits and establishing control for interest to be paid on time deposits, it would save the member banks an amount of money equal to that which they would be called upon to pay into the insurance fund. This provision about interest was a very wise one and has been very helpful to the banks, particularly in the months immediately following the passage of the bill. I believe power should be given to the Federal Deposit Insurance Corporation to control the interest to be paid by the nonmember banks belonging to the fund. As things have developed since the Banking Act of 1933 was passed, it is apparent that the elimination of interest on demand deposits and the reduction of interest on time deposits would have been absolutely necessary even had there been no such legislation. And progressively since that time, rates have, of necessity, been reduced and almost eliminated.

The particular point which I wish to make, however, is one which I think may have been overlooked by some, in the consideration of this subject. Banks carry accounts with other banks—the small banks with those in larger cities, and those in turn with banks in Reserve and central Reserve cities. When the payment of interest on demand deposits was prohibited, the resulting saving to banks was not paid by the general public alone, but was paid in a very large amount by those banks which had balances with the larger banks. In other words, the showing of reduction of total interest cost does not reflect the whole condition. On the other side of the ledger is a very large reduction in the amount of income to depositing banks, which they formerly received on balances maintained with their city correspondents.

I put in Saturday morning trying to find data which I could give you, which would give a proof of the amount of that. I could not find it; perhaps I have not been to the right place.

But without giving you an accurate estimate of the proportion of the total interest paid—which was, in turn, a loss to some other bank—we can say that it is a very substantial percentage of the amount which is frequently spoken of as being a net saving to the banking system as a whole. And the incomplete figures which I have been able to get from the Federal Reserve bulletins fully justify, I think, the assertion that at least 30 percent of the apparent savings to banks have merely meant that another member of the "family" did not get it; and therefore, it was not a net saving to banks, as a whole.

Senator GLASS. It seems to me that we have discussed this question solely with respect to the loss of savings to the banks, themselves.

However, there are approximately 40 millions of depositors in the time- and savings-deposits class. Do you not think they ought to have some consideration? They are not primarily investors. A very small percentage of them, if any at all, would know how to go on the stock exchange and buy a share of stock—either railroads, industrials, or any other description of stock. They merely deposit their savings in their local banks, with the expectation that they may draw them out at their convenience, when necessary. They are not investors.

Now, it has seemed to me that to rather arbitrarily cut the rate of interest to be paid to these 40 million depositors, is a matter which needs to be carefully considered, in their interest as well as in the interest of the banks.

Mr. ALLENDOERFER. Very well.

It is in the interest of the banks, if their interest is protected, Senator. And certainly the power of the Federal Reserve Board or the Federal Deposit Insurance Corporation, if granted to regulate rates of interest on time deposits, should be exercised only to the point of restricting excessive rates, which lead to bad banking practices.

Senator GLASS. And it has not been exercised either in the spirit or the text of the law.

We discussed this matter in our subcommittee, and we talked of it in our hearings on the Banking Act of 1933. And there was intended to be a uniform rate throughout the United States. We came to the conclusion that there was no more reason to have a uniform rate of interest to be paid to depositors than there was to have a uniform rate of discount throughout the United States.

Mr. ALLENDOERFER. I think that is perfectly true.

Senator GLASS. And I have not departed from that conclusion.

Mr. ALLENDOERFER. My expression here, as used in my memorandum and in my oral testimony. with reference to giving the power to the Directors of the Federal Deposit Insurance Corporation, to fix maximum rates of interest on time deposits, is only with the thought that that is a very important control over bad banking; in paying excessive rates of interest in order to have funds to use is not the best way for investment by the bank.

Page 10, line 24: A date to determine the deposits upon which assessment is computed. The present act creating a permanent fund, and the bills introduced in the Senate and House, set particular days which are to be used as a measuring stick of the deposit liability of the bank on which its assessments are to be based. It seems to me clear that any predetermined date for this purpose is a serious mistake. It will either result in very great inequality by the dates being set, as they were set, at periods when certain banks will have large amounts of temporary deposits placed with them to meet dividend payments, payment of coupons, and so forth, or even if there is no attempt made by the banks themselves to control their deposits as of date of assessment, inequality will result by reason of natural fluctuations making these days far from the proper average deposits of particular banks. And the invitation is there to all banks to attempt to control their deposits on those assessment dates known in advance.

Senator GLASS. Just as there is a great temptation for the individual depositors, in States where a tax is levied against deposits, to check out on the day before the date, and to redeposit on the day after.

Mr. ALLENDOERFER. The methods possible in the use of these controls need not be discussed in detail, unless some member of the committee wishes it. The new House bill, no. 7617, makes some changes in the date of assessment by saying that the total deposits for assessment purposes shall be determined as of the close of business on one day in each of 3 or more months preceding January and July of each year. It seems to me that the ideal arrangement would be an average of the total deposits shown by the daily statement book of the bank over all the business days of each 6 months' period; and I can think of no important reason why that method should not be used. It does not seem to me that the attempt to correct the matter, as expressed in the new House bill, includes enough days on which the average is to established. And if there are good reasons why the average shall not be that of all the business days within the period, then at least it should be based on the average of a considerable number of days. The same error of establishing a predetermined date occurs in a minor matter on page 11, line 24, where the deposits of a bank becoming a new member of the fund are established, for the purpose of assessments, as being at the close of the fifteenth day after it becomes an insured bank—a predetermined date again.

On page 30, line 12 and following, is a provision under which a depositor in a closed bank has only 1 year in which to claim his benefits under the insurance fund. I believe this to be entirely too short a time. The new House bill extends this to 18 months; and it occurs to me that it might be made 24 months, as the assets of the closed bank are not likely to be fully liquidated before that length of time, and therefore those engaged in the liquidation of the bank would have to keep their books open and might very properly give all depositors the benefit of 24 months in claiming their benefits.

On page 34, line 13 and following, in the first sentence in that paragraph is a provision that the board of directors of the Federal Deposit Insurance Corporation shall gather information and data and 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 new House bill omits both this sentence and the following sentence, which provides for a report to Congress of the findings of the board of directors of the Corporation. It seems to me to be desirable that this Corporation do gather information and data and make this available by the publishing of a report thereof.

Because, as we discussed a moment ago, that does not include data concerning the banks not members of the Federal Reserve System, on which we have not previously had consolidated information.

I would urgently recommend the omission of the words, however, in the last of the original paragraph, "and the security of depositors and adequacy of service to borrowers." The first phrase seems entirely unnecessary, as it covers only what is already provided for in many other ways. And the last phrase, "adequacy of service to borrowers", seems to promise little which would be of substantial good, but rather to call for inquiry which can do nothing more than make mischief.

Senator COUZENS. How do you mean "make mischief"? How would it make mischief?

Mr. ALLENDOERFER. Senator, we have had, during the last year, inquiry of the adequacy of service to borrowers—these inquiries being of Federal agencies, that have made some reports, frequently of minor importance. If any good has been accomplished by that investigation and report, I do not know what it is. That report simply brought to light whether or not banks were refusing loans, and that recovery was being delayed because of their attitude.

It was then thrown open so that the R. F. C., Mr. Jones' Corporation, and the Federal Reserve banks, themselves, could loan to borrowers who were not being taken care of by banks. And the extent to which that has been found useful is not a very great proportion of the needs of the borrowing public on the whole.

Senator COUZENS. Are not your conclusions rather based on an unusual economic condition, rather than on a permanent law?

Mr. ALLENDOERFER. I do not want to seem to express any dissatisfaction with the fact that it has been considered, and that the agencies have been set up to take care of loans which banks were not making. There has been a good job done on that.

But this requires that the Federal Deposit Insurance Corporation shall gather information and data continuously, and shall publish a report—make a report to Congress, which report shall be published.

Senator COUZENS. But it does not mention any bank or any particular locality. I suppose it would be done in general terms, just as the report of the Comptroller of the Currency is made in general terms.

Mr. ALLENDOERFER. That would depend on whether or not the Corporation felt that this put a charge on them to make a report to Congress regarding the adequacy of service to the public by banks. I cannot feel that that is important.

Senator GLASS. As a matter of fact—and I am asking this question because I take infinite satisfaction in having once turned out to be a prophet—were not the legitimate requirements of industry vastly overestimated, for direct loans?

Mr. ALLENDOERFER. I think the record so shows.

Senator COUZENS. Let me ask this question: The restrictions for opening up new banks are rather strict. And assuming that there was only bank in a community, and that it was a monopoly, and autocratic, so that the people of that particular locality had to go to other cities to get their loans, because of the autocracy of the local banks, or the undue rigidity of their requirements, might it not be well to have some information as to that? Because I can conceive that, under the proposed law, there will be greatly increased restrictions on the opening up of new banks and the creating of competition.

Mr. ALLENDOERFER. Senator, I still think that there is nothing but mischief in a charge on the Federal Deposit Insurance Corporation to investigate, continuously and annually, and to report upon the adequacy of service of the banking system—as a whole, and including all members of the Federal Deposit Insurance Corporation—to borrowers.

Senator COUZENS. Well, we do not have to decide that among ourselves.

Senator GLASS. After all, it is a matter of judgment. Some people think—and I do not mean anything personal—that the judgment of the Bureau, here in Washington, is vastly superior to the judgment of bank boards in the various localities throughout the country—just as they think that when a dollar is taken from the pocket of the taxpayer, and is brought here to Washington, it becomes most sanctified, and is multiplied to several dollars.

Senator COUZENS. In view of what the Senator from Virginia says, I suppose I shall have to engage in some further controversy: I think that the fact that an industry was able to go out from its community, and get the loan somewhere else, in some other community, would be almost prima facie evidence that the particular bank refusing the loan was not supplying proper credit.

Senator GLASS. Suppose that the bank did not have the money to lend? It is not loaning its money, but the money of its depositors.

Senator COUZENS. That can be determined.

Senator GLASS. How can a bureau, here in Washington, determine that better than the people in the particular localities?

Senator COUZENS. We do not ask them to determine that. We ask them to bring in a report of the facts, and then we can decide it. However, we can decide that among ourselves.

Mr. ALLENDOERFER. Shall I go ahead?

Page 36, line 19 and following, reads:

> Each insured bank shall provide such protection and indemnity against burglary, fidelity, and other similar insurable losses as the board of directors by regulation may require adequately to reimburse the bank for such losses.

The purpose of the paragraph is unquestionably sound. It seems to me that it is so worded that the directors of the Corporation have a charge upon them which it is next to impossible to fulfill.

The carrying of insurance, which in all cases would adequately reimburse the bank for losses, would mean the carrying of insurance on all cash, all securities owned by the bank, all collateral held by the bank to secure loans made by it—such insurance being against burglary and robbery—and a fidelity bond on each employee of the bank of such size as to unquestionably adequately reimburse the bank for any possible defalcation, all of which would be so expensive as to be entirely beyond the demands of good business. The new House bill changes this sentence. Perhaps I should read that. The change reads [reading]:

The Corporation may require any insured bank to provide protection and indemnity against burglary, defalcation, and other similar insurable losses.

Reasons for the change of the word "fidelity" to "defalcation" are obvious. It is a grammatical proposition there. My proposal for change in this wording, before I had read the new House bill, was as follows [reading]:

Each insured bank shall provide reasonable protection and indemnity against burglary, defalcation, and other similar insurable losses.

I prefer this to the language of the House bill, because it puts a charge on the banks themselves to provide protection without waiting for a requirement from the Corporation. The next sentence gives the Corporation power to see that this is done if they do not do it of their own accord.

With reference to title III, page 64, line 25, and following, reads——

Senator COUZENS. You are not going to deal with title II at all? Is that it?

Mr. ALLENDOERFER. No, sir. I was under the impression that it was not desired that those testifying today should touch on title II.

The CHAIRMAN. I would put it a little differently from that. The legislative committee of the American Bankers Association asked the chairman to summon these gentlemen to testify on titles I and III.

Mr. ALLENDOERFER. That is a better expression of my understanding.

Page 64, line 25, and following, reads:

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), including cash items with Federal Reserve banks and other banks in process of collection, checks on other banks in the same place, and exchanges for clearing houses.

The new House bill changes the last clause to read:

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.

I have no choice between the two expressions. I know the subject has been up before, but I want to bring it up again with a suggestion that the deductions from gross demand deposits should include the amount of United States currency and coin on hand in the bank. There is some measure of unfairness to banks which are not located in Federal Reserve cities by reason of the fact that they must carry an amount of cash in their vaults for their daily needs, quite in excess of the proportion necessarily carried by banks in cities where Federal Reserve banks are located. Quite aside from the point of unfairness, I know of no real reason why cash in the vault should not be qualified as a deduction fully as much as a check on a remote bank, which is in the mails for collection.

On page 67, line 3: This is part of a long paragraph which gives to the Federal Reserve Board the power to limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and provides that every bank whose deposits are insured under the provisions of section 12B of this act (except mutual savings banks and Morris Plan banks which are not members of the Federal Reserve System) shall comply with the provisions of this paragraph and the paragraph immediately preceding and with the rules and regulations prescribed by the Federal Reserve Board. In this and some other sections of the bill and the present act it is exceedingly mystifying to me why mutual savings banks and Morris Plan banks are put on a different basis from other banks.

I do not argue against the attempt to set up a preferential rate or even a separate permanent insurance fund for mutual savings banks, but I cannot see the logic of including Morris Plan banks in the Federal Deposit Insurance Corporation, and exempting them from control as to the payment of interest on deposits. By the way, incidentally although nearly every other character of bank is specifically described in the early sections of title I giving definitions of what is meant by a member bank, nonmember bank, and so forth, there is no definition given of a "Morris Plan bank." Perhaps some members of the committee will understand better than I can, why preference should be given to corporations of that character.

Since I have written that, I have searched again through this bill. I may be wrong; it may be that if you got all of the clauses tied together, the Morris Plan banks would be under control of the Federal Deposit Insurance Corporation as to the rate of interest to be paid on deposits if the Federal Deposit Insurance Corporation is to be granted that power. But the clauses are just so confusing to me that I decided I would read that even if my comment is wrong, because this exception of the Morris Plan bank business all through here, I just cannot understand.

The CHAIRMAN. As to the mutual savings banks, we need not give ourselves any concern, because they en bloc have declined to go into the Insurance Deposit Corporation, with a few exceptions.

Mr. ALLENDOERFER. I do not want to argue the matter of mutual-savings banks, but in these exceptions, they are spoken of in the same breath all the way through.

The CHAIRMAN. I was not arguing the question; I was just stating the fact. I never argue.

Mr. ALLENDOERFER. Page 67, line 8, and following: This paragraph requires member banks to maintain the same reserves against deposits of public moneys by the United States as they are required by this section to maintain against other deposits. At this time when all banks have an excess of reserves anyway, it does not matter much whether there is a requirement that reserves be maintained on Government funds or not. The present situation will not always be true. It does seem unnecessary to require that reserves be maintained against deposits by the Government with member banks secured in full by the deposit of Government securities which are readily marketable, or usable as collateral, in case it is necessary to rely upon the securities to restore reserves when the deposit is withdrawn. Perhaps it is not a matter to make a serious complaint about, but it just seems to be an unnecessary and annoying requirement which could be very well foregone.

On page 69, line 12: This is to amend a subsection of the Federal Reserve Act dealing with moneys borrowed by executive officers of banks from their own institutions. I happen to have the good fortune not to be indebted to the bank with which I am connected, nor have I ever been so indebted, and I speak without any personal or selfish motive. I do know, however, many bank officers who have been greatly worried and who have made substantial sacrifices in an attempt to get their paper paid by June 16 of this year as required in the present act. The extension of the period during which such loans must be retired seems to me to be a very wise one indeed, and I hope this section at least can be hurried to enactment before the deadline of June 16.

The subject has been mentioned by Mr. Graettinger, and I think will be mentioned also by Mr. Andrew, as to the change proposed in the new House bill which will eliminate the requirement that State banks become members of the Federal Reserve System by 1937 or some other date, in order to become members or to remain members of the Federal Deposit Insurance Corporation. I do not wish to speak on that paragraph.

Senator COUZENS. Why?

Mr. ALLENDOERFER. It is 20 minutes of 12, Senator, and I believe you adjourn at noon, and Mr. Andrew is to speak on that subject following me.

Senator COUZENS. Have you any views about it yourself?

Mr. ALLENDOERFER. No views that I would wish to present to the committee. If you are interested in my reasons, I will say to you that I had understood all the while that they were obliged to become members at some time of the Federal Reserve System.

Senator COUZENS. I do not think that by July 1, 1937, they will.

Mr. ALLENDOERFER. I hope not. This new proposal that that requirement be eliminated leaves me trying to think about whether I am in favor of that, and I am confused about it, and so I do not want to say anything in the record expressing an opinion about it.

Senator COUZENS. You just said, "I hope not." So I thought that was an opinion.

Mr. ALLENDOERFER. By 1937, I said. However, I mentioned that because I do want to say that I believe that if the requirement of membership in the Federal Reserve System is retained, then it is proper to favor the modifications in requirements as to membership in the Federal Reserve System on capitalization which are proposed in this bill and practically modified in the House bill. I favor the liberalization of the capital requirements of State banks becoming members of the Federal Reserve System.

The CHAIRMAN. We are obliged to you, Mr. Allendoerfer.

(The witness withdrew from the committee table.)

STATEMENT OF L. A. ANDREW, FORMERLY SUPERINTENDENT OF BANKS, STATE OF IOWA; RECENTLY PRESIDENT OF THE STATE BANK DIVISION OF THE AMERICAN BANKERS' ASSOCIATION, DES MOINES, IOWA

The CHAIRMAN. Mr. Andrew, we will be glad to have your views.

Mr. ANDREW. Mr. Chairman and members of the committee, we wish to urge, first, the importance and the necessity of having legislation along the lines of titles I and III. I wish to speak particularly of the assessments on banks with regard to the F. D. I. C. fund. The smaller State banks have had the same troubles as the national banks in regard to earnings. At the present time the earnings of all banks, both national and State, are practically negligible. The State bank members and the banks not members, in 1934, after charge-offs, showed a deficit in their undivided profit accounts. In the latest report of national banks for the 6 months ending December 31, 1933, covering 5,159 banks, the deficit was $154,988,000.

It might be well to bring up at this time and press the importance of the number of State banks not members of the Federal Reserve System, their deposits, and the number of customers they have. From the latest reports published, it is revealed that 7,683 insured banks are not members of the Federal Reserve System. They have insured deposits of $3,580,000,000 and uninsured deposits of $1,363,000,000. The ratio of their insured deposits to total deposits is 72.43. The depositors fully insured are 13,687,000. Nearly 14,000,000 people are doing business with banks outside of the Federal Reserve System at the present time. The ratio of fully insured deposits in nonmember banks to their total deposits is 99.1.

The State banks not members of the Federal Reserve System and their 14,000,000 customers are quite exorcised over the requirement of becoming members of the Federal Reserve System by the set date. They feel that this requirement should be changed, either eliminated entirely or put at a later date, say, 1940.

I wish to bring respectfully two points to your attention on this subject. Those who have the best interests of the Federal Reserve System at heart might think, perhaps, that the requirement of putting such a large number of banks into the System, particularly with changed capital and other requirements, might not be of advantage to the Federal Reserve System itself. With unification of our banking system worked out very satisfactorily through the F. D. I. C., might it not be well, with the great changes now being talked of in the Federal Reserve System itself, and probably put into legislation, to allow that to be worked out for a reasonable time before forcing nearly 8,000 banks into the System that are now out?

The CHAIRMAN. Abolish the Federal Reserve System and turn them all over to the F. D. I. C.?

Mr. ANDREW. No, Senator. Let each take its own place. The F. D. I. C. has a great obligation in working out this insurance fund satisfactorily. But here we have great changes proposed in the Federal Reserve System, by attempting to compel some 8,000 more banks to join the Federal Reserve System. A number of these banks, say 2,500, cannot qualify and their closing would create considerable disturbance in this country.

I want to call attention particularly to the kind of banks they are. These are community banks. Their range of business seldom extends beyond a 7-mile limit. They are the lifeblood of the community in which they exist. They are just as important to Jonesville as the Chase or the National City Bank is to New York, and they have the same relative importance to the people in the community. They have taken care of their communities perhaps better than any other class of banks in the country. Although there was quite a mortality among those banks, the total failures are no greater in proportion than in national banks or even in Federal Reserve banks.

As regards the total of deposits in the System and out of the System, the proposed material changes as to the requirements for admission, particularly as regards capital, are certainly necessary, providing this compulsion is carried forward. But I think it would be well worthy of consideration at this time to question whether it is really necessary, with the other great changes going on, to force this large number of banks, with only a small proportion of the total business of the country, into what they consider an undesirable relationship.

The State banks already contribute 42 percent of the total assets of the Federal Reserve System. They have done their full share and will continue to join the System because, in our opinion, any bank doing a commercial business having deposits of a million dollars should belong to the System. As to the amount of assessments, with the large decrease in earnings it is going to be a great charge on these banks to stand one-eighth of 1 percent annually. With a bank of only $1,000,000 of deposits, this means $1,250. When 92 percent of them are losing money, that is quite a charge. It makes 2½ percent of the average capital of a bank of that size $50,000. We believe that a limit of one twelfth of 1 percent annually would cover the situation quite satisfactorily; probably collectible semiannually.

We believe in the building up of a substantial reserve fund; $500,000,000 has been suggested—because it is very evident to those of us who have worked in the regulation or supervision of banks that there will be losses and substantial losses as years go on; and if the F. D. I. C. is going to mean anything, it must mean the prompt payment of all losses as they occur.

This brings up also the fact in our minds that the F. D. I. C. board must be given greater powers in the regulation and supervision of the banks that are insured. Personally I am in favor of the examination of these insured banks being on a very strict basis.

Senator COUZENS. You said a while ago that all banks with deposits of a million dollars ought to be members of the Federal Reserve System. That is what you said, is it not?

Mr. ANDREW. Yes.

Senator COUZENS. Would you approve of an amendment to the act requiring that?

Mr. ANDREW. Yes, sir. I think it might be a very good solution of that question. As a suggestion only, a plan might be worked out whereby insured State banks each having more than $1,000,000 in deposits would be compelled to join the Federal Reserve System as a condition of continued insurance in the Federal Deposit Insurance

Corporation. This would bring into the Federal Reserve System over 900 insured State banks with total estimated deposits of $3,126,000,000. If such a plan should be followed it would eliminate compulsory membership for about 6,600 insured State banks with total deposits of approximately $1,800,000,000. The importance of firm regulation and firm examination of insured banks is something that cannot be overemphasized. Personally, I believe it should be in large measure through the F. D. I. C.

There are one or two other small points that I wish to mention. Section 314, page 59 of S. 1715, permits the payment of dividends only after one-tenth of the net earnings for the preceeding half year has been put into surplus. A large number of banks declare dividends annually, and by having only one-tenth of the net earnings for 6 months specified it would relieve them from putting aside one-tenth of their earnings for the full 12 months which is covered by the dividend. The wording might be changed to cover the period of the dividend.

The provision of the bill on page 49 in regard to real estate does not seem sound in a great many regards to those who have had experience in the supervision of banks, and it should be at least restricted as regards territory.

I think that covers practically the suggestions that I wished to make, particularly as regards the size of the assessment and the necessity of the smaller nonmember banks being protected.

The CHAIRMAN. We are greatly indebted to you for your testimony, and I assure you that we will give it consideration.

The committee stands adjourned until 10:30 o'clock tomorrow morning.

(Whereupon, at 12 o'clock noon, the committee adjourned until tomorrow, Tuesday, May 7, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

WEDNESDAY, MAY 8, 1935

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

The subcommittee met, pursuant to adjournment on Monday, May 6, 1935, at 10:30 a. m., in room 301, Senate Office Building, Senator Robert J. Bulkley presiding.

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

Senator TOWNSEND. Senator Bulkley, I have some bankers from my State, who would like to give their views on S. 1715, the banking bill.

Senator BULKLEY. Very well; we shall be glad to hear them.

Senator TOWNSEND. The first gentleman who, I think, desires to give his opinion, is Mr. Evans.

Senator BULKLEY. Very well.

Mr. Evans, will you please give your name, and the name of your connection, to the reporter?

STATEMENT OF ELWYN EVANS, REPRESENTING THE CLEARING HOUSE BANKS, WILMINGTON, DEL.

Mr. EVANS. I am appearing for the clearing house banks, at Wilmington, Del.

Senator TOWNSEND. You are appearing for the clearing house banks of Delaware?

Mr. EVANS. The clearing-house banks of Wilmington, Del.

Senator BULKLEY. Very well; we shall be glad to hear you.

Mr. EVANS. My associates, Mr. Ridgely and Mr. Hughes, and myself are appearing at the request and on behalf of a group of medium-sized banks in a medium-sized community, a group which has no desire to absorb its rural neighbors and which, on the other hand, does not desire to be absorbed by any metropolitan chain; a group whose vital interests are against any greater centralization than the irresistible exigencies of our times require, whether that centralization be localized in New York, Washington, or any other place. We honestly believe that we know the sentiments of that group and their customers.

My feeling is that the attitude of this group is typical of the attitude of the great majority of the banks of this country, outside the metropolitan centers, because our fundamental interests are identical. But whether or not this feeling is justified, you are in a better position to judge than I am. We purport to speak only for ourselves.

Without exception, the severest criticisms which we hear are leveled against those portions of title II which may be said to increase political influence over the Federal Reserve System. In order to be specific I shall call your attention to those portions.

Section 201 (a) exempts the governors of the various Federal Reserve banks from the requirement that all class C directors "shall have been for at least 2 years residents of the districts for which they are appointed." In this provision our group sees the possibility of regional banks being ruled by emissaries from Washington—they may be good emissaries or they may be bad emissaries—but who, in any event, need not be sympathetic or even conversant with the needs and problems of the districts.

Section 201 (a) further provides that the governor of a Federal Reserve bank's term as a class C director shall expire when he ceases to be governor, and that the governor shall be chosen annually by the board of directors, subject to the approval of the Federal Reserve Board. It also provides that the governor shall not be limited to two consecutive terms of 3 years each, as in the case of the other directors. Section 203 (3) contains similar provisions with respect to the Governor of the Federal Reserve Board, but goes even further, in that it provides that his tenure of office shall be "until the further order of the President."

Our group thinks that these provisions mean one thing, and one thing only—which is that the key men of the Federal Reserve System, the men upon whom the responsibility for its actual operation devolves, would hold office so long, but only so long, as they studied to please whatever political group happened to be in power.

It means not only a dictatorship over our whole banking and credit system but a dictatorship by influences whose primary concern is—and quite properly so—not banking but politics.

Having made certain this political dictatorship, the act then goes on to broaden the Federal Reserve System's powers. Section 206 provides that "any Federal Reserve bank may make advances to a member bank on its promissory notes secured by any sound assets of such member bank." We may be pardoned if we inquire: "What are sound assets? How are they to be recognized and determined?" Many people, including bankers, back in 1927 and 1928 invested in what were apparently sound assets, but which later turned out to be anything but sound—whence comes many of our present difficulties.

If this measure is enacted, there would be nothing to prevent any Federal Reserve bank from accepting any asset which it may be under pressure to accept—unless, indeed, it be a stubborn and, I might add, highly unpolitical attitude on the part of the Federal Reserve officials, an attitude which the act does everything to discourage.

On the other hand, how are we, as practical bankers, going to know positively which of our assets are going to be accepted without question in the event of a crisis?

Senator BULKLEY. How can you get away from the necessity of determining, every day, as a matter of judgment, what assets are sound and what are not sound?

Mr. EVANS. There is no question about it; you do have to determine that.

Senator BULKLEY. And how can you get away from it?

Mr. EVANS. There have to be checks and balances.

Senator BULKLEY. But it is still presumed that they are going to be sound?

Mr. EVANS. It is still presumed that they are going to be sound. But that is a very difficult problem to determine.

Senator BULKLEY. Of course.

But it also helps, as a matter of judgment, to determine it; and it has to be exercised every day, does it not?

Mr. EVANS. There is no question about that.

But the trouble with this bill is that it makes too broad a classification. There ought to be some classification of what assets you can accept.

Senator BULKLEY. A limitation as to the purpose for which the loan is made does not make the assets any more sound, does it?

Mr. EVANS. Not the slightest.

But you can at least prescribe by law certain categories of assets.

Now, you can borrow from Federal Reserve banks secured by Government bonds. And that is all right.

But there ought to be some other categories prescribed and not leave it wholly to the Federal Reserve Board to prescribe rules and regulations, or leave it to the judgment of the officers of the Federal Reserve banks.

It is vitally important for us to know whether we can classify our assets as rediscountable or acceptable.

Senator BULKLEY. But under existing law you can rediscount a piece of paper that is based on a commercial transaction?

Mr. EVANS. Right.

Senator BULKLEY. But it might be wholly unsound; and in that case the bank could reject it.

Mr. EVANS. That is perfectly true.

Senator BULKLEY. Then there still has to be judgment about whether or not it is sound?

Mr. EVANS. Oh, judgment has to be exercised.

But this just opens wide the door and says, "any sound assets."

Senator BULKLEY. I take it that we have always had the requirement of soundness, and that soundness is always a question of judgment, and as to which a banker may be wrong.

Mr. EVANS. There is no question about that.

However, this is just one of those provisions by which the powers of the Federal Reserve System are widened, without any corresponding limitations put on them.

Now, there are other respects in which the powers are widened. For instance, section 208 removes the safeguards against an overexpansion of Federal Reserve notes which are contained in section 16 of the Federal Reserve Act, and provides instead that Federal Reserve notes shall be secured by a first and paramount lien on all the assets of such bank. It seems to us that this substitution of a vague general lien for a specific pledge of assets makes it improbable that the size of the note issue will have any relationship to the requirements of industry and commerce.

Section 208 further provides that Federal Reserve notes shall be issued and retired subject to such rules and regulations as the Federal Reserve Board shall prescribe, and shall be legal tender for all purposes. I do not need to dwell upon the limitless possibilities of this provision as an easy and somewhat obscure method of financing our ever-mounting budgetary deficits. It is interesting to note, however, that even during the days of the inflation, the French Chamber of Deputies thought it wise to impose some statutory limits upon the note issues of the Bank of France.

Senator BULKLEY. I am interested in what you say about the Bank of France.

May I ask if you are suggesting that there should be a limitation by law as to the amount of notes to be issued by the Federal Reserve banks?

Mr. EVANS. That is one device to prevent overissue.

They provide for a redemption fund of 5 percent. But the only limitation here is 40 percent in gold certificates reserve behind the note issue. Every other limitation is removed.

And Governor Eccles, in the statement that he has put out with respect to this bill, himself acknowledges that we would be in a period of dangerous inflation long before that limitation would be reached.

Then, take the matter of power to vary those member banks' reserve requirements; why, the Federal Reserve Board would say that every bank must maintain 100-percent reserves against all deposits. For section 209 gives the Federal Reserve Board power to vary member-bank reserve requirements at will; there is no limitation. It is even possible to impose the most drastic requirement upon only one bank or group of banks as a purely punitive measure. It is needless to say that if these possibilities are availed of it would mean the end of banking as we understand it. Section 205 creates a Federal Open Market Committee in such a way as to make certain that it will not be independent of political control, while section 207 removes all restrictions as to the kinds of Government obligations it can deal in.

The people of our community and State—bankers, business men, and everyone else we know of—who have taken the trouble to become informed about this bill, are practically unanimous in their condemnation of these unrestricted and sweeping powers. I cannot say whether or not they would approve these if the element of political domination were removed from the bill. I suspect serious doubts on their part as to the wisdom of granting such sweeping powers to any group of men, however chosen, without the most effective scheme of checks and balances.

Senator BULKLEY. What is your suggestion as to this bill?

Mr. EVANS. I have not worked out definite suggestions; but it certainly ought to be easy to work out such limitations.

The expansion of powers is the least objectionable feature of the bill.

It seems to us, however, that a judicious system of checks and balances ought to be worked out.

Senator TOWNSEND. Do you care to work out a definite proposal along that line and submit it later?

Mr. EVANS. I have no objection to doing that.

Senator BULKLEY. I think that we would be interested to know what you think of as an acceptable alternative, inasmuch as you think there should be some acceptable increase of the powers of the Federal Reserve Board.

Mr. EVANS. I think the element of political control is the most vicious element. I think it is necessary to safeguard our banking system by a judicious system of control.

Senator BULKLEY. What do you suggest as an alternative to what you call "political control"?

Mr. EVANS. The elimination of the provisions to which I called attention: First of all, the approval by the Federal Reserve Board of the selection of the governors of the banks. I do not think that is necessary; I think that is a key place where the political domination from the head of the system is brought to bear on member banks.

Secondly, the Governor of the Federal Reserve Board practically holds office at the pleasure of the President. And Governor Eccles has pointed out, in this memorandum, a very interesting device that, I confess, had not occurred to me before: That the President of the United States, when he wanted to remove the whole Federal Reserve Board, could designate each member, in turn, as Governor of the Federal Reserve Board, and remove him tomorrow.

Governor Eccles says he does not think there is any danger of that. But the bill does not provide that the member of the Federal Reserve Board must accept the appointment of Governor; but it simply says that the President may appoint him—and then, the next day, the President can remove him.

Now, I am fully aware that many of the proponents of this measure will frankly admit all of the features of title II to which we object, and justify them as a necessary part of their political and economic philosophy. The most intelligent expression of this viewpoint that I have heard was made by Governor Eccles in his Lincoln's Birthday speech to the Ohio Bankers' Association. He says—quoting from his speech:

> There is no political or economic power more charged with the general social interest than the power to increase or decrease the supply of money. If the sovereign authority delegates this power to a particular group or class in the community, as it has done in large part in this country, it divests itself of a part of its effective sovereignty. It is my personal conviction that our system of broad political representation, faulty as it may be, constitutes a better guarantee that the general interest will be served than would control by a group of individuals chosen, let us say, entirely by bankers or business leaders.

Senator BULKLEY. Do you take issue with that?

Mr. EVANS. I do.

I realize the futility of argument when it comes to any man's broad philosophical viewpoint. I will say, however, that our group does not believe that political dictatorship over banking and credit is a good thing nor does it believe that the American people in the long run will think it is a good thing.

Senator BULKLEY. In your use of terms, now, is there a difference between political dictatorship and governmental control?

Mr. EVANS. Yes; there is.

Senator BULKLEY. Will you develop that a little? I should like to make sure of the particular sense in which you are using those words.

Mr. EVANS. I should say that governmental control is the control which is permanently resident in Congress. Congress can set up a system of central banks, or a Federal Reserve System, or whatever it pleases, and can change it, constantly.

Senator BULKLEY. There is no question in your mind that Congress is a political body, itself?

Mr. EVANS. It is; but it is constantly representative of the people.

Senator BULKLEY. Yes.

Mr. EVANS. And Congress, I take it, does not concern itself with the actual operations of banking, or even with the Federal Reserve System. Congress concerns itself when there is something wrong with the system, and steps in. and tries to correct it.

But political control is executive control, wherein the daily operations of the banks and of the whole system of open-market operations and of note issue, and of the thousand and one highly technical and complicated movements, are controlled by political controlled people, who can be removed at will.

I am about to develop the theory and the difference as to what sound and proper principles should be embodied in governmental organization of the Federal Reserve System.

Senator BULKLEY. It looks to me as though you are developing the thesis that congressional control is apt to be on a higher plane than Presidential control; and I am very much interested in that, because many people have expressed the opposite view.

Mr. EVANS. I understand. And I think it is opposed to the general expression of opinion at the time.

But I think the bankers would rather have Congress step in and study the System, when the Federal Reserve System is not working and then prescribe the changes to be made so that it shall work, rather than to have the daily supervision by the President or his appointees.

Now, we believe in the fundamental ideas which were embodied in the original Federal Reserve Act, and which were characterized by Woodrow Wilson as a "democracy of credit." We believe in them for the same reasons that we believe in democracy in government. Conceding that dictatorship may be more efficient and more intelligent, we do not believe that any system of human organization has yet been devised which will insure the continuity of a benevolent and capable dictatorship or guarantee the removal of a stupid or corrupt one.

"Democracy of credit" means, I take it, that the sole consideration for the extension of credit shall be the ability to repay—whether you look at it from the standpoint of the direct extension of credit by an individual bank, or the total volume of credit extended to an industry or to the country as a whole. It has nothing to do with purely personal considerations which must necessarily be the lifeblood of partisan politics. We think it is no insult to either, to say that politics and banking do not mix. Their objectives and methods are widely divergent. Politics necessarily involves doing the popular thing; sound banking on the other hand frequently requires unpleasant and unpopular refusals.

It has been said that the Federal Reserve System ought always to be unpopular, in that it ought always to be counteracting, or at least getting ready to counteract, the economic tendencies of the moment. When the mood is confident, it is the duty of the System to be cautious; when the mood is fear, it ought to be more daring; it ought always to be courageous.

It has even been suggested that political domination over banking may be as bad for politics as it is for banking. If the party in power assumes absolute responsibility for the management of the banking and credit system of the country, it might also have to assume all the blame for a future financial crisis, even though it may be the result of irresistible economic forces. It has been somewhat facetiously suggested that bankers might welcome the idea of the Government being the only scapegoat of the next depression.

Senator BULKLEY. Is there any evidence of that sentiment?

Mr. EVANS. It is perhaps a local one, and one not as well expressed.

But it is a dangerous thing for politics, as well as for banking, to assume full responsibility for the banking system and to assume daily control over it.

There is a wide-spread belief that the Federal Reserve System's real weakness lies in its lack of independence and, to a certain extent, in its lack of power. It is always dangerous to say what would or would not have happened if someone in the past had done something different, but there is a strong suspicion abroad that if the Federal Reserve authorities, back in 1927 and 1928, had been less afraid of political pressure from the vast public which was profiting from the boom, they would have taken the unpopular steps necessary to check the speculative madness which led to the collapse of 1929.

Senator BULKLEY. You do not think the Federal Reserve Board lacked power?

Mr. EVANS. Yes; it did lack power.

Senator BULKLEY. In what respect?

Mr. EVANS. It had plenty of power at the time, within limits.

Senator BULKLEY. It was lacking either in judgment or in nerve?

Mr. EVANS. In nerve; in independence.

My impression, from a study of the Federal Reserve reports at that time, is that they knew pretty much that there was a dangerous over-expansion of credit.

Senator BULKLEY. What do you think should have been done?

Mr. EVANS. First of all, the Federal Reserve Board vetoed the raising of the rediscount rates in Chicago.

Senator BULKLEY. You do not think they should have?

Mr. EVANS. I do not think they should have. Whether or not it would have been effective, no man can say.

Senator BULKLEY. But it would have been helpful, in your judgment?

Mr. EVANS. Yes.

And furthermore, the Federal Reserve Board vetoed the raising of the rediscount rate in New York—vetoed it 10 times. And it is my personal opinion that that would have been helpful.

Senator BULKLEY. Very well; proceed.

Mr. EVANS. We submit as our firm conviction that the future security of our banking system, if not our whole economic well-being, lies in the direction of greater independence of our Federal Reserve authorities. It lies in a judicious broadening of the powers of the system, subject, however, to carefully worked out checks and balances.

That is all I have to say, as a prepared statement.

Senator TOWNSEND. Would you care to comment on titles I and II?

Mr. EVANS. I do not care to comment on those.

Senator TOWNSEND. You confine your remarks to titles I and III?

Mr. EVANS. I do not care to comment, for the reason that I have not explored the sentiment; but on title II I have explored the unanimous sentiment of every banker in the State of Delaware. And on titles I and III I have not explored that sentiment, and would be talking purely personally.

Senator BULKLEY. Assuming that we would agree with you that the Federal Reserve Board missed a chance to save the situation just before the great crash, what changes would you suggest in the Federal Reserve Board that would make it more likely to perform satisfactorily in the future?

Mr. EVANS. Take the Secretary of the Treasury off and take the Comptroller of the Currency off the Board. That would be a step in the right direction.

They represent the viewpoint of the administration at the moment. What we need is a Board of greater independence.

Senator BULKLEY. The question of removing the Secretary of the Treasury from the Board has, as you know, had a great deal of discussion and argument.

Mr. EVANS. Yes; it has.

Senator BULKLEY. There has not been so much said about the Comptroller of the Currency.

Mr. EVANS. No; because he does not so directly represent the views of the administration that happens to be in power.

Senator BULKLEY. Do you think he is a particularly dominating influence in any event?

Mr. EVANS. I think he must be. The whole temper of the financial condition of the country is his direct concern. He has to float Government bond issues.

Senator BULKLEY. You are speaking of the Secretary of the Treasury?

Mr. EVANS. Yes.

Senator BULKLEY. I am speaking of the Comptroller of the Currency.

Mr. EVANS. Well, of course, his influence is not so direct. But I think he should be removed from the Board.

Of course, the Comptroller of the Currency is appointed by the President.

Senator BULKLEY. I am inclined to agree with you that the Secretary of the Treasury should be off the Board. Do you think that would be an adequate solution?

Mr. EVANS. It might not be. I am not prepared to say. This whole subject requires a very intensive study. There are features in this bill that just stand right out, that are bad, and those where we have tested the sentiment, we feel they are very bad, bad enough to make us come down here and give our views on them, and they are the unanimous views of all our people.

Senator TOWNSEND. Do you care, after you have given it further study, to give us your views?

Mr. EVANS. I should be very glad to give them for whatever they are worth.

Senator BULKLEY. Thank you very much.

Mr. Ridgely, do you want to come next?

Mr. RIDGELY. Yes, Mr. Chairman.

Senator BULKLEY. Will you give the reporter your name and connections?

STATEMENT OF HENRY RIDGELY, PRESIDENT OF THE FARMERS BANK OF THE STATE OF DELAWARE, IN DELAWARE

Mr. RIDGELY. My name is Henry Ridgely, president of the Farmers Bank of the State of Delaware, in Delaware.

Shall I proceed?

Senator BULKLEY. Yes; please proceed, Mr. Ridgely.

Mr. RIDGELY. I take it that it is admitted that this bill would centralize and concentrate the control of money and credit in a little group.

Senator TOWNSEND. May I interrupt you there?

Mr. RIDGELY. Yes, sir.

Senator TOWNSEND. Are you confining your remarks also to title II?

Mr. RIDGELY. To title II.

Senator TOWNSEND. All right, sir.

Mr. RIDGELY. It has been pointed out that this is susceptible of partisan domination. Doubtless it is big with possibilities in that direction. But I want to stress another and greater danger. Under the power conferred by this bill, or, rather, the power conferred by this bill could be used to commit this country to an economic policy dictated by a small group. It could be used to impose an economic theory upon this Nation and its nationals, willing or unwilling. True, Congress can do that now; but at least it cannot be done quite overnight and without the knowledge and right of protest of our representatives from own own communities.

In other words, this bill gives a chance for ex parte acts, whereas under the existing law there must be at least a hearing, with a right for each party to be present and attend. Ostensibly, or rather, I think it is no answer to say that the Federal Reserve Board is amenable to Congress. Once started on an economic course, it is tragically difficult to retrace steps. Business and industry cannot make readjustment without breaking bones. Ostensibly, this bill is in the interest of banks and banking. I fail to see how it is going to improve the banking situation or strengthen the public confidence in banks.

I do see that it could be used to compel banks to support a political or economic policy. A good deal has been said in these days in the way of a contrast of English and American banks to the disparity of the latter. So far as I know, there is nothing in this bill that is paralleled in the English system. I think its fundamental idea is neither English nor American, that it more nearly represents the European idea, but not, I think, in such an open and forthright avowal of its purpose. For this bill does not profess to set up a central bank, and yet it confers the distinctive powers of central banking.

If it is said that banks are withholding credit, I think we have the right to ask for a bill of particulars. What banks, and what credits? So far as my State is concerned, I am confident that the charge is unfounded. I am frankly skeptical that it is true anywhere. Certainly the banks—our banks—have done all reason could ask in the way of helping Government financing. I think we can show a very good comparison with the English banks in that particular.

I am not holding any brief for bankers. I think some of the great bankers turned out to be pretty small. I am trying to speak for the depositors. It seems to me the dangerous thing is to vest in any group the right to commit the country to some economic course without a chance for the fullest, most complete hearing and discussion and in a democratic assembly. We may or may not think that Congress acts wisely or always acts wisely, but after all Congress still is democratic. It still gives an opportunity just as you are giving us here an opportunity to be heard.

If you were not in Congress and applied to some Government board, you might find you would not always be granted that opportunity. I believe the American idea or theory is still worth holding onto, that too great powers should not be placed beyond the reach of the people in any one man or group of men.

Lord Macauley, I think, said somewhere that the despotic government or a perfect despotic government was the most perfect form of government provided you could get a perfect despot.

This bill is not emergency legislation, but is proposed for the banking system of this country. And we have to think, or should think, I believe, not of particular individuals who may have the carrying out of its provisions at the moment but the possibility of what it would mean or what it opens the door to. After all, isn't the whole theory of the American system of government that we had rather be less efficient, provided we are in a position where we can defend ourselves from encroachments? And is it true that the present banking system is the cause for the present depression? Frankly, I think it is rather ignorant to hold so. England would not be in the depression if it was simply the American banking system that caused it.

Speculation, gambling, if you please, that occurred in 1927, 1928, and 1929 aggravated conditions, but did not bring them about.

Our position, then, is that in our opinion title II should be dropped from this bill.

As to titles I and III, frankly, I am not able to give an opinion because I have not made a sufficient study of them.

But we believe that title II should be dropped and that then full consideration should be given to the question as to whether, and if so how, the powers of the Federal Reserve Board should or may be strengthened.

Senator BULKLEY. Do you think there should be no change at all in the requirements as to what is eligible for rediscount at the Federal Reserve banks?

Mr. RIDGELY. I think under the present law it could be left as it is without doing any harm.

Senator BULKLEY. You feel confident that there is in existence enough eligible paper to carry on if it is worked out all right?

Mr. RIDGELY. No, but we have also, have we not, the Federal Government bonds, as well as the commercial paper. Commercial paper should not alone be sufficient; but with the Government obligations, I think it should be both. Of course, there would be no harm that I can see in widening, but even in the case—I think, Mr. Chairman, you asked my associate whether or not in the case of sound assets, whether it wasn't always a question of opportunity.

Senator BULKLEY. Yes; I did.

Mr. RIDGELY. Yes. Undoubtedly, but you can have your boundary limits, just as you know we have statutory regulations as to the investment of trust funds. You can increase your catalog, but there ought to be some sort of a catalog, it would seem to me.

Senator BULKLEY. Are you prepared to suggest what limit you would state?

Mr. RIDGELY. Well, in the first place, I would say Government bonds, United States Government bonds, and the commercial paper; I should think that would be sufficient, Mr. Chairman. I would be willing to go further, however. I would be willing to go further than that. I would be willing to take bonds of the States, under certain prescribed conditions, just as our trust investment law has those limitations.

I think it would be quite easy to enumerate a number of securities or investments that could be used and still leave the question of their soundness open.

Senator BULKLEY. Do you think it would be desirable to add such a list to what is already eligible?

Mr. RIDGELY. Frankly, I don't think so; because so far as I know it is not needed with the addition of the Government obligations.

Senator TOWNSEND. Are you familiar with what percentage of the banks' assets in our State are invested in Government obligations?

Mr. RIDGELY. I am not, I am sorry to say; I am not familiar with it.

Senator BULKLEY. Well, it would seem——

Mr. RIDGELY. Of course, all over the country there is a large number of Government bonds held in our banks.

Senator TOWNSEND. Yes.

Senator BULKLEY. It would seem there is not likely to be any shortage of Government bonds.

Mr. RIDGELY. No; and that seems to me really like the answer to his question.

Senator TOWNSEND. Well, that is what I was trying to develop.

Mr. RIDGELY. Yes. Just what the percentage is, I don't know. I don't think there would be any trouble about that part of it, Senator.

Senator TOWNSEND. Now, I understand that Mr. Hughes would like to say a word, Mr. Chairman.

Senator BULKLEY. All right, Mr. Hughes, will you state your full name and connection for the record?

STATEMENT OF JAMES H. HUGHES, JR., DIRECTOR AND COUNSEL, DELAWARE TRUST CO., WILMINGTON, DEL.

Mr. HUGHES. My name is James H. Hughes, Jr. I am director and counsel of the Delaware Trust Co., Wilmington.

Senator BULKLEY. All right, Mr. Hughes, will you state your views?

Mr. HUGHES. Mr. Chairman, I have not prepared a written statement of my views.

I have, however, read this bill and I think I know the sentiment of our community and other communities of like character.

Senator BULKLEY. Are you talking about the whole bill now or only title II?

Mr. HUGHES. I am talking particularly with reference to title II. In reading a bill of this sort, there is bound to come to your mind, "What is the purpose of this form of legislation?" It does not appear to us to be emergency legislation in the sense of relief legislation. We do not admit for a moment that the banks as a whole are responsible for the depression. We are willing to assume such responsibility for the depression as is fair. But we do not admit that the banks, the individual banks, are responsible, are in any small degree responsible. We think that there is in the present Federal Reserve Act, with which, I may say, we are in hearty accord, with the theory and principle of the Federal Reserve Act. There is ample authority in the Federal Reserve Board to control credit to the extent of mitigating, ameliorating, or preventing crises such as the 1929 crisis.

Senator BULKLEY. Do you think there is enough power there now?

Mr. HUGHES. Yes, sir. It was testified before this or a similar committee, Senate committee, that the Federal Reserve vetoed 10 times an effort of the New York Reserve Bank to increase interest, discount rates, and discouraged statements of that bank that we were going into an inflation which could only result disastrously. That attitude of the Board was distinctly political, as we see it. The Board publicly so stated, that they feared it might precipitate a crisis, not apparently realizing a crisis was coming insofar as heeding the warning of the New York and like banks.

Senator BULKLEY. Well, did not the New York bank contribute to the situation by buying a large amount of bonds when credit generally did not need that stimulation?

Mr. HUGHES. It might be that was brought about under the domination of the Board. I think few of the banks as banks can be charged with that responsibility. They were acting under an assumed domination of the Federal Reserve Board, as I see it.

Senator BULKLEY. You think that was a mistake of the Federal Reserve Board?

Mr. HUGHES. Yes; I think that that was clearly a mistake of the Federal Reserve Board, and I think that Board was the responsible body.

Now, that Board was apparently acting under domination of other influences. It was a matter of daily press comment, or almost daily press comment, that things were fine, conditions were sound, prices were going higher, and everybody rushed back to buying. Those statements were coming directly from Washington at the time. A review of the press at the time will illustrate that.

Senator BULKLEY. Well, are you contending that the Secretary of the Treasury was responsible for that?

Mr. HUGHES. Partially, yes. At any rate, I do not recall any statement of the Secretary of the Treasury which supported the sound Reserve banks, such as the New York bank, at that time seemed to be.

Now, if this is not emergency legislation, and if my position is correct that the Board at the present time has adequate authority to control credit and to provide liquidity in member banks, then what is the purpose of this legislation?

Senator BULKLEY. Well, Mr. Hughes, my own view is that the Board has rather wide authority at this time, but I do not feel very well satisfied with the way they have used it. Do you?

Mr. HUGHES. No.

Senator BULKLEY. What are we going to do to improve that situation?

Mr. HUGHES. There is only one way, Senator Bulkley, that I know. That is to remove political influence from that Board.

Senator BULKLEY. Well, specifically, now, you mean remove the Secretary of the Treasury?

Mr. HUGHES. For one thing; yes.

Senator BULKLEY. What other thing?

Mr. HUGHES. I cannot answer. I would be glad to develop my thought there. I must speak in generalities.

Now, we have other conditions or Government agencies from which the political element has been practically emasculated. If the political influence on this Board could be eliminated so that they were acting freely and were capable and free to use their own good judgment, I think they have ample authority.

Senator BULKLEY. Now, will you develop that thought a little further, by way of illustration or otherwise, so that we will see more clearly what you mean?

Mr. HUGHES. Well, the result I have told you, and I am speaking of testimony before this or a similar committee, which sat I think in 1931, at which time I think an investigation of the 1929 break was made.

The Interstate Commerce Commission, so far as I know, is practically free of political domination. Whether that is because political domination is not attempted there, I don't know, but if as an ideal, a board of this character could act as freely as Federal judges, or as freely as another appointee so that they can and do act in such a way as to use their own judgment and not an inspired judgment——

Senator BULKLEY. Of course, Federal judges are made somewhat independent by being appointed for life. Do you advocate Federal Reserve Board members being appointed for life?

Mr. HUGHES. I should much prefer that to any recall, which strangles and stifles their own judgment. So long as the judgment of a Federal Reserve Board member is strangled, then he is merely a creature of some superior thought and knowledge, and unless he can use his own judgment, he cannot and ought not to be held fully responsible. Now, just how that is to be done, Mr. Chairman, I of course. would not have the temerity to suggest to this committee.

Senator BULKLEY. But you do say the Secretary of the Treasury ought to be taken off the Board?

Mr. HUGHES. I would think so.

Senator BULKLEY. Do you care very much whether the Comptroller is taken off?

Mr. HUGHES. No.

Senator BULKLEY. You do not think that is important?

Mr. HUGHES. I doubt that that is important, because I do not think the functions of the Comptroller——

Sentaor TOWNSEND. Would you care, after careful study, Mr. Hughes, to offer your further views in that matter?

Mr. HUGHES. I would be glad to.

Senator TOWNSEND. We would be very glad to have you do it.

Mr. HUGHES. Now, if my position, the predicate of this statement is correct, that there is the authority, then why do we need title II of this bill? What is attempted here? It is stated in the most worthwhile criticisms that I have read from financial writers and people who have thought this out that it is a measure which essentially seeks to manage the currency and money and credit of the country. In other words, we get back to the money-management idea.

Now, frankly, we are just old-fashioned enough in my community, and I think that is pretty generally true, to doubt and scout the soundness and economic validity of a managed currency or managed credit.

We cannot avoid the conviction that the law of supply and demand still applies and that is the paramount law both as to affecting credit, money, and other economic influences. With a distrust of the managed currency we are distrustful of this title.

Senator BULKLEY. Well, now, Mr. Hughes, the difficulty is, it is conceded, that we got a tremendous inflation under the old system and naturally some thought is being given as to how we are going to chart our course better for the future.

Mr. HUGHES. Yes, sir. Well, I say we got into that credit inflation situation by reason of the sins of the Reserve Board, and they are either traceable to the weakness of that Board, which I do not judge; but either that or to outside political influence. I suspect the latter.

Senator BULKLEY. Well, you mean that the whole trouble that we got into was due to political causes?

Mr. HUGHES. I suspect that that is the fact. That is my view, that when the credit inflation started in 1926 and 1927 and rolled up in 1928, finally reached its apex in 1929, no one in high Government position was willing, I suspect for political reasons, because the campaign was coming on, to tell the people that they had better stop. On the contrary.

Senator BULKLEY. Now, if you do not believe in the Government control, what was there to do but to let things go as they were?

Mr. HUGHES. If they had let things go and not give the hypodermics every time we seemed to go into a lull, and to use some judgment, get some common-sense view, the press was immediately full of a new injection of it, which simply stimulated people to go forward, and the Government acted affirmatively. They did not let it go. But here is a governmental agency, this Board, and governmental agents, it must have been the design of the Federal Reserve Act that it not only had the responsibility to free credit, but also to limit credit. That power was given to it——

Senator BULKLEY. There is no doubt but that the Federal Reserve Board has more power than most people give it credit for and I think——

Mr. HUGHES (interposing). Not the slightest doubt about that.

Senator BULKLEY (continuing). You agree with me?

Mr. HUGHES. Yes.

Senator BULKLEY. There is a thought that is very freely expressed, that credit is sure to be controlled somewhere, and if the Government does not control it, somebody else will. What do you think about that?

Mr. HUGHES. I don't think that is true. If it is true, I think it is bound to be controlled more safely in the long run by the law of supply and demand forces than by purely artificial dictation.

Senator BULKLEY. You do not think that the Government ought to be in control at all? Would you reduce the power of the Federal Reserve Board to control?

Mr. HUGHES. No; I would not. I am entirely in favor of the Federal Reserve Act and what is was designed to do. Its great function was to democratize, or to make credit available to more people. Now, that is all good, that is a good theory, as I say, a good banking principle. But I certainly would not go to the extent of permitting such an agency of governmental control of money entirely to the point that this act seems to go, and that is what we are distrustful of. We don't think we need it. We have history in support of our position. This effort, as I see it, Mr. Chairman, is nothing more nor less than a revivification of the old Bank of the United States.

Now, almost exactly a hundred years ago the Bank of the United States was dissolved, and it was dissolved for the same reason that we feel is present, the thing we feel may be present here. There was in that situation a consolidation of control of currency, credit, and so forth, which was felt to be dangerous, and the people as a whole thought it was dangerous. Therefore, the bank was done away with. Now, the country has grown in this 100 years. Credit has not been lacking. That is obvious. Else the country could not have grown. The lawful play of supply and demand of credit has been the background of the growth of the country.

If this title II does not have within it the seeds of a new Bank of the United States, it hasn't anything.

Now, what has hapened, we say, in the hundred years that indicates that our forefathers were wrong 100 years ago and that therefore we must go back and pick up their error and attempt to supplant it? All the things that we criticize here were the subject of criticism of that old bank charter, that old situation. We are distrustful of this sort of aggregation of power because we cannot keep politics out of it. It couldn't be done when the country was much simpler. Why do we think it could be done now? And if political domination of credit and currency was bad then, why is it to be good now?

Senator BULKLEY. Now, is political domination synonymous in your mind with governmental control?

Mr. HUGHES. No.

Senator BULKLEY. Will you draw that distinction a little bit clearer, and tell us how you make a distinction between political domination and governmental control?

Mr. HUGHES. I agree with Mr. Evans; I think the two terms are not synonymous, although there is some similarity between them, and sometimes they seem to be the same thing. The Federal Reserve Act provides a large amount of political control, or governmental control, but that does not mean that that is political domination and it doesn't follow that this agency is thereby used as a political football, or to be converted to solely political ends.

Senator BULKLEY. Of course, all these words are used from time to time to express different shades of meaning, so that we have a difficult task to express exactly what we do think.

Mr. HUGHES. That is quite true.

Senator BULKLEY. But I am sure that unless we can draw some distinction between political domination and governmental control, we are going to get into a bad dilemma, I am sure, where the only alternative is between Government control and private banking control, because in that event I am afraid we have got to take the Government control with whatever disadvantages it may have.

Mr. HUGHES. Well, I have said, and I repeat that we are not quarreling with the Federal Reserve theory. We think that the act is sufficient as it stands. Now, that provides governmental control. It does not necessitate political control. We are unable to see how title II, if it is enacted, with the tremendous power that is carried there, political control of the governmental function is to be avoided.

Senator COUZENS. You say that the Federal Reserve is governmentally controlled now; is that your conclusion?

Mr. HUGHES. It is a Government agency; yes, sir.

Senator COUZENS. And it is Government-controlled?

Mr. HUGHES. In the sense that it is an agency created by the Government, yes, but only that.

Senator COUZENS. It certainly is not controlled to the same extent that the Interstate Commerce Commission controls the railroads, is it?

Mr. HUGHES. I should think pretty much the same, sir, because the Federal Reserve now, the Federal Reserve Board and banks set the rates very much as the Interstate Commerce Commission sets freight rates and so forth. I think it is quite a parallel.

Senator COUZENS. I hardly think that is quite a correct answer, because the Interstate Commerce Commission undertakes to see that there is justice between communities, there is no discrimination, that the rates are uniform for a like service; and that is certainly not a part of the functions that have been exercised by the Federal Reserve Board, is it?

Mr. HUGHES. The Federal Board fixes discount rates very much as the Interstate Commerce Commission fixes freight rates. In that sense, I think—and after all, probably that is the greatest power that the Interstate Commerce Commission has—the other things, all these other things of fairness and justice between communities, of discriminatory rates and so forth flow from the fixation of the rate, that the rate cannot be discriminatory.

Senator COUZENS. Well, but the Federal Reserve Board does not fix the rates for loans.

Mr. HUGHES. In discounting paper they do.

Senator COUZENS. No; I am talking about loans. I am not talking about the discounting of paper. That is a secondary step; but I am talking about the original step. Certainly the Federal Reserve Board does not attempt to fix the rates that the banks may charge.

Mr. HUGHES. No; if I go to a bank to borrow money, I make my own terms, naturally.

Senator COUZENS. That is true if you go to a bank and borrow money, but it is not true of a carload of freight.

Mr. HUGHES. No. But if I take that paper, a bank takes that paper, the Federal Reserve fixes that discount rate.

Senator COUZENS. But that is done by districts.

Mr. HUGHES. In their district.

Senator COUZENS. Yes. So that in fact the Federal Reserve does not fix it in all the districts; that is, the same rate for all districts?

Mr. HUGHES. There are differences, but if the difference is too great you have the flow of paper from one district into another.

Senator COUZENS. Do you discern any difference between Government control and political control in the Interstate Commerce Commission?

Mr. HUGHES. Well, I should say that is Government-controlled.

Senator COUZENS. Have you considered that political-controlled?

Mr. HUGHES. No; I can't say that I have.

Senator COUZENS. Well, is it not possible, then, under a Federal Reserve Board, to have Government control without political control?

Mr. HUGHES. I maintain that the present Federal Reserve Board is susceptible to political control, which was the thing I have just said.

Senator, I beg your pardon for not acknowledging you when you came in, but I stated——

Senator COUZENS. I do not want you to repeat that. I will read it in the record.

Mr. HUGHES. Yes; I maintain that there is ample authority and power, Government control in the present act, and if that Board can and will exercise the authority which it has, there is the governmental control.

Senator COUZENS. Do you think it has exercised the control it has?

Mr. HUGHES. No; I do not.

Senator COUZENS. The power it has?

Mr. HUGHES. I do not.

Senator COUZENS. Had you been a member of the Federal Reserve Board, would you have voted differently, would you have done differently than the Federal Reserve Board did?

Mr. HUGHES. Senator, if you ask me now, I should be inclined to say " Yes." If it was 1929, of course, that is hindsight, but I am rather influenced, however, by what they did in overruling the New York bank ten times, did what we must now, what now seems to have been a very unwise thing, and they did that, according to the testimony before this committee.

Mr. Evans just suggested on this question of Government control, the members of the Board are appointed by the President, which appointment must be ratified by the Senate, and removal is only for cause, not removal at the pleasure of either the Senate or of the Executive without cause. I think that is a Government control and I don't think that needs to be political control.

Senator BULKLEY. But do you think that political control has been exercised through the Federal Reserve Board?

Mr. HUGHES. Undoubtedly.

Senator COUZENS. How would you prevent it?

Mr. HUGHES. Senator, that is rather a large order. I will undertake to answer that if I may give it thought. I know I am quite clear as to what I should like to see. How we can do that is a very different matter.

Senator TOWNSEND. Senator, Mr. Hughes has agreed to submit, after careful thought, to the committee some ideas along that line.

Mr. HUGHES. What I should like to see, Senator, is that the Federal Reserve Board be given absolute freedom of action and responsibility for its duties, without fear of removal or influence. I think if they had been in that position in 1929 they would not have overruled the reserve banks as they did.

Senator COUZENS. Well, what control were they under in 1929 that prevented them from free action?

Mr. HUGHES. Well, they were under—" control " may be too strong a word. It must have been under influence. I suspect that they were under the influence of the then administration which refused to take the responsibility for stopping the credit inflation and the rising stock prices.

Senator COUZENS. Now, can Congress enact any law or draft any sort of legislation which may not be influenced by individuals or powers that be?

Mr. HUGHES. Well, I would think so. Just how they are going to go about it, how it would be phrased, I would not be prepared at the moment to say. I haven't thought that out. I think the present act, the danger of the threat of a managed currency, and further political domination, which this bill carries, which is necessarily inherent in this bill, can be avoided.

Senator COUZENS. You think title II ought not to be considered at all?

Mr. HUGHES. I think title II ought to be eliminated entirely. I do not believe the people of this country want that; I don't think the bankers want it, and I don't think the depositors want it.

Senator BULKLEY. Do you think there is any occasion for liberalizing the rules for eligibility of paper for rediscount?

Mr. HUGHES. Senator, I think probably that as the banks under the insurance deposit plan join the System, there will be some regulations, some quite careful consideration of what is to be accepted to entitle them to join, which will take care of that situation.

Senator BULKLEY. Do you agree with your colleagues here, that title II goes too far in that respect?

Mr. HUGHES. I beg your pardon?

Senator BULKLEY. Do you agree with Mr. Evans and Mr. Ridgely that title II goes too far in that respect?

Mr. HUGHES. Yes; I do, indeed.

Senator BULKLEY. Can you suggest to us what liberalization you think would be proper?

Mr. HUGHES. I would hesitate to state at the moment, sir. Mr. Ridgely has suggested that there might be some parallel definition of eligible securities paralleling what we call regulations.

Senator BULKLEY. I understood Mr. Ridgely to say that we did not need any liberalization at all.

Mr. HUGHES. Do you think so, Mr. Ridgely?

Mr. RIDGELY. My own thought is that we have got along now, in addition to Government bonds, with long-term bonds.

Mr. HUGHES. By 1937 it would seem to me that any bank ought to be prepared to qualify. That is, they have 2 more years, and if Government bonds would be accepted, as I take it they must be under the present law, that should be, I should say, adequate time to permit them to exchange current holdings for an adequate amount of any form of security.

Senator COUZENS. What are the current holdings you refer to that they might exchange? I mean just give me the general character of the securities.

Mr. HUGHES. All the things that a country bank loans on, chattel mortgages, real-estate mortgages, and two-name paper largely. A great many of the country banks loan on a different sort of things than a city bank does.

Senator COUZENS. Where could they get rid of that? You said it would enable them to get rid of the current holdings and take Government bonds. Where would they get rid of those holdings?

Mr. HUGHES. Some of the present loans would be paid and they would invest their funds in Governments. There is hardly a sound bank in our community that could not liquidate a certain amount of its outstanding loans and convert them into cash and buy Governments.

Senator TOWNSEND. As a matter of fact, as far as you know, every bank has plenty of Governments?

Mr. HUGHES. Yes; at the time of the bank holiday, all of our Wilmington or local banks could have qualified on the basis of either cash or Governments. We had a million and a half dollars of currency at that time in Wilmington.

Senator TOWNSEND. All right.

Mr. Chairman, that concludes——

Mr. RIDGELY. I would like to say just one thing.

Senator BULKLEY. Yes; come back, Mr. Ridgely.

FURTHER STATEMENT OF HENRY RIDGELY, PRESIDENT OF THE FARMERS BANK OF THE STATE OF DELAWARE

Mr. RIDGELY. I want to say a word about the question of the Federal Reserve Board suggesting inflation. Speaking for myself alone, I think that if you are trying to devise a bill of that kind, you are trying to find a way to the moon.

Senator COUZENS. That is what the bankers did in 1929, was it not?

Mr. RIDGELY. Not simply the bankers.

Senator COUZENS. Well, they provided the roadway for it.

Mr. RIDGELY. I think it is very easy to get up, of course, and preach against not all, but some of the bankers, but I think it would be just as easy to get up and preach against the statistical investment services, the economic experts, and the college professors. It happened that I made a speech in 1928 before a group of bankers, in which I said that I questioned whether we were not in fact going entirely too far with the question of inflation of credit, and I was followed by a college professor who demonstrated that I was ignorant because we were on a new era. That is what you heard constantly, that we were on a new era.

Senator COUZENS. And the bankers fell for it.

Mr. RIDGELY. The bankers were human, but I don't believe the bankers fell for it any more than anyone else fell for it.

Senator COUZENS. No; I am not charging that, but as I said before, the bankers had the roadway, they had the vehicle by which the people could travel to the moon and they permitted the investors and the professors and all those others to start the public on the pathway to the moon which the bankers established.

Mr. RIDGELY. But, Senator, what would you do if you were president of a bank or were on a bank board and you were approached by a citizen who was a perfectly respectable citizen and he asked you to loan him some money and he offers you collateral for it? Now, what are you going to do in that case? If you have a suspicion that he is going to invest, just exactly what is your idea of the duty of the banks and of the bankers?

Senator BULKLEY. Is there not something in this, Mr. Ridgely, that the banker would look to the quoted prices of the securities offered, as quoted on the stock exchange, and disregard any consideration of intrinsic values?

Mr. RIDGELY. Well, of course they took the market in many instances as the test of the values.

Senator BULKLEY. Without looking very much further, did they not?

Mr. RIDGELY. Yes. Of course they did not stop simply at the market quotations; they had those statistical services. I guess every bank has them, and you may recollect, if you looked over them at all, that some of them made the statement that in the early part of 1929 or perhaps even the middle of 1929, that stocks looked high, but as a matter of fact in 5 years we would be looking back at them and saying how cheap and low they are.

Senator COUZENS. Now, why did the bankers fall for that after all the long experience they have had?

Mr. RIDGELY. Because, frankly—I will tell you why. I think they fell for it for this reason: I think they got it into their heads that we were on a new era, and I think the cause of the trouble was the great war. That started, accelerated everything, the people simply lost their judgment. You cannot kill millions of people and destroy billions of capital and let loose our passions without disarranging economic conditions and also clouding judgments, and I think that they believed, a good many of them, that we were on a new era. You take the question of real estate. Of course, real estate values fell in certain sections quite as much as stocks did. How were you going to judge the value of real estate?

I am not trying to make a brief for bankers. I do not feel that I am defending them. I am not called on to defend the profession, because banking is not my real profession. I got caught in it. I was asked to take a position in a bank on the eve of the 1929 collapse, and I have been held there against my will, wanting to get out. So I am not trying to defend bankers. I have it in for some of the bankers, but I also know that it has been rather—well, what shall I say?—a little nauseating to see everybody trying to load his own mistakes on somebody else's back. As a real matter of fact, the whole country was swept by inflation, and I don't believe, no matter what kind of a board you set up, when that thing strikes again, and it will—those of us who are old enough to have gone through these things before don't believe that we are getting to any millennium where any act of Congress can stop them——

Senator TOWNSEND. Well——

Mr. RIDGLEY. Well, I was just going to say, I don't believe you can stop it. That does not mean you ought not to use all possible means, if you can, to check it. But my point is, the point I am trying to make is, that that is not going to be done completely by vesting the great power or great powers in a particular board or group. That is not going to insure it against such conditions.

I do believe in eliminating, so far as we can—I would use the word "partisan" instead of the word "political"—the possibility of partisan domination. I should think that might be helped by removing any particular political nominee that was on the Federal Reserve Board, and making the term a longer term. You might give to the members of the Board 12 years, say, or something of that kind, and let it go at that. I think you would come closer in that way than by this bill.

The question was also asked as to whether Government control wouldn't be political control. Well, I make the distinction between Government regulation and partisan control. I think we ought to have a board. I think it is good to have a board for Government regulation, and by Government regulation I don't mean partisan regulation. I simply mean it is a board set up by the Government, or I mean it is a part of the Government, not set up by the Government, a part of the Government. And when you place in that board a power to commit the country to some political or economic theory or philosophy or policy, that is where, I think, control comes in.

Senator TOWNSEND. I think the bankers of Delaware can be very proud of their record, because I think the record of the bankers of Delaware stands out as about the best of any State in the Union.

Senator COUZENS. Now, do not start that, because I would have to bring in Michigan, and you know what that would mean.

Senator TOWNSEND. I think that concludes our testimony, Mr. Chairman.

Senator BULKLEY (presiding). We will adjourn to 10:30 o'clock Friday morning, May 10.

(Thereupon, at 12:10 p. m., an adjournment was taken to Friday, May 10, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

FRIDAY, MAY 10, 1935

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

The subcommittee met, pursuant to adjournment, on Wednesday, May 8, 1935, 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.

STATEMENT OF MARRINER S. ECCLES, GOVERNOR OF THE FEDERAL RESERVE BOARD

Senator GLASS. Governor, the Senate committee fortunately has available in print your testimony before the House committee, but it occurred to me that you might care to make a supplemental statement, and we would be very glad to have you do that if you desire.

Governor ECCLES. I would like to make a statement before this committee, and for that purpose have prepared one, and I should like to read that statement and then file it with the committee. [Reading statement.]

In discussing the proposed banking bill of 1935 before your committee, I should like to present a statement of some of the fundamental issues that are raised by the proposed legislation, and then to outline the proposals in title II of the bill, section by section, with such modifications as I should like to recommend in the text as introduced.

Character of proposed legislation.—The amendments to the Federal Reserve Act proposed in this bill are important and are urgently needed at the present time. Their general objective is to improve the administrative machinery of the Federal Reserve System, to determine more clearly the distribution of authority and responsibility between the Federal Reserve Board and the Reserve banks, and to eliminate unnecessary restrictions on the Reserve banks and the member banks that have proved to be ineffective in preventing disaster and are now hampering economic recovery.

Senator TOWNSEND. Governor, do you mind being interrupted?

Governor ECCLES. No.

Senator TOWNSEND. Are you familiar with the recommendations of the special committee of the American Bankers' Association on the proposed Banking Act of 1935?

Governor ECCLES. I am.

Senator TOWNSEND. Do you approve the changes in the act as recommended by the American Bankers' Association?

Governor ECCLES. I do not know what you specifically have in mind, Senator.

Senator TOWNSEND. Well, the suggestions as outlined by the special committee, I refer to.

Governor ECCLES. Most of the suggested amendments which they propose to the act, as introduced, were recommended by me in the hearings before the House committee. There was a difference in the recommendations which I made before the House committee and the recommendations which they made with reference to the Open Market Committee.

Senator TOWNSEND. Well, I will not ask you that question now. I have one other question I want to ask you when you have finished, about that.

Governor ECCLES. I believe that was about the only change.

Senator TOWNSEND. Then you practically agree with their recommendations? Is that what I am to understand?

Governor ECCLES. Yes; that is right.

Senator TOWNSEND. All right.

Governor ECCLES (continuing statement). The proposals made in this bill are definite and limited in scope and arise out of the experience of the past 20 years. They are not revolutionary; they do not alter the fundamental character of the Federal Reserve System, or the regional nature of its organization, and they do not, as has been asserted by critics, make the Federal Reserve System a football of party politics or an engine of inflation.

Need for public control of monetary policy.—The most wide-spread criticism of the bill has come from those who see in it an attempt to subordinate the Federal Reserve System and, through it, the country's banking system, to political control. On this subject there appears to be much misinterpretation of what the present bill provides, coupled with a lack of clear understanding of existing law and of the proper relationship between the Reserve System and the Government. This bill aims to clarify the powers and responsibilities of the Reserve Board in matters of national monetary policy and at the same time preserves and increases the regional autonomy of the Reserve banks in matters of local concern. There is nothing in this bill that would increase the powers of a political administration over the Reserve Board.

That matters of national credit and monetary policy should be under public control has been recognized since the System was first proposed. For example, in the report of the Senate Committee on Banking and Currency in 1913 on the original Federal Reserve legislation there is a statement to this effect:

> The function of the Federal Reserve Board in supervising the banking system is a governmental function in which private persons or private interests have no right to representation, except through the Government itself. The precedent of all civilized governments is against such a contention.

The statement by President Woodrow Wilson before the Congress in joint session on June 23, 1913, is even more decisive. On that occasion President Wilson said:

> The control of the system of banking and of issue which our new laws are to set up must be public, not private; must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

The necessity of placing the regulation of monetary policy under Government control, which was clearly recognized by the proponents of the Federal Reserve Act in 1913, is the guiding principle of the legislation which is now under consideration by your committee.

Senator GLASS. Well, of course, Governor, that is your peculiar interpretation of the language of the report. You do not emphasize the important word there, "supervisory." In other words, the Federal Reserve Board was to be a supervisory censor body, altruistic in its nature, totally devoid of any acquisitiveness, to supervise the administration of the law.

Senator COUZENS. Do you see a distinction there, Governor?

Senator GLASS. Evidently not; but I do, a very grave distinction.

Governor ECCLES. Of course, there is a distinction between the use of the word "supervisory"—I suppose you would have to read the entire——

Senator COUZENS (interposing). Report.

Governor ECCLES (continuing). The entire report.

Senator GLASS. Inasmuch as I wrote the report, I know what "supervisory" means.

Governor ECCLES. The reading of the statement of President Wilson here [reading]:

> The control of the system of banking and of issue which our new laws are to set up must be public, not private——

Senator COUZENS. Did you write that, Senator?

Senator GLASS. What?

Senator COUZENS. Did you write that, too?

Senator GLASS. No. Woodrow Wilson wrote that. Nobody ever wrote anything for him that I know of. Nobody ever wrote anything for me.

Governor ECCLES (continuing reading):

> must be vested in the Government itself, so that the banks may be the instruments, not the matters, of business and of individual enterprise and initiative.

Senator GLASS. I agree to all that. Pardon me for the interruption. Go ahead.

Governor ECCLES. That is all right. [Continuing statement:]

The need for public control of the function of supplying the medium of exchange to the people of the United States, both by issuing currency and by regulating the volume of bank deposits, seems to me to be almost a noncontroversial matter. It is in direct recognition of the constitutional requirement that Congress shall coin money and regulate the value thereof. In delegating this power Congress has chosen, and, in my opinion, always will choose, to delegate it, not to private interests but to a Government body like the Federal Reserve Board, created by Congress to serve as its own agency in discharging its responsibility for monetary control.

I might quote in this connection a statement by the late Paul Warburg, who said on November 12, 1910:

> The management of the central reservoir must be absolutely free from the dangers of control by politics and by private interests, singly or combined.

Senator GLASS. What do you conceive Mr. Warburg meant by the "central reservoir" there?

Governor ECCLES. I think he meant the use of reserves.

Senator GLASS. Well, he meant a central reservoir in the respective Federal Reserve districts. There was no other central reservoir. The Federal Reserve Board had no reservoir. It has none now.

Governor ECCLES. He is speaking, of course, of the control of the reservoir of bank reserves. [Continuing statement:]

Public—not political—control.—The necessity of public control, as I have said, can hardly be questioned. Apprehension can only be expressed against the dominance in the Federal Reserve System of political, and particularly of partisan, control as distinguished from public control. On this point I wish to emphasize that the bill, far from proposing an increase in the powers of a political administration over the Federal Reserve System, contains provisions intended to increase the independence of the Federal Reserve Board. For this purpose the bill provides that members of the Board shall be well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies. I recognize that the requirement of such qualifications cannot insure that only qualified persons will be appointed to the Federal Reserve Board, but it is a step in the direction of strengthening the tradition that members of the Federal Reserve Board must be qualified to carry the responsibilities which their duties entail. The bill also provides for more adequate compensation for Board members and for pensions when they retire. These provisions would further add to the independence of the Board members.

I notice that the House of Representatives did not adopt our recommendations for an increase in the salaries and for pensions for Board members. I believe that these provisions are an essential part of the bill. They are an important means of increasing the Board's independence, as well as making the positions on the Board more attractive in the future to outstanding men who may not have independent means.

There is in the bill a much misunderstood provision which was introduced for the purpose of making the position of Governor of the Federal Reserve Board more attractive to competent men with banking experience. This provision states that, when the Governor is no longer designated as Governor by the President, he shall no longer be a member of the Federal Reserve Board and shall be considered to have served out his term. This would make it possible for a Governor, if he be drawn from the banking field, to reenter the banking business without having to wait for a 2-year period when he is no longer designated as Governor.

There has been a great deal of discussion about the fact that this makes the Board a more political board. You know, gentlemen, as well as I do that no man would stay on the Board if the President of the United States wished to appoint someone else in his place. The present act provides that the President shall designate one of the appointive members as Governor of the Board, and this has been consistently interpreted to mean that the Governor serves as such at the pleasure of the President. It seems to me to be immaterial whether a Governor has or has not a technical right to stay on the Board, if the President prefers to have someone else as Governor, because no person who is qualified for that position would choose to remain in these circumstances.

The bill as reported in the House has modified this provision so that the Governor could retain his position on the Board, if he were not redesignated, but if he resigned, he would be permitted to resume his banking connection without the 2 years' delay.

Recognition of the fact that control over money is a matter of national concern that must be retained by the sovereign power or delegated by it to an agency of its own creation is as old as government itself. The change that has occurred in the past quarter of a century has been in the nature of adaptation of an ancient idea to modern conditions. The change has arisen out of a growing recognition of the fact that monetary control must not be confined to control of currency because, to an ever increasing extent, the bank check has taken the place of currency. In this country fully nine-tenths of all payments are made by check rather than in cash. Control over the supply of money, therefore, involves under existing conditions a control over the volume of bank deposits and bank credit.

The statutes of all the newer central banks of the world recognize the necessary relationship between the Government and the central bank. That it is not clearly recognized in the charters of some of the older central banks is due primarily to the fact that the relationship between central banking, commercial banking, and the money supply has been a gradual development and the responsibility of public control over deposit banking has only been gradually appreciated. There is in the world today no central banking institution, whatever the facts as to stock ownership or the legal provisions of its charter, which is not subject to control by government. This is just as true of the Bank of England, which is commonly cited as an example of a completely independent central bank, as it is of any other central banking system.

Senator GLASS. On the contrary, I heard a very well-informed man in New York, thoroughly familiar with the laws and practices of the Bank of England, say that the Chancellor of the Exchequer would not dare tell the Bank of England what it must do, but the Bank of England very frequently told the Chancellor what he should do.

Governor ECCLES. I think there is, of course, a very responsive relationship between the Bank of England and the Chancellor of the Exchequer.

Senator GLASS. They have concord; yes. But the Parliament does not pretend to direct the activities of the Bank of England. It sometimes enacts a law sanctioning the action of the Bank of England in exceeding its reserve requirements or, rather, in falling below its reserve requirements, when the exigencies of a particular policy suggest.

Governor ECCLES. I think there is a very responsive cooperative relationship between the Chancellor and the Bank of England. Mr. Goldenweiser has just handed me a statement by Mr. Snowden that I might read in that connection [reading]:

The relations between the Bank of England and the Treasury are most intimate. No important departure in policy is ever taken by the bank without consultation with the Treasury. The Treasury has assumed functions in recent years which were formerly discharged by the Bank of England. Under the last Currency Act the Treasury can decide, within limits, the amount of the currency issue. Under the gold standard the maintenance of the par value of the pound was automatically regulated. Now when we have no exchange standard the Treasury tries to control the exchange in some mysterious way by the use of an exchange equalization fund of £350,000,000.

I do not see that it could make any difference to the management or policy of the Bank of England if it were nominally made into a State Bank—for all practical purposes it is that now. Mr. Lloyd George does not propose that it should become a Government department like the Treasury. It would be fatal to bring the bank under political control. (Viscount Snowden, "Mr. Lloyd George's 'New Deal'", pp. 41–42.)

Senator McAdoo. Is that equalization fund there, the amount in pounds or dollars?

Governor Eccles. Pounds; 350,000,000 pounds is the amount. [Continuing statement.]

The necessity of Government control arises from the fact that governments are largely instruments for the formulation and execution of economic and financial policies. Since changes in the supply of means of payment, both in the form of currency and in the form of deposits, are an important and at times a determining factor in economic changes, a central bank, if it chose to pursue an antagonistic policy, could greatly hinder a government in achieving its objective. Since central banking institutions derive their power from the Government—are in fact creatures of the Government—they do not, and in the nature of things, cannot work at cross purposes with the Government, particularly at times of emergency. Hence, in one form or another there must be cooperation between the Government, which determines economic policies, and the bank of issue which determines monetary policies.

Senator Glass. Are you in favor of a Government central bank?

Governor Eccles. No; not in the sense that we should transfer the ownership of the stock of the Reserve banks to the Government and create one bank.

Senator Glass. Why not? Are you in favor of Father Coughlin's bank bill?

Governor Eccles. No; I am not.

Senator Glass. Why not?

Governor Eccles. Well, I do not think it is a practical arrangement. It seems to me that the question of the ownership of the stock in and of itself is not the vital matter; whether the Government owns the stock or the private banks own the stock, there must be management; there must be provision for the selection of directors of the respective banks. It seems to me that the powers that are given those charged with the responsibility for management is the important matter, rather than the question as to who may own the stock.

Senator Glass. Well, is it not important that a central bank should have a propriety interest—indeed, own the assets of the bank?

Governor Eccles. I do not understand your question, Senator.

Senator Glass. Well, I mean if it is a central bank it ought to be a bank which——

Governor Eccles. Yes.

Senator Glass (continuing). Ought to own its own assets, ought it not?

Governor Eccles. That is correct.

Senator GLASS. And it ought to have a proprietary interest, I would say an exclusive proprietary interest in the money that is to be loaned to business, of whatever nature; is that not so?

Governor ECCLES. That is correct.

Senator COUZENS. Governor Eccles, assuming that your bill had been in force in 1928 and 1929, what procedure would you have taken?

Governor ECCLES. I am unable to answer that, Senator. That is rather a broad question.

Senator COUZENS. Well, is that not important, though, in determining whether or not we should change the functions of the Federal Reserve Board? In other words, it seems to me that there was a lot of criticism of the Board during those years and subsequent years, and I would like to know in what manner this bill of yours would correct that.

Governor ECCLES. I think that the Banking Act of 1933, giving to the Board control over speculative activities of the banks would have been more effective in 1928 and 1929, probably, than the provisions of this bill.

Senator GLASS. This bill destroys that control, does it not?

Governor ECCLES. The control over margin requirements and over brokers' collateral loans would seem to me to deal directly with the problem of speculation.

Senator COUZENS. Well, as a matter of fact, then, your answer indicates that most of the trouble that occurred in those years has been remedied by the 1933 Banking Act; is that correct?

Governor ECCLES. Well, so far as the question of speculation itself is concerned, I think the Banking Act of 1933 enables the Federal Reserve Board to meet that effectively. My statement covers the specific reasons for the proposals in the present bill.

Senator COUZENS. Do you not have them in mind?

Governor ECCLES. What is it?

Senator COUZENS. Do you not have them in mind?

Governor ECCLES. Well, I can recite them, I can give them to you, but——

Senator COUZENS. Yes; but what I am trying to find out is how this bill of yours effectually changes existing conditions so there would be no future evils arise, which it is alleged did arise as a result of the activities of the Federal Reserve Board under the old act.

Senator MCADOO. May I interrupt, Senator?

Senator COUZENS. I would like an answer to my question, first.

Senator MCADOO. I beg your pardon, but I wanted to ask him whether or not, before he attempts to answer your question, he has the answer in the statement he has prepared. If so, perhaps it would be better to get it in the logical form he is presenting it than to ask the question.

Governor ECCLES. I would prefer to finish the statement, and then I would be glad to answer any questions that you may desire to ask that I am able to answer.

Senator GLASS. Well, you may do that, so far as I am concerned, except that I would like to supplement the question that the Senator from Michigan asked. He asked what you would have done——

Governor ECCLES. Yes.

Senator GLASS (continuing). In 1928 and 1929. I would like to ask what the Federal Reserve Board did do in 1928 and 1929, because you propose now to charge it with supreme authority in this matter. What did it do in 1928 and 1929?

Governor ECCLES. I do not know that I can tell you exactly what they did, Senator.

Senator GLASS. The record is perfectly clear.

Governor ECCLES. Yes.

Senator GLASS. I assume that you do not know. If you do not, you will find it in your own records that the Federal Reserve Bank of New York for, I think four consecutive weeks, proposed an appreciable raise in the rediscount rate, and that the Federal Reserve Board, I think for the same number of weeks, positively refused to sanction that action.

Now state what you would have done.

I do not know, but I do know what the Federal Reserve Board did do.

Senator COUZENS. Of course, if Governor Eccles does not want to answer this, I submit in all humility to the two former Secretaries of the Treasury and will let them run the meeting.

Governor ECCLES. I would prefer to read this and I would be glad to answer the questions later.

Senator GLASS. I do not want to run the meeting, but as a member of this committee, I am going to take the privilege of asking questions.

Senator COUZENS. I asked a question and did not consult the chairman or the Senator from California, but an effort was attempted to estop an answer to my question at the moment because of the austerity of the two former Secretaries of the Treasury.

Senator GLASS. As a matter of fact, so far from attempting to estop an answer to your question I supplemented your question so that the answer might be more complete.

Senator McADOO. I may say for the record that I had no thought of preventing an answer to the question of the Senator from Michigan. My only purpose was to expedite the hearing, perhaps, by allowing him to complete his statement and then have him answer the question. I have no objection to his answering the question.

Senator COUZENS. The Senator from California knows that after the reading of a long statement many of the thoughts and questions we desire to have answered are forgotten by the time the statement is completed. If the Senator from California does not want me to interrupt, I will not interrupt any more.

Senator McADOO. I do not care, but I think, and I am quite sure that the Senator from Michigan underrates his mental processes if he cannot retain in his memory the questions he wanted to ask until after the statement is concluded.

Senator GLASS. Proceed, Governor. Or if you prefer, answer the question by the Senator from Michigan, and my supplemental question.

Senator TOWNSEND. I think the Senator from Michigan is entitled to an answer to his question, if the Governor is prepared to answer.

Senator McADOO. Certainly he is. I only made the suggestion for the purpose of trying to expedite the testimony.

Governor ECCLES. Will you repeat the question?

Senator COUZENS. You are proposing a new form of activities and procedures of the Federal Reserve Board. I asked if this act you are now proposing had been in effect in 1928 and 1929 what you would have done under this proposed act.

Governor ECCLES. Of course, the bill is not proposing any new activity.

Senator COUZENS. What is the purpose of it, then?

Governor ECCLES. It is placing the responsibility for the three instruments of monetary control in the Federal Reserve Board. The most important of those three instruments, that of open-market operations, the initiation of them, is in the hands of an open-market committee. The matter of the discount rate is now in the hands of the Board. The increase in reserve requirements was provided for in the Thomas amendment to the Agricultural Adjustment Act, with the consent of the President, by declaring an emergency. What the bill proposes to do is to recognize the three principal functions of monetary control which I have just enumerated, and to place the responsibility for the exercise of these monetary control functions in the Federal Reserve Board, and to provide for a committee of five representatives of the Federal Reserve banks to be selected by the 12 governors, to be an advisory committee to the Board in the exercise of all three functions. I will not go into extensive detail, because if I do there would be no occasion to read this statement which covers that point fully, but——

Senator TOWNSEND. Are the five advisory members permitted to vote?

Governor ECCLES. They are not in the proposal here. The American Bankers' Association have submitted a suggested amendment providing that the five members be added to the Board for that purpose. The five members of the advisory committee in my proposal are given the power to initiate. The Board is required before taking action to give this committee of governors a hearing, an opportunity to express their views, so that both the Board and the committee would have the power of initiative.

The Board, however, in the final analysis, is charged with whatever responsibility is taken.

Of course, I recognize that in monetary control alone, that is, in attempting to increase or diminish the supply of money through monetary action, there is no solution for all of our economic problems, and as I said before the House committee, I do not believe that through monetary action alone the difficulties that confronted this country in 1928 and 1929 could have been entirely avoided. I believe that the question of distribution of income is a very important factor because it tends to affect the velocity of money. So, I do not believe that purely through monetary control we could have avoided the depression.

Senator COUZENS. I am indebted to the Governor for his statement, but I still have not got an answer to the question as to what he would have done in 1928 or 1929 under the conditions as they then existed.

Governor ECCLES. You mean what Federal Reserve policy I would have adopted?

Senator COUZENS. Yes; that is what we are talking about; is it not?

Governor ECCLES. Of course, I feel that instead of reducing income taxes during that period they should have been increased.

Senator COUZENS. I will agree with that; but the Federal Reserve Board could not do that.

Governor ECCLES. That is right; and as I say, there was a limitation as to what the banking system could do toward maintaining stability, business stability.

Senator MCADOO. As I understand, the Senator from Michigan——

Senator COUZENS. Just a minute. The Senator will pardon me. I am still insisting upon an answer to that question, please. If this bill had been a law, what should the Federal Reserve Board have done; what would they have done that was not done in 1928 and 1929?

Governor ECCLES. I could not answer that, Senator.

Senator COUZENS. Well, just why this bill, if you do know what is going to happen?

Governor ECCLES. Well, I think it is a very difficult thing to say what you are going to do at any given time, until you know what the problem is.

Senator COUZENS. We will assume——

Governor ECCLES. I have not analyzed the problem of 1929 with the idea of seeing how this bill would apply if it had been in existence. One cannot express an opinion on a subject as important as that. It would be like——

Senator COUZENS (interposing). Well, it will be some time, I guess, before we pass this bill, and would the Governor mind going back and assuming, for example, that this bill was a law in 1928 and 1929, and come back and tell us what he would have recommended to do during that period had this law been in effect or this bill been in effect?

Governor ECCLES. I will be glad to.

Senator MCADOO. And if he had been in charge of the administration of the act?

Senator COUZENS. Yes.

Senator MCADOO. Of course, he cannot assume what other men might have done, but what he would have done if he had had the responsibility, and the law was in effect as it is suggested.

Senator COUZENS. In other words, he might have done as the Senator from California recommended, paying all of our bills by printing-press money, and if he would recommend that, I should like to know that.

Senator MCADOO. I think the Senator from Michigan does not know what printing-press money is.

Senator COUZENS. No; I confess I have expressed my humility to being inferior to the Senator from California.

Senator MCADOO. That is certainly a gratifying announcement.

Senator TOWNSEND. Governor, while we are on this subject, what would be the result if there was created the Federal open-market committee, consisting of the entire Federal Reserve Board and five governors of the Federal Reserve banks, each member of the said open-market committee having a vote in the deliberations of the committee, and should make the changes, namely, first, open-market policy; second, the change in the discount rate; and, third, a change in the member bank reserve requirements?

Governor ECCLES. What would be the objection, is that your question?

Senator TOWNSEND. Yes; or the result.

Governor ECCLES. I do not believe there is a very great difference in the proposed bill and that proposal from the standpoint of its practical operation. It is true the five governors, as proposed in the bill passed by the House, do not have a vote. I believe the suggested proposal would be a very big improvement over the present set-up. I believe that it is the best compromise, if there is to be a compromise, between what is proposed in the bill and some other proposals that I have heard. I have made certain recommendations before the House, and am making them before your committee, and they express my views of the most desirable arrangement. Next to this arrangement the proposal that you have just read would be the most acceptable to me.

Senator TOWNSEND. Thank you.

Senator GLASS. Governor, if I may venture to ask a question, do you discover any difference between a real central bank which has a proprietary interest in its own funds and may manage its own loans of its own funds and the central bank which has exclusive control of the funds belonging to other people and directing the manner in which and the extent to which the funds belonging to other people may be loaned?

Governor ECCLES. I cannot conceive of a central bank except it be a bank that handles the funds of others. Every central bank, I think, in the world is nothing more nor less than a banker's bank. It is a bank that holds the reserves of the private banking system.

Senator GLASS. It is a bank of deposits?

Governor ECCLES. That is right—a bank of deposits for the banks. The ownership varies in different countries. The organization varies from institutions owned entirely by the Government to institutions owned entirely by the public. In the case——

Senator GLASS. But the stockholders of a central bank of that description have a responsibility to the depositors, have they not?

Governor ECCLES. Yes; whether they be private stockholders or whether the Government be the stockholder, I would say they have.

Senator GLASS. Yes; but the Federal Reserve Board has no responsibility to the depositors in the various banks, member banks of the country, has it?

Governor ECCLES. Only to the extent that it is given responsibility for monetary action, monetary control, and responsibility for making rules and regulations that would affect the depositors. To that extent it would have responsibility.

Senator GLASS. Well, of course, the statute now and the rules and regulations of the existing Federal Reserve Board charge it with that responsibility; but that is a very different matter from determining to whom and to what extent the deposits in the various banks may be loaned.

Governor ECCLES. There is nothing in this bill that does that, Senator Glass.

Senator GLASS. Well, you may not have discovered it.

Governor ECCLES. I have not. There is nothing in this bill that prescribes how the Federal Reserve banks shall loan their funds. The responsibility for credit extended to member banks by Reserve banks rests with the Reserve banks. The Board may make certain rules and regulations governing the basis upon which credit could be extended to member banks.

Senator GLASS. Not inconsistent with the statute itself.

Governor ECCLES. That is right. That is correct.

Shall I proceed?

Senator GLASS. You may proceed.

Governor ECCLES (continuing statement): *Limitations and objectives of monetary control.*—Recognition of the importance of monetary control and of cooperation between the Government and the bank of issue is not based on the belief that all economic ills can be cured by monetary action alone.

It has been asserted that the proponents of this bill, and I in particular, hold such a belief. Speaking for myself alone, I am keenly aware of the limitations of the influence of monetary measures on economic conditions. I realize that without a properly managed plan of Government expenditures and without a system of taxation conducive to a more equitable distribution of income, monetary control is not capable of preventing booms and depressions. The volume and cost of money are important, however, and are the particular responsibility of the Federal Reserve System. That is the reason why our immediate concern in this legislation is to make the machinery of regulating the volume of money as efficient as possible so that the system may exert its influence toward the achievement of the desired objective.

This objective, in my opinion, should be more clearly defined than is the case in existing law. For the somewhat indefinite phrase of "accommodating agriculture, commerce, and industry", I would suggest the substitution of a definite mandate that the Federal Reserve Sytem shall exert such powers as it has toward promoting business stability and moderating fluctuations in production, employment, and prices, insofar as that can be accomplished within the scope of monetary action and credit administration.

Senator TOWNSEND. Would you care to clarify that by an example?

Senator GLASS. You would not care to usurp the authority of the Department of Agriculture and its A. A. A. provisions that require the plowing under of so many crops, and how otherwise would you control production? You could not produce crops or things of that sort when you would have to plow them under or rent the land and pay a subsidy?

Governor ECCLES. Only as the monetary policy induces inflation or deflation.

Senator COUZENS. Have you studied the conditions sufficiently in 1928 and 1929 to have reached a conclusion as to how the monetary policy might have been controlled at that time to have prevented the killing of pigs and plowing under of crops?

Governor ECCLES. I do not know that I have. I may have some views on the subject, but I would not want to pose as an authority.

Senator COUZENS. Would you mind giving them, because it might exert a great influence upon the distinguished committee?

Governor ECCLES. I think that could possibly be answered in connection with the question you asked a little while ago. I think it would be closely related to the whole subject.

Senator COUZENS. You say you think you would like to report later on that?

Senator GLASS. How would you correct that vice of Congress, with apologies to these Members of the Senate, of appropriating hundreds of millions of dollars to prevent overproduction, and then appropriating hundreds of millions of dollars to reclaim swamp lands and irrigate deserts to increase production?

Governor ECCLES. Well, that is a——

Senator GLASS. If you can do that, I am in favor of electing you to the United States Senate.

Senator COUZENS. That would not be enough, because there are too many other questions.

Senator MCADOO. Perhaps that is the last thing that he wants to happen.

Governor ECCLES. You are right.

Senator GLASS. All right, Governor, go ahead. We simply want to point out some of the difficulties you would encounter when you propose that.

Governor ECCLES. I am quite aware of them. I am quite aware of the limitation of monetary policy alone. [Continuing statement:]

This objective, which is similar to the one recently adopted for the Bank of Canada, states the aims that must guide the Federal Reserve Board in the formulation of its policy and at the same time clearly recognizes the limitations of its power. I believe that the Federal Reserve Board will be in a position to exercise its powers more effectively if it is given a more definite indication by Congress of the broad objectives of monetary policy. It will also increase the Board's power to resist political pressure for the use of its authority for purposes inconsistent with the maintenance of business stability.

Senator MCADOO. Let me interrupt you there, Governor. I am violating the suggestion I made to the distinguished Senator from Michigan, when he lectured me so effectively a moment ago, but I should like to ask at this juncture just what you mean by political influence. Do you think it has been exerted on the Federal Reserve Board heretofore, and if so, when? Have you information?

Senator COUZENS. I think I can answer that one—when you were Secretary of the Treasury.

Senator MCADOO. You could not, because you did not know anything about it at that time.

Senator COUZENS. Well, we can read history, you know.

Senator MCADOO. You do not mean it is history, do you?

Senator COUZENS. Oh, yes. You made an historical speech on the floor of the Senate. That will go down in history.

Senator MCADOO. I hope so. Let us hope so. It had nothing, however, to do with the consideration of this question.

Senator COUZENS. Oh, yes; it has to do with monetary policies. It is very important.

Senator GLASS. I should like to compose the austerities of this committee.

Senator COUZENS. Well, I must confess that I am terribly disturbed when two distinguished former Secretaries of the Treasury take opposite positions.

Senator MCADOO. Well, we have not taken any opposite positions. We are asking for information.

Senator COUZENS. I observed the Senator from Virginia did not vote for the printing press money the other day.

Senator GLASS. Gentlemen, gentlemen.

Governor ECCLES. I don't believe I can answer that question as to when political influence may have been exercised, Senator.

Senator MCADOO. You referred to it, and I wanted to learn when that had been effective.

In connection with this printing-press money that seems to disturb the Senator from Michigan so much, I remember hearing my distinguished colleague, the Senator from Virginia, present upon the floor of the Senate a bill and ask what it was. He did not so express it, but the others knew that it represented at the moment printing-press money and nothing else. It is a felony to take the money and convert it into gold.

Senator GLASS. Well, the money that we once had was not printing-press money. It took it away from those who had it.

Senator MCADOO. That is what I mean.

Senator GLASS. It took it away from those who had it. It has as much right to take your shirt as to take your gold.

Senator MCADOO. I am very thankful mine was not taken. I do not know how I could replace it.

Senator GLASS. If I had more shirts than gold, I would say that.

Senator MCADOO. I may say that I think I understand the good-natured observations of my good friend from Michigan. I know the spirit in which he made them.

Governor ECCLES (continuing statement): *Increased regional autonomy.*—An important feature of the proposed legislation is that it clarifies and increases regional autonomy of the Reserve banks in matters of local concern. This is contrary to the contention of critics who allege that the bill would abolish local autonomy and inaugurate completely centralized control over the Federal Reserve System. In its proposals along this line the bill follows the principles laid down in 1913 by the House Banking and Currency Committee in its report on the original Federal Reserve legislation, in which it was stated:

> Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward.

Recognition of the necessity of striking the proper balance between national and regional considerations in the organization and operation of the Federal Reserve System, therefore, dates back to its origin. The principle is that responsibility for policies of national scope and purpose shall be lodged in the Federal Reserve Board and that actual banking operations and all activities or policies of local concern shall rest with individual Reserve banks, subject only to the necessary degree of coordination.

The proposed bill, as already stated, strengthens the regional autonomy of the Reserve banks. At present the Reserve Board appoints three directors of each Federal Reserve bank, including the chairman. Under this bill the Board will appoint at the most two and possibly only one director. The governor, who will be a class C director, and the vice-governor, who may also be a class C director, will be appointed by the local directors, subject only to the Federal Reserve Board's approval. In the bill as introduced, annual approval by the Board is prescribed. I believe that one approval of the governor for the period of his 3-year term as a class C director would be sufficient, and I consequently recommend such a change in the bill.

Senator COUZENS. May I ask at that point just why the Federal Reserve Board wants the power to approve the appointment of these directors?

Senator MCADOO. You mean the governor?

Senator COUZENS. Yes.

Governor ECCLES. The Board now appoints the chairman, who is the—well, I think this next statement answers your question. As I go on here I think that it explains the advisability of combining the offices of chairman and governor. (Continuing statement:)

At the present time the Reserve agent is by law the Board's representative at the Reserve bank——

Senator MCADOO. He is the chairman as well as the agent?

Governor ECCLES. That is right [Continuing statement:]

And maintains an office of the Reserve Board on the premises of the Reserve bank.

Now, I do not know whether that answers your question or not.

Senator COUZENS. In other words, you are just substituting a governor for an agent and it is your opinion because the appointment of the agent must be approved you would approve the appointment of the governor?

Governor ECCLES. The Board appoints the agent. We appoint the agent and his entire staff. We believe that it would be a better organization, that it would make for better coordination to have one head of the bank, by combining the office of the governor and the agent, and it is felt that inasmuch as the Board no longer would appoint the chairman who, as I understand it, was expected to be the executive head of the bank, that they should have the approval of the governor and chairman at least each 3 years, when the term as a class C director would expire. In other words, a person occupying that position should be a person agreeable both to the local board and the Board here for the purpose of having proper coordination and cooperation.

Senator MCADOO. Then what you do is this—pardon me.

Senator COUZENS. I was going to say, have you any figures as to the number of employees each 1 of these 12 Federal banks have?

Governor ECCLES. Yes. I do not have them in mind. I think we have a total of something like 12,000, as I recall the number.

Senator COUZENS. Divided among 12 banks?

Governor ECCLES. Yes.

Senator COUZENS. Will you furnish the number that is in each bank?

Governor ECCLES. Yes, sir; I shall furnish you the number of people in both the agents' division and the governors' division.

Senator GLASS. Was that included in your testimony before the House?

Governor ECCLES. No, it was not, Senator; it was not requested.

Senator TOWNSEND. Will you also furnish the number that will be in the new set-up?

Governor ECCLES. There will not be any more. It is impossible to furnish what that would be.

Senator GLASS. It will not be any more? There will just be one less?

Governor ECCLES. There should be more than one less.

Senator McADOO. In order to make perfectly clear what you are detailing there, I want to know if I understand you correctly; under the present law, nine directors are chosen for each Federal Reserve bank?

Governor ECCLES. That is right.

Senator McADOO. Divided into classes. Now, of the 9, 3 are class C directors, and they are appointed by the Government; that is, by the Federal Reserve Board?

Governor ECCLES. Yes.

Senator McADOO. Acting for the Government; and one of those is now designated as chairman of the Board and Federal Reserve agent?

Governor ECCLES. Yes.

Senator McADOO. And he has certain functions to perform; he has to attend the meeting of the Board, and his business is to see to the issue of currency and to provide for the necessary collateral to protect that currency issue, as well as perform certain other functions?

Governor ECCLES. Yes.

Senator McADOO. Now, the nine members of the Board select the governor, and since the banks control six of the directors, the banks, or the stockholders, I mean, who own the stock, it being owned by the bank that selected the governor, and he is the chief executive of the bank and directs its affairs. Your proposal is to merge the chairman of the Board and the Federal Reserve agent and the governor into one, is it not?

Governor ECCLES. That is right.

Senator McADOO. And you require the selection of one of the class C directors as a governor?

Governor ECCLES. No; whoever is selected as governor by the local board and approved by the Board will be a class C director.

Senator McADOO. Well, then, the Government has two directors under your plan, only?

Governor ECCLES. That is right.

Senator McADOO. Because you are caused to accept, then, the nominee of the bank, or the stockholders?

Senator GLASS. Or disapprove.

Senator McADOO. Or disapprove.

Governor ECCLES. Yes.

Senator McADOO. One or the other. But you can never have the third class C director a governor unless the Board approves it?

Governor ECCLES. That is right.

Senator McAdoo. The effect of it is really to put the selection of the governor in the control of the Board and, really, that is the effect of it, is it not?

Governor Eccles. Well, no; we cannot designate the governor at all.

Senator McAdoo. Well, you can continue to disapprove until you get one whom you are willing to accept, which is in effect the same thing.

Senator Couzens. Well, hardly, because we have that same thing in the confirmation of an appointee by the President. We cannot select him, but we can confirm or disapprove. All we can do is to approve or disapprove.

Senator Glass. Yes; but we always confirm.

Senator McAdoo. Yes; as a rule we do.

Governor Eccles. Well, possibly.

Senator McAdoo. Now, you think that by the consolidation of these two offices into one, and having the Board practically select the governor, that you get better administration?

Governor Eccles. I do.

Senator McAdoo. Can you give us particular reasons for that as a matter of organization?

Governor Eccles. That is explained here.

Senator McAdoo. All right, go ahead.

Governor Eccles. I am quite sure if I could read this it would answer a good many questions that are being asked.

Senator Glass. Go ahead, sir.

Governor Eccles (continuing statement): At the present time the Reserve agent is by law the Board's representative at the Reserve bank, and maintains an office of the Reserve Board on the premises of the Reserve bank. Not only is he himself directly appointed by the Board, but the appointment of his entire staff, including bank relations and economic services, is subject to approval by the Board. Under the proposed bill the agent's department would be abolished and its functions and personnel brought directly under the governors of the Reserve banks. The proposed change concerning eligibility requirements for discount and the proposed elimination of the collateral requirements for Federal Reserve notes will likewise increase local discretion and autonomy. The Reserve banks will under these provisions have increased responsibility in dealing with member banks. The power of the Federal Reserve Board to delegate some of its functions to its representatives will also enable the Board to authorize Reserve banks to handle many administrative matters, which under present law must be passed upon by the Federal Reserve Board as a whole. These matters may include passing on applications for membership, granting of voting permits for holding companies, and many others.

It is apparent that the present proposals will not destroy the regional character of the system, but, on the contrary, will carry to its logical conclusion the principles which were in the mind of President Wilson and of proponents of the original act, namely, the granting of wide discretion and autonomy to the Reserve banks in local matters and the concentration in the Reserve Board of authority over national monetary policies.

Senator GLASS. But there was another thing in the mind of President Wilson and of the proponents of the Reserve Act, and it is reflected textually in the statute itself, and that is that the facilities of the Federal Reserve System should not be used for speculative purposes. The Board is authorized to make its own definitions of eligible paper, but it is distinctly prohibited from including in its definition speculative investment transactions.

Now, is it not possible that under your proposed alteration of the law member banks might engage in speculation to their heart's content?

Governor ECCLES. I do not think so. I think that——

Senator GLASS. Evidently the counsel to the Board do not think that the chairman knows anything about the Federal Reserve Act, but the chairman thinks he does.

Governor ECCLES. This proposed bill would not change the law with reference to the member banks' loaning activities, except by liberalizing the real-estate loan provisions.

Senator GLASS. Yet you propose to permit them to loan on any sound asset and the brokers testified before our committee that the soundest asset upon which loans were ever made were brokers' loans.

Governor ECCLES. We do not permit the member banks to loan upon sound assets. They are already permitted to loan on sound assets. The proposal is to permit the Reserve banks to lend to the member banks on sound assets.

Senator GLASS. That opens the facilities of the Federal Reserve banks for speculative investments.

Governor ECCLES. Sound assets do not necessarily mean speculative investments. If banks must confine all their lending to what is known as "commercial paper", with the present business structure, with the structure of business for a number of years, there will not be enough commercial credits or commercial lending to go around.

Senator GLASS. So, if we keep on spending, there will not be any.

Governor ECCLES. The total amount of commercial paper in the banking system today which is considered to be eligible by the member banks is less than 8 percent of their total loans and investments.

Senator GLASS. Well, is that not because of this unprecedented depression in business?

Governor ECCLES. In 1929, Senator, the total was only between 12 and 13 percent.

Senator GLASS. After the crash?

Governor ECCLES. No, before the crash; and it has declined from a little over 4 billions to approximately 2 billions.

Senator GLASS. How many banks in the system are without eligible paper for rediscount?

Governor ECCLES. I could not answer that. I would say that most of the banks would have some eligible paper. It would vary. Most of the eligible paper, however, is held by the larger banks because the commercial credit seeks the lowest money market. Particularly is that true with large concerns that are able to sell their paper in the market. So that the larger banks would have the greater amount of what would be known as "strictly commercial" or "eligible" paper. The rates on paper of that sort at the present time are extremely low.

Senator McAdoo. Governor, could you have put in the record here, later, as a supplement to your statement, the testimony you are now giving, some figures to show for a few consecutive years before and since the panic of 1929 just what percentage the eligible paper is of loanable assets that the banks held in the various Federal Reserve districts?

Governor Eccles. By districts, you mean?

Senator Glass. At this time?

Senator McAdoo. No; I say for a few years preceding 1929, and a few years following.

Governor Eccles. The total was between 12 and 13 percent.

Senator McAdoo. Of loanable assets?

Governor Eccles. Yes.

Senator McAdoo. What of the deposits, related to deposits?

Governor Eccles. That would be a different figure. I think the total is 12 to 13 percent of the loans and investments. Now, it would make a lower percentage.

Senator McAdoo. Of course.

Governor Eccles. Based on other resources. Now, as to what the figures are by districts, I couldn't say. We can get those figures.

Senator McAdoo. That information is available?

Governor Eccles. Yes.

Senator Bulkley. Governor, you do not contend that there is any shortage of eligible paper in the Federal Reserve banks today, do you?

Governor Eccles. No.

Senator Bulkley. Together with Government bonds?

Governor Eccles. No.

Senator McAdoo. The point I wanted brought out is that you are proposing here the broadening of requirements for eligible paper in the Reserve banks.

Governor Eccles. Yes, sir.

Senator McAdoo. And these figures would be of value, in enabling us to judge whether or not such an enlargement would be of value.

Senator Glass. And expunging the requirement that they shall relate themselves specifically to commerce, industry and agriculture.

Senator McAdoo. Well, I would not expunge that.

Senator Glass. But I say the proposal is to expunge.

Senator McAdoo. The proposal here is, but I am preserving the law in that respect as it was.

Senator Glass. At least, I think that is the present provision. Maybe counsel for the Federal Reserve Board can tell us better than I.

Governor Eccles. I will proceed, if I may.

Senator McAdoo. Mr. Chairman, may I ask, please, is it your intention to continue the hearing? I myself am obliged to be at the session.

Senator Glass. Well, I am content to continue.

Very well, go ahead.

Senator McAdoo. I will have to ask you to excuse me.

Governor Eccles [continuing statement]:

Summary of reasons for proposed changes.—Perhaps the best way to explain the reasons for the changes proposed in this bill is to ask you to consider what kind of a system would be devised, if a plan for such a system were to be formulated at the present time. It would be considered desirable that all banks carrying deposits subject to check be members of the system. It would also be deemed desirable that the banks be supervised, but in a country the size of ours it would be undesirable to centralize in Washington all operations pertaining to individual banks.

Senator GLASS. The House does not agree with you on that, does it?

Governor ECCLES. No; they do not.

Senator COUZENS. Neither do I.

Governor ECCLES (continuing statement). What would be done is to provide for regional Reserve banks with a large degree of local autonomy in dealing with their local member banks. It is equally clear that national monetary policies would have to be under public, not private or banker, control. Such policies would be placed under a body appointed by the President and confirmed by the Senate. Provision would be made to insure as far as possible that the controlling body be composed of the best talent available and that it be in a position to resist pressure to pursue policies for undesirable purposes. To this end both authority and responsibility would be concentrated in that body; its members would be made financially independent; high qualifications for membership and an objective toward which policy should be directed would be laid down. That body would be entrusted with sufficiently effective instruments of policy to make the system responsive to changing conditions, and would be given discretion in the regulation of bank operations.

The system, which I have ventured to suggest would be established if a new plan were now being formulated, differs little from the Federal Reserve System with the changes proposed in the banking bill of 1935. We propose to facilitate entrance of nonmember banks into the Federal Reserve System. We propose to increase the regional autonomy of the Reserve banks in matters pertaining to local credit administration. We propose to increase the authority and responsibility of the Federal Reserve Board in matters pertaining to national monetary policies; to lay down new qualifications for future Federal Reserve Board members; to grant to future members pensions and higher salaries. In these ways we hope to make a position on the Board more attractive to outstanding men. We suggest a specific objective of monetary policy. We propose that the system's organization be made more amenable to Federal Reserve Board policy; that the banking system be made more responsive by making it safe for the banks to meet the changing nature of the community's requirements for loans, and by liberalizing the provisions in respect to real-estate loans; and, finally, we propose the removal of various impediments to effective policy, such as collateral requirements for notes.

Proposal for a commission.—Opponents of this legislation have proposed the creation of a commission of experts which would review the whole field of banking legislation at leisure and would then make a report to serve as a basis for reform.

Senator GLASS. Would not you like to modify that by saying "some of the opponents"?

Governor ECCLES. I am willing.

Senator GLASS. Not all of them, by any means.

Governor Eccles. I am willing to modify it to that extent. I think that is more nearly correct, Senator. [Continuing statement:]

A proposal for a commission is not infrequently made as a means of gaining time in order better to organize opposition to undesired legislation. It is not infrequently advocated by persons who are opposed to a measure and think that the first and easiest step is to prevent its immediate passage by proposing a commission for the study of the subject.

In my opinion the public interest will be best served through the adoption of banking measures in the order of their urgency and in accordance with our capacity to formulate concrete conclusions. The Banking Act of 1933 was such a measure. It did not cover the whole field of our banking problems, but dealt primarily with the specific problems concerning the speculative use of credit and the relations of investments to commercial banking on the basis of our experience in the years immediately preceding the depression. It is gratifying to have this law on our statute books and to feel that there are adequate means at our disposal through that act and the Securities Exchange Act to prevent the occurrence of another speculative orgy like that of 1929.

Similarly the provisions of the present bill are based on the actual experience of the Federal Reserve System for the past 20 years and particularly on its experience during this depression. They were prepared in the light of past events and in consultation with persons who have worked in the System for many years. Statements that have been made to the effect that the bill was hastily drafted without competent advice do not correspond to the facts. The proposals in this bill are simple and concrete; without modifying the essential nature of the Federal Reserve System, they strengthen its power to meet future emergencies, and increase the ability of member banks to facilitate recovery.

The argument that an elaborate study should be made before any banking legislation is enacted ignores the fact that committees of both Houses of Congress have been studying the subject for years and that there is a vast volume of material available in the hearings and reports of these committees. It also ignores the fact that the Federal Reserve System, commercial bankers, and other agencies have been almost continuously studying the problem in recent years.

It is my conviction that the measures proposed in this bill would not be greatly modified by additional years of study, and that in the meantime the banking system would not be in so advantageous a position for contributing its share toward recovery, and the Federal Reserve System would not be well equipped to cope with inflation if it should develop.

Differences of opinion on the proposals contained in title II of this bill are not the kind that can be resolved by study. They represent fundamental differences of approach to economic problems. Proponents of this bill are irrevocably convinced of the necessity of public control of national monetary and credit policies. Opponents believe in a minimum of Government supervision and represent two different points of view: One believing that monetary control should be left with the private banks that own the Federal Reserve System; the other holding the opinion that no control at all is necessary, that the free play of natural economic forces will result in the monetary system functioning for the public welfare. These divergent points of view cannot be reconciled by argument, nor can they be clarified by further study. They call for a decision by the Congress of the United States.

Summary of provisions.—A brief discussion of the provisions of the bill, section by section, may be appropriate at this point and may be helpful in indicating what was intended to be accomplished by the proposals.

Section 201 proposes that the offices of governor and chairman of the Federal Reserve banks be combined.

This proposal is in recognition of the situation that has developed in the banks. It gives the governors of the Reserve banks a status in the law and combines their office with that of the chairmen of the boards of directors. It is, of course, essential that the holders of these combined offices be approved by the Federal Reserve Board.

In this proposal there is no encroachment on the autonomy of individual Reserve banks. It merely reestablishes the original plan of the Federal Reserve Act that the Federal Reserve Board, which has responsibility for national policies and for general supervision over the Reserve banks, shall be a party to the selection of the active heads of the 12 Reserve banks. This change will work toward smoother cooperation between the Board and the banks and will establish within the banks a greater unity of administrative control than now exists. It will also result in considerable saving through the elimination of one of the two highest officers in each Federal Reserve bank.

Section 201 also provides that directors of Federal Reserve banks shall not serve more than 6 consecutive years. This is proposed to avoid the crystallization in the boards of directors of the influence of any one individual or groups of individuals. That such a policy is desirable is evidenced by the fact that it has already been adopted in some of the Federal Reserve districts.

Section 202 would give the Federal Reserve Board authority to waive capital requirements for membership for insured nonmember banks joining the System prior to July 1, 1937, when all insured nonmember banks are required by law to become members of the System. This proposal is for the purpose of making it possible for numerous nonmember banks with small capital to join the Federal Reserve System and thus not lose their privilege of belonging to the Federal Deposit Insurance Corporation. In providing that insured banks must become members of the Federal Reserve System by July 1, 1937, the Banking Act of 1933 took an important step in the direction of unified banking which is universally admitted to be desirable.

Senator GLASS. Well, it is not universally admitted, because the House has vitiated the whole thing.

Senator TOWNSEND. Have you a record of how many State banks and nonmember banks have come into the System since that time?

Governor ECCLES. No. I could get that for you. I do not have it in my mind, but I can get it for you.

Senator GLASS. What do you think would happen to the insurance fund if the action of the House should be confirmed by the Senate?

Governor ECCLES. Of course, it would depend to what extent power to admit banks to the insurance fund was given to the Federal Deposit Insurance Corporation and what powers they have of examination and expulsion of members from the fund and how well they administer the powers that are given them.

Senator TOWNSEND. What powers are given in the House act?

Governor ECCLES. I do not recall just how the act was finally passed. As I understand it, as I recall, the powers that were asked by the Federal Deposit Insurance Corporation were not all given to them, and I think it is very essential that they certainly be given adequate power to determine what banks shall be admitted to membership, and also power over examinations, and power to expel for cause. In connection with this same matter I have something to say here about it. [Continuing statement:]

This provision of the present bill is designed to facilitate the process of unification. I wish, however, to recommend a modification of the section in the bill as it was introduced which I recommended to the House; that is with reference to the phraseology of the provision providing for the admission of nonmember banks, giving the Board certain powers to waive requirements. I shall include this proposed modification with others that I wish to recommend.

I should like to call attention to the fact that the bill as reported by the Banking and Currency Committee of the House eliminated from this proposal the limitation that it shall continue in force only up to July 1, 1937. The House committee also made a change in title I of this bill and amended the Banking Act of 1933 to eliminate the requirement that all banks that are members of the Federal Deposit Insurance Corporation shall become members of the Federal Reserve System by July 1937. This change appears to me undesirable. It is generally agreed that unification of banking under national supervision is desirable and that the conflict of jurisdiction and authority over banks which has prevailed has been a source of weakness in the banking system. There ought to be national control of charters granted to banks, and there ought not to be unfair competition between member and nonmember banks in regard to interest on deposits and other matters. In case, for example, the Federal Reserve System should find it necessary to raise reserve requirements, as it has authority to do under the law, the fact that a substantial group of banks would not be affected would be a distinct limitation on the effectiveness of the measure.

For these reasons, it would be in the public interest to bring about as rapidly as possible a unification of the banking system. At the same time it is recognized that there are many small banks that would find it difficult to join the Federal Reserve System even under the liberalized provisions proposed in this bill. For one thing, many of these small banks derive a considerable proportion of their income from exchange charges which they would have to abandon if they joined the Federal Reserve System. It has occurred to me, therefore, that the situation might be met by a proposal—and it is a suggested compromise proposal—that all insured banks with deposits of $500,000 or more shall join the Federal Reserve System within a year after they become members of the Deposit Insurance Corporation. That would apply to new banks or within a year after their deposits reach $500,000 or more. Banks of this size do not have to depend on exchange charges for their earnings and should be in a position to qualify for membership in the Federal Reserve System in other respects. Under this proposal smaller banks would have the option of joining the Federal Reserve System if they wished. I should like, however, to provide that any new bank chartered after the passage of the banking bill of 1935 be required to belong to the Federal Reserve System, if it joined the Federal Deposit Insurance Corporation.

Senator GLASS. You, of course, know that the exchange question has been one of the most bitterly controverted problems with which we have had to deal. It has entailed a considerable amount of litigation, it has gone through court stages up to the Supreme Court, it has saved, it is computed, the businss interests of the country, that is, the existing law has, approximately $250,000,000 a year. The existing law, as you know, provides that these banks may charge the actual cost of exchange transactions, but nobody has ever been able to find an actuary or in accountant who could estimate the positively inappreciable loss to the banks. So that banks that want to get exchange want to get something for nothing.

Governor ECCLES. Continuing on this question [continuing statement]:

I am informed that there are 5,644 State nonmember banks belonging to the Insurance Corporation whose deposits are $500,000 and under, and 2,038 whose deposits are over $500,000, so that roughly three-fourths of the insured nonmember banks would not be obliged to joint the Federal Reserve System, if my suggestions were adopted, and only one-fourth, representing the larger banks, would be required to join. This would not deprive the small banks of the earnings from exchange charges. At the same time it would not seriously interfere with the system's monetary policies, because the banks with deposits of over $500,000, which would have to join the system, hold 77 percent of the total deposits of all insured nonmember banks.

This would mean that although in numbers less than two-thirds of all the banks of the country would be members of the System, if banks with deposits under $500,000 were left out, that we would have more than 95 percent of the deposits of the banking system in member banks.

Another important advantage of this proposal, as compared with the House proposal, would be that the larger banks that are now members of the Federal Reserve System would not be free to retain the benefits of deposit insurance and at the same time to leave the system whenever it suited them. That is a matter of vital importance, because the right of member banks to free themselves from regulation by the System by giving up membership might at any time limit the System's ability to make its monetary and credit policy effective.

Section 203 deals with qualifications for membership on the Board——

Senator GLASS. Before you get to that, Governor, and adverting to the question of the small banks, do you believe in branch banking?

Governor ECCLES. I do.

Senator GLASS. State-wide?

Governor ECCLES. Either state-wide or regional, trade area. I believe in the extension of limited branch banking.

Senator GLASS. Do you think that would in a large measure solve the problem of the small banks?

Governor ECCLES. I do.

Senator TOWNSEND. Is that provided for in this bill?

Governor ECCLES. It is not.

Senator TOWNSEND. Would you favor putting it in the bill?

Governor ECCLES. Not at the present time. I am expressing, of course, a personal opinion, and I recognize how controversial the question is, the question of State's rights that arises in connection with giving national banks the right to establish branches in States where branch banking is not permitted. The problem raises an issue which I think sooner or later must be met.

Senator GLASS. Does that mean to suggest that you do not mind controverting the judgment of the Senate but you do not like to undertake to controvert the judgment of the House?

Governor ECCLES. No; I would not say that. I do not want to consider too many controversial questions. It seems to me that there have already been introduced sufficient, possibly, for one——

Senator GLASS. Is not that a vital problem?

Governor ECCLES. It is a vital problem, and it is a problem that must be met. I personally have been in favor of the unification of banking and branch banking and have recognized the need for a good number of years.

Senator GLASS. Well, we have been studying that problem, to my personal knowledge, for 35 years. Why need we study it any further? Why not act?

Governor ECCLES. Well, of course, there has been progress in the development of branch banking in the last few years. Even the States have taken some initiative and leadership; and the bill that was passed in 1933 permitting national banks to establish branches in those States where States permitted it was a step in the right direction. Progress is being made, I think, in that regard.

Senator GLASS. Yes; but you do not want any more made right now; is that your idea?

Governor ECCLES. Well, I can——

Senator GLASS. You want it made, but you do not want a controversy?

Governor ECCLES. I, personally, am in favor of it, because I believe it is constructive. I think it would serve the public interest. I think it would strengthen the banking system.

Senator COUZENS. I think you would find a very considerable diversity of opinion on that.

Governor ECCLES. I recognize that. I think that is one reason it may be well to consider it at some other time. I feel, however, that branch banking should be limited in its scope; and I also feel that where there are communities, small communities, that have banking service, that it should not be——

Senator GLASS. That is provided in existing law.

Governor ECCLES. Yes. That a bank should not be permitted to go in and establish a bank and drive out an existing bank that is already there and established.

Senator GLASS. Your ideas are more liberal than mine. You want it regional, and I think it ought to be confined to the States.

Governor ECCLES. Well, I have thought of it in connection with Federal Reserve district branch areas, from the standpoint of administration, because the banks carry their reserves, and bank examinations are conducted from that area, and it is a logical business unit, it seems to me.

Senator GLASS. I do not disagree there, but right at that point I join you in not wanting too much controversy.

Governor ECCLES. I think it would be——

Senator GLASS. I want to get rid of this talk about States' rights. The States have no rights left, so far as that is concerned, but I would like to get rid of that much of it.

Senator COUZENS. May I ask, leaving aside for the moment the public benefit, if by having a unified banking system—can you, in a brief way, state to me the advantages of an independent bank, well financed, becoming a member of the Federal Reserve System?

Governor ECCLES. You mean the advantage to the bank?

Senator COUZENS. Yes.

Governor ECCLES. Or an advantage to the public?

Senator COUZENS. I said, leaving aside the public advantage of a unified banking system, and considering the question of just what advantages a bank may have in becoming a member of the Federal Reserve System.

Governor ECCLES. Why, I think that the rediscount privileges, the opportunity to borrow funds, and the clearing facilities that it gets through the Reserve System are very important elements. The safekeeping service that it gets——

Senator COUZENS. Safe-keeping service of what?

Governor ECCLES. Securities. It is my experience in the banking business; from the very beginning of the organization of the Federal Reserve, I have always felt that it was to the interest of the bank to be a member of the Reserve System.

Senator COUZENS. I know that is the general conclusion, but I was trying to get the details of why you thought it was better.

Governor ECCLES. There is a certain amount of public confidence as a result of membership, and that is given largely through the access to Federal Reserve facilities.

Senator COUZENS. I think you had better check up on that answer and see how many banks there are with signs on the window, "Federal Reserve System", that closed and have not paid out their depositors.

Governor ECCLES. There is no question that there were closed banks in all classes, national member banks, State member and State nonmember banks, but the figures will show that the State nonmember bank mortality and loss of deposits far exceeded those of the banks in the System. The shrinkage of deposits and the bank mortality were very much greater than for the member banks.

Senator COUZENS. Have you ever heard of the criticism that exists among the ordinary depositors of the fact that they felt that when they saw "Federal" on these windows that they felt that they were guaranteed and taken care of by the Federal Government?

Governor ECCLES. I haven't heard that.

Senator COUZENS. Never heard that?

Governor ECCLES. No.

Senator COUZENS. I have had a number of letters to that effect.

Senator TOWNSEND. You have heard of criticism of the names of banks, for example, the United States Bank?

Governor ECCLES. Yes; I have; I have heard that criticism, but never of the Federal Reserve System.

Senator TOWNSEND. Well, they were a member of the Federal Reserve System.

Governor ECCLES. Yes; but I have not heard of cases where people felt, simply because a bank was a member of the Federal Reserve System, that it was a Government-owned bank. I have heard of cases where people thought that a first national bank was Government owned; but those cases, I think, are quite remote. I will continue.

Senator GLASS. Well, is it not a very vital consideration, in banks which are not even members of the Federal Reserve System, that we no longer have currency panics in this country?

Governor ECCLES. Well——

Senator GLASS. In other words, history shows that almost decennially we have had in this country, or we did have in this country prior to the enactment of the Federal Reserve System, currency panics when banks would be compelled to close; banks with ample assets could not get a dollar, and they would have to issue clearing-house certificates instead of currency. That has never occurred since the adoption of the Federal Reserve System, and the Federal Reserve System, as it seems to me, is an insurance against its ever occurring again.

Governor ECCLES. That is correct. As long as a bank is a member of the Reserve System and has reserves, that bank is solvent; or so long as a member bank has assets on which it can borrow from the Reserve System, as far as that bank is concerned and its depositors, they are always able to get currency. There is an elastic currency created as a result of the Federal Reserve System, because they can create currency based upon the call for currency by their members, so long as those members have reserves with the Reserve System.

Senator GLASS. Yes.

Senator TOWNSEND. And there is no urgent demand for printing more currency?

Governor ECCLES. No; not at all. You couldn't keep it out if you printed it. You just could not get it out.

Senator COUZENS. Well, if you put the Patman money out, that will not mean anything, will it?

Governor ECCLES. It will not mean that you will increase the amount of money in circulation, because the Patman money would displace some of the existing currency, but the total amount of currency that will be in circulation as a result of paying the $2,000,000,000 bonus would not be increased any more than by putting out $2,000,000,000 of Government bonds.

Senator GLASS. In other words, the Patman currency would signify just an easy way to pay the Government's indebtedness by running the printing presses, but the possibility is that the Bureau of Engraving and Printing would be kept busy hereafter doing the same thing?

Senator TOWNSEND. Because it is a payment of the debt.

Governor ECCLES. Mechanically the Government can create money by the issuance of currency and by using that currency to pay its debts or to take care of appropriations that Congress makes, or it can finance the deficits which such appropriations create through a sale of its obligations, Government bonds, in the market. Now, in either case, whether it is through a bond issue or through a currency issue, you increase the means of payment by that amount. The difference——

Senator GLASS. And if you keep it up, you make your currency worthless.

Governor ECCLES. Yes; there is no question about that.

Senator GLASS. I have got right here in my pocket now a practical illustration of that. I have got a hundred-million-mark note here that was once worth—what?—$46,000; and now it is not worth carrying around in my pocketbook except to exhibit it as a curiosity.

Governor ECCLES. Of course, Congress would have to appropriate the funds that would create the deficit.

Senator GLASS. There would not be any difficulty about that. We have not experienced any so far.

Senator TOWNSEND. Well, of course, by issuing that money we would have a certain degree of inflation, would we not?

Governor ECCLES. No more inflation than by issuing the same amount of Government bonds to take care of a deficit, from a purely mechanical standpoint. From a psychological standpoint, there is always a possibility, when financing is done by currency issues rather than bond issues, of creating a certain fear psychology that would cause a rapid velocity of funds, which would tend to bring about a degree of inflation; and, if kept up long enough, it would decrease the value of money roughly according to the total mediums of payment that was created.

Senator GLASS. When the money was on a sound money basis, there was a vast deal of difference between bond issues and the issuance of currency. One is a demand obligation, and the other usually has a long time in which to mature, and the practice with respect to bonds has always been a refunding practice. Whereas the issuance of an immense amount of demand currency, if we were on a sound money basis, would simply wipe out the entire gold reserve.

Senator TOWNSEND. Well, as a matter of fact, the bonds that we issue without the protection of a sinking fund, in providing for the interest charge, is inflation, is it not?

Governor ECCLES. To the extent that they create a deficit.

Senator TOWNSEND. That is right.

Governor ECCLES. But no more of an inflation than the same amount of credit expansion by the banking system. In other words, a deficit financed by Government bond issues of $4,000,000,000 will add, if those bonds are taken by the banking system, $4,000,000,000 of deposits to the banking system. The deposits will first go to the Government, the Government spends the funds, and they come to the banks as deposits of individuals and corporations.

Senator GLASS. Yes; but if the bonds are taken by individual investors?

Governor ECCLES. In that case it increases velocity without changing the volume of deposits. In other words, it makes use of existing deposits; the depositors in a bank draw those deposits out and buy

Government bonds. The Government spends that money, and the deposit goes right back in the bank in the account of somebody else, so that the person or corporation that has bought the bond has simply changed its money for bonds. It does not mean a change in the amount of money, and from the standpoint of money it is not inflationary.

To the extent that banks buy the bonds, it has the same effect as extending credit and is inflationary.

Senator TOWNSEND. What percentage of the bonds now are being taken by the banks?

Governor ECCLES. I think it is just a rough guess. About 44 percent of the Government obligations outstanding today are held by the Reserve and member banks. I think that the proportion that is currently taken by the banks today would run larger than that. I think that may run as high as 60 percent. Of course, you are speaking of new issues, rather than refunding?

Senator TOWNSEND. Well, I was speaking of both, really.

Senator GLASS. Well, go ahead.

Senator COUZENS. There is one question I want to ask. There is a famous columnist that keeps asking in his column what is the difference between an issue of a Government note—demand note, which is simply a promise to pay back—and a Government bond bearing interest, with a promise to pay at a specific time? He keeps asking that question. and I have never happened to have seen the answer, and so I would like an expert to answer it.

Senator GLASS. I am not an expert, but I gave the answer to the question as to the difference between a demand obligation and a Government bond a few moments ago. The whole history of the financing of the Nation shows that the time obligation is usually refunded, whereas the demand obligation, if we are on a sound-money basis——

Senator COUZENS. Well, we are not on a sound-money basis, and I want him to answer it under the situation as it now exists. not if we were on a sound-money basis. I do not want any "ifs" in it at all. But what is the difference between a Government issue of a note without interest and a note with interest?

Governor ECCLES. I will be very glad to give you my view, my interpretation, of the difference. The Government issues its bonds. The bonds have a definite maturity date, and they bear a definite, fixed rate of interest. And the banks buy those bonds.

Senator GLASS. Why restrict it to the banks?

Governor ECCLES. I am going to say there is a different situation between the banks buying the bonds——

Senator COUZENS. I am not talking about the banks. I am talking about the public. I am asking as to the difference that would exist between a demand note without interest and a bond with interest, in the public hands.

Governor ECCLES. I will explain the difference, but I have to go through this to make the distinction.

Senator COUZENS. All right.

Governor ECCLES. The banks buying the Governments debit the asset account when they buy the Governments, and they credit the deposit account to the Government. That money is spent and comes back in and hence increases the deposits of the banks by that amount.

To the extent that the public buys the Government bonds, it in no way changes the volume of money. It does affect the velocity of money because the individual buying the bond draws the money to buy the bond, the money is transferred to the Government and then the Government spends it. It in no way changes the volume of money in the System when the individuals and corporations buy the bonds, but when the banks buy bonds it does make a difference. To the extent that the deposits are increased by the banks purchasing bonds, the excess reserves of the banks are reducd by 10 percent.

In other words, if the banks buy a billion dollars of Government bonds, the deposits of the banks as a rule are increased by a billion, and the average required reserve is increased by $100,000,000. Therefore, if the banks have a 1-billion-dollar excess reserve and they buy a billion dollars worth of Government bonds and increase the deposits a billion dollars, the excess reserve is reduced to $900,000,000. If they bought 20 billions of Government bonds, the banks would increase the deposits in the banks 20 billions and their excess reserves would be entirely wiped out through that operation.

Now, let us take cash and currency.

Senator BULKLEY. You are speaking of surplus?

Governor ECCLES. No; I am speaking of excess reserves.

Senator COUZENS. While your discourse is very interesting, you have not yet told me the difference.

Governor ECCLES. I am going to.

Senator COUZENS. It is not necessary to go through the banks. I am not talking about the banks. Here is a Government bond bearing a 3-percent interest rate, with a specified maturity. Here is a Government note without any specified maturity, and no interest.

Governor ECCLES. Yes.

Senator COUZENS. What is the difference in the value of those?

Governor ECCLES. The bond might fluctuate in total value, depending on its maturity and interest rate, based upon the market for money at that time. The note will not fluctuate.

Senator COUZENS. I am not talking about fluctuation. I am talking about the value of it. It is strange I cannot get a straight answer.

Governor ECCLES. The value to whom?

Senator COUZENS. The owner. In other words, the Government bond has a promise to pay.

Governor ECCLES. Yes.

Senator COUZENS. At a specified time, not in gold.

Governor ECCLES. That is right.

Senator COUZENS. And here is a hundred-dollar bond, baby bond, for example, and all it is is a promise to pay. Here is a hundred-dollar note, a note without any maturity, simply the Government's promise to pay. I ask you what the difference is in the security of those two?

Governor ECCLES. There is no difference in the security.

Senator COUZENS. That is answered.

Governor ECCLES. There is no difference in the security. There may be a difference in the value, but no difference in the security.

Senator COUZENS. I am talking about the security. I am not talking about the value of it. In other words, if the Government issues

Patman money, and promises to pay it, the person who has it is just as secure as though he had bonds?

Governor ECCLES. Yes; there may be a difference in the value, depending on the market at the time.

Senator COUZENS. I am talking about the security. So I am just as secure when I take a Government note with a promise to pay as I am with a bond with a promise to pay. I am just as secure in money?

Governor ECCLES. Yes.

Senator GLASS. You are not secure in either case.

Senator COUZENS. I am not talking about that. This famous columnist is quite correct in his contention, then, that there is just as much security behind a Government note as there is behind a Government bond that bears an interest rate?

Governor ECCLES. That is right.

Senator GLASS. And you cannot get the security on either proposition. They put you in jail if you do.

Senator COUZENS. Then I want to ask another question. Is there not automatically an estoppel on a bond, on the issuance of bonds, dependent upon the people's willingness to buy, while there is no estoppel anywhere on the issuance of notes whereby people have to take the notes in payment of debts?

Governor ECCLES. I think that is possibly correct, that——

Senator COUZENS. In other words, if the Government issues a billion of bonds and there are no buyers, buyers have lost confidence, they do not buy, and so we cannot sell them, therefore the Government cannot spend any more. Their credit is gone. If, however, they issue a billion dollars' worth of notes, without interest and without maturity date, and they pass them around to pay their debts to all their employees, including Senators and all others, we have got to take them, haven't we?

Governor ECCLES. That is right.

Senator COUZENS. So is it not a fact that there is an automatic estoppel upon the sale of bonds, while there is no automatic estoppel on the issuance of notes; is that correct?

Senator COUZENS. Is that correct?

Governor ECCLES. I do not know that there is an automatic estoppel on the sale of bonds; at least, I do not know where it is.

Senator COUZENS. At least, it is when the people stop buying them?

Governor ECCLES. Yes, sir.

Senator BULKLEY. Is not what the Senator from Michigan has said a good deal mitigated when you can make the member banks buy bonds?

Because, of course, they can get the currency on the bonds after they have bought them.

Governor ECCLES. Congress can appropriate money and can find means of either raising it through bond issue or, failing to do that, they could raise it through the issue of currency.

Now, with reference to the Reserve banks and the member banks buying Government bonds, the indication or the inference has been made, at different times, that they are being forced or that pressure has been brought to bear to support the Government credit.

As a matter of fact, the amount of bonds held by the Reserve System has not increased since November 1933, and the total interest paid by the Government on its indebtedness today is less than at any time between 1919 and 1925.

Senator BULKLEY. I think that is very interesting and very encouraging.

But my question was purely a theoretical one. As to whether the force of Senator Couzens' distinction was not in large measure arrested, so long as the Government can put pressure on the banks to buy bonds, and the member banks, in turn, can get currency against the bonds as needed.

Governor ECCLES. Of course, if the Government can put pressure on them, that is true.

But there is nothing in the law that gives to the Government the power—either in the proposed legislation or in existing legislation—to require the Federal Reserve banks to buy Governments.

Senator BULKLEY. Now, let us see about the proposed legislation; I am inclined to think there is. Is there any doubt that the Federal Reserve Board can require the banks, through the open market committee, to buy any securities that they see fit?

Governor ECCLES. Government bonds, you mean?

Senator BULKLEY. Government bonds or any other securities.

Governor ECCLES. The Federal Reserve Board, under the proposal here, is charged with the responsibility of carrying out a monetary policy which deals with open market buying and selling of bonds, with discount rates, and reserve requirements, and is directed to use these instruments toward a condition of business stability, and so forth.

The power is given to the Board to require the Reserve banks to purchase or sell Government bonds.

Senator BULKLEY. Within what limits?

Governor ECCLES. There is no limitation.

Senator BULKLEY. That is what I thought.

Governor ECCLES. That is right; there is no limitation.

However, at the present time, of course, the Treasury is a monetary authority on its own account, to quite an extent, with a stabilization fund the size that it is, and with the balances that it carries in the member banks, from one to two billion dollars, and with the very large amount of trust funds, which include Postal Savings and F. D. I. C. and others; and it is in a position to exercise very great influence over the money market.

Senator BULKLEY. All of which reinforces what I am saying: That the distinction that Senator Couzens makes is not very material, if we should enact this law.

Governor ECCLES. I think that is correct.

The danger in issuing currency is this: It does not diminish the reserves at all. The banks get an increase in deposits, the same as when bonds are issued. But it all goes in to increase the excess reserve.

A $2,000,000,000 currency issue would increase the present excess reserve from about $2,000,000,000 to nearly $4,000,000,000, while the same amount, financed by Government bonds, would decrease the excess reserve by $200,000,000.

That seems to me to be an important difference.

Senator TOWNSEND. What percent of the stabilization fund was invested in Government bonds?

Governor ECCLES. That is a question that I should prefer you to ask the Secretary of the Treasury.

I have no responsibility in connection with the handling of that fund.

Now, I am going to skip some of this statement here, inasmuch as we have discussed it.

Senator GLASS. If it conforms to your convenience, Governor Eccles, we shall have you back on Monday morning, if you please.

Governor ECCLES. I shall be glad to be here at the convenience of the committee.

Senator GLASS. Very well; we shall adjourn for today.

(Thereupon, at 1 p. m., an adjournment was taken until Monday, May 13, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

MONDAY, MAY 13, 1935

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

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

Present: Senators Glass, Bulkley, Townsend, Bankhead, Couzens, and McAdoo.

Senator GLASS. Governor, you had not quite finished with your statement?

Governor ECCLES. Yes; that is correct.

Senator GLASS. We would be glad to have you proceed and conclude.

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

Governor ECCLES. All right. I didn't conclude the prepared statement at the hearing on Friday, and I will omit a portion of it and then file the statement for the record, if that is all right, in order to save time.

Senator GLASS. That will be entirely satisfactory.

Governor ECCLES. There are, however, certain sections of it which I would like to read.

Senator GLASS. Very well.

Governor ECCLES (continuing statement): Section 203 deals with qualifications for membership on the Board, provision for a more adequate salary and a pension system, and also with the matter of the Governor's appointment, which I have already discussed.

Section 204 would authorize the Board to assign duties to designated Board members or its representatives and thus would enable it to be relieved of a mass of administrative detail and to give its time to the study of policy matters.

Section 205 of the bill would provide for an open-market committee to consist of the Governor and two members of the Board, elected annually by the Board, and two governors of the Federal Reserve banks, elected annually by the governors of the Federal Reserve banks. It would be the duty of this committee to formulate the System's open-market policies which would be binding on the Federal Reserve banks. The committee would also make recommendations about discount rates.

A change in the provision about open-market policy is necessary in order to place definite responsibility on a national body with a national viewpoint.

Under the present law, open-market policies are formulated by the Federal Open Market Committee, which consists of the governors of the 12 Federal Reserve banks. The recommendations of the committee have to be approved by the Federal Reserve Board, and the boards of directors of each Federal Reserve bank retain the authority to refuse participation in the policy adopted. It would be difficult to conceive of an arrangement better calculated than this for diffusing responsibility and creating an elaborate system of obstructions.

In my opinion, however, the proposal in the bill as introduced would not be a satisfactory solution of the problem. I recommended before the House, and I wish to recommend, instead, a provision clearly vesting in the Federal Reserve Board full power and responsibility to initiate, adopt, and enforce open-market policies for the Federal Reserve System, after consulting with an advisory committee consisting of 5 representatives of the Federal Reserve banks selected annually by the governors of the 12 Federal Reserve banks. The Board should be required to consult this committee before adopting an open-market policy, a change in discount rates, or a change in member bank reserve requirements.

Such a provision would eliminate conflicts of jurisdiction and policy and at the same time would preserve the participation of Federal Reserve bank governors in the deliberations leading to the adoption of open-market policies.

Senator GLASS. Do you know of any conflict that has happened?

Governor ECCLES. Between the governors and the Board?

Senator GLASS. The Federal Reserve Board and the Open Market Committee?

Governor ECCLES. No; I don't know of any.

Senator GLASS. The Secretary of the Treasury does not know of any himself, because he told me explicitly that the Treasury has had 100 percent, to use his exact language, cooperation from the present Open Market Committee.

Governor ECCLES. So far as I know, that is correct. [Continuing statement:]

Open-market operations might be initiated by either the committee or the governors or by the Board, but the ultimate responsibility for making a final decision and the power for adopting and carrying out national policies would be centralized in one place and in one body, as they should be.

Open-market operations as a means of credit control in this country are a post-war development. They were not regarded as a major instrument of policy when the original Federal Reserve Act was passed. From small informal beginnings, whose significance was not fully appreciated, open-market operations have gradually come to be recognized as the principal instrument of credit control. At first the individual operations of the separate Reserve banks were designed merely to equalize the earnings of these banks in periods when rediscounts were diminishing; then, as their effect on bank reserves and the volume of member bank credit was realized, operations were conducted at first by a self-appointed committee of the governors of the eastern Reserve banks and later by the same committee after approval by the Reserve Board. Owing largely to the circumstances of their origin, these operations, though they have come to be the most important features of our monetary policy and are definitely national rather than regional in purpose and in effect, still remain chiefly under the control of the regional Reserve banks.

Local, or regional, control of open-market policy is, in fact, impossible, because the effects of such policy cannot be restricted geographically. Local control has been tried and voluntarily abandoned. The question, therefore, is merely where the national control shall be lodged. In my opinion it should be lodged in the Federal Reserve Board, which has the responsibility for other instruments of monetary policy through discount rates and changes in reserve requirements.

I am recommending an amendment to the bill to carry out this proposal.

Section 206 proposes that the Federal Reserve banks, under regulations by the Federal Reserve Board, be authorized to make advances to member banks on the basis of any sound asset. This proposal arises out of the experience of the Federal Reserve System.

The view on which the original eligibility provisions of the Federal Reserve Act were based was that bank assets should be self-liquidating. This view rests on the theory that member banks should engage in purely commercial banking; such a view, however, is not realistic in a situation where only 8 percent of bank assets consist of presumably self-liquidating paper. The banking system cannot subsist on the $2,000,000,000 of eligible paper that is available; particularly since this paper is largely concentrated in the financial centers. Furthermore, in an emergency it does not remain self-liquidating. The banking troubles of this country in 1919 to 1921 were based to a considerable extent on the frozen condition of what was considered self-liquidating assets.

In an emergency no type of bank asset is liquid, and it is the function of the central banking institution to provide such liquidity, subject only to the requirement that the assets shall be sound. There is not and can never be a substitute for soundness, which must be based upon the competent exercise of banking judgment. The present provision would introduce into the Federal Reserve Act for the first time the express requirement of soundness of assets as the fundamental and single requirement for eligibility for borrowing from the Reserve banks. If the Reserve banks are to give genuine assistance to the commercial banks, they must serve in an emergency as an agency for liquefying all sound assets. During the depression many banks were forced into bankruptcy not because their assets were bad but because they could not meet the narrow and essentially unrealistic eligibility requirements, and it became necessary, by the Glass-Steagall Act of February 1932, to pass emergency legislation permitting the member banks to borrow from the Reserve banks on sound assets.

It has been suggested that the proposed amendment would impair the assets of the Reserve banks themselves. The implication is that the Reserve banks would lose their judgment of the soundness of bank assets. That this fear is fanciful would seem to be indicated by the fact that under the Glass-Steagall Act the Reserve banks made loans of this character amounting to over $300,000,000 and that of this amount all but about $1,500,000 had been repaid at the beginning of this year.

Section 207 makes provision for placing securities guaranteed as to principal and interest by the United States Government on the same basis in regard to eligibility for purchase by the Reserve banks as direct obligations of the United States Government. There seems to be no reasonable ground far discrimination against these guaranteed obligations.

Section 208 provides for eliminating collateral requirements for Federal Reserve notes. The requirement for segregation of collateral against Federal Reserve notes adds nothing to the quality of the notes, which are a prior lien on the assets of the issuing Reserve banks, and an obligation of the United States Government. Being a prior lien, the notes are secured in effect by the best assets that the Reserve banks have. They cannot be issued except in return for assets that the Federal Reserve banks are permitted and willing to acquire.

The complex machinery of providing for special segregation of collateral behind Federal Reserve notes is not in conformity with the fact that there is nothing more sacred in the note liability than in the deposit liability of the Federal Reserve banks. The deposits are the reserves of our banking system and, therefore, are back of all the deposits of all the depositors in all the member banks. These deposits surely deserve the same degree of protection as do Federal Reserve notes. The proposal does not go this far but merely places Federal Reserve notes on a basis of equality with deposits so far as collateral is concerned, without making any change in reserve requirements. It would preserve their status as paramount liens on the assets of the issuing banks and as obligations of the Government, and would have no effect either on the quality of the notes or on the elasticity of our currency. It would result in a simplification of the machinery of currency issue and in considerable economy for the Federal Reserve banks.

While these collateral requirements are not a protection for Federal Reserve notes, they have at times been the cause of serious difficulty for the Federal Reserve System. At a time when the System was pursuing an easy money policy through the purchase of Government securities there developed a shortage of eligible paper, with the consequence that it was necessary to impound a large amount of gold as collateral against the notes over and above the 40 percent reserve requirement. Such a situation prevailed in the early months of 1932, when the Federal Reserve banks, because their gold reserves were impounded behind the Federal Reserve notes, were unable to pursue a policy that would tend to arrest the deflationary process. At that time it became necessary for Congress to pass the Glass-Steagall Act, which authorized the use of Government securities as collateral for Federal Reserve notes. This law has since been extended, but it expires in March 1937.

It is proposed here to do away with collateral requirements altogether. They serve no useful purpose, they are expensive and cumbersome, and at times result in danger to the country's financial structure.

Section 209 is designed to clarify and expand somewhat the power of changing reserve requirements, provided in the so-called Thomas Amendment. It would permit the Board to change reserve requirements without declaring the existence of an emergency and without the necessity for obtaining the approval of the President. This is one of the ways in which the bill would diminish political control over the Federal Reserve Board.

I wish to recommend that the bill be modified so as to limit the power of the Board to change reserve requirements to two groups of banks, central reserve and reserve city banks and all other banks, and not to permit changes for individual Federal Reserve districts. There is urgent need for the authority to change reserve requirements, in view of the large amount of excess reserves now available to member banks and the possibilities of further additions to these reserves.

Section 210 would liberalize the provisions for real-estate loans. The modifications here proposed include an increase in the total volume of such loans that a bank may make, an increase in the proportion of the value of real estate that banks may lend, and provision for amortized loans with longer maturity.

Upon further consideration of this matter I wish to suggest that the section be modified to give the Federal Reserve Board power to regulate real-estate loans, subject to the limitation that new loans shall not exceed 60 percent of appraised value of the real estate.

This is the amendment that was proposed to the House and is included, with some changes, however, in the House bill.

As you know, real-estate loans are not a new form of investment for our commercial banks. They have been lending on real-estate mortgage security for decades. Liberalization of the real-estate loan provisions, combined with the broadened eligibility requirements for borrowing at the Federal Reserve banks, may encourage activity in the construction industry, which is essential to recovery.

Criticism of these provisions has come largely from those who believe in the separation of savings banking from commercial banking. Whatever may be said in favor of such a separation as a desirable thing in theory, it is not feasible so long as we have thousands of small banks that cannot operate profitably on the basis of their demand deposits alone. The member banks have $10,000,000,000 of time deposits which represent the people's savings. So long as they have time deposits for which they must pay interest, they of necessity must participate in financing long-term undertakings that will yield enough to pay for doing the business. The law places no limits on what the banks may do in the purchase of bonds or of other long-time paper; there is no reason for singling out real-estate loans for special restrictions.

Our banks have been losing a large part of their business to the Government, which has sold its bonds to the banks and has used the funds to make mortgage and other loans, many of which the banks should be in position to make themselves. Unless the banks regain some of the business which has been taken over by the Government credit agencies, there will not be sufficient business to support the banking system. There will also be great pressure for a constantly growing public debt incurred in part in taking over business that could be done by the banks.

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I note that the Banking and Currency Committee of the House in reporting out the bill has made two changes in the recommendations which we made with reference to real-estate loans. In the first place a limitation has been inserted that aggregate real-estate loans shall not exceed 100 percent of the capital and surplus or 60 percent of savings deposits, whichever is the greater. I think this rigid limitation is undesirable. It would be much better to leave this matter to the discretion of the Federal Reserve Board because the aggregate amount that may be safely loaned on real estate varies with banks, localities and periods of time.

The second change in the bill as reported by the House Committee is the elimination of the provision applying the regulations on real-estate loans to State member banks, as well as to national banks. This is a serious omission, because under it national banks would be at a competitive disadvantage as against State member banks, many of which are under little or no limitation in regard to their real-estate loans. Furthermore, the Federal Reserve System, which has a vital interest in the solvency of State member banks, would be given no authority over real-estate loans that the State member banks may make. This is inconsistent with provisions in the Banking Act of 1933 which in dealing with investment securities placed State member banks on the same basis with national banks. One of the important advantages in having State banks members of the Federal Reserve System would be lost if there were no uniformity in such matters.

Senator GLASS. Of what advantage to national banks is a national charter with a right of circulation withdrawn?

Senator BANKHEAD. I could not hear that statement.

Senator GLASS. I say, of what advantage is it to national banks to remain in the System with the circulation privilege withdrawn?

Governor ECCLES. I never considered the circulation privilege of very great value to national banks. Particularly has that been true the last year or so, where banks had excess reserves. Many of the banks, I think, up to the extent of about $200,000,000, deposited funds with the Treasury to offset their circulation. In other words, so long as they had the excess funds, they could not afford to pay the tax for the privilege of circulation. There is some small earning that accrues to national banks through the circulation privilege under conditions where they do not have excess reserves.

Senator GLASS. Well, what other distinctive privilege will a national bank have over a State bank in the event the circulation privilege is canceled as is now proposed?

Governor ECCLES. They will not have any.

Senator GLASS. Exactly.

Governor ECCLES. They will not have any. That is one of the dangers.

Senator GLASS. Exactly.

Governor ECCLES. Yes.

Senator GLASS. Then, will there be any particular reason why national banks should not convert into State banks and enjoy the peculiar privileges that the various States offer?

Governor ECCLES. There is likely to be reason for conversion.

Senator GLASS. Well, I did not mean to interrupt you there.

Senator BANKHEAD. Is there not an element of confidence in national banks?

Senator GLASS. What is that?

Senator BANKHEAD. I am asking if there is not an element of confidence in national banks, generally speaking, as distinguished from State banks, growing out of the system of examination, and so forth?

Governor ECCLES. The record of the national banking system has been much better than the record of the State banking system as a whole—but with the Federal Deposit Insurance Corporation insuring the deposits of not only national and State member banks but also State nonmember banks, it seems to me that that element of advantage and confidence is pretty largely wiped out.

Senator GLASS. Well, go ahead, Governor.

Governor ECCLES (continuing statement):

Reccommended modifications in the proposed bill.—Following is a brief summary of the modifications in the bill that I wish to recommend. These are the same modifications that I recommended to the House Banking and Currency Committee when I testified before it. A detailed statement of the verbal changes that would be necessary to incorporate these recommendations will be furnished to the committee.

1. Section 201. The appointment of governors and chairmen and of vice governors of the Federal Reserve banks shall be approved by the Federal Reserve Board every 3 years rather than annually, so that their terms in these offices may coincide with their terms as class C directors.

2. Section 202. On the admission of insured nonmember banks, the Board shall have authority to waive not only capital requirements, but all other requirements for admission, and the Board shall be permitted to admit existing banks to membership permanently with capital below that required for the organization of national banks in the same places, provided that their capital is adequate, or is built up within a reasonable time to be adequate, in relation to liabilities to depositors and other cerditors.

3. Section 203 (2). The pension provision shall be modified so that any member of the Board, regardless of age, who has served as long as 5 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. That is, he is to receive a pension of $1,000 for each year of service up to 12.

4. Section 204. It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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.

5. Section 205. Authority over open-market operations shall be vested in the Federal Reserve Board, but that there would be created a committee of 5 governors of Federal Reserve banks, selected by the 12 governors of the Federal Reserve banks, and the Board shall be required to consult this committee before adopting an open-

market policy, a change in discount rates, or a change in member-bank reserve requirements.

6. Section 209. The Board shall not have the power to change reserve requirements by Federal Reserve districts, but only by classes of cities. For this purpose banks shall be classified into two groups: one comprising member banks in central reserve and reserve cities, and the other all other member banks. Changes in reserve requirements, therefore, would have to be either for the country as a whole or for the financial centers, or for the country districts.

7. Section 210. The conditions under which real-estate loans may be granted by member banks shall be left to the discretion of the Federal Reserve Board to be determined by regulation. No real-estate loan hereafter made shall exceed 60 percent of the appraised value of the property; but this shall not prevent the renewal or extension of loans heretofore made.

In closing, I should appreciate it if an opportunity were given the Board's counsel to present to the committee a number of minor amendments, in the nature of drafting changes, that have been perfected since the bill was introduced.

Senator GLASS. He can file that, either with the chairman of the committee or with the clerk.

[The amendments referred to by Governor Eccles are herewith printed in full.]

AMENDMENTS PROPOSED BY GOVERNOR ECCLES TO TITLE II OF S. 1715

SECTION 201 (A)

Page 39, line 14, change the comma following the word "directors" to a period, strike out everything thereafter through and including the period following the word "bank" in line 18, and substitute the following:

"His first appointment shall be subject to the approval of the Federal Reserve Board. He shall not take office until approved by the Federal Reserve Board and thereupon he shall become a class C director of the bank for the unexpired portion of the term held by his predecessor as chairman of the board of directors or, if such term was completed, then for the next regular term of three years. At the expiration of such term as a class C director, and of each term of three years thereafter, his continuance in office shall be subject to the approval of the Federal Reserve Board, and he shall cease to be Governor at the expiration of any such term unless his reappointment be approved by the Federal Reserve Board. Upon such approval he shall become a class C director for the ensuing term of three years."

Page 40, line 2, after the period following the word "bank", insert a new sentence reading as follows:

"His appointment and reappointment shall be subject to approval by the Federal Reserve Board in the same manner as that of the Governor."

Page 40, strike out the sentence commencing in line 14 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."

SECTION 201 (B)

Page 41, between line 4 and line 5, insert a new paragraph reading as follows:

(c) The paragraph of such section 4 which commences with the words "Such board of directors shall be selected" is amended by striking therefrom the words "holding office for three years, and".

SECTION 202

Page 41, strike out all of lines 5 to 20, inclusive, and insert in lieu thereof the following:

"SEC. 202. Section 9 of the Federal Reserve Act, as amended, is amended by inserting after the tenth paragraph thereof the following new paragraph:

"Upon application to the Federal Reserve Board at any time prior to July 1, 1937, by any nonmember bank which at the time of such application has been admitted to the benefits of insurance by the Federal Deposit Insurance Corporation under section 12 B of this Act. the Federal Reserve Board, in its discretion, in order to facilitate the admission of such bank to membership in the Federal Reserve System, may waive in whole or in part the requirements of this section relating to the admission of such bank to membership: *Provided*, That, if such bank is admitted with a capital less than that required for the organization of a national bank in the same place and its capital and surplus are not, in the judgment of the Federal Reserve Board, adequate in relation to its liabilities to depositors and other creditors, the Federal Reserve Board may, in its discretion, require such bank to increase its capital and surplus to such amount as the Board may deem necessary within such period prescribed by the Board as in its judgment shall be reasonable in view of all the circumstances: *Provided, however*, That no such bank shall be required to increase its capital to an amount in excess of that required for the organization of a national bank in the same place."

SECTION 203 (2)

Page 42. before the word "retirement" in lines 19 and 23, insert the word "annual"

Page 43, line 2, strike out the words "after he reaches the age of 65."

Page 43, line 5, change the period following the word "paragraph" to a comma and insert the follows: "except that, if his term expire before he reaches the age of sixty-five and he decline to accept reappointment, he shall not receive any retirement pay."

Page 43. line 8. insert before the quotation marks the following: "Nothing in this section shall prevent the President from reappointing any member of the Federal Reserve Board holding office on July 1, 1935."

SECTION 203 (4)

Page 43, between lines 21 and 22. insert the following new paragraph:

(4) By adding at the end of the second paragraph the following: "Upon the expiration of their terms of office, members of the Federal Reserve Board shall continue to serve until their successors are appointed and have qualified."

SECTION 204

Page 43, line 22. immediately before the word "subsection" insert "(a)."

Page 44. line 1, strike out the word "such" and insert before the comma following the word "regulations" the words "prescribed by the Board." Also on page 44, line 2, before the word "duties" insert the words "any of its"; after the word "services", insert a semicolon; and strike out the words "so specified" and the comma following such words.

Page 44. between lines 7 and 8, insert a new paragraph as follows:

(b) Section 11 of the Federal Reserve Act, as amended, is amended by adding at the end thereof a new subsection as follows:

"(c) It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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."

SECTION 205

Page 44. Strike out everything commencing with line 11 through and including line 17 on page 45 and substitute the following:

"SEC. 12 A. (a) There is hereby created an Open Market Advisory Committee (hereinafter referred to as the 'Committee'), which shall consist of five representatives of the Federal Reserve banks. The members of the Committee and an alternate to serve in the absence of each of them shall be elected annually by the governors of the twelve Federal Reserve banks in accordance with procedure prescribed by regulations of the Federal Reserve Board. Vacancies shall be filled in the same manner. The terms of the members of the Committee shall expire at the end of each calendar year, and a person elected to fill a vacancy shall serve for the remainder of the terms of his predecessor. The Committee shall elect its own chairman. Meetings of the Committee shall be held from time to time upon the call of the chairman or upon the call of the Governor of the Federal Reserve Board. Meetings shall be called whenever requested by a majority of members of the Committee or by a majority of the members of the Federal Reserve Board.

"(b) The Committee shall 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. The Committee shall also aid in the execution of open-market policies adopted from time to time by the Federal Reserve Board and shall perform such other duties relating thereto as the Federal Reserve Board may prescribe. The Federal Reserve Board shall consult the Committee before making any changes on its own initiative in the open-market policy, in the rates of interest or discount to be charged by the Federal Reserve banks, or in the reserve balances required to be maintained by member banks.

"(c) After consulting with and considering the recommendations of the Committee, the Federal Reserve Board, from time to time, shall prescribe the open-market policy of the Federal Reserve System. Each Federal Reserve bank shall purchase or sell obligations of the United States, bankers' acceptances, bills of exchange, and other obligations of the kinds and maturities made eligible for purchase under the provisions of section 14 of this Act to such extent and in such manner as may be required by the Federal Reserve Board in order to effectuate the open-market policies adopted by the Board from time to time under the provisions of this section, and each Federal Reserve bank shall cooperate fully, in every way, in making such policies effective.

"(d) All transactions of Federal Reserve banks under authority of Section 14 of this Act shall be subject to such regulations, limitations, and restrictions as the Federal Reserve Board may prescribe."

Section 206

Page 47, line 21, immediately before the word "upon", insert: "Notwithstanding any other provision of law."

Section 208 (1)

Page 46, line 21, after the word "retired", insert the words "by Federal Reserve banks."

Page 47, line 22, after the words "Comptroller of the Currency", insert a comma and the following: "under the direction of the Secretary of the Treasury."

Page 48, line 5, strike out the word "numbers" and substitute the word "letters."

Page 48, line 11, strike out the words "by the Federal Reserve banks."

Section 208 (2)

Page 48, line 15, strike out the words "and also" and the word "and" and insert commas in their places.

Page 48, line 18, change the period following the words "Federal Reserve agent" to a comma and add the following: "the words 'or any Assistant Treasurer', the words 'or Assistant Treasurer', and the words 'by the Treasurer at Washington upon proper advices from any Assistant Treasurer that such deposit has been made.'"

Section 209

Page 49, commencing with the words "by member banks", in line 1, strike out everything through and including the quotation marks at the end of line

3 and substitute the following: "by member banks in reserve and central reserve cities or by member banks not in reserve or central reserve cities or by all member banks."

SECTION 210

Page 49, strike out everything commencing with line 7, through and including line 8, on page 51, and substitute the following:

"SEC. 24. Subject to such regulations as the Federal Reserve Board may prescribe, any national banking association may make real-estate loans secured by first liens upon improved real estate, including improved farm land and improved business and residential properties. The amount of any such loan hereafter made shall not exceed 60 per centum of the appraised value of the real estate; but this limitation shall not prevent the renewal or extension of loans heretofore made and shall not apply to real-estate loans which are insured under the provisions of title II of the National Housing Act. The Federal Reserve Board is authorized to prescribe from time to time regulations defining the term 'real-estate loans' and other terms used in this section and regulating and limiting the making of real-estate loans by member banks, with a view of preventing an unreasonably large proportion of each bank's assets from being invested in real estate and real-estate loans, preventing such loans from exceeding a reasonable percentage of the appraised value of the real estate in view of the circumstances existing at the time, and otherwise requiring the banks to conform to sound practices in making real-estate loans. On and after the date on which the regulations first adopted under this section shall become effective, no State bank or trust company which is a member of the Federal Reserve System shall make new real-estate loans except to the same extent and under the same regulations and limitations as national banking associations are permitted to do so."

Section 210 alternative amendments, if foregoing substitute not adopted:

Page 50, line 8, change the first word to "of."

Page 50, line 12, strike out the words "second or subsequent."

ADDITIONAL SECTION TO BE ADDED TO TITLE III

The second paragraph of section 9 of the Federal Reserve Act, as amended, is amended by striking out the period at the end thereof and adding thereto the following words: "except that the approval of the Federal Reserve Board, instead of the Comptroller of the Currency, shall be obtained before any State member bank may hereafter establish any branch and before any State bank hereafter admitted to membership may retain any branch established after February 25, 1927, beyond the limits of the city, town, or village in which the parent bank is situated."

[NOTE.—The sole purpose and effect of the above amendment is to correct a technical error in the Banking Act of 1933 which results in State member banks being required to obtain the approval of the Comptroller of the Currency, instead of the Federal Reserve Board, before establishing out-of-town branches or retaining such branches upon admission to the Federal Reserve System, if they were established after February 25, 1927. It would neither enlarge nor diminish the right of State banks to establish or retain branches, but would merely require them to obtain the approval of the Federal Reserve Board instead of the Comptroller of the Currency.]

Governor ECCLES. The committee requested certain information on Friday with reference to the number of employees in Federal Reserve banks and the paper eligible for rediscount with Federal Reserve banks as reported by member banks. The latter statistics were prepared for selected call dates from 1928 to 1934, and include the total amount of eligible paper from that date, from 1928 to 1934, as well as the ratio of eligible paper to total loans and investments, by Federal Reserve districts.

Senator GLASS. Just file that with the reporter. Mr. Smead gave me that a month ago.

(Paper submitted by Governor Eccles, entitled, "Paper Eligible for Rediscount with Federal Reserve Banks as Reported by Member Banks on Selected Call Dates", is as follows:)

Paper eligible for rediscount with Federal Reserve banks as reported by member banks on selected call dates, Oct. 3, 1928 to Dec. 31, 1934

[In thousands of dollars]

Call date	Total, all districts	Federal Reserve District											
		Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Oct. 3, 1928	4,368,094	275,804	1,301,316	304,300	252,135	210,598	221,689	615,802	221,978	174,477	252,840	244,467	292,688
June 29, 1929	4,389,853	250,909	1,352,130	272,383	263,789	210,474	234,465	634,105	196,331	177,119	275,890	238,833	283,425
June 30, 1930	3,904,968	229,645	1,096,224	253,586	237,517	191,961	196,266	570,820	199,531	179,398	250,202	218,977	280,841
June 30, 1931	3,197,984	177,123	1,003,659	226,847	196,059	155,905	140,852	386,962	153,827	177,621	205,650	173,203	200,276
June 30, 1932	2,427,959	155,741	814,581	190,503	159,204	112,237	95,629	233,616	103,211	125,640	153,798	121,730	162,069
June 30, 1933 [1]	1,977,459	130,490	721,286	129,492	110,487	73,858	65,747	252,786	67,197	101,951	119,541	96,750	107,874
June 30, 1934	[r]2,058,907	155,567	772,883	147,769	[r]106,388	87,479	77,445	201,457	61,146	106,810	124,337	93,129	124,497
Dec. 31, 1934	2,144,381	147,498	771,243	145,498	99,127	96,253	116,148	194,708	87,001	108,514	124,739	103,590	150,062

RATIO (PERCENT) OF ELIGIBLE PAPER TO TOTAL LOANS AND INVESTMENTS

Call date	Total, all districts	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Oct. 3, 1928	12.51	10.66	12.02	11.30	7.36	15.73	18.67	11.98	15.85	18.80	20.36	25.46	9.15
June 29, 1929	12.29	9.60	11.48	10.05	7.56	15.84	19.93	12.55	14.64	19.20	22.24	24.96	9.13
June 30, 1930	10.95	8.86	8.85	9.35	6.83	15.94	18.53	11.57	15.48	20.61	21.73	25.18	9.03
June 30, 1931	9.43	7.21	8.61	8.14	5.82	13.66	14.71	8.63	13.53	21.14	18.67	21.57	6.29
June 30, 1932	8.67	7.75	8.49	7.85	5.80	11.35	11.17	6.97	10.98	17.10	16.61	18.13	5.87
June 30, 1933	7.98	7.12	7.56	6.34	5.42	8.94	9.27	10.72	8.99	16.38	14.66	15.78	4.08
June 30, 1934	7.58	8.23	7.67	6.90	4.61	8.78	9.54	7.00	6.97	15.64	13.74	13.63	4.26
Dec. 31, 1934	7.62	7.83	7.55	6.65	4.19	9.09	13.34	6.19	9.32	15.53	13.04	14.28	4.83

[1] Beginning June 30, 1933, figures are for licensed banks only.

[r] Revised since publication of Member Bank Call Report.

Governor ECCLES. The number of employees of the System is 11,789. Five hundred and seventy-five is the number in the agents' departments, engaged in the issuance of Federal Reserve notes, in bank examinations, the statistical and analytical work, and the Securities Exchange units.

Two thousand three hundred and forty-one is the number in the fiscal agency, custodianship and depositary departments. That includes the number in the Treasury Department, Reconstruction Finance Corporation, Farm Credit Administration, Public Works Administration, and the Home Owners' Loan Corporation units.

There are 8,873 in the banking departments, all other units of the banks, including auditing. I will file these figures.

That concludes my statement, Senator.

Senator GLASS. We are very much obliged to you, Governor, for giving us that statement. Unless there are questions to be asked——

Senator COUZENS. I suppose the Governor will come back at the first opportunity and answer the question I asked last week.

Governor ECCLES. All right.

Senator COUZENS. Because I want that as a matter of record. I am anxious to have it in the record.

Governor ECCLES. I think, Senator Glass, in connection with your statement, you also asked that I state what the Federal Reserve Board did.

Senator GLASS. Well, you need not do that. I know very well what they did do, and the Senator from Michigan seems to think that my supplemental question, which was designed to aid him, was in some sense an antagonistical question. So you need not answer my question, because I know it.

I am much obliged to you, Governor.

Governor ECCLES. I have some copies of that, if any of the members of the committee want any.

Senator MCADOO. I would be glad to have a copy of it, Governor.

Governor ECCLES. Thank you.

(The information supplied is as follows:)

Average number of officers and employees of the Federal Reserve banks during the last 6 months of 1934

Total	11,789
Federal Reserve agents' departments (Federal Reserve note issues, bank examination, statistical and analytical, and securities exchange units)	575
Fiscal agency, custodianship and depositary departments (Treasury Department,[1] Reconstruction Finance Corporation, Farm Credit Administration, Public Works Administration, and Home Owners' Loan Corporation units)	2,341
Banking departments (All other units of the banks, including auditing)	8,873

Senator GLASS. Professor Kemmerer.

STATEMENT OF EDWIN WALTER KEMMERER, WALKER PROFESSOR OF INTERNATIONAL FINANCE, PRINCETON UNIVERSITY, PRINCETON, N. J.

Senator GLASS. Professor, just give your name and occupation to the official reporter.

[1] Except certain depositary operations such as maintenance of the Treasurer's general account for which separate figures are not available.

Professor KEMMERER. My name is Edwin Walter Kemmerer. I am Walker Professor of International Finance at Princeton University.

Senator GLASS. Doctor, have you had any experience in the setting up of banking systems in this country and abroad?

Professor KEMMERER. I have had considerable.

Senator GLASS. And if so, briefly state what it has been.

Professor KEMMERER. I have had considerable experience abroad and have cooperated from time to time in this country; but my work in this connection has been largely abroad. I was currency and banking expert of the Philippine Government from 1903 to 1906, and at that time was the adviser in the inauguration of the gold standard and drafted first hand, or with the assistance of others, a good deal of the banking legislation of that time.

In 1917 I was currency expert to Mexico. In 1918, in the summer, I was with the Federal Reserve Bank of New York, assisting in the preliminary work of the establishment of their statistical department. In 1919 I was financial adviser to Guatemala, and I went down there on a second mission sometime later; the first one was a Government mission, and the second one was under private auspices but as a friend of the Government.

In 1922, I was a trade commissioner-at-large, and spent a greater part of the year traveling in South America studying banking and currency problems.

I was president of the American Commission of Financial Advisers to Colombia in 1923.

Senator BULKLEY. Was that a United States Government position?

Professor KEMMERER. It was. That was a dollar-a-year job.

Senator BULKLEY. Under what department?

Professor KEMMERER. Department of Commerce. I was a free-lance but I had the official job of going down there to secure information in reference to the conditions down there.

Senator BULKLEY. In what year was that?

Professor KEMMERER. 1922. In 1923, I was president of the American Commission of Financial Advisers to the Republic of Colombia. And in that connection we drafted the legislation that established the central bank of Colombia, the Bank of the Republic, put the country back on the gold standard after many years of paper money, drafted the general banking legislation, and so on, which is still in operation. We covered other fields, including taxation, accounting, tariff administration, and credit policy.

Then, later, I was currency expert to the Dawes Committee in connection with the German banking and currency reorganization.

In 1925, I was chairman of the American Commission of Financial Advisers to Chile. We drafted plans for the almost complete reorganization of the currency, banking, and auditing and accounting laws of Chile. There, we established the Central Bank of Chile, helped get the country back on the gold standard, drafted legislation for the general banking law, and so on.

In 1927, I was chairman of Commissions of Financial Advisers of Ecuador and Bolivia, which did much the same things in those countries.

In 1926 I was chairman of a similar commission to Poland, in which we—among other things—drafted plans for revising the Central Bank of Poland, and for getting the country back on the gold standard. In 1924 I was—along with Girard Vissering, the president of the Bank of The Netherlands—currency expert to the Union of South Africa. We went down there and worked out a plan for the return of South Africa to the gold standard before Great Britain came back.

I had a commission as financial adviser to China in 1929. We spent practically the entire year there, and our work covered the field of currency, banking, taxation, auditing, accounting, public credit, financial administration, and railroad finance.

I had a second commission to Colombia in 1930, similar to the first one, in which we followed up and tried to perfect and improve our original work.

Last year I was invited to Turkey and assisted in carrying out what was known as the "Hines-Kemmerer Economic Survey of Turkey." In connection with our work there we worked out plans for helping in the monetary stabilization and the reorganization of banking.

Senator COUZENS. Would you kindly tell us who paid your expenses and salary at the time you went to Turkey?

Professor KEMMERER. Who paid my expenses?

Senator COUZENS. And salary?

Professor KEMMERER. Mr. Walker D. Hines was invited to make an economic survey of Turkey and he associated with himself a group of experts, who went out there. He had a financial arrangement with the Government for the work. It was continued for sometime, and Mr. Hines became ill. They wanted to get someone who had been familiar with this field to assist in carrying on that work. So they asked me if I would be willing to cooperate, and I said "yes." I got a group of people who were interested in that sort of thing and we cooperated with the original group, with Mr. Hines' group. Mr. Hines died shortly afterward, but we carried on from this end, and those in Turkey did likewise.

We finished the main report in May of last year, but did not finish the work on currency and banking until late summer, for I was unwilling to make any definite recommendations in that field until I had been on the scene in Turkey for 6 weeks.

Senator GLASS. Until what?

Professor KEMMERER. Until I had been on the scene, been out there. I went out there with a couple of assistants last summer, was there for 6 weeks and finished that work.

Mr. Hines' law firm made the arrangements with the Government of Turkey, and his firm paid me my expenses and honorarium. I had no negotiations in that case directly with the Government. In my Peru commission my negotiations and work were directly with the Reserve Bank of Peru, but it was work for the Government.

Senator COUZENS. While you are on that subject, you have mentioned many times the fact that you were an expert. So that us laymen understand just what an "expert" means, would you kindly define an "expert"?

Professor KEMMERER. Well, a popular definition of an expert is, "A guy who is long ways from home." To be serious, however, the word "expert" is one that is bandied around a great deal. I don't know any definition of an "expert" that is entirely satisfactory. All I can say is that, from my point of view, an expert in a field would be a man who had made a careful study of that field and because of that study and perhaps also, though not necessarily, but desirably, because of experience in that field, had accumulated a certain amount of knowledge in it that would qualify him to speak with more authority than people who had not had such experience and made such studies.

Senator COUZENS. I understand your interpretation of the word "expert". Is it possible for a man to become an expert by training and actual experience, activities—rather than book learning—to become an expert?

Professor KEMMERER. I should think it is.

Senator COUZENS. So, in effect, you admit that there are two kinds of experts. One is your kind, where you fit yourself, as you say, by studying, and then there is the other kind of expert, who gathers experience over a long period of years, and he, I assume, under your interpretation, is also an expert?

Professor KEMMERER. Well, I think there are a great many varieties of experts. I should think that a man could become an expert in a field by experience; but I think when it comes to fields of this kind it is highly desirable that an expert should have been a student of the scientific development of the subject, of the history of the development of thought in the subject, should know the theory and should have had practical experience as well. That is, he should have roots as well as flowers. A good many people, I think, may, by individual study, without university work, have qualified for that sort of thing, but I believe that a fair grounding in the theory and principles and the history of the thought on the subject, and the experience in our own country and other countries, is desirable for an expert.

I know some pretty well-qualified men in some fields who have had only part of the things I have mentioned.

Senator COUZENS. So, in fact, some of them are all flowers, and some of them are all roots; and so you are both?

Professor KEMMERER. No; I am making no such claim, sir.

Senator GLASS. Doctor, I asked you to give your experience and observations in order that the committee might determine the value of your testimony here. Have you finished along that line?

Senator BANKHEAD. I want to ask him a question about his experience.

Professor KEMMERER. I have acted in an advisory capacity in one sort or another, in 13 countries. I have been in two of them twice, Colombia and Guatemala.

Senator GLASS. Well, you have omitted a very important, if gratuitous part, of your work, in failing to state that you were in frequent communication with me as Chairman of the Banking and Currency Committee of the House of Representatives, and perhaps with the Treasury Department when we adopted the Federal Reserve Banking System.

Professor KEMMERER. Yes; that is true. I was working with a committee that was active in the work with you, and I was a member of the American Economic Association War Finance Committee during the war.

Senator BANKHEAD. You said you acted in many capacities, Professor Kemmerer. As I have read from time to time in the newspapers for the last 8 or 10 years, I have gathered the impression that you devoted your activities, especially in foreign countries, largely to trying to get those countries on the gold standard. Is that correct?

Professor KEMMERER. Well, most of my missions have covered a broad field, Senator, currency and banking and taxation and auditing and accounting, and the whole general field of finance. But in most of the countries I have been in the currency problem has been an important one and in a considerable number of them, in fact, most of them, we had the problem of reestablishing the gold standard.

Senator BANKHEAD. How many countries have you aided in getting on the gold standard?

Professor KEMMERER. Well, I will have to count them. The Philippines. I could hardly say Mexico. There was some work there, but it was rather a matter of holding on to the gold standard at the time I was there. Guatemala, Colombia, Ecuador, Bolivia, Chile, Peru, Poland, and the Union of South Africa. We didn't get China onto a gold basis except as regards her customs duties. We made recommendations, however, looking in that direction ultimately. Turkey is in fact on a form of the gold standard but we made recommendations looking toward the improvement of her currency.

I think you have them all there.

Senator BANKHEAD. How many of those countries are still on the gold standard?

Professor KEMMERER. There are not many countries in the world that are still on the gold standard. Poland, Germany, Guatemala, the Philippines, and Turkey, although Germany's gold standard is largely nominal. I might say that, of course, there are very few countries firmly on the gold standard today, except France, Holland, Switzerland, and Poland.

I might say that a good share of my countries like my South American countries—I call them my countries, I mean the countries I have worked in—remained on the gold standard until after England went off.

Senator GLASS. You do not feel in any sense responsible for any of them going off the gold standard?

Professor KEMMERER. Well, I should hate to take that responsibility. I think that we had a world catastrophe and practically all went off, and if I wanted to make an alibi, and I am not interested in alibis, I would say that before they went off all of them departed from the principles and rules that we laid down; but I am inclined to think the pressure was pretty strong and they did not have much choice in a number of cases.

Senator BANKHEAD. In other words, the situation must be such in order for them to say on the gold standard that they have a sufficient volume of gold as compared with the volume of business transacted?

Professor KEMMERER. There are a great many other things. I think it is more complicated than that, Senator.

Senator BANKHEAD. What do you say are the main factors?

Professor KEMMERER. I do not think the main factor is having a large amount of gold. A number of these countries which went off the gold standard had large amounts of gold. I think the main factor is to keep the supply of the currency and circulating credit limited to the needs of business and to maintain public confidence in that currency and circulating credit. I think a number of those points will be brought out in my testimony, Senator.

Senator BANKHEAD. All right, I do not want to interrupt you.

Senator GLASS. Doctor, to get down to brass tacks, I believe that is the expression of people who are engaged in levity, you are familiar with this proposed bank bill of Governor Eccles, are you?

Professor KEMMERER. I have read it carefully; yes, sir.

Senator GLASS. We would like to have your testimony in regard to it.

Professor KEMMERER. I have prepared a brief memorandum, which, if it is agreeable to the committee, I would like to go through and then have the committee ask such questions as they may desire.

Senator GLASS. Very well.

Professor KEMMERER. In this memorandum I have not touched all the phases of the bill. There are a good many provisions in the bill on which I have not any positive conviction one way or the other and I had a feeling that perhaps I could be most helpful to the committee if I would stress the points on which I fundamentally disagree with the bill.

I should say my chief criticisms of title II—and I am confining my remarks entirely to title II of the proposed Banking Act of 1935—may be briefly discussed under two general headings.

First, the bill provides for an increased governmental and political control of our banking and credit system.

Second, it contains a number of provisions that are likely to result in a leveling down of the quality of our bank assets and, therefore, in a weakening of the security of our bank deposits.

The increased political control is expressed in three ways: (*a*) An enlargement of the President's powers over the Federal Reserve Board; (*b*) an increase in the powers of the Federal Reserve Board over the Federal Reserve banks; and (*c*) an increase in the powers of the Federal Reserve banks over member banks. The net result would be a great increase in the power of the President over our entire monetary, banking, and credit system.

How would this take place under the provisions of this bill?

INCREASED POWER OF PRESIDENT OVER FEDERAL RESERVE BOARD

Section 203, paragraph (3) (pp. 49 and 50) repeals sentence 4 of paragraph (2) of section 10 of the Federal Reserve Act, which says:

> Of the six persons thus appointed, one shall be designated by the President as Governor and one as Vice Governor of the Federal Reserve Board.

For this provision the bill substitutes the sentence:

> 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 sentence mentioned is the one that fixes the term of office of the members of the Board at 10 years.

This amendment, therefore, specifically places the tenure of office of both Governor and Vice Governor completely in the hands of the President. It encourages the prevailing idea that the office of Governor of the Federal Reserve Board is a political office.

Senator McAdoo. May I interrupt there just a moment?

Professor Kemmerer. Oh, yes.

Senator McAdoo. The present Federal Reserve Act already confers that power upon the President?

Professor Kemmerer. Yes, sir.

Senator McAdoo. He designates the Governor?

Professor Kemmerer. Yes, sir.

Senator McAdoo. Who holds at the pleasure of the President?

Professor Kemmerer. I think what I have to say will appear in my brief. You notice what I said, that it encourages the prevailing idea that the office of Governor of the Federal Reserve Board is a political office. I will come to that a little later.

Senator McAdoo. All right.

Professor Kemmerer. The original Federal Reserve Act apparently contemplated that the office should be nonpolitical.

In my judgment, the position of Governor of the Federal Reserve Board should be as nonpolitical as that of Chief Justice of the United States Supreme Court. I believe that it would be sounder public policy to amend the law in the opposite direction to that proposed and to have the Governor and Vice Governor elected annually by the Federal Reserve Board. This would be similar to the practice in the Bank of England; also in a number of other central banks, including those of Canada, Chile, Colombia, Greece, and Italy.

Members of the Federal Reserve Board consist entirely of men who live and work in Washington—the most politically minded city in the Nation. Every member of the Board is an appointee of the President, and one of them is a member of his Cabinet. By the terms of the proposed law both the appointment and the removal of the Governor of the Board and of the Vice Governor are placed entirely in the President's hands.

Now, I grant that in practice the President does appoint them now.

Senator McAdoo. He can remove anyone now?

Professor Kemmerer. All right.

Now, the bill does not say specifically he can, but, as a matter of fact, he does, and we are now putting that specifically in statutory law.

While a Governor who is removed from office by the President may legally continue on the Board under the terms of this bill as revised, his position would be an uncomfortable one, and he is not likely to do so. Furthermore, the idea seems to be widely entertained here in Washington, whether rightly or wrongly I do not know, that the tenure of office of the other members of the Board is in reality also at the President's discretion. Every member of the Board today, except Governor Eccles, belongs to the same political party as the President.

Senator Glass. Governor Eccles does, because he voted for the President.

Professor KEMMERER. I checked up in various ways, and found that the only one listed as not being of the same political party was Governor Eccles.

The proper duties of a banking and credit policy board like the Federal Reserve Board are not of a political character. They are not performed best in an atmosphere that is highly charged with political motives.

Increased power of Federal Reserve Board over Federal Reserve banks: The second broad criticism of the bill which I would make under this general heading of enlarged political control is the increased powers the bill gives to the Federal Reserve Board over the 12 Federal Reserve banks. The powers possessed by the Board over the 12 Federal Reserve banks have, in fact, always been large and they have been increased considerably during the last few years as a result of temporary emergency measures. This bill increases them further and makes the enlarged powers permanent.

Bill gives complete power over open-market operations to Federal Reserve Board: The bill takes away from the Federal Reserve banks themselves practically all of their present control over open-market policies, the most important and far-reaching policies appertaining to the Federal Reserve System, and places them entirely in the hands of the Federal Reserve Board. The Board, it is true, is to be assisted by an open-market advisory committee of 5 representatives of the Federal Reserve banks and 5 alternates. This committee, however, is purely advisory and has no power whatever in determining open-market policies.

At present open-market operations are in charge of a Federal Open Market Committee of 12 members, 1 chosen annually by the Board of each Federal Reserve bank. No Federal Reserve bank, however, is permitted to engage in open-market operations, except in accordance with regulations adopted by the Federal Reserve Board. Furthermore, the recommendations of the Committee are subject to the approval of the Board. Any Federal Reserve bank at the present time, however, has the option of refusing to participate in any open-market operations recommended by the Committee. The representatives of the banks themselves, therefore, under the existing arrangement, have adequate control over the use of their own funds in open-market operations. Since 6 of the 9 directors of a Federal Reserve bank are chosen by the member banks themselves, whose deposited reserves constitute the bulk of the money which would be used in open-market operations, this allocation of authority over open-market operations to the representatives of the 12 Federal Reserve banks themselves is a reasonable assignment of responsibility. It is not reasonable to put the complete power in the hands of a group of political appointees over the disposition of funds like these for which they are not financially responsible.

Open-market operations are now, and are likely to be for a long time to come, the principal credit operations of the 12 Federal Reserve banks. Under the proposed law it would be entirely in the power of the Federal Reserve Board so to conduct the open-market operations as to eliminate all the rediscounting business of the 12 Federal Reserve banks (as it is practically eliminated today) and to limit the granting of Federal Reserve bank credit entirely to open-market purchases. The open-market operations for a long time have consisted almost entirely in the purchase and sale of United States Government securities. The funds used in these operations consist largely of the reserves of the member banks upon which rests the bank-deposit structure of the Nation. Through the circulation of deposits in the form of checks the country does over 90 percent of its total business, amounting in all to something like a trillion dollars in a normally prosperous year. In other words, a board consisting entirely of appointed Government officials, the head of which, and at least two, if not all, the other members hold their offices at the discretion of an elected Government official, will have complete control over the use of the Nation's reserve money, and may use it to any extent it may desire for the purchase and sale of the Government's own debt. Such concentrated political power over the open-market operations of the 12 Federal Reserve banks, in my judgment, is fraught with great danger both to our banking system and to American democracy itself.

Increased power over reserve requirements given to Federal Reserve Board: Another substantial increase in power given by this bill to the Federal Reserve Board is that contained in section 209, revising the provisions of the existing law concerning reserve requirements of member banks. The law now provides definite minimum reserve requirements for member banks which are classified in three groups according to their location as central reserve city banks, reserve city banks, and country banks. These requirements are qualified by an emergency provision (sec. 19, par. 3) declaring 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 from time to time, in its discretion, the reserve balances required to be maintained against either demand or time deposits.

This emergency authority to vary member bank reserve requirements is a very broad one and has only recently been given to the Federal Reserve Board, under the stress of the present crisis. The proposed bill substitutes for this passage the following:

> Notwithstanding the other provisions of this section, the Federal Reserve Board, 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 member banks in reserve and central reserve cities or by member banks not in reserve or central reserve cities or by all member banks.

It will be noted that this involves four important changes in existing law: (1) The emergency character of the existing provisions is entirely eliminated; (2) the requirement of Presidential approval is eliminated; (3) the requirement of five affirmative votes of the Board for such action is eliminated, thereby making a majority of a quorum sufficient; and (4) in changing these reserve requirements, the bill gives the Board authority to discriminate among classes of banks, since it may require such changes to be made "by member banks in reserve and central reserve cities or by member banks not in reserve or central reserve cities or by all member banks." Experience would probably show that under this authority it would be much easier to lower reserve requirements than to raise them, and that the exercise of this power would result in a progressive leveling down of reserve requirements. Raising the requirements for any large group of banks would be likely to hit hard a considerable number of banks which were already close to the existing margin, and to arouse strong opposition, particularly in the case of the country-bank group. In my judgment, the emergency character of the existing power to vary reserve requirements should be retained, including the requirement of five affirmative votes to make it effective. There is much to be said in favor of such an emergency power if its exercise is very carefully guarded, but it is a highly dangerous power to be entrusted to a mere majority vote of a politically controlled Board.

Appointment of Federal Reserve bank governor made subject to approval of Federal Reserve Board: Another provision by which the power of the Federal Reserve Board over the Federal Reserve banks is increased under this bill is through the provisions of section 201, which combine the offices of chairman of the Board and governor of the bank under the title of governor. The governor is made the chief executive of the bank and is to be appointed annually by the board of directors. His first appointment, however, is made subject to the approval of the Federal Reserve Board; and, since he is only chosen as a director for a 3-year period, his reappointment as governor after each 3-year period would require the approval of the Federal Reserve Board. His original appointment and his continuance in office, therefore, require him to be persona grata to the Federal Reserve Board. Since all the officers and employees of a Federal Reserve bank are directly responsible to the governor, this provision of the proposed law places in the hands of the Federal Reserve Board a means of effectively controlling the operations and the personnel of the 12 Federal Reserve banks.

In my judgment, this requirement that the appointment of the governor of a Federal Reserve bank be approved by the Federal Reserve Board is a dangerous one and should not be adopted. The power of the Federal Reserve Board to appoint the three class-C directors of each Federal Reserve bank board is an adequate liaison.

Increased power over member banks given to Federal Reserve banks: We now come to the third form in which governmental authority over our banking and credit system is increased by this bill. The first form was an increase in the power of the President over the Federal Reserve Board; the second was an increase in the power of the Board over the Federal Reserve banks; and the third is an increase in the power of the Federal Reserve banks themselves over member banks, which may very well mean ultimately over all commercial banks of the country, as the pressure is becoming increasingly strong under our system of guaranteeing bank deposits for forcing all commercial banks into the Federal Reserve System.

Increases discretionary power of Federal Reserve banks over assets back of Federal Reserve notes. Under this heading, the first important change to observe in the bill is that it wipes out practically all specifications as to the quality of the assets back of the Federal Reserve notes and all of the provisions of the existing law pledging specific assets for the security of these notes. Section 208, revising section 16 of the existing Federal Reserve Act by striking out the first 10 paragraphs and substituting new provisions therefor, transforms the Federal Reserve notes into a simple asset currency. The notes continue to be a first and paramount lien on all the assets of the banks, and the existing 40-percent reserve requirement is maintained. Practically all restrictions, however, are removed as to the type of assets which a Federal Reserve bank may hold against the notes, except the simple requirement that they shall be sound. Since the Federal Reserve banks under regulations imposed by the Federal Reserve Board and with practically no statutory limitations would determine what kind of assets the Federal Reserve banks could hold, they would determine the kind of assets against which our bank-note currency would be issued. This is a great and dangerous extension in the powers of the Federal Reserve banks and of the Federal Reserve Board.

These Federal Reserve notes today constitute about 57 percent of our total monetary circulation. Concerning them as they will exist in the future if this bill becomes a law, the following facts should be noted:

(1) There is likely to be a decided leveling down of the quality and liquidity of the assets back of the notes as compared with what they were a few years ago, when the notes were secured almost entirely by gold and commercial paper.

(2) There is no limit whatsoever as to the volume of Federal Reserve notes that can be issued in the purchase of United States Government debt and can be secured by this debt. The notes are secured by the Government debt and the Government debt is payable in the notes.

I repeat, the notes are secured by the Governmnt debt, and the Government debt is payable in the notes.

(3) While the bill provides for a reserve of 40 percent in gold certificates to be held against the notes, there is no obligation on the issuing Federal Reserve banks to redeem the notes in these gold certificates, the certificates themselves are not legally permitted to circulate, they are redeemable in gold only at the option of the Government. If the Government chooses to redeem them, it may legally do so at any rate between 50 cents and 59 cents of our former gold money to the dollar.

If the Executive should put into operation some of the powers he has under the Thomas amendment, he would smash it down to 50 cents.

(4) Even the 40-percent gold-certificate reserve is not compulsory, for section 11 (c) of the Federal Reserve Act authorizes the Federal Reserve Board "to suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this act."

So that may all be waived by administrative action.

There is provided a graduated reserve deficiency tax, the equivalent of which is to be added to the interest and discount rates, to apply in case of such suspensions, but even this does not apply when the reserve deficiency arises from the purchase by the Federal Reserve banks of United States Government obligations under the terms of the Thomas amendment. The discretionay power enjoyed by the Federal Reserve banks under the aegis of the Federal Reserve Board over the issue of Federal Reserve bank notes is, therefore, already dangerously large, and this bill increases it still further.

Increased discretionary power given to Federal Reserve banks in determination of eligible paper: Another form in which the power of the Federal Reserve banks over the member banks is extended consists in the extremely broad power given to the Federal Reserve banks under section 206 of this bill as regards the type of paper against which a Federal Reserve bank may make advances to member banks. This section authorizes a Federal Reserve bank, subject to regulations to be imposed by the Federal Reserve Board and upon endorsement of the member banks, to "discount any commercial paper, agricultural, or industrial paper and * * * (to) make advances to any such member banks on its promissory note secured by any sound asset of such member banks." The sky is thus made the limit as to types of securities against which advances may be made and the Federal Reserve authorities themselves without any statutory restrictions whatsoever are the sole judge as to what shall constitute a "sound asset." This term is so broad and indefinable that it may mean all things to all men.

By this clause practically all of the carefully prepared statutory restrictions of section 13 of the Federal Reserve Act and of the regulations that have been built upon them, based upon years of our own and foreign experience, and limiting Federal Reserve advances largely to certain high types of liquid paper, are swept away entirely. And this is done, despite the fact that all of the noncapital liabilities of the Federal Reserve banks are demand liabilities consisting mostly of Federal Reserve notes, our principal form of money, and of the deposited bank reserves of the country, and despite the further fact that highly frozen capital loans and investments have been one of the principal causes of our 13,000 or more bank failures of the last decade and a half.

The two dangers that most seriously threaten central banks:

It has been my duty to draft the laws for the establishment of central banks in 4 different countries, namely, Colombia, Chile, Ecuador, and Bolivia, and, in addition, to assist in the work of revising the organic central bank laws of 7 different countries, namely, Germany, China, Colombia, Peru, Union of South Africa, Poland, and Turkey.

In nearly all of these countries the central banks were threatened by two serious dangers against both of which I and my associates endeavored to set up effective checks and safeguards. The attitude of my various financial advisory commissions on this subject is typified by the following quotation from our report accompanying the project of law which led to the creation of the Central Bank of Chile in 1925 (pp. 51–52):

> The Commission in its conferences with bankers, business men, government officials and others, with reference to the Central Bank, has found that the most widespread and pronounced fear for the success of the Bank is the fear that it may fall under undue government influences, and be wrecked by politics—a fear which the past banking history of many American countries has shown to be fully justified.

Senator BULKLEY. What are you quoting from there?

Professor KEMMERER. I am quoting from our report to the Chilean Government, Senator, which led to the creation of the Central Bank of Chile. [Reading:]

To meet this danger * * * (the proposed law) limits the Government's representation on the Board to three out of ten directors.

A second fear—

again quoting from this Chilean report—

almost as widespread as the fear of political exploitation of the bank, which your Commission has encountered, is the fear that the bank may be unduly controlled by the banking interests of the country, and administered with too much regard for the profits of bankers and too little regard for the broad, general welfare of the country.

I am still quoting from the Chilean report, and I could quote essentially the same ideas from the reports of a number of my other financial advisory commissions. [Reading:]

As a general proposition, the interests of the banking community and the interests of the country as a whole are probably the same in the long run. Bankers, however, do not always view questions from this long-run point of view and, whether rightly or wrongly, the interests of the banking community, as bankers view them, and the interests of the general public as the public view them, are frequently in conflict. This is true in all countries. Whatever else a central bank may be, it is a quasi-public institution, * * * a public trustee, charged with a great public responsibility, and should be administered with primary regard not to profits but to public service.

In accordance with this principle the Chilean law provides that 3 of the 10 members of the board of directors shall be chosen by the Government, 3 by the member banks, 2 by certain large business interests consisting of the National Agricultural Society, the Society for Encouragement of Manufactures, the National Nitrate Producers Association, and the Central Chamber of Commerce. One is appointed by the stockholders at large and one is appointed by the General Board of the Federation of Labor. That is an innovation so far as I know in central banks, and I am very proud of it. Thus there is someone on the board to interpret the bank to labor and labor can see that the members of the bank board do not all have horns, and there is someone who can interpret labor to the board.

In 1911, when the so-called "Aldrich plan" was before the country, I criticized it strongly on the ground that it gave too large a degree of control to the bankers.

Senator Glass will remember that.

Senator GLASS. Yes.

Professor KEMMERER. In an address before the Western Economic Association in Chicago in 1911, I said—Journal of Political Economy, December 1911:

Is not the National Reserve Association too much of a public institution to be so largely controlled by one type of business interest, that is, that of the banking fraternity? We must get away from the prevalent idea that the National Reserve Association is to be principally a banker's affair just because its capital is to be furnished entirely by banks. We must bear in mind that its public deposits alone will for some time probably exceed its paid-up capital, that the funds which the banks deposit with the Association will be chiefly those which the public has deposited with the banks, and that the paper which the banks rediscount with it will be that of the business community. We must not forget that the National Reserve Association is to have a tremendous public power and responsibility, through its right to fix the bank rate of discount, its power over the foreign exchanges and gold shipments, its right to issue the country's only elastic paper currency, its supervisory power over banks, and its function of holding a large percentage of the country's reserve money, together with the privilege of having its promises to pay, in the form of its deposits and bank notes, counted as lawful reserve money for banks.

Now it is possible, although by no means certain, that the interests of bankers as a class and those of the public are identical. It is certain, however, that history furnishes numerous instances in which what the public believed to be its interest and what bankers believed to be theirs were in conflict. * * * The task of securing and maintaining a thorough-going banking reform is at best an arduous one, and the plan proposed must be not only intrinsically meritorious, but above suspicion. Otherwise it will have a difficult road in Congress, and if it finally gets through it will be in subsequent danger of becoming a football of politics.

The Aldrich plan was in error in giving the bankers too large a degree of control over the proposed central banking organization. The Federal Reserve System, however, created by the law of 1913, when, as a compromise measure, it made every member of the Federal Reserve Board—the policy-determining body—an appointee of the President, went too far in the other direction. It subjected the Federal Reserve System unduly to the danger of political exploitation.

Of course, it got a bad start in the stress and strain of the war period.

During the greater part of the history of the Federal Reserve System, however, part of the Board consisted of members of the political party which was out of power. At present, I understand, every member of the Board except the Governor is an adherent of the party in power. Never, moreover, during the most trying days of the World War did the percentage of the Federal Reserve banks' earning assets consisting of the Government debt and of loans secured by the Government debt, even remotely approach the present astounding figure of nearly 99 percent.

A policy-determining Board possessing autocratic powers over the discount rate, the size of the country's bank reserves, the types of paper eligible for loans—where the sky is the limit—the expansion and contraction of bank credit, and the absorption by the banks of Government securities, a Board comprised entirely of Presidential appointees and holding office practically at the will of the President—such a Board will exercise a tremendous influence upon our economic life under conditions in which political considerations are likely to dominate. By political considerations I mean vote-attracting power in the near future for the political party in office.

Political pressure is usually exercised in the direction of cheap money: This political pressure most of the time will be predominantly in the direction of what is popularly called "liberalizing bank credit", holding down interest rates, and of resulting monetary and credit expansion. In other words, it will be a pressure almost continually exercised in favor of cheap money and inflationary policies. The opinion of the masses is almost never in favor of deflation or even in favor of restricting a dangerous boom while it is yet in a stage in which it can be controlled. In boom times the advocates of restraining measures such as advancing discount rates, substantial open-market sales, increased reserves, and more exacting loan requirements are usually very unpopular. The Administration and Members of Congress feel the pressure of this inflationary public opinion. Both directly and indirectly it will be felt by the Federal Reserve Board. This situation will be particularly true if an important election is approaching. A well-known British economist (Prof. T. E. Gregory, independent, Dec. 29, 1934) recently said: "To avoid depression it is necessary to avoid the boom; but central banks are driven by their fear of public opinion to postpone action until it is too late." The more politically minded and politically controlled the members of the policy-determining board are, the greater is the danger.

It is undoubtedly true that in times of excessive speculation and of incipient boom, bankers and business men are likely to be unduly optimistic and unduly reluctant to put on the brakes. Experience, however, I believe, has shown that economists, business men, and bankers can be depended upon to put on the brakes more quickly than men in political positions.

Under conditions heretofore existing the Federal Reserve Board has had ample power to contract or expand credit for the stabilization of our money market, whenever they cared to use it. Dr. Adolph Miller, in recommending to this committee (Jan. 23, 1931) that an affirmative vote of five members of the Board be required whenever the Board is asked to approve something out of the ordinary, such as open-market purchases of Government securities, said:

> You must not leave it too easy for the Federal reserve system to inflate. We have had too much inflation in the Federal reserve system, and its favorite instrument is the open-market purchase of Government securities.
>
> We have had something of an obsession for easy money in the system, a feeling that it makes the atmosphere of business; that it can stop a recession of business and turn a period of depression into one of recovery (p. 147).

Broadly speaking, the increasing of the President's power over the Federal Reserve Board, the increasing of the Board's power over the 12 Federal Reserve banks, and the increasing of the powers of the Federal Reserve banks over the member banks provided for in this bill will all be forces that in general will make for cheap money and for inflationary policies. Heretofore, however, the Federal Reserve authorities have all too often been weak and tardy in putting up resistances against inflationary forces. The enactment of this bill would aggravate this danger.

At the beginning I stated that my objections to title II of this bill could be summarized under two headings: First, increased governmental and political control of banking and credit; and, second, a leveling down of the quality of bank assets and, therefore, a weakening of the security of our bank deposits.

The first topic I have now discussed and, in doing so, have incidentally touched upon certain phases of the second topic. My discussion of the second topic, therefore, will be very brief.

The bill levels down the quality of our bank assets: The substitution, for the present statutory restrictions contained in section 13 of the Federal Reserve Act, of the provision of section 206 of this bill declaring that any paper shall be acceptable for Federal Reserve advances that is "secured by any sound asset" of the member bank, in my judgment, will result in a decided leveling down of the quality and liquidity of the assets of both member banks and Federal Reserve banks. Under the competition for leniency in loan requirements in our dual system of banking there has been going on for some time a process of leveling down in the quality of our banking assets, and this provision will encourage a further deterioration, and clinch what we have done so unfortunately in the last few years, and to meet emergency conditions. I do not accept for one moment the idea of which we hear so much of late, that liquidity of assets in a commercial bank or a central bank, whose liabilities are largely demand liabilities, can be ignored by the law, provided the assets are of a type that would prove to be sound if liquidated over a substantial period of time. In practice liquidity has shown itself to be a quality of much higher rank for such assets than shiftability. The old-fashioned doctrine that demand liabilities should be supported chiefly by quick assets of a self-liquidating character is still sound, both in theory and in practice. Our banking reform legislation should be turned in that direction rather than in the opposite one designated by this bill.

Extending the powers of national banks to make real-estate loans unwise: In this connection, section 210 of the bill, amending section 24 of the Federal Reserve Act, greatly liberalizes the conditions under which national banks may make loans on real estate. It is fundamentally that same fallacy which was underlying the whole issue of assignats of the French, which were supposed to be secured by land which was sound.

The present limit of 5 years for the maturity of such loans is removed. The authorized maximum amount of any such loan is changed from 50 percent of actual value to 60 percent of the appraised value. Moreover, the aggregate amount of such real-estate loans a national bank may have is increased from 50 percent of capital and surplus as at present to 100 percent, or from 50 percent of its savings deposits as at present 60 percent of "the amount of its time and savings deposits." This further weakening of the restrictions on real-estate loans, in my judgment, is unwise. Real estate in general is not a liquid asset. It is not usually recognized as such for commercial banks in England and Canada, whose bank records have been incomparably better than ours. Even in the United States under our national banking system loans on real-estate collateral (with certain minor qualifications) were prohibited by law until 1913.

Senator GLASS. Doctor, may I interrupt you there a moment?

Professor KEMMEMER. Yes.

Senator GLASS. Admiral Byrd, from my State, is to appear before the Senate now, and I am chairman of the joint congressional committee to greet him. Could you come back at 2 o'clock and finish your testimony?

Professor KEMMERER. Certainly.

Senator GLASS. Is that agreeable to the members of the committee?

Senator COUZENS. Ought we not to have it over in the Capitol instead of here?

Senator GLASS. We can have it over there, yes; in the Appropriations Committee room, where it will be convenient for voting.

Very well.

(Whereupon, at 12:05 p. m., a recess was had to 2 p. m. of the same day.)

AFTERNOON SESSION

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

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

Senator GLASS. Professor, you may resume your testimony, now, if you please, sir.

STATEMENT OF EDWIN WALTER KEMMERER, WALKER PROFESSOR, PRINCETON UNIVERSITY, PRINCETON, N. J.—Resumed

Professor KEMMERER. Senator, I had very nearly finished what I had to say in this direct statement, and I will take up where I left off and finish in just a few minutes. I was speaking of real-estate loans, and I said that even in the United States under our national banking system loans on real-estate collateral, with certain minor qualifications, were prohibited by law until 1913.

This restriction, like many others, gradually broke down after the war, largely as a result of the leveling down contest for so-called "liberalization" of banking laws and regulations under our dual system of banking. The resulting extension of real-estate loans by commercial banks for many years has been freezing the assets of these banks and has been an important cause of the enormous crop of bank failures we have had since the war. Loans secured by equities in farm lands have been responsible for much of our banking trouble in agricultural communities. The volume of these loans has often been much larger than bank reports seem to indicate. The listed mortgage loans were often only a small proportion of the loans actually secured by equities in land, many of which were in form short-time business loans, but in fact long-time capital commitments. Often the first mortgages were held by insurance companies and the bank's securities were little better than second or third liens on farm lands taken at inflated values. In this way the banks became involved in the farm real-estate boom and its collapse. Such loans caused comparatively little trouble when the prices of agricultural products and of farm lands were rising rapidly, as they were between 1914 and 1920, but when the break from wartime prices came, they brought distress upon the farmer and upon the bank from which he borrowed.

A similar situation developed in connection with the real-estate loans of commercial banks in many urban communities.

It seems to me that the lesson of these experiences is written clearly in bold letters. It is that real-estate loans should have at most a moderately small place in commercial banks. They belong in savings banks, land banks, insurance companies, building and loan associations, and similar institutions. They may be proper assets within reasonable limits against deposits that are, in fact as well as in name, time deposits withdrawable only after a substantial notice. They are not satisfactory assets against deposits payable on demand or on short notice. Instead of further increasing the powers of national banks to lend upon real estate, as this bill does, we should gradually reduce the powers they already have.

May I conclude this statement by endorsing the memorandum submitted to Congress a short time ago by 62 members of the Economists' National Committee on Monetary Policy, of which I am a member? The memorandum is as follows:

The undersigned members of the Economists' National Committee on Monetary Policy believe that there are no circumstances which make it necessary to engage at this time in any important legislation affecting the Federal Reserve System.

Considering the questionable provisions embodied in title II of the Banking Bill of 1935, it is especially important that there be no legislation for the present with respect to these aspects of the Federal Reserve System until a careful study has been made by a commission composed of recognized experts and a model bill is drafted. Such a commission should have sufficient time to study thoroughly our money and banking problems and, upon the basis of ample and carefully-examined evidence, prepare a comprehensive and properly integrated plan which will reflect the best thought on the subject. Such a plan, should then be enacted into law after adequate hearings, thus replacing the hastily prepared Banking Bill of 1935 which is now under consideration. Only a well considered bill prepared by competent experts in an atmosphere of calm deliberation should be enacted into law.

Only minor technical changes in our banking law should be made at the present time, and then only upon the recommendation of the Federal Reserve Board, accompanied by a statement from the Board explaining that such changes are necessary because of existing conflicts in law or because some specified emergency demands that such technical changes be made at the present time.

Senator COUZENS. May I ask you, Professor, whether you have read Professor Sprague's statement to the committee?

Professor KEMMERER. I read the press summaries of it and I have been trying to get copies of the hearings, but have not succeeded in doing so. I read the press accounts of it.

Senator COUZENS. Do you believe that he is a sound economic expert?

Professor KEMMERER. Yes, I do. I do not agree with him on a number of things, but I have a great respect for Professor Sprague.

Senator COUZENS. When you distinguished gentlemen disagree, where do we poor laymen get off?

Professor KEMMERER. We do not disagree very much on fundamentals, Senator; and I do not care what field you get into, whether it is the law or politics or medicine or any other field, where is independent thinking you are going to have differences of opinion. I think it is surprising the remarkable approximation of unanimity on fundamentals that we have in these matters. For example, this statement I just read is signed by 62 economists who are devoting their lives largely to the scientific study of money and banking problems. Sprague was one of the number.

Senator GLASS. Doctor Sprague was very clear and very emphatic in his statement that this proposed bill could not within the remotest stretch of anybody's imagination contribute to recovery from the depression; and he also was very explicit in his statement that there is nothing that could immediately be done, under this bill, that would contribute to such recovery that cannot be done under existing law.

Professor KEMMERER. I would agree with that entirely.

Senator COUZENS. You object to commercial banks investing in real-estate mortgages. What is your idea as to what they should invest in, now that commercial paper has so extensively disappeared?

Professor KEMMERER. I think that the disappearance of commercial paper in anything like the degree to which it has taken place is a temporary situation. I do not think it is a permanent situation. I think it is an emergency situation that has grown out of conditions immediately following the war, and at the present time when our large corporations, or a great proportion of them, have a great amount of idle funds, when business is down at a low level and the banks have large excess reserves. I think the situation in that regard is a temporary one. I think we ought to do all we can to encourage the use of commercial paper and financing of short-time business operations through short-time loans rather than through stock flotations and bond flotations of the type we were doing before the crisis. I think we have done something in that direction. I think, for example, that the prohibitions that are now imposed on lending money on the stock exchange for the account of others is a step in that direction. I think the removal of the right to pay interest on demand deposits is another step in that direction. But I think the development of financing current short-time credit requirements we have recently had in this country, by which our large corporations that have been floating bonds and stocks on a great scale and then taking the proceeds and putting them into our banks as time deposits, and getting substantial rates of interest upon them, and then just as fast as they need funds, transferring them over to demand deposits, under which the banks are enabled to get along with a 3-percent reserve instead of the much higher reserve required against demand deposits has caused an enormous development of time deposits in our banks which are rather unhealthy, and I think we must sooner or later make a distinction between a savings deposit, which is for the small man, carefully protecting and restricting savings deposits, and those large time deposits that go to such big figures.

Senator COUZENS. Would you abolish interest on these large time deposits?

Professor KEMMERER. I am not ready to go as far as that, Senator. I have not thought that thing through sufficiently; but I think there are two or three things I would do. I would distinguish between a savings account and the large time account. I would place a limit on the size of time deposits which these banks could carry, and on the total amount which would bear a certain relationship to the capital funds of the banks, and I am inclined to think that I would go so far as to require the same reserve requirements against time and demand deposits.

Senator COUZENS. Is it not a matter of fact that the very low cost of money at this time acts as an impetus to those people to finance themselves over a long period of time, rather than having to relp upon banks?

Professor KEMMERER. I suppose there is something in that; but this low rate of interest at the present time, in my judgment, is a perfectly abnormal and temporary situation. I do not believe for a moment that the rate of interest on short-time obligations has gotten down to one-tenth of 1 percent a year, or anything like that. I think these low rates of interest are a result of a situation in which the market is just flooded with funds of a short-time character, in which the business world is afraid to borrow, and the market is glutted with funds. However, I think it is only temporary. It seems to me there is a great danger in legislating and crystallizing our rules of the game in this thing on the basis of emergency and abnormal conditions of the type we have at the present time.

Senator COUZENS. What effect do you think the income tax has upon the fact that these large corporations retain their surpluses instead of paying them out in dividends, especially very closely integrated companies?

Professor KEMMERER. I do not know; I have never made a study of that, Senator.

Senator COUZENS. Do you not think that that is important?

Professor KEMMERER. I think there is a case where we have got to weigh the pros and cons. I think there are some cases where there have been abuses of that kind. I am very thankful again and again, as an American citizen, though, when I look back and see what we have gone through in the last few years, that we have had some corporations that did build up their surpluses to meet emergencies. I think in a great many cases those surpluses have been dug into to maintain operations at a loss, to keep employment that otherwise would have been destroyed. I think they have been a factor of safety, and I think it is exceedingly unfortunate to discourage them unduly. On the other hand, I would agree with what you imply, that there is a possibility of danger there, and we cannot permit the indefinite evasion of income taxes by piling up surpluses that are not reasonably necessary. But sooner or later those funds appear in the form of dividends that are distributed in one way or another, and you get the tax revenue then.

I think that is a subject that we have got to be very careful about. It deserves a great deal of study and an abundance of caution, because it would be a social calamity and would be a very serious thing in cases of future emergencies if we should now unduly discourage the accumulation of surpluses, and if we were to have another world crisis without the type of accumulation that we have had with which to meet this one.

Senator COUZENS. Do you approve of an excess-profits tax so as to prevent all of this saving that goes on in excess profits?

Professor KEMMERER. I have not gone into that field lately. I believe in reasonably progressive income taxes, but I have not gone into the field of profits taxes enough lately to feel like expressing my judgment.

Senator COUZENS. It seems to me that all of these questions are closely related to the banking question. If these strictly commercial banks which you have been talking about are not going to have places in which to invest their money, a closely related question, it seems to me, is the question of taxation, because obviously if these institutions that retain these large balances are not to be taxed for them, there will progressively be less commercial paper for the commercial banks than there is now.

Professor KEMMERER. Well, before this crisis came on we had a great deal more commercial paper than we have now. We had a very substantial amount of commercial paper before the war. I think that if things get back to normal again and we provide the proper kind of regulations we can bring back a considerable amount of short-time financing through commercial paper. I believe that a commercial bank whose deposits are demand deposits should have assets that are essentially liquid assets.

Senator COUZENS. That is what I am trying to get at. If I were running a commercial bank, just what would I make my investment in? I am somewhat at a loss. Expenses are high and there would be a lot of overhead charges. I do not see how they are going to pay their expenses under existing conditions, and they will not make any profit for their stockholders.

Professor KEMMERER. I do not think these existing conditions will continue. I think we will move back to a situation where the interest rate will be very substantially higher, where the excess reserves of banks will be nothing like what they are, where the excess funds of corporations will be nothing like what they are. This is a situation that I have never seen anywhere in the world, a situation where we have the type of excess reserves that we have at the present time and where we have interest rates on short-time obligations going down to these infinitesimal figures, but where we have large corporations so highly liquid with enormous funds which they are afraid to use and are just holding them. I think that is a purely temporary situation and that we should not legislate on the ground that it is going to be permanent.

Senator TOWNSEND. What, in your judgment, would be the effect on banks and the country generally if the Patman bill should prevail and we should print money to pay the bonus?

Professor KEMMERER. Well, I feel that that would be a calamity. It is one of those propositions that seems to me to be really so preposterous that I can hardly find words with which to express myself on it. Here is a country in which we are doing, roughly speaking, something like two-thirds or a little over two-thirds the physical volume of business that we did before the depression, in which we have a stock of money about twice what we had before the depression, in which we have practically doubled, in terms of dollars, our gold stock in a little over a year's time, in which the bank deposits of the member banks are probably a little more than they were in the boom times, in which we have two billions and a quarter of excess reserves, something like fifty times what we had in 1929 and the boom years, in which the member banks of the country are borrowing practically nothing from the Federal Reserve banks and the interest rate is at a very low figure and in which the public is so badly scared that the bank deposits are moving at about half the normal rates, the velocity of circulation in 1934 being the lowest of any year since 1919, the earliest date for which figures are available. And then we propose in a situation of that kind to issue 2 billions of greenbacks on top of what we have, to put them in circulation, which will increase our greenback circulation to five times the maximum in the most trying days of the Civil War, when the maximum outstanding at any time was $436,000,000, and when the greenback depreciated to a low of 35 cents gold to a dollar. Right off the bat we increase that fivefold. If you put more money into circulation, if you increase the supply of money or of deposit currency relative to the demand, you tend to make in cheaper. The law of supply and demand applies to money and credit just as it applies to anything else. You suddenly make a great increase in that circulation. As you do, it tends to make money cheaper and it would tend to check the inflow of gold and would probably tend to make the gold go out. You have got too much money now, and it is not moving. You put more in, and you tend to force it out. That excess can go out in various ways. It might go out by further demand for gold, stopping the import of gold and stimulating the export of gold. It might go out by just forcing Federal Reserve notes back into the banks and having greenbacks more or less take their place, removing the only elastic element that we have in our currency and putting these rigid greenbacks in its place. It is pretty hard to tell just how it would work. It would work in a great many ways; but there would be a great increase of pressure to make money cheap and force out gold; and one of the things that we are likely to do is to very substantially break confidence in our currency. To my way of thinking, one of the most surprising things in this emergency situation up to the present time has been the degree to which the public have maintained confidence in the currency despite all that has been done.

Senator GLASS. Yes; you are right about that. They do not know yet.

Professor KEMMERER. A great many people are scared. They are getting the money out. There has been a flight from the dollar, but it has not yet reached the mass of the people as it did in France and Belgium and Italy and most of the other countries after the war, and as it did in the United States after the Civil War. There seems to be popularly a great confidence in the money, although that confidence is breaking. The enactment of this Patman bill would give another impetus to that breaking of confidence. If you once have that you will have a real flight from the dollar; and, as I say, the velocity at which your deposits are circulating now is about half normal. Under normal conditions and recovery it would be doubled, and that would be due to an increase in business confidence. But if you lose confidence in your money and get a flight from the dollar, as they had in these other countries, then that velocity will be multiplied manyfold.

In Germany the velocity of circulation of German bank notes increased from an average of something like once every 2 weeks to several times a day. Everyone wants to get rid of the thing that they think is going to depreciate, and the psychological factor is a tremendous factor in the velocity at which money and deposit currency move. Anything that breaks confidence in your money may start up those velocities at any time and may create a stampede.

I should expect the passage of this Patman bill would have a great influence in weakening confidence in our money and encouraging a flight from the dollar. We have shown such remarkable resistance so far that I am not going to prophesy as to when and how far, but I think we are on the brink of a volcano in that regard.

Senator TOWNSEND. Would you care to give us your opinion as to the difference between printing money and issuing bonds?

Professor KEMMERER. Yes. In the first place, I would say that the difference there as between printing money and paying for the bonus by bonds, if the bonds are forced down the throats of the banks and the banks issue credit against them, is not a very fundamental one. If either occurs, you will be likely to have a serious inflation as a result of it.

Our currency system is of this type. Bank deposits and bank notes are interchangeable. If I go to my bank and borrow $10,000 I have the amount placed to my deposit; there is a deposit credit. If I decide I want it in the form of notes, I draw a check on it and take the notes. The deposit is canceled and I get the notes. If I have too much cash and prefer to make my payments by check, I take the notes and deposit them. In that way they are interchangeable. As prices go up in the community and you need more and more money to carry this higher and higher price level, the proportion of money that people will want in notes and the proportion in deposits are more or less the same, and it really does not make much difference with which one you inflate as long as they are interchangeable.

So I think that, while the Patman bill is cruder and perhaps would give a greater shock to the public, therefore stimulating more quickly the flight from the dollar, the ultimate results of the Patman bill and the Vinson bill would be much the same.

Senator TOWNSEND. According to your illustration, the spending of this 2 billions of dollars in either way would inflate the currency. What is going to be the effect of spending 5 billions that we are already considering doing and as to which we have to raise money on bonds?

Professor KEMMERER. I think that likewise is going to be a strong pressure for inflation. Broadly speaking, there are really three methods—perhaps you can make it four if you want to—by which you can finance a situation of this kind. You can tax the public. The theory of a democracy is that as expenditures go up the public is called upon to pay increasing taxes, and they put up their resistances as they feel that these tax burdens are greater and greater. This so-called " public control of the purse " is the method by which a democracy is maintained. The Congressmen who vote for extravagant expenditures, or expenditures that the public consider extravagant, whether they are or not, which result in heavy taxes, will hear from it, as you gentlemen know, pretty quickly. There is a wholesome democratic resistance of the taxpayer to extravagant expenditures. If this were being financed by taxation there would be such a storm of protest, as you all know, that it just could not be done.

Another method is selling those securities to the public. If the public bought the securities, took the money out of their banks and put the bonds in their strong boxes, there would be a shifting of investment from one hand to another. Then the public would be very, very much concerned as to whether the Government were balancing its budget, as to whether the payments were going to be made in the right kind of money, and all that. If the public as private investors were buying these bonds and putting them in their strong boxes, they would resist any such increase of expenditures as we are making and this rapid increase in the public debt.

If you do neither one of those things, if you borrow the money of the banks, if the Federal Reserve banks or the member banks buy short-time certificates and you issue the credit in the form of bank notes or in the form of bank deposits, you do not take it out of the taxpayer at once; you do not take it out of the private investor at once. You create banking credit to pay for those expenditures. You expand your currency; you expand your banking credit. It might not circulate right away because of the lack of business confidence, but it represents a potential expansion of the circulating media continually pressing in the direction of inflation.

We have a situation today where about 99 percent of all the earning assets of the Federal Reserve banks consist of Government debt—98.6 percent last week—where something like 50 to 60 percent of all the public debt is in the hands of banks where in the last 2 or 3 years something like 87 percent of the new flotations of Government debt have gone into the hands of banks. That is financing by inflation.

Suppose we say we have 9 billions of gold. If you have a flight from the dollar, everybody wants to get away from the dollar and wants to get gold. Suppose we redeem in gold. How long would it last? When you started you would have 20-percent gold reserve. At the end of the first day you would have 36 billion dollars of bank deposits and notes left, but not a dollar of gold. You would have jumped from 20 percent gold reserve to zero. If you did not pay your gold out but just held it idle, you would be in just the same position as Germany was. A gold reserve that is not used is ineffective; and, if you use it, it disappears overnight.

Senator GLASS. That is what I have been saying for some time.

Senator COUZENS. Have you any views with respect to returning to the gold standard?

Professor KEMMERER. Yes, I have, Senator. In the first place, my definition of a gold standard is this. Some of my colleagues do not agree with it. It seems to me that a country is on the gold standard whenever gold is the standard. In other words, the gold standard exists in any country when the monetary unit in which exchanges are made, in which debts are contracted, carried, and paid, consists of the value of a fixed quantity of gold in a free gold market. When your actual monetary unit consists of the value of a fixed quantity of gold in a free gold market, then you are on the gold standard, regardless of the mechanism by which you maintain it at that point.

Senator COUZENS. Do you mean when we are able to get gold as redemption?

Professor KEMMERER. No; I have not said a word about redemption or legal tender or convertibility. The essential fact is that the value of your monetary unit shall consist of the value of a fixed quantity of gold in a free gold market. So long as we maintain the price of gold in this country at $35 an ounce in the free gold markets of the world—they are pretty narrow now—we are on the gold standard.

We are on the gold standard in this country now. I do not like the kind of gold standard we are on. It is not a statutory gold standard; it is an administrative gold standard. It might be scrapped overnight by an Executive order of the President or by his exercising any one of a number of powers he has under the Thomas amendment. But as long as we maintain our gold dollar as the equivalent of 13.71 grains of pure gold on the free markets of the world, no matter how we do it, we are on the gold standard. So I would not speak about going back to the gold standard; I would speak about going back to a statutory gold standard.

Senator COUZENS. Is Great Britain on the gold standard now?

Professor KEMMERER. No.

Senator COUZENS. But we are?

Professor KEMMERER. We are.

Senator GLASS. What good is a gold standard when you cannot redeem your currency and your promises to pay in gold?

Professor KEMMERER. Senator, do not misunderstand me. I am not defending the kind of a gold standard that we are on now. I do not believe it is sound. But convertibility of paper into gold is a mechanism, a means, a method of maintaining the gold standard. There are a number of other methods of doing it. But if by any means you succeed in maintaining the value of your paper dollar at the value of a specific amount of gold on a free market, it is a gold standard. Our present standard is an exceedingly dangerous form of gold standard. This form of the gold standard never existed before.

Senator GLASS. It is an idiotic gold standard. Is not convertibility of the very root and definition of all business activity and confidence?

Professor KEMMERER. I think it is highly desirable for the maintenance of public confidence in our currency, Senator. But I am perfectly willing to say that for a limited period of time, by manipulation of your currency, you may maintain the form of a gold standard. But there is likely to be little confidence in it. It will not be lasting. It is unsatisfactory, but I think it is a gold standard.

You ask what should be done. My feeling is that the gold standard we are on should cease to be an administratively maintained gold standard; that it should be made a statutory gold standard; that just as under the Act of 1900 we were put on a definitive gold standard, we should have an act of that kind now which would declare the country on the gold standard at the present unit of value. It would impose upon the Secretary of the Treasury the obligation of maintaining all the currency at parity with gold and maintaining redemption in gold bars on demand as a statutory requirement. I am willing to go to the gold-bullion standard with convertibility in gold bars. I think we should do that and make it a statutory gold standard on a gold-bullion basis, and we should take the initiative in trying to get England and the other countries of Europe, including the gold bloc, to get together and internationally agree on such a basis; and I do not think that you are going to get confidence restored in business or any enduring forward movement until you do that very thing.

Senator COUZENS. When you say "get together", Professor, you mean that each country would fix the number of grains of gold in its monetary unit?

Professor KEMMERER. Yes. We cannot dictate to the others, but we should cooperate with them. If some of the gold bloc feel that they must make a certain reduction to bring them down into harmony with the others that have gone off gold, all well and good. Others may feel that the better thing is to wait, and by waiting they will get the necessary world convertibility price adjustments and that it will be less harmful to do that than to change. But I think it is a matter of getting an international agreement by international cooperation to restore definite gold values and then to maintain them by cooperation as far as we can.

Senator COUZENS. You are not so much concerned about the grains of gold contained in the monetary standard unit than that it be fixed?

Professor KEMMERER. Yes; but I would certainly not reduce it any further. I think it is hopeless for us to try to go back to the old gold parity. In our case I would stabilize where we are; and I think if England would stabilize approximately where she is so that we could again have the old relationship between the pound and the dollar it would be desirable.

Senator COUZENS. Do you think that France should stabilize at the same content of her franc that she now has?

Professor KEMMERER. That is a debatable question. France suffered terrifically from inflation, and a great mass of the people of

France are opposed to inflation. They are fearful of it. In fact, all the countries that have gone through it recently are afraid. It is only those that have not gone through with it recently that are playing with it that are not afraid. Public sentiment in France is very strongly against further devaluation. If the world goes back to gold and we get an effective stabilization and gold is pulled out of the hoards and is put back into active use and begins to move, prices in gold-standard countries are going to move up. The great trouble now is not that there is not enough of it, but that it is being hoarded.

Senator COUZENS. Hoarded by governments?

Professor KEMMERER. Hoarded by governments and by private individuals and by central banks. The leading countries of the world, most of which are off the gold standard, have something like 25 percent more gold than they had in the maximum days of the gold standard.

Senator GLASS. What was the necessity of this Government going off the gold standard?

Professor KEMMERER. It was not necessary at all. Most of the countries that are off the gold standard have more gold than when they were on. It is not a question of the world's not having enough gold, but the fact that the whole world is hoarding gold. We have more than twice as much gold in terms of dollars as we had when we were on the gold coin standard before the depression. England has a great deal more than she had before she went off the gold standard, and the same is true of most other advanced countries. As soon as confidence is restored you are going to have a great rise of prices in gold-standard countries without any further devaluation. If the world would go back to the gold standard the prices in France would rise very decidedly, even if she did not devaluate. Every day that France waits these price adjustments take place. They tend to bring her back into equilibrium.

Senator COUZENS. Would you say that in the state of the public mind as you understand it, it would be safe for the United States to remove its embargo on gold?

Professor KEMMERER. Yes. Well, perhaps that was too hasty.

Senator COUZENS. It did sound hasty.

Professor KEMMERER. I would say this, Senator. If the President of the United States would make a declaration that we are going to have no further reduction in the gold content of the dollar under the provisions of the existing law, if Congress would pass an act definitely fixing the gold content of the dollar at 59 cents, and the President would declare it the policy of this Government, as it was declared in 1900, to use all the resources of this country to return to a statutory gold standard and to make that gold standard effective, and if at the same time we should adopt vigorous measures looking toward economy and a balancing of the Budget at the earliest possible date, I believe you would have such a restoration of confidence in this country, such a forward movement, that nothing could stop it. Gold is moving into this country, not out. Gold is worth more here than it is in almost any other country in the world, because our commodity prices have not risen sufficiently to take up the slack created by the reduction in the gold content of the dollar, and gold is likely to move into this country for a considerable time to come. If confidence were restored these velocities which are so low now would move up toward normal, and prices would move up, and the draining of gold from other countries to this country would tend to stop; and the minute you have international cooperation with a restoration of confidence there would be no danger about our letting gold go out freely. We have got by far the largest percentage of the world's supply of monetary gold of any country in the world and we owe foreigners practically nothing. They would have no call on us for any substantial amount. The only thing that would make it go out of this country is lack of confidence and a flight from the dollar.

Senator COUZENS. You do not think they would take our present dollar and convert it into gold if it was free?

Professor KEMMERER. No, sir. If the public keeps scared and we have prospects of further inflation and you get this flight from the dollar that we were talking of a little while ago, everybody that can get gold will want to hoard it and many who can get it out of the country will want to get it out. But the minute you restore confidence, the gold would move in the other direction.

Senator COUZENS. So your answer is not exactly "Yes", considering the state of the public mind at the present time?

Professor KEMMERER. That is correct. It is a qualified statement—if you will do those things; yes.

Senator COUZENS. If the condition of the public mind changed, your answer would be "Yes"?

Professor KEMMERER. Yes; and you can change the public mind if you do the several things that I am talking about.

Senator GLASS. Has the public any mind on the subject?

Professor KEMMERER. I think a good deal of this is down rather below the cerebrum.

Senator COUZENS. I will ask this question, in view of what Senator Glass has said about the public mind. When you speak of a return of confidence, you mean confidence on the part of what section or what portion of the public?

Professor KEMMERER. I think that as long as we remain in a capitalistic country you are not going to get any safe, sane, and enduring forward movement until you inspire confidence on the part of the financial, business, and industrial leaders of the country, upon whose initiative alone you must depend for any forward movement. It is not the mass of the people; it is the people upon whose initiative you must depend, and they are the ones that are scared. The masses are not half as much scared as the people upon whose initiative you must depend to get ahead.

Senator COUZENS. Do you believe if public confidence were restored to that section of the public to which you have just referred that labor in its present unsettled and discontented state of mind would be satisfied to go along?

Professor KEMMERER. I think you would have a return of prosperity, and with returning prosperity I think labor would be a good deal better off than it is going to be under a continuation of the present situation, under which I think labor will become increasingly dissatisfied, because if we do not turn right about face very soon we are going to have a rapidly increasing inflation—that is, higher prices. We are going to have a greatly increased cost of living in the next few years, and as the cost of living goes up you get two things:

You get consumers' strikes, particularly on the part of the womenfolk—and I think we are beginning to get them now, and you are going to get them on a larger scale—and you get labor strikes on the part of labor because they see the cost of living going up more rapidly than their wages and they become increasingly discontented. So I think you are going to have more labor strikes and more consumers' strikes under this inflation plan than on the other plan.

That has been the experience of Europe. I think if you will study the recent inflation experiences of the countries of Europe you will find one outstanding thing, and that is that in every country the class of people that has suffered the most has been the great middle class. The upper class came out fairly well, while the lowest class, the unskilled-labor class, did not suffer very much even in Germany. But skilled labor and other members of the great middle class were the ones that suffered most. I think that will happen in this country. I think the class of people in this country that will suffer the most is the great middle class, which is the very bulwark of our institutions.

Senator COUZENS. Have you given any thought and consideration to the ability to use labor under our capitalistic mass production processes?

Professor KEMMERER. Only as a general economist. My attention has been directed lately in the field of currency, banking, and international finance. That subject of labor I have left to my labor colleagues who have been specializing in that particular field. I could not qualify as an expert on that subject.

Senator GLASS. Are there any other questions? We are very much obliged to you.

Senator TOWNSEND. So say we all.

Senator GLASS. It has been an intellectual treat to me.

(Whereupon, at 3 p. m., the subcommittee adjourned until tomorrow, Tuesday, May 14, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

TUESDAY, MAY 14, 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, Townsend, and Couzens.

Senator Glass. The committee will come to order. We will first hear Mr. Heimann of the National Association of Credit Men. Mr. Heimann, will you be good enough to give to the committee reporter your name and occupation?

STATEMENT OF HENRY H. HEIMANN, EXECUTIVE MANAGER OF THE NATIONAL ASSOCIATION OF CREDIT MEN, NEW YORK CITY, N. Y.

Mr. Heimann. Mr. Chairman, my name is Henry H. Heimann. My residence is Niles, Mich. My office is in New York City. My position is that of executive manager of the National Association of Credit Men.

Senator Glass. Mr. Heimann, we have the proposed bank bill, S. 1715, and we are trying to get the reaction of the banking and business public to the provisions of the bill. Recalling that in 1913 the National Association of Credit Men were of infinite help to those of us who fabricated the Federal Reserve Act, I thought it would be desirable to hear from your association, and would be glad if you would have something to say on the subject.

Mr. Heimann. Senator Glass, I should like at the start, if I may, to read a general statement, following which I will make comments on the bill.

Senator Glass. Very well.

Mr. Heimann. The views I am going to present reflect the opinions of the greater part of the membership of the National Association of Credit Men, of which organization I am executive manager. The National Association of Credit Men is a non-profit-making organization composed of some 18,000 wholesalers, jobbers, and manufacturers who have representation in our organization through their credit executives. Our organization devotes its interest exclusively to wholesale, manufacturing, and banking credit, as distinguished from retail or consumer credit.

The organization is 38 years old and has at all times been vitally interested in legislation affecting receivables and banking. Our interest does not lie in the direction of any one group. We have no iron in the fire. Our interest is solely a desire to secure a foundation of sound banking legislation upon which proper banking can be developed, and, consequently, sound credit practices and principles assured, since banking is the basis of industrial credit. We were very much interested and very active in the enactment of the original Federal Reserve Act, and have since followed it very closely in all of its amendments.

To further provide you with the facts that will enable you to appraise the representation I bespeak, may I advise that the organization is composed of 125 affiliated local organizations in the principal cities of the United States. These local offices have local autonomy and the national office coordinates, supervises, and in some measure directs the local organizations.

In giving consideration to the Banking Act of 1935, our organization has in recent months made a careful study in all of its local units of the pending bill. This has been done through a series of monthly meetings on the subject, by activity of our local legislative committee, and distribution to the general membership of pertinent material on both sides of the question. The opinions I will express reflect those of our organization wholly divorced from any personal or selfish interest. They are the result of careful consideration of both the views of those sponsoring and those opposing the pending bill.

I would like to add that we do not conduct what is normally known as a referendum, to get the views of the 18,000 of our members, in the sense that each individual member is asked his opinion. We have what is called an economic credit council in each local association. This council is composed of several key men in the local organization who are chosen for their ability to reflect the views and opinions of their local group. Thus we are able to get a quick and relatively complete survey of the thought and opinion of our membership.

A current survey through these councils indicates that in general about 75 percent of our membership is opposed to the bill, while 25 percent is generally favorable to it. Therefore, it becomes my mandate to reflect general opposition to the bill.

Senator TOWNSEND. Might I interrupt you right there to ask if you are speaking of the titles in the bill, I, II, and III, or to the whole bill?

Mr. HEIMANN. I am speaking to titles I and II. There is more opposition to title I but not quite as severe opposition as there is to title II. But as to title III there is no opposition.

Senator TOWNSEND. All right.

Mr. HEIMANN. I have broken down the views of our members by sections of the country. In the country west of the Mississippi, in general, I find that the proportion of those voting is about 2 unfavorable to 1 favorable to the bill. The country east of the Mississippi is more generally unfavorable to the bill and thus brings the ratio for our association down to 1 out of 4 favorable to the bill. In breaking down the tabulation by industrial groups, such as wholesaling, manufacturing, and banking firms, I find that there is no considerable difference of opinion among the various industries. Of course, there is a certain percentage of our membership consisting of credit executives of banking institutions and their views may be said to register slightly greater opposition to the pending bill than the average.

Let me say that we have been particularly anxious to have our members receive the administration's point of view, since we wish to enter an appraisal of this nature with an open mind.

Senator GLASS. Right there, as to the administrations' point of view: This bill is frequently, more frequently than otherwise, spoken of as the "administration bill." It is Governor Eccles' bill.

Mr. HEIMANN. I might more properly say then, Senator Glass, that we are particularly anxious to present our opposition to the point of view of the Governor of the Federal Reserve Board.

Senator GLASS. A little more than 10 days ago the President had not read a word of it.

Mr. HEIMANN. I think I shall clear that up later, Senator Glass, if I may.

Senator GLASS. You may proceed.

Mr. HEIMANN. To this end I secured summaries of the testimony of the Governor of the Federal Reserve Board, which in turn were given to our council members. For this, as well as other very generous cooperation by the Governor, we are very grateful.

Although we do not register serious objection to title I of the bill, we do wish to make certain observations as to the subject matter of this section. The membership of the National Association of Credit Men feels that Federal deposit insurance or any other type of banking insurance should be limited to emergency periods. We are convinced that the insurance of bank deposits in a critical situation such as we have faced, and to some extent are continuing to face, restores confidence and returns funds from hoarding.

The psychological as well as the practical effect counter-balances the dangerous precedent of seeking to accomplish through legislation a protection that heretofore has only been realized through sound management. We feel, however, that, over a long-range period of time, bank deposit insurance will retard rather than promote sound bank management. Theoretically the exercise of great care and prudence in the issuance of bank charters to competent people would vitiate the possible danger of inexperienced and incompetent management being attracted to the banking field due to universal deposit insurance. In practice, we fear, discriminatory judgment will frequently be scuttled by political or personal influence.

The average bank offers its depositors protection by way of sound management. That is primary. Sound management is appraised upon the basis of the bank's performance. With deposit insurance, performance as indicated by sound management might become secondary in the minds of many depositors. We would, therefore, express the view that title I should not necessarily accept bank insurance as a permanent part of our national economics. As an emergency measure we recommend its continuation. We are wholly unconvinced that any experience thus far with respect to the insurance fund has any material significance. Presumably, at least, when the banks were reopened and qualified for F. D. I. C., their capital was intact. Assuming competent audits, and we have no reason to doubt these audits, the banks which qualified had their capital structures in excellent shape, even though they may have been augmented by Government subscriptions. This being true, the first year's experience could scarcely be said to have any bearing upon the soundness or unsoundness of a Federal deposit insurance plan since during the first year there was scarcely any risk assumed.

We know from our own experience that if a man enters the manufacturing business with a paid-in capital of a reasonable amount and a clean balance sheet, it is very unlikely that he could dissipate that capital to the point of insolvency during the first or second year of his operations unless his venture was an unusually hazardous undertaking.

Because a man who owns a new automobile does not have any tire trouble in the first thousand miles of driving, it would be ridiculous, we believe, to assume that there would be no trouble of consequence in the mileage to come. In other words, we feel that the risk that has been taken in the first year of F. D. I. C. has not been a normal risk, that the real test of the soundness or unsoundness of F. D. I. C. can only be appraised after the experience of a normal risk.

Secondly, we feel that with Government securities forming so large a portion of the banks' portfolios, F. D. I. C. bank insurance to a degree is self-insurance. And we know from our experience that self-insurance in only rare cases is real protection.

Assume that Government bonds were to depreciate and that liquidation of bank assets became necessary. The very drop in Government securities would cut two ways. First it would call upon the F. D. I. C. to assume heavy losses in case the decline in value of the Government bond portfolio of a large number of the banks were such as, under certain necessitous liquidation, to cause these banks to close. The loss in that case would be occasioned by the necessary payment in full to depositors who had suffered by reason of the banks closing. Secondly, it might start a vicious spiral in which each succeeding loss would have the effect of further depressing Government bond prices. This would be brought about by the Government finding it necessary to come to the rescue of the F. D. I. C. when its reserves were depleted. Such help might involve further Government issues to be distributed in a falling market.

It might well therefore be asked, To what extent are the depositors really covered?

We merely submit that these observations be seriously considered when attempting a permanent insurance program. Finally, with respect to title I, even though we feel the reserves may be inadequate, we recognize that a charge of one-eighth of 1 percent of total deposits upon the banks in these days of "profitless prosperity" for banks may well spell the difference between an earning and a loss for the insured bank. Our minds are not closed to the permanent plan of deposit insurance, but we believe if permanent legislation is desirable, better conclusions will be reached after several years of experience with a deposit-insurance plan.

With respect to certain other provisions of title I, we offer no comment merely because they are problems that can best be answered by the industry. We do, however, register a strong conviction that all banks should be members of the Federal Reserve System.

It is our conviction that title II of the present banking bill proceeds on the theory that it is possible to meet situations such as arose from the World War and its consequent aftermath. To simply accept the inevitable and say that nothing can be done to help soften the blows would, of course, be self-indictment. The point we wish to make, however, is that in our opinion no banking system of any kind could have functioned in such a manner as to have prevented the entire avoidance of some of the abuses found both in the very conflict itself and in its aftermath.

We believe that wide powers and unusual controls are really types of banking legislation which should be legislated in an emergency period or, if now passed, limited in use to such critical situations. It is our impression that title II of the present bill proceeds on the theory that we shall always have these present unusual situations with us. We do not believe this to be a proper basis of assumption. We believe it more essential that a permanent pattern of banking legislation be drafted that will in its major part deal with sound banking as it exists in what might be termed fairly normal conditions.

We are vitally interested in the promotion of sound credit practices and the free circulation of credit in this Nation. It may be stated that some of the provisions of title II would develop and make available to industry and agriculture tremendous credit reserves. Theoretically, we accept this, but we doubt that sound credit would ensue. Credit is earned, not legislated. Credit arises out of commercial activities and not out of legislation. Only to the extent that we have a sound reservoir of credit available can legislation borrow from it. All other legislation tending to create credit is, in fact, creating counterfeit credit, which will not be redeemed. Such would be a return to the situation that confronted us in 1927, 1928, and 1929.

At no time, in opposing the bill, have our views been tempered in any way by a poor appraisal of those who might presently be charged with the administration of the bill. Quite the contrary. We confine our observations wholly to the bill because we know of the successful business operation of some of those who are sponsoring this legislation.

In respect to title II, we feel that central bank history warns of the dangers of legislation as proposed in this section. This conclusion is based upon the thought that the banking system, though it should closely cooperate with the Government, should not be governmentally controlled. Among the objectives of a central banking institution is the direction of credit for industry and agriculture. But when the central bank is too much a part of the Government, this objective has too often been made subservient to the Government's fiscal requirements. We know that some of the disastrous inflation that has occurred in Europe has been due to governmental control of central banking institutions. The most successful central bank now in operation does not have such governmental control as is proposed in title II of the pending bill. Its stock is privately owned; its directors are privately selected. Though it cooperates closely, it is independent of the Government.

And might I add, outside of my prepared paper, that it has earned that cooperation from the Government, and the Government in turn has earned that cooperation from the central bank.

As a Nation we are still in our young manhood with respect to banking experience. The traditional policies of close cooperation with government, irrespective of politics have evolved in England through the space of almost three centuries. In about half of the same period, this Nation has seen political influences frequently, though not intentionally, placed ahead of sound Government needs. That is not said critically, being merely an expression of historical observation. Such political expediencies might easily lead to dangerous situations with banking legislation such as is proposed in title II. Our views, however, are dissociated from the matter of personnel or administration.

Let us consider the present Federal Reserve Act. We do not maintain that it could not be improved. But we do believe the whole problem is one that should be carefully studied and that legislation should result from recommendations arising from such a careful analysis and investigation. We believe the banking needs and the sound credit needs of the country could best be fulfilled after the requirements were carefully surveyed by an independent authority.

We do not contend that those who are sponsoring the present bill have not made such a study. Quite the contrary. We know they have done so, and we believe they have sincerely and conscientiously given it their best thought, but we believe an issue as vital to the prosperity of the Nation as banking should be studied from all points of view and should have a wider diversification of critical analysis.

Having no iron in the fire, and merely being interested in the promotion of sound banking, we submit that the best evidence of our sincerity is that we would recommend the study of our banking and credit needs by a commission which would be under obligation to make a report at the conclusion of a definite period of time, preferably not over 2 years, and within a year if possible. This would call for intensive work. But we suggest this limited tenure because it would remove tke argument that those who are suggesting a study are merely hoping that such action will delay and eventually defeat the present bill.

We believe the present situation in the banking field is relatively not critical, that there is no conflagration in the banking world, and we feel very definitely that delay would not be harmful.

In considering the criticism of the Federal Reserve System, let us recall the effect of Government influence on banking as we have experienced it in the past 20 years. Any criticism of the present act should be directed toward the fact that it has been rather a matter of administration than a matter of the particular system that might be subject to criticism.

In the period of 1921 and 1922, for instance, one of the reasons for the difficulties at that time may be linked to the pressure of the Treasury Department exercising the restraint on the Federal Reserve Board until such time as it could get its victory and liberty loans out of the way. Again in 1927, 1928, and 1929 there was a choice between necessary liquidation policies or a continuation of those policies that brought on the so-called "prosperity" of those years. The latter won, to our eventual great discomfort. This illustrates our point that it is not a matter of which party is in control. Substantially any party in power is apt to adopt politically expedient measures when conditions become critical. Under the pending bill there is a possibility of the abuse of centralized powers. It does not necessarily follow that because centralization of power in other nations has led to abuses, such centralization would be abused here. But we ask, why subject ourselves to the possibility?

We feel that the proposed method of conducting open-market operations, as well as the entire open-market-operation policy, is fraught with danger. We feel that the centralization of open-market operations fails to insure proper restraints. We know that open-market operations in the past, through certain European central banks, have led to enormous difficulties, notably in France and Germany. Even when limitations have been sought with respect to the central banks' purchase of Government bonds, these limitations have been violated by subsequent widening until eventually a serious crisis has resulted.

The present Federal Reserve System calls for balanced representation composed of industry, agriculture, banking, and the Government. The proposed act may or may not represent a balanced organization bringing in all points of view. It is felt that the composition of the Open Market Committee, as provided in the bill, would destroy the checks against unsound Government operations. While we realize that no such operations may be contemplated at this time, it is essential that legislation be more forward looking. In this respect it is important to know that the open-market operations are limited in other central banking authorities in foreign countries, particularly so under the recent German and French laws, because of their experiences in the previous decade.

We agree that there should be no division of banking functions. Certain central banking functions have recently been lodged in the Treasury Department under the Gold Reserve Act of 1934. Under the Thomas amendment the President also has certain rights which he may exercise. The power of open-market operations, as it is proposed to concentrate them in the pending act, we believe to be highly dangerous. Central banking policies have an influence on business activity, but they by no means control it. On the other hand, we feel that Government credit should seek its normal level. Industrial and commercial credit is to a large extent restricted when Government deficits absorb so large a part of credit needs. The restriction arises out of a lack of confidence.

We do not believe that the real-estate provisions are consonant with banking traditions. We believe they will lead to dangers and difficulties. We feel that an educational campaign to develop more commercial paper through wider use of trade acceptances and other commercial instruments might well develop a volume of self-liquidating paper that would be helpful to the present banking situation and would help insure liquidity of commercial banks in the future.

The real-estate provisions are based upon an assumption that a large volume of commercial instruments and self-liquidating paper has definitely vanished and that it will no longer, in the future, form a large part of a commercial bank's portfolios. We question that. We feel that the period of easy capitalization preceding the depression can scarcely be expected to return. We feel further that, while at the moment many leading industries have available cash balances which will preclude the necessity of their getting into the commercial market for bank accommodations, this situation will not continue and by no means can be said to be permanent.

We would suggest that when income and other taxation keeps abreast of our present budgets that this in itself will exercise some restraint upon new security flotations by way of junior equities insofar as it may restrict net earnings available for distribution.

Furthermore, it is our opinion that the Securities Exchange Commission will no longer countenance the wild orgy of stock flotations that so characterized the insane days of 1927, 1928, and 1929. Even large organizations now possessed of these surpluses will in the course of time, find it advisable to effect larger distribution, since all legislation seems to be tending in the direction which would make such action judicious.

We feel, therefore, that there will again return a market for commercial paper and commercial loans. We believe that no more effective work could be done for the promotion of sound banking than a development on the part of the Federal Reserve System of such instruments as trade acceptances. If the volume of available commercial loans and commercial paper by commercial banks could be materially increased it would insure sounder banking.

We further believe the authority to be vested in the central board with respect to member bank reserves to be highly dangerous.

We are purposely avoiding making recommendations of certain amendments which might make the bill more acceptable. Our observations on the bill are for the purpose of bringing out such general principles as we hold essential to proper banking legislation and a further suggestion that more time be given to a study of this legislation.

Senator GLASS. Mr. Heimann, do you know whether or at what time the Federal Reserve authorities ever sought to create an open-market commercial transaction?

Mr. HEIMANN. Do you mean in the past?

Senator GLASS. Yes. In other words, have they not always confined themselves to securities rather than to commercial paper? Have they ever tried to build up an open market in commercial paper?

Mr. HEIMANN. To the best of my knowledge there has been no real effort made in that respect. We tried to secure the cooperation of the Federal Reserve Board some 3 or 4 years ago in an endeavor to build up the trade acceptance, which we feel is one of the finest pieces of paper that could be built up for banking institutions. But our efforts were largely unsuccessful because we could not register enough enthusiasm in the various Federal Reserve banks and likewise in the member banks. The trade acceptance, however, in all European countries as you know has been developed to a very high degree.

Senator GLASS. Yes; but it is a different sort of acceptance from that which is proposed here.

Mr. HEIMANN. It is somewhat different, but there is no reason why you could not——

Senator GLASS. Here it is a contingent liability and there it is a real business transaction.

Mr. HEIMANN. There is no reason why you could not pattern certain types of commercial paper in this country along the lines of tested experience which has been had in other countries. I think commercial paper should be developed.

Senator GLASS. I think there is no reason why, but it has never been done. Have you any questions, Senator Bulkley?

Senator BULKLEY. I believe not.

Senator GLASS. Senator Couzens, Mr. Heimann is from your State. Have you any questions to propound to him?

Senator COUZENS. I cannot think of any now.

Senator GLASS. I judge from the general tenor of your statement you would favor the separation of titles I and III, in a separate bill, and put title II in another bill.

Mr. HEIMANN. I would, Senator Glass, because there are not the objections to title I and title II that there are to title II.

Senator GLASS. Senator Couzens, I might state that Mr. Heimann represents the National Association of Credit Men.

Senator COUZENS. Are your headquarters in Detroit?

Mr. HEIMANN. No. I happen to be a citizen of Niles, Mich., but our headquarters are in New York. We have offices in every city in the United States.

Senator GLASS. This association asked to be heard, and recalling that the association was of very great help to us when we adopted the original Federal Reserve Act, I asked them to designate one of their executive officers to present to us the views of the association. And Mr. Heimann has stated here, or stated before you came in, Senator Couzens, that they sent copies of the bill to their various groups throughout the United States, and made an intensive study of it, and his testimony is the result of that study.

Senator COUZENS. Has your association reached any conclusion or estimate as to the continuance of this cheap money which disposes of the old commercial paper we used to have for rediscount?

Mr. HEIMANN. As to how long it will continue?

Senator COUZENS. Yes.

Mr. HEIMANN. No; we have not.

Senator COUZENS. Have you any conclusions as to how banks can make any money if they cannot get commercial paper, and cannot invest in real estate or other things? What can they invest in in order to operate profitably?

Mr. HEIMANN. I think, so long as you are operating as you are at the present time in the deposits of the Government, your Government is practically doing the work the banks would normally do; you are facing a difficult situation. That is what it amounts to. You take the whole line of possible bank transactions.

Senator COUZENS. Does your association come in contact with the paper of these credit associations, such as time sales of automobiles and refrigerators and other such things?

Mr. HEIMANN. A great many of our members handle those. But we as an organization do not handle them. The experience on those has been fairly good, I can say to you.

Senator COUZENS. And they are not rediscountable, are they, with the Federal Reserve System?

Mr. HEIMANN. I do not believe they are.

Senator COUZENS. Do you believe they should be?

Mr. HEIMANN. Within a limited sense; yes. The entire subject of installment sales is really what you are driving at?

Senator COUZENS. Yes.

Mr. HEIMANN. It is one which would require limitations both as to the article covered and likewise with respect to the transaction.

Senator GLASS. Why do you think they are not rediscountable? They represent industrial activities.

Mr. HEIMANN. The most of them do not come within the 90-day period.

Senator GLASS. Oh. That is it.

Senator COUZENS. Some of the gentlemen here from the Federal Reserve Board shook their heads just now and said they were not rediscountable, and that has been my understanding.

Senator GLASS. They are not if they do not come within the maturity exactions of the law.

Senator COUZENS. They do not come within that. And I know that there has been pressure from time to time by these financial agencies to have them rediscounted at the Federal Reserve as a matter of law. You do not think they ought to be rediscountable?

Mr. HEIMANN. I question whether you could, or rather whether they should be broadly discountable. There are some types of paper that might be, but I do not see how you could make a practical limitation.

Senator GLASS. Of course they are not discountable if they do not come within the period required. And right on that point I will say that I have been considerably—well, should I say amused or interested in the clamor for extending the maturity requirements of the Federal Reserve Act. It will be recalled that the limit established by the Bank of England was 28 days. And Senator Aldrich in framing what was known as the "Aldrich bill" followed the Bank of England and made the limit 28 days. In the preparation of the Federal Reserve bill, as I recall it, Senator Bulkley, we first had it 60 days and then moved it up to 90 days. We first had agricultural credits established at a maturity of 6 months and afterward moved it up to 9 months. So that in respect of maturities the Federal Reserve Act far exceeds in liberality any other rediscount agency I know anything about.

Mr. HEIMANN. If I might make an observation right there, Senator Glass, it is this: That I think the time limit is more than sufficiently liberal, particularly in view of the fact that the tendency has been toward restriction of the length of time of credit paper. That has been brought about, and I think perhaps has done some damage, through the adoption of the code, in which it was sought to put it in narrow terms.

Senator COUZENS. Has your association ever gone on record with respect to the desirability of what is called now "consumers' credit"?

Mr. HEIMANN. No. We do not go into the consuming credit field. Our organization is limited entirely to the wholesale manufacturing and banking field.

Senator COUZENS. So you have no views as to the desirability of that?

Mr. HEIMANN. As to anything affecting individual or personal credit there is another organization in the country which would have views on it.

Senator COUZENS. And what is the name of that organization?

Mr. HEIMANN. The Retail Credit Association.

Senator GLASS. Well, we are obliged to you.

Mr. HEIMANN. We have registered specific objection to the various provisions of the bill, but there has been so much repetition of it here that I have not felt it necessary to go through the bill with you on that matter. Practically all of the objections we would raise, paragraph by paragraph, have been raised already here.

Senator GLASS (chairman of the subcommittee). Very well; we are very much obliged to you, Mr. Heimann.

Mr. HEIMANN. And I wish to thank you gentlemen of the committee.

(Thereupon Mr. Heimann left the committee table.)

Senator GLASS (chairman of the subcommittee). We will now hear from Mr. F. M. Law, president of the First National Bank of Houston, Tex. Just give your name, please, to the committee reporter.

STATEMENT OF FRANCIS M. LAW, PRESIDENT OF THE FIRST NATIONAL BANK IN HOUSTON, TEX.

Mr. LAW. My name is Francis M. Law. I am president of the First National Bank in Houston, Tex.

Senator COUZENS. Is that the bank that Mr. Jesse Jones was or is connected with?

Mr. LAW. No, sir.

Senator COUZENS. Did he ever have any connection with it?

Mr. LAW. No; not with our bank.

Senator COUZENS. What is the name of the bank he was supposed to have been connected with?

Mr. LAW. The National Bank of Commerce. He is still chairman of it.

Senator TOWNSEND. Do you mean chairman of the board?

Mr. LAW. Yes, sir.

Senator GLASS. Mr. Law, as you have already heard me state to the preceding witness, we have under consideration the bill S. 1715, proposing a rather radical reorganization of the Federal Reserve banking system, and we are trying to get the views of bankers, business men, merchants, and industrialists generally, and would be very glad to hear any views you may care to express on the subject.

Mr. LAW. Perhaps it is in order for me to say that I am appearing upon request of the American Bankers' Association.

Senator GLASS. Are you a member of the legislative committee of the American Bankers' Association?

Mr. LAW. No. I am a member of what is known as the "Banking Studies Committee," and I retired from the office of president of the American Bankers' Association last October.

Senator GLASS. All right.

Mr. LAW. The proposed changes in the set-up of and authority given to the open-market committee is the subject that I should like to discuss. As was brought out a little while ago, the importance of the relationship of these open-market transactions to the volume and cost of credit was not recognized until comparatively recently, and I believe that the status of the open-market committee of the Federal Reserve System was only legally recognized 2 years ago.

At the present time this open-market committee consists of the 12 governors of the regional banks, and they have the power and authority to initiate policies for open-market operations. They are then referred to the Federal Reserve Board for approval or disapproval. And then the Federal Reserve Board rerefers them to the regional banks, and the regional banks, through their own boards of directors, have the right to accept or reject.

The proposal as it stands in the bill today constitutes a very wide departure. The authority of the open market committee is greatly enlarged, now becoming threefold:

First, there is the authority given to it which bears directly upon open-market transactions.

Second, the authority is conferred which has to do with the changing of discount rates of the regional banks; and

Third, the authority has to do with the right to change reserve requirements of the member banks.

It is perhaps fair to say that it is agreed the main objective which the proponents of the bill have is stabilization of trade and production and employment and wages.

It is proposed under the new bill to change the personnel of this open-market committee. Whereas it formerly consisted of 12 regional governors, representing the 12 regional banks, with of course full power to vote, it is now proposed to set up a committee on which the representatives of the regional banks will have no right to vote.

The bill as originally introduced provided for an open-market committee of 5 members, 3 members of the Federal Reserve Board and 2 governors, and those 2 governors were to have full membership including the right to vote. The bill as passed by the House has changed that.

Senator GLASS. It creates the Federal Reserve Board as an open-market committee.

Mr. LAW. Yes; the bill as it finally passed the House provides that the committee shall consist of the entire Federal Reserve Board, and in addition thereto a Federal Advisory Open-market Committee to consist of five governors of regional banks, with no right to vote. Under the proposal as passed in the House either the Federal Reserve Board or the advisory committee consisting of the governors, would have the right to initiate policies or operations. The Federal Reserve Board would be required to consult with the advisory committee before taking any final action. But as I see it, this advisory committee, with no right to vote, would be not much more than a gesture. My experience with advisory committees and councils is that they are not very effective. You have to have the right to vote in order to back up your views if you are to get anywhere.

In my opinion it is a matter of very vital importance that the representatives of the regional banks should have full membership on this open-market committee, including the right to vote. And I have five reasons for so believing:

In the first place, it seems to me that it is a pretty broad jump from the plan where the 12 governors had all the voting right, to a plan under which the governors or any other representatives of regional banks would have no right to vote. It seems to me that in making a change of this sort it might be wise to invoke a more orderly process of what one might call evolution.

Now, I repeat that I believe these governors or other representatives sitting in an advisory capacity would be more ornamental than otherwise.

Senator GLASS. They would not be even ornamental, would they?

Mr. LAW. Likely not. The second point I have in my mind is that the regional banks are owned by the member banks; and, furthermore, that the funds which are used in these open-market operations are largely the reserve funds of the member banks. And it does seem to me in all fairness on account of, first, the fact that the regional banks are owned by the member banks, and secondly, that it is the reserve of the member banks that is being used in these open-market operations, that these regional banks should have direct representation on the committee and given authority in regard to these operations including the right to vote.

Senator COUZENS. If that were done would your objections be overcome?

Mr. LAW. Not entirely, but it would go a long way.

Senator GLASS. To get right down to the root of it let me ask: Do you think that any authority having no pecuniary interest whatsoever, and having no risk on earth, contributing no banking skill or knowledge of whatever description, should be allowed to spend the money represented by the banking reserves of the country?

Mr. LAW. I do not, Senator Glass, and I do not know of any sound precedent for it anywhere.

Senator GLASS. All right.

Mr. LAW. In my opinion these regional governors, representing these regional reserve banks, would bring a view to the open-market committee that would be of considerable practical value. I mean now, if they were sitting on the committee, not in an advisory capacity but in an actual capacity of full membership.

The members of the Federal Reserve Board sit and live in Washington 12 months in the year. Now, these governors or whatever representatives might be selected from the regional banks, live in their respective localities. They therefore have a much better opportunity of direct contact, of knowing what the problems and conditions of their respective localities are, and these are changing from time to time.

Members of Congress stay in Washington I understand approximately one-half the time, but you have the very valuable advantage as I see it of living the other half among your own constituents and thereby keeping in touch with changing needs and conditions of the country.

Senator COUZENS. That is quite evident from the passage of the Patman bonus bill.

Senator GLASS. Well, Senators may speak of their own States in that respect but I will say that I have gotten I think 11 telegrams on the subject of the Patman bonus bill. But I was in the office of a colleague less than 10 days ago and he had a file of telegrams that would reach from the floor above the top of this table.

Mr. LAW. Shall I proceed, Senator Glass?

Senator GLASS. Yes. I just want to defend Virginia. [Laughter.]

Senator COUZENS. Well, they know you are incorrigible and there is no use wiring you.

Senator GLASS. The Senator from Michigan is so placid and pliable that they bother him a good deal, I imagine. [Laughter.]

Mr. LAW. Another thought that comes into my mind, and I am speaking now entirely in terms of arguments as to why these regional banks should have representation on this open-market committee: There is, I believe, a rather strong current of criticism running against what is regarded as the overcentralization of power in any small group. I believe that if you would give these regional representatives, representatives from these regional banks located in different parts of the country, membership on that committee it would do much to quiet the criticism and allay the fears of many men.

Now, the fifth point is this: As I understand it the Federal Reserve Act when it was originally drawn contemplated, or rather recognized, the principle of the local autonomy of these regional banks.

Senator Glass, you spoke a little while ago of changing the maturities. I came to Washington as a member of what was known as the "country bank committee" in 1913, and appeared before your committee to urge that agricultural paper—that is, the maturity of agricultural paper—be lengthened to 6 months. And as you pointed out a little while ago, I believe now it is 9 months. But we believe that this principle of local autonomy is vital and should be maintained. We believe that these governors living in different parts of the country are familiar with the needs and conditions of their respective constituencies. And we believe that to give them membership on the committee would do much to preserve the principle of local autonomy, and that at the same time it would be productive of great practical value, as I have already outlined.

Senator GLASS. Mr. Law, might I interject right there: The fact that we gave the regional banks local autonomy was not a haphazard conclusion. You will recall that we considered the Federal Reserve bill for 18 months, and not only was it not a haphazard conclusion but it was deliberately adopted in contradistinction to the proposal of the Aldrich scheme, which was never even considered for a moment in the Committee on Banking and Currency of either House of Congress, and which was never presented by any Representative or Senator in Congress as a substitute for the Federal Reserve bill. And the reason of that, aside from the conferences and deliberations and the consequent conclusions of those days, was that the Democratic platform on which Mr. Wilson was elected declared in terms against the Aldrich scheme and against any central bank. And the Progressive platform written by Mr. Theodore Roosevelt himself, declared in specific terms against the Aldrich bill and against centralization of credit.

So that we felt at that time we were fully sustained by the overwhelming public sentiment of the country in giving these regional banks autonomy as against the scheme for central bank control. And I do not think the sentiment of the country has changed a particle in that respect.

Mr. LAW. Mr. Chairman, I have outlined some of the reasons that have occurred to me why these representatives of regional banks should be given full membership on the open-market committee. I have tried to be perfectly fair and to explore the other side of the question to see if I could find some good and valid reason on the negative side, but——

Senator COUZENS (interposing). How many members would it make if five were added to the voting power?

Mr. LAW. There are eight members of the Federal Reserve Board.

Senator COUZENS. So there would be 13.

Mr. LAW. Right there, Senator Couzens, the proposal of the American Bankers' Association is that the Board should be reduced to 5 members, and that the full membership of the Board should sit with this open-market committee, with 4 representatives added with full membership privileges, making 9. But the bill as passed in the House provides for 13, being 8 and 5.

Senator GLASS. Well, for facility of work and permanence of conclusions what practical difference is there between a membership of 12 and a membership of 9 on the open-market committee?

Mr. LAW. I do not think there is any substantial difference.

Senator GLASS. All right.

Mr. LAW. Now, Senator Glass, if there are no good reasons on the negative side, we submit that these regional banks by reason of their ownership, the member banks being the owners, by reason of the fact that it is the reserve of the member banks that is being used in these open-market transactions, it is not in order to deprive them of full representation on the committee that is to be given such wide and far-reaching power and authority.

As I understand it under the bill as passed by the House, this open-market committee, consisting entirely of members of the Federal Reserve Board, would formulate the policies. It is true they are required to hear any suggestions made by the advisory committee, but as I stated a little while ago, I do not attach any importance to that. I think it would be a mere gesture. I just do not exactly understand why anybody would want to fool away his time with acting on an advisory committee of that sort.

But after they have gone through the motions of hearing them, then they form their own conclusions, and then they have the right to tell these regional banks exactly what they must do.

Senator COUZENS. Your criticism is only directed, as I understand it, to the open-market operations.

Mr. LAW. You see, the open-market operations have been greatly extended, and——

Senator COUZENS (interposing). But does your criticism only apply to that, or does it also apply to the rediscount rate?

Mr. LAW. It applies to all three matters.

Senator COUZENS. Your proposal is to have 9 members, 4 from the outside banks, to constitute a permanent board?

Mr. LAW. Yes.

Senator COUZENS. And they would have jurisdiction to handle rediscount rates, and reserves, and open-market operations?

Mr. LAW. Well, now, I said a permanent board. Four governors would be elected annually, and there might be a turn-over in personnel as to them, but it would be a permanent set-up.

Senator COUZENS. All right.

Mr. LAW. Now, with reference to the reserves, and it is a matter of tremendous importance: Under the bill as passed by the House this open-market committee, consisting entirely of Federal Reserve Board members, could make any changes they pleased in the reserves of member banks. But under the law as it stands today there are certain safeguards and limitations.

Senator GLASS. There are statutory provisions.

Mr. LAW. Yes. For instance, the Board now has to declare an emergency. There have to be five members of the Board voting affirmatively in order to declare an emergency, and then they must get the approval of the President of the United States. All these safeguards are removed under the new bill and just a bare majority of a quorum could act.

Senator GLASS. In the ordinary course of the banking business there is a statutory requirement as to reserves?

Mr. LAW. Yes, sir.

Senator GLASS. In the case of the country banks and in the reserves of the Federal Reserve System itself.

Mr. LAW. Yes, sir. Now, they propose to give the Federal Reserve Board, sitting as an open-market committee, the right to do just exactly as they please about that, with no limitations up or down. They could go up to 100 percent or down to zero for that matter.

Senator GLASS. You live in Houston, Tex., I believe.

Mr. LAW. Yes, sir.

Senator GLASS. And are president of a bank there?

Mr. LAW. Yes, sir.

Seantor GLASS. Do you imagine that a central board here in Washington with correspondence contact with the banks in Dallas Federal Reserve district could possibly know more about conditions there, and the habits of business, and other things desirable to know, than the board selected by the Dallas district bank?

Mr. LAW. I do not.

Senator GLASS. Is it conceivable that that could be so?

Mr. LAW. I think it would be most unreasonable to assume that it could be so.

Senator COUZENS. As I understand the situation, the American Bankers' Association proposal is that concentrated authority is to be made up in some form.

Mr. LAW. Yes.

Senator COUZENS. In other words, you do not like a division of authority such as now exists between the 12 Federal Reserve banks and the Federal Reserve Board.

Mr. LAW. We thought that might be improved upon.

Senator COUZENS. In other words, there must be some concentrated authority somewhere and not have it divided among 12 Federal Reserve banks.

Mr. LAW. Our plan would contemplate a thorough coordination between the Federal Reserve Board and these representatives from the regional banks. The Federal Reserve Board would still have the majority. The regional banks would, however, have minority representation on the committee.

Senator GLASS. I want to put it in the record again right here, and if the committee desires it I will summon the Secretary of the Treasury to come here to repeat it, that the Secretary of the Treasury within the last 2 weeks has told me that there has been complete accord between the Treasury and the open-market committee as now constituted; or to use his exact words, 100 percent accord. Now, why do you favor disturbing a situation of that sort?

Mr. LAW. I did not know that that was true, but even granting that it is true, and if the Secretary says it is I am sure it is, that might not always be true.

Senator GLASS. Well, suppose it is not always true. Suppose your bank at Dallas, intimately acquainted with banking conditions in that region, should come to the conclusion that it was neither able nor was it desirable to participate in an open-market transaction initiated by, we will say, the Federal Reserve Bank of New York, why should they be compelled to do it?

Mr. LAW. I can only answer that question by expressing my personal view: I do not think they should be compelled to do it. But that is a personal expression.

Senator COUZENS. Senator Glass, why did you mention the Federal Reserve Bank of New York?

Senator GLASS. Well, any other Federal Reserve bank for that matter.

Senator COUZENS. I thought this open-market operation was supposed to be begun by the bankers' own proposition, by 5 Federal Reserve Board members and 4 outside members, so that it would not be done by the bank in New York, would it?

Senator GLASS. Oh, no. That would not be the bank in New York, but I am talking about this bill as stripping the regional bank of all initiative, of all right to dispose of its own property as it may be directed to do by its own board of directors.

Senator COUZENS. What I am trying to get on the record is that there is a very great difference of opinion between you and the American Bankers' Association with respect to having concentrated authority somewhere, and not authority divided among the 12 Federal Reserve banks.

Senator GLASS. Let me see if there is. Let me ask you, Mr. Law, this question: As I understand the recommendation of the legislative committee of the American Bankers' Association, it is an alternative proposition. I do not understand, but maybe I am misinformed, that your association initiatively is here in advocacy of any material change in the law right away.

Mr. LAW. I think, Senator Glass——

Senator GLASS (continuing). But you are saying that if there is to be this proposed change, if the regional banks are to be stripped of any degree of their autonomy, then you want some part of it retained.

Mr. LAW. We want to save all we can. I might say this, that the American Bankers' Association of course is a very large body, consisting of different kinds of banks, and there is a school of thought within the association, a very respectable school, that believes that title II of the bill should be divorced from titles I and III on account of the controversial character of many of its provisions. And that further study should be given to title II, that it would perhaps be a bit hasty for this Congress to attempt to pass title II. I say, there is a substantial number of our members who feel that way about it. But if the Congress in its wisdom does decide that title II is necessary in some form, then we want to do all we can to help the Congress, according to the best talent that we can offer, to set up a bill that will be workable and that will save some measure of representation to private banking.

Senator COUZENS. Let me ask you about this——

Mr. LAW (interposing). Senator Couzens, is that clear? I mean what I have just said.

Senator COUZENS. No, not quite clear. I do not get your sentiment yet. Obviously, in such a large organization as the American Bankers' Association there is a difference of opinion.

Mr. LAW. Yes, sir.

Senator COUZENS. Have they taken any action in convention or otherwise with respect to this proposed legislation?

Mr. LAW. No, not in convention. We had a meeting in Augusta, Ga., 2 or 3 weeks ago of what we call our Executive Council, with representatives from every State in the Union. This council heard the report of our special committee, and they approved it. Now, that special committee said just about what the Senator indicated a little while ago, that if the Congress feels it is necessary to have title

II, while many of our members wish it were not necessary and that it ought to be postponed, yet if the Congress thinks it is necessary, then we have certain suggestions to make. And it is along the lines of the open-market committee that I am undertaking to make these suggestions to you today.

Senator COUZENS. What would your association say, or what would your executive council or whatever it is, say with respect to the desirability of revamping the Federal Reserve Board under the plan that you have just mentioned. Would they be in favor of it?

Mr. LAW. Do you mean reducing the number to five?

Senator COUZENS. Yes; to have 5 Federal Reserve Board members and 4 outsiders.

Mr. LAW. The association itself has not had an opportunity to pass on that. You see, we have a convention only once a year, and it met in October of 1934 and this bill of course was introduced, I believe in February of this year.

Senator COUZENS. What does your executive council say about it, the one that met at Augusta, Ga.?

Mr. LAW. The executive council approved the plan of having 5 and 4.

Senator COUZENS. If a plan that is fair——

Senator GLASS (interposing). That is just as to the open-market committee?

Mr. LAW. Yes.

Senator GLASS. And not as to the members of the Board itself?

Mr. LAW. No; they go further than that and they suggest that the Federal Reserve Board be cut down to five members.

Senator GLASS. That is what I say, but the four bankers are not to be members of the Federal Reserve Board but simply members of the open-market committee.

Mr. LAW. Yes, sir.

Senator COUZENS. The four bankers outside are not to be members of the Federal Reserve Board?

Mr. LAW. No, sir.

Senator COUZENS. Are they to have any voice in the establishment of reserves or the making of rediscount rates?

Mr. LAW. Yes, sir. The threefold powers accorded to the open-market committee, they would share in all of them.

Senator COUZENS. And all other work would be done by the five members of the Board, is that right?

Mr. LAW. I beg your pardon?

Senator COUZENS. I say, all other work would be done by the five members of the Board?

Mr. LAW. Oh, yes; their sphere would be limited to the open-market operations.

Senator GLASS. I do not understand that the proposed open-market committee is to have control of reserves and rediscount rates. The Board itself has that control.

Mr. LAW. Senator Glass, it is included in the authority given to the open-market committee. It is a threefold power.

Senator GLASS. I do not find it so.

Mr. LAW. Now, of course, it is a difference between tweedledee and tweedledum if you are going to have the Board sit as an open-market committee and nobody else sit with them.

Senator GLASS. I understand that full power is given to the Board itself. Well, of course, under this proposition as it is now the Board is the open-market committee.

Mr. LAW. Exactly.

Senator GLASS. But the full power of reducing or raising or suspending reserves is given to the Federal Reserve Board.

Mr. LAW. My understanding is that under this bill as passed by the House the authority of the open-market committee is threefold—first, having to do with open-market transactions as they are commonly known; and, secondly, having to do with changing discount rates; and, thirdly, having to do with the changing of reserves.

Senator GLASS. Well, of course, that is technically true, because under the House bill the Board is the open-market committee.

Mr. LAW. Yes, they do not say anything there about the open-market committee. They just say "the Board." I see your point. The House bill as passed, and as I recall it, does not say in so many words that the Federal Reserve Board shall sit as an open-market committee. It just says the Federal Reserve Board shall do so and so and it sets up an advisory committee.

Mr. Fleming has just reminded me that while our association as a convention has not passed on this matter, yet that we delegate that authority to the executive council, and they met 2 or 3 weeks ago in Augusta, Ga., and did approve this program I have outlined to you. So it carries the full force and effect of a mandate of a convention itself of the association.

Senator GLASS. Do you believe in delegated authority?

Mr. LAW. Yes.

Senator GLASS. Well, I do not

Senator COUZENS. Well, at any rate we now know what the American Bankers' Association wants.

Mr. LAW. If I may be allowed I want to say just one word here, and I did not intend to say this at the outset: The other day before leaving Houston, Tex., it got out in the papers that I was coming up here to Washington to appear before this committee. Now, I work in a bank down there that has something over 200 country bank correspondents, and my phone began to ring, and it was ringing almost constantly until I got my hat to go to the railroad station—for almost 24 hours. And these little country banks were concerned about the size of the assessment, the rate of the assessment; they had seen that in the House bill it had been fixed at one-eighth, and they had been hoping it would not be more than one-twelfth.

I have this observation to make, that I think far more important than the rate should be the power given to properly supervise these banks that are members or this insurance fund, because after all that is going to determine how much of a fund you are going to need, and what the demands on the fund are going to be. If I am correctly informed the House left out of its bill the authority that Mr. Crowley, the Chairman of the Federal Deposit Insurance Corporation, asked for. He wanted authority to pass on the application of banks desiring to come into the Insurance Fund; and he also wanted authority to put any bank out of the fund which persisted in improper practices after warning and hearing.

I believe that is of very vital importance, much more important than the rate of assessment. I know that country banks particularly have been hard hit, that it has been necessary for them, although their earnings have been decreased almost to the vanishing point, to use what little they can accumulate to set up a reserve for losses.

Senator COUZENS. And they do not want to be compelled to come into the Federal Reserve System either, do they?

Mr. LAW. No, sir; they do not.

Senator GLASS. Mr. Law, you were here in 1913 when we adopted the Federal Reserve Act. Did you ever hear it suggested in any of those discussions, whether publicly on the record or privately in conference, that the Federal Reserve System was set up to finance the Government of the United States?

Mr. LAW. Yes, sir.

Senator GLASS. You did?

Mr. LAW. Just occasionally I heard that there might be something of that sort, but there wasn't any—oh! I would say that any comment of that sort was sporadic or desultory.

Senator GLASS. To finance the Government of the United States?

Mr. LAW. Yes. I heard that in Boston. I heard some of the boys talking along that line, that it might be. It was entirely due to a misapprehension of the purpose. You understand that there was, or I take it that you did know about it, much misinformation.

Senator GLASS. Well, how there could be any misinformation to that effect is beyond human conception. At that time the indebtedness of the United States was less than a billion dollars. Eight hundred and forty-seven million dollars of that amount was held by the national banks for circulation purposes, and a considerable portion of the outstanding remainder was held by individuals and estates. What possible need at that time was there for setting up an institution to finance the Federal Government?

Senator COUZENS. May they not have seen the war in sight?

Senator GLASS. Well, let me add right there: If Congressmen were guilty of any such discernment as that they have not been guilty since. [Laughter.]

Mr. LAW. Senator Glass, I think perhaps I answered your question somewhat inaccurately. Upon reflection it may be that I ought not to say that I heard criticism directed at that particular thing, as to whether or not this Federal Reserve System was being set up to finance the Government or might be used for that purpose. What was in my mind was that I did hear discussion along this line: That there were dangers, incipient dangers in this proposal on account of the possibility that sometime or other it might become politically controlled.

Senator GLASS. Oh, as to being politically controlled and being set up to finance the Government, they are two very separate and distinct propositions. The bill itself textually sets out what it was designed to do. It was to respond to the requirements of commerce, industry, and agriculture.

Mr. LAW. Yes.

Senator GLASS. And that is all. And there was never the remotest dream upon the part of the proponents of the act that it would ever be used to finance the Federal Government. The supposition of Congressmen at that time was that the Federal Government would always be able to finance itself. And as to the open-market requirement of the law: The purpose of that was set forth in the report to

Congress and in my speech presenting the bill, if I may be personal The sole purpose of the open-market requirement was not to permit Federal Reserve banks to engage in speculative investment transactions, but was entirely separate from that. It was to enable them to use any surplus funds they might have on hand in order to cover overhead charges, and to enable them to do as the Bank of England has always done, to enforce their rediscount rate. And that was all. It never was intended that they should go into speculative transactions and buy all sorts of securities and all that sort of thing.

Mr. LAW. I think, Senator Glass, that perhaps you fail to take into account this fact: You were sitting there writing this bill, with certain fundamentals and objectives in your mind every minute. The layman or even bankers, with an imperfect knowledge of what was contemplated, got a lot of misinformation about it. In other words there was a lot of difference I know in my attitude after I came down to Washington and attended the hearings and heard more about the bill. It changed completely, or very largely at least, my attitude in regard to it after I got additional information and got rid of some of the misinformation which I had acquired.

Senator COUZENS. Did you testify against the act in 1913?

Mr. LAW. No, sir. I was on this country bank committee, coming here from an agricultural district, representing the agricultural interests there. We realized that in order for the farmers and the livestock men to be benefited by it the length of the maturity of their paper would be of great importance. That is what I was interested in then.

Senator COUZENS. To meet the seasonal situation?

Mr. LAW. Yes, sir.

Senator GLASS. Very well, Mr. Law, we are very much obliged to you.

Mr. LAW. And I wish to thank you.

(Thereupon Mr. Law left the committee table.)

Senator GLASS (chairman of the subcommittee). Mr. Brown, of the First National Bank of Chicago, will now be heard. Just give your name and occupation to the committee reporter for the record.

STATEMENT OF EDWARD E. BROWN, PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO

Mr. BROWN. My name is Edward E. Brown. I am president of the First National Bank of Chicago, and I live in Chicago.

Mr. Chairman, I should like to address my remarks to title II of the bill, and more particularly to sections 205, 206, and 209.

Section 205 as the committee knows deals with open-market operations. Section 206 deals with a definition of what is eligible for rediscount and for making advances. And section 209 deals with the power to vary the reserve requirements of member banks.

As the committee knows and of course has heard from numerous witnesses, the present system of conducting open-market operations under the law is by 12 representatives, generally governors of the 12 Federal Reserve banks. The bill as introduced by Mr. Eccles provided that the Federal Reserve Board should select 3 of its members, who would, of course, inevitably represent the majority of the Board, and that they should sit with 2 governors or 2 representatives, elected by the Federal Reserve banks.

I do not think it is necessary to point out that such an arrangement would mean that the 3 members of the Federal Reserve Board elected by the majority would inevitably vote as a unit, and whatever group within the Board or whatever power outside the Board controlled the Federal Reserve Board, would control the votes of those 3 men, and that the 2 governors or other representatives of the Federal Reserve banks, as the case might be, in effect would have nothing to say.

The bill was amended in the House of Representatives, and as the House bill is before you it contains a provision that open-market operations should be conducted by the Federal Reserve Board, and provide for the creation of an advisory committee of five governors of Federal Reserve banks.

I know something about advisory committees in general that have no power to vote, and it so happens from my own experience that I know a good deal about the work of the Federal Advisory Council which is supposed to advise the Federal Reserve Board. Two of my predecessors, presidents of the First National Bank of Chicago, were chairmen of the Federal Advisory Council, and another, Mr. Traylor, was vice chairman. And since the inception of the council the secretary of the board has generally been an officer or employee of the First National Bank of Chicago, as it has happened. And the entire record of the Federal Advisory Council in its relations with the Federal Reserve Board is that it gives advice and when its advice is not palatable they pay no attention to it, and they frequently suppress it, and, furthermore, I will say that generally speaking advisory committees and councils serve as a source of irritation, and they just have no power and no practical utility.

The CHAIRMAN. And sometimes they get their communications returned to them, do they not?

Mr. BROWN. That has happened recently, as I think this committee knows, with the statement that the communication was impertinent. So, obviously, under the set-up of the bill as it was introduced by Governor Eccles, or as it was amended in the House, the power to control open-market operations will be entirely in the hands of whoever controls the majority of the Board, whether that control is exercised by a majority of the Board members or is exercised from the outside.

Now, open-market operations have become much more important than fixing the discount rate, and they have an enormous effect on the business of the country. The effect, as experience has shown, is that they can increase or diminish the amount of reserves of member banks. Not always of course, or in exceptional conditions, but generally they tend to make credit easier or tighter. I do not believe their power as affecting credit or affecting the price level goes beyond that.

I am very much concerned as the president of a large bank—and I am speaking for myself and not for the American Bankers' Association, or anybody else—about the make-up and the ultimate control and the motives which may dominate a board which is charged with open-market operations. I am particularly afraid of a board which would be apt to force Government obligations on Federal Reserve banks which the investing public was unwilling to take.

I am not unmindful that in a real emergency, such as war, or such as the situation as existed at the end of the Hoover administration or at the beginning of the present administration when the banks were closed, that it may be necessary for the Treasury to go to Federal Reserve banks, and to go to member banks, and get temporary assistance.

But it is a very different propostion to put it in the power of a mere majority of the Federal Reserve Board, either directly or through an open market committee responsive to that mere majority, which is apt to be dominated by political considerations or be responsive to administration pressure, to get money to enable the Government to function for a period of 30 or 60 or 90 days until securities can be distributed to the investing public with which to carry on the Government; and to give the power to the mere majority of that Board to compel Federal Reserve banks to buy long-term securities of the United States at a rate which the investing public is unwilling to take them at. I am very fearful if this bill is adopted either as presented by Governor Eccles, or as it came to the Senate from the House, that such power would be given and would be apt to be used.

After all the best "stop, look and listen" sign I know for the administration, or the Congress, or the people of the country in their financial and budgetary operations, is the fact that the Government cannot dispose of its obligations except at rising rates of interest. It is a check to everybody, including the people of the country, in that it makes them think where they are going.

I think the passage of the bill, either in the form recommended by Governor Eccles or as it comes from the House, would be quite apt, if Government issues went sour and were not taken by investors because they did not like the rate of interest, to mean that the Federal Reserve Board directly or through the open-market committee, which would be under the absolute domination of a chance majority of the Board, would force Federal Reserve banks to take Government obligations which they did not want to take and which the investing public would not buy.

Senator Couzens. Do you agree with what Mr. Law said about the set-up of the Federal Reserve Board?

Mr. Brown. I think the Federal Reserve Board should be reduced.

Senator Couzens. But do you agree with what Mr. Law said, or did you hear his testimony given here?

Mr. Brown. I heard his tesimony. I should say as to the Federal Reserve Board, if it was reduced to five members as proposed by the American Bankers' Association, and the Secretary of the Treasury and the Comptroller of the Currency were eliminated—they being direct Government representatives—sitting with four elected governors as an open-market committee, that there would be very little chance of that sort of thing happening.

I should like to say that I happen to be a member of the executive committee of the American Bankers' Association, and was present at the meeting in Augusta, Ga., and the view of the members of the American Bankers' Association there very definitely was that unless this or some similar compromise was reached which would take the power away from the Federal Reserve Board alone to control open-market operations, that all of title II of the bill should be opposed by the association.

Senator COUZENS. Would you prefer the recommendations of the American Bankers' Association to the existing set-up?

Mr. BROWN. No. I would prefer the existing set-up, I will say frankly. But if the pressure of the administration is very strong, and if the pressure in Congress is strong on the point that open-market operations are so important, that the public interest must be represented by people other than those responsible to the directors of the Federal Reserve banks elected as to two-thirds by member banks, and that the Government should have more voice in open-market operations, then I would be willing as a compromise, because I do not believe it involves any great danger, to have a joint open-market committee on which not delegated members of the Federal Reserve Board, but all the members of the Federal Reserve Board as reduced, and governors would act together.

Senator COUZENS. So you would not be particularly disturbed if this bill were passed with the set-up as proposed by Mr. Law and the American Bankers' Association?

Mr. BROWN. No.

Senator GLASS. How do you reconcile that with your statement made at the beginning that members of the Federal Reserve Board on the open-market committee would act as a unit. If they have a majority they would do as they pleased, would they not?

Mr. BROWN. Well, what I was saying——

Senator GLASS (interposing). But I mean as the American Bankers' Association proposes. It proposes minority representation for the Federal Reserve banks which own the money that is to be invested or speculated in or whatever you may please.

Mr. BROWN. Yes, but——

Senator GLASS (continuing). And the majority of the open-market committee is to be composed of people who do not own a dollar in the banks, who have no pecuniary interest whatsoever in them. You started your testimony, as I remember to have heard it, by saying that this majority would always act as a unit, and they will.

Mr. BROWN. Senator Glass, what I said was that in Governor Eccles' proposal the majority of the Board would select 3 members to represent the Board, and that those 3 would inevitably act as a unit and represent the opinion of the majority of the Board.

Senator GLASS. Exactly.

Mr. BROWN. If the Board, however, were reduced to 5 members and they were appointed for 12-year terms, except as to 1 who would be selected by the then existing administration, the governor say, and not removable, and those 5 sat with 4 governors, and each 1 of the 9 had an equal vote, I do not believe the 5 members of the Federal Reserve Board would vote as a unit; and if the 4 governors could persuade 1 of the 5 to vote with them, they would have a majority.

Senator GLASS. Well, you are more credulous than I am; that is all I can say about that.

Mr. BROWN. It may be so. I have seen a good deal of the Federal Reserve Board and generally it has been split, and I think it is apt to continue to be split.

Senator GLASS. Yes. They split before this bill was proposed; and for that matter it remains to be seen if they are not very materially split on this bill, because not a member of it saw this bill until it was sent up here and was printed.

Mr. Brown. I do not think it necessary to call to the attention of this committee that if any open-market committee forces long-term bonds which the investing public are unwilling to buy, on the Federal Reserve banks, or short-term bonds for that matter which the public won't buy, that you can have and will have inflation, which because it is hidden largely at the beginning is apt to get so far under way that it will be impossible to stop it without enormous damage to the people of the country.

Senator Glass. Well, it has been testified here that 60 percent of the public indebtedness is owned by the banks now. How much more would you like to see owned by the banks?

Mr. Brown. I should like to see much less than that percentage owned by the banks. There is also a danger I think which exists and which makes it important that somebody elected by the people whose reserves are in Federal Reserve banks, through their representatives, the boards of directors and governors of the regional Federal Reserve banks—that is, to see to it that the open-market operations shall not be undertaken in order to try out some entirely untried and unproved economic theory.

I mention that fact because the present Governor of the Federal Reserve board has employed an economic advisor, who has recently published a book the thesis of which is that the price level can be controlled through Federal Reserve open-market operations. I do not believe in the theory. I do not believe the majority of the economists of the country accept that theory. And I think if the theory is tried out they will be unable to materially affect the price level—but God knows how much damage they may do to the business of the country and to the member banks in trying. I think it highly important to avoid open-market operations under the sole control of a Federal Reserve board, or a majority of a Federal Reserve board, when the majority is certainly going to be responsive to whatever administration happens to be in power.

Senator Couzens. Mr. Brown, you have had long expereince and you must recognize that control has to be located somewhere for almost any activity, I take it.

Mr. Brown. Yes.

Senator Couzens. Therefore it would seem desirable to reorganize the Federal Reserve Board because the control is now divided between 12 Federal Reserve banks in the matter of open-market operations, and under this bill, or some modification of it, the control will be centralized, will it not?

Mr. Brown. Yes.

Senator Glass. Do you believe in control being centralized rather than regional?

Mr. Brown. I do. On that point I differ from Mr. Law. I think when open-market operations by their very nature affect——

Senator Glass (interposing). I am not talking about open-market operations alone. There is the question of the rediscount rate. Do you think that should be uniform throughout the United States?

Mr. Brown. I do not.

Senator Glass. Well, you do not think the control should be centralized, then. If control is centralized they could make the rediscount rate uniform throughout the United States.

Mr. Brown. I thought I said to Senator Couzens, Senator Glass, that I believed control of open-market operations should be centralized. And I would say that I think that control should be centralized because it is——

Senator Glass (interposing). Well, it is centralized now in a statutory committee of 12 governors, is it not?

Mr. Brown. Yes.

Senator Couzens. But nobody has to act upon the order of the centralized control. Each of the 12 Federal Reserve banks can do just as it pleases.

Senator Glass. Well, why shouldn't you do as you please with your own money? You would not want anybody to spend your money for you.

Senator Couzens. It is not their money.

Senator Glass. Why isn't it?

Senator Couzens. Ask depositors who have money tied up in banks now whether it is their money or the banks' money.

Senator Glass. The reserves belong to the banks, and that is the money this committee will use.

Senator Couzens. And that money comes from depositors.

Senator Glass. It comes from transactions had with banks.

Senator Couzens. And it all originates with depositors' money.

Senator Glass. Of course, the banks lend depositors' money. That is what the banks are for.

Senator Couzens. And that is the reason we are attempting to keep some control over them, so they cannot lend without some governmental supervision.

Senator Glass. You have ample governmental supervision now. What I am talking about is governmental confiscation. But, never mind; we will argue that out among ourselves. Pardon me, Mr. Brown, as I do not like to exhibit my arbitrary views in contrast with the placid and deliberate views of my colleague here, of whom I am very fond.

Mr. Brown. Gentlemen of the committee, I think that such a compromise as is proposed by the American Bankers Association, with Federal Reserve Board of 5 members, with an open-market committee composed of members of the Federal Reserve Board, with only 1 member that changes with the administration; if there were 4 governors against 5 members of the Federal Reserve Board controlling open-market operations, it would greatly minimize the danger of such open-market committee loading the Federal Reserve banks with Government obligations in the way I have mentioned. I think it would afford great insurance against trying out unproven economic theories with the hope of affecting the price level.

Senator Glass. I might agree with you there, but if the undeniable fact exists of an open-market committee composed of 12 Federal Reserve bank governors have already loaded the Federal Reserve banks up with 2½ billion dollars of Treasury securities, and isn't that a fact?

Mr. Brown. Yes. There has been a situation in this country where the administration, the President if you will, and his Cabinet officers, have had an extraordinary and unusual influence over everybody, including the Congress, up to date, and over Federal Reserve banks as well.

Senator Glass. Well, do not apply that to just one President. That was the case in Mr. Hoover's administration. It began there and it has been intensified since the 4th of March 1933. I am quite willing to suspect that some influence is exercised on the Congress by the administration. [Laughter.]

Mr. Brown. If Congress should decide that it is desirable to keep the Secretary of the Treasury or the Comptroller of the Currency, who are necessarily administration officials, responsible to the administration, on the Federal Reserve Board, then I think the open-market committee should consist of unofficial members. That is, members other than the Secretary of the Treasury and the Comptroller of the Currency, sitting with a number of governors of the Federal Reserve banks, having either equal votes or only one less vote. I think it important that there be not less than four or five governors on such committee because the interests of the different sections of the country are of different types. New York, for instance, has interests which are predominantly financial and concerned with export trade. The industrial Middle West, represented by the Cleveland and Chicago Federal Reserve banks, has interests which are very different from those of the South or from those of the agricultural sections, such as center in Minneapolis or Kansas City. And I do not think you could get adequate representation on an open-market committee of governors unless you have at least 4 or 5; and I do not believe that a committee of 13, or even 15, is unworkable.

On the subject of section 209, which in the House bill gives power to the Federal Reserve Board to increase reserve requirements or lower reserve requirements of member banks without declaring an emergency, I think that is just about as dangerous to the stability of the business of the country and the country as a whole as the section dealing with open-market operations.

The present reserve requirements of Federal Reserve banks are low enough. If anything, in my own opinion they are too low. The power to suspend them is by the present law given to five members of the Board, with the approval of the President on declaring an emergency. It seems to me that that is sufficient authority, and that if an emergency existed it would be because of a currency panic, and everybody would know of the emergency and the President and the Board would not hesitate to go ahead and lower the reserve requirements.

If the Board, without declaring an emergency, and in order to combat inflation, wants to raise the reserve requirements upward, then certainly a ceiling, or up limit, as to the amount to which the reserves could be raised, should be written into the bill. If it is not written into the bill, it would give the power to a majority of the Federal Reserve Board by requiring very high reserves to abolish private banking in this country. I will say that while there is a large body of radical opinion which favors such abolition, and favors socialization of credit and nationalization of banking, the Congress does not, or a majority of the Congress does not, and a law should not be written which would give the power to any board by fixing arbitrary reserve requirements to force private banks out of business without legislative sanction, and without the opportunity to debate or discuss the matter.

Furthermore, I frankly am afraid that if that power should exist and that emergency should arise and the Federal Reserve Board wanted to put pressure on member banks to buy Government bonds which they did not think they should buy, or wanted them to do something else they did not want to do, that by threatening to raise the reserve requirements to a point where private banking would become almost impossible, great pressure could or might be put on the member banks. And for the life of me I cannot see any objection to putting an upper or ceiling limit on the reserve requirements which could be required of member banks.

Before the passage of the Federal Reserve Act banks in the central reserve cities at least demonstrated that they could operate on a reserve of 25 percent, and I would suggest a ceiling limit of 25 percent of all deposits, if the reserve requirements are going to be changed and you are going to give the right to the Board to make them flexible other than in an emergency. Personally I prefer to see the section left untouched, with merely an emergency clause for the Government to act on.

Senator GLASS. Would you for the present desire to see the Federal Reserve Act left untouched until the matter could be given mature consideration?

Mr. BROWN. Personally, I would be, Mr. Chairman.

Senator GLASS. Do you think that is the consensus of opinion of the members of the American Bankers' Association?

Mr. BROWN. I should say that nine-tenths of the bankers present at the executive council meeting in Augusta, and I am speaking now not as an officer of the association but of my own private impressions, would be greatly in favor of having no action taken on title II of the bill at the present time. But if the administration is going to insist on title II of the bill, then the instructions to the legislative council were to fight it, unless certain modifications were put into the bill as finally written.

On the question of eligibility or what can be rediscounted and the proviso that advances can be made against any sound assets, I disagree with Mr. Heimann, and I think some amendment should be made to the act, although I do not think it is an emergency matter, by way of broadening what is rediscountable paper.

Business conditions have altered very materially since the passage of the Federal Reserve Act. The supply of ordinary commercial paper has become much shorter. I think it would be much more preferable to amend the act by making specific definitions of what is eligible for rediscount.

Senator GLASS. Well, as a matter of fact, isn't that matter almost entirely within the control of the Federal Reserve Board now, except that it shall relate eligible paper to commerce, industry, and agricultural interests of the country? What other interests would you add?

Mr. BROWN. I would not put in other interests, but I myself would make finance-company paper, with certain restrictions, eligible. And when I say "finance-company paper" I mean the paper of finance companies like General Motors Acceptance Corporation, and paper of the Commercial Investment Trust. I would make tax notes and tax anticipation warrants eligible. I would make serial municipal bonds of short maturity eligible. I would make obligations payable on demand secured by grain or other commodities eligible. I would make cold-storage warehouse paper eligible. This paper because of the fact that storage warehouses advance money to dealers in food products is not now eligible under the terms of the act. But certainly if the present draft allowing a Federal Reserve bank to make advances on any sound asset is adopted, and I think it is necessary to broaden the rediscount base, there should be written in a provision that advances on sound assets, whatever that means, should bear a differential in interest charge which would discourage their being held on the theory that they could be discounted. Possibly advances on sound assets, other than Government bonds, should be at a rate of 2 percent, or 3 percent even, above the rediscount rate for rediscountable paper as defined in the act. This would not tend to encourage banks to invest their money in unliquid assets because liquidity and soundness in banking go together.

Senator BULKLEY. Are there available statistics to show how much paper, as you have suggested, would be eligible which is now held by banks?

Mr. BROWN. I do not know of any statistics covering the whole banking field, but I do know in the case of our own bank that the amount of eligible paper which we hold, which is small not because we do not try to get it but just because it is not there, would be more than doubled by such a definition.

Senator BULKLEY. Do you think the adoption of your suggestion would practically double the amount of eligible paper?

Mr. BROWN. Based on my own experience, I think it would be doubled.

Senator GLASS. I am just wondering right there: Isn't that largely provided for in the existing act? I have not had occason to examine the rules and regulations on eligibility adopted by the Federal Reserve Board, but I very distinctly recall the provisions of the act, and any paper of the statutory maturity which relates itself to commerce, industry, and agriculture may be comprehended in the definition of the rules and regulations of the Federal Reserve Board. The only prohibition in that regard is a prohibition against including in its definition speculative investment securities and loans for the purchasing or carrying of speculative stocks. That is the only prohibition.

Mr. BROWN. Well, the Federal Reserve Board has interpreted the act to prohibit the eligibility of paper which is issued by a concern that finances others. Whereas, an automobile manufacturer may borrow money, yet if that automobile manufacturer sells his accounts receivable to a finance company the Federal Reserve Board has felt that they have no right to make such paper eligible. They have held that they have no right to make cold-storage-warehouse paper eligible where the cold-storage company instead of owning the stored products directly, holds notes of local produce men secured by the pledge of foodstuffs.

Senator GLASS. Is not that a regulation of the Board rather than a requirement of the statute?

Mr. BROWN. They say it is their interpretation of the law, and that even if they wanted to they could not make that class of paper eligible.

Senator GLASS. Well, I imagine they know more about i [Laughter.] Well, sir, we are greatly indebted to you. I very much interested in your testimony.

Mr. BROWN. I thank you.

Senator GLASS. The subcommittee will now suspend. T we will hear Mr. Aldrich of the Chase National Bank of N City, I believe, and will meet at 10:30.

(Whereupon, at 12:35 p. m., Tuesday, May 14, 1935, the coı recessed until 10:30 o'clock the following morning.)

BANKING ACT OF 1935

WEDNESDAY, MAY 15, 1935

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON
BANKING AND CURRRENCY,
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. Aldrich is the chairman of the Chase National Bank of the City of New York and is to be heard this morning. Mr. Aldrich, simply give your name and occupation to the committee reporter for the benefit of the record.

STATEMENT OF WINTHROP W. ALDRICH, CHAIRMAN THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK

Senator GLASS. Mr. Aldrich, the subcommittee has before it S. 1715, being the proposed amendments to the existing banking law, and we shall be very glad to have you comment on the proposals.

Mr. ALDRICH. Mr. Chairman, I was a member of a special committee of the American Bankers Association which made a study of the bills now pending before your committee and as passed by the House of Representatives, and thereafter made a report to the American Bankers Association, which was unanimously adopted by the executive council of the association at its meeting in Augusta, Ga., a few weeks ago.

The suggestions for changes in the bills I will make to you today include the recommendations made in that report. But I will make certain additional recommendations and certain modifications of the recommendations made in that report, which are the result of further study of the Senate bill and of the bill as passed by the House of Representatives.

These latter recommendations represent my own personal views. I am also a member of the Business Advisory Council for the Department of Commerce, and was chairman of a committee appointed by that body to make a study of these bills. The report of that committee was unanimously adopted by the Business Advisory Council for the Department of Commerce, and I understand was delivered to the President last week. That report, however, is not ready for publication, and I do not here of course speak in any manner for the Business Advisory Council for the Department of Commerce.

Senator GLASS. Mr. Aldrich, right there let me ask you: Have you a copy of that report?

Mr. ALDRICH. I have not one with me; no, sir.

Senator GLASS. Why is it not available for publication?

Mr. ALDRICH. I will say that I have here a letter from the assistant to the chairman of the Business Advisory Council, which I have not yet had the time to read myself. I just received it this morning, but——

Senator GLASS. Does it touch upon this banking bill at all?

Mr. ALDRICH. Perhpas I might read it, although as I have said I have not read it myself as yet——

Senator COUZENS (interposing). Perhaps there may be some secrets in it and you better not read it.

Mr. ALDRICH. It outlines the procedure that was agreed upon between Mr. Kendall, the chairman of the Business Advisory Council for the Department of Commerce, and the President at a meeting which they had a week ago today. The letter says:

> At Mr. Kendall's meeting with the President last Wednesday, the latter suggested that the chairman of each committee of the Council having pending reports, discuss his report fully in company with either Mr. Kendall or myself with those members of the administration designated by the President—

and I might explain that this particular letter is signed by Mr. Wetmore Hodges, the assistant to the chairman of the Business Advisory Council for the Department of Commerce. I continue reading—

> that as nearly after the conclusion of that meeting as his engagements permitted, the President would meet with the group for a short discussion of the report; and that at the conclusion of these two meetings, the Council would be at liberty to make such further disposition of the reports as it wished.

Senator GLASS. All right. You may proceed.

Mr. ALDRICH. I submitted that report yesterday to Mr. Eccles, but I have not yet discussed it with the President.

Senator GLASS. Well, if the report is available to Mr. Eccles, why is it not available to this subcommittee, which has under consideration the Eccles banking bill?

Mr. ALDRICH. That is not for me to say, Senator Glass.

Senator GLASS. All right.

Mr. ALDRICH. Now, if I might do so, I should like to read a statement of my views on the bill.

Senator GLASS. All right.

Mr. ALDRICH. I regard this bill as one of the most important measures now before Congress. It is more than a banking bill: it is a credit and currency bill. As such it deserves the most careful consideration not only of bankers but of business men generally. It has even a wider scope, for it touches at vital points every person in the United States. This is true whether the individual works for hire, owns or rents property, has an income, buys, sells, produces, or consumes.

For these reasons I shall not speak simply as a banker, though a thorough understanding of the bill requires a certain amount of banking knowledge, and more than that, a knowledge of the very specialized department of banking which has to do with the business of a bank of issue. I shall discuss the practical as well as the theoretical aspects of the bill and attempt to explain how I think its provisions will work under conditions as they now exist or may exist in the future.

I shall not take up the time of the committee at this point with a discussion of title I, which is designed to perfect the system of Federal deposit insurance, or title III, which makes technical amendments in existing banking laws. To do so would require speaking of matters which are of primary interest to banks, whereas title II is the concern of the whole country. If at the close of my testimony the committee will permit me to do so, I should like to make some observations with respect to title I, which relate especially to certain provisions of that title as it was adopted by the House of Representatives. And I should like also to make some remarks about a provision of title III which has been changed by the House of Representatives.

Senator GLASS. Unhappily we have not had the House bill before us at all. In my view it should have been referred to this subcommittee as soon as it came over to the Senate, but it has not been, and therefore we have only had the Senate bill for discussion.

Mr. ALDRICH. There is one very important change made in the House bill, in title III, that appertains to a matter about which I have already testified before this committee in the past, and I should like to make reference to that, if I may.

Senator GLASS. You can say anything you please.

Senator COUZENS. Mr. Chairman, do you know where the House bill is?

Senator GLASS. The clerk of the committee here may tell you where it is.

The ACTING CLERK OF THE COMMITTEE (Mr. SPARKMAN). I am informed by the chairman that the full committee has not as yet referred the House bill to anyone.

Senator GLASS. It is in the hands of the chairman of the full committee. It should automatically come to this subcommittee, it would seem to me. That is what we are here for, to consider that bill in connection with the Senate bill. But you may proceed, Mr. Aldrich.

Mr. ALDRICH. In the meantime I shall proceed, if the committee pleases, to discuss title II, which greatly changes the theory and practice of Federal Reserve administration, and therefore has a broad bearing on the economic life of the United States.

RESERVE SYSTEM FUNDAMENTALLY CHANGED

According to the newspaper reports of his testimony before this committee, the Governor of the Federal Reserve Board has testified that the changes to the Federal Reserve Act proposed in this bill are urgently needed at the present time. I shall endeavor to show that this testimony is not justified by the facts. Governor Eccles has further testified that the proposals made do not alter the fundamental character of the Federal Reserve System or the original nature of the organization. It will be remembered that the National Reserve Association, as origially proposed by the Monetary Commission, consisted of a privately owned central bank of issue with branches, but that under the leadership of President Wilson and Senator Glass this central bank was converted into the Federal Reserve System of 12 regional Federal Reserve banks with a high degree of individual autonomy, the Federal Reserve Board being set up in order to coordinate their activities. I will endeavor to show that the fundamental character of the Federal Reserve System so created is completely altered by the proposals made in this bill.

Governor Eccles has further testified that there is nothing in this bill which would increase the powers of a political administration over the Federal Reserve Board, and at the same time undertook to defend Government control over the management and operation of the Federal Reserve System by referring to foreign central banks.

He is reported to have said:

There is in the world today no central banking institution, whatever the facts as to stock ownership or the legal provisions of its charter, which is not subject to control by government.

If Mr. Eccles intended to say that in the modern state the Government can alter by constitutional means the charters of central banks, just as it can perform other acts within its constitutional limitations, he is merely reciting a truism. If he meant to imply that the central banks and the governing authorities should take counsel with each other so as to avoid conflicts of policy, or even that the Government is represented, as in the existing organization of the Federal Reserve System, in the administration of many foreign central banks, he also is right. But if he meant to inform the committee that political authorities abroad have the same powers of dictation over their central banks that this bill would provide with respect to the Federal Reserve System, he is wide of the facts.

LIMITED GOVERNMENT CONTROL OF FOREIGN CENTRAL BANKS

The evidence to the contrary is overwhelming. I find, for instance, on page 17 of the authoritative work on Central Banks, by Sir Cecil H. Kisch and W. A. Elkin, the following paragraphs:

* * * Since the war the tide has set strongly against State interference with the functions of a central bank. The Brussels Conference resolution of 1920 in favor of the creation of independent central banks crystallized the general feeling. Resolution III proposed by the Commission on Currency and Exchange and adopted by the Brussels conference, 1920, says, "Banks and especially a bank of issue should be freed from political pressure and should be conducted solely on the lines of prudent finance."

The independence of the bank of issue was a cardinal feature of the League of Nations reconstruction scheme for Austria and Hungary, and the League's financial committee have remained strong advocates of independent central banks, as is apparent from the statutes for the banks of Estonia and Greece, drafted in 1927. Further, in countries where the pre-war legal provisions remain, the actual tendency has been strongly against active political control. The operation of a similar principle is to be discovered in the constitutions prescribed for the central banks recently established in certain South American republics. Central banks have more and more come to be looked upon as analogous to large public trusts and less and less as departments of state.

I shall speak later of the elaborate safeguards set up in the German Reichsbank and the Bank of France against the use of central bank credit for financing the German and French treasuries. In each case the safeguards were the product of grievous experience. In the case of the German Reichsbank the law goes to great lengths to prevent political control. The first words in the Reichsbank law are the following: "The Reichsbank is a bank independent of government control." It is 100 percent privately owned, and up to the present regime its officers were freely elected by the General Council, subject only to confirmation by the President. In Italy, where the central bank is also privately owned, the governor and senior officers are appointed by the directors subject to approval by the Government, and the directors in turn are elected by the shareholders. The directors of the Bank of England, which is privately owned, are elected by the shareholders, and the governor and deputy governor are nominated from their own number by the directors and elected by the shareholders. The directors fix the rate of discount, though the governor can do so on his own authority if an emergency intervenes between meetings of the directors. The Netherlands Bank is privately owned and the directors are elected by the shareholders, who also propose the name of the governor for appointment by the Queen. The Swedish Riksbank, which is an exception to the general rule, is government-owned, and six members of its board of directors are elected by Parliament and one is appointed by the King. In the new Bank of Canada which opened for business early this year, and which is privately owned, the board of directors is elected by the shareholders, and the directors appoint the governor and principal officers for terms of 7 years, subject to the approval of the Government. Short-dated loans may be made to the governments of the Dominion and the Provinces, but in strictly limited amounts and must be repaid by the first quarter of the following year.

THE BILL POTENTIALLY DESPOTIC

These are instances which I have selected more or less at random. It is, of course, impossible to deduce from them a uniform rule universally followed, as Mr. Eccles implied. There is much variation in the procedure of selecting the central banking authorities, in their functions and in the restraints which the law places on the exercise of those functions. But I find nowhere among the central banking organizations abroad so complete political control as the present bill provides for. The members of the Federal Reserve Board are already 100 percent appointed by the President acting solely on his own initiative, subject, of course, to the advice and consent of the Senate. It is to this group, three of whom are directly representative of the political administration, that the bill would grant powers more extensive than are granted to any foreign central bank that I know of—first, the power to force on the Federal Reserve System an indefinite amount of Government obligations of any and all maturities whether purchased directly from the Treasury or not; second, the power to fix rates of discount and interest charged by the Reserve banks; third, the power to fix at will what deposits the member banks shall keep with the Reserve banks; fourth, the power to lower the standards fixed in the law describing the quality of paper the Federal Reserve banks may buy or lend upon; fifth, the power to dilute the currency; and sixth, the power to force the Reserve banks to engage in whatever open-market operations it may decree. This is not liberalizing the Federal Reserve System. It is making it over into an instrument of despotic authority.

In my discussion I shall base most of what I have to say on the Senate bill as it stands, but where the bill recently passed by the House of Representatives deviates from it in important particulars, I shall refer to that bill also.

I. Local Self-Government in Federal Reserve Administration

Section 201 (a) of the Senate bill provides that the governors of the Federal Reserve banks shall be annually appointed and that after each appointment they shall be approved by the Federal Reserve Board as a condition to their taking or retaining office. The governor becomes chairman of the board of directors, and the joint office of Federal Reserve agent and chairman is eliminated. The House bill varies this program somewhat. The governor's first appointment is made subject to the approval of the Reserve Board. He serves out the unexpired term of the chairman whom he succeeds, and then must be appointed and approved again. Thereafter he has to be appointed and approved every 3 years. The effect of the House bill for the immediate future is to make the governor's name come up for approval twice in a little more than 2 years.

EXISTING PLAN PROVIDES BALANCED CONTROL

The change which either bill proposes in the administrative plan of the Federal Reserve System goes much deeper than appears on the surface. It raises the whole question of how far local self-government in the system is to be preserved. One of the outstanding characteristics of the Federal Reserve plan as it has operated since the establishment of the system 20 years ago has been the balance carefully maintained among all the parties at interest. The System has been operated under the joint control of business (including agriculture and industry), the member banks and the Federal Government. These three parties at interest have been equally represented on the boards of directors of the regional banks, having three directors each. Throughout the life of the Reserve banks the men sitting on their boards of directors have consistently represented the highest standards of their respective districts. They have elected the governors and the other officers and have been responsible for the administration of the Reserve banks. The operations and personnel of the Reserve banks have been notably free from political influence or group domination, and the quality of their operation has compared favorably with the best business practice.

In addition to its representation on the boards of the Federal Reserve banks, the Federal Government already has complete control over the personnel of the Federal Reserve Board in Washington, designed primarily as the coordinating agency for the system and the general supervisory authority.

The effect of this arrangement has been to preserve local self-government and at the same time provide for the exercise of Federal authority both to the central coordinating agency and in the Reserve banks themselves.

PRESIDENT WILSON AN ADVOCATE OF THE BALANCED PLAN

President Wilson recognized that a correct balance between local self-government and central authority was one of the outstanding features of the Federal Reserve System. The Governor of the Federal Reserve Board, testifying before this committee the other day, was quoted as putting Mr. Wilson's views in a somewhat different light. Mr. Eccles read the following sentence from President Wilson's message to Congress on June 23, 1913:

> And the control of the system of banking and of issue which our new laws are to set up must be public, not private; must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

It seems to me, after reading that message that Mr. Eccles was a little too selective. I find at least two other parts of it that bear on the point. The first is this:

> It is absolutely imperative that we should give the business men of this country a banking and currency system by means of which they can make use of the freedom of enterprise and of individual initiative which we are about to bestow upon them.

There is no reference here to a centralized authority which would be charged with a mandate to regulate economic life as a whole. Emphasis is placed upon freedom of enterprise and individual initiative. And my next quotation makes it clear that in President Wilson's view it was imperative that the monetary resources of the country must not be concentrated anywhere in a few hands:

> The principles upon which we should act are also clear. The country has sought and seen its path in this matter within the last few years—sees it more clearly now than it ever saw it before—much more clearly than when the last legislative proposals on the subject were made. We must have a currency, not rigid as now, but readily, elastically responsive to sound credit, the expanding and contracting credits of everyday transactions, the normal ebb and flow of personal and corporate dealings. Our banking laws must mobilize reserves; must not permit the concentration anywhere in a few hands of the monetary resources of the country or their use for speculative purposes in such volume as to hinder or impede or stand in the way of other more legitimate, more fruitful uses.

All of this, of course, was some 6 months before the original Federal Reserve Act became law. A year or so later he was able to speak in less general terms, for the text of the act was before him and the Federal Reserve banks were in process of organization. In a letter written on October 17, 1914, to Representative Oscar W. Underwood, then leader of the Democratic majority in the House of Representatives, President Wilson gave his ideas of the balanced system which a few days later was to begin operations. He spoke both of the coordinating Federal authority and of the value of local self-government. After describing the merits of the elastic currency provided by the new system, he went on to say:

> More than that, the power to direct this system of credits is put into the hands of a public board of disinterested officers of the Government itself who can make no money out of anything they do in connection with it. No group of bankers anywhere can get control; no one part of the country can concentrate the advantages and conveniences of the system upon itself for its own selfish advantage. The board can oblige the banks of one region to go to the assistance of the banks of another. The whole resources of the country are mobilized to be employed where they are most needed. I think we are justified in speaking of this as a democracy of credit. Credit is at the disposal of every man who can show energy and assets. Each region of the country is set to study its own needs and opportunities, and the whole country stands by to assist. It is self-government as well as democracy.

This is no plea for centralized authority. On the contrary, it is an accurate forecast of how the Federal Reserve System was to function through the next twenty-odd years, with fair representation of all the parties at interest and arbitrary powers for none. What Mr. Wilson said applies to the Federal Reserve Act as the act stands today. It does not apply to the changes proposed in the bills. They violate in the essential particulars of local self-government and a balanced system the principles which Mr. Wilson set forth.

RUPTURE OF THE BALANCED PLAN

Though section 201 (a) makes few alterations in the form of the Federal Reserve administrative plan, it goes far to change its substance. The abolition of the joint office of Federal Reserve agent and chairman involves no question of principle and may serve somewhat to simplify organization. But the provision that the governor shall be elected frequently and must be approved as frequently by the Federal Reserve Board before he can take office raises the whole question of local self-government in the System. The effect of the change is to make the governor of every Federal Reserve bank, heretofore the appointee solely of a local Reserve bank's board of directors, inescapably responsive to the Federal Reserve Board in Washington.

But the result goes even further and would make the administration of the 12 Federal Reserve banks directly subordinate to the central authority of the Federal Reserve Board. Since the bill makes the officers and employees of the Reserve banks directly responsible to the governors instead of to the directors of the Reserve banks, and the governors in turn are made subject to frequent approval by the Federal Reserve Board, the chain of control is complete. If the impartial operation of the Reserve System is to be maintained, and if the personnel of the Reserve banks is to be kept clear of politics, the independence of the governors must be preserved and they must not be controlled by anybody or any group other than their own boards of directors who themselves are representative of business (including agriculture and industry), the member banks and the Federal Government.

Senator Couzens. Mr. Aldrich, might I interrupt you at this point?

Mr. Aldrich. Yes, sir.

Senator Couzens. Would you define what you mean by "politics"? You refer to it in a number of places and I am somewhat confused about what you mean.

Mr. Aldrich. I am coming in a moment, Senator Couzens, to the fact that under the bill as it stands any member of the Federal Reserve Board is removable at the pleasure of the President. And if that is to be so it would make every member of that Board subject to political pressure. And by "political pressure" I mean the possibility of the desire on the part of an administration to use the credit and currency system of the country for the purpose of political advantage. Also this particular provision I have just referred to opens the door to political patronage.

Senator Couzens. Well, if you are going to cover that later on I will not interrupt you further.

Senator Glass. I might interject there that I have not regarded as seriously as others have the talk about political control, because the President might now remove any member of the Federal Reserve Board he wants to remove. The law does not specifically so provide but it has been decided by the highest court of the land that the President may remove any Federal officer he may appoint.

Mr. ALDRICH. I am going to touch on that in just a moment, too.

Senator COUZENS. Might I also ask at that point if there is not politics in activities of life other than the holding of public office?

Mr. ALDRICH. I do not know exactly what you mean by that question, Senator COUZENS.

Senator COUZENS. Well, I do not quite understand what you mean by "politics." That is the reason why I am confused. If I understand the meaning of "politics" it does not just apply, or at least it has not in the past just applied simply to public officials. And therefore I asked the question: Does not politics apply, in part at least, to other activities of life, I mean other than to holding public office?

Mr. ALDRICH. I suppose it does.

Senator COUZENS. Have you ever had any example of politics playing any part in private business or banking?

Mr. ALDRICH. Not in the sense I am using it here.

Senator COUZENS. Well, in what sense have you seen politics played as applied to private banking or business, I mean differently than you intend it to be applied here?

Mr. ALDRICH. What I intend to mean here is that to place the control of the currency and the credit of the country in the hands of individuals who are subject to removal by an administration, is to place the power in an administration to utilize the system for the purpose of creating a boom at the time when an election approaches.

Senator COUZENS. Well, has not that occurred?

Mr. ALDRICH. The whole purpose of the removal of the System from the control of any group is to prevent any group from playing politics in that sense with the System.

Senator COUZENS. Have you ever found any other group playing politics with business, I mean other than public business?

Mr. ALDRICH. I could not say about that, or at least I could not name an instance where any group has used the Federal Reserve System for political purposes.

Senator COUZENS. How do you interpret that provision of the Constitution which says that Congress must issue money and regulate the value thereof? What is your interpretation of that language? I have always been anxious to have some competent banker to tell me his interpretation of that language.

Mr. ALDRICH. My own interpretation of that is that it means exactly what it says, that the Congress has the power to issue money and to fix the value thereof.

Senator GLASS. You mean to coin money.

Mr. ALDRICH. Yes; to coin money.

Senator COUZENS. To coin money and to fix the value of it.

Mr. ALDRICH. It means exactly that.

Senator COUZENS. Have you any idea how the Congress should proceed to coin money and fix the value thereof?

Mr. ALDRICH. Of course that provision of the Constitution has been construed over the course of the years to widen the powers of the Congress, and to give to the Congress a power which is broader than the express provision of the Constitution. Of course, I believe, and I am going to touch upon that in just a moment, that the question of the control of the credit and currency system of the country is a matter of congressional jurisdiction.

Senator COUZENS. You say you do believe that?

Mr. ALDRICH. Yes; I do believe that.

Senator COUZENS. But it appears that you differ as to the method, is that right?

Mr. ALDRICH. I differ from these bills, absolutely yes. And I am going to make a specific recommendation on that.

Senator COUZENS. All right. I will not interrupt you further at this time.

Senator GLASS. As a matter of fact, has not the Congress all these years provided for the coining of money and the fixing of the value thereof?

Mr. ALDRICH. Absolutely.

Senator GLASS. Up to the present time. Even when it reduced the value of the gold content of the dollar to approximately 13 grains.

Mr. ALDRICH. That is correct.

Senator COUZENS. Of course the Chairman's comment there would imply that the only method of fixing the value would be on the basis of gold and not on the value of anything else. And that is wherein our difficulty arises, because while we provide for the number of grains as the content of the dollar, that is a very small factor in fixing the value of the dollar, or in fixing the value of the coins that we authorize the use of.

Senator GLASS. But the Congress itself has related the grain content of the gold dollar to all the currency it has ever issued.

Mr. ALDRICH. I think it is like so many other provisions of the Constitution, that at the time it was written it covered a situation which was perfectly well known and which was a perfectly simple situation, but it has been construed in the course of the years to cover situations which are a great deal more complicated but which grow out of the currency and credit problems of the country. That is just the doctrine of constitutional construction that has enabled the Supreme Court of the United States to cover into that phrase the creation of the Federal Reserve System as a matter of fact. But I should like to go into that rather more fully when I get to the question of——

Senator COUZENS (interposing). All right. I will not interrupt you further at this time.

Mr. ALDRICH. The existing law—section 4 of the Federal Reserve Act—provides that "every Federal Reserve bank shall be conducted under the supervision and control of a board of directors" and that the latter "shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law." The high technical standard of work done by the personnel of the Federal Reserve banks testifies sufficiently to the success of this arrangement. I believe it to be a backward step to diminish the authority of these men and to relieve them of responsibilities which they have fully lived up to.

The bill in other sections which I shall presently discuss adds greatly to the powers to be exercised by the Federal Reserve Board and diminishes certain of the powers heretofore exercised by the directors of the Reserve banks. At the same time it gives the governors of the Reserve banks, or certain of them, at least advisory participation in the formulation of policies which the Reserve banks would be obliged to carry out irrespective of any opinion which the directors may have with regard to them. If the governors are independent, they will bring to their work supplementary judgment adequately reflecting the opinion of the local directors, and thereby afford the country additional protection against the adoption and enforcement of hasty or experimental policies.

It should be added that the Reserve Board's authority seems already sufficient to deal with misconduct in office, for it has the power under section 11 of the present act to suspend or remove any officer of a Reserve bank upon stating the cause in writing.

RECOMMENDATIONS ON SECTION 201 (A)

I accordingly recommend that section 201 (a) of the bill be changed so that the election of a governor of a Federal Reserve bank be made subject to the approval of the Federal Reserve Board only once and that no reapproval be required. Corresponding changes should be made in the bill with respect to the vice governors of Federal Reserve banks.

I also recommend that the date when the other proposed changes shall become effective, including the abolition of the joint office of Federal Reserve agent and chairman, be not "90 days after the enactment of the act", as the bill provides, but as of the first of the next calendar year. This will make the change to the new plan coincide with the expiration of the terms of office of three directors in each Federal Reserve bank, thereby minimizing the disruption of the existing organization.

II. The Federal Reserve Board

Section 203 of the Senate bill and the same section of the House bill deal specifically with the Federal Reserve Board. Each leaves the total membership of eight as provided in the present law. Each changes the description of the qualifications which the President shall have in mind in selecting the six appointive members. The Senate bill (but not the House bill) raises the compensation of the members of the Board, and provides for pay after retirement. Each makes the designation of the Governor terminable upon order by the President, but under the House bill a governor whose designation is withdrawn can continue on as a member of the Board until his term expires.

I understand that one of the reasons advanced for the foregoing amendments provided for in the Senate bill is to establish firmly the prestige of the Federal Reserve Board. I heartily endorse that purpose, for I believe that the members of the Board should hold a position among bankers corresponding to that of the Justices of the Supreme Court among lawyers.

In setting forth the qualifications which the President shall have in mind in selecting persons for membership on the Federal Reserve Board, the existing law says that—

> 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 bill omits this clause and in substitution therefor it prescribes that—

> the President shall choose persons well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies.

Senator GLASS. The President could select all the members from New York, could he not?

Mr. ALDRICH. That is correct.

Senator GLASS. All right. You may continue.

Mr. ALDRICH. It may be true that the present law stresses too much the strictly representative principle in the selection of members of the Federal Reserve Board. Since the Board is a national body, its members should frame their policies for the benefit of the Nation as a whole rather than for the advantage of any particular section or group. Yet this change in the text of the act cannot be appraised independently of other sections in the bill. Accordingly, I shall reserve my comments upon it until a later point in my discussion when I hope to draw together the various provisions granting new powers to the Federal Reserve Board. I shall then be able to consider this clause in the light of the bill as a whole.

For the moment I suggest merely that the experience qualifications be made somewhat more explicit since the business of the Federal Reserve Board relates in large part to technical banking matters. It seems entirely in order that some members of the Board should have had practical experience in the administration of Federal Reserve banks or of member banks. If the Board has among its members at least two men who are familiar in a practical way with the problems with which the Board is daily confronted, much time will be saved and its efficiency will be conserved.

"A SUPREME COURT OF BANKING"

I now come to a phase of the existing law which I think is open to question and which each of the present bills continues. If either bill is to achieve the purpose of making the Federal Reserve Board a body of the highest prestige, corresponding to the Supreme Court, its independence from political control must be assured. The six appointive members, as the law now stands, are in fact removable at the pleasure of the President. Until 2 years ago the law provided that they should serve for fixed terms "unless sooner removed for cause by the President." This provision was eliminated by the Banking Act of 1933.

I believe it is vital that the bill should provide that members of the Federal Reserve Board should serve for fixed terms and should be removable only for cause and after notice and hearing.

I realize that the case of *Myers* v. *United States*, 272 U. S. 52, decided by the Supreme Court of the United States in 1926, raises serious questions as to whether the Constitution permits Congress to place any limit upon the power of the President to remove from office any officer appointed with the advice and consent of the Senate, and unless that case is distinguished by the Supreme Court of the United States from the *Humphrey case*, now pending before that Court, the Court in effect may hold that Congress has no constitutional right to place any limitation upon the power of the President to remove any member of the Federal Reserve Board at any time and for any reason he sees fit. If the Court should so decide, the possibility of removing political pressure from the members of the Federal Reserve Board would be terminated. This, it seems to me, constitutes a very serious reason why action upon this bill should be postponed until after the decision of the Supreme Court in the *Humphrey case* has been rendered.

Now, if I might, Mr. Chairman, I should just like to take a moment to go into that question of constitutionality.

Senator GLASS. You may.

Mr. ALDRICH. I have before me and should like to call the attention of the subcommittee to the fact that the act adopted June 10, 1921, providing for the office of Comptroller General and Assistant Comptroller General, has this provision, which was adopted after lengthy debate in the House, and which debate I have here and would be very glad to file with the subcommittee if you wish it; but this provides that:

> Except as hereinafter provided in this section, the Comptroller General and the Assistant Comptroller General shall hold office for 15 years. The Comptroller General shall not be eligible for reappointment. The Comptroller General or the Assistant Comptroller General may be removed at any time by joint resolution of Congress after notice and hearing when, in the judgment of Congress, the Comptroller General or Assistant Comptroller General has become permanently incapacitated or has been inefficient, or guilty of neglect of duty, or of malfeasance in office, or of any felony or conduct involving moral turpitude, and for no other cause and no other manner except by impeachment.

The point is this, that in the debate which took place at the time of the adoption of that resolution the whole question of removal of officers appointed by the President came up, and it was pointed out in that debate, and it is also pointed out in the argument in the *Humphrey case*—and the Supreme Court in deciding that case may make clear its position—that in the cases heretofore decided by the Supreme Court in connection with the removal of officers appointed by the President they have been administrative officers carrying out the executive powers of the President. And they have made a distinction where the officer whose removal from office has been attempted is carrying out an administrative function in connection with power which is vested in Congress by the Constitution. In other words, that the Congress may have the constitutional power to limit the removal of an officer who is carrying out a constitutional power vested in the Congress.

And that is the very point, Senator Couzens, that would justify that kind of limitation upon the power of a President to remove an officer of the Federal Reserve Board, because that officer is carrying out a constitutional power vested in the Congress. And the *Humphrey case* I imagine you all will remember is the case where the President removed a Federal Trade Commissioner although the Federal Trade Commission Act provided that Federal Trade Commissioners should not be removed except for cause. And the President removed a member without specifying a cause.

Now, that *Humphrey case* was argued before the Supreme Court of the United States on the first of May. Questions were asked by members of the Supreme Court as to whether the Government went so far as to contend that the President could remove an Interstate Commerce Commissioner because such Commissioner refused to reduce railroad rates at the request of the President. And of course that same question is involved in connection with the Federal Reserve Board. I think the particular point you raise, Senator Couzens, is a point which would justify a limitation of the power of the President to remove a member of the Federal Reserve Board.

Senator GLASS. Well, I will say quite frankly that I do not think that question is one of vital importance; far from it. The President for 20 years has had authority to remove members of the Federal Reserve Board and never has removed one of them. I think it is more important for him to appoint good members than to have the power of removal.

Mr. ALDRICH. I agree with the Senator. On the other hand, the Federal Reserve Act, section 10, prior to 1933, contained this provision with regard to appointment and tenure of office of members of the Federal Reserve Board:

> One shall be designated by the President to serve for two, one for four, one for six, one for eight, and one for ten years, and thereafter each member so appointed shall serve for a term of ten years unless sooner removed for cause by the President.

Senator GLASS. Yes; and I must have been asleep when that was eliminated from the act. I have no recollection of it.

Mr. ALDRICH. I think the elimination of that clause is as good an instance of the danger of hasty legislation as one could possibly imagine. As a matter of fact, in talking to Governor Eccles yesterday I found that he did not know it had been eliminated. And I do not believe anybody in the Federal Reserve Board knew it.

Senator GLASS. I do not know that it was due to hasty action. It might have been due to covert action. I never heard of it until the other day.

Mr. ALDRICH. And as a matter of fact the whole discussion of this bill in the House has been predicated upon the assumption that the President did not have the power to remove a member of the Federal Reserve Board except for cause.

Senator GLASS. All right. You may proceed with your statement, Mr. Aldrich.

Mr. ALDRICH (continuing):

A SMALLER BOARD DESIRABLE

Under both the Senate and House bills the Federal Reserve Board is continued as a body of eight members, including the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members. They fix more closely than heretofore the responsibility of the Governor to the Executive. In consequence, three members of the board become directly representative of whatever administration is in power. I do not question the principle that the fiscal policy of the Federal Government should be closely coordinated with the broader policy of the Federal Reserve System. Unless the Treasury and the Reserve System work in harmony, each is able to counteract or perhaps even nullify the policy of the other. I think, however, that this unity of policy can be adequately assured through the person of the Governor of the Reserve Board. I would even go so far as to suggest that his term might be made to coincide with that of the administration under which he was appointed. In making that suggestion I merely recognize a tendency which has become more and more marked in the System even under the present law.

Since a governor so appointed is able adequately to represent prevailing Treasury and administration policies, the reason disappears for retaining the Secretary of the Treasury and the Comptroller of the Currency as members of the Federal Reserve Board. The Reserve

Board would become less subject to political pressure and less disposed to use its powers for financing budget deficits if these two ex-officio memberships are terminated. If the powers of the Federal Reserve Board are to be in any wise enlarged, the need for eliminating these memberships becomes correspondingly more important.

I propose also that the total membership of the Federal Reserve Board should be reduced to five. There is at present an even number of members and on certain critical occasions the vote of the Board has been evenly divided, resulting in inaction and indecision. Accordingly in addition to eliminating the Secretary of the Treasury and the Comptroller of the Currency, one of the appointive memberships should be allowed to lapse, thereby bringing the total down to five.

RECOMMENDATIONS ON SECTION 203

My explicit recommendations are the following:

(*a*) Section 203 (1) should be amended so that at least two of the appointive members of the Federal Reserve Board shall be selected from persons of tested experience as executives either of Federal Reserve banks or of member banks.

(*b*) Section 203 (2) should be amended so that any member of the Federal Reserve Board, regardless of age, whose term expires after a service of at least 5 years and who is not reappointed, would be entitled to a pension on the same basis as if he had reached the retirement age; that is, an annual pension of $1,000 for each year of service up to 12. The provisions for increasing compensation, eliminated in the House bill, should also be restored.

(c) Section 10 of the existing act should be amended by providing that the members of the Federal Reserve Board shall be removable, prior to the expiration of their respective terms, only for cause and after notice and hearing.

(*d*) The total membership of the Federal Reserve Board should be reduced from 8 to 5, by eliminating the designation of the Secretary of the Treasury and the Comptroller of the Currency as ex-officio members, and by reducing the appointive members from 6 to 5. With the Board thus reduced, Section 203 (3) might be amended so as to make the Governor's term identical with that of the administration under which he was appointed; but he should not be removable except for cause, as in the case of other appointive members of the Board.

III. The Federal Open Market Committee

Section 205 of the Senate bill provides for the creation of a committee of 5 members, serving for a calendar year, to be composed of the Governor of the Federal Reserve Board, who shall be chairman, 2 members of the Board whom the Board itself shall select, and 2 governors of Federal Reserve banks selected by the governors of all Federal Reserve banks. This committee is to have the power to frame open-market policies which the Federal Reserve banks will have no choice but to put into effect. It is also to have the duty of making recommendations to the Federal Reserve Board regarding the discount rates of the Federal Reserve banks.

The House bill varies this arrangement in important particulars. The Federal Open Market Committee as such disappears and in

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place of it an Open Market Advisory Committee is created, consisting of 5 "representatives" of the Federal Reserve banks, selected annually by the governors of the 12 Reserve banks. The committee thus created is to have no authority whatever, beyond that of making recommendations which the Federal Reserve Board can take or not as it chooses. The Board, on the contrary, can impose its will on the Reserve banks, though it must consult the Advisory Committee before it makes any changes on its own initiative—I quote the language of the bill—

in the open-market policy, in the rates of interest or discount to be charged by the Federal Reserve banks, or in the reserve balances required to be maintained by member banks.

Senator GLASS. That Board could have a junket to Washington occasionally, could it not?

Mr. ALDRICH. I believe so.

Senator GLASS. All right.

PROPOSED CONCENTRATION OF POWER

Mr. ALDRICH (continuing). The existing open-market procedure is the outgrowth of experience. For several years prior to 1933 there was an open-market committee upon which the various Reserve banks, or such of them as desired to participate, were represented. It was the group through whom Reserve bank purchases of bankers' acceptances and Government obligations were organized and distributed. The existence of the committee was recognized in the Banking Act of 1933 and it was made a formal body. Each of the 12 Reserve banks by vote of its board of directors selected a member. There was no Reserve Board representation on the committee, though the members of the Board were authorized to attend the meetings if they desired. The Federal Reserve Board retained the power to issue regulations concerning open-market transactions and could approve or disapprove of policies initiated. But the directors of any local Federal Reserve bank could in their discretion decide not to participate in open-market operations.

The change now proposed is complete. Whereas under the existing law the Reserve banks themselves have the power to initiate open-market operations subject to approval of the Federal Reserve Board, the Senate bill would give them no authority over them save for the presence on the committee of a two-to-three minority in the persons of two Reserve bank governors who in turn must depend upon the Board for their continuance in office beyond a year. Under the House bill this remnant of authority is further reduced, and the Reserve banks are left in the position of advisers only. Further, under the existing law any Reserve bank can decline to engage in open-market operations, whereas under either bill they would have no choice but to follow the instructions of the central authority.

The effect is to concentrate in a majority of the committee, or in a majority of the Federal Reserve Board, as the case may be, the right to dictate to the Federal Reserve banks when they shall buy or sell acceptances or Government obligations and in what amounts, with no discretion whatever remaining to them or to their boards of directors. Exclusive authority thus passes into the hands of men dependent for their positions upon whatever political administration is in power, and three of whom are directly representative of it. I refer, of course, to the Governor of the Federal Reserve Board himself, the Secretary of the Treasury, and the Comptroller of the Currency.

The function of open-market operations in the Reserve System has been much distorted recently in theoretical discussions which appear to have received a certain amount of official credence. In some respects their influence has been magnified far beyond what is warranted by actual experience. In other respects their influence has been minimized or overlooked entirely. I refer here to the vast consequences which may follow from the purchase of Government obligations by the Reserve banks directly from the Treasury, a type of transaction which falls within the meaning of "open-market operations" as commonly understood in the Reserve System.

OPEN-MARKET OPERATIONS AND CREDIT CONTROL

In a published defense of the bill, Governor Eccles made an issue of the fact that open-market operations are an instrument of Federal Reserve policy. He said:

> By these operations reserves may be given to or taken away from member banks; and it is on these reserves that deposits are based. It is not too much to say that the power to control open-market operations is the power to control the expansion and contraction of bank credit, and thus in large measure to control the country's supply of money.

It is, of course, true that the power to buy and sell Government obligations and acceptances in the market often furnishes a useful instrument of Federal Reserve policy, but I do not find that in practical operations actually put through in the last 5 years it has given control of bank credit. The most that can be said is that open-market operations may influence but not necessarily control bank credit. Whether they do or not and to what extent depend upon conditions as they prevail at the time the operations are put through. Far from controlling bank credit there are recent instances which go to show that open-market operations have resulted in the reserve banks losing the control they previously had possessed over bank credit. Moreover, under conditions as they exist at present, operations conducted in the open market would have very little effect if designed to expand credit; they could have substantial effect only on the downward side; that is, to reduce the volume of credit and raise interest rates.

In order to illustrate from actual experience, I think it would be of interest to refer to operations which the Reserve System has conducted in the last 5 or 6 years under the authority it has had and now possesses.

Between October 1929, for instance, and March 1930, the Reserve bank holdings of Government obligations rose about $400,000,000 to a total of about $540,000,000. Simultaneously the member banks retired debt at the Reserve banks by about $600,000,000. This operation was fairly successful mainly because the member banks were in debt at the Reserve banks. The principal effect was to enable the member banks to pay off at the Reserve banks and there was relief from strain in the money market which resulted in a temporary boom in the stock market.

In March 1932 the Reserve banks undertook the use of open-market operations in an effort to combat the depression. This was after the passage of the Glass-Steagall bill in February of that year, which gave the Reserve banks temporary authority to offer Government obligations as security for Federal Reserve notes. At the beginning of the operation the Reserve banks held about $800,000,000 of Government obligations. By the end of the year they had increased these holdings to upward of $1,800,000,000. The chief effect was to reduce the bill holdings of the Reserve banks to almost nothing and to bring down the member banks' borrowings to less than $300,000,000 for the entire System. Though the operation appears to have been successful in checking the decline of bank credit then in progress, it did not stimulate its growth.

In May 1933 a further extension of open-market operations was undertaken. In the 6 months up to November a further $600,000,000 of Government obligations were purchased and the total of $2,430, 000,000 was reached, a level at which they have since remained. Member-bank borrowings again declined, but the expansion of bank credit was slight as compared with the facilities afforded.

In giving the foregoing instances I should make it clear that I have left out of account other developments of great importance such as the losses and gains in gold, the effects of the gold-buying policy, and so on, which have exerted influences on the member banks' reserves similar to those which open-market operations tend to produce. The point to be observed is that beyond an initial and rather gentle influence, open-market operations carried on under such conditions as have prevailed, have not succeeded in increasing proportionately the volume of bank credit. This has been true because influences of vast importance, some practical and some psychological, which have affected the business public as a whole, have restrained their effect.

One of the results of past open-market operations which we still have with us is the additional reserves over and above statutory requirements which the member banks have on deposit at the Federal Reserve banks. In February of this year their reserves were about $2,300,000,000 above requirements, quite the largest excess on record. The excess is now around $2,200,000,000. I do not mean to imply that this vast excess is due only to open-market operations; an even more important factor in their growth appears to have been the inflow of gold during the past year. But the point I want to emphasize is that this margin is surely enough for the stimulation of credit, if credit is to be stimulated that way. It is hard to see how the excess reserves, if further increased by open-market operations, would have any substantial influence upon the growth of banking credit.

I can well imagine, however, that results would follow from an operation if now conducted in the reverse direction, that is, if the Federal Reserve banks should sell to the market any considerable part of their holdings of Government obligations. Such action would, of course, draw down the member banks' excess reserves and tend to raise interest rates. Of course, any such operation seems out of the question at ths time, in view of the present financial policies of the Government.

I deduce from the foregoing that the possibility of effective use of large scale open-market operations on the side of purchases of securities lies more or less remotely in the future, and that the probability of such operations being undertaken on the side of sales of securities is extremely remote.

OPEN MARKET OPERATIONS AND BUDGETARY DEFICITS

I now come to a feature of the bill which must cause any thoughtful person great concern, though I have seen no reference to it in any official discussions of the bill. As I have already indicated, the proposed powers are broad enough to permit the central authorities—whether the Federal Reserve Board under the House bill or the Federal Open Market Committee under the Senate bill—to compel the Federal Reserve banks to purchase Government obligations directly from the Treasury. When I speak of such transactions, I should make it clear that I am not referring here to the short-term advances or temporary overdrafts such as the Reserve banks commonly grant to the Treasury over maturity and tax dates. I am referring to the use of the Reserve banks as a means for financing the Treasury.

The machinery thus provided in the bill corresponds closely with the machinery which was utilized at the time of the German inflation and the French inflation with most serious consequences to business life and the welfare of the people. In each case the central bank bought bills directly from the Treasury, thereby providing funds as and when desired. In each case, also, the Treasury acted, as it no doubt supposed at the time, according to the highest sense of duty. The heads of the central banks concerned felt that they had no choice but to comply. Similar motives with even more efficient machinery such as that now proposed can produce similar results.

ABUSE OF BANK CREDIT IN GERMANY

I think it worth while to read at this point a paragraph from the book of Prof. James W. Angell, of Columbia, who went to Germany after stabilization and wrote a work entitled "The Recovery of Germany", published by the Yale University Press for the Council on Foreign Relations. It is one of many similar paragraphs obtainable from a multitude of sources. Professor Angell says on page 29:

> * * * The fundamental difficulty was the state of the Reich finances. In the 5 years from 1919 to 1923 the Government's receipts, measured in gold values, never came anywhere near to equaling its expenditures, and for the period, as a whole, averaged only about 25 percent of them. This state of chronic deficit was again due to the waves of exchange depreciation and the consequent further increases in prices. However adequate a given tax measure might have seemed at the time it was passed, weeks or months necessarily elapsed before the receipts began to come in; and in the meantime a further depreciation of the exchanges had usually pushed prices and wages still higher, and with them most of the Government's expenditures. A deficit, of course, resulted. To meet it the Government had to resort to further borrowing which led to the printing of more notes and the vicious circle of inflation was thus renewed. Moreover, despite the unceasing growth in the note issue, the rise in prices was even more rapid, and the gold value of the total currency circulation fell to absurdly low figures—at one time to less than 1 percent of the pre-war level. An acute currency shortage resulted, and to keep the country's economic life going at all still more notes had to be printed. It should be observed, however, that the Government did not itself print notes, except for the negligible volume of the Reichskassenscheine. After the end of the war the deficits in the budget were met chiefly by floating short-term treasury loans of various sorts. Of these an increasingly large proportion were discounted at the Reichsbank in exchange for Reichsbank notes, and this produced the principal increases in the currency circulation.

I think this paragraph of Professor Angell's illustrates pretty clearly how convenient and how fatal it is to finance Treasury deficits with central bank credit.

RESTRICTIONS UNDER NEW GERMAN BANK LAW

When the German inflation was finally stopped, the gold mark was worth a million million paper marks. In order to prevent a repetition, the Germans in their new bank law proceeded to block up the channels between the Treasury and the central bank. The new Reichsbank law was passed as part of the Dawes Plan of 1924 which was drawn up, as the committee will remember, with American advice and assistance. Effective steps were taken to divorce the bank and its officials from the control of the political authorities and severe limitations upon lending to the Treasury were written into it. The latter were for the protection of the entire population against devastating inflation, and have had unvarying popular support from that time to the present because the people as a whole have learned from experience what disaster inflation inescapably causes. Under the law of 1924, purchases of Treasury bills and the amount loaned upon them could not together exceed a total of 400,000,000 reichsmarks (then about $100,000,000). Latterly the Reichsbank has obtained authority similar to that which the Reserve banks now have to buy bonds of the Reich in the market but, as the law explicitly states, "for the purpose of regulating the money market." Otherwise it cannot buy Government obligations beyond the limits originally set.

THE FRENCH EXPERIENCE

The lesson to be learned from the French handling of their post-inflation legislation is similar. When the French stabilized in 1928, they like the Germans were careful to avoid a repetition of the conditions which led up to the inflation and tapped off about 80 percent of the gold value of their currency. The Bank of France makes no advances to the Government over the amount of a fixed loan of 3,200,000,000 francs which it agreed to hold at the time of stabilization and has held ever since. The law gives it no authority to engage even in open-market operations except as regards the so-called "Caisse bills" (bills of the Caisse d'Amortissement) issued to it in 1928 in return for certain bonds of the Republic held at the time of stabilization. The bank can sell these Caisse bills to the market and buy them back again. Because of the failure of the law to provide for open-market operations of the usual sort, the Bank of France declined some months ago to buy short Treasury bills from the market as proposed by the present Premier, M. Flandin, and the governor of the bank was dismissed on that issue. Under the agreement subsequently effected with the general council of the bank and the new governor, the Bank of France is now prepared to grant advances, not directly to the Government but to the banks on the security of Treasury bills. These advances can run for only 30 days and are restricted in amount to not more than 80 percent of the nominal value of the Treasury bills pledged. Even with this liberalized procedure the Bank of France still makes no advances directly to the French Treasury.

I would repeat the point: Both France and Germany suffered ruinously from inflation and when they revised their banking laws they undertook to prevent a repetition. The changes made recently in their respective central banking procedures are very moderate and in neither case grant anything that the Federal Reserve banks have not had for years. Law and practice still prevent the very things which title II of the present bill freely provides for. Indeed, title II goes even further and makes such transactions compulsory if a majority of the Federal Open Market Committee, or as the case may be, the Federal Reserve Board, so decides.

The use for any length of time of central bank credit to finance the Public Treasury has never succeeded. It has always failed with most serious consequences to the population as a whole; and those who have suffered most are the laboring and middle classes. I see no reason, granted sound Treasury policy, why any such facilities as I have been discussing should be even temporarily useful in the United States. There is therefore no occasion to grant an unlimited authority which can only have an unsettling effect upon the public and business mind because of the dangers inherent in its use.

EXTENSION OF RESERVE BOARD POWER OVER RATE CHANGES

So much for open-market operations as such. I now want to refer to a matter which is set forth clearly in the House bill and is implicit in the Senate bill. This is the power granted to the Federal Reserve Board to make changes on its own initiative in the rates of interest or discount to be charged by the Federal Reserve banks.

The Federal Reserve Act now provides in section 13 that rates of interest charged on advances to member banks, and in section 14 that rates of discount on paper purchased in the market, shall be established by the Federal Reserve banks "subject to the review and determination of the Federal Reserve Board." The establishment of interest and discount rates by the Federal Reserve banks has been one of the most responsible functions of their respective boards of directors. Obviously, the exercise of this power ordinarily involves directly and inescapably the relations of each Federal Reserve bank with the banks in its own district, and is therefore an important element in the whole issue of local self-government.

Throughout the history of the Reserve System, with only two or three exceptions, the regional boards of directors have acted first in making rate changes, and the Federal Reserve Board second. This sequence seems a rational compliance with the terms of the act, since the Reserve banks are charged with "establishing" the rate, "subject to the review and determination of the Federal Reserve Board." I realize that the Federal Reserve Board itself has not always shared this view, and in one notable case at least has fixed a rate against the opposition of a Federal Reserve bank's board of directors. The House bill clearly, and the Senate bill implicitly, now seek to resolve this question of initiative in favor of the Federal Reserve Board.

Senator GLASS. I might state right there, Mr. Aldrich, that my information is the Federal Reserve Board so intensely regretted its action in that case that it eliminated it from the record.

Senator McADOO. Is that the *Chicago case*?

Senator GLASS. Yes.

Mr. ALDRICH. Yes; the *Chicago case* in 1927.

Senator GLASS. All right.

Mr. ALDRICH. To the outside observer this seems a strange solution, for on the whole the record of the Reserve banks has been better in the matter of rate changes than the record of the Federal Reserve

Board. I refer especially to the long difference of opinion between certain of the Reserve banks and the Federal Reserve Board over the proposed increase of discount rates in the first half of 1929 as a means for curbing the rising tide of stock-market speculation. The rate at the New York Reserve bank remained unchanged from July 13, 1928, until August 9, 1929, notwithstanding the vast speculation then in progress. From the beginning of 1929 onward, the directors of the New York Reserve bank, as well, I believe, as the directors of certain other Reserve banks, voted consistently to raise their rates, and as consistently the Federal Reserve Board failed to determine them. Now, that is a matter of record, and if this subcommittee wanted to do it it would be possible to see the record.

Senator GLASS. We know about it.

Senator MCADOO. I should be glad if the instances might be cited for the record.

Mr. ALDRICH. You would have to get those from the Federal Reserve Board but it is a matter of record.

Senator MCADOO. Do you mean it is a matter of record with the Federal Reserve Board?

Mr. ALDRICH. Yes.

Senator MCADOO. All right.

Mr. ALDRICH. This long postponement had immeasurable consequences both on the height of the speculative tide and the extent of the collapse and has come to be regarded as quite the most conspicuous failure of the Federal Reserve System since its inception.

The implications of the present law that the directors of the regional banks should have the power to initiate rate changes seem indisputably correct. These are men who represent all the parties at interest, including that of the Federal Government; they have consistently represented the highest standards of their respective communities, and they are close to practical affairs.

The proposed change in the law looks precisely in the wrong direction. The House bill goes even so far, I think, as to make the establishment of the rate by the Reserve banks a ministerial act only and leaves this whole delicate and gravely responsible matter exclusively in the hands of the Federal Reserve Board, all the members of which depend for their positions upon whatever political administration is in power.

Senator COUZENS. Might I ask you at that point: Have you any reason in your mind for the Federal Reserve Board failing to act in 1929 when these other banks were recommending a raise in the rediscount rates?

Mr. ALDRICH. I would hesitate to express any opinion about that, but it has been the general experience that it is very difficult for any body of men to impose restraints on what may appear to be an existing prosperity by raising the discount rates or anything of that kind; to put a brake on speculative power. It takes a great deal of courage and independence.

Senator COUZENS. Would you suggest that that was the result of political control?

Mr. ALDRICH. I would not, no. I do not know enough about it to know. I definitely would not——

Senator GLASS (interposing). I think, Senator Couzens, the reason, or at least as I understood it at the time because the matter was for some reason brought to my attention, was that speculation had proceeded to such an extent that a rise in the rediscount rate could scarcely have had any influence on the situation. In other words, people buying stocks on margin with the expectation of making—oh, all the way from 25 to 100 percent upon their investment, could not be deterred by a psychological increase of 1 or 2 percent in the rediscount rate——

Senator COUZENS (interposing). Well, as a matter of fact——

Senator GLASS (continuing). On the other hand, the contention of the regional Reserve bank directors was that the situation was such that should the rediscount rate be raised progressively and opportunely in the matter of time, it would put banks and speculators on notice that money was going to be dearer and not too cheap.

Senator MCADOO. Is it not a fact though that there was a vast amount of loanable funds in New York not subject to the control of the board of directors of the Federal Reserve banks and which could not be influenced directly by the Federal Reserve Board?

Mr. ALDRICH. I understand that that was a part of the reason, but the——

Senator MCADOO (interposing). That that was the situation at that time?

Mr. ALDRICH. Yes. There was a tremendous amount of money available in the market which was loaned for the account of others. That of course is the very thing that Senator Glass had in mind in drafting the Banking Act of 1933, to prevent that.

Senator GLASS. Precisely.

Mr. ALDRICH. And it was the very situation that existed at that time that those provisions were put in the Banking Act of 1933.

Senator MCADOO. And those funds not only come from private individuals and corporations in this country, but also come from other countries.

Senator GLASS. Yes, those funds in part come from abroad.

Senator MCADOO. Yes. They come from France and England and Canada and you cannot control that by the rediscount rate.

Mr. ALDRICH. That is true.

Senator GLASS. That is true, but the record also shows that the facilities of Federal Reserve banks were employed to a tremendous extent in the encouragement of that sort of speculation.

Mr. ALDRICH. But, Senator Glass, as you know better than I do, the Banking Act of 1933 is so designed as to meet both of those things.

Senator GLASS. I know it does, but this bill does not.

Mr. ALDRICH. Well, it does this——

Senator GLASS (continuing). Of course it does not.

Mr. ALDRICH. As a matter of fact, as the situation stands today, with these enormous excess reserves, the Federal Reserve Board and nobody else can accomplish anything by the discount rate. They are so much out of touch with the market that a change in the rates, I mean a rise in the discount rate, would have no effect whatever.

Senator GLASS. None whatever.

Senator COUZENS. I still want to go back to the question of political control, which interests me so much, and that is, that in the boom of 1929, when these Reserve banks were advocating a rise in discount rates, the mere contact of any administration here with the Federal

Reserve Board would have been an influence against any act which would help to boost the boom; is not that true?

Mr. ALDRICH. I should say that is true.

Senator COUZENS. It is a practical question. So I do not get so stirred up about this mere technical assertion of political control; because the Senator from Virginia and the rest of the Senators on the subcommittee know just as well as I do that you can have political control whether you have political domination or not.

Senator GLASS. The Senator from Virginia has said the same thing.

Senator COUZENS. Yes. So that when you talk about political control of the Federal Reserve Board or political control of anything else, as a matter of fact it does not have to be on the statute books in order to give political control. You can have political control of all kinds without a word on the statute books.

Mr. ALDRICH. Well, Senator Couzens, I think the ideal which has been most desired is to create a body in the Federal Reserve Board which would be similar to the Supreme Court of the United States and would be equally independent of *any* control. Let us put it that way. I do not think it is necessary to put the accent on the word "political."

Senator GLASS. Let me say right there for the record that in the original Federal Reserve Act there was intended to be a measure of political influence. And that is why we insisted upon putting the Secretary of the Treasury and the Comptroller of the Currency on the Board. When I say "political influence" I do not mean partisan political influence. I mean that a considered public opinion might find some expression. So that if we should have a Federal Reserve Board that might be flagrantly disregarding the public judgment and there should be a change of administration, why, the action of that Board might be in some sense controlled by the votes of the Secretary of the Treasury appointed by the new President and by the Comptroller of the Currency. So that that measure of public control I would not call political control in the sense that it was partisan, either Democratic or Republican or Progressive or Coughlin or whatever you might call it.

Senator COUZENS. I was not speaking of that kind of control. I know when it comes to financial matters it does not make much difference whether you are a Democrat or a Republican or a Coughlinite, there is no failure of their getting together when they have the same objective. So it does not make much difference whether you call it political control or partisan control or what other kind of control, and there is no use of our getting excited about mere words in the bill, because we cannot write statutes that will prevent this kind of control or influence. I do not get disturbed about these matters, but I was talking about Mr. Aldrich's words here; I do not get disturbed about those words because I know what goes on regardless of mere words which may appear in a statute.

Senator GLASS. You may proceed.

Mr. ALDRICH (continuing).

RECOMMENDATIONS ON SECTION 205

In summary of my discussion of section 205 of both bills: The Federal Open Market Committee as recognized in the present law is able to serve all the practicable purposes advanced for the changes proposed in the new bill. The changes, on the other hand, introduce new factors of uncertainty, perhaps of danger. They take powers away from the Reserve banks and confer them upon the Federal Reserve Board, creating a concentration of financial authority hitherto unknown in this country and rarely equaled anywhere else. In order to promote the coordination of the system without incurring new and unnecessary hazards, I recommend that the amendments be rewritten, taking account of the following points:

(*a*) That the Federal Open Market Committee be composed of 9 members, 5 comprising the entire membership of the Federal Reserve Board reconstituted as proposed above, and 4 being governors of Federal Reserve banks, whose independence shall have been protected in the manner already recommended, and who shall be freely elected to the committee by the governors of all Federal Reserve banks.

Senator COUZENS. This was recommended I think by Mr. Law yesterday.

Mr. ALDRICH. Yes. Or you mean the American Bankers Association committee?

Senator COUZENS. Yes.

Mr. ALDRICH. And next:

(*b*) That it be plainly recognized that the directors of the regional Reserve banks possess the initiative to establish rates on Federal Reserve bank advances and discounts, subject to the approval without time limitation of the Federal Reserve Board—that is a little different from the recommendation of the American Bankers Association—but that if in the opinion of the Federal Open Market Committee, constituted as above, a rate change is desirable in the general interest, a new rate can be imposed by a two-thirds vote of the committee. That also is slightly different from the A. B. A. report.

(*c*) That the direct purchase of Government obligations from the Treasury or any Government agency be specifically declared not to be open-market operations within the meaning of the act.

Senator COUZENS. What would be the practical effect of the difference?

Mr. ALDRICH. The difference is this: If you can only purchase in the open market the securities have to be in the open market. If you purchase directly from the Treasury you go directly from the banks to the Treasury, as in Germany and France; and we have a bill which permits the issuance of currency against Governments owned by the Federal Reserve banks themselves, so that they can go right around in a circle of buying more Government obligations and issuing notes against them.

Senator COUZENS. Do you believe that Federal Reserve banks should be authorized to issue notes with Federal Reserve bonds as security?

Mr. ALDRICH. I personally think it should never be done except in an emergency. Of course that power also is given by existing law as an emergency power to be used by the Congress, and it has seemed to me it should be so.

Senator GLASS. Let me say for the record on that point that when we were considering that bill there was intense opposition to that proposition and we were assured, the subcommittee was assured, it was intended to be merely psychological, and that they did not expect to use a dollar for that purpose. Were you on the subcommittee then, Senator Townsend?

Senator TOWNSEND. Yes.

Senator GLASS. Then no doubt you will remember it. Otherwise it would never have been reported.

Mr. ALRICH. With that power the door is wide open for doing the very thing I have just described, buying Government bonds directly from the Treasury and issuing currency against Government bonds. And that is exactly like using the printing press.

Senator GLASS. And that was pointed out, and we were over and over again assured it was not intended to make use of the provision except in a psychological way.

Senator COUZENS. Do you think this should be repealed in this act?

Mr. ALDRICH. I personally do. Now I think I ought to make it plain that a great many bankers do not think so.

Senator GLASS. Of course they do not.

Senator COUZENS. I can understand why they do not. But I want to get your unbiased comments, because you are not a born banker, are you? [Laughter.]

Mr. ALDRICH. No, sir.

Senator GLASS. You may proceed.

Mr. ALDRICH (continuing):

IV. BROADENED ELIGIBILITY REGULATIONS FOR FEDERAL RESERVE BANK LOANS AND INVESTMENTS

Two sections of each bill affect more or less broadly the assets which Federal Reserve banks are empowered to acquire. The first is section 206 which says that "subject to such regulation as to maturities and other matters as the Federal Reserve Board may prescribe" the Reserve banks may discount any commercial, agricultural, or industrial paper for the member banks upon their endorsement. It also says that the Reserve banks may make advances to the member banks on their "promissory notes secured by any sound assets" they may desire to pledge. The bill is not quite clear in stating whether the Reserve Board is authorized to make regulations on the latter category of loans as freely as on the first category, but I presume that the intent is to give the Board corresponding regulatory powers in both cases, including the power to determine what constitutes sound collaterial.

This section replaces in somewhat broader terms the authority conferred as an emergency measure under section 10 (b) of the present act, which lapsed on March 10, 1935. The exercise of such authority, as a matter of fact, finds its justified use only in times of emergency. The Federal Reserve Board should not have as part of its day-to-day procedure the power to broaden at will the carefully written specifications given in sections 13 and 13 (b) of the present act where the intent of Congress is expressed concerning the loans which the Federal Reserve banks may make to member banks.

A POWER FOR EMERGENCIES NOT FOR ORDINARY USE

The point can be made clear in a practical way. Let us suppose that this section is already law and the Federal Reserve Board adopts a regulation tomorrow broadening in some substantial way the character of paper which a member bank may pledge at the Federal Reserve bank. Will a well-conducted bank immediately start making loans of sorts that fall within the new classification? The Federal Reserve Board has the power not only to make the regulation but to cancel it, and if canceled the banker who has has made loans in reliance upon it is left with paper which he cannot make use of at the Federal Reserve bank. Is it not common sense for a banker to shape his course according to what Congress has written into sections 13 and 13(b) and not rely upon regulations subject to change without notice?

But there is another point involved. The rediscounting facility, however broad the Federal Reserve Board may make it by regulation, is only partial insurance against loss. And the ability to pledge "any sound asset" does not mean that the value of that asset cannot decline. I seriously doubt the expediency of throwing out to member banks generally the hope implied in the bill that any sound assets may perhaps be acceptable or become acceptable at a Federal Reserve bank in any and all circumstances. In an emergency some such provision as this might be very useful but I seriously question the wisdom of making it open to use at any time and under all conditions.

There is also a third question involved. If in ordinary times the Reserve banks accumulate portfolios of slow or doubtful items, the capacity of the Reserve System to respond adequately to emergency conditions will be impaired. And, still more broadly, it should not be forgotten that this amendment is proposed as a new paragraph in section 13 of the Federal Reserve Act and for that reason any obligations acquired under it become immediately eligible as security for Federal Reserve notes. This is true whether section 16 of the present act, which describes the security behind Federal Reserve notes, is altered in the way this bill proposes or not. In other words, they can issue Federal Reserve notes not only against Governments but against any sound assets that get into a bank.

Senator COUZENS. As a practical proposition, when any bank makes application to a Federal Reserve bank for a loan, does it analyze the situation of the bank making the application and the necessity for rediscounting?

Mr. ALDRICH. I should say not. I should say that they look at what is presented, but——

Senator GLASS (interposing). The agent of the Federal Reserve bank does it.

Mr. ALDRICH. Well, they examine it.

Senator COUZENS. I am talking about the question of the need for rediscounting. Let us assume that I am running a bank and am a member of the Federal Reserve System and have some sound security authorized under the act and I want to rediscount it with the Federal Reserve bank. Does the Federal Reserve bank that rediscounts it analyze my needs for rediscounting?

Senator GLASS. Well, I should think it would if it performed its duty.

Senator COUZENS. But I am trying to ask Mr. Aldrich.

Mr. ALDRICH. Under the Banking Act of 1933 there are provisions which prevent an undue use of credit for speculation. Now, outside of that if you present sound collateral, collateral that is covered by the act, to a Federal Reserve bank, I do not think such bank would ask whether you really need it or not.

Senator COUZENS. Of course the definition of sound collateral is not very accurate in this bill, and that is what I was wondering about, whether or not the disposition of it as collateral to a Federal Reserve bank would be looked into, whether the reason for it being rediscounted would be included.

Mr. ALDRICH. I do not think it would except under the provisions of the Banking Act of 1933 which are intended to prevent an undue use of funds for speculation. As a matter of fact I am arguing against including all sound assets anyway as provided for in this bill because I think it opens the door to not only lowering banking practices in the member banks but lowering the type of assets in the Reserve banks; and then further because of the fact, and this is in section 13, it has the possible effect of lowering the character of the assets behind the currency.

Senator COUZENS. In other words, a Federal Reserve bank when offered a security by a member bank has no voice in the matter of the type of security if it has been declared sound by the Federal Reserve Board, is that correct?

Mr. ALDRICH. That is correct.

Senator COUZENS. All right.

Senator GLASS. Well, I am not willing to say or to think that that is so. I think it is the business of the Federal Reserve bank——

Senator COUZENS (interposing). But I asked him if that was in the bill.

Senator GLASS. Yes; I see.

Senator COUZENS. And he says it is in the bill.

Senator GLASS. Certainly.

Mr. ALDRICH. I do not mean to say that the act of 1933 did not attempt to prevent the very thing which Senator Couzens is referring to. That is, I take it the act of 1933 was intended to give Federal Reserve banks the duty to prevent the use of credits for unduly speculative purposes.

Senator GLASS. Yes; but it is proposed to sweep away those provisions in this bill.

Mr. ALDRICH. Yes; that is correct.

Senator GLASS. All right.

Mr. ALDRICH. In order to retain the usefulness of the provision in an emergency in the sense corresponding with that contemplated in section 10 (b) and at the same time to prevent its being abused for the sake of profit, I suggest that member banks' borrowings under section 206 be made subject to a penalty rate. This will afford necessary protection in a practical way.

The second of the two sections broadening the credit powers of the Reserve banks is section 207. The effect of this section, as I see it, is merely to permit the Reserve banks to buy longer-dated obligations guaranteed by the United States in just the same way as they are now qualified to buy and hold the direct obligations of the United States. On this clause taken by itself I have nothing to suggest, but it should be remembered that under the present reading of the section dealing with the Federal Open Market Committee it would be possible for the latter to oblige the Reserve banks to buy longer-dated guaranteed obligations of the Government both in the open market and direct from the issuers; and under section 208, which I shall discuss in a moment, it would be possible for these obligations to be used as collateral for Federal Reserve notes.

RECOMMENDATIONS ON SECTION 206

I confine my recommendation with respect to the proposals for broadening the eligibility regulations to section 206. I suggest that it be amended so that paper discounted or loans made under its authority shall be subject to a rate not less than 1 percent higher than the highest discount rate then in effect at the Federal Reserve bank concerned, and that no such paper shall be discounted or loans made under that authority until after all other eligible assets of the applicant bank shall have been exhausted.

Now, mind you, that is assuming that any such power is necessary at all.

Senator GLASS (chairman of the subcommittee). Mr. Aldrich, would it suit your convenience to meet with us again at 2 o'clock?

Mr. ALDRICH. Yes, sir.

Senator GLASS. In the hearing room of the Committee on Appropriations over in the Capitol, please.

Mr. ALDRICH. Yes, sir.

Senator GLASS. Some of the members of the subcommittee are anxious to be on the floor now in the consideration of a measure pending there, and if that would suit your convenience we would be obliged to you.

Mr. ALDRICH. Yes, sir.

Senator GLASS. So we will reconvene at 2 p. m.

(Thereupon, at 12:15 p. m., Wednesday, May 15, 1935, the subcommittee recessed to reconvene at 2 p. m. in the hearing room of the 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, United States Capitol Building.

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

Senator GLASS. Mr. Aldrich, you may resume your statement, if you please.

STATEMENT OF WINTHROP W. ALDRICH, CHAIRMAN THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, NEW YORK, N. Y.—Resumed

V. RESERVE AND OTHER SECURITY FOR FEDERAL RESERVE NOTES AND DEPOSITS

Mr. ALDRICH. I had reached the point where I was about to discuss the reserve and other security for Federal Reserve notes and deposits.

Section 208 of both the Senate and House bills strikes out the first 10 paragraphs of Section 16 of the Federal Reserve Act and substitutes in place of them 4 new paragraphs. The principal effect of the changes, aside from the alterations in procedure required by the elimination of the joint office of Federal Reserve agent and chairman, has to do with the security behind Federal Reserve notes. These changes introduce a totally new theory into the Federal Reserve Act, since they abandon the idea of specific cover for notes and replace it with the idea of a general and undefined claim against assets.

The present law (par. 2, sec. 16) provides that the Federal Reserve banks shall tender to the Federal Reserve agent specific collateral in an amount equal to the sum of the Federal Reserve notes applied for. The collateral thus pledged shall be "notes, drafts, bills of exchange or acceptances acquired under the provisions of section 13 of this act" (the section relating to member banks' discounts and advances) or bills of exchange and acceptances purchased in the market, or gold certificates. The present law also authorizes the Reserve banks to offer as collateral security "direct obligations of the United States", in an amount not less than the sum of Federal Reserve notes applied for. This authority, which was granted as an emergency power to terminate on March 3, 1935, subject to further extension up to 2 years, was in fact extended for the full period by proclamation of the President on February 14, 1935. Pending further discussion of the use of Government obligations owned by the Reserve banks as collateral for their note issue, the point I want to emphasize here is that the present law provides not only that the circulation shall be 100 percent covered, but that the special quality of the cover is defined and restricted.

The new bill wipes out all of these prescriptions. It provides simply that Federal Reserve notes shall be "secured by a first and paramount lien on all of the assets" of the respective Reserve banks. Further, the bill does away with the existing redemption provisions and would appear to permit one Federal Reserve bank to pay out another Federal Reserve bank's notes. Instead, it grants to the Federal Reserve Board the power to prescribe rules and regulations under which Federal Reserve notes shall be issued and retired, a clause which in itself is so broad and in terms so vague that the Federal Reserve Board, acting within its authority, might assume an arbitrary control over the volume and quality of the preponderant part of the country's currency. The issue involved in the proposed change is not whether the nominal amount of the security behind Federal Reserve notes is sufficient to pay them off, but whether the quality of that security is sufficiently defined and its volume sufficiently restricted to maintain the soundness of the country's currency. These surely are not matters which can be left to the discretion of a small group endowed with arbitrary powers.

NEED FOR PROTECTING THE NOTE ISSUE

The universal experience of banks of issue in other countries and of the Federal Reserve banks up to the present time, is that the law must prescribe as precisely as possible exactly what assets can be used as cover—or collateral—for the note issue or else make some other arrangement to prevent undue expansion or arbitrary contraction of the currency. Central banks the world over have adopted some or all of three methods as follows:

1. An exact definition of the quality of assets to be pledged against currency—whether gold, commercial paper, or other self-liquidating assets.

2. A rigid restriction of the quantity of notes that may be issued over and above the notes specifically secured by gold. The fiduciary issue of the Bank of England, specifically limited in amount, is an example of this type of restriction.

3. Limitations upon the amount of Government obligations owned by a bank of issue which it can use as security against notes; or else limiting their use to collateral for short-dated promissory notes of other borrowers which in turn can be used as cover for circulation.

In addition to the foregoing are the familiar requirements for metallic reserves or, in a diminishing number of cases, for metallic reserves and foreign exchange.

It is practically the unbroken record of central banking that where there has been no restraint on the type of collateral against which notes can be issued, the currency has become debased. And whether there are restrictions or not on the kind of business paper that can be used as cover, if there are no limitations on the use of Government obligations for that purpose, debasement is almost sure to occur as soon as the budget gets out of balance. I have already indicated in my discussion of the section of the bill dealing with the Federal Open-Market Committee that the power of the central bank to buy Government obligations directly from the Treasury and to issue notes against them furnished the chief mechanism for the French and German inflations. The same rule holds true with respect to other historic instances of inflation in many parts of the world.

EFFECTS OF THE BILL ON FEDERAL RESERVE NOTES

This bill, nevertheless, sets up the machinery for the same thing. The Federal Open Market Committee may decree, and the Reserve banks must undertake, the purchase of Government obligations in the market or, what is still more dangerous, from the Treasury itself. The transaction will be settled in Federal Reserve credit which will be immediately convertible into notes, and the purchased bonds will be their adequate security under this law.

The same sequence holds, of course, for any other assets the Federal Reserve banks may acquire under the provisions of the bill. I have already discussed the section which permits the Reserve banks to lend to member banks on their promissory notes secured by "any sound assets." The fantastic extremes to which this power could be carried under the direction of a complacent Federal Reserve Board or under a Federal Reserve Board riding some theory of desired expansion will occur immediately to anyone. As soon as such paper becomes part of the assets of the Federal Reserve banks, it would provide security for additional issues of notes.

It is true that the requirements of the law calling for a minimum gold certificate reserve of 40 percent against Federal Reserve notes appear to set a limit to the expansion of the circulation. But this limit is very remote and would exercise little restraint before vast damage had been done. The gold certificates held by the Reserve banks plus the surplus gold held by the Treasury are now upwards of

$8,700,000,000, whereas the amount of Federal Reserve notes in circulation is about $3,200,000,000. After making due allowance for other fluctuating elements, it is clear that the margin of currency expansion is very great before the restraints of the required reserve would be felt.

And this leaves out of account three very important factors affecting the currency: First, the authority of the Federal Reserve Board under section 11 of the present act to suspend reserve requirements subject to penalty; second, that under the conditions specified in section 43 of the act approved May 12, 1933, the reserve requirements may be suspended without penalty; and third, the substantial increase in the silver certificate circulation already under way.

RECOMMENDATIONS ON SECTION 208

In my other recommendations I have proposed safeguards against the concentration in a few hands of the power to precipitate inflation or deflation. Amendments to the bill in the manner suggested would not only offer protection in those other connections but to the note issue as well. My recommendations with respect to section 208 have been made with those proposals in mind and in order also to further the purpose of simplifying Federal Reserve internal procedure. The earmarking of individual collateral against notes has gradually become, I understand, largely a matter of form and it is urged that it be dispensed with on the ground that its elimination will do away with an unnecessary and cumbersome procedure. My recommendations admit of the elimination of that requirement while still adhering to the principle that the note issue be covered 100 percent with assets satisfying the rules of eligibility and furnishing certain other essential safeguards.

I recommend accordingly:

(*a*) That the specifications of section 16 of the present act with respect to the types of security eligible as cover for Federal Reserve notes be retained in the law, without, however, the requirement that individual collateral be explicitly earmarked. The amount of notes must never exceed the amount of the collateral eligible and available.

(*b*) That the use of Government obligations owned by the Federal Reserve banks as security against notes shall be subject to a penalty of at least 1 percent above the rate carried by the obligations so used.

I pointed out to Senator Couzens before lunch, and that is the place where that point arises, that as far as I am concerned I would be willing to see that power limited entirely rather than a penalty put on its use.

VI. Changes in Member Bank Reserve Requirements

Section 209 of each bill gives the Federal Reserve Board power to change from time to time the reserve requirements of member banks; that is, the proportionate amounts of their own deposits which they are obliged to keep on deposit with the Reserve banks. Under conditions as they exist and as they are likely to remain for some time to come I can see in this proposed power only an instrument of deflation. Because of the leverage which the reserve requirements exert on the member banks, as I will presently explain, a vigorous application of this authority would prove a very powerful instrument of deflation.

This section is proposed as an amendment to the sixth paragraph of section 19 of the existing Federal Reserve Act. In order to point out the differences between the existing law and what is proposed, I shall read the paragraph which it is desired to amend:

Notwithstanding the foregoing provisions of this section, the Federal Reserve Board, upon the affirmative vote of not less than five of its members and with the approval of the President, may declare that an emergency exists by reason of credit expansion, and may by regulation during such emergency increase or decrease from time to time, in its discretion, the reserve balances required to be maintained against either demand or time deposits.

The principal points of difference between the existing law and the proposed amendment are the following:

1. The existing law requires the declaration of an emergency by the Federal Reserve Board with the approval of the President. The new bill requires no declaration either by the Board or the President, and makes the adjustment of reserve requirements an ordinary function of the Board.

2. The existing law presumes that credit expansion is already under way. The new bill permits the exercise of the power as a preventive to forestall either expansion or contraction.

3. While there is some ground for assuming that the existing law contemplates nation-wide action only, there is no doubt on that score in the Senate bill at all. The latter would give the Federal Reserve Board specific authority to alter the reserve requirements by Federal Reserve districts or by banking groups; that is, central reserve city banks, reserve city banks, and country banks; or by banking groups within any Federal Reserve district. It also seems to give the Board power (though this is probably not intended but merely a mistake in drafting) to alter the reserve requirements of any individual member bank anywhere. The House bill modifies this arrangement somewhat by dividing the member banks of the country into two classifications, (1) banks in reserve and central reserve cities, and (2) banks elsewhere. But its language is still so vague as to leave doubts whether or not the Reserve Board could alter the reserve requirements of any individual bank.

In other connections I have referred to the very large deposits which the member banks now have with the Federal Reserve banks. Taking the member banks as a whole, these deposits are about twice as much as the law requires—the existing requirements for banks in the central reserve cities are 13 percent of their net demand deposits, for banks in reserve cities 10 percent, and for banks elsewhere 7 percent; on time deposits the required reserves are 3 percent for all banks. The excess of the total deposits of member banks in the Reserve banks over their required reserves is now about $2,200,000,000, the result of two principal causes; first, the purchases of Government obligations in the open market up to the autumn of 1933, when they ceased, and second, the great influx of gold into this country in the last 15 months.

THEORETICAL USE AS A MEASURE OF CONTROL

Before I consider what would happen under conditions such as these, if the Federal Reserve Board were to make use of the authority which it is proposed to give it, I should explain the theoretical use of this power as a measure of control. Under the requirements as they stand at present, the member banks on average have to keep about $1 with the Reserve banks for every $10 of their demand deposits. If there are no excess reserves, an increase of a dollar in the Reserve deposits will support, by and large, an additional $10 of member bank demand deposits. Of course, if any individual bank expanded its loans at that rate when its reserve deposit increased, it would promptly get into trouble. But taking the banking structure as a whole, the rule holds theoretically good. A decline in a member bank's reserve deposits works theoretically in the reverse direction, and it either has to borrow additional reserve or reduce deposits, also at the ratio of about 10 to 1.

Accordingly, if the reserve requirements are raised or lowered, a powerful lever theoretically comes into play which has the effect either of inducing a member bank to lend more freely, or, on the other hand, forcing it to borrow or to contract its deposits.

PRACTICAL USE UNDER EXISTING CONDITIONS QUESTIONABLE

I now want to test out this theory under conditions as they exist at present, when the excess reserves are so very large. If the Federal Reserve Board were to reduce the reserves which the member banks have to keep with the Reserve banks the result would be merely to add to the excess reserves already existing. There is no ground for assuming that such a reduction under present conditions would give any substantial impulse to the growth of bank credit. An additional few percent of excess reserves would not afford an appreciable supplement to the stimulating factors which already exist nor would they remove any of the depressing factors. As for the future, I, of course, cannot prophesy; but I think it will be a long time before conditions are ripe for a reduction of reserve requirements to be effective in the direction of expansion.

But in the direction of contraction and deflation the exercise at times such as these of the power to raise reserve requirements would become effective very promptly, and increasingly so as reserve requirements were progressively raised. This is a matter of first-rate importance to business and recovery. While the member banks as a whole now possess reserves nearly twice the amount required, it does not follow that all individual banks are so placed. If the Federal Reserve Board should start raising requirements, one bank after another would find its reserves inadequate and would be obliged to borrow or sell investments or to call loans—or what is broadly the same thing, to let loans run off without granting new loans. Deflation thus artificially set in motion would be on the way before the existing excess reserves of the banks as a whole were exhausted.

It follows from this that under present conditions the exercise of the powers asked for in this section would not be effective in stimulating the growth of credit, but would be very effective in retarding it, or even contracting the existing volume of credit. Moreover, the very existence of this authority in the unrestricted form proposed would have a restraining and even deflationary effect whether it was used or not, because it would introduce a new factor of uncertainty into banking and business calculations. No banker would know how to lay out his lending policy because at any moment the Federal

Reserve Board, in its uncontrolled discretion, might decide to force him into debt or oblige him to curtail credit.

If it were not for the fact that the power to alter reserve requirements might have value in an extreme emergency, as contemplated in the existing law, I would recommend that section 209 be eliminated altogether, but in order to preserve whatever contingent value it may have, I recommend that it be retained with the following changes:

(*a*) That the power to alter reserve requirements of member banks shall be limited to emergency use, that its exercise be restricted within any 60-day period to a range of 10 percent of the requirements as they now exist and that the maximum reached at any time shall not be higher than double the present level, or the minimum be lower than 75 percent of the present level.

(*b*) That any increase or decrease shall apply to all member banks, and shall be proportionate to the reserves now required to be maintained.

VII. Loans on Real Estate

Section 210 of the Senate bill amends section 24 of the Federal Reserve Act, considerably broadening the power of national banks to lend against real estate.

The geographical restriction (within 100 miles) is removed. Loans up to 75 percent "of the actual value" are permitted on condition that regular amortization within a period of 20 years is provided for. Otherwise the loan can be but for 60 percent and the period but 3 years. (This compares with 50 percent and 5 years under the present act.)

The aggregate amount of real-estate loans of a national bank may not exceed its unimpaired capital and surplus or 60 percent of its "time and savings deposits whichever is greater." (This compares with 25 percent of the unimpaired and paid-in capital and 25 percent of the unimpaired surplus, or 50 percent of its savings deposits, as provided in the present act.)

The House bill makes material changes in the foregoing. It provides that national banks shall not make new real-estate loans for more than 60 percent of the "appraised value" of real estate, but maturities are not specified. The Federal Reserve Board is to have general powers of regulation which perhaps include the power to determine maturities.

I am opposed to any change in the law which tends to weaken the banking structure and prevent it from doing its duty in times of emergency. Accordingly, in the light of the experience many banks, especially country banks, have had in recent years with real-estate loans, I seriously doubt the wisdom of relaxing the existing loan conditions. To the real-estate speculator easier credit terms would no doubt be advantageous, but to the lending bank they might well prove the reverse.

WEAKENING THE BANKING STRUCTURE

The tendency to weaken the banking structure is twofold. In the first place, certain bankers, forgetting the experience of former years and yielding to the desire for earnings which all bankers have at this time, may go ahead under the terms of the bill and make loans they would not grant on their own merits, trusting that the Federal

Reserve banks under the authority proposed under section 206 would admit mortgages as collateral for Reserve bank advances. In doing so, they would be counting on an uncertainty, because under section 206 this facility can be withdrawn as readily as it is given. I think any banker making such a loan and finding out later that the Federal Reserve Board had changed the rules in the meantime, would be justified in charging that he had been misled. But the damage to his bank would have been done.

In the second place, even if this facility could be counted on, the lending banker would have no safeguard against a decline in the value of the mortgaged property to a point far below the high limits fixed in the bill. Real-estate values are peculiarly subject to local influences, which central credit policies, however generously conceived, can hardly affect. In cases of decline—and we have seen many such in recent years—the lending banker would be left with a depreciated mortgage or depreciated real estate, and if he had already pledged the mortgage at a Reserve bank, he would have to make good on it. Thus the bill introduces a factor of insecurity which is bound to come to the surface at the most inconvenient time.

Moreover, even if the section were not open to objection on these practical grounds, I would oppose it for more general reasons. If, as I understand to be the intention, real-estate mortgages are to be admitted as collateral for Federal Reserve bank advances, then such loans under section 208 will become security for Federal Reserve notes. I know of no grounds upon which this procedure can be approved, and experience in foreign countries is against it.

Finally, the Senate bill as it stands does not sufficiently take into account the practical difficulties involved in the renewal of old real-estate loans falling due at this time. The Federal Reserve Board should have power to provide by regulation for such renewals so as to avoid the necessity for forcing liquidation as old loans mature. This point seems to be adequately covered in the House bill.

RECOMMENDATIONS ON SECTION 210

I therefore recommend that as to new real-estate loans by national banks the following conditions shall apply:

(*a*) Unamortized loans to mature in not more than 3 years, and to be in amounts not exceeding 50 percent of appraised valuations.

(*b*) Amortized loans to mature in not more than 12 years, and to be in amounts not exceeding 60 percent of appraised valuations.

(*c*) Territorial limitations and the provisions with respect to the aggregate amount of real-estate loans a national bank may make, to apply as in the present act.

VIII. General Conclusions

I have now reached the point in my discussion where I can draw some general conclusions based upon the analysis I have already given of title II, section by section.

First. The principle of local self-government in Federal Reserve administration is impaired. The authority of the directors of the 12 Federal Reserve banks is much reduced. These are men of the highest standing in their several communities, fully representative of all the parties at interest, and intimately aware of local requirements. They lose their power to determine investment policies, their right to initiate discount rate changes definitely passes out of their hands, and their authority over the administration of the banks is largely taken away. Their power to elect the governor becomes merely the power to nominate, and their nominee for governor must be approved and frequently reapproved by the Federal Reserve Board in Washington. The governor, in this manner made subject to the Reserve Board, is also made the person to whom "all other officers and employees of the bank shall be directly responsible." Thus the way is cleared for central domination—even for central political domination—of the Federal Reserve banks, their policies and their personnel, with the directors occupying the impossible position of bystanders.

Second. The Federal Reserve Board or, as the case may be, the Federal Open Market Committee which the Board is able to control, can undertake at will to force an expansion or contraction of credit. The Reserve banks can be forced to buy or sell Government obligations in the market or to buy them directly from the Treasury itself. The Federal Reserve Board can arbitrarily raise or lower the reserve requirements of member banks. Operations of either sort, depending upon the circumstances in which they are undertaken, may work as powerful levers on the supply of credit, may be perfectly futile, or may produce results of great importance but entirely unpredictable. We cannot be sure that these powers would not be used for political purposes.

Third. The standards of banking practice are lowered. Encouragement is given to banks to make a character of loans they would not ordinarily make in reliance upon the power of the Federal Reserve Board to change the eligibility rules by regulation. These regulations in turn are changeable at will. It is not only the banking structure which may thus become enfeebled. The currency itself may deteriorate, for under the terms of the bill the Federal Reserve banks may acquire not only in an emergency but at any other time a type of assets which world-wide experience has proved to be unsuitable as security for the note issue.

The foregoing are serious indictments of the bill as it stands. Yet I believe I have given the adequate basis for each of them. I believe also that the changes I have recommended, assuming them to be adopted as a substantial whole, would remove from the bill the principal points of objection.

There remains one practical question. If the Federal Reserve Board gets the new powers proposed for it in title II, what can it do with them? I shall try to answer this question, having regard not to conditions as they may exist in theory or at some future time, but to conditions as they exist at present.

THE OBJECTIVE OF THE BILL

Let me first attempt to define the objective. Aside from such indications as the proponents for the bill have given in their testimony before the House committee, there are three pieces of evidence in the bill itself which go to show the purpose of the legislation. The first of these appears in section 203, where the qualifications of the appointive members of the Federal Reserve Board are described:

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.

This is the paragraph which supplants the requirement in the present law that in selecting members of the Federal Reserve Board—

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 second appears as section 204 (b) of the House bill as it was passed. I believe an amendment to the same effect has now been offered to the Senate bill. That section says:

(*o*) It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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.

The third piece of evidence is negative. Both bills, the one now before the Senate and the one passed by the House, omit from the redraft of section 12A, which deals with the Open Market Committee, the following prescription for open market operations:

(*c*) The time, character, and volume of all purchases and sales of paper described in section 14 of this act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

It is clear from the foregoing that the objectives set up for Federal Reserve policy differ materially from what Congress has fixed heretofore. Instead of "accomodating commerce and business", for example, the Federal Reserve administrators are to be qualified "to participate in the formulation of national economic and monetary policies", and are to exercise such powers as they possess and as far as they can to mitigate "unstabilizing fluctuations in the general level of production, trade, prices, and employment." This introduces the planning idea into Federal Reserve policy. In addition it constitutes a mandate to try out the powers granted in the bill plus those that the Federal Reserve authorities already have, in order to put the plans into effect.

So it appears that the objective of the bills is to put into the hands of a few persons—a majority of a total of eight—the power to manipulate the credit and currency system of the United States in furtherance of a plan or a sequence of plans which they themselves may draw up. And all 8 hold office at the pleasure of the President; and 3 of them represent directly whatever administration is in power. This is a concentration of authority such as has not been known heretofore in the United States. It is set up without check or balance in law and with few restraints in fact. And perhaps the most serious aspect of all is that the exercise of these powers is capable of drawing off the savings of the people, of dissipating the endowments of our educational and charitable institutions, of cutting down the real wages of labor, of putting a hidden tax on everyone who consumes and on many who produce. This bill is a measure not of security but of insecurity, for the exercise of powers freely granted under it can wipe the practical value of all social security legislation off the slate, and make benefits granted to the aged or the unemployed mathematical expressions only.

In saying this, I do not imply that any man or group of men would draw plans intentionally to such ends. Nor do I offer any criticism of planning as such, if by planning we mean the exercise of rational foresight and prudence. But I am opposed to planning if we mean experimentation with one powerful instrument after another upon the credit and currency of the United States, or if we mean the riding of one superficial, simple theory after another through the vast complex of American economic life.

THREE EXPERIMENTS THAT MISFIRED

I think of at least three experiments tried in the last few years which have misfired. They have produced few or none of the results hoped for them, and on the contrary have started processes of incalculable consequence, the end of which is not yet.

The first of these, and perhaps the least important because reversal is at any time possible, was undertaken by the Federal Reserve banks themselves under powers they stilll possess. This was the purchase of Government obligations to which I have already referred in my discussion of the Federal Open Market Committee. Between March 1932 and November 1933 the Reserve banks bought about $1,600,000,000 of Government obligations. What were the results? Federal Reserve bank loans to member banks went down $600,000,000, and their holdings of bankers' acceptances declined about $90,000,000. Thus, out of the $1,600,000,000 of Government obligations purchased some $690,000,000 represented only a shift in the form of Federal Reserve bank assets. The effect in the beginning was to relieve strain in the member banks, but notwithstanding a strong impulse given to bond prices in the market, which has continued since that time, there was no proportionate stimulation of the growth of bank credit, one of the purposes which the purchase of Government obligations was intended to achieve. But the operation had one unexpected and profoundly important consequence which we still have with us in augmented form. The member bank excess reserves increased $735,000,000, which are capable of supporting some $7,000,000,000 of additional member bank deposits. The excess reserves so created may be regarded as a dangerous byproduct remaining over from an operation which was only partly successful.

The second experiment, quite the most important of the three I have in mind, was the devaluation of the dollar coupled with the purchase of gold at prices above the old gold parity of $20.67 an ounce. The purpose as I understood it at the time was to raise domestic prices roughly in proportion to the degree of devaluation. It is now nearly 2 years since we left the gold standard as we formerly knew it, and 18 months since we began to buy gold at prices gradually increasing until the present price of $35 an ounce was fixed on January 31, 1934. There are few persons who pretend that this operation has accomplished its purpose. I recognize the fact that the prices of some basic commodities widely dealt in in the world markets have risen, but prices by and large have lagged far behind the rise in the price of gold; and even such increases as we have observed may be attributed in considerable part at least to the drought, to processing taxes, and to other causes. Meanwhile great damage has been done in other directions. Deflation and business distress have been forced upon other countries, currencies have become unsettled and foreign trade has been further depressed. For our part, we have increased our holdings of gold by some $1,500,000,000, but it has done us no good. The influx has merely added to our already ample gold stock and at the same time has caused the excess reserves of the member banks to rise to their present great proportions. Though the gold and these excess reserves are now dormant, they are in fact a potential source of danger in addition to that already existing, which must cause any thoughtful person serious concern.

The third experiment to which I refer was the silver-buying policy. As in the case of gold, it was hoped that it would result in raising the general price level. But except for its obvious effect on the price of silver itself, any healthy influence on the general level of prices has not been detectible. Far from improving conditions in the Far East, it has had the result of imposing a condition of acute depression upon China, and has seriously affected Mexico. As for our own currency, the result appears for the moment to be unimportant. New silver certificates have merely displaced to a relatively modest extent other forms of currency. Excess reserves of member banks have been further increased.

In citing these three experiments I have no desire to question the motives of their proponents. I cite them merely as examples of how the three outstanding efforts at currency and credit management have worked. They have not accomplished in any substantial fashion the results they were designed to produce. On the contrary, they have produced results which were not desired and are not desirable. Is there any reason to assume that the five men who will constitute the majority of the Federal Reserve Board, now to be endowed with arbitrary powers, will be any more successful in accomplishing desired results through credit and currency management?

I think they will be less successful, rather than more so. And for a reason that does not in the least reflect upon their capacity but merely takes account of facts as they are.

THE STUBBORN OBSTACLE TO CREDIT MANAGEMENT

Perhaps the most unlooked-for result of these three experiments is that credit and currency management in any effective sense was not brought nearer but was made more remote. I have referred many times to the excess reserves of the member banks, now about $2,200,000,000. These were created almost entirely by the three experiments I have referred to; but they will have to be eliminated, or nearly so, before the Federal Reserve authorities can even start a program of currency and credit management. They furnish a cushion between the Reserve banks and the member banks which necessarily softens the impact of any policy of expansion or contraction which the central authorities may put in operation. This is a stubborn fact of primary importance in considering the practical value of the powers it is proposed to place in the hands of the Federal Reserve Board.

Assuming that the powers are granted, what can the Board do to eliminate the excess reserves? One way, which would be entirely within the authority of the Federal Reserve Board, would be to contract Federal Reserve credit. It could order the Reserve banks to sell to the market out of their own holdings successive lots of Government obligations, thereby drawing down the deposits of member banks at the Reserve banks until the excess reserves were exhausted. The effect upon the market for Government obligations and upon the credit policies of banks generally as this process was followed through has already been discussed in the section on the Federal Open Market Committee. As an alternative to this method, the Reserve Board could arbitrarily raise the reserve requirements of member banks. Again, as in the case of the sale of Government obligations to the market, deflationary effects would become more and more acute as the process went on. There are, of course, other possibilities, such, for instance, as a loss of some $2,000,000,000 of gold to foreign countries, and a withdrawal of Treasury balances from the member banks. But I dismiss the first as very unlikely to occur, and the second because it would be only a temporary expedient to be immediately reversed as soon as the Treasury paid out the funds in the course of business.

The other way of eliminating the excess reserves is by processes of expansion of member bank credit. That is, the deposits of member banks would have to rise to such a degree that the excess reserves would become part of the required reserves. I hesitate to assign a figure to the expansion which would have to take place because many cross currents could intervene to change the result. But the present deposits of member banks in the Reserve banks are rather more than twice what the law requires, and it is obvious, therefore, that a vast change must take place in the existing situation before the excess reserves would all fall into the category of required reserves.

The Federal Reserve Board has only partial powers, even under the expanded authority granted in the bill, to carry such a program through. It can relax the rules governing the kind of paper eligible for rediscount. It can encourage the member banks to make mortgage loans, for example, on the chance that such loans can be pledged as collateral for advances at the Reserve banks. It can, in other words, persuade the member banks to make loans of a sort they would not ordinarily make, so as to swell the volume of bank credit.

These are relatively slow methods, because the lending bankers will have to take the brunt of the risk, and with the experiences of the past few years in mind many will exercise restraint. But here another factor intervenes, the combination of a widely unbalanced budget, heavy Treasury borrowing, and complete independence of such checks as market conditions ordinarily impose. The extent and speed with which this combination could operate to eliminate the excess reserves would be determined only by the will and capacity of the Government to spend.

ARTIFICIAL FACILITIES FOR TREASURY BORROWING

I have referred already to the fact that purchases by the Reserve banks of Government obligations directly from the Treasury are commonly regarded as open-market operations. I repeat it here merely to emphasize the ease with which the Treasury and the Reserve Board could collaborate in financing the budget deficit. The Reserve banks would have to supply the funds whether they approved or not. Nor s this all. Under legislation such as the proposed social security bill, insurance reserve funds are to be set up in the Treasury for unemployment insurance and old-age pensions. These funds offer every facility for financing budget deficits. The reserve fund under the social security bill would amount in 7 years to some $9,000,000,000, and ultimately to $32,000,000,000. Sums of such magnitude, coupled with ready access to the credit-making powers of the Federal Reserve banks, would detach any Congress and indeed any Secretary of the Treasury completely from reality and tempt them to a course of reckless extravagance.

THE DANGERS OF FURTHER EXPERIMENTATION

We must not delude ourselves. The three efforts to accomplish a higher price level by manipulating credit and the currency have failed. But they have left behind them a vast amount of explosive material which some future effort may set off. The potentialities are so vast, and the restraints so few that should some later effort succeed the result would most likely not be an isolated detonation but a vicious and perhaps uncontrollable conflagration.

In the recommendations I have made in the course of my discussion of the several sections of the bill I have attempted to remove the hazards to business and the public welfare which the bill contains, and to preserve those features which promote the efficiency of the Federal Reserve system for both ordinary and emergency action. In making my proposals and in my discussion I have had to draw on banking knowledge and to use banking terms. But the language used should deceive no one. This bill is not the business of the banks, except as they are concerned in the welfare of the nation as a whole. Its effect is upon every member of the community, and the threats it contains are directed, however unwittingly, against the entire citizenship of the country.

Senator GLASS. Does anybody care to ask Mr. Aldrich any questions?

Senator MCADOO. I think I would like to ask a question.

Mr. Aldrich, what would you call sound currency in the present state of our financial affairs in this country?

Mr. ALDRICH. Well, I think that under the present circumstances the currency provisions of the present Federal Reserve Act, with the stabilization on the basis of gold as now provided, make sound currency.

Senator MCADOO. You are taking into consideration the fact that we are off gold, of course?

Mr. ALDRICH. Yes; and I have not taken into account the action that we might take under a bill such as this is which permits an expansion of currency which would be out of any relation to gold. May I just state that more accurately? The amount of the currency available for payment is well regulated by the amount of gold.

Senator MCADOO. In what way?

Mr. ALDRICH. By those provisions of the Federal Reserve Act with regard to gold certificates.

Senator MCADOO. There is no gold reserve back of the certificates——

Mr. ALDRICH. The entire provision as to the payment of gold either in currency or Government obligations has been eliminated, but there is a provision for gold certificates, although you cannot get gold for them.

Senator McAdoo. Assuming that we have a gold base, how much gold backing would you consider we should have against currency to make it sound, without other security?

Mr. Aldrich. I have not given any consideration to that, Senator. I have felt that the provisions of the original Federal Reserve Act which provided for gold backing plus commercial paper and other assets were sufficiently sound. I have never given any thought to the percentage of gold backing that is necessary, because at the present time you could not get gold. The only possible effect of the provision is to limit the amount of currency outstanding to a certain ratio to the free gold available.

Senator McAdoo. What ratio would you say was reasonable to make the currency a sound currency?

Mr. Aldrich. The present ratio provided is 40 percent, is it not?

Senator McAdoo. Yes. Do you think a currency based on 40 percent would be sound?

Mr. Aldrich. Of course it was not based on 40 percent of gold alone; it was based on 40 percent of gold plus certain other assets.

Senator McAdoo. I am talking about a currency based on gold, now. Take United States notes. We have about 347 millions of outstanding notes and we have a little over 40 percent back of them. Do you consider that sound currency?

Mr. Aldrich. I would think so; yes. Of course I do not pretend to be an expert on the amount of gold backing that is necessary behind currency. I suppose in theory the purpose of setting 40 percent reserve is that in ordinary times that would be sufficient. At the present time of course it has no effect at all except for providing a theoretical limit to control the amount of currency in actual circulation.

Senator McAdoo. Yes; but I am disregarding that and asking you the question as to whether or not you regard a currency as sound that is backed by 40-percent gold reserve.

Mr. Aldrich. If I had to answer that question with the small knowledge that I have—and I do not pretend to be an expert on the subject—I would say yes.

Senator Glass. If there is nothing else?

Mr. Aldrich. Provided you had the other assets you have in the system as provided for.

Senator McAdoo. I am not speaking of the Federal Reserve System. We will take, for instance, United States notes which are backed by a little more than 40 percent of gold reserve. They once had no gold reserve, and we put 40 percent of gold back of them, or 44 percent. Is it not axiomatic that a gold reserve of 40 percent back of currency establishes it as sound money?

Mr. Aldrich. I should say that that was so, although, as I have said, I do not pretend to be an expert on the subject.

Senator Couzens. Is the Senator trying to get an answer from Mr. Aldrich as to the difference in value of those United States notes and Patman notes?

Senator McAdoo. No. I was just trying to find out what bankers regard as necessary, in the way of a gold reserve back of currency, to establish sound currency.

Mr. ALDRICH. I really ought not to try to answer the question, Senator, because I have not given it any serious consideration.

Senator McADOO. Is it not axiomatic among bankers that 40 percent of gold is an adequate reserve, regardless of anything else?

Mr. ALDRICH. That would be my own impression.

Senator GLASS. That was not the view of bankers in 1913 when we adopted the Federal Reserve Act, because we put 60 percent of commercial paper behind the 40 percent gold reserve.

Senator McADOO. One hundred percent of commercial paper.

Mr. ALDRICH. I may have misunderstood Senator McAdoo's question; but this act as it stands provides for 40 percent gold backing plus this other security.

Senator McADOO. I understand that. I was just trying to develop what is, I think, the accepted axiom among bankers, that a 40-percent gold reserve back of currency is an adequate reserve to establish sound money.

Senator GLASS. We have not got any now.

Senator COUZENS. You mean, 40 percent of gold, not——

Senator McADOO. Yes; 40 percent of gold back of currency is generally accepted as creating sound money.

Senator COUZENS. You would want something else besides that.

Senator McADOO. Not necessarily. In the Federal Reserve Act we did, in the beginning, have a hundred percent, as I recall it.

Senator GLASS. At first, and then it was reduced to 60 percent.

Senator McADOO. I mean, 100-percent commercial paper and a 40-percent gold reserve. And we had no currency before that time that was anything like so well secured as that. We had never had in the history of our country.

Senator COUZENS. Would you think that currency supported by 40-percent gold alone and without anything else would be adequate to establish a sound currency?

Mr. ALDRICH. I do not know of any such provision; I should not think it would be.

Senator McADOO. It depends on whose currency it is, does it not?

Mr. ALDRICH. That may be.

Senator GLASS. It depends very much upon circumstances. As a matter of fact, I am old enough and I hate to confess it——

Senator McADOO. We deny it, anyway.

Senator GLASS (continuing). To remember when greenbacks were worth 34 cents on the dollar. We did not call them money at all; we called them "shin plasters" when I was a boy.

Mr. ALDRICH. I understood the Senator's question to refer to the type of security issued under the Federal Reserve System.

Senator GLASS. No.

Mr. ALDRICH. If he is talking about greenbacks, that is another matter.

Senator GLASS. I will not undertake to say what he referred to. The Senator has gone now.

Senator COUZENS. My impression was that he was referring to the Patman notes. I am not sure.

Senator GLASS. Yes; you indicated that that was your impression.

Mr. ALDRICH. The Patman notes have no coverage at all, have they?

Senator GLASS. They have not as much coverage as a Government bond.

Mr. ALDRICH. As a matter of fact, at the present time I do not think you could get gold for any obligation.

Senator GLASS. Neither of them is covered now. We are on a fiat currency and a fiat bond basis.

Mr. ALDRICH. Of course that is the danger of the whole situation, if that is the fact.

Senator GLASS. Of course it is the fact. If you think it is not a fact, get caught with any gold in your pocket. They will put you in jail.

Mr. ALDRICH. May I make a few observations as to title I?

Senator GLASS. Yes.

Mr. ALDRICH. In the bill passed by the House the assessment rate has been increased to one-eighth of 1 percent of the average total liability for deposits (instead of one-twelfth of 1 percent of the total deposit liability). The average is to be determined as of the close of business on 1 day of each of 3 or more months preceding July and January in each year. The days are to be designated by the F. D. I. C. board of directors in June and December of each year. The provision of the Senate bill for a lower rate of refund or credit not exceeding 50 percent of the annual rate has been eliminated.

I just want to say apropos of that change that the one-twelfth of 1 percent of the total deposit liability, with the possibility of a refund of part of it, is a very heavy burden on all of the banks as it stands, and to raise that to one-eighth creates, I believe, a very serious situation, because it is taking away the earnings of the banks which might very well be held by the banks individually as additional reserves against losses, and putting the amount of money so taken away into a fund in the F. D. I. C. which only becomes usable in case of the insolvency of some bank. In other words, it is preventing that fund from being used as reserve by banks which are doing business, and putting it into a place where it is held dormant until some emergency occurs.

Senator COUZENS. Might not that also be used for dividends as well as reserves, if it was not collected by F. D. I. C.?

Mr. ALDRICH. Yes; but with the banks where they are now it is either a question of having to put up reserves—I mean, that is something that they would be obliged to do. It would mean, as a practical matter, the banks that are paying dividends would be forced to reduce dividends, or the banks that were not paying them would be unable to put up the reserve. It depends upon what is the condition of the individual bank, of course.

Senator GLASS. What do you think of the suggestion that the assessment in no event should be an annual assessment except until a fund of half a billion dollars was created, and then the assessment automatically ceases until that fund should be impaired, say, by 25 percent, and then the assessment is automatically resumed?

Mr. ALDRICH. I should think that would be very much better than the present plan. I think there is a real reason for enabling banks at the present time, with the great difficulty they have of making any money because of the low interest rates and the difficulty of getting out credit—I think they ought to be permitted, as far as possible, after this fund has been built up to a reserve fund and until it was reduced again, to keep their earnings so that they can set them up in reserves for contingencies or maintain the present dividend rate, because there will not be any banks increasing their dividend rate, I believe.

There is one other thing that I would like to say about title I of the bill. In the bill passed by the House the factors to be considered (and certified by the Comptroller of the Currency or the Federal Reserve Board) in determining whether banks may be accepted for membership in the F. D. I. C. are only the financial condition and adequacy of the financial structure. The Senate bill provides that in addition to the above-mentioned factors the following should also be considered: Future earnings prospects, general character of management, convenience and needs of the community served, and whether corporate powers of the applicant bank are consistent with the purpose of the F. D. I. C.

I just wanted to say that it seems to me that the provisions of the Senate bill are very much better in that respect than the provisions in the House bill.

There is one thing about title III that I would like to refer to if, I may. Did you have some question, Senator Couzens?

Senator COUZENS. No.

Mr. ALDRICH. That is with respect to paragraph 2 of section 21 (a) of the Banking Act of 1933. In regard to that, this is what the House committee has to say [reading]:

Section 303 (b) would repeal entirely paragraph (2) of section 21 (a) of the Banking Act of 1933, which makes it a crime for any person, firm, corporation, association, business trust, or other similar organization, other than a financial institution or private banker which is subject to examination and regulation under State or Federal law, to engage to any extent whatever in the business of receiving deposits, unless such person, firm, corporation, association, business trust, or other similar organization submits to examinations and makes reports to the Comptroller of the Currency of the Federal Reserve bank of the district. Furthermore, this paragraph has given rise to many administrative difficulties because of the division of authority between the Comptroller of the Currency and the Federal Reserve Banks, the lack of any provision for defraying the costs of examinations, and the lack of any provision for requiring corrective actions when unsatisfactory conditions are discovered.

The Comptroller of the Currency recommended some amendments to this paragraph but the committee voted to repeal the paragraph altogether, not only because of doubts as to its constitutionality but because it did not appear that the paragraph could be amended in a practicable manner so as to eliminate difficulties inherent in the situation. Inasmuch as dangerous conditions found to exist in such institutions are not subject to correction under the law, the present situation tends to deceive the public by causing it to have a false confidence in such institutions, based on the knowledge that they are subject to Federal examination, because the public will assume that being subject to such examination they are also subject to supervisory regulation and control.

The Comptroller, in his statement at the hearing before the House committee, said that section 303 (b) as proposed in title III of the pending bill (reading)—

makes it clear that section 21 (a) (2) of the Banking Act of 1933 does not require that business institutions which accept deposits only from their own officers, agents, or employees need submit to examination and publication of reports of condition. Hundreds of corporations, such as the B. & O. Railroad, Chrysler Motors, Deere & Co. permit employees to leave part of their wages on deposit and in turn loan these funds to other employees so as to encourage thrift and be of assistance thereto.

This section also makes it clear that the expense of examining private banks by this office or by the Federal Reserve Board shall be paid by the institution examined, as there are otherwise no funds available to bear the expense of such examination.

I think the chairman of the subcommittee will remember that 2 or 3 years ago I submitted to him a brief on the constitutionality of that section.

Senator GLASS. Yes; that is your "baby."

Mr. ALDRICH. The repeal of that section will have the effect of permitting commercial banks, other than incorporated banks, to proceed without regulation or publication of statements in all States where the State law does not provide therefor; and to my mind it is a very unwise thing to repeal that provision.

Senator GLASS. Does your State now provide for examinations?

Mr. ALDRICH. It does not.

Senator GLASS. It did not at that time, I know.

Mr. ALDRICH. It does not now, except for banks which take deposits of less than $7,500. I have a memorandum here saying that the New York law does not require examination or supervision by the New York Superintendent of Banks of private banks which only accept deposits of $7,500 or more from any person. I just call the attention of the committee to that——

Senator COUZENS. Is it your idea that it ought to be reinstated?

Mr. ALDRICH. I think the recommendations of the Comptroller of the Currency with regard to that section, as stated in the hearings before the House committee, should be followed. There is no indication from what source the suggestion of changing that section comes, except that shown in the report of the House committee. There is nothing in the testimony before the House committee, with the exception of the statement of the Comptroller of the Currency that I have just read.

Senator BYRNES. With reference to a private bank, do you think Congress has the power to legislate with reference to an individual bank in the city of New York, for instance, in accepting deposits?

Mr. ALDRICH. I submitted to Senator Glass 3 years ago a memorandum to the effect that under the powers of Congress with regard to the currency and its powers with regard to banking, it has the right to provide that any bank taking deposits shall submit to examination.

Senator GLASS. I have the brief filed away somewhere; but I will say in all frankness that I did not agree with that brief, but we put it in nevertheless.

Senator BYRNES. As to examination of these banks, as I recall it the Comptroller expressed the view that the result of the examinations was filed in the Comptroller's office and he knew not what to do with it. He had no power to enforce it.

Mr. ALDRICH. This is the testimony of the Comptroller that I have right here, that I just read from.

Senator BYRNES. I mean before this subcommittee he made that statement.

Mr. ALDRICH. When was that, Senator?

Senator BYRNES. A few weeks ago. He made the statement that he could not forward it to the State bank examiner because the State bank examiner had no power to regulate private banks, and he had no power, and therefore it was on file. They were conducting an examination, entering the bank, but it was simply an academic matter, that they could not accomplish anything, and that he had no power and the State had no power. I wondered what your view was with reference to it.

Mr. ALDRICH. The effect of that provision of the law has been that commercial banks, not incorporated banks, have been required to file statements and make them public.

Senator BYRNES. But this is what the Comptroller stated, which impressed me at the time, that there was no regulatory power that could be enforced, but at the same time a banker could advertise to his depositors that he had been examined and investigated by the United States Government, and it gave to him a prestige that was not warranted.

Mr. ALDRICH. He would be advertising a fact which was not so.

Senator BYRNES. But maybe it is so that he was investigated.

Senator COUZENS. Can we not make a prohibition against that?

Senator BYRNES. I think something should be done about it. If you are advertising to your depositors that reports are being made by the United States Government, it gives a security that is not warranted, since the Government has no such power.

Mr. ALDRICH. If any banks are holding out to their depositors anything which is not so, they ought to be prevented from doing it.

Senator BYRNES. As a matter of fact, the statement made to us was that such reports were being filed.

Senator TOWNSEND. I think, Senator Byrnes, that the Comptroller's statement was on the basis of the examinations being made by both his department and the F. D. I. C.; the F. D. I. C., for instance, accepted the report of the State examiner.

Senator BYRNES. I understood the suggestion to be, and it rather impressed me as being meritorious, that if they have no responsibility they should not be considered.

Senator GLASS. When we begin to take up the bill we will get the Comptroller to tell us what he means.

Let me ask you one question, Mr. Aldrich. Of what particular advantage is a national charter to a bank if the right of circulation is to be canceled?

Mr. ALDRICH. Well, I cannot say that it has much advantage except that of course it is subject to the jurisdiction of the Federal courts in a great many cases, not to the jurisdiction of the State courts.

Senator GLASS. The reason I asked the question was that I wanted to be careful and not encourage national banks to go out of the Federal Reserve System by adopting laws that might be peculiarly offensive and damaging to their business.

Mr. ALDRICH. Of course that is a difficulty which is inherent in this whole situation; there is no doubt about it, if these things are carried to the point where it is made impossible or extremely difficult to operate profitably there will be a tendency to withdraw from the System and take out a State charter.

Senator COUZENS. What would be the advantage of a State charter if they were forced into the Federal Reserve System?

Mr. ALDRICH. I do not get that, Senator Couzens.

Senator COUZENS. It is contemplated to force all of the State banks into the Federal Reserve System; and I ask you whether there would be any greater advantage in having a State charter under those circumstances than having a national charter.

Mr. ALDRICH. If they are all members of the Federal Reserve System?

Senator COUZENS. Yes.

Mr. ALDRICH. I doubt it.

Senator COUZENS. In other words, you think it would be a case of Tweedle-Dee and Tweedle-Dum between a State charter and a national charter if they were all members of the Federal Reserve System?

Mr. ALDRICH. I should think so.

Senator GLASS. Well, you could transact various kinds of business under a State charter, if you were a nonmember bank, that you would not be permitted to transact as a member bank in the Federal Reserve System.

Mr. ALDRICH. That is quite true; but I understood the Senator to say, would that advantage continue to exist if we were forced into the Federal Reserve System. I do not think it would.

Senator GLASS. My suggestion was as to nonmember banks.

Mr. ALDRICH. They would have an advantage, unquestionably, and there is no doubt but what it is a real advantage.

Senator COUZENS. In other words, you would rather have a State charter without membership in the Federal Reserve System than a national charter; is that right?

Mr. ALDRICH. No; I don't think that at all. As a matter of fact, I personally have the greatest pride in representing a national bank. I do not want to do anything like that.

Senator COUZENS. In other words, you see enough advantage in having a national charter and being a member of the Federal Reserve System to justify your being in it?

Mr. ALDRICH. I would not put it that way. As far as I am personally concerned, I have been in a national bank at all times, and I think that up to the present time there certainly has been no reason for saying that I see any advantage in being a State nonmember bank which would make me feel like giving up the national bank charter and becoming a State nonmember bank. But I can conceive of a situation arising where that might be advantageous.

Senator GLASS. Not to your particular bank, but you know of other banks, perhaps, to whom it would be advantageous?

Mr. ALDRICH. Yes. It is more apt to be smaller institutions than ours.

Senator COUZENS. Are the smaller national banks making any money now?

Mr. ALDRICH. Well, yes; but not much. This F. D. I. C. assessment is something terrific. It is going to cost us a million and a half dollars a year.

Senator COUZENS. How much interest did it cost you before you were prohibited from paying interest on commercial deposits?

Mr. ALDRICH. I cannot remember, but it was a substantial amount.

Senator COUZENS. I would venture to say it was more than a million and a half.

Mr. ALDRICH. I doubt it. It might have been. But in any event, we are not earning much money now, any of us, and that is a very substantial amount.

Senator COUZENS. But you have been saved from a lot of competition that you used to encounter.

Mr. ALDRICH. Undoubtedly there has been a saving in the provision that we cannot pay interest on demand deposits.

Senator COUZENS. Absolutely. I know that many of the big institutions used to shop around and get big prices for their deposits, which now they cannot do.

Mr. ALDRICH. That is right.

Senator GLASS. The chief reason for putting that provision in the law was that the big banks were drawing all the surplus funds from the interior banks. That is why we put it in. We were not so much concerned about your making money. We were concerned about drawing all the money from the balance of the country.

Mr. ALDRICH. Senator, may I say just one more word about the matter in regard to the Comptroller General? He is appointed by the President, and I would like, with a great deal of seriousness, to call your attention to section 42 of title 31. I really would like to urge upon this committee with the greatest seriousness the consideration of putting into the provisions with regard to the term of office of the members of the Federal Reserve Board the same kind of restrictions on removal that are provided for by title 31. Section 303 of the act of June 10, 1921, with regard to the removal of the Comptroller General, provides that [reading]:

> The Comptroller General may be removed at any time by joint resolution of Congress, after notice and hearing, when in the judgment of Congress the Comptroller General has become permanently incapacitated or has been inefficient or guilty of neglect of duty or of malfeasance in office or of any felony or conduct involving moral turpitude, and for no other cause and in no other manner except by impeachment.

That is, during his term of office, of course.

Senator COUZENS. Certainly I would not approve of any such proposal as that. I know too many officers now that ought to be removed.

Senator GLASS. We are obliged to you, Mr. Aldrich.

(Whereupon, at 3:15 p. m., the subcommittee adjourned until tomorrow, Thursday, May 16, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

THURSDAY MAY 16, 1935

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

The subcommittee met, pursuant to adjournment on yesterday, at 11 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.

Present also: Senator Thomas P. Gore of Oklahoma.

Senator GLASS. The committee will come to order. Dr. Anderson, we have before us the Senate bill with which you are undoubtedly familiar, and also the bill as it passed the House, No. 7617; and we will be glad to have your judgment of the bills before the subcommittee Just give your name and occupation for the record.

STATEMENT OF BENJAMIN M. ANDERSON, Jr., ECONOMIST, CHASE NATIONAL BANK OF THE CITY OF NEW YORK, RIVERDALE, N. Y.

Mr. ANDERSON. My name is Benjamin M. Anderson, Jr. I am economist of the Chase National Bank of the city of New York, and my address is Riverdale, N. Y.

Mr. Chairman, I do not want to try to go over the whole bill or to take up administrative features of it. I want to concentrate on title II, and in connection with title II I want to talk chiefly about certain questions of principle, theory and objectives rather than the details of the matter. The presentation yesterday was very full and very thorough, and I do not want to go over that whole ground.

Senator COUZENS. May I ask, before you begin, if you concur completely in all the testimony of Mr. Aldrich?

Mr. ANDERSON. Just about as completely as one vigorous man can with another, Senator. I associate myself very gladly with the general propositions and practically every detail that Mr. Aldrich presented.

Senator COUZENS. I am glad that you are not going to repeat it, then.

Senator GLASS. You may proceed, Dr. Anderson.

Mr. ANDERSON. My first proposition would be that title II does not seem to me to be needed for any present purpose, from the standpoint of the Administration's policies; that it contains no provision which is needed to enable the President or the Federal Reserve Board or the Treasury to do anything that they wish to do with respect to the present situation. The President has today full power to proceed on virtually any monetary or credit theory that he wishes to proceed on, under the powers granted by the Thomas amendment, the gold bill of 1934 and the recent silver legislation. I do not see that the temporal limitations in the gold bill would affect this proposition. They relate to only two points in the gold bill.

I do not see that the temporal limitation in the Thomas amendment for the receipt of silver for interallied debts makes any difference in the proposition. The Treasury has enormous power to expand the already terribly excessive reserves of the member banks in connection with the stabilization fund, and the power to contract member bank reserves and, through them, the general volume of bank credit exists adequately. The Federal Reserve System could sell Government securities or, under the Thomas amendment, the existing reserve requirements could be raised, or the Treasury could float a funding loan and turn the proceeds into the Federal Reserve banks and take up Government securities. There are no limitations on the power of the President growing out of the existing gold reserves. Gold reserves are notoriously very excessive, and there is no evidence of any disposition on the part of the Federal Reserve System to resist the administration's program.

So that I see no reason for the enactment of title II in a hurry. There is plenty of time to work the matter out right if you are going to reorganize the Federal Reserve System.

I want to talk about title II from the standpoint of long-run policy, the theory and objectives of it. For one thing, I believe that it is designed to embody in our law a radically new theory regarding Federal Reserve policies and objectives. It prescribes new qualifications for the members of the Federal Reserve Board which sound harmless as stated, but which attain a dangerous significance when the background is understood. The members of the Federal Reserve Board are to be persons well qualified by education or experience or both to participate in the formulation of national economic and monetary policies.

I think if you had been concerned with this problem in the drafting of the original Federal Reserve Act you would have said that they should be persons well qualified to regulate the money market and to regulate the banking system of the country, which is a very different thing.

This provision of the proposed new law should be read also in connection with the language defining the objectives of Federal Reserve policy as stated in the new draft of H. R. 7617 of April 19, 1935 [reading]:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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 as far as may be possible within the scope of monetary action and credit administration.

This passage says nothing about the more fundamental function of the Federal Reserve System, which is to protect the soundness of the currency and to protect the quality of credit in the country, to provide additional currency for seasonal needs and for emergencies, and to expand credit as needed for the accommodation of commerce, industry, and agriculture. That is their first job.

Senator COUZENS. Do you think the omission of that has any great significance?

Mr. ANDERSON. I do, Senator. I think the omission of that has great significance. I think that right here we have a radically new theory and a radically new proposal.

Senator McADOO. Do you think that the inclusion of what you read there a moment ago is of any value, that it means anything?

Mr. ANDERSON. I would like to see it much more definite, and I would like to see definite provisions as to the quality of credit and as to checking unsound speculative booms, because this new theory, in application by the men who are behind it, insisted in 1928–29, "Don't raise interest rates." They held then, Professor Cassel especially—

> Commodity prices are not rising; in fact, they have gone down a little. The Federal Reserve System must not tighten money under those circumstances. Rather it should make money easier. What the stock market does is not the concern of the Federal Reserve System. It is concerned with keeping steady the level of commodity prices.

Senator COUZENS. Did you agree with him then?

Mr. ANDERSON. I did not, sir; and I want to offer for your record, if I may, a speech which I made in 1929 in Rotterdam before the Netherlands University, taking as my text Professor Cassel's doctrines and undertaking to refute them. I will offer that for the record, asking, however, that for the statistical appendix there be substituted the statistical appendix to the Chase Economic Bulletin of May 1932, which gives the same figures but brings them down to a later date.

Senator BULKLEY. I am not sure that I get the significance of what you are saying about the error of the Cassel theory in 1929. What did you mean to imply by that?

Mr. ANDERSON. The issue was before us. I was proposing, as were others who looked at this thing as a banking matter, that the Federal Reserve System move vigorously to tighten the money markets, to stop the wild speculation and to prevent the continued diversion of bank credit into speculative loans. Professor Cassel said in substance:

> No; that is not their business. Their business is to maintain the level of commodity prices, and as commodity prices have actually gone down a little, they should make money easier instead of tighter.

That was the issue.

Senator BULKLEY. What do you draw from that?

Mr. ANDERSON. The new theory behind this bill, as I understand it, is this theory that it is the business of the Federal Reserve System to try to keep the volume of demand deposits and money in circulation at such a level as will keep commodity prices, the volume of business, and so on, on a fixed level, ignoring this more fundamental thing of the quality of credit and the duty of tightening up to stop unsound tendencies.

Senator BULKLEY. Your idea is that he ignored more fundamental things in his statement?

Mr. ANDERSON. Yes.

Senator BULKLEY. I do not see how you tie this in with any mistake that Professor Cassel may have made, assuming that he did make a mistake. How do you tie this bill in to that?

Mr. ANDERSON. I am coming to that.

(Address delivered by the witness before the Students' Union of the Netherlands Commercial University on May 7, 1929, at Rotterdam, The Netherlands, will be found printed in full in the record at the close of the witness' testimony just before the recess.)

Senator COUZENS. Before you go further: Is there any objection to combining what you want and what Professor Cassel wants, in this bill?

Mr. ANDERSON. I would say that it is the business of the Federal Reserve Board to try to look at the whole business situation.

Senator COUZENS. That is what I am getting at. I am asking you now if you think it would be desirable to have both objectives. I do not see that they conflict particularly, nor do I see any vital objection to an effort being made somewhere in some place to stabilize, as far as possible, industry.

Mr. ANDERSON. My view would be that the banking system cannot play God; that the banking system is only a part of the general economic system, and that the banking system makes its best contribution to general stability when it itself is handled rightly, when credit is not allowed to be unduly excessive or unduly tight, when the money market is well regulated; that you have got different functions for different parts of the economic system.

Senator GLASS. Is not that succinctly stated in the existing law and in the original Federal Reserve Act when the banks were authorized and empowered to respond to the requirements of commerce, industry, and agriculture?

Mr. ANDERSON. They did not so interpret it in action, Senator. I thought it was misinterpreted in action.

Senator GLASS. Of course it has been misinterpreted.

Mr. ANDERSON. But your objectives were clear; yes, sir.

Senator MCADOO. What you are criticizing and what you are proposing should be substituted for it is a futility, anyway, is it not? It is merely declaratory. It has no binding effect. You cannot enforce it. It is not legislation. It is a sort of a speech. I do not think that the incorporation of such matter in legislative enactment is of any value. It may show intent on the part of Congress, but its enforcement rests within the judgment and discretion of the board. There is no way that you can determine whether or not the accomplishment of it has even been attempted by the administrative authority.

Mr. ANDERSON. I believe it would be possible to frame that kind of policy in such a way as to make it clear to them that they must do certain things and that they must not do other things.

Senator MCADOO. Then I think we ought to have express provisions in the act of such a specific and definite character that they are enforceable, and that the board is compelled to observe such provisions. However, that is just an observation on my part.

Mr. ANDERSON. I know the difficulty of enacting a law that is going to be applied in just the way you mean it.

The question as to the linkage between Professor Cassel's view and this bill, if you want further evidence, is more fully gone into in an analysis which I made of a recent book by the technical adviser of the Federal Reserve Board who took part in the formation of this bill—Dr. Lauchlin Currie. I offer it for the record. I will not read it.

Mr. Eccles has said, I believe, in testimony before the House committee, that Dr. Currie was one of those that took part in the preparation of this bill.

Senator BULKLEY. Are you advised that Professor Cassel was in any way connected with the drafting of this bill?

Mr. ANDERSON. His connection with the American Congress was when he appeared before the House committee and testified there, and his views have had a great deal of influence, I think, on the thinking of certain members of that committee. But I have no way of linking him up directly. I do know the body of thought out of which this bill proceeds, and it is with reference to that that I thought I could be most useful to the committee.

Senator BULKLEY. I am just trying to get at the truth of it. I am not advised whether Professor Cassel was connected with those gentlemen. If you are, I think it would be very interesting to know it.

Mr. ANDERSON. To ask me for personal contacts, and so on—even if I knew them it would be pointless for me to talk about them. I know the logical connections in economic theory, and it is with reference to that that I want to testify.

Senator BULKLEY. Is that the way you are going to link it up?

Mr. ANDERSON. That is the best way to do it, I think. There I can speak with authority, but if I say this and that and the other thing, I am talking hearsay. But I know the logical connections of economic theories. That is my job.

May I offer for the record, Mr. Chairman, an analysis which I have made of Dr. Currie's book which very definitely takes a position with regard to the old-fashioned elasticity of credit—credit going up with the upswings of business and going down with the downswings of business, that that is perverse and that we want rather to have a kind of policy that will keep bank credit—or, as he would put it, demand deposits—from rising with the upswings of business; that would make them stay up or rise with the downswings of business. The new theory is very definitely embodied in that doctrine.

I offer that analysis of Dr. Currie's book for the record.

Senator GLASS. It will be printed in the record.

(Analysis of book by Lauchlin Currie, Ph. D., referred to and submitted by the witness, is here printed in full as follows:)

A CRITICAL ANALYSIS OF THE BOOK BY LAUCHLIN CURRIE, PH.D., "THE SUPPLY AND CONTROL OF MONEY IN THE UNITED STATES"

An address by Benjamin M. Anderson, Jr., Ph.D., economist of The Chase National Bank of the City of New York before the New York chapter of the American Statistical Association at a dinner on Friday, April 26, 1935, in New York City

(The importance of Dr. Currie's book grows out of the fact that he is technical advisor of the Federal Reserve Board, and that title II of the pending banking legislation gives evidence that his theories lie behind it.)

WHY DR. CURRIE'S BOOK IS IMPORTANT

The importance of this book is to be found, not in its contribution to the scientific study of money and banking, but in the fact that the author is at present technical advisor of the Federal Reserve Board, and in the further fact that title II of the pending banking legislation gives evidence that his theories lie behind it. It becomes, therefore, a matter of first importance that his book should receive rigorous critical analysis from students of money and banking.

The writer of the book is so intensely preoccupied with the application of a single highly simple theory, regarding the control of incomes and commoditv prices by means of the control of the supply of money, that he disregards virtually everything else in the whole financial picture and in the general picture of economic life.

CURRIE'S INACCURACIES IN MATTERS OF FACT

The book contains, moreover, grave inaccuracies in matters of ascertainable fact. I regret the necessity for saying this. His statements regarding real-estate loans will illustrate this inaccuracy. On page 118 he says: "Real-estate loans of all member banks remained below 10 percent of earning assets until 1932 when, owing to the relatively greater decline in other loans, they amounted to 10.5 percent." On page 119 he speaks of "the smallness of the yearly fluctuations in real-estate loans." These two statements, taken together would completely mislead the reader with respect to the history of real-estate loans in member-bank assets. The facts are shown in the following table:

Real-estate loans and total loans and investments

[In millions of dollars]

End of June	Real estate loans of— National banks	Real estate loans of— All member banks	Total loans and investments of all member banks
1918	185	461	18,507
1919	184	577	22,240
1920	230	953	25,559
1921	280	1,135	24,121
1922	371	1,432	24,182
1923	463	1,749	26,507
1924	535	1,990	27,167
1925	637	2,338	29,518
1926	725	2,650	31,184
1927	1,062	2,926	32,756
1928	1,285	3,068	35,061
1929	1,413	3,164	35,711
1930	1,473	3,155	35,656
1931	1,585	3,218	33,923
1932	1,617	2,894	28,001
1933	1,327	2,372	24,786
1934	1,331	2,357	27,175
Percent increase			
1918-28	594 6	565 5	89 4
1918-32	774 1	527 8	51 3

Sources Annual reports of the Federal Reserve Board, Comptroller's reports, Statistical Abstract of the United States, and Federal Reserve bulletins.

The facts are that real-estate loans increased very much more rapidly than total member bank earning assets [1] in the period from 1918 to 1928, the percentages being real-estate loans 565 percent, total loans and investments 89 percent.

The rapid growth of real-estate loans in banks was one of the most unwholesome of all the "new era" developments. This error is particularly important in view of the provisions of title II of the pending banking act regarding real-estate loans.

CURRIE'S VERSION OF THE QUANTITY THEORY—THE BASIS OF HIS WHOLE ARGUMENT

Currie starts out with an apology for writing a book which may be damned "with the deadly accusation 'quantity theory'", and speaks of the "almost universal abandonment of the quantity theory of money." He thinks that there is danger that the pendulum may swing too far in the opposite direction, and that the effect of variations in the supply of money may be unduly minimized. He proposes to repair, in part, the neglect of variations in the quantity of money and says that criticisms of his study on the ground that it does not give a full account of the forces affecting the value of money are irrelevant since this is not its pur-

[1] The word "fluctuations" in the passage quoted from Currie cannot have a technical statistical meaning related to the "trend line" forreal-estate loans considered separately, because the conte' (pp.. 11) makes it clear that he is talking of the proportion of real-estate loans in bank assets.

pose (p. 3). By the time he reaches page 6, however, he has become the uncompromising advocate of an extremely tight and inflexible version of the quantity theory. I quote: "* * * is not the really fundamental explanation of the rise in prices the increase in the supply of money?

"Although the net annual increments to a country's supply of money appear small in relation to the aggregate money incomes * * * still there are indications that they are of surprising importance in determining the secular trend of prices * * *. Assume the quantity of money of a country to be $25,000,000,000 and the monetary income to be $75,000,000,000 so that the income velocity of money is 3. Then an addition of 1 billion new money, or 4 percent, would, assuming no change in the income velocity, increase incomes by $3,000,000,000, or 4 percent. * * * The income velocity of money is subject to fluctuations from year to year, sometimes very wide, but apparently it does not increase sufficiently over a period of years to maintain prices." In a footnote (p. 6) he gives figures regarding what he calls the "income velocity of money" and concludes (I quote): "Hence the major part of the increase in money incomes was attributable to the expansion of money." On page 15 he discusses the money-market effects of the transfer of an individual time deposit to a demand deposit, and then says, "The effect on incomes and prices is clear." By page 53, he even refers to Irving Fisher, and gives Fisher's equation of exchange as ground for disregarding all forms of credit except demand deposits. By page 177 the doctrine has become very familiar and has been used many times as a basic assumption, the statement on page 177 being: "Since the expansion of adjusted demand deposits up to 1929 was *just sufficient* to *maintain* relative stability of commodity prices * * *."

Currie would distinguish his own quantity theory from that of Irving Fisher. Currie reckons with what he calls "income velocity." He calculates this by dividing figures for the national income by his figure for "money", money being actual pocket cash in circulation plus "adjusted demand deposits."[2] Fisher, on the other hand, reaches his velocity by comparing the total expenditures of money for whatever purpose with the supply of money somewhat similarly defined. On pages 169–170 Currie discusses this difference. I reserve comment for a later point of this paper. The significant thing for present purposes is that Currie and Fisher, though reaching their conclusions by formally different mathematical schemata, both believe that regulation of the quantity of money, including demand deposits, will regulate the general average of commodity prices (not defined in the same way by both).

CURRIE HOLDS FEDERAL RESERVE POLICY SHOULD CONTROL VOLUME OF DEMAND DEPOSITS, NOT QUALITY OF BANK ASSETS

Currie is not always sure that he wants to make the control of commodity prices his objective. Sometimes he talks of regulating incomes and sometimes of other purposes. It is reasonably clear, however, that he thinks that, in regulating incomes one is also regulating commodity prices. But the whole thesis of the book is that the combined amount of money in the pockets of the people and "adjusted demand deposits" is to be regulated by the Federal Reserve authorities with reference to one of these objectives, and that everything else in legislative policy and Federal Reserve policy concerning money, credit, and banking is to be subordinated to this.

The Federal Reserve banks, he maintains, have allowed themselves to consider irrelevant matters, and particularly the matter of the quality of the assets of the commercial banks. He draws the line sharply between two objectives: (1) The control of the total of money, which he advocates, and (2) the policy directed toward control of the quality of the assets of the member banks, which he condemns.

HOLDS FEDERAL RESERVE SYSTEM SHOULD NOT TRY TO CONTROL SPECULATION

It is not the business of the Federal Reserve banks to check or hold down stock market speculation if in so doing they are obliged to reduce the total of demand deposits, he holds. Federal Reserve policy in 1927, when they increased member bank reserves by their vast purchases of Government securities, was, he holds, "wholly admirable." I quote:

[2] Currie's "adjusted demand deposits" are demand deposits, minus interbank deposits, but plus Government deposits. Fisher keeps the velocity of money in circulation separate from the velocity of deposits in his calculations.

CURRIE APPROVES 1927 FEDERAL RESERVE POLICY

"The 1927 policy has been generally condemned on the ground that it was responsible for the 'speculative mania' of 1928–29, one of the members of the Federal Reserve Board having since gone so far as to say that it represents 'one of the most costly errors committed by any banking system in the last 75 years.' To the writer it appears wholly admirable, rather to be characterized as one of the most successful policies ever pursued. Though one cannot positively say that it was responsible for arresting the downward trend of prices and production and for easing the pressure on foreign central banks, we are justified in claiming that it was the policy acceptable in theory for the attainment of those ends. Since we have argued that the call-money rate plays a minor role in the calculations of speculators and that the major part of the rise in stocks appeared reasonable and defensible on the basis of the then existing knowledge, it follows that the 1927 policy was responsible for the subsequent rise in stock prices only in the sense that it resulted in an upswing in business activity and profits." [3]

CURRIE CONDEMNS BANKING ACT OF 1933

Currie says: "* * * the provisions in the Glass-Steagall Act of 1933, seeking to give the Reserve Administration greater control over the loans of member banks indicates a complete misreading of the 1928–29 episode and do not mark any advance in either central banking theory or practice."[4]

CONDEMNS EFFORTS OF FEDERAL RESERVE SYSTEM TO CONTROL SPECULATION IN 1929

The effort of the Federal Reserve System to tighten money and to hold down the stock-market boom in 1928 Currie approves mildly on the ground that business had definitely turned the corner, with the qualification that "it perhaps need not have been quite so drastic." But the efforts of the Federal Reserve System in 1929 to check the speculation was "a grave blunder." What they should have done in 1929 was to reverse policy and to make money easier. "This course, which has never as yet been tried, appears as first sight so bold—almost foolhardy—that it was not even considered. To the writer, however, it appears to have been the only way out."[5]

CURRIE'S THEORY RUNS COUNTER TO ALL ACCEPTED PRINCIPLES OF BANKING—HOLDS COMMERCIAL LOANS "PERVERSE", LIQUIDITY UNIMPORTANT

Currie's theory that everything is to be subordinated to the control of the quantity of money runs remorselessly against virtually every accepted principle of credit and banking. He regards liquidity of banks as unimportant. Loans that can be readily liquidated and that are liquidated when the borrowers no longer need them, as borrowers, draw down their deposits at the banks in paying off their loans, are indeed "perverse", since such loans interfere with the control of the volume of demand deposits by the central authorities. Commercial loans in banks are particularly bad from this point of view, because they tend to expand with a resultant expansion of demand deposits at times when business is active and prices are rising, at which time the policy of control would call for holding down demand deposits, and because they contract when business is falling off. (Compare pp. 42 and 131.)

INVESTMENTS HELD "IDEAL" TYPE OF ASSETS FOR BANKS

Investments by banks are far better from the standpoint of the kind of control Currie wants. Indeed, he uses the word "ideal" in connection with them—"From the viewpoint of control, investments are the ideal type of assets" (p. 122).

LOANS "FOR ACCOUNT OF OTHERS" IN 1929 DECLARED "FORTUNATE" BY CURRIE

In Currie's view, security loans stand in between. Like commercial loans, they tend to decline in the downswings of business, but "fortunately, in 1929, banks were not supplying the whole of this market." Loans "for account of others" stood at a vast figure in 1929, and bank loans against securities and demand deposits increased as the "others" withdrew in panic from the loan

[3] Currie, Monetary Policy and the Depression, from the Journal of Political Economy, Chicago, April 1934, pp. 168 and 169. This article is cited with approval in the book under discussion on pp. 145 and 146.
[4] Ibid., p. 176, n.
[5] Ibid., pp. 169–170.

market. Currie continues, "Although, curiously enough, banks appear to resent what they call 'bootleg' loans, it is difficult to see how a serious contraction of money [6] would have been avoided in 1929 if they had not existed." In a footnote, Currie gives evidence of a little uneasiness about this absurd statement because he says, "Unless it is held that the height of loans on account of others was responsible for the liquidation." But he continues: "Despite the bad repute in which nonbank security loans are generally held * * * it is to be hoped that they will increase in the future. Their existence affords a much needed degree of elasticity to bank security loans" (p. 121).

CURRIE'S COMPLETE MISUNDERSTANDING OF 1927–29 DEVELOPMENTS

To one who lived through the crash of 1929, viewing the matter from the inside of a great bank, this view is so fantastic as to be incredible. I myself would hold the view that loans "for account of others" were often useful in the period preceding 1924. They came in times of tension and crisis, attracted by high rates of interest, from men who were well informed and who had steady nerves, men who knew the risks and knew how to protect themselves against them. The entrance of such lenders eased the burden on the banks in a crisis. As they came in, they reduced their deposit balances with the banks at the same time that they took over loans which the banks would otherwise have to carry. This facilitated, without forced sales of securities in the market, a reduction both of bank loans and of bank deposits, with the result that the reserve ratios of the banks were improved and with the consequence that interest rates were held down or reduced. Interest rates on short bank loans are primarily governed by the question of whether reserves are excessive, adequate, or deficient with relation to deposits, and a period of tight money is eased off either by a decline in deposits or by an increase in reserves or by both.

But the role of brokers' loans for account of others in the 1929 episode was a radically different thing. These loans were made, not in the crisis, but in the period of the boom, and when the crisis came there was a sudden panicky withdrawal of these loans "for account of others", with the result that there had to be an immense expansion of bank credit, loans, and deposits, to take care of it. In the panic week of 1929, the total of loans for the reporting member banks in New York City increased by $1,281,000,000, while the demand deposits of these same banks showed an increase of $1,565,000,000. Of this increase in loans, 374 millions, or over 29 percent, was in the Chase National Bank alone, where the present writer was in a position to know very definitely what was going on and what the money market consequences were.

The situation was studied closely as it developed through 1928 and 1929, and it became increasingly clear that a grave problem existed. The volume of brokers' loans for "the account of others" looked manageable in late 1928, but it grew by leaps and bounds through 1929, and it became increasingly clear that only heroic measures could meet the crash when it came. The New York banking community was increasingly preparing itself for this shock, and made an eminently creditable performance in meeting it by a gigantic expansion of loans and a corresponding expansion of deposits.

But the contention that it was a good thing that they should have had to do so, because otherwise demand deposits would have gone down, is one of the most fantastic things ever said by any writer on money and banking.

CURRIE ABSOLUTELY WRONG ON RELATION OF DEMAND DEPOSITS AND INTEREST RATES

The reason for this is partly to be found in a curious obsession of Currie's concerning the relation of demand deposits to interest rates. Currie believes that an increase in demand deposits lowers the rate of interest. I quote: "In the former case, the banks create deposits by increasing loans. This has a tendency to lower interest rates" (p. 20). Currie apparently believes that the existing volume of deposits can be loaned by banks, even their time deposits (p. 152). He believes that the contraction of demand deposits of member banks in the first 9 months of 1928 was "probably the major cause of the abnormal rise in interest rates in that period" (p. 145).

He apparently does not realize that banks do not own their existing deposits. Their existing deposits are liabilities of the banks. They are the debt of the banks to their customers. Their customers can lend them, if they wish, but the

[6] "Money" in Currie's language means cash in the hands of the public plus "adjusted demand deposits."

banks cannot. A bank can lend only if it has enough cash reserves to permit it to create a new demand deposit liability to a borrowing customer, or to pay out cash in making the loan—or, of course, if it has liquid assets other than cash reserves by the disposal of which it can promptly get more cash. The facts with reference to the relation of deposits and interest rates are precisely the reverse of Currie's assumption and belief. When a bank's deposits are low, in relation to a given volume of cash reserves, its ability to lend is great, its temptation to lend is great, and if other banks are similarly placed, the competition of banks for loans makes interest rates go low. As deposits increase with the same given volume of reserves, interest rates tend to go higher.

The fact is, further, that the decline in demand deposits in 1928, instead of raising the interest rates, as Currie supposes, tended to ease off interest rates and tended to defeat the efforts of the Federal Reserve System to control the stock market speculation by tightening money. Moreover, the fact is that the sudden increase in demand deposits at the end of 1929, as the member banks were obliged to take over the loans "for account of others", operated to hold up interest rates and to retard the efforts made by the Federal Reserve banks to ease off the money market.

DEMAND DEPOSITS AND BROKERS' LOANS, 1928–29

The main explanation of the decline in demand deposits in 1928 was the growth of brokers' loans "for account of others" and for the account of out-of-town banks, though other factors entered as shown below. The present writer analyzed this while it was going on, in three numbers of the Chase Economic Bulletin.[7]

Instructed by a customer with large demand deposits to make a loan for his account to stock exchange brokers, the bank might do one of two things. It might, most simply, turn over to the customer a loan which it had already made, debiting his deposit balance as it did so. Here, obviously, in the bank's figures, loans go down and deposits go down, and no change takes place in any other bank, so the total of loans and deposits in the banks is reduced, and pressure on the bank's reserve is reduced. The bank is in a better position to make a new loan than it was before. A more complicated case would be where the bank made a loan at the "money desk" in the stock exchange for the customer's account, and debited his deposit balance, giving a cashier's check to the broker who took the loan. The bank, in this case, assuming that it reserves were just adequate—and the reserves were under pressure in general throughout 1928—would be disposed to call a loan made for its own account on the same day, in order to avoid a deficit in its dealings with the clearing house and the Federal Reserve bank the following day. In this case, also, deposits go down for the bank and for the banking system, and loans go down for the bank and for the banking system. This matter is analyzed fully in the bulletin above referred to, Brokers' Loans and Bank Credit.

The remarkable thing about loans "for account of others" in 1928–29 is the altogether unprecedented volume of money available for this use. It had never happened before in our history, and that it should have happened at that time calls for a very special explanation. The explanation is to be found in the preceding gigantic expansion of bank credit between 1922 and early 1928, amounting to 13½ billions of deposits, demand and time together, and to 14½ billions in loans and investments, for the commercial banks of the country, savings banks not included.

This bank expansion was based (*a*) on inflowing gold, and (*b*) on easy money policies of the Federal Reserve banks, very especially on the great open-market purchases of Government securities in 1924 and in 1927, the latter being the episode so highly praised by Dr. Currie. This expansion had put redundant liquid resources into a great many hands. Between the middle of 1927 and the middle of 1928, for example, as a result of the immense expansion of cheap money, some 1,800 millions of new foreign securities refunding excluded, were placed in the United States, an amount far exceeding the needs of foreigners for meeting current interest and for offsetting our favorable merchandise trade balance, the proceeds of which they were in a position to lend to our securities market when the rates of interest there attracted them.

The growth of the issue of new securities of all kinds during this period of bank expansion was very great; 1923 was the one year during this period in which there was no bank expansion. The total of new securities publicly placed was 4,300 millions in that year, taken up by investors' money. In the calendar year 1927, on the other hand, with an expansion of bank credit of approximately 3

[7] (1) An Analysis of the Money Market, June 1928, pp 18–19, (2) Brokers' Loans and Bank Credits, Oct 31, 1928, and (3) Some Side Lights on the Money Situation, Feb 13, 1929.

billion dollars, the total of new securities publicly placed was 7,790 millions, the increase over 1923 in investors' savings being 490 millions, but 3 billions of the excess being a resultant of bank expansion.

Security issues

[In millions of dollars]

Year	Total securities publicly placed (refunding excluded)	Total corporate securities publicly placed (refunding excluded)	Foreign securities publicly placed in the United States (refunding excluded)
1922	4,304 4	2,335.7	634.5
1923	4,304 4	2,702.5	280.3
1924	5,593.2	3,322 3	996.6
1925	6,220.2	4,100.7	1,086.2
1926	6,344.1	4,357.0	1,145.1
1927	7,791.1	5,391.0	1,561.1
1928	8,114.4	6,079.6	1,319.2
1929	10,194 9	8,649.4	757.8
1930	7,023 4	4,944.4	1,009.2
1931	3,115 5	1,763.4	253.7
1932	1,192 2	325.4	26.0
1933	709 5	160 7	.1
1934	1,419.5	178.3	0

Source: Commercial and Financial Chronicle.

These new security issues not only gave foreigners excess liquid funds, but also placed the business corporations of the country in a position where they had a great excess of liquid funds. They very largely paid off their commercial loans at the banks, and still remained with excess liquid resources which came as loans to the securities market when interest rates grew attractive. Rapidly rising security prices and real-estate prices through this period—the vast increase in real-estate loans in the banks was a very important factor in the great rise in real-estate prices during the period—put large liquid resources into the hands of those owners of real estate who were wise enough and fortunate enough to sell at the rising prices, and as many of them hesitated to reinvest in either securities or real estate in 1928 or 1929 at the high prices prevailing, they also had funds available for loans to the securities market. And the same thing, of course, is true of the wise investors who sold their stocks and held themselves liquid in 1928 and 1929.

The vast volume, in other words, of broker's loans "for account of others" was the product of the prior expansion of bank credit based on incoming gold and the cheap money policies of the Federal Reserve banks.

Never before in our history has it happened that so vast a quantity of mobile liquid resources were available. When, in 1928 and 1929, the Federal Reserve authorities made their belated effort to check speculation and to reverse the policy of bank expansion, they found themselve confronted with many unexpected difficulties.

If the water is allowed to overflow in the tub of an upstairs bathroom for 5 minutes, it is a fairly simple matter to "mop up" when you turn off the tap. But, if you let it overflow for 6 years and then turn off the tap, you have a tremendous amount of pumping to do before you get the house dry again. And long after you have pumped enough to take up the water in sight, you find water pouring in from the interior of the walls and from other unexpected places—this is assuming a very strong house which doesn't collapse entirely.

OTHER FACTORS EASING TENSION IN 1928–29

With the tension of money in 1928 and 1929, accompanied by the exciting securities market and the rapid rise in security prices, a wide variety of resources manifested themselves, all tending to ease off the strain on bank reserves and to prevent the measures which the Federal Reserve banks were taking, which would ordinarily have been entirely effective, from reversing the movement. (1) As already explained, brokers' loans "for account of others" took brokers' loans out of the banks and reduced demand deposits. (2) On a substantial scale, new bank stocks were issued, with the result that the banking system as a whole changed deposit liabilities to depositors into capital liabilities to stockholders, reducing deposits and offsetting the pressure on reserves. (3) There was a very substantial growth in the substitution of acceptance credits for straight loans, the acceptances being very largely held by the Federal Reserve banks and foreign banks. To the extent that this occurred, both bank loans and bank deposits were reduced, while, to the extent that the Federal Reserve banks bought the acceptances, new reserve money was created. (4) There was an immense increase in rediscounting by the member banks—an increase which would not have come on anything like so great a scale had the Federal Reserve banks held their rediscount rates above the market in accordance with the orthodox rule. (By "the market", in the United States, I mean the rates on loans to prime borrowing customers in great city banks.) (5) There was a reduction in the volume of "money in circulation" (i. e., actual currency outside the Treasury and outside the Federal Reserve banks). This figure, on the average, stood at $110,000,000 less in 1928 than in 1927, making a net addition of that amount to the reserve deposits of the member banks.

For these various reasons the measures which the Federal Reserve System took, which, on the basis of their previous experience, they expected to be adequate, proved inadequate and ineffective, though there never was a time when by really vigorous measures, including rediscount rates above the market, they could not have accomplished their purpose.

Be it observed that the first three of these factors which operated to ease the money market had the effect of holding down or reducing demand deposits, directly contrary to Currie's theory that decreasing demand deposits raise interest rates. Again and again, the informed student of monetary matters is impressed with Currie's complete misunderstanding of important financial episodes because of his exclusive preoccupation with a highly simple and exceedingly unrealistic theory.

ANY SIMPLE THEORY OF MONEY AND CREDIT IS WRONG

In this connection, I venture the proposition that any simple theory purporting to explain money and credit is wrong. And any effort to recast our whole financial fabric on the basis of any single simple theory must make incredible disturbances and disorders totally unanticipated by the men who believe in the simple theory.

CURRIE'S GENERALIZATIONS BASED ON ABNORMAL PERIOD—NEGLECTS EARLIER EXPERIENCE

A further very important thing to observe in this connection is that the period from 1922 to 1934 and, above all, the 10 years from 1924 to 1934, represent highly abnormal phenomena in the field of money and banking, and an increasing pathology in the System. Currie's generalizations are almost entirely based upon this period and, very especially, upon the period from 1927 on. His generalization quoted above, for example, that speculators are very little influenced by interest rates, is based on their behavior in 1928 and 1929, though, if he had extended his study even into the autumn of 1927, he would have found good reason to believe the contrary. (See Chase Economic Bulletin, An Analysis of the Money Market, June 4, 1928, p. 18.) In ordinary times, low money rates encourage speculative borrowing and rising security prices, while firm money rates discourage them. The study made by Warren M. Persons,[8] for example, covering the years 1903–14, gives very abundant and exact evidence on this point. The extent to which Currie's generalizations are based on very recent years, lacking the perspective which earlier financial history would give, will be recognized, I think, if the reader will examine in his book pages 36, 117–125, 131, 133, the last paragraph of 135, 137, 172.

[8] Review of Economic Statistics, April 1919, pp. 111–113. Persons generalizes for the period 1903–14: "Prices of securities reached a maximum at the same time the rate for capital was at a minimum."

HE WOULD APPLY SAME POLICY TO NORMAL AND ABNORMAL SITUATIONS

The same general comment may be made with respect to the application of his theory. The only abnormality which apparently can exist, from the standpoint of Currie's analysis, is a deviation in the total of "adjusted demand deposits" and pocket cash from what his norm would require for the purpose of the regulation of incomes or prices, which apparently are his control for business activity. And he would apply the same reasoning to 1928–29 as he would apply to any other period with respect to these matters. (See his discussion, pp. 49–50 and the bottom of 97.)

CURRIE IGNORES INDUSTRIAL EQUILIBRIUM, FOREIGN TRADE EQUILIBRIUM, AND QUALITY OF CREDIT

But these years were years which had been preceded by such a gigantic growth of credit that even that part of credit which he alone recognizes, namely, demand deposits, could still have been excessive. The world was, in fact, shot through with abnormalities in 1928–29. For one thing, we had been for years getting out an excess of exports over imports, giving credit to foreign countries in the process, with high tariff barriers which prevented their repaying these credits. Banks all over the world had had their liquidity impaired by the rapid expansion of credit going into illiquid uses. (See Chase Economic Bulletin, Some Major Forces in the International Money Market, Oct. 29, 1927, pp. 19–23, 26–29.) A vast volume of debt had been created—and debt is the other name for credit—as a result of these tendencies. Credit expansion had been laboring for years against trade barriers and had been for years preventing necessary industrial readjustments, especially in England. Currie sees nothing of the growing industrial disequilibria, sees nothing of the growing abnormalities in international trade relations, sees nothing of the increasing artificial controls of commodity prices, sees nothing of the growing inflexibilities created by Government policies. All that he can see and all that he can say is, apparently, the monotonous "tit-tat-to"—"money, credit, prices; money, credit, prices", and his formula is the same for an industrial situation desperately out of balance as it is for one well shaken down and ready to respond to an easy money market.

LIQUIDATION NEVER TO BE PERMITTED

One thing that appears quite clear from Currie's analysis is that never, under any circumstances, must a real liquidation of bank credit be allowed to take place. That we have got out of previous crises as we have liquidated credit, eliminating the insolvent and verifying the solvency of those who were good, so that confidence was restored in the credit situation, at the same time reducing commodity prices and wages and readjusting long term contracts where necessary, involving rentals and even bond interest, means nothing to him. He has found the necessary magic to prevent all this in the proper adjustment of the supply of money.

CURRIE LIMITS "CREDIT" TO DEMAND DEPOSITS

Currie limits the word "credit" to demand deposits and, strictly speaking, to his "adjusted demand deposits." Time deposits he identifies with savings (pp. 16, 152). The fact that time deposits are owned by big corporations or others of wealth is "extraneous." "The savings of a number of people acting collectively, as in a corporation, should have no different economic effect than the same amount of savings of the people individually" (p. 16).

To Currie, loans are not credit and book credit is not credit. Eliminating time deposits and eliminating loans and investments from his picture of credit and looking only at the demand deposits, he would make the expansion of credit in the period of 1922–28 much less than it evidently is when we look at the whole picture of deposits of both kinds, and loans and investments in the commercial banks.

CURRIE'S FUNDAMENTAL ERROR REGARDING TIME DEPOSITS—TIME DEPOSITS AND SAVINGS DEPOSITS

Time deposits, he says (p. 99), are "not affected to any great extent by inflows or outflows of reserve funds." He speaks of the steady secular growth of time deposits (p. 132) and says they "exhibited little cyclical movement from 1921 to 1929," though he admits the secular growth was arrested in 1928–29, and is apparently puzzled by it. The facts are that time deposits were immensely responsive to the inflow and outflow of reserve funds, that they expanded with great rapidity in periods when the Federal Reserve Banks were making reserves easy by cheap money policies, and that they slowed down their growth sharply or even ceased to grow when the Federal Reserve Banks tightened up. I have discussed this in great detail in the Chase Economic Bulletin, "Bank Espansion versus Savings," June 25, 1928, from which I quote the following passage:

"But the great growth of time deposits has been in the periods of monetary ease and rapid bank expansion, and not in the periods of relatively firmer money and retarded bank expansion. The year 1922 was a year of rapid expansion. The Federal Reserve Banks increased their open market purchases, gold came in, and deposits moved rapidly. From January 4, 1922, to January 3, 1923, the time deposits of the reporting member banks increased from $3,011,000,000 to $3,748,000,000, or 24.5 percent. The year 1923 was one in which the Federal Reserve banks reversed their policy and offset the incoming gold by reducing their open-market purchases and raising their rates of rediscount. The time deposits of the reporting member banks in this year rose from the $3,748,000,000 of January 3, 1923, to $4,104,000,000, or 9.5 percent, by January 2 of 1924. The year 1924 was one of very great Federal Reserve bank expansion, great ease of money and very rapid bank expansion. Time deposits moved up in this year from $4,104,000,000 on January 2 to $4,849,000,000 on January 7 of 1925, or 18.2 percent.

"The case is even more striking when we observe the behavior of time deposits in certain of the major cities. From April 12, 1922, to April 11, 1923, time deposits in New York City moved up from $353,000,000 to $627,000,000, or 77.6 percent. In the following year, the period of restricted credit, the same time deposits moved up only from $627,000,000 to $649,000,000, or 3.5 percent (by Apr. 16, 1924). In the following year, coming down to April 15, 1925, a period of great monetary ease, time deposits moved up to $816,000,000, or 25.7 percent, whereas in the next year to April 14, 1926, there was an actual decrease of $2,000,-000, the 1926 figure being $814,000,000.

"A similar story can be told for Chicago. From April 5, 1922, to April 11, 1923, time deposits increased from $311,000,000 to $372,000,000, but from April 11, 1923, to April 16, 1924, they increased only $1,000,000 to $373,000,000. This high variability in the growth of time deposits is very different from the steady growth which characterizes the figures of the savings banks.

"Again, the growth of time deposits has been very much more rapid than the growth of savings deposits, as shown by the following figures for the mutual savings banks, on the one hand, and the time deposits of the reporting member banks and national banks, on the other hand.

Comparative growth of savings deposits and time deposits

[In millions of dollars]

Date	Deposits of all mutual savings banks	Time deposits of national banks	Time deposits of reporting member banks in New York district [1]	Time deposits of all reporting member banks [1]
June 30, 1922	5,780	4,122	666	3,380
June 30, 1923	6,289	4,755	901	4,000
June 30, 1924	6,693	5,260	972	4,418
June 30, 1925	7,147	5,925	1,174	5,172
June 30, 1926	7,578	6,314	1,263	5,650
June 30, 1927	[2] 8,077	7,316	1,472	6,212
Jan. 1, 1928	8,315	[3] 7,808	1,622	6,611
Percent increase over 1922	43 9	89 9	143 5	95 6

[1] Figures for reporting member banks are for dates nearest June 30
[2] Estimated.
[3] Dec. 31, 1927.

Surplus reserves generated time deposits more rapidly than demand deposits in 1922–28, the reason being very simple. Business men and most other people tend to be economical in the use of money. They do not usually carry pocket cash or till money in great excess of their needs. Instead they deposit it in the banks. But they usually do not carry demand deposits with the bank at low interest or at no interest in great excess of their needs when they can get a substantial rate of interest on time deposits. Consequently the immense expansion of credit, running far beyond any needs of trade from the middle of 1922 to early 1928, generated primarily an expansion of time deposits.

Some banks, and especially country banks, were lulled into a false sense of security by this, and used the funds which came to them through the growth of their time deposits in such a way as to tie them up in illiquid form, very especially in real-estate loans. But most of the New York City banks were alert to the dangers, and realized that they needed to keep their assets against their time deposits quite as liquid as against their demand deposits. They knew that their time deposits were chiefly the temporarily idle funds of great business corporations or of foreign banks or of rich investors who had temporarily disposed of investments and were awaiting opportunities in the market. The most unfortunate case of all would be the case of the country bank which, by a time deposit rate above the city rate, attracted temporarily the idle funds of a great business corporation in such an amount as to represent an important percentage of the bank's total deposits. Many such banks had to appeal suddenly to city correspondents as these deposits were suddenly withdrawn. Currie is impervious to all of this. He is concerned with a schema, and the facts must fit the schema.

CURRIE'S VERSION OF THE HUNDRED PERCENT RESERVE FOR DEMAND DEPOSITS PLAN—ABSURDITY OF THE PLAN

The most obvious evidence of Currie's misunderstanding of the nature of time deposits and the general nature of bank credit comes in his proposal of an "ideal" system of control, not recommended for immediate application but offered to illustrate his principle, in chapter XV. Here he proposes a device which he recognizes as essentially similar to the 100-percent reserve for demand deposits plan (p. 156, footnote), though he puts it in a somewhat different way. He would split up the existing banking institutions into two parts. He would have the Government take over the demand deposits of the banks and run-of-the-mine assets to correspond, and he would leave the banks their time deposits matched by the rest of their assets. He would divorce the supply of money from the loaning of money. Faced with the question then as to how commercial loans could be made, he says:

"While our interest in this study is centered in money and the conditions of its supply, nevertheless it remains true that the loans of banks to individuals who could not readily secure loans elsewhere have been of great importance in the past and still remain of importance. What would happen to such loans if all money were issued by the Government? The answer to this valid objection depends on the handling of savings deposits. The best solution would appear to be to leave them with existing banks. They are not money, and therefore, apart from laying down conditions for their safe investment, the State has not the same interest in them as in deposits subject to check. Savings deposits comprise some 60 percent of all deposits. They would, therefore, if left with existing banks, permit continuance of loans to borrowers who cannot secure loans elsewhere. The volume of such loans is commonly overestimated. They belong to a past era * * *."

This is a very remarkable proposition. The banks cannot lend their time deposits. Their time deposits do not belong to them. Their time deposits are their liabilities. Banks can lend only if (a) they have cash to lend, or if (b) they are in a position to create new demand deposits. Banks thus placed, forbidden to create demand deposits, increasing their loans only as new time depositors bring them cash or as they are able to get cash by reducing their existing loans or by selling existing assets, would be in no position whatever to expand loans in any emergency, in no position whatever to expand loans to meet seasonal needs, and would be able to meet the annual growth of industrial borrowings only if it should so happen by accident that their customers brought them in the right amount of cash. Pure savings banks very properly recognize no obligation to meet the borrowing needs of their depositing customers. They may lend to depositing customers if they have some extra cash. Primarily they invest—when and if it suits them.

Further, if the banks were thus cut in two, the difference between true savings deposits and time deposits held by corporations and large investors would speedily manifest itself. The banks which had only time deposit liabilities would speedily find themselves being drained as many of their customers withdrew their time deposits in order to turn them into working cash. A great lot of the existing time deposits are held by banks in connection with the total customer relation, which includes a borrowing equity on the customer's part. Very many customers with time deposits build them up at certain reasons of the year and let them turn, at due date, into demand deposits at other seasons of the year, so that they may use them, check against them. These customers, finding themselves suddenly dealing with savings banks rather than commercial banks, would very speedily pull out—and we should have an immense liquidation of the dismembered institutions, and of the people that owe them money.

CURRIE WOULD DROP RESERVE REQUIREMENTS AGAINST TIME DEPOSITS AND INTERBANK DEPOSITS

Currie's misunderstanding of the nature of time deposits and his identification of them with savings leads him to the extreme proposition (page 163) that with more stringent regulations insuring that time deposits cannot be checked against, all reserve requirements against time deposits could be removed. But the low 3-percent reserve against time deposits (most of which could not be transferred by check) was a major factor in making the ruinous expansion of bank credit between 1922 and early 1923, and, had there been no reserves at all required against time deposits, the thing would have gone very much further. Throughout his book, Currie seems to be concerned to eliminate almost every possible restriction on every form of credit except his "adjusted demand deposits." Thus, on pages 165–166, he says: "If, however, the deposits of the nonmember banks with member banks are not placed there as reserves but rather as investments, and the bulk of them appear to be of this nature, the imposition of reserve requirements may tend to bring about a contraction of money when such balances are increasing and an expansion when they are decreasing * * *. There is, however, a clear case against the requirement of reserves against deposits of other member banks."

CURRIE'S INADEQUATE KNOWLEDGE OF ACTUAL BANKING PRACTICES

Incidentally, it may be remarked that the foregoing passage is an illustration of Currie's inadequate knowledge of what banks do. To a banker, the statement that the bulk of the deposits of nonmember banks with member banks are investments rather than reserves is fantastic. In part, at least, they are necessary working funds for domestic exchange transactions. They are, in large part, primary reserves, usually part of legal reserve requirements, and for the rest they are secondary reserves, highly liquid resources, to meet seasonal needs or to meet crisis emergencies or to create "borrowing equities" for the purpose of meeting seasonal needs and crisis emergencies. The following figures, representing the behavior of deposits and loans of 59 small banks through a wide range of the country, chiefly nonmember banks, with the Chase National Bank in 1920–21, will illustrate this. The banks were picked at random, except that larger places were avoided.

	Balances	Loans
January 1920	$1,426,400	$459,200
September 1920	1,215,800	1,057,500
October 1920	1,221,200	1,677,800
November 1920	1,091,800	1,346,400
December 1920	754,200	801,500
January 1921	759,200	951,300

IMAGINARY DIFFICULTIES IN CONTROL

Currie finds a good many difficulties in the present organization of banking when one is considering the problem of effective control of the volume of money. He says, on page 142: "One may indeed become discouraged when it is realized that the factor on which the reserve administration must place chief reliance in checking expansion—the repugnance of member banks to continuous indebtedness to the reserve banks—is itself subject to variations, becoming weaker in the upswing and stronger in the downswing of business."

This difficulty, of course, to the extent that it is a difficulty, would not exist if the Federal Reserve banks made use of the orthodox principle of keeping rediscount rates above the market—meaning by "the market" the "bottom" of the great city market, namely, the rates paid by prime borrowing commercial customers.[9]

He sees a further obstacle to the effectiveness of Federal Reserve policy, namely, their special acceptance policy, which he correctly recognizes could easily be altered (p. 143). But he manufactures an enormous number of difficulties in discussing the relations of commercial banks, the flow of funds between central reserve cities and interior institutions (with resultant changes in reserve requirements) and the like. (See especially chap. VII.) It is perfectly true that when money is easy banks will be less economical with their reserve funds and their vault cash than they will be when money is tight, and that this change in bank policy will operate against effectiveness of Federal Reserve policy seeking to expand or to relax the money market. But this means merely that the Federal Reserve banks need to do a little more than they would otherwise have to do in the matter of exerting control. They are in a position to have, at all times, a very close knowledge of the extent to which reserves of all the member banks are excessive or are deficient, and if they are at all "close to the market" relatively moderate changes in discount rate or in open-market holdings can meet the situation. The existing difficulties of control are not made by the organization of the banking system, but by the appalling plethora of member bank reserves, artificially created in large part.

VARYING MEMBER BANK RESERVE REQUIREMENTS AS A MEANS OF CONTROL

Currie is an advocate of the doctrine of varying reserve ratios of the member banks of the Federal Reserve System as an important instrumentality of control. The present writer is of the opinion that this is a resource which is very unlikely to be used in a boom when tightening up is called for. Its effect would be very unlike the effect of the more familiar methods of control such as raising discount rates and the selling of Government securities by the Federal Reserve banks, or the failure of the Federal Reserve banks to buy acceptances as their acceptance portfolios run off. These measures strike first at the great money centers, where the banks are most liquid and where they are in a position to stand it. The raising of reserve requirements hits both the banks that have excessive reserves and those that have reserve deficiencies. The method of varying required reserve percentages is therefore most likely to be used in lowering reserves at a time when it is desired to bring about expansion. It would be eminently desirable if reserves against time deposits were forthwith raised, though even that at the present time might bring an outcry from certain parts of the country. Certainly all future increases in time deposits should have to carry a much higher reserve percentage than is at present required. The present writer is of the opinion that the general effect of the effort to vary reserve requirements frequently would be to make bankers constantly apprehensive, as it would give them a new incalculable variable to deal with, making times of uncertainty still more uncertain. It is far better to use familiar methods which bankers know how to reckon with.

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[9] This is an over simple statement of the principle of keeping above the market as applied to the American situation. See Hepburn and Anderson, The Chase Economic Bulletin, The Gold and Rediscount Policy of the Federal Reserve Banks, vol I, no. 5; reproduced in the revised edition of Hepburn's A History of Currency in the United States.

THE FALLACY OF CHEAP MONEY AS A SUBSTITUTE FOR ECONOMIC READJUSTMENT

Experience prior to the present great depression had been that low interest rates were among the circumstances which preceded and facilitated the revival of business. Other attendant circumstances, however, were low prices of raw materials, reduced wages and other costs, the clearing up of the weak spots in the credit situation by insolvency or composition, and low commodity prices which attracted increased consumer buying. To these should be added the correction of maladjustments in the proportions of our industrial activities and the growing clarification of opinion as to which industries could most profitably expand. In general there was required such a readjustment in the relations among the industries and in the relations of costs and prices as to make it clear that profits could be made by increasing activity.

Certain writers preoccupied with money, credit, and prices, ignoring the rest of the economic situation, have incorrectly generalized from this experience not merely that business could be made to revive in a time of depression by artificially easier money, but that active business could be indefinitely continued by the manipulation of interest rates. So far as this rests on the basis of experience rather than on monetary theories, it is obvious that the same reasoning would apply to the price of raw materials or to wages or to any other element in the situation. There have probably been times when a boom could have been prolonged for a time by the artificial holding down of the prices of raw materials—though the upshot would, of course, have been that at a later time the supply of raw materials would have grown acutely short and the reaction from the boom would have been even more violent. To take any one factor in such a situation and seek, by manipulating it artificially, to make it unnecessary for the other factors in the situation to readjust and to get into proper relation to one another, is a very grave error.

COMMERCIAL LOANS AND BANK LIQUIDITY

Currie's book seems to rest upon a very narrow base of information, both as to the theory of money and banking and as to the general facts of money and banking. Evidence that he has practical banking knowledge is absent. His theoretical sources appear to be almost entirely such writers as Keynes, Hawtrey, and Robertson. His statistical evidence is very largely drawn from the highly abnormal period 1922–33. Money, credit, and prices, moreover, are treated almost as if they operated in a vacuum. The organic interrelations of money, credit, banking and prices with industry and commerce, considerations of industrial equilibrium, considerations of international financial and trade equilibrium and similar things are almost entirely lacking.

Currie is definitely hostile to commercial paper in banks, regards investments as the ideal form of banking asset and declares that commercial paper is of declining importance (p. 117) and even belongs to a "past era" (p. 152). He emphasizes the growing importance of security loans and bank investments.

In this connection he says: "It will be obvious * * * that the restriction of bank loans to commercial borrowers would be a highly dangerous policy. The application of the banking principle, in other words, most assuredly would not secure business stability" (p. 36), and in a footnote he says, "For a defense of the banking principle see B. M. Anderson, Jr., Chase Economic Bulletin, volume X, no. 3."

It is certain that the present writer has never advocated the restriction of bank loans to commercial paper. On the contrary, he believes that he is one of the pioneers in pointing out the immense growth of bank investments in bonds and of stock exchange collateral loans as compared with commercial paper. (See Value of Money, New York, 1917, ch. on Bank Assets and Bank Reserves.) The present writer has been studying this problem, both theoretically and practically, for many years, and he finds Dr. Currie's observations with respect to the matter exceedingly superficial and misleading.

Commercial loans grow with the growth of the business of the country when money rates are not unduly easy and when bank credit is not expanding with undue rapidity. The rapid growth of stock market loans and bank investments in the period from 1896 to 1904, for example, was a phenomenon associated with the enormous increase in gold in the world, and, above all, in the United States.[10] Even during this period, however, there was a rapid growth of commercial loans also. But the extreme rapidity with which security loans and bank investments grew, between 1922 and 1929, and very especially between 1924 and 1929, was primarily due to the fact that money was so excessively easy and the issue of new securities, especially stocks at high prices, was so excessively easy, that virtually every corporation in the country which had any kind of credit standing put out new securities, paid off or reduced its bank loans, and accumulated cash.

[10] Currie gives figures (p 117) to indicate a steady long time downward trend in the percentage of commercial loans to total earning assets of banks Our best long statistical series here is, of course, our figures for national banks, and the item chosen to represent commercial loans is the so-called "all other loans", as distinguished from secured loans. Currie recognizes, of course, that the "all other loans" contain certain noncommercial loans. Moreover, some of the secured loans are true commercial loans, e g , loans secured by commodities, loans secured by crop liens, and part of the livestock paper are also self-liquidating loans which really belong in the commercial loan category (See my Value of Money, ch. XXIV)

Currie gives the following figures.

Percentage of "other loans" to total earning assets of national banks

	Percent
1890	61
1914	47
1929	36

This looks like a pronounced and emphatic long-time downward trend Let the reader, however, look at the following table in more detail

Loans and investments of national banks

	Number of banks	In millions of dollars					Ratio of all other loans to total loans and investments
		Total loans and investments	Total loans	Secured loans [1]	All other loans	Total investments	
1890	3,540	2,256	1,970	566	1,404	286	62.2
1893	3,781	2,204	1,831	575	1,256	373	57.0
1894	3,755	2,411	1,992	675	1,317	419	54.6
1896	3,676	2,328	1,877	627	1,250	451	53.7
1898	3,585	2,750	2,156	799	1,357	594	49.3
1900	3,871	3,463	2,687	1,103	1,584	776	45.7
1903	5,042	4,544	3,481	1,373	2,108	1,063	46.4
1904	5,412	4,867	3,726	1,519	2,207	1,141	45.3
1907	6,544	6,108	4,679	1,702	2,977	1,429	48.7
1908	6,853	6,307	4,751	1,920	2,831	1,556	44.9
1909	6,977	6,776	5,129	2,017	3,112	1,647	45.9
1910	7,173	7,073	5,467	2,032	3,435	1,606	48.6
1911	7,277	7,363	5,611	2,006	3,605	1,752	49.0
1912	7,372	7,808	5,954	2,136	3,818	1,854	48.9
1913	7,473	8,026	6,143	2,168	3,975	1,883	49.5
1914	7,525	8,284	6,430	2,410	4,020	1,854	48.5
1915	7,506	8,635	6,660	2,633	4,027	1,975	46.6
1916	7,579	9,977	7,679	3,074	4,605	2,298	46.2
1917	7,604	11,706	8,958	3,400	5,558	2,748	47.5
1918	7,705	14,036	10,136	3,838	6,298	3,900	44.9
1919	7,785	16,003	11,010	4,770	6,240	4,993	39.0
1920	8,030	17,732	13,611	4,900	8,711	4,121	49.1

[1] Includes loans on demand secured by stocks, bonds, and other personal securities and loans on time secured by stocks and bonds; also loans on time secured by other personal securities, etc , from 1915 on.

Source Comptroller's Report for 1920, pp 774–777

This table would show that, while the trend from 1890 to 1900 was strongly downward in the percentage of "other loans" to total earning assets, from 1900 through 1917 there was a clear upward trend It would also show an upward trend as between 1900 and 1914 For the period 1919 to 1932, I use the series of the reporting member banks, which can be obtained weekly, whereas the national bank figures are available only 3 to 5 times a year. This table appears in the text above. On the basis of this table, I have discussed the trend since 1920.

Since 1924 the development has been definitely pathological Moreover, from 1924 to 1928, the "all other loans" of the reporting member banks contain a rapidly growing proportion of real-estate loans and instalment finance paper, so that the decline in the percentage of commercial paper was more marked even than the figures themselves would indicate.

Currie gives also, on p. 117, figures starting with 1926 to show the decline of commercial paper eligible at the Federal Reserve banks, for the member banks of the Federal Reserve System.

It so happens that the present writer, in early 1927, in the Chase Economic Bulletin, took occasion to comment on the dangerously low percentage of such paper in the assets of member banks, and gave figures showing how rapidly this percentage had dropped in the 3 preceding years (Chase Economic Bulletin, Apr 8, 1927, pp. 17–20.) Currie takes as his base figure, in other words, a year when the pathology was already far advanced. It is impossible to draw standards for banking practice from the figures after 1924.

Currie, in common with not a few others who observed the phenomenon while it was going on, thinks of it as due to changed corporate policy. The present writer is quite sure that it was due rather to money market ease. The following figures for the composition of the earning assets of the reporting member banks of the Federal Reserve System illustrate this strikingly:

Loans and investments of reporting member banks (monthly averages of weekly figures)

[In millions of dollars]

Date	Total loans and investments	Total loans	Loans on securities	All other loans	Investments	Ratio of all other loans to total loans and investments
December 1919	16, 387	12, 412	4, 703	7, 710	3, 975	47 0
March 1920	16, 853	13, 242	4, 454	8, 788	3, 611	52 1
March 1921	16, 066	12, 785	3, 921	8, 864	3, 281	55. 2
March 1922	14, 617	11, 034	3, 641	7, 393	3, 583	50. 6
March 1923	16, 368	11, 796	4, 116	7, 680	4, 572	46. 9
March 1924	16, 443	12, 138	4, 181	7, 956	4, 306	48. 4
March 1925	18, 523	13, 320	5, 122	8, 198	5, 204	44 3
March 1926	19, 420	14, 172	5, 652	8, 521	5, 248	43. 9
March 1927	19, 989	14, 536	5, 867	8, 670	5, 453	43. 4
March 1928	21, 502	15, 370	6, 586	8, 784	6, 133	40. 9
March 1929	22, 472	16, 491	7, 580	8, 911	5, 981	39. 7
March 1930	22, 352	16, 746	7, 964	8, 781	5, 607	39. 3
March 1931	22, 839	15, 452	7, 302	8, 150	7, 387	35 7
March 1932	19, 434	12, 375	5, 388	6, 987	7, 059	36. 0

Source: Statistical Abstract of the United States.

The period from March 1922 to March 1923 was characterized, on the whole, by a great expansion of bank credit, due to the fact that the Federal Reserve banks had bought Government securities and acceptances easing the money market, a policy which they began to reverse in January of 1923. During this period, security loans and bank investments grew rapidly in relation to commercial loans. March 1923 to March 1924 was a period when the Federal Reserve banks were holding back and bank expansion was not taking place. Commercial loans grew during this period at virtually the same rate as the year before. Security loans increased hardly at all and bank investments actually declined.

The following year, March 1924 to March 1925, was characterized by an immense expansion of bank credit based on Federal Reserve purchases of Government securities and inflowing gold, and in this year there began the great increase in the proportion of bank investments and security loans to commercial loans. For the rest of the period, down to 1929, this tendency went on, accelerated sharply by the great expansion of credit in 1927.

No radical change in corporate policy took place in this short period. The significant variable was the money market itself.

Currie is not at all concerned about the quality of bank credit and, indeed, makes a sharp issue between his theory, which calls for policy directed toward the control of the quantity of demand deposits, and the antagonistic policy of protection of the quality of bank loans and investments. I stand emphatically for the other point of view. I am concerned about the quality of money and credit. I trust a situation in which no new credit or debt is created without due consideration of the sources from which repayment can come, in which adequate margins exist to provide against risks and in which the general situation is adequately liquid. In this connection I concern myself very especially with considerations of the underlying industrial and trade equilibrium as well as with the technical position of particular borrowers.

I would emphasize, and did emphasize in my 1917 study, that modern corporate organization and the development of the great stock market have made bank loans against securities safe and desirable when held within proper limits and when properly handled. But such a radical change as that which took place between 1923 and 1929 in the proportions of commercial loans, security loans and investments was a source of great disquiet to me, as the situation developed, and was a circumstance which led me to give repeated warnings.

One of the finest developments in American banking in the last two or three decades has been the improvement in credit technique in connection with commercial loans. The bank credit men of the United States have done, outside of academic walls, an altogether superior piece of scientific work in studying the conditions under which commercial loans may properly be extended and in developing a tradition and a code with respect to this matter—as well as a very fine system of interchange of information. Further, when business men get an important part of their working funds from the banks, they come and sit with the banker once a year or more, to discuss their plans, and especially to consider how much money they may wisely use. Industrial policy is very much improved by these conferences. When, however, the business community, as was true from 1923 to late 1929, can go instead to the securities market and freely obtain money it may or may not need, adequate for its guessed-at needs for the next several years, a very different situation is created. The careful and exact and fine calculation disappears. The amount borrowed, or the amount secured by stock issues, becomes a matter of the accidents of the money market rather than a matter of the actual industrial outlook. The volume of credit is much less closely apportioned to the general needs of the commercial and industrial situation, and has nothing like so fine an adjustment in quality and in detail to the actual processes of industry and grade. The commercial loan should be encouraged and not discouraged.

To substitute for the fine scientific job which the bank credit men of the country have done, which can deal in detail with the credit needs of the country, the vague speculations of the "modern monetary theorists" like Messrs. Keynes and Currie, concerned with the total amount of money and credit which the whole country needs from the standpoint of regulating incomes and prices and the "relation of savings to investment", does not seem to be scientific progress or reform.

The old view that only short-term commercial loans are self-liquidating the present writer himself has objected to, and he has emphasized the liquidity—not merely the "shiftability", but the actual liquidity—of loans to the stock market. Brokers' loans, for example, at the beginning of 1920, stood in New York at 1,750 millions, and were reduced to under 700 millions by the end of 1920 at a time when commercial loans were being rapidly increased as the banks took care of the borrowing needs of their commercial customers in the crisis. And even the vast and unwholesome total of 8½ billions of brokers' loans in the stock market in late 1929 was actually reduced by liquidation to under 300 millions by the summer of 1932 (offset in minor part by a shift to bank customers' loans against securities). But the principle of liquidity the writer would insist upon, and the same reasons which led Adam Smith to reject the real-estate loan as a proper banking asset persists in the mind of the present writer as good and valid grounds for rejecting reale-state loans. The present writer has emphasized that not all of the so-called "commercial loans" are truly liquid. An important part of them are. Loans to local customers often are not. The bank must take care of them. The British bankers make a sharp distinction between their advances to commercial and manufacturing customers and their commercial bills, the latter being highly liquid. American bankers have long made sharp distinctions among their customers from the standpoint of liquidity, certain of them being highly liquid, certain loans being definitely seasonal, and also between their holdings of customers' paper on the one hand and of outside commercial paper and acceptances on the other hand.

Currie (p. 38) holds that neither security loans nor commercial loans are liquid en masse. This is not true. At the very worst of an extreme strangling crisis it tends to be true, but, in general, it is not true. You can't liquidate all loans at one time, but you can, barring an extreme panic, liquidate enough to correct an unsatisfactory situation. If, however, you neglect the quality of your credit through a period of years, and, by overdoing quantity, bring about a general qualitative deterioration, as we did from 1922 to 1929, the problems of liquidation become extremely difficult. The desirable thing is to hold a firm grip on the situation at all times and to watch both quality and quantity at all times.

CRITICISM OF CURRIE'S VERSION OF QUANTITY THEORY

Where Irving Fisher builds his quantity theory on the notion of quantity of money going through all kinds of payments, using a "velocity" concept that tries to take account of all of the turnovers of money, Currie uses a different velocity concept, namely, what he calls "income velocity." This is obtained by dividing the figures for the total income of the country in any one year by the average quantity of money for that year, money being the actual hand-to-hand circulation outside of banks, plus "adjusted demand deposits." He thinks of the money and income velocity in combination as the factors governing the volume of income, and volume of income apparently is what governs the price level.

No doubt a man can make the arithmetical calculation required to estimate an income velocity. But that a casual theory can be erected upon this simple mathematical operation is an extraordinary notion. Why could it not be equally said that the national income and the money together govern the income velocity, or why could it not be equally said that the income velocity and the incomes together govern the quantity of money? Why should anybody suppose that all of the money and credit actually goes through incomes in the course of a year? Why may not large parts of it be limited entirely to capital transactions and other business transactions? If so, ought not the figure for money that goes into the computation be reduced (how much one does not know) with a resulting increase (by how much one does not know) in the velocity figure?

And why should one be sure that income always governs prices? It appears equally obvious that prices govern income! And the truth about the matter, in the present writer's opinion, is that no single, simple formula can possibly be correct. There is a complicated interplay of forces, and a sound theory of prices must be integrated with the whole body of economic theory.[11]

CURRIE'S QUANTITY THEORY CONDEMNED BY KEYNES

Mr. Keynes (to whose views Dr. Currie in general adheres) himself repudiates vigorously the quantity theory concept that Dr. Currie employs. Mr. Keynes not only separates income velocity from the "velocity of business deposits", but he also separates "income deposits" and "business deposits." Of the concept employed by Dr. Currie he says: "But the relationship between the total annual receipts of income receivers and the average stock of money held for all purposes is a hybrid conception having no particular significance."[12] I concur fully with Mr. Keynes in this one point.

NAÏVE APPLICATION OF SIMPLE MATHEMATICAL FORMULA TO COMPLEX ECONOMIC LIFE

To the economist accustomed to the study of the general factors governing incomes and volume of production, to the economist accustomed to the general theory of value (of which the theory of the value of money ought to be a special case), and to any man who has studied economic problems enough to be impressed with their intricacy and complexity, this simple piece of mathematical computation, offered as the basis for the determination of public policy with respect to money, credit, and banking in a great complex modern economy, appears incredibly naïve.

Senator McAdoo. In order to save our time in trying to read these books, have you not made succinct analysis of them so that we can read it in digest form?

Mr. Anderson. This is a booklet of some 32 pages.

Senator McAdoo. That is the reason I asked the question.

Mr. Anderson. If you wish me now to summarize certain of the main points, I should be glad to.

Senator McAdoo. We would like to know what the main points are and what your theory is; at least, I would.

Mr. Anderson. Let me state my theory rather briefly. Phrased in the statements quoted yesterday from Woodrow Wilson that bear

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[11] I have tried to do this in my Value of Money.

[12] Keynes' Treatise on Money, vol II, p. 24. In general, it must be said that the concepts of Mr. Keynes' Treatise on Money deal with unknown and unknowable quantities on so extensive a scale that it would be almost impossible to base policy on them. Mr. Keynes is sometimes realistic enough to recognize this when he goes to make estimates. Thus, with respect to one important variable in his scheme, he says that it is probably more than 5 percent and less than 12 percent but he places it provisionally at 8 percent—a range of uncertainty of 140 percent, with no certainty as far as the present writer can see that even the upper and lower limits have validity. (Treatise on Money; vol. I, p. 46, vol. II, pp. 25–30.)

upon it, when we speak of the ebb and flow of credit, I believe it is the business of bank credit to adust itself to the ebb and flow of commerce, and not to try to force the pace. I believe in elastic bank credit, credit that rises as commodity prices rise, credit that is responsive to decline of commodity prices and the decline of business, credit that is kept closely related to living, flowing business, credit that is kept sweet and clean and quickly ready to respond. I believe that the large matter of prosperity and depression is governed by a great many factors, of which money and credit are only one. If you have a bad boom, a long-continued boom, you get many things out of adjustment, you get certain prices much too high and some others lag behind.

In 1920, for example, we had railroad congestion. The railroads could not carry the goods because there was too much being done. We had a great unsettling factor in that much of our business was directed toward foreign markets and credit was growing weaker and weaker on the other side. We had a multitude of other maladjustments growing out of the war and the post-war boom. To have tried to overcome all those things then by further expansion of credit would have been clearly wrong. Rather, we let it go down. We had a smash. We gave them what credit they needed in the crisis so as to protect the solvency of the solvent man, and we did not keep pumping out more and more credit to validate insolvent positions. We had a readjustment, and it was a terrific readjustment. Commodity prices had risen from 100 in 1913 to 248, and they dropped in a 13-month period to 138. Wages came down. A lot of bankruptcies occurred. We cleaned up the weak spots of the credit situation. Various other costs came down. In 13 months we accomplished the readjustment, the tide turned, and by the spring of 1923 we had a labor shortage in this country.

Bank credit did its job there. Federal Reserve credit expanded in 1920 up to the end of the year, nearly. It did it by rediscounts. It did not do it by open market operations. We did not try to make Federal Reserve credit do the impossible thing. One country did, however. That was Japan. Japan tried to avert that crisis and liquidation. Japan choked off the crisis by great expansion of bank credit. The great banks, the government, the great industries, carried over the stale unliquid position, using bank credit for 8 years until 1927—endured 7 years of stagnation to avert losses on 1 year's inventory. And then the smash. Then they learned something. They got flexible. Since 1927 Japanese prices, wages, costs, industrial methods, have all been very flexible. They have also allowed their currency to depreciate, though they were not first in doing this, and part of it appears to have been due to their Chinese and Manchurian military expenditures. They seem to be almost the only country whose exports have been really helped by currency depreciation. This I attribute to two factors: (1) A small country, they did not shock world credit when their currency broke, as England did, and as we did; and (2) their internal cost-and-price fabric was highly flexible. They had heavy currency depreciation between 1920 and 1927 without any help to their foreign trade relations and without internal prosperity.

This time we have used the Japanese method of 1919–20. We tried to make bank credit do all the work. We tried to prevent the readjustments that were necessary. Cheap money is helpful in getting out of a depression if, along with it, you get things shaken down and readjusted. You have had your commodity prices down, your raw materials down; you have had your wages down where necessary; you have had a shifting in the proportions of the industry; and if things are well shaken down cheap money is very helpful. But to try using bank expansion or currency debasement as a substitute for readjustments, is simply to carry on an impossible situation. It gets worse and worse, and when the final smash does come it is very, very difficult.

There is my theory as to what bank credit can and cannot do. In a crisis expand credit to save solvent men. Give solvent men with slow assets time to make use of their slow assets in meeting their quick liabilities. Do not try to validate the bad assets of insolvent men.

Senator COUZENS. You have tried to tell us what you would do in the case of a depression, not to allow credit to be used to maintain false standards. What would you do to prevent an occurrence such as happened in 1928 and 1929 when values went down?

Mr. ANDERSON. My position is made clear in a series of discussions running from 1921 on. I would have prevented the use of bank credit during that period as a substitute for readjustment of our foreign-trade position. We had at that time a foreign trade which would have gone to pieces at any time——

Senator BULKLEY. What time are you speaking of now?

Mr. ANDERSON. The period preceding 1929.

Senator BULKLEY. How long preceding?

Mr. ANDERSON. The thing was pretty clear almost from 1921 on, as to what was called for. What was called for was lowering of the tariff so as to get export trade out in return for imports. But instead, we kept the tariffs high and we got the exports out on credit; and we made that credit possible by unsound Federal Reserve policies, keeping rediscount rates below the market. Then these great open-market operations made it possible to float vast foreign loans here and also to have our wide speculation in real estate and our expanding in instalment finance and all those other unsound things.

Senator BULKLEY. Are you attributing all that to the Federal Reserve policy?

Mr. ANDERSON. They could have held it down closely. The incoming gold would have made a problem for the Federal Reserve System to have offset that incoming gold entirely. It might have met the situation in some other ways. I indicated in 1924 how we could have avoided any expansion of bank credits, as far as that is concerned.

Senator BULKLEY. Are you going to repeat that now so that we will understand it?

Mr. ANDERSON. In 1924 my proposal was rediscount rates above the market. That is not the first time I made that proposal. That is the old orthodox view. I protested vigorously against the market operations then in process. I proposed that we might retire national bank notes as a means of taking up some of the gold that was coming in and proposed that we move vigorously toward getting Europe to stabilize——

Senator BULKLEY. What were the open-market operations that you protected against?

Mr. ANDERSON. In 1924 to 1927. However, I would like to leave the discussion of open-market operations until later, because I want to trace the history of that.

Senator BULKLEY. I do not want to draw you out of order.

Senator COUZENS. You answered my question as to what you thought we should do to prevent the occurrence of a condition such as we had in 1928 and 1929. Are you going to tell us how you would put that into legislative form as you go along?

Mr. ANDERSON. If you want a draft from me, I would be glad to try to prepare it; but right here and now I am not capable of it. I am not a lawyer. If the committee wishes it, I will gladly work out with a legal friend a formula for the policy of the Federal Reserve System for your consideration. Would you wish me to do that?

Senator COUZENS. I would like to have that; yes.

Mr. ANDERSON. I do not know how good it will be, but I will do my best on it.

Senator COUZENS. If it covers your theory, I think we have plenty of lawyers and legislative draftsmen around here to get it in legal form.

Mr. ANDERSON. The primary function of Federal Reserve banks, as I see it, is to do these old-fashioned things: Protect the currency, maintain quality of credit, check wild booms, meet emergencies, meet seasonal needs, and things like that. The other theory, that they must try to regulate commodity prices especially, I think is dead wrong. For instance, this passage here [reading]:

> In stabilizing fluctuations in the general level of production, trade, prices, and employment.

You cannot stabilize all those things. There will be times when, if you try to stabilize prices, you are going to have production falling off, trade falling off, and employment falling off.

Senator GLASS. Do you think there is any man or any set of men wise enough to carry into practical effect the suggestion in that voluminous declaration of policy there?

Mr. ANDERSON. I think not, Senator. It is impossible by credit methods.

Senator GLASS. Do you think God has endowed any man or set of men with sufficient discernment to do what is proposed there?

Mr. ANDERSON. It is impossible, certainly in the present state of scientific knowledge; and I should suppose that that will continue.

Senator MCADOO. It is impossible, too, when we consider the capacity of the human brain as we know it; is it not?

Mr. ANDERSON. The limitations are these, Senator. I think I know something about economic theory. It is possible for a man well trained in economic theory for a little while, when his energies are high, to see in outline a picture of the interrelations of the industries, of the interrelations of the various commodity markets, the money markets, and the stock market, the interrelation of the national and international activities, and the general schematic plan of the relation of prices to costs. But that is a skeleton thing, and it is useful for certain broad conclusions regarding policy. But for any man to try to put flesh and blood into that and to get statistical data and fill it out and make it live so we can regulate the economic life of this country, I do not believe is possible. I am afraid that no board can do it, because a board made up of good economists would not all see that picture in the same way.

Senator COUZENS. During your association with the Chase National Bank, of course, you could not see what they were eventually in for, could you?

Mr. ANDERSON. I thought I could foresee. My business is to study the general economic situation of the country. I thought I could foresee what the country was in for.

Senator COUZENS. What I was trying to get at was that with all your study and ability you could not advise the Chase National Bank to avoid the pitfalls that it did get into, could you?

Mr. ANDERSON. I was not concerned very much with the management of the bank. I am a student, a scholar; not a manager.

Senator COUZENS. Did you not give to the directors and the management the benefit of your scholarliness?

Mr. ANDERSON. I was consulted many times. I expressed opinions about many things. Sometimes my opinions were taken and sometimes they were not.

Senator TOWNSEND. They did not always take your advice?

Mr. ANDERSON. No; and sometimes they were right in not taking it.

Senator MCADOO. You are the economic adviser of the bank, are you not?

Mr. ANDERSON. Yes.

Senator MCADOO. Your business is to submit to them for their consideration your views on the various economic and monetary policies that arise from time to time?

Mr. ANDERSON. Yes.

Senator MCADOO. If you happen to be right and they do not follow your advice, then they are wrong. If you happen to be wrong and they do not follow your advice, they are right. Is not that about the size of it?

Mr. ANDERSON. There is always uncertainty in complex causes, whether a particular view at the moment is right or wrong. It has to be judged on the basis of what you knew then.

Senator GLASS. Dr. Anderson, in plain layman's language, from 1921 to 1923 or a little beyond, this country had that readjustment which you spoke of?

Mr. ANDERSON. Yes, sir.

Senator GLASS. Then it proceeded and everybody proceeded on a fictitious expansion of credit and an excess of speculation and it resulted in the crash; is not that a fact?

Mr. ANDERSON. That is a fact; and it was done on the basis of the theory which is to be embodied in title II, and the proposal is that we shall keep on doing that thing indefinitely.

I want to bring this country back to the old-fashioned thing, Senator. We know how that worked.

Senator MCADOO. But under the old-fashioned thing we had many panics in the United States. What we are trying to do is to find some panic-proof thing.

Senator GLASS. The Federal Reserve System cured currency panics. There cannot be a currency panic in this country any longer so long as business is transacted.

Mr. ANDERSON. Let me tell you why the System did not do what you meant it to do when you first framed it.

Senator GLASS. I know the reason. It was because it was maladministered.

Mr. ANDERSON. I will show you in what particular it was maladministered.

Senator MCADOO. I suppose you have that in an orderly form in your paper?

Mr. ANDERSON. Yes, sir.

Senator MCADOO. I think it would be better to let Dr. Anderson proceed without interruption, then, Mr. Chairman.

Senator GLASS. Yes.

Mr. ANDERSON. I would say about Dr. Currie's policy with reference to this matter—and I want this to go into your record—that Professor Cassel, before the stock-market crash, said that the Federal Reserve System should not concern itself about the stock market but only about commodity prices, and should keep on making money easy when necessary to keep up commodity prices and to keep business active.

Dr. Currie said, after the stock-market crash—and I want to read this from an article entitled "Montetary Policy and the Depression", from the Journal of Political Economy, Chicago, April 1934, pages 168 and 169 [reading]:

> The 1927 policy has been generally condemned on the ground that it was responsible for the "speculative mania" of 1928–29, one of the members of the Federal Reserve Board having since gone so far as to say that it represents "one of the most costly errors committed by any banking system in the last 75 years." To the writer it appears wholly admirable, rather to be characterized as one of the most successful policies ever pursued. Though one cannot positively say that it was responsible for arresting the downward trend of prices and production and for easing the pressure on foreign central banks, we are justified in claiming that it was the policy acceptable in theory for the attainment of those ends. Since we have argued that the call-money rate plays a minor role in the calculations of speculators and that the major part of the rise in stocks appeared reasonable and defensible on the basis of the then-existing knowledge, it follows that the 1927 policy was responsible for the subsequent rise in stock prices only in the sense that it resulted in an upswing in business activity and profits.

With respect to the policy in 1929, when they were trying to hold down speculation—not adequately, but trying—Dr. Currie says that the policy was a grave error, and he proposes an alternative policy. I quote [reading]:

> An alternative course open to the Reserve administration in 1929 was to reverse this policy and counteract rather than intensify the rise in interest rates. This course, which has never as yet been tried, appears at first sight so bold—almost foolhardy—that it was not even considered. To the writer. however, it appears to have been the only way out.

That is on page 170 of the same article.

The issue is pretty clear, I think, between those two points of view: One, that bank credit shall move with business and respond to business needs; that when business, through any one of many causes, gets in reverse, bank credits shall follow; that you shall have periodic liquidations of bank credit before it gets too badly deteriorated.

The other, that you are not going to permit that; you are going to force the pace, always with enough credit to keep prices up and business active. Do not bother about the stock market; do not bother about speculation.

The theory applies apparently no matter how bad the situation is.

Now, I want to see what the old theory would have required. I want to look at the matter from the standpoint of the function of the Federal Reserve System as it was originally conceived, and I want to see what kind of things are needed from the standpoint of additional currency and credit, looking at it from the standpoint of keeping an adequately elastic currency supply, adequately elastic credit, adequate meeting of seasonal needs, adequate meeting of crisis needs.

The Federal Reserve System was designed to prevent a repetition of the troubles of 1907. In 1907 we had what we call a "money panic", due to the fact that the currency supply of the country was inelastic, except as gold came in and out, and periodically in times of acute strain the banks had to restrict cash payments and we had to devise clearing-house certificates, and the banks had to issue scrip. This had happened in 1873, 1884, 1890, 1893, and 1907. We wanted to prevent that for the future. Such panics are too frequent if they come as often as 1893 and 1907. It is too frequent if such a panic happens at all. Our general system was really not anything like as bad as often stated. The country grew with it very rapidly, and that old system had the merit of forcing us rather frequently to pull up before unsound tendencies went too far. You got some tight money and you got liquidation, and a banker had to be on his toes.

Senator McAdoo. I do not want to interrupt, but under the old system we had excessively tight money conditions every year.

Mr. Anderson. In the autumn; yes, sir. We had the knowledge that that was coming, and it made the bank keep more liquid, keep in better shape than they would be if they were free from any worry about it.

Senator McAdoo. It was rather expensive to agriculture and to the country.

Mr. Anderson. It was; and we needed the Federal Reserve System. We got out of the panic of 1907 by the importation of $100,000,000 in gold. That was enough. As that came in, the banks were able speedily to resume cash payments, and the emergency currency and scrip quickly disappeared.

In 1908 we passed the Aldrich-Vreeland Act, which provided for an emergency currency to be issued by groups of national banks against assets other than Government bonds, upon payment of a tax of 6 percent; and in the Federal Reserve Act of 1913 this Aldrich-Vreeland provision was fortunately retained, with the reduction of the tax to 3 percent.

The shock of the outbreak of the war in 1914 found us with the Federal Reserve System not yet in existence; but with this temporary resource available, the Aldrich-Vreeland provisions were used.

Senator McAdoo. They were modified considerably, however, to meet the situation.

Mr. Anderson. Yes, sir.

Senator Glass. Not one bank in New York could have utilized the Aldrich-Vreeland Act unless it was modified.

Mr. ANDERSON. With the provision as it was applied, something like $350,000,000 additional national-bank notes were issued, and that was enough.

Senator McADOO. About $385,000,000, as I recall it. I may be in error.

Mr. ANDERSON. I think you are right, Senator. From January 1, 1914, to December 1, 1914, the increase was $354,000,000; but from the low of 1914, which was in July, to the high, which was in November, the increase was $370,000,000.

Senator McADOO. That is not very material.

Mr. ANDERSON. That worked; and that was a pretty bad crisis. It was a great shock, with the World War beginning and with cotton unsalable because of the cutting off of the export trade.

Senator GLASS. It worked after we made it workable.

Mr. ANDERSON. But I mean, without the Federal Reserve System yet, we were still able, with $370,000,000, to avoid a money panic. Now I want to come to the question of open-market operations——

Senator COUZENS. Before you go into open-market operations, are you going to discuss the kind of assets that should be eligible?

Mr. ANDERSON. I am coming to that; yes, sir. I want to say some very definite things about that.

Senator COUZENS. Why do you not do that before you come to open-market operations? Or does that relate——

Mr. ANDERSON. In the orderly exposition of my thought, it is better the other way. If it is more convenient for you, I would be glad to reverse the order.

Senator COUZENS. That, in my judgment, is one of the most important elements of the bill.

Mr. ANDERSON. I agree with you. I want to discuss it.

Senator McADOO. Is it your intention, Mr. Chairman, to continue this hearing after 12 o'clock?

Senator GLASS. I would like to go on with Dr. Anderson, unless we are called to the Senate.

Senator McADOO. My engagements make it necessary for me to go, and I was rather anxious to hear this testimony. I thought if we were going to adjourn until this afternoon, we might adjourn now and resume at 2 o'clock.

Senator BULKLEY. Let us resume at 2 o'clock.

Senator GLASS. We will resume at 2 o'clock, but we have two other witnesses to be heard.

Senator COUZENS. Let us go on for 10 or 15 minutes more.

Senator GLASS. Let us finish with this open-market business.

Senator McADOO. Before Dr. Anderson takes up the other phases of the bill, I would be glad if you would take a recess until 2 o'clock.

(Senator McAdoo thereupon retired from the committee room.)

Mr. ANDERSON. Open-market operations in England, before the war, where this notion originates, viewed from the standpoint of the kind of things we have got used to lately, were microscopic. I have looked back into the records and into the financial press in British pre-war days to see just what the Bank of England did, what operations attracted the attention of the market. The things that generally attracted their attention were not in operations to ease the market. The Bank of England used these operations primarily to tighten the market. If there was some tendency that was unsound that was going on, they would raise the rate; and then if the general market rate did not respond quickly enough to suit them, they would sell something to the market to take up the floating supply of money and make the bank rate effective. They kept very close to the market almost always, and very small operations would do it. I found the case where just about a million pounds of Indian Council bills were sold, taking up the floating supply of the market. Five million pounds was a big transaction in open-market operations.

During the war the British learned something, and then we learned it from them. At the outbreak of the war the first recourse of the Government was to the Bank of England, because they wanted some money and they had to get it quickly from borrowing by the Treasury from the Bank of England. The amount was not large. They found that eased the money market greatly, increasing the reserves of the other banks of the country, and as the Government spent the money it went into Lloyds, the Midland, and the other British banks. Then that greased the wheels for a big flotation of treasury bills, and then when that got along they would have a big funding loan and take it out of the banks. It was not an open-market operation in the strict sense; it was a direct loan to the Government of relatively small amounts, and this, with increased reserves of the banks, made it easier for them to buy a lot of Treasury bills. Finally they would have a big public loan to take up these Treasury bills, and the Bank of England would get this money back. Just temporary overdrafts was what it amounted to. It was part of the war financing, rigging the money market to make it easier for the Government to get money. That is what it was.

Our Federal Reserve System learned that from the Bank of England, and when we got into the war, at the time of the issuance of each of our Liberty loans, we did some of that, but just temporarily. I thought I had the exact figures here, but I see that in this carbon copy they are not written in, so I should like the privilege of correcting my figures if my memory is incorrect, in my revision.

None of the First Liberty Loans involved more than $100,000,000 of purchases of Government securities by the Federal Reserve banks. One of them was only about $30,000,000. But that eased off the money market enough. After the Liberty Loan transaction was completed the Federal Reserve System sold these governments again. It was a vast transaction to assemble $7,000,000,000 all over the country. When the Fourth Liberty Loan of $7.000,000,000 came, at a time when the capital market had been drained, my recollection is that these purchases ran from about $79,000,000 up to $350,000,000 for a very short period, and then back again to $118,000,000.

Senator GLASS. Purchases by the banks?

Mr. ANDERSON. By the Federal Reserve banks. There again it was just a temporary thing, and I think that in that $350,000,000 there was a Treasury overdraft connected with interest payments. But I am not absolutely sure.

We went through the crisis of 1920 with very little of open-market operations. The Federal Reserve banks provided over $3,000,000,000, but it was almost wholly discounts; it was not open market purchases.

In contrast with these very modest open-market operations of the war, here are the figures for 1924 and 1927. In 1924, without any need for it from the standpoint of money and credit needs of the United States, but just on this theory of making business good, forcing the pace, they bought $519,000,000 worth of Government securities between January 9 and September 7. It took less than $100,000,000 to float any one of the first three Liberty Loans. In 1927 the increase was $451,000,000.

Senator COUZENS. Have you not overlooked in those statements the war psychology, the ease with which the Government put out those securities without the necessity of resorting to the Federal Reserve or any other banks?

Mr. ANDERSON. There was necessity for resorting to the Federal Reserve System. There was necessity for resorting to the other banks. The banks cooperated magnificently in that matter.

Senator COUZENS. I am not denying that; but I say you are making a comparison of the extent to which the Federal Reserve banks were used during the war, during 1920 and during 1927, and so on, and I ask you if there was not some difference in the psychology of the people in the war period when they bought more themselves, and therefore the Government did not have to rely so much upon the Federal Reserve banks.

Mr. ANDERSON. There was a great deal of expansion of credit in connection with the financing of the Government. People bought bonds, but they did not have the cash. They would go to their banks and borrow part of it and then try to pay off the balance later. The banks had what they called " war paper ", which was their own holdings in Government bonds and loans to customers, and it amounted to something over six billions in the summer of 1919.

Senator GORE. They did reduce the reserve requirements?

Mr. ANDERSON. Yes, sir. That was a thing that was done at that time in 1917.

Senator GLASS. In 1919, when I floated the Victory loan, the war was over and had been over for some time. All of the exultation had disappeared; all of the anxiety and concern for the boys abroad had disappeared, and the banks were insisting upon floating the loan upon a purely business basis. I recall but one banker in the United States who agreed with me—and that was Mr. George Baker, now dead—that it ought not to be on a strictly business basis. Twelve millions of American citizens bought bonds. More people in my State, Virginia, and I imagine, three times as many in the State of Michigan, invested in bonds, than the total number who have invested in the " baby bonds " that were offered lately.

Mr. ANDERSON. It was a highly successful operation.

It is in these gigantic open-market operations which may run as high as 25 or 30 percent of the total member bank reserves——

Senator GORE. I do not believe you finished your statement as to what it was in 1927.

Mr. ANDERSON. In 1927 there was an increase of $451,000,000.

Open-market operations of this sort, on a scale of these magnitudes, and 25 or 30 percent of the member bank reserves, and running a long time, not just temporary things such as you had during the war, give an altogether false picture and create the illusion of unlimited capital. They lead to the diversion of bank money from current liquid uses into unliquid, frozen capital uses and speculative uses on a colossal scale.

Apparently it is this kind of policy which title II of this bill seeks to make a regular thing for the future; that the initiative shall be taken by the Federal Reserve System in putting money out and taking money in, if it is ever to be taken in, instead of waiting for the borrowers to come to the Federal Reserve banks——

Senator GLASS. Not exactly the initiative of the Federal Reserve System. The Federal Reserve Board, you mean.

Mr. ANDERSON. Yes, sir.

Senator GLASS. There is a great difference.

Mr. ANDERSON. A great difference. My next point will probably take me about 10 minutes to get into. Possibly it will take me somewhat longer than that. It leads to the discussion that Senator Couzens was particularly interested in.

Senator GLASS. Suppose, then, we adjourn until 2 o'clock, to reassemble in the Appropriations Committee room at the Capitol, so that we will be in close contact with the Senate.

Mr. ANDERSON. Very well, sir.

(Address delivered by the witness before the Students' Union of the Netherlands Commercial University, referred to and submitted by him, is as follows:)

[Chase Economic Bulletin]

COMMODITY PRICE STABILIZATION A FALSE GOAL OF CENTRAL BANK POLICY[1]

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I invite you to join me in the analysis of a dangerous economic fallacy. It is proposed that central banks, including our own Federal Reserve System, shall be guided in their discount policy and in their other dealings with the money market by one sole criterion, namely, the general level of commodity prices. If commodity prices are moving upward, central banks are to restrict credit. If commodity prices are moving downward, central banks are to expand credit, the objective being always to maintain a stable level of commodity prices. All other considerations are to be made subordinate to this end. If, for example, a dangerous stock-market speculation is under way, making insatiable demands upon the credit resources of the country, and impairing the liquidity of bank assets, the central bank or the Federal Reserve System is still not to alter its credit policy so long as the general level of commodity prices is not changing.

This doctrine has many protagonists, not all of whom would state it as extremely as the preceding paragraph does. The preceding paragraph does represent, however, the position of Prof. Gustav Cassel, of Sweden, who is the outstanding figure among the numerous European adherents of this view, and the view has recently been stated in terms little, if any, less extreme by various men prominent in my own country, where well-organized and well-financed propaganda is being made for the general project of commodity-price stabilization by Federal Reserve bank action.

I believe that these views are wrong and dangerous. And I believe that these views have so many adherents, both in the United States and in Europe, that it is highly essential that they should be challenged. I am happy to be able to inform you that our Federal Reserve Board is on record as opposing the legislative proposal now pending before the American Congress, which

[1] An address delivered before the Students' Union of the Netherlands Commercial University (Vereeniging Voor Studiebelangen Aan De Nederlandsche Handels-Hoogeschool) at Rotterdam, the Netherlands, on the afternoon of May 7, 1929.

would require Federal Reserve policies to be guided by the price-stabilization principle.[2]

In opposition to this new doctrine, I offer the old-fashioned doctrine, rarely questioned in pre-war days, well understood and well tested in experience, that central-bank policy should be guided by the banking position of the country and the state of the money market, with heavy emphasis placed on the domestic banking position and the domestic money market, but with occasional cooperation with other central banks in international emergencies.

Whereas the new theory asks central banks to stabilize the commodities market, I maintain that they have a great enough task in steadying the money market.

The Old-Fashioned View of Central Bank Functions and Central Bank Policy

The traditional prewar view of the duties of a central bank is definite, clean-cut, and simple.

(1) It is the business of a central bank to protect the paper money of the country by converting it into gold on demand. This is its first and most essential function, and everything else must be subordinated to this.

(2) It is the business of a central bank to ease off monetary stringencies and to prevent business crises from degenerating into money panics. In a crisis, the central bank supplies whatever money is necessary at a steep discount rate. It enables solvent men to protect their solvency, but it does not regard it as its duty to validate the unsound assets of really insolvent men, or to help defer the liquidation of stale positions.

(3) In times of great speculative excesses, whether in commodities or in securities, central banks should act to prevent the extension of unsound credits, to protect the liquidity of the banks of the country, and to check speculative excesses, by tightening the money market.

(4) It is not the business of a central bank to finance a boom—least of all, a stock-market boom.

CENTRAL BANK INFLUENCES ON THE MONEY AND CAPITAL MARKETS

Central bank policy is only one factor governing money rates and governing the volume of money and capital available in the money and capital markets.

There are five main sources of capital: (1) Consumers' thrift; (2) the turning back of business profits, including corporate profits, to industry and trade; (3) taxation, when the proceeds of the taxes are used for capital purposes and very especially for the purpose of reducing public debt; (4) direct capitalization, as when a farmer spends his spare time in building barns and fences, or putting in subsoil drainage, or when a farmer allows his herds and flocks to grow instead of selling off the annual increase; (5) new bank credit, the product of bank expansion, based on excess bank reserves, which may grow out of (*a*) inflowing gold, or (*b*) increased central bank credit.[3] It is the abuse of this source of capital which is responsible for our present financial problems.

Rates of interest in the capital market and in the money market depend upon both supply and demand. There are many subdivisions of the money market and the capital market, each with its own special supply and demand, and each with its own special rate or rates. There are the markets for real-estate mortgages, for highly liquid commercial paper, for call loans and time loans at the stock exchange, for customers' loans, secured and unsecured, at banks, with various rates depending upon the length of the loan, the liquidity of the loan, etc. There is the bond market, with subdivisions—railroad bonds,

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[2] Testifying before the congressional committee, which has the so-called "Strong bill" under consideration, the Honorable Roy A Young, Governor of the Federal Reserve Board, stated categorically on Mar. 19, 1928, "The Board is opposed to the bill" Hearings before the Committee on Banking and Currency, House of Representatives, 70th Cong, 1st sess., on H. R. 11806, p. 11.

[3] Many old-fashioned writers would deny that expending bank credit is a source of capital They would say that it is absurd to contend that the mere creation of two liabilities, namely the liability of the borrower to the bank and the bank's deposit liability to the borrower, creates new capital. But, held within limits, it must be recognized that this is a real source of capital. The great trouble in recent years is that this source of capital has been overworked to an extent which passes far beyond the limits which any theory of credit can justify See the Chase Economic Bulletin, vol. VI, no. 3, November 1926, pp. 24–27, and the Chase, November 1920, pp. 318–326.

industrial bonds, municipal bonds, Government bonds—bonds listed on the stock exchange, and bonds sold only "over the counter." There is the market for corporate shares, competing for funds with these other divisions of the money market. These markets, though in considerable measure distinct, are connected. There is a tendency for rates of interest or rates of return in each of these markets to have certain relations to rates in the other markets, with differentials,[4] of course, to compensate for differences in safety and liquidity.

Great intensity of demand in some of these specialized markets, with moderate demand in others, can lead to temporary very great discrepancies in rates among them, as we have seen in recent months, in the United States, where open-market commercial paper has been moving at 5¾ to 6 percent, while time money on the stock exchange has been at 8¾ to 9 percent, and call money at the stock exchange has gone as high as 20 percent. But, even so, a greatly increased demand at any one place makes a firmer tendency throughout.

It is, therefore, clear that central-bank policy cannot ordinarily be expected to dominate even the money and the capital market. Its influence is wholly on the side of supply. Demand it cannot control. On the side of supply it can influence only one of the main sources of capital, our no. 5 above, namely, bank credit The abnormal concentration of gold in the United States has given our Federal Reserve System a leeway in this respect in recent years almost unprecedented in history,[5] and very unlikely to be duplicated in the near future. Investors' savings, corporate savings, Government policy with reference to paying off the public debt, and direct capitalization, are all beyond the control of the central bank.

Even in the regulation of commercial-bank expansion, central-bank credit is only one of two[6] major influences, the other being the international movements of gold. The power of a central bank, therefore, to regulate even the money and the capital markets is limited, and we must not ask too much of it. We may properly expect it to prevent extreme variations, to moderate the movements in money rates and interest rates, to take up slack at times when rates are unduly low, to meet seasonal needs for increased hand-to-hand currency and seasonal variations in the commercial demands for credit, and, above all, to prevent fantastically high interest rates in times of crisis and emergency. But, under anything like normal conditions, it is quite unreasonable to ask more than this of a central bank.

Artificial manipulation of interest rates by a central bank seeking to overcome all the other factors in the money market and the capital market generates troubles which lead to excessive rates in the other direction at a later time.

This proposition holds true for all markets. An artificially low price for coal would check coal mining, on the one hand, and lead to wasteful use of coal on the other, with the result that sooner or later a great scarcity of coal would come, which could only be corrected by extremely high coal prices, checking the use of coal, and increasing its production.

The main cause for the very high money rates in the United States today is the excessively low rates from 1921 to 1928, and particularly the final cheap money episode in the autumn of 1927, which turned loose the incalculable psychological force of speculative contagion, which has seemed insatiable in its demand for credit even at very high rates.

CENTRAL BANK POWER OVER COMMODITY PRICES

If it is unreasonable to ask a central bank to fix money rates and interest rates, far more unreasonable is it to ask a central bank to fix the level of commodity prices. Central bank policy is only one factor in the money and capital market, and the state of the money and capital markets is only one of many factors affecting commodity prices. In no way, except through the regulation of the money and capital markets, can the central banks influence commodity prices, and this influence is an influence of second or third remove and of indeterminate degree.

The general average of commodity prices is governed by a multitude of forces. In 1924, for example, in the United States we had a moderate rise in commodity

[4] In periods of extreme speculation, these differentials become gravely distorted, so far as the return on equities is concerned, either through exaggerated emphasis on future prospects, or through a complete failure to calculate.

[5] The expansion of bank credit between 1896 and 1903 is a remarkable episode, which we have studied in The Chase Economic Bulletin, vol. IX, no. 1.

[6] *Cf.* Chase Economic Bulletin, vol VIII, no. 1, for an analysis of all the factors affecting commercial bank reserves, and bank expansion, in the United States.

prices beginning in the middle of the year. It started in a sharp rise in wheat, growing out of a world shortage, with positive disaster in the Canadian crop, accompanied by an abundant wheat harvest in the United States. American agriculture, which had been very depressed, found its position greatly improved, and agricultural buying of manufactured goods increased sharply. Simultaneously, the Dawes plan restored confidence in Eprope among American investors. We had placed only $267,000,000 of foreign securities (refunding excluded) in our market in 1923. But in 1924 we took nearly a billion dollars worth of such securities, mostly in the second half of 1924. Coincidently, our Federal Reserve authorities carried through the purchase of a great volume of Government securities, flooding our markets with money, leading to very excessive commercial bank reserves, and to a great credit expansion. This facilitated the enormous placement of foreign securities, which the second half of the year brought. Our export balance of commodities had dropped to about $375,000,000 in 1923, and rose to a billion dollars in 1924. Commodity prices increased from an average of 148.7 in the first half of 1924 to an average of 158.4 in the first half of 1925. In the absence of any of these three factors, the rise in commodity prices would have been less than it was.

In general, central bank policy has a very limited control of the general average of commodity prices in a gold-standard country. The relation between goods and gold is an international matter. Long-time variations in the production and consumption of gold, taking the world as a whole, have a great deal to do with commodity prices. Changes in the production and consumption of goods of various kinds have a great influence.

Changes in the proportions in which various goods are produced may make radical changes both in particular prices and in the general average of prices. If, for example, agricultural goods are produced in great excess, while manufactured goods are produced inadequately, the resultant break in agricultural prices may so reduce the buying power of the farmers that they are unable to take even the relatively scant product of the manufacturers at prevailing prices, and a break in the prices of manufactured goods comes also. Prices are interrelated. We saw precisely this situation as one of the major factors in the break in commodity prices in the United States and in the world in 1920–21.[7]

The theory of value and prices is an intricate and complicated thing, and it is no part of my purpose today to do more than illustrate some of the complications.[8]

My purpose is accomplished if I have shown you how fantastic it is to expect central bank policy, operating via the money market and the capital market, to fix the level of commodity prices. The gravest difficulties arise at every link in the chain. First, the central bank cannot control even the money market and the capital market. It can, at best, mitigate and moderate their movements. Second, the money market and the capital market are, at best, only one of many factors affecting the commodity markets. Third, the money and capital markets have a far more decisive influence on the markets for securities, real estate, and foreign exchange than they have on commodities, and their influence on commodities usually works through these channels.

THE FACTS VERSUS THE QUANTITY THEORY OF MONEY

How little influence the money-market developments even of a very great country, have upon commodity prices has been strikingly illustrated in my own country in recent years. We have had in the past 9 or 10 years a classical test of the quantity theory of money. This theory is the basis of the whole project of stabilization of prices by central-bank action. The theory holds that, allowing for changes in volume of trade, the average of commodity prices will go up or down in precise proportion to the quantity of money and bank deposits. (I do not forget here "velocity of circulation" of money and deposits, which the quantity theorists also bring into the picture.)

In the middle of 1919, the quantity theorists told us that we were on a permanently higher level of commodiy prices as a result of the great expansion of bank credit, and we were assured that while prices might rise or fall moderately 5 or 6 percent above or below the existing level, with the business cycle, the existing level was permanent and safe. In the year and a half that fol-

[7] Cf. the Chase Economic Bulletin, vol. I, no. 3.

[8] I venture to refer here, for a systematic exposition of my views on this point, to two books, Social Value, Boston, 1911, and the Value of Money, New York, 1917.

lowed, commodity prices first rose 15 percent, and then dropped precipitately 49 percent, with the volume of bank credit higher at the end of the drop than it had been at the beginning of the rise.

Following the great drop, the quantity theorists told us that prices would have to rise again to very high levels, because of the great flow of gold that was coming in to us, a flow which continued year after year on a colossal scale, reaching its climax in 1927. The gold came, but the rise in commodity prices did not materialize. The average of commodity prices stands in 1928 precisely where it had stood in 1921.

Facts do not ordinarily make a great impression upon the quantity-theory school, as John Stuart Mill observed long ago.[9] In this case, however, the facts have been so startling, so notorious, and so perverse, that they have at least awakened the attention of certain quantity theorists in Europe, and have aroused them to the creation of a myth as a means of explaining the facts away. The myth is that our Federal Reserve authorities have sterilized the gold which has come to us, and have prevented it from working out its normal effects upon our money market and our commodity markets. That this is a myth, I shall demonstrate in the figures that follow.

The incoming gold has had its normal effect upon our money market, making money cheap, making bank reserves excessive, and in generating a perfectly tremendous expansion of bank credit. So far from the Federal Reserve authorities hindering this process, they actually helped it along, until the end of 1927, since which time there has been a reversal of Federal Reserve policy. This reversal of Federal Reserve policy did not come until after we had ceased to gain gold and until after our gold supply had begun to be reduced. Federal Reserve policy through the whole of this period, and even to the time of writing, has held rediscount rates below the market rates, encouraging the member banks to borrow to relend at a profit, though in recent months the Federal Reserve authorities have by admonition been discouraging the member banks from doing this. In the second place, when despite the low discount rates, member banks were not borrowing in large amount, the Federal Reserve authorities have several times greatly increased the volume of Federal Reserve credit, and greatly increased the volume of bank reserves, by open-market purchases of Government securities and acceptances, intensifying the influence of the incoming gold.

The result has been an expansion of bank credit of great proportions, as shown by the following tables:

DEPOSITS OF COMMERCIAL BANKS[10]

Apr. 11, 1928	$44,234,100,000	Apr. 11, 1928	$44,234,100,000
June 30, 1919	27,728,241,000	June 30, 1921	29,831,015,000
Increase	16,505,859,000	Increase	14,403,085,000
Percent increase	59.5	Percent increase	48.2

LOANS, DISCOUNTS, AND INVESTMENTS OF COMMERCIAL BANKS[10]

Apr. 11, 1928	$47,607,000,000	Apr. 11, 1928	$47,607,000,000
June 30, 1919	31,724,523,000	June 30, 1921	34,209,282,000
Increase	15,882,477,000	Increase	13,397,718,000
Percent increase	50.1	Percent increase	39.1

[9] "Not only has this fixed idea of the currency as the prime agent in the fluctuations of price made them shut their eyes to the multitudes of circumstances which, by influencing the expectations of supply, are the true causes of almost all speculations and of almost all fluctuations of price; but in order to bring about the chronological agreement required by their theory, between the variations of bank issues and those of prices, they have played such fantastic tricks with facts and dates as would be thought incredible, if an eminent practical authority had not taken the trouble of meeting them, on the ground of mere history, with an elaborate exposure. I refer, as all concersant with the subject must be aware, to Mr. Tooke's History of Prices. The result of Mr. Tooke's investigations was thus stated by himself, in his examination before the Commons Committee on the Bank Charter question in 1832; and the evidences of it stand recorded in his book: 'In point of fact, and historically, as far as my researches have gone, in every signal instance of a rise or fall of prices, the rise or fall has preceded, and therefore could not be the effect of, an enlargement or contraction of the bank circulation.'" (Principles of Political Economy, book III, ch. 24, par. 1.)

[10] The figure for Apr. 11, 1928, is estimated. See the Chase Economic Bulletin, vol. VIII, no. 1, appendix A.

Let us now compare this growth of bank credit with an index of the need for bank credit.

	Index of bank credit (1919=100)		Index of need for bank credit [1] (1919=100)		
	Index of loans, discounts, and investments of all commercial banks	Index of all deposits of all commercial banks	Combined index of production and transportation (physical units)	Index of wholesale prices	Index of need for bank credit (production-transportation index multiplied by prices)
1919	100.0	100.0	100.0	100.0	100.0
1920	113.9	113.4	104.7	111.3	116.5
1921	107.8	107.5	88.9	70.4	62.6
1922	104.3	110.6	100.8	69.7	70.2
1923	113.6	118.0	116.3	72 5	84.3
1924	116.7	127 4	112.4	70 7	79.4
1925	126 1	138 9	118.0	74 6	88.0
1926	132 8	145.1	123 4	72.1	89 0
1927	140.0	149.9	121.6	68.8	83.6
1928	150.1	155.9	124.5	70.4	87.6

[1] See The Chase Economic Bulletin, vol. VI, no. 3, pp. 4 and 5, vol. VII, no. 4, p. 20, and vol. IX, no. 1, pp. 12 and 13. See also vol. VIII, no. 2, for a refutation of the contention that the growth of bank credit represents savings.

We are now ready to test the quantity theory on the basis of American statistics for the past 10 years, measuring prices, volume of money, volume of bank credit, velocity of circulation of money and credit, and volume of trade, in accordance with the usual methods of the quantity theorists. I regret to have to inform you that the 10-year test ends in a tragedy. The beautiful theory is crushed by the weight of facts. Prices would have to be 83 percent higher than they are if the quantity theory of money were true! I shall not read the figures here, but shall present them in an appendix.

The expenditure of ammunition in the form of credit expansion has been tremendous. The effect on commodity prices, on the face of the record, has been nil. But we have financed a magnificent real-estate speculation, chiefly in urban and suburban districts, though in one case covering a whole State, Florida; and we have financed a stupendous stock exchange speculation, as shown by the following figures:

Prices of stocks

(New York Times averages)

50 combined stocks—25 rails and 25 industrials:	
1921	[11] 58.6
1929	[12] 252.05
Increase	193.45
Percent increase	330.1
25 industrials:	
1921	[11] 66.2
1929	[12] 368.93
Increase	302.73
Percent increase	547.2

Meanwhile, since 1927, the rapid growth of demand for credit for stock-market purposes, accompanied by the loss of gold, has led to a very sharp rise in our interest rates, and to a growing concern among our Federal Reserve authorities, and the banking community in general, over our credit situation.

THE NEW FORMULA OF THE STABILIZERS

But the stabilizers show us no mercy. They say to us that the Federal Reserve authorities have no concern with what the stock market does, that commodity prices are not rising, and that this is evidence that there is no excess of credit. They abandon, in other words, the quantity theory formula

[11] Low.
[12] High.

of proportioning credit to physical volume of trade and look solely to the level of commodity prices as a test of credit policy. Professor Cassel even complains that not enough credit was given in 1925–27. I quote: "In the particular case before us, this means that the supply of bank cash from the side of the Federal Reserve System during the years 1925–27 has not been quite sufficient for meeting the growing needs of American business life. * * * In fact, it is impossible to find any other explanation for the 10-percent fall of this (commodity price) level which has taken place in the said period." [12] Professor Cassel has, moreover, been telling us—and his views have had much applause among our own stabilizers—that an increase in stock-exchange loans does not raise rates of interest or withdraw money from other uses, and that our Federal Reserve authorities should look only at the commodity-price level and not at anything else in framing their discount and open-market policy.

PROFESSOR CASSEL'S VIEW: LOANS AT THE STOCK EXCHANGE AND INTEREST RATES

This view is so remarkable that I feel it necessary to quote Professor Cassell's own language: [13]

"If money flows into the stock exchange for the purchase of shares at higher prices, the sellers of the shares must get *exactly the same amount at their disposal as the buyers have invested.* Hence the rise in the quotations of the stock exchange cannot lead to the withdrawal of any capital from production." (Italics mine.)

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"If we follow the comments of the financial press on the subject, we shall repeatedly come across statements to the effect that the loans to the New York Stock Exchange have withdrawn money from productive uses. * * * *It has also been contended that the large demands of the stock exchange have forced up the rates of interest on capital for productive purposes.* * * * *This whole view is in reality devoid of any foundation.* (Italics mine.) If the New York member banks increased their loans to the Stock Exchange, in round figures, from three milliard dollars in July 1927 to four and a half milliard dollars in June 1928, this by no means signifies that the enormous sum of one and a half milliard dollars has been withdrawn from industry and commerce. Viewed in the rough, what has happened is merely this, that speculators have borrowed one and a half milliard dollars in order to buy securities on the New York Stock Exchange, but that exactly the same sum has gone to the sellers of those securities, and has thus been placed at the disposal of the real capital market. On the stock exchange part of the sum has been used to raise the prices of previously existing shares. Such a rise, however, is merely a nominal change and does not withdraw any capital from other uses. The remainder of the one and a half milliard dollars which have gone to the stock exchange have been used for the purchase of newly issued shares. An equivalent amount has then immediately been placed at the disposal of those productive purposes for which these shares have been issued. It is thus a mistake to suppose that producers have any ground of complaint.[14]

This argument is shot through with fallacies. An increase in commercial bank loans, of whatever kind, whether stock market loans, commercial loans, real-estate mortgage loans, or loans of any other kind, tends to reduce the ability of the banks to make other loans, and tends to raise rates of interest to other borrowers. The point is that when a bank makes a loan, it must

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[12] Post-War Monetary Stabilization, by Gustav Cassel, Columbia University Press, New York, 1928, pp 92–93

[13] "This means that we should try as far as possible to stabilize the value of gold and thereby the general level of prices This is a function of the central banks, because inevitably the central banks have an influence on the value of gold. I want to add that this is the only point where the central banks necessarily have an influence on prices *Therefore you should abstain from adding any other duties to the central banks.*" (Italics mine) Hearings before the Committee on Banking and Currency, House of Representatives, 70th Cong., 1st sess , on H R 11806, pp 372–373

"Sometimes, however, other motives are allowed to disturb this policy. The most important case is when a central bank tries to combat a rising wave of speculation by an increase in its discount rate which is not justified by any tendency towards a rise in prices As long as speculation is confined to the stock exchange and thus does not directly affect the prices of commodities, it ought, as far as possible, to be checked by other means than a raising of the discount rate" *Post-War Monetary Stabilization,* by Gustav Cassel, Columbia University Press, New York, 1928, p. 86.

[14] Quarterly Report, Skandinaviska Kreditaktiebolaget, October 1928.

either pay out cash from its reserves, reducing its ratio of reserves to deposits, or else increase its deposits, which again reduces the ratio of reserves to deposits, though at a less rapid rate. With declining reserve ratios, interest rates rise. Stock market loans have precisely the same effect here that any other loans have. Interest rates in the United States today would undoubtedly be a great deal lower for all purposes than they now are if four or five billion dollars of deposits were canceled in the process of liquidating four or five billion dollars of bank loans against securities.

In the second place, the contention that money loaned to the stock market speculator comes back to industry in one way or another is at least equally true of a commercial loan or of a real-estate mortgage loan. The merchant who borrows uses the borrowed money in paying a manufacturer or wholesaler for goods. The builder, who borrows on real-estate mortgage, uses the money in paying a contractor for putting up a house. But all of them, by their borrowing, operate to lessen the free loan funds of the banks and to raise rates of interest to other borrowers.

Professor Cassel's analysis pretends to a mathematical exactitude, which it is far from possessing. He says, "If money flows into the stock exchange for the purchase of shares at higher prices, the sellers of the shares must get *exactly the same amount* at their disposal *as the buyers have invested*." (Italics mine.) This proposition is not true. The sellers of the shares get very much more than the buyers invest. The buyer "invests" $250,000, namely, his margin, but the seller gets $1,000,000, of which, say, $50,000 comes from the broker, lent by the broker to the buyer, and $700,000 comes from the bank, as the product of new bank expansion. The buyer's $250,000 and the broker's $50,000 represent existing capital. The $700,000 represents new bank expansion added to existing capital. The seller gets the whole million dollars and may do what he pleases with it.

But what will he please to do with it? The matter is very clear in Professor Cassel's mind. He says, "Exactly the same sum has gone to the sellers of those securities and has thus been placed at the disposal of *the real capital market*." (Italics mine.) Professor Cassel puts it all into the capital market, but the seller, in general, does not do this. Part of this $1,000,000 represents profit to him. He has sold his shares in a rising market, and for a good deal more money than he paid for them, and he feels cheerful. His daughter wishes a new automobile; his wife would like a trip to Europe; he himself feels disposed to enjoy some unaccustomed luxuries. The probabilities are that he will preserve intact his original capital, and that he will turn into capital part of his profit, but the probabilities are also high that part of his profit will be spent in consumption, or, in other words, that part of the capital of the margin buyer and the broker, and part of the new bank credit, will be spent in unusual consumption.

The greatest complaint of all is regarding the progressive undermining in the quality of credits, as the capital values on which they rest are pushed to more and more extravagant heights. In the banking field, the complaint is, in particular, of the substitution in the assets of the banks of stock and bond collateral loans, bond investments, real-estate mortgages, and installment finance paper, which cannot be rediscounted at the Federal Reserve banks, for the commercial paper which can be rediscounted at the Federal Reserve banks. Speaking of this point, Professor Cassel says: "Technically speaking, this is, of course, a drawback as the solvency of the member banks is thereby impaired. * * * These observations, however, do not go to the root of the matter." [15]

HOW THE GREAT CREDIT EXPANSION HAS AFFECTED COMMODITY PRICES

I have said that our great expansion of bank credit, running far beyond any need for credit, has had no apparent effect upon our commodity price level. Prices in 1928 stood precisely where they stood in 1921. But I would maintain that our commodity price level would be lower today if this great expansion of bank credit had not taken place. The expansion has had its influence, not in raising commodity prices but in maintaining them. It has worked, however, not as the quantity theorists maintain, by a mechanical equilibration of the quantity of money, on the one hand, and the quantity of goods in the process of exchange, on the other hand. It has worked rather in indirect ways, the most important of which are as follows:

(1) The great expansion of bank credit has made it possible for us, a creditor nation with very high tariffs, to maintain a great export trade, and even a

[15] Ibid., p. 58.

great export surplus. The outside world has been unable to sell goods within our borders in sufficient quantity to obtain earned dollars with which to pay interest on its debts in our country, and to buy goods from us. But the great expansion of bank credit has made possible the flotation of a tremendous volume of foreign securities, giving the outside world borrowed dollars with which to pay interest on past borrowings and to continue to buy our goods.

(2) There has been immense activity in our building trade, and in other long-time construction, including the building of roads and highways, which would not have gone so far had the volume of bank expansion been less.

(3) The financing of instalment buying with bank credit has gone much further than would have been possible under ordinary circumstances.

(4) Consumer demand has been swollen on a great scale by profits in stocks, bonds, and real estate which have accrued with the speculative developments in these fields. The Federal Treasury reports in 1928 that almost 11 percent of the income reported for taxation in that year represented either profits on stocks, bonds, and real estate or capital net gains on assets held over 2 years. This percentage represents only the case of realized profits on transactions actually completed. In addition, we know very well that the successful speculator, who has large paper profits, has a tendency to increase his expenditures through drawing on his balance with the brokers when the balance greatly exceeds margin requirements. "Brokers' loans" have increased to offset these withdrawals, and thus in part represent consumers' expenditures, including trips to Europe and automobiles!

In these four ways our expanding bank credit has operated to hold up commodity prices. If the stabilizers find comfort in this fact they are welcome to do so. For myself, I should prefer a lower and a more dependable price level, maintained by the expenditure of normal income. I should prefer to have an export trade soundly based on the balancing of goods and services against goods and services. I should prefer to have a building trade financed primarily out of investors' savings.

THE FUTURE ADEQUACY OF THE WORLD'S GOLD

The school of the stabilizers, and here again Professor Cassel is conspicuous, are viewing with apprehension the future production of gold. They doubt its adequacy to maintain the existing price level. They urge the central banks of the world to get together to economize the use of gold. They wish reserve ratios to be lowered. They wish the gold exchange standard to be employed in lieu of the gold standard, to economize gold. Nothing must be done to prevent such an expansion of credit as is required to maintain the existing level of commodity prices. Everything must be done to encourage such an expansion of bank credit as is necessary to maintain the existing level of commodity prices.

Let me say to them that if the existing tendencies in money and credit are continued, if to maintain the present level of commodity prices we must continue to let the speculators have all the money they wish for stock-market speculation and real-estate speculation, if instalment finance must spread over the world on the basis of expanding bank credit, and if credit throughout the world must continue to expand as the means of forcing out exports into countries reluctant to receive them, then the inadequacy of gold will manifest itself in a very short time.

I agree that it would be unfortunate if the world got into a position such that a shortage of gold hampered the process of exchange, and put the world on short rations in the matter of credit for commercial purposes. But I maintain that the surest way to bring about this inadequacy of gold is to follow the counsel of the stabilizers, to regard the present level of commodity prices as sacred, and to force at all hazards such an expansion of bank credit as is necessary to maintain it.

We must look at this problem from the standpoint of both supply and demand. We may seek to meet the unlimited demands of excited speculators at low rates of interest, or we may stop the unsound tendencies now, cease the excessive diversion of bank credit into capital uses and speculative uses, and then undertake to supply the legitimate needs of business for an indefinite period at rates of interest which correspond to the actual facts of the capital situation—which rates, I venture to suggest, will be substantially higher than the artificially low rates of recent years, though, I trust, reasonably lower than the rates now prevailing in the United States.

STABLE COMMODITY PRICE LEVELS AND CRISES

Since commercial crises are usually accompanied by sharp changes in the commodity price level, the ingenious theory has been devised that we could prevent commercial crises if we should stabilize the commodity price level. This doctrine is more dangerous and more fallacious than would be the doctrine that we could prevent fevers and chills by preventing changes in the clinical thermometer. Movements in the clinical thermometer have no influence on the course of fevers and chills. They merely record what is taking place. Movements in commodity prices, however, not merely indicate industrial unbalance but they also actually tend to correct the industrial unbalance.

Falling prices check the production of goods, which are being produced to excess, and increase the consumption of such goods, while rising prices encourage the production and check the consumption of scarce goods. Such price changes are wholly beneficial, and should not be interfered with, and such price changes often involve not merely changes in particular prices, but also changes in the general price level of a country, if large groups of producers are involved. This is particularly likely to be the case in a country where international trade is large in proportion to domestic trade, and where a particular type of export commodity is highly important—as silk in Japan, nitrate in Chile, grain and meat in the Argentine, coffee in Brazil, sugar in Cuba, or diversified manufactures, as in England. To resist such price changes is to invite trade stagnation. To resist the industrial readjustment and the readjustment of costs indicated by such price changes is to prolong trade stagnation.

THE GENERAL PRICE LEVEL IRRELEVANT [16]

The general price level is, after all, merely a statistician's tool of thought. Business men and bankers often look at index numbers as indicating price trends, but no business man makes use of index numbers in his bookkeeping. His bookkeeping runs in terms of the particular prices and costs that his business is concerned with.

It would be a very stupid undertaking, in a country where agriculture has been depressed, and where agricultural prices are beginning to turn upward, for the central bank to try to offset the influence of this upon the general average of commodity prices by taking measures which would force the prices of manufactured goods down to compensate. It is far better that the general price level should rise in such a situation.

Satisfactory business conditions are dependent upon proper relations among groups of prices, not upon any average of prices. In Russia, today, for example, the great difficulties grow, not out of the general price level but rather out of the wide discrepancy between the very high prices of manufactured goods, on the one hand, and the very low prices of agricultural goods, on the other. A downward movement in the Russian price level, growing out of increased manufacturing output at lower costs, would be an unqualified boon to the Russian business situation.

THE FORCED MAINTENANCE OF A PRICE LEVEL

By itself central bank policy cannot control commodity prices. Central bank policy, however, in conjunction with a variety of other artificial measures, can for considerable periods delay the liquidation of unsound positions and prevent the price changes necessary to restore industrial balance. The combination of foreign trade restrictions, price-fixing agreements, powerful trade-union organization, valorization credits, Government subsidies and doles, and the like, can delay for very long periods necessary readjustments.

THE CASE OF JAPAN

Japan was able to push policies of this sort further than most countries would be able to do. In early 1920 a few great banks, a few great industrialists, and a powerful government, abruptly checked the crisis and liquidation that began late in 1919. Aided by all the bank credit that was called for,

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[16] Price stabilization projects have taken a number of concrete forms, the one discussed in this paper being vaguer and less carefully thought out than some of the others. For critiques of other projects see the Chase Economic Bulletin, vol. V, no. 1, the Gold Standard versus "A Managed Currency" and the Fallacy of "The Stabilized Dollar", a pamphlet issued by the Chase National Bank in 1920

the stale position was held over until 1927, with a partial liquidation intervening at the time of the earthquake in 1923. Trade stagnation was endured. Unearned dividends, and even unearned wages, were paid out of corporate reserves, which ought to have been used in paying off bank loans. When the final reckoning came in 1927, it developed that not only were many industrial firms hopelessly insolvent, but also that important banks were hopelessly involved with them. Japan did not gain by enduring 7 years of stagnation in the vain hope of averting losses on inventory representing less than a year's production. The losses were not averted, but rather terribly intensified, and the greatest loss of all was in the prolonged stagnation.

Japan has straightened these things out now, and our Japanese friends are very willing that the matter should be discussed if the western world can profit by their experience.

WHAT ARE "RIGHT PRICES"?

"Right prices" are prices which will move goods and clear the markets. But nobody knows in advance what prices will do this. Experimentation in the markets, with free prices and two-sided competition, is the only way known to find out quickly and surely what prices are "right."

APPENDIX

THE FAILURE OF THE QUANTITY THEORY OF MONEY

The modern version of the quantity theory of money deals with six factors: (1) The volume of money in circulation, (2) the velocity of circulation of that money, (3) the volume of bank deposits, (4) the velocity of circulation of bank deposits, (5) the volume of trade, and (6) the average of commodity prices at wholesale.[17] The contention of the quantity theory is that the general average of commodity prices is governed by the other five factors. If money in circulation or volume of bank deposits increases, this operates to raise prices proportionally, assuming that velocities of circulation are unchanged and that volume of trade is unchanged. An increase in velocity of circulation either of money or of bank deposits likewise operates to raise prices proportionally. On the other hand, an increase in volume of trade operates to reduce prices proportionally, according to this theory, assuming that the other factors named remain constant.

Prices are supposed to be passive, having no casual influence on the other factors named; whereas the other five factors, namely: money and bank deposits, and their velocities, and the volume of trade, are supposed to be active causes, all operating on prices.

The doctrine is sometimes formulated in an equation as follows:

$$MV+M'V'=PT,$$

where M is hand-to-hand cash; V, its velocity; M', bank deposits; V', its velocity; P, prices; and T, volume of trade.

The following figures give index numbers for each of these magnitudes, based on the American statistics since 1919:

[17] Quantity theorists differ among themselves as to bringing other prices into this average. Cassel refuses to admit any others. Fisher's average is overwhelmingly dominated by wholesale commodity prices. For present purposes, which relate to commodity price stabilization projects, other factors are irrelevant.

Year	Index of M [1]	Index of V [2]	Index of M′ [3]	Index of V′ [4]	Index of P [5]	Index of T [6]	Index of MV	Index of M′V′
1919	100.0	100	100.0	100.0	100.0	100.0	100.0	100.0
1920	112.1	100	112.8	97.6	111.4	108.1	112.1	110.1
1921	100.7	100	104.3	81.1	70.4	87.6	100.7	84.6
1922	91.5	100	108.5	86.9	69.8	99.9	91.5	94.3
1923	98.9	100	116.7	92.7	72.6	116.8	98.9	108.2
1924	99.4	100	125.0	93.7	70.8	112.5	99.4	117.1
1925	98.7	100	136.2	98.5	74.7	119.3	98.7	134.2
1926	100.2	100	142.6	97.1	72.2	125.3	100.2	138.5
1927	99.5	100	149.9	96.6	68.8	121.4	99.5	144.8
1928	98.4	100	157.3	103.4	70.5	124.4	98.4	162.6
1929	97.3	100	155.3	121.4	69.6	128.3	97.3	188.5
1930	92.7	90	156.1	97.1	62.3	110.9	83.4	151.6
1931	98.9	70	143.1	80.1	52.7	94.1	69.2	114.6

[1] This index is based on revised figures of money in circulation reported by the Comptroller of the Currency at the end of each fiscal year

[2] Hand-to-hand cash in circulation makes less than one-tenth of all the payments made in the United States, the greater bulk of our payments being made by check. MV is thus so unimportant in our calculation that a constant velocity of money has been assumed for the period previous to the hoarding movement which began in 1930. In estimating velocity of money for 1930 and 1931, the amount of hoarding has been taken into consideration.

[3] This index is based upon total deposits of all reporting commercial banks as of June 30 for each year indicated If individual deposits subject to check were taken instead, the increase in deposits would have been less and the velocity would have been correspondingly greater, and M′V′ would have remained unchanged.

[4] V′, or the velocity of bank deposits, is estimated by dividing the total of bank clearings of the country plus Federal Reserve clearings by deposits. For the period 1919–28, inclusive, the results are essentially the same if "debits to deposit account" are used instead of clearings, and the results are also essentially the same if clearings outside New York are weighted by 5 in accordance with Professor Fisher's method as laid down in his Purchasing Power of Money. Appendix to chapter XII. It has seemed unnecessary to apply these checks to the years 1929–31.

[5] Bureau of Labor Statistics Index number, with base shifted from 1926 to 1919

[6] This index of physical volume of trade is constructed on lines familiar to students of the quantity theory. I have criticized this entire procedure in my Value of Money, chapters VIII and XIX, as being irrelevant to the simply truism of the "Equation of Exchange," which is merely that sellers receive what buyers pay. For the purpose at hand, however, I am following the procedure of the quantity theorists. (Professor Fisher includes sales of securities with his physical indicia, but gives them a weighting of only one out of 24, so that practically they do not count I have not put them in at all) The index is an arithmetic mean of a production index and a transportation index The index of production is a weighted average of indices of agriculture (40), mining (7), and manufacturing (53), the data being drawn from the Federal Reserve Bulletin and Bureau of Agricultural Economics as quoted in the Statistical Abstract. (The 1931 figure for agricultural output is estimated) The index of transportation is itself an average of the indices for tonnage of revenue freight of class I railroads, ton-miles of revenue and nonrevenue freight, and carloadings of revenue freight, based on data drawn from the Interstate Commerce Commission and the Bureau of Railway *Economics*.

When the effort is made to apply these indices to filling out values in the so-called "equation of exchange", fantastic results appear, as shown by the following table:

	Index of (MV+M′V′)= [1]	Index of PT	Hypothetical P which would justify quantity theory and fulfill equation of exchange	Actual P which disappoints quantity theory and spoils equation of exchange
1919	100=	100	100	100
1920	110.3=	(?)120.4	102.0	111.4
1921	86.2=	(?) 61.7	98.4	70.4
1922	94.0=	(?) 69.7	94.1	69.8
1923	107.3=	(?) 84.8	91.9	72.6
1924	115.3=	(?) 79.7	102.5	70.8
1925	130.7=	(?) 89.1	109.6	74.7
1926	134.7=	(?) 90.5	107.5	72.2
1927	140.3=	(?) 83.5	115.6	68.8
1928	156.2=	(?) 87.7	125.6	70.5
1929	179.4=	(?) 89.3	139.8	69.6
1930	144.8=	(?) 69.1	130.6	62.3
1931	110.1=	(?) 49.6	117.0	52.7

[1] The index of MV+M′V′ is based on the indicia of MV and M′V′ taken separately, weighting M′V′ by 9 and MV by 1. A more precise mathematical technique would be called for if MV were quantitatively important But over 90 percent of all payments in the United States are made by check.

(Whereupon, at 12 :10 p. m., a recess was taken until 2 p. m., in the committee room of the Senate Committee on Appropriations, in the Capitol.)

AFTER RECESS

The subcommittee resumed at 2 p. m., on the expiration of the recess, in the hearing room of the Committee on Appropriations in the Capitol.

Senator GLASS (chairman of the subcommittee). The committee will be in order.

Dr. Anderson, you may proceed.

STATEMENT OF BENJAMIN M. ANDERSON, JR., ECONOMIST, CHASE NATIONAL BANK OF THE CITY OF NEW YORK, RIVERDALE, N. Y.—Resumed

Mr. ANDERSON. I want to say one thing by way of summary in order to give a little clearer answer to a question put to me as to the position of banking and money in their general relation to the problems of prosperity and depression.

Good business depends upon a good general equilibrium of the main factors in economic life. Industries should be in equilibrium, not too much agriculture, not too little of manufacturing. Railroad transportation should be adequate to carry goods. There should be good equilibrium among industries. There should be equilibrium in foreign trade, exports and imports in proper relation to one another; equilibrium in the relations of prices and costs; a sound financial equilibrium, which includes the credit situation in quality and detail and a lot of other elements. This is merely schematic.

Now, when the situation is out of equilibrium and activity begins to flag, and you force the banking system to keep on expanding with additional credit in the effort to keep activity going when really we ought to pause and readjust, the result is an intensification of the evils and a greater smash later.

Neither in medicine nor in economics is it possible to take just one factor and regulate everything else by means of it. There is, I believe, a school of medicine known as the "chiropractic school", which I am told traces all diseases to the spine, and which proposes by manipulating the spine to keep health throughout the whole organism. Physicians I know do not agree with this type of thought. They tell me that to be sure there are some diseases of the spine, and rickets is one, but they do not cure even that by manipulation of the spine. They cure it with phosphoric acid, cod-liver oil, and sunshine. I do not think it is a caricature to describe this type of monetary theory I have been opposing today as chiropractic economics. It proposes to make use of money and credit as a cure for everything, to regulate everything, even though the economist who is used to looking at the whole field finds the disease centering somewhere else, and——

Senator COUZENS (interposing). It may be in taxes and labor.

Mr. ANDERSON. Yes; taxes and labor, unbalanced budgets, and everything else. There are pathologies of credit and money. Irredeemable paper money is a disease of money, and the cure is redemption in gold, a balancing of budgets, and a sound financial policy. But the effort to use money and credit as a substitute for readjustment throughout the general economic system seems to me utterly futile and indefensibly dangerous.

Now I come to a very vital distinction which bankers understand and which constitutes the very first thing in the training of a banker but which this new school of monetary theorists shows very little disposition to recognize. That is the distinction between bank credit and capital, or the distinction between long money and short money, the distinction between liquid and illiquid employments of funds. This bill is apparently designed to do away with, or at least greatly to lessen, the liquidity requirements both in the assets of the individual banks and in the assets of the Federal Reserve banks. I hope you will bear with me while I analyze the sources and nature of capital briefly, because it is very vital here.

I recognize five main sources of capital, the first four of which have been recognized by economists for a long time back, though some economists would not recognize this fifth as a legitimate source of capital at all. The first four are thoroughly wholesome, whereas the fifth is subject to very grave abuse, though it is wholesome if kept within proper limits.

The first source of capital is investors' savings. A man with an income of $10,000 spends $8,000 and saves $2,000, and uses the $2,000 to lend to somebody who wants to build a house with it on mortgage security, or he buys a bond with it so that a corporation can use it for business purposes, or he puts it into the savings bank, which in turn buys a bond, or he puts it into his own business.

The second source of savings is business savings, and especially corporate savings, turning back part of the profits into surplus. I suppose the most striking illustration of this in our time is the upbuilding of the great Ford industry. That industry, I think, was almost entirely financed not by new capital put in by the outside but by turning back profits into the business.

Senator McAdoo. Did you say the Ford industry?

Mr. Anderson. Yes, sir. Now, this kind of thing has been criticized recently as being one of the causes of the crisis, but I do not believe it. I think it has been a very wholesome practice. The thing that should be criticized in this connection is the issuing of securities by corporations in an easy money market for more money than they needed and the holding of these funds in liquid form. But I shall come to that in connection with my fifth source of capital, because there is where the real trouble is.

The third source of capital is taxation for capital purposes, as when a public body taxes for the purpose of reducing public debt or for other capital purposes.

And right here let me cite an illustration: I remember in my own home county in Missouri the people had had a bad experience with paying off a bond issue for a railroad that was never built, the bonds having been issued right after the Civil War, when most of the white men were disfranchised. The farmers would never vote for a bond issue again. Our courthouse was getting pretty old. Finally the proposal was made to have a special tax levy for 3 years and to build a courthouse in that way. They did that, and the county owed nothing when the courthouse was completed. That is taxation for capital purposes.

Senator COUZENS. Did I understand you to say that you did not approve that?

Mr. ANDERSON. Oh, no. I approve that. It was a good thing and it is a good thing when a county can afford it. Of course, if it is a great big thing it is better to ease that burden off by borrowing for a longer period of time. But even then I like rapid amortization. That is thoroughly sound.

Senator COUZENS. Would that apply to railroads, too?

Mr. ANDERSON. They are not public bodies.

Senator COUZENS. Well, they do not amortize their bond issues. They put themselves perpetually in debt.

Mr. ANDERSON. I should like to see a situation where railroads could and would amortize their bonds.

Senator MCADOO. Their only sinking funds are their refunding operations. I think to that might be attributed the most of the difficulties that confront them today.

Mr. ANDERSON. That is safe only when you are sure you will have indefinite growth. When the reverse situation comes in it is not good. Of course, you can never be sure of indefinite growth.

Senator GLASS. You may proceed.

Mr. ANDERSON. Now, the next source of capital, the fourth source of capital, is direct capitalization and does not involve money as an intermediary. It is chiefly important in agriculture. For instance, a farmer uses his spare time in building fences and barns, or a farmer lets his flocks and herds increase instead of selling off the increase, or a farmer turns his wheat land into orchard and waits 8 years for a return instead of getting a return every year.

These first four sources of capital are wholesome, sound, dependable, and no case can be found, I think, where a country has gone wrong by doing these things.

The trouble comes with the fifth source, and that is bank expansion running beyond the needs of trade, based on excess reserves, with the result that bank money, instead of keeping to liquid, commercial paper and other liquid uses, goes into real-estate loans or into speculative loans, investments on a great scale in bonds, installment finance paper and other loans which look like commercial loans but which turn out to be loans against hotel furniture and fixtures and the like.

Now, I do not want to be doctrinaire about this, and I want to make some distinctions here. Always a certain amount of slow loans, and some real-estate loans, we can stand. The country would have blown up long since if that had not been true. Some loans to local industry that a bank expects to carry along for a long time are legitimate. The banker has got to be in a position to meet his seasonal needs and his emergency needs, however. That was one of the things that happened to so many country bankers in this last great trouble. Country bankers had always been able to take care of themselves in previous troubles, but for 6 or 7 years this expansion of credit went on, from 1922 to 1929, and they never had any pressure at the peak. Now, the country banker in the old days knew this situation: Well, my farmers are going to begin to borrow in the spring, and will borrow more through the summer as they make their crops, and then as they approach crop-making time will borrow more to pay their labor, and I will be borrowing in New York up to the limit in order to get money for them, and so on. The country banker based on that experience knew that when the crops were moved he would get his cash, in the fall, say in December, and he kept it liquid, knowing he was going to need it again next year. He would not put it out on long loans and consequently he was always in good shape. But in the period I have mentioned, of 6 or 7 years, that banker had too much money and it ruined him. He tied his money up in local loans, real-estate loans, and his money was frozen when the pressure came. He just could not get his money.

Now——

Senator COUZENS (interposing). That is not all that he tied up his money in, either.

Mr. ANDERSON. Oh, no; it was in lots of things. What they did during that period——

Senator COUZENS (interposing). And they purchased all kinds of foreign bonds and all that kind of thing.

Mr. ANDERSON. Yes.

Senator COUZENS. And real-estate bonds.

Mr. ANDERSON. Yes, sir; and if there was any possible mistake they could have made that was not made it is hard for me to know about it.

Senator GORE. Mr. Chairman, might I ask a question of Dr. Anderson?

Senator GLASS. Certainly.

Senator GORE. During that period these two parallel movements went on, and while I do not know that they had any connection, yet I want your reaction to it. The banks in the country, at least in Oklahoma, were urged by bank examiners to call a lot of local loans and put the money into what they called a " secondary reserve ", made up of bonds. They were advised that they would be liquid, and the bankers had the impression that that word came down I think from the office here in Washington of the Comptroller of the Currency. Anyway a lot of those little banks in my State put a lot of their surplus money into foreign bonds, at the instance or the suggestion of the bank examiners.

Now, paralleling that, these big underwriting concerns were disposing of foreign bonds, and they were allotting certain quantities to these little country banks, and while, perhaps, they were not compelled to take them yet they were expected to take them; and I understand that a good many of them were told if they did not take them their names would go off the list. So that while one might say they were perfectly free to take them or not, yet it was understood if they did not take them their names went off the list of the underwriting syndicates. Now, these two things did go on. Was there any connection between the two in your judgment?

Mr. ANDERSON. I think, Senator Gore, with reference to your last point, that as to people being on the list and having to go off if they did not go along, that the period from 1922 to 1929 was very much freer from that than earlier periods. I think the competition in underwriting operations had changed in that period so that that was not generally true.

Senator GORE. And the little banker took the word of the big banker, often in New York, did he not?

Mr. ANDERSON. Yes, sir.

Senator GORE. And, if he was told they were good, all right, but he did not know. I know of bankers in Oklahoma that had bonds who could not even find the country on the map that had issued the bonds.

Mr. ANDERSON. There were many underwriting houses initiating issues which in the period up through 1924, say, had excellent records of careful scrutiny of new issues; which, say, down through 1924 did careful credit work on new issues, and studied them; and then from 1924 to 1929 money was so plentiful and there was such an unlimited demand for bonds they worked under pressure and put them out altogether too fast. And I was worried then, Mr. Chairman, and was writing about these things at that very time.

Senator GLASS. Yes; and I was talking about it in the Senate, but nobody paid any attention to me.

Mr. ANDERSON. Yes; the trouble was that both commercial bankers and investment bankers, used to normal things in the past and confused by this great abnormality of unlimited money, lost their heads. You cannot have that kind of situation without men losing their heads, and sometimes even men going off sound moral standards.

Now, I do not want to be doctrinaire and I do not believe that banks should be limited to commercial loans or anything of that sort, but I do want bank credit to be related to the growth of industry. Loans to the securities market have had a very good record in American banks. The bank should not lend to the railroad directly for the construction of terminals or bridges, or to a business corporation for plant and equipment, but, if an active stock market exists, with a large body of traders, the bank can safely lend, with a proper margin, against the shares and bonds which represent the terminals and the bridges or the plant and equipment. But when you get the proportions of these things changed, when you get your ordinary volume of business going like this, and new issues going like that, and a greater rate of bank money going into new issues, it is a dangerous pathological thing.

Senator GLASS. It is especially dangerous for 16,000 banks to be doing that when not one-tenth of them know anything about buying stocks and bonds.

Mr. ANDERSON. It is very dangerous. That notion of bonds being a secondary reserve, that is, bonds of the kind that Moody would rate as triple A and that had good records in all our past crises, was justified in the past, and may be again. The banker who had a triple A bond could get money on it. But in this period we have been talking about it was overdone so badly that I think some such bonds sold at times as low as 50.

Senator MCADOO. What would you have as a secondary reserve?

Mr. ANDERSON. Personally I want banks to keep short. I do not want them to be putting bonds into their portfolios running for 20 or 30 or 40 years. I look upon 10 years as pretty long for a bank, and would rather keep them down to 6 or 7 years.

Senator MCADOO. You want fluid investments?

Mr. ANDERSON. Yes, sir. I want acceptances and short Government paper, and for them to keep some money with their New York correspondent building up a borrowing equity there.

Senator McADOO. That is almost a primary reserve.

Mr. ANDERSON. Well, it is above the requirement.

Senator McADOO. That is in effect a primary reserve also.

Mr. ANDERSON. Yes, sir; except that we used to pay interest on those deposits.

Senator McADOO. But could you find enough of that high-class stuff you are talking about to give the banks the necessary field for their surplus funds?

Mr. ANDERSON. You could always do that down to 1924. After that these things happened. Your commercial paper was very much reduced because corporations were putting out new stocks and paying off commercial paper. There were acceptances, it is true, but it was difficult to get them in adequate volume.

Senator COUZENS. I take it you would not like to rely upon stock-market quotations on railroad bonds and other issues that you referred to a while ago. In other words, if a bank has some surplus funds and wants to buy a bond, whether a railroad bond, a utility bond, or whatnot, if it was quoted on the New York Stock Exchange and traded in freely, wouldn't that be a fairly good secondary reserve for a bank?

Mr. ANDERSON. Ten years ago I should have said yes, without question.

Senator COUZENS. But you would not say yes now; is that it?

Mr. ANDERSON. Well, the bond market is more dependable than it was and we are cleaning up this mess we have been through. But I myself would not encourage a bank to take anything today over 4 years.

Senator TOWNSEND. What would you put your excess reserves in today?

Mr. ANDERSON. I beg your pardon?

Senator TOWNSEND. If you had excess reserves today, what would you buy?

Mr. ANDERSON. I would buy governments up to 4 years. I would buy corporation notes up to 4 years. I would buy what acceptances I could get. They buy almost anything along that line.

Senator McADOO. Do you say governments up to 4 years?

Mr. ANDERSON. I am talking about banks now.

Senator McADOO. And you were speaking of governments. Would you buy them for no longer period than 4 years? You mean short-term stuff?

Mr. ANDERSON. In general; yes, sir.

Senator McADOO. And you would not buy long-time governments? What would constitute sound banking in the light of what we have gone through? I should like to know whether or not there is available a field for the kind of investment for a secondary reserve, or for the capital investments of a bank, that would make it strong in ways other than what it has been during the last 5 years. It is a pretty hard thing to do, is it not?

Mr. ANDERSON. Well, the banks that had commercial paper and had governments——

Senator McADOO (interposing). Long-term governments?

Mr. ANDERSON. Even long-time governments, at the worst of the trouble in 1932 and 1933, were in very good shape. Long governments went down, as you know. You saw banks losing on a good many bonds, say, the 3 percents that came out, shortly after 1929.

Senator TOWNSEND. Because you say governments went down?

Mr. ANDERSON. Yes. I do not want banks to have long-time bonds.

Senator McADOO. Not long-time bonds of any kind, Government or municipal bonds or State bonds or corporate bonds?

Mr. ANDERSON. No, sir.

Senator McADOO. You draw a distinction between the investment of a bank's capital and the investment of its reserves, do you not?

Mr. ANDERSON. Yes. A bank of large capital can afford to have a larger amount of illiquid stuff, of course.

Senator McADOO. They are sound investments or safe investments, we will say, but illiquid.

Mr. ANDERSON. Yes, sir.

Senator GLASS (chairman of the subcommittee). You may continue.

Mr. ANDERSON. Now, then, we had a change in this situation between 1924 and 1929, as corporations were able to issue so many securities that they got more money than they needed for years ahead, and they paid off their loans at the banks, so that commercial paper actually went down in the banks and the percentage of bank assets devoted to the securities market went rapidly up.

Senator GORE. I have seen the statement that when the Federal Reserve System was established bank loans secured by commercial paper was perhaps five times as much as loans collateraled by stocks and bonds, but that that ratio has now been reversed. Could you make an estimate on that?

Mr. ANDERSON. I think I may have some figures here that have a bearing on that. I have here the national-bank figures from 1890 to 1920, and commercial loans or so-called "all other loans", and that means loans not secured by stocks and bonds, and the categories are not very good, because the "all other loans" are not exclusively commercial paper and because secured loans include some stuff that is commercial stuff—crop liens and cattle paper, and things of that sort—but take the relation of all other loans to total loans and investments, and you get something of the history of commercial loans. Between 1890 and 1900 they went down sharply. In 1890 they were 62.2 percent of total loans and investments, and by 1900 they had gone down to 45.7 percent, very much of it occurring in the period 1896 to 1900, when we settled the gold-standard question and gold was coming rapidly into the country——

Senator McADOO (interposing). And that was also because of revival of business.

Mr. ANDERSON. Yes, sir. Then from 1900 down to 1914 the percentage of commercial paper went up again, and that was true down to 1917. Then the war came on and the Government began borrowing from banks, which put the ratio down. The ratio in 1900 was 45.7 percent, and in 1914 it was 48.5 percent, and in 1917 it was 47.5 percent, and in 1919 it was 39 percent, as the peak of the war paper in the banks showed itself. Then with the commercial boom that followed it went up again, and——

Senator McADOO (interposing). The Government had very little paper in the banks at that time.

Mr. ANDERSON. It was the paper of customers borrowing against Government securities, bonds owned and everything, which was estimated at about $6,000,000,000, about the middle of 1919.

Now, then, in——

Senator McADOO (interposing). The point I wanted to make was that it was not an investment by the bankers in Government paper.

Mr. ANDERSON. No, sir.

Senator McADOO. It was collateral-secured stuff, because we had the purpose during the war to distribute bonds to the public.

Mr. ANDERSON. Yes, sir; chiefly.

Senator McADOO. And keep them out of the banks. Now, of course, the man who owned a bond might go to a bank and borrow, but then you had his personal responsibility, although backed by security.

Mr. ANDERSON. Senator McAdoo, looking back on war financing in the United States in 1917 and 1918, I want to congratulate you on a magnificant piece of sound work.

Senator McADOO. Well, it is very good of you to say that, but——

Senator COUZENS (interposing). And still he is for the Patman bill.

Senator McADOO. I had not intended by my question to invoke any such compliment, Mr. Anderson, but you will notice that the Michigan Senator is not sound on the Patman bill.

Senator COUZENS. I observe that.

Mr. ANDERSON. On this question of commercial paper, from 1919 to 1932 we have a different series of figures, namely, those of the reporting member banks. Now, the ratio of all other loans to total loans and investments for March 1920 was 52.1 percent. Liquidation took it down to 50.6 percent in March 1922. The period of 1922–23 was the period when the Federal Reserve banks were buying Government securities on a great scale and bank expansion moved rapidly, and it went outside into stocks and bonds, and the ratio dropped to 46.9 percent by March of 1923. But the next year, to March of 1924, the Federal Reserve System was holding back, they sold their Governments. They got frightened about the boom starting and tightened up the money market, and while bank credit as a whole did not expand commercial loans did expand, and the banks got money by selling some investments, and that ratio went up to 48.4 percent again.

Commercial paper will increase if you do not make money too abundant. Banks will take commercial paper first. On the other hand, if you make money abundant then it will go into other things. From 1924 it went down, and it was 39.7 percent in 1929. The percentage of eligible paper in the banks went down. I was protesting against that vigorously early in 1927, and everything is pathological——

Senator TOWNSEND (interposing). Have you any figures after 1929?

Mr. ANDERSON. The figures I am giving you are taken from my discussion of the book by Mr. Currie, which has gone into the record anyhow. These are figures for national banks from 1890 to 1920, and for reporting member banks from 1919 to 1932.

Senator TOWNSEND. What about 1932?

Mr. ANDERSON. That is 36 percent.

Senator TOWNSEND. All right.

Mr. Anderson. Now, among other evils of this is the fact that it robbed both business men and bankers of that fruitful, wholesome contact between bankers and business men that comes by reason of the business man discussing once a year with his banker how much money he can borrow; his line of credit. It is manifestly useful to both sides. The banker learns what is going on in the business world. The business man has his mind sharpened as to unsound uses of credit. It may be that he has not enough working capital, or it may be that he has too much cash. While the latter does not usually bring him to the bank to borrow, yet in any case the bank man and the business man get together on the problems of business in a fruitful way.

Further I want to say that during the past 2 or 3 decades commercial credit men, commercial bank credit men, have done one of the finest pieces of scientific work I have ever seen done in analyzing the principles under which you can make loans to particular kinds of businesses. First, to business in general and then to particular kinds of business, what sort of ratio there should be in each business between current assets and liabilities, what net worth should be in proportion to other things. They have adopted a technique of independent audits and it is a very wholesome thing.

I want to see for the future commercial loans grow rather than decline. I want the credit policy to be such that commercial loans will grow, and the conditions under which commercial loans will grow will be that you do not have too much money; that they cannot get it too easily in the matter of capital purposes.

Now, then, this leads me to my comment upon the provisions of title II of the bill permitting the Federal Reserve System to loan against "any sound assets." The Federal Reserve Act allowed member banks to go to Federal Reserve banks and rediscount commercial paper, and agricultural paper, and borrow against Government securities. Commercial paper in the larger banks especially, was, as a rule, liquid, particularly under the regulations laid down for the Federal Reserve System, and a great deal of the agricultural paper was liquid, although not all of it was; and, for that matter, not all of the commercial paper was. But, generally speaking, the Federal Reserve banks got the cream of the paper that the commercial banks had.

Government securities, moreover, were instantly marketable at a price—and there was no question about it, the Government-securities market needed no artificial support.

Now, these things were the things that were naturally liquid. The proposal now is to substitute for natural liquidity a kind of conventional liquidity, based simply on the law. The proposal is that everything can be made liquid by virtue of the Federal Reserve banks' ability to take it.

Now, there are two main objections here. One, the only assumption which can justify this is that the Federal Reserve banks and the Government, in combination, are so impregnable that they do not have to regard the question of loss of liquidity. The governments and the central banks of smaller countries know better. They know that they too have limits. In Austria, those limits were reached very quickly when you had the illiquid Boden Credit Anstalt unloaded on the Credit Anstalt, making it illiquid, then the central bank coming to the rescue and being put in jeopardy, and then the Government coming to the rescue of the central bank, and finally the whole thing going down together.

A similar episode, carried not quite so far, marked the Japanese course from 1919 to 1927.

Senator COUZENS. While on the point let me ask you this question: Do you think the guaranty of bank deposits has obviated some of the necessity for liquidity?

Mr. ANDERSON. If it leads to a loss of liquidity it is going to lead to collapse. The only thing that can make the guaranty safe is to watch the banks to see that they keep liquid.

Senator COUZENS. Yes; but I meant to ask you whether there was the same necessity for keeping liquid with the guaranty of bank deposits that there was prior to that time.

Mr. ANDERSON. There is the same necessity, but the thing can be masked longer and the disaster resulting from loss of liquidity can therefore be greater.

Senator MCADOO. It does not obviate the necessity for fundamental soundness in the case of loans.

Mr. ANDERSON. No, sir.

Senator COUZENS. That is true, but I have not yet secured quite the answer I wanted in that much of the need for liquidity occurred when runs began on banks because of fear. It is assumed that that fear has been obviated to a large extent by guaranteeing bank deposits, and therefore I ask you: Does the same necessity exist for liquidity?

Mr. ANDERSON. I think that the basic necessity for liquidity—but of course you are now talking about the extreme cases, bank failures.

Senator COUZENS. No; not at all.

Mr. ANDERSON. I am thinking of what should go on in the ordinary course of business anywhere. Banks have seasonal operations. We will say that here is a good bank in an agricultural community, and there is a crop failure and the bank must carry the farmers over to another season. That bank must of necessity have liquid resources in order to be able to do it. Further on the principle you are suggesting: If banks generally over the country were to say, "We do not have to be so liquid now because we do not have to be afraid of runs", you will finally get a frozen situation where the deposit guaranty won't work.

Senator COUZENS. Of course that is a possible outcome, but I meant under existing conditions, the same fear psychology cannot arise, for instance like in Michigan in 1932–33, where hundreds and thousands of people went in to get their money, and which necessitated a liquid situation such as does not now exist.

Mr. ANDERSON. May I use this illustration: Say we have a piece of blotting paper before us. When you drop water on it you will find it will absorb an awful lot of water, but just you try to get some of that water back and it will be very difficult. From 1922 to 1929 we did just that, we let this liquid bank credit go into blotting paper and we could not get it back. If we carry through these same policies again I do not know how long it would be before the thing would be frozen up. But I would advise any banker going into another inflation episode to know where his funds are.

Senator GORE. One hears a good deal about frozen assets, and a good deal about liquidity. You can liquefy air and get frozen air, and it is liquid but it is still rather frozen and cannot be handled with much freedom.

Mr. ANDERSON. It cannot be handled with much comfort.

Senator GORE. It cannot be handled with much freedom. Trying to liquify these illiquid assets is a good deal like that, I take it.

Senator GLASS (chairman of the subcommittee). You may continue your statement.

Mr. ANDERSON. With our immense resources we could go a long way before we got governments and Federal Reserve banks both so weakened that our whole financial fabric would collapse. Some adherents of this view perhaps might feel that even then we could get out of it by printing paper money and letting our exchanges go to pieces in the foreign exchange markets. But I do not think that either good bankers or responsible statesmen could contemplate this kind of way out with equanimity.

The second objection to the change, however, is that it removes from the banker, in his daily work, an inhibiting factor of first-rate importance. If legal-conventional liquidity is accompanied by natural liquidity, if the Federal Reserve bank will take the things the banker ought to have anyhow, then the banker has constant pressure on him to follow the rules of sound banking and not to make frozen loans.

I know that as a matter of experience. During the period from 1924 on I was constantly working with bankers to get their houses in better order, and they would say to me: These loans are good. I have plenty of collateral back of the loan, and the maker has plenty of securities in his strong box. But I would say to them: You cannot take it to the Federal Reserve bank. I would show them according to their own figures that they did not have enough to go to the Federal Reserve bank. Then they would listen to that. And if you had had this provision "any sound asset" in that period from 1922 to 1929, that boom would have gone very much further and the consequences would have been more disastrous. The fact that they could not take it to the Federal Reserve bank made it clearer to them.

As against these considerations the argument has been offered, and doubtless pressed upon this committee, that it ought to be possible for the Federal Reserve banks to lend on any sound assets to prevent bankruptcy of banks which could otherwise pull through. I should be quite willing to have emergency provisions to meet this situation. I want to keep the restraints on the banks in ordinary times and in boom times, but I am willing to have legislation passed which would permit the Federal Reserve Board, by a three-fourths vote, for a limited period of time and renewable, to lend against any sound asset, but I would not want bankers to have that before them in ordinary times.

Senator GLASS. We have that on the statute books now.

Mr. ANDERSON. But let it be an emergency thing, not a regular thing. We are going to have terrific trouble in holding the banking community down to anything like sound banking assets when the existing gigantic excess of member-bank reserves gets to working, when prices begin to rise and people get to feeling good. And it is the same with the banker. I know them; I know their magnificent elements of strength, but I also know their limitations. The same banker who today says he would never do it will be doing it as a matter of course when his competitors are doing it and he himself is feeling cheerful.

A similar argument I would like to make about this collateral provision, holding it strictly to the rule of Federal Reserve notes against gold and commercial paper, including loans against Government securities.

Senator COUZENS. Would you continue its issuance against Government securities?

Mr. ANDERSON. No; loans against Government securities; the rule as it was before the Glass-Steagall bill.

Senator COUZENS. You would not let them issue Government bonds as security?

Mr. ANDERSON. Not regularly. The argument is made, and I think it has force, that if we ever do get into such a mess again as we were in early 1932, it ought not to be necessary for Congress to have a spectacular debate before relief can be given. I am willing to have it provided in the law that if a special emergency arose, for limited periods of time they can substitute Government securities as collateral, but not all the time and not regularly.

Senator COUZENS. You mean, as collateral for notes?

Mr. ANDERSON. Yes.

Senator GLASS. This bill provides that it may be the normal thing?

Mr. ANDERSON. Yes.

Senator MCADOO. You are speaking of gold. We could not put any requirement about gold into existing statutes——

Mr. ANDERSON. You could say "gold certificates."

Senator GLASS. What do they mean?

Mr. ANDERSON. That was explained to me as I was testifying before this committee in connection with the gold bill of 1934. One of your colleagues told me very kindly, after I had made a protest with regard to gold against the certificate, putting it in the general fund, and so on—he said, "You do not understand about these gold certificates. These are not certificates that you can get gold; these are certificates that gold has been taken away from you."

Senator GLASS. That was a very logical way of stating it.

Mr. ANDERSON. With respect to both these points as to collateral against notes and loans against any sound assets, what I have in mind is this. A crisis will not be so severe if we have restraints in ordinary times. The removal of restraints in ordinary times means that we do not have a safe margin for use in crisis times. If we go through a boom without restraints, first, the boom lasts longer and goes to more violent heights; second, when the crisis comes we have nothing left with which to fight it.

Senator GORE. No parachute.

Mr. ANDERSON. I want that reserve for the last half hour of the battle, and I do not want to be over-extended when the last half hour comes.

I want to say a word about real-estate loans. I am not going to try to discuss the whole bill at all. This is the last point that I am going to raise, myself.

I am very much afraid of this provision.

Senator McAdoo. You mean the provision for amortized loans over a 20-year period? Is that what you have in mind?

Mr. Anderson. It has been improved in the House bill, but even there it goes too far. I would endorse the proposal that Mr. Aldrich made, though I want to add something to that. This still links real-estate loans to time deposits; 50 or 60 percent, I have forgotten which, of these deposits. Now, there is a great difference between time deposits at large and savings deposits in a strict sense. A very great part of the expansion of credit that took place between 1922 and 1929 was in time deposits. They were looked upon as savings, and the Comptroller's reports even spoke of them as savings. They were not savings. They were the product of expanding bank credit. Their behavior was very different from the behavior of ordinary savings deposits. Savings deposits move rather steadily and moderately. These things moved rapidly in the period when the Federal Reserve banks were expanding, and they stopped advancing when the banks were holding back. I have a lot of evidence on that in the discussion of Mr. Currie's book that I put into the record.

They were owned by rich investors who pulled out of the market and were awaiting a chance to come back, or they were surplus funds of great business corporations. Very frequently you had a pitiful plea from some country bank, "Help us out", because some big business corporation that had been attracted by the high rate of interest paid by the country bank on time deposits was drawing funds out. The country banks found that was a big percentage of their deposits, and they had the funds tied up in illiquid uses and we had to help them out. There were also funds of foreign banks and even of foreign central banks; anything but the steady, dependable thrift accounts of the people.

I hope that you will amend this language—if you pass this bill—in such a way as to make the sharpest kind of distinction between thrift accounts, savings accounts, and time deposits, and limit your percentage provision to 50 percent of the trne thrift accounts.

Senator Glass. It is 60 percent.

Mr. Anderson. Whatever it is. I would say, 50 percent, for that.

Senator McAdoo. Do you think we did a wise thing in prohibiting the payment of interest on demand deposits?

Mr. Anderson. I am glad you raised that point, Senator. I believe we are going to have to change that law just as soon as we approach a normal money market. I think at all events interbank interest—interest on deposits of one bank with another—ought to be allowed. Here is a great lot of excess reserves in one Federal Reserve district which can be used in another section if it is needed. They ought to be able to get it by paying for it.

Senator McAdoo. I was speaking more, of course, of demand deposits. Do you think we did a wise thing in prohibiting the payment of interest on demand deposits?

Mr. Anderson. I think the only place where a definite abuse existed that needed public regulation was time deposits in smaller places. I think they paid rates much too high, and there should have been public regulation of that; but I think that the practice in New York as to interest on demand deposits and interest on time deposits under clearing-house regulations was quite wholesome. Some bankers did not like it. Some of them welcomed your abolition of interest. But I am looking at it as an economist. I want a good flow of funds, and interest is the way to move them.

Senator McAdoo. Suppose, for instance, we had said that we would permit the payment of interest on demand deposits on interbank transactions; would you still say that we should also permit the payment of interest on customers' demand deposits?

Mr. Anderson. My view would be "yes."

Senator McAdoo. You think that would be wise?

Mr. Anderson. Yes, sir.

Senator McAdoo. You know that great abuses had risen out of that practice?

Mr. Anderson. You have the power of regulation.

Senator McAdoo. The bidding by banks against each other for the deposits of customers who had large deposits and who were relatively highly favored while the small depositors got practically nothing. It led to unwholesome competition between the banks and an unwholesome condition, so far as demand deposits were concerned, because the big depositors usually had some knowledge of what might happen and they pulled their deposits out when they got scared, which weakened the condition of the bank more than the withdrawals of a large number of small deposits.

Mr. Anderson. You are thinking now of the case of a small community where some big outsider brings funds to deposit?

Senator McAdoo. I am thinking about any community where that condition exists.

Mr. Anderson. I do not think it existed in New York.

Senator McAdoo. In the city of Los Angeles, a city of 1,250,000 people, with quite a large number of banks, the abuse got to be very great, so bankers have informed me. One bank would offer a large depositor a very much higher rate of interest than was justified, and at the first sign of trouble this large depositor got uneasy and withdrew his whole deposit at once, which was a very bad thing for the bank, or it might have been, whereas, in the ordinary course of business, where interest was not paid on demand deposits, and deposits might be more widely distributed, less injury might follow from a large number of small withdrawals.

Mr. Anderson. You could have a rule that the rate in each city should be the same so that the banks in a particular city are not competing by varying the rate against one another. The main thing that I have in mind to be accomplished is that if Los Angeles is needing money which Chicago has, it should be possible to bring that money to Los Angeles at a higher rate.

Senator McAdoo. It was experimental, of course, to prohibit the payment of interest on customers' demand deposits. If it has not worked well or if it is inadvisable, the question in my mind is whether or not it might not be restored with provision for the regulation of the rate of interest by the Federal Reserve Bank of the district or by Government authority, just as we permit the regulation of the rate of interest now on time deposits.

Mr. Anderson. I would so recommend, Senator.

Senator GLASS. As a matter of fact, there were various reasons why we did that. In the first place, country banks had what they call standard rates of discount. It is almost impossible ever to get them to depart from that standard rate of discount. They would rather bundle up their surplus funds and send them to the money centers at a nominal rate of 2 percent than to give the merchants of the town or the industries of the town or the locality the benefit of an abundance of money and an abundance of credit.

Senator MCADOO. And at a more reasonable rate.

Senator GLASS. Yes. They never reduced their standard rate. They have always taken the silly position that if they once reduced it they never could restore it. They could restore it for exactly the same reason that they could reduce it. When money was tight their rate would and should be high, and when money was free the rate would and should be low. But it resulted in the withdrawal of all the interior funds of the country banks and the transferring of them to the money centers for speculative purposes. That was a major reason why we prohibited the payment of interest on demand deposits.

Senator MCADOO. And also for another reason, that where we were requiring the bank to pay a premium to insure any part of their deposits, to relieve them of this payment of interest on demand deposits we gave them an additional means by which they could pay premiums upon insurance.

Mr. ANDERSON. With these very low interest rates now prevailing the banks are moving very rapidly to protect themselves anyhow. We have abolished interest on time deposits in New York because we cannot afford to pay it. We don't want money that we have to pay for.

Senator GLASS. The Government is in direct competition with banks all over the country.

Senator MCADOO. Why do you not lend this money out now?

Mr. ANDERSON. Come up, Senator, and we will talk business with you.

Senator GORE. A banker in Oklahoma City stated that one of the acute and precipitating causes of the trouble in that region was the withdrawal by banks of their accounts which resulted from the withdrawing of deposits from the banks in Kansas City. Did you observe any movement of that sort?

Mr. ANDERSON. In times of wild panic, which there was in early 1933, I suppose that every single normal thing that ever was done looked bad and went wrong and you regretted having made a perfectly good loan. I am very glad to be able to say that we were loaning up through the last day.

Senator GORE. I was wondering whether you thought it would be wise to vest authority in some agency to regulate or control interbank deposits?

Mr. ANDERSON. Oh, no. If a bank owes anything on demand it is the business of that bank to be ready to pay it. If a bank has customers who have a borrowing equity, the right to expect a loan, it is the business of the bank to make the loan, and if it cannot make it, something is wrong.

What I want is such a general handling of this credit situation that the banks will always be able to meet deposit withdrawals and 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 requirements, 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?

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 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 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?

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.

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.

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.

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.

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.)

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?

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 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?

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.

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.

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.

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.)

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 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 win 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.

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 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 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.

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 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 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.

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.
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> 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 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.

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.)

(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 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 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 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 in th the [illegible] 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 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 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 *an*other 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.

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.

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 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 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* 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. * * *"

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. 16. 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."~~

(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~~

~~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.

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 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 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 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 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 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 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?

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.

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, 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?

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

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 necessary 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 representative 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.

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 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 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-

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.

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

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.

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.

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.

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.

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

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 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 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 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 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, 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, 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.

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.

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 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.

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?

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 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 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."

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 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, 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 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 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

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 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 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 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 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.

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?

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

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 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.

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 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 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 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 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 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).

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.)

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.

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 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 opinions 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.

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 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.

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;

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 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?

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 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?

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.

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.

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 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 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.

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.

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 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 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 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 limitation 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—

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?

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 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.

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.

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.

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.

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 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 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.

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 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 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 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 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.

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 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.

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 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 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."

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, 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 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, 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.

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 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 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).

Eearnings 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 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 continued, 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 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.

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.

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 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 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 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

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 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 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.

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.

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 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.

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.

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 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 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 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.

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 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.

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.

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.)

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 resolution 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.

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?

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, nonliquid 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

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.

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.

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 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, 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.

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.

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.

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 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.

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.

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.

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 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.

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?

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 cannot 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.

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

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?

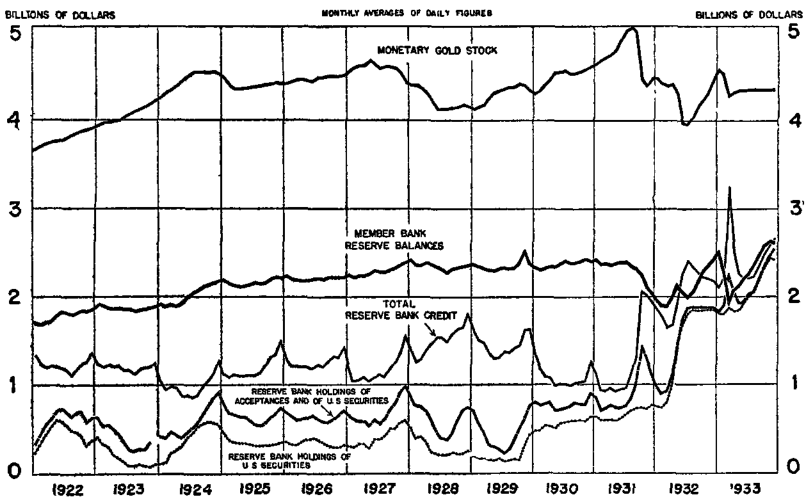
Mr. MILLER. Yes; their purchase and sale. You will notice the first great purchase operation was in 1922. We were then coming out of the postwar depression. We had an enormous influx of gold. The member banks were taking down their rediscounts, getting out of debt, with the result that the Reserve banks were hard put to make earnings. They therefore began to enter the open market 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

MEMBER BANK RESERVES—GOLD—RESERVE BANK CREDIT



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.

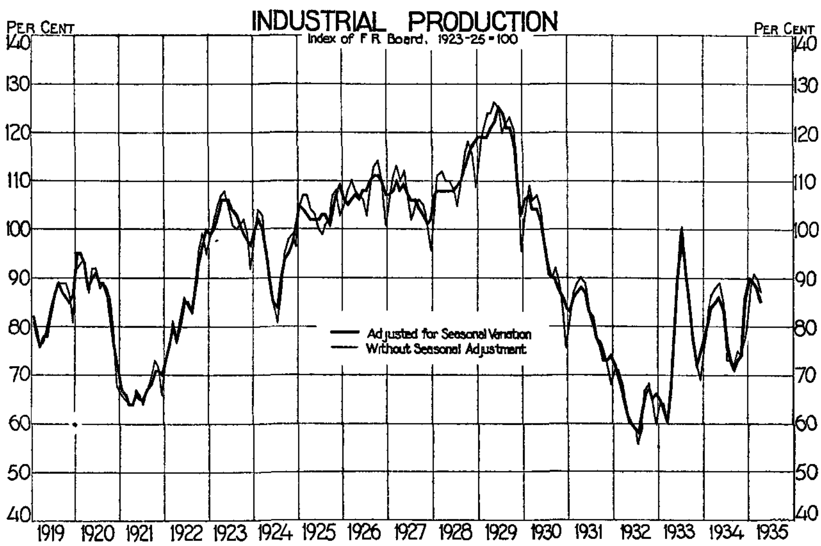
Senator COUZENS. Those figures do not show in dollars and cents.

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 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?

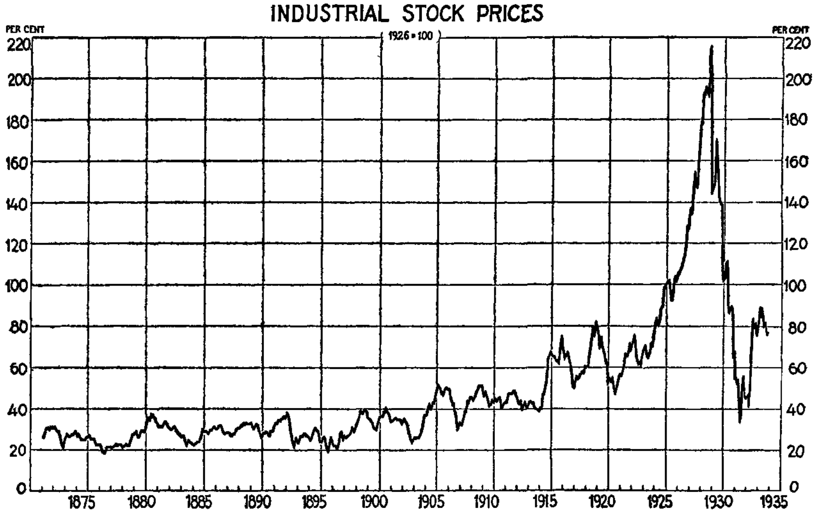
Mr. MILLER. Yes. I have always felt that that was a critical year, that we began to lose the fear of inflation, the fear of the previous experiences, and felt certain assurance and solidity that actually was not warranted by the later developments.

Senator COUZENS. Now, take it to 1927, if you please, when you performed these operations in behalf of international bankers.

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

INDUSTRIAL STOCK PRICES



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?

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

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.

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 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.

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.

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 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, 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, "Let not the medicine of emergency become the daily food of the banking system of the country."

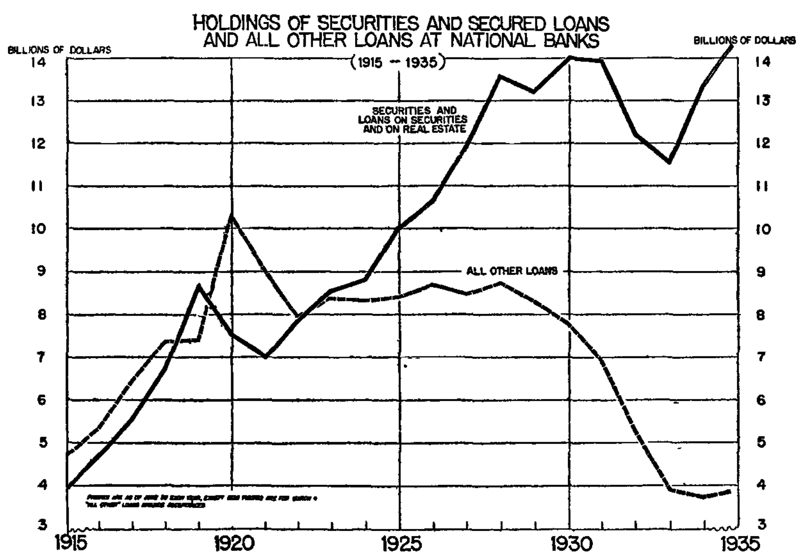
I think that is sound advice, and I hope you gentlemen will give it great thought before you throw down the eligibility provisions. It is true that eligibility is closely associated with liquidity of assets, but——

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.

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.

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.

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.

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 [a]	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%

[a] REAL ESTATE LOANS OTHER THAN FARM LANDS
[1] PARTLY ESTIMATED
[2] DECREASES

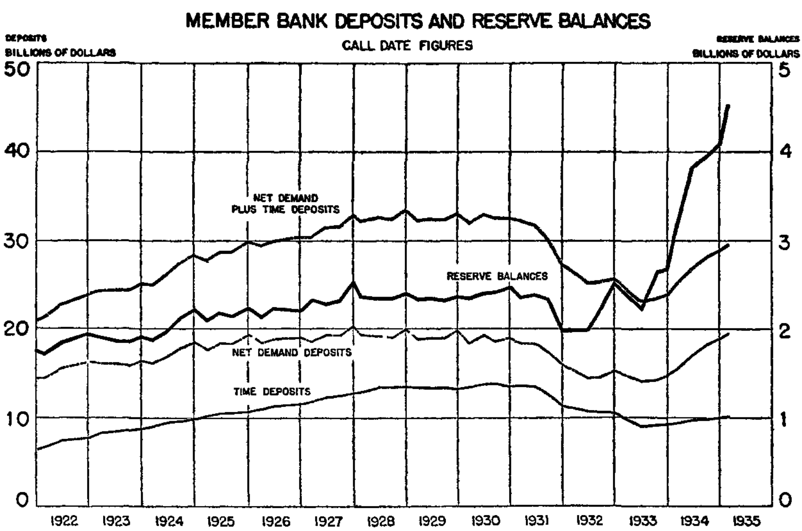
Owing to so many conditions, partly induced by the tremendous influx of gold into the country, partly through a practice that member banks began to indulge in of shifting demand deposits to time deposits, which took reserve requirements of 3 percent as against 7, 10, and 13 percent for demand deposits, 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 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



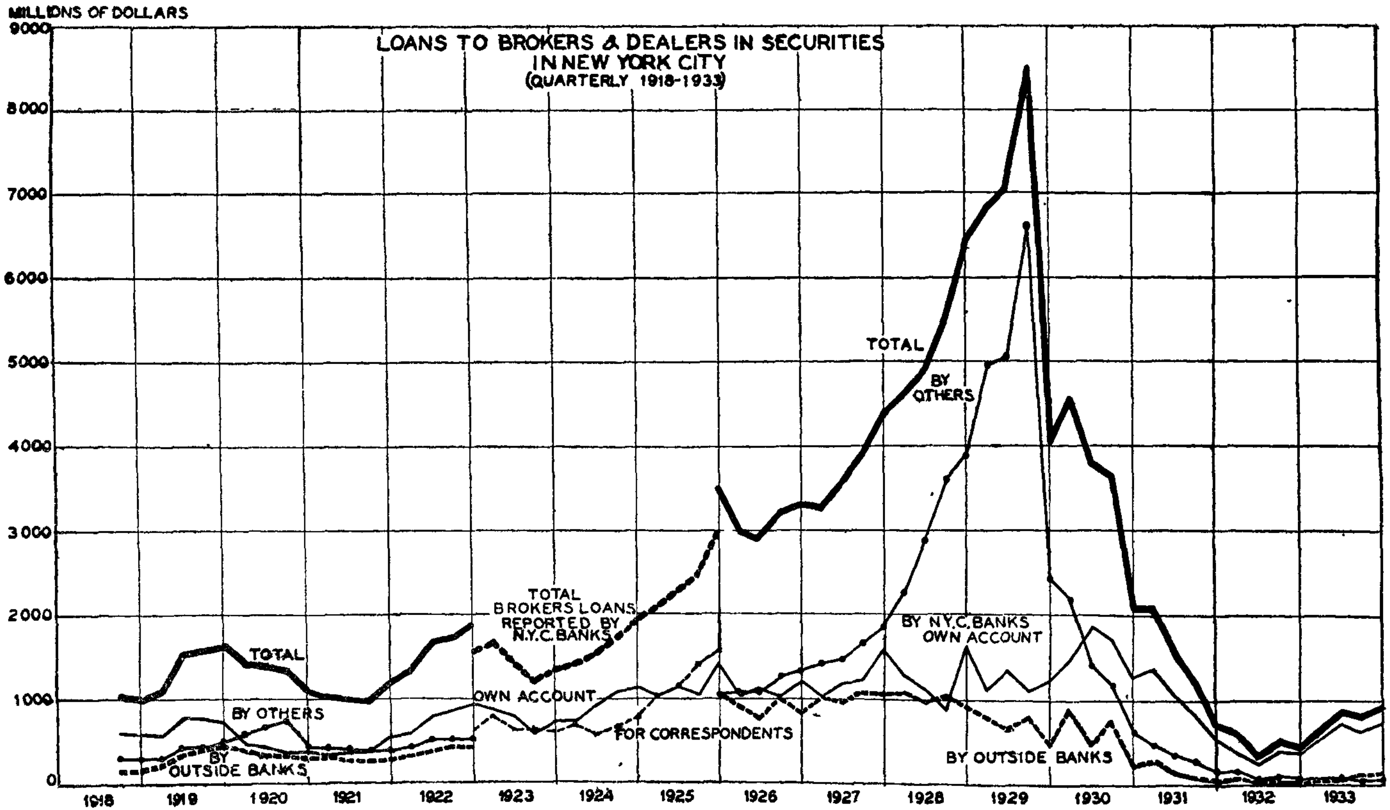
because we had this development in the past, which I would say was a development that indicated we were going sour during those years, that, therefore, we have to recognize it and admit as a fact and make it a base for extensive alteration of perhaps one of the most valuable safeguards of the whole Federal 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.

CHART VII


MILLIONS OF DOLLARS
LOANS TO BROKERS & DEALERS IN SECURITIES
IN NEW YORK CITY
(QUARTERLY 1918-1933)
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
TOTAL
BY OTHERS
TOTAL
BROKERS LOANS
REPORTED BY
N.Y.C. BANKS
TOTAL
BY OTHERS
BY N.Y.C. BANKS
OWN ACCOUNT
OWN ACCOUNT
FOR CORRESPONDENTS
BY OUTSIDE BANKS
BY OUTSIDE BANKS
1918
1919
1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
1930
1931
1932
1933

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.

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.

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.

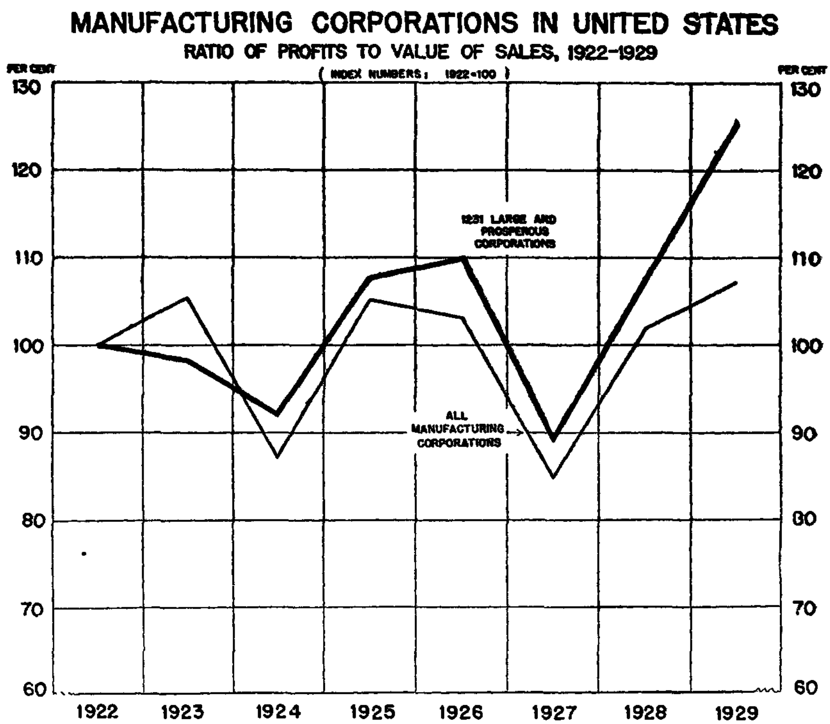
Senator COUZENS. Yes; and it is not mentioned.

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?

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?

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.

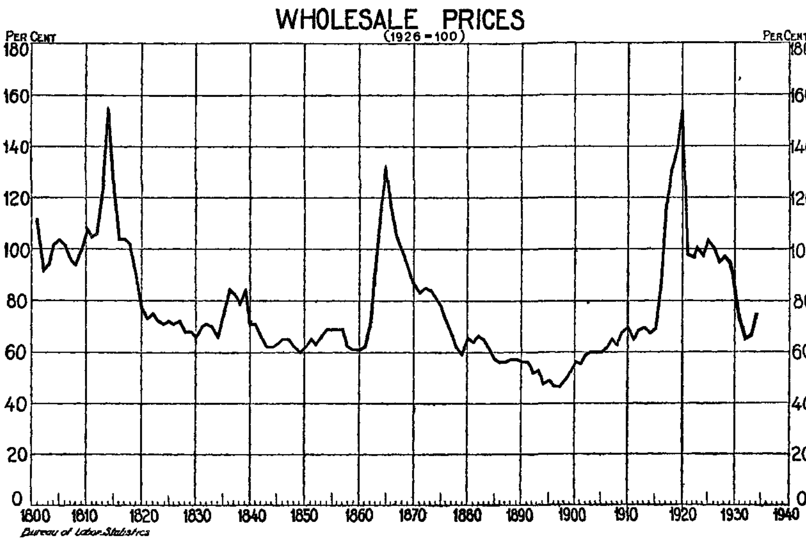
Notice, please, the period we have under review [chart X]—1922 to 1929.

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, 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?

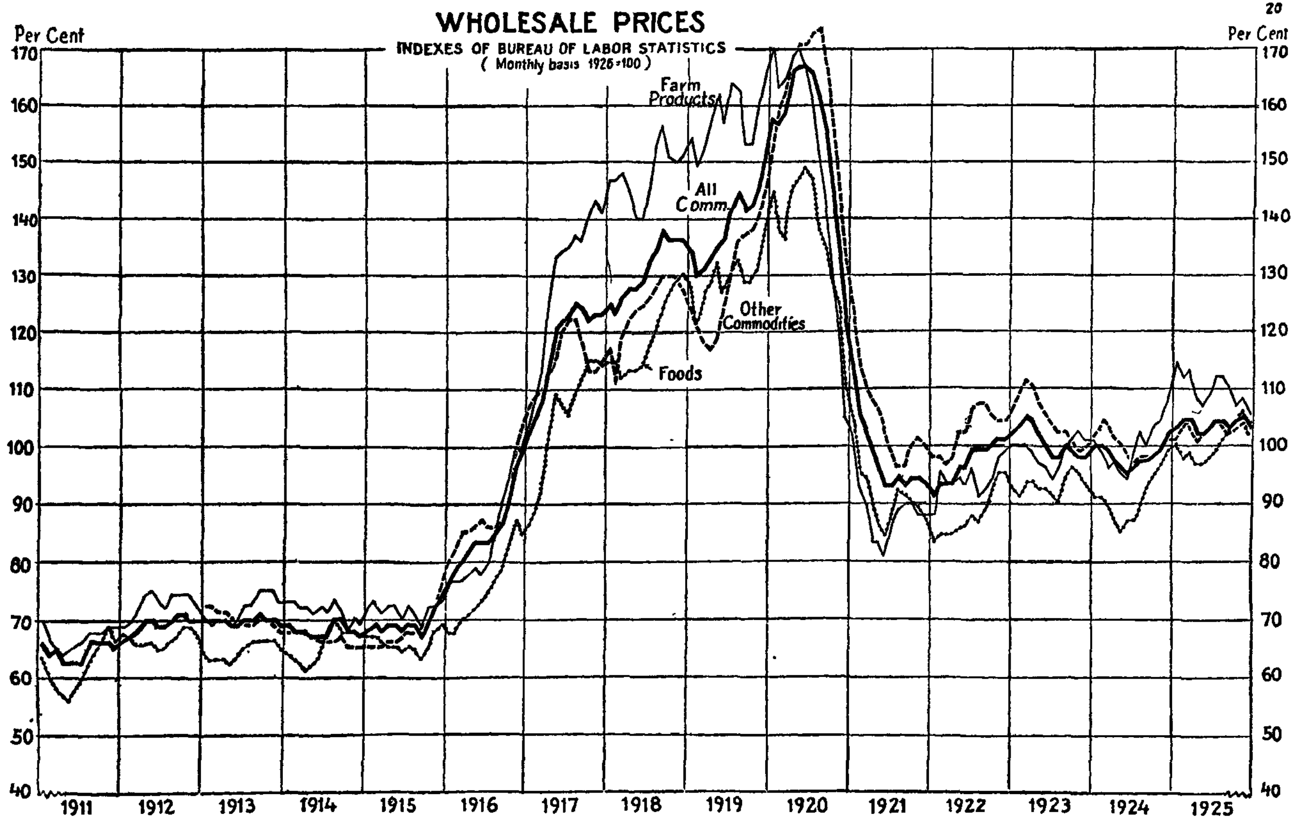
Mr. MILLER. It was.

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.

CHART XB


WHOLESALE PRICES
INDEXES OF BUREAU OF LABOR STATISTICS
(Monthly basis 1926=100)
Per Cent
20
Per Cent
170
160
150
140
130
120
110
100
90
80
70
60
50
40
Farm Products
All Comm.
Other Commodities
Foods
1911
1912
1913
1914
1915
1916
1917
1918
1919
1920
1921
1922
1923
1924
1925

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

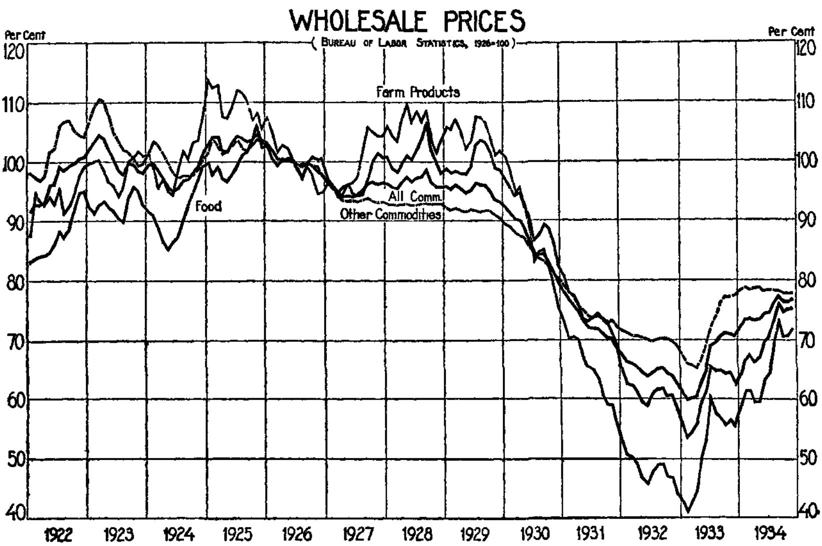


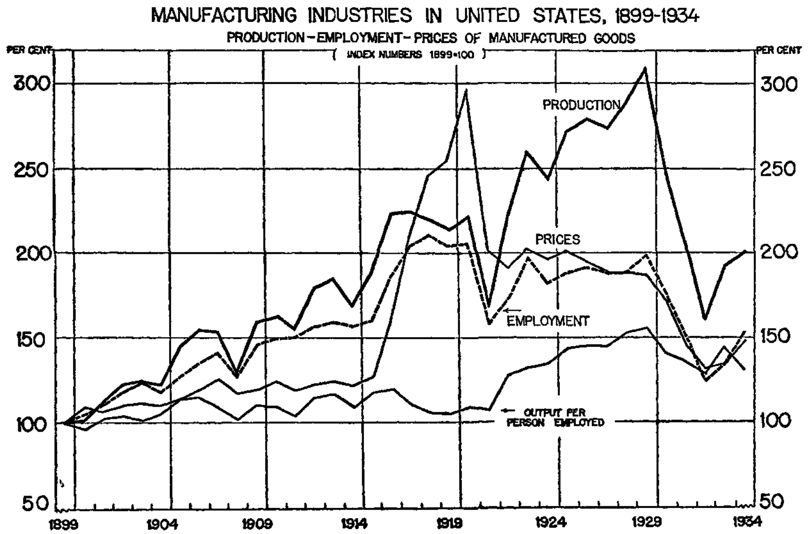
CHART Xc

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, 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.

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 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 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

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 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 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].

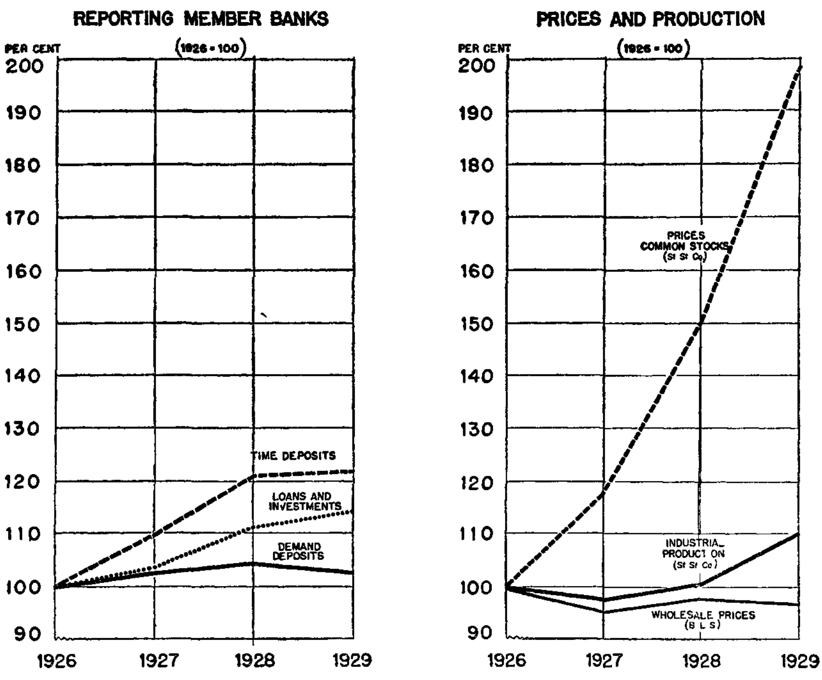
This black line [indicating on right-hand chart] represents the course of industrial production. Those, I think, are the Standard Statistics Co. figures. The bottom line represents the course of wholesale commodity prices, according to the Bureau of Labor Statistics. The top line represents the prices 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.

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



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 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.]

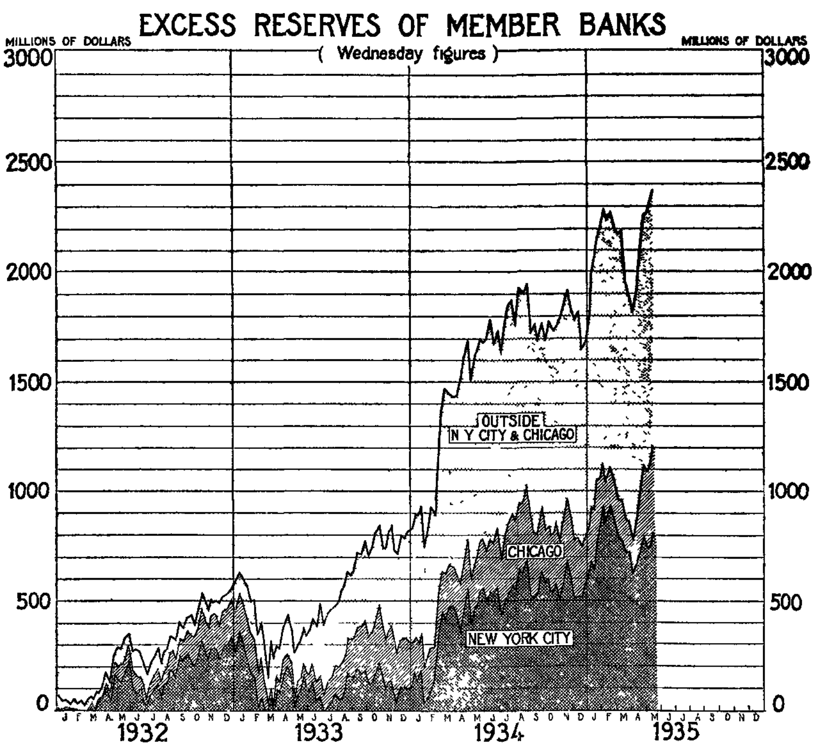
Mr. MILLER. At any rate, I have an excerpt here.

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 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.

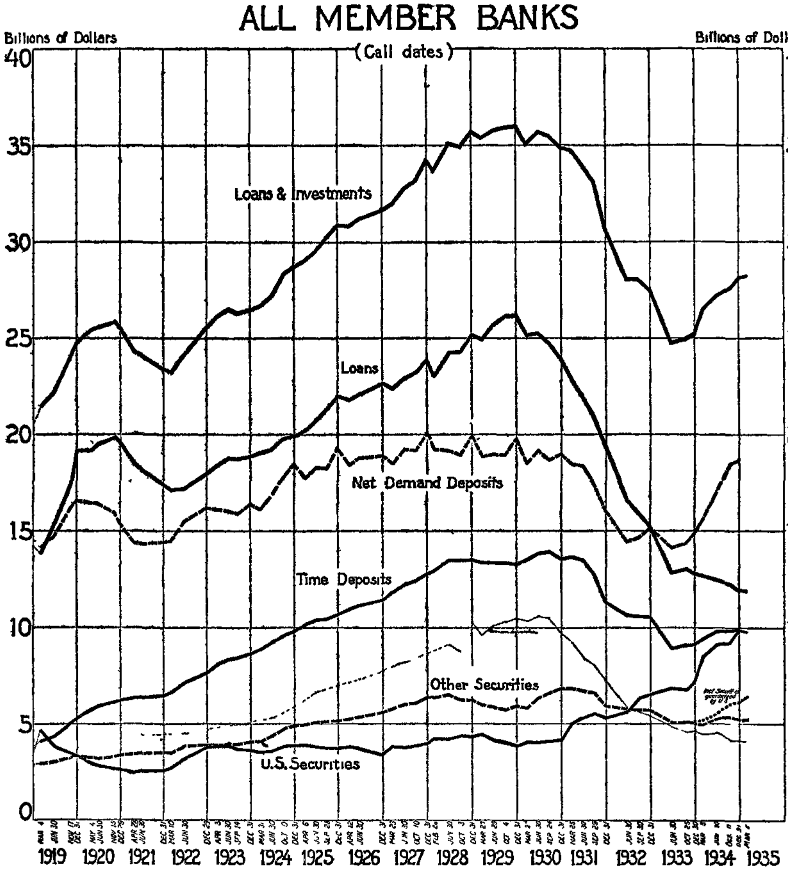
Senator COUZENS. I think the full committee did.

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]:

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 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.

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.

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.

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.

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

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
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.

Resources and earnings required for Federal Deposit Insurance Corporation Assessment—Continued

	Year	Resources	Earnings
			Percent
14	1932	$3,106,951	20
	1933	3,055,439	(2)
	1934	3,123,474	8 33
M	1929	6,520,294	9 13
	1930	7,010,703	12 95
	1931	7,703,708	(2)
	1932	7,338,035	23 8
	1933	7,765,523	(2)
	1934	7,683,983	28 4
23	1930	15,891,000	12 6
	1931	13,678,000	(2)
	1932	11,527,000	(2)
	1933	11,725,000	(2)
	1934	11,860,000	(2)
24	1930	10,814,000	100
	1931	10,521,000	61 5
	1932	9,835,000	80
	1933	10,176,000	(2)
	1934	10,813,000	(2)
25	1932	3,892,000	16 7
	1933	3,752,000	100
	1934	3,866,000	(2)
26	1930	639,000	(2)
	1931	1,053,000	16 6
	1932	1,119,000	22 9
	1933	1,599,000	(1)
	1934	1,727,000	12
27	1932	3,204,000	(2)
	1933	3,075,000	78.2
	1934	2,909,000	48 8
28	1930	6,074,000	7 9
	1931	5,407,000	7 5
	1932	4,726,000	(2)
	1933	4,851,000	11.7
	1934	4,531,000	(2)
29	1930	1,493,000	100
	1931	1,397,000	(2)
	1932	1,264,000	(2)
	1933	1,192,000	(2)
29	1934	$1,437,000	(2)
30	1933	2,971,000	(2)
	1934	2,805,000	35.3
31	1933	3,575,000	(2)
	1934	3,638,000	(2)
32	1933	1,617,000	22.5
	1934	3,650,000	(2)
33	1932	3,689,000	12.9
	1933	3,505,000	(2)
	1934	4,017,000	21.7
34	1930	5,247,000	16.4
	1931	5,946,000	100
	1932	5,429,000	(2)
	1933	5,826,000	(2)
	1934	7,056,000	(2)
35	1933	2,210,000	(2)
	1934	2,238,000	7.1
36	1930	8,169,000	22.7
	1931	8,550,000	39.5
	1932	7,436,000	(2)
	1933	7,454,000	(2)
	1934	6,894,000	(2)
37	1930	14,107,000	10.7
	1931	15,053,000	10.9
	1932	13,473,000	(2)
	1933	12,632,000	(2)
	1934	12,919,000	(2)
38	1933	2,765,000	(2)
	1934	2,611,000	50 2
39	1930	7,017,000	15 7
	1931	6,854,000	(2)
	1932	5,199,000	(2)
	1933	5,176,000	(2)
	1934	5,118,000	(2)
40	1930	5,793,000	6 3
	1931	4,833,000	10 1
	1932	4,868,000	34 5
	1933	4,998,000	(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 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 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 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 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 individual 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.)

BANKING ACT OF 1935

MONDAY, MAY 27, 1935

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

The subcommittee met, pursuant to adjournment, on Friday, May 24, 1935, in room 301, Senate Office Building, Senator Carter Glass presiding.

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

Present also: Senator Norbeck, of South Dakota.

Senator GLASS. Doctor Miller, you may resume your statement.

STATEMENT OF ADOLPH C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD, WASHINGTON, D. C.—Resumed

Mr. MILLER. Mr. Chairman, I want to say a word or two very briefly regarding what I think may have been a misapprehension with respect to a reply that I made to Senator McAdoo Friday morning when he asked me with respect to our currency, whether it was printing-press money, and I replied, " Yes." He asked the question in a technical, matter-of-fact way, and I answered it in a technical, matter-of-fact way, implying by the statement only this, that it was not technically a convertible currency. But no implication was intended by me as to the character or quality or goodness of either our currency or of any so-called " printing-press currency." Of course, our own currency has stood up beyond possibility of criticism since the period of the suspension of gold redemption. The same is true of the British currency. The same is true of the Swedish currency.

There is nothing inherently vicious in the fact that currency is not redeemable. The prejudice against so-called " irredeemable " currency gets its foundation from the fact that usually, in time, and given time, it goes wrong and then becomes an unsound and injurious element in the circulation of the country.

Senator BULKLEY. Doctor, will you make clear for the record under just what circumstances a person might get gold now for currency?

Mr. MILLER. In this country?

Senator BULKLEY. Yes.

Mr. MILLER. I know of none.

Senator BULKLEY. In the settlement of export balances, is there no way of getting gold?

Mr. MILLER. There is no method by which an individual American can get gold, unless it be by acquiring a balance on export, or through the purchase of exchange upon some country such as France, we will say, where there is still convertibility of credits in gold.

Senator BULKLEY. That would involve buying French currency. Can you not get gold at all for our currency?

Mr. MILLER. I know of no method. I have not tried it, but I know of none. I have not heard of any. There is no redemption.

Senator BULKLEY. There is no free redemption, but you say there is absolutely no redemption of any kind.

Mr. MILLER. No redemption whatever. If I am in error about that, I would like to be set right.

Senator BULKLEY. I am not sure enough to press it. I was under the impression that there were some circumstances under which you could get gold.

Mr. MILLER. There can be no discriminating redemption, Senator. If there is redemption for one dollar there is redemption for another dollar.

Senator BULKLEY. There is discriminating redemption in France, based on the amount that is redeemed, is there not?

Mr. MILLER. Yes. You have, in certain countries, what is sometimes called "bullion redemption." You had it in England before she suspended the gold standard; that is, you could get redemption only upon amounts of a certain size but no redemption on amounts under that. I think under the British gold standard of 1925 the redemption was absolutely in bullion, and only in bullion, but not in sovereigns.

Senator BULKLEY. Up to a few days ago you could get any amount of gold against francs by having enough to get a bar, could you not?

Mr. MILLER. Yes, sir.

Senator BULKLEY. I believe they have put some new restrictions on it very recently.

Mr. MILLER. I think that is true. However, I am not fully informed as to what the immediate status is. Gold is procurable here on permission for export. That you know.

Senator BULKLEY. But that has nothing to do with currency.

Mr. MILLER. It has a great deal to do in its effects upon the maintenance of the dollar in international exchange, but it has nothing to do with redemption per se.

Senator BULKLEY. Let me ask just one further question. Where does the significance come in of our being attached to the gold standard at all? In other words, what is the practical significance of the fixing of the new gold content of the dollar, and in what way are things any different since that was done than they were when we were off the gold standard and before the Gold Reserve Act was passed a year ago?

Mr. MILLER. I think none, actually, but that is a matter of difference of opinion.

Senator BULKLEY. You think there is no difference?

Mr. MILLER. I think there is none, if I understand your question. I am thinking, in answering the question, of the economic effects that followed the one course as compared with the other, not the legal factors or the legal fictions.

Senator GLASS. Do you have any expectation or hope of this country getting back on a metallic standard?

Mr. MILLER. Senator, it is easy to indulge a hope; and, of course, I indulge that hope. When it comes to an expectation, I am inclined to think that much, if not all, will depend upon how soon the world returns to a state of normal mentality, and governments, in their relations to one another, are actuated by reasonable respect for world opinion, and interlocking mutual world interests, and upon how good an account of themselves in the interim these various monetary provisional systems that have been set up in the last few years give. If, perchance, they should give a good account of themselves, I would be inclined to think that we would have an international gold standard restored but in a form different from that which prevailed before the suspensions.

Senator GLASS. If you attach no importance to a metallic standard in which paper money may be redeemed, why have it?

Mr. MILLER. Of course, the importance that has been attached to it, and the importance I attach to it, is derived from the fact that up to this day it has never yet been demonstrated that any agency can be invented to which power to govern the currency could be intrusted without ultimately disastrous consequences. Whether that is inhereint in the situation or whether we have a new psychology, a new sense of responsibility and of the seriousness and gravity of the problem, I do not know. I am inclined to think that there has been a good deal of growth of appreciation of monetary problems, the relationship of monetary management to the good functioning of the economic system; and it is possible that out of that may come a better regime in the future than we have had in the past, where we have been willing to trust the economic fate of the country to—call it what you want: in the old-fashioned terms "paper money"; or in the new-fangled terms "managed currency."

Senator GLASS. You will recall very distinctly, I am sure, that those of us who undertook to manage the Federal Reserve bill through Congress encountered the very bitter criticism from Senator Root and others that it was a fiat currency, notwithstanding that we had 40-percent gold reserve, and 100 percent of liquid commercial paper of short duration behind it. Why all that ado if a metallic standard is of no account?

Mr. MILLER. The metallic standard, as I think, justified itself in the past, but I think the more recent economic history of the world, and the history of our own country in the post-war decade, has demonstrated that the metallic standard alone, under certain conditions, is no guarantee of economic safety. The old currency policy of the different countries was to maintain the external stability of their monetary units. External monetary stability on fixed exchanges was what they were after.

Our experience, in the anomalous position of the world in the twenties, showed that a country could be in an impregnably strong gold position, and have its exchanges beyond any possibility of assault, and yet have a regime as to currency and credit that nursed factors of economic instability, so that out of that I think we have had a rather more exacting conception of what—to use the conventional phrase—sound money has got to imply in the future. In other words, that it is not alone sufficient that you should have convertibility, redeemability of the currency in gold to insure good credit and economic conditions so far as they are affected by changes in the quantity and quality of a country's money.

Senator GLASS. Do you think Great Britain went off the gold standard willingly?

Mr. MILLER. No. She was swept off by the force of circumstances. There was no alternative.

Senator GLASS. Is it your opinion that Great Britain would very earnestly desire to get back on the gold standard when it has gold enough to justify it?

Mr. MILLER. I would expect that the British will remain true to type, and that when they judge that conditions are favorable—not only material conditions, but the mentality of the world—they would wish to restore the gold standard in some form.

Senator GLASS. Why do that, if it is of no consequence?

Mr. MILLER. Because it gives to the world what the world, I think, will not be able to dispense with, a common international currency, something in terms of which——

Senator GLASS. Why does the world think that, if it is of no consequence at all? Why does the world think it is of consequence? Is not that the history of banking and currency for several hundred years?

Mr. MILLER. Yes. I think it is of consequence, Senator. I think it is of very great consequence, but I think it is also of consequence, in the times into which the world is moving——

Senator GLASS. Do you think that [producing a $10 bill] is money?

Mr. MILLER. Yes. If you do not, I will take it.

Senator GLASS. Will it pass anywhere in the world at its face value?

Mr. MILLER. No.

Senator GLASS. Why not, if it is money?

Mr. MILLER. I said it was money. I did not say it was international money.

Senator MCADOO. No currency of any other nation passes every other nation at par.

Senator GLASS. Oh, yes. When we were on the gold standard, a pound sterling passed America for its face value, just as much as it did in London.

Mr. MILLER. With those who knew it. I fancy if you went into the Ritz in Paris, or the Carlton in London——

Senator GLASS. If you presented a pound note to a man who had never seen one before, he would not know what it was, and would not want it. But I am talking about people who know what it is.

Mr. MILLER. I am inclined to think that if you went into a Paris shop or hotel and offered this, you would not be allowed to get away with it. They would take the note, and you would get the goods.

Senator GLASS. Yes; but you would get them at a very much reduced value. I know that by experience in London. I offered them, and I had to pay the reduced exchange.

Mr. MILLER. You get it at the current exchange. You would not get it at the old gold parity exchange.

Senator GLASS. Why not? What has the gold parity got to do with it, if you say it is of no concern, and if that is money, why does the United States of America promise to pay you money for it?

Mr. MILLER. That is a question I would rather not discuss.

Senator GLASS. That is a promise to pay. That is not money.

Senator McADOO. The chairman has an archaic note at the moment. If you get some of the new ones, they do not have that on them.

Senator GLASS. No; I have not got any archaic note, either. I have a note signed by " the greatest Secretary of the Treasury since Alexander Hamilton." That is not archaic.

Senator McADOO. Where is it?

Senator GLASS. I do not mean any reflection on you.

Senator McADOO. I thought it was your own note.

Senator GLASS. No; it is not.

Senator McADOO. You are the greatest Secretary of the Treasury since Hamilton. I yield the palm. [Laughter.]

Senator GLASS. I was the greatest Secretary of the Treasury since William G. McAdoo.

Senator McADOO. Do not get ironic.

Senator GLASS. This is signed by Mr. Mellon, so it is not archaic. I do not care to pursue the subject any further.

Senator McADOO. What I mean, Mr. Chairman, is this. This has all been by way of pleasantry. Of course, since we went off the gold standard these notes issued prior to that time call for something which the Government is not now doing. In other words, it is not paying in gold.

Mr. MILLER. That is true.

Senator GLASS. Do you think this note is worth as much as it was before we went off the gold standard?

Senator McADOO. I think so.

Senator GLASS. You go out and try to buy some white meat, as my chauffeur does, and you will have to pay four times the price for it.

Senator McADOO. I think it is just as good in domestic commerce as it was before we went off the gold standard.

Mr. MILLER. It is not legally convertible.

Senator GLASS. It passes in domestic commerce, but not at the same value.

Senator McADOO. That is because the prices of commodities have gone up; not because we have gone off the gold standard, but for other reasons.

Senator GLASS. Why? Because cotton has been plowed under, and hogs slaughtered, and so forth?

Senator McADOO. Yes.

Senator GLASS. Of course, those things are contributory to the existing condition.

Senator McADOO. I do not think you can attribute it solely to gold.

Senator GLASS. Not solely.

Senator McADOO. You have devalued also.

Mr. MILLER. You have devalued. I should say, Senator, that the modern world must distinguish, in order to think on monetary subjects clearly, between technical legal convertibility and what I would call economic convertibility—what you can buy with it.

Senator GLASS. Let us go ahead with the bill.

Senator McADOO. I would like to interject, if I may, just a word——

Senator COUZENS. We are going to have to discuss all this when we get into executive session.

Senator McADOO. I am very much interested in what you say, Doctor, because I think the trend of all you have presented here is in line with what is being considered even in Great Britain and other great powers, and I think it is inescapable. I think Sir Reginald McKenna, if I have not misread the papers, or if he was not misquoted in what I saw in the papers, has expressed views quite similar to those you are putting forward here.

Senator BULKLEY. Sir Reginald McKenna does not believe in going back to the gold standard at all. I am sure of that. In that respect it is different from what Doctor Miller said.

Senator McADOO. I said "somewhat similar."

Mr. MILLER. I do not want to speak for Mr. McKenna, and I do not presume to know what is in his mind, but I think what may be in his mind is in the minds of a great many people, that we go back to a gold standard that has a bigger element of management in it than the old gold standard before the war, just as the gold standard we had in the twenties——

Senator BULKLEY. He may have changed his mind in the meantime, but about a year and a half ago he told me definitely that England should never go back to the gold standard.

Mr. MILLER. I would not venture to quarrel with Reginald McKenna, for whom I have very high esteem, but I would venture to prophesy that he is in error, and that she will go back, and we will go back.

Senator BULKLEY. You do not think England will ever go back to the old gold content of the pound, do you?

Mr. MILLER. I think they will allow that to be governed by circumstances, and not undertake to make the circumstances. I think they will establish the value of the pound, when they do establish it again, exactly as they did in 1816. They did it then in a very practical way, and I think they will do it exactly on the same basis in the future.

Senator BULKLEY. They established the value in 1816.

Mr. MILLER. They will do it realistically, with the intention of making the value of sterling——

Senator McADOO. In the light of conditions existing at the time.

Mr. MILLER. Absolutely.

Senator McADOO. You do not mean to say you think they will go back, necessarily, to the same standard?

Mr. MILLER. Not at all.

Senator BULKLEY. The value in 1816 represented a devaluation, did it not?

Mr. MILLER. A slight change; but the idea was to get a unit that would maintain itself and therefore be recognized as a unit all over the world, in which you could safely trade. I think they will do it again.

These things are all aside of my purpose, Senator, and I have no desire to pursue them.

Senator GLASS. Oh, yes; you can trade in paper with more facility than you can in metal, though.

Mr. MILLER. I am inclined to think that their thought in those things will be highly constructive and be based upon the great mass of experiences that have percolated into the British mind and British character.

Senator BULKLEY. Doctor, you did testify that no matter whether we like it or not, we are bound to go into a certain measure of conscious control of currency, did you not?

Mr. MILLER. I do not care anything about the "conscious" part. I think that is gratuitous.

Senator MCADOO. We are going into control.

Mr. MILLER. Into a greater measure of management, if you want to use the word.

Senator BULKLEY. Yes; that is a satisfactory word.

Mr. MILLER. Than has been true in the past. I dare say it is quite within the region of probability that there will be some degree of concert of interests and responsibility among the leading gold-standard countries, with a view of tempering and steadying the action of the gold standard so as to avoid those ruptures and breaks and occasional serious disturbances that characterized even the old gold standard when it was working pretty efficiently. Even the old prewar standard in Great Britain had its action tempered by the wisdom of British financial authorities, treasury authorities, and, chiefly, the Bank of England. That is why it was such an excellent standard. They did not simply let it take its own course.

Now, gentlemen, if I may proceed, the two previous hearings have ranged over a pretty wide field. We have come back to the same topic in one connection or another. I want to gather up just a few skeins before I proceed this morning.

I have indicated, in answer to certain questions in the previous hearings, that it was my belief that conditions had clearly indicated that it was necessary to get a more definite concentration of authority and responsibility with respect to the open-market policies of the Federal Reserve System, particularly in the future. I shall presently present a plan or set-up for the open-market committee of the Federal Reserve System which, in my judgment, would, if adopted, promise as good a result as we have any right to expect.

Senator GLASS. Right on that point, and altogether pertinent to the discussion, what trouble have you had with the present statutory open-market committee?

Mr. MILLER. The present statutory system goes back to 1933. There has been only one operation of considerable magnitude that has called for open-market policy.

Senator GLASS. The act of 1933 simply confirmed and continued the open-market system that had long been in practice.

Mr. MILLER. Yes.

Senator GLASS. What difficulty did you have with that?

Mr. MILLER. We had difficulties.

Senator GLASS. What were they? Were they insuperable difficulties, or were they difficulties that were adjusted?

Mr. MILLER. Two or three of them proved to be—I will not say insuperable, but, at any rate, resulted in a determination that, I think, the Federal Reserve Board would have preferred not to have been reached.

Senator GLASS. Would you mind giving us the examples for the record?

Mr. MILLER. I have not the record here, but I will say that in 1931 some of the Reserve banks and the Reserve Board had reached the conclusion that it would be desirable to try to relieve the situation by an open-market operation of considerable extent. Strong opposition was encountered on the part of two or three of the reserve banks, with the result that the outcome of the discussions was that an open-market operation was undertaken, but to a very much more limited extent than the Federal Reserve Board and some of the Reserve-bank governors would have wished to see.

Senator GLASS. Do you mean to say you wanted to buy more than two and a half billion of United States securities?

Mr. MILLER. Not all at once. Three or four hundred million, I think, was under discussion at that time.

Senator GLASS. Were not the resources of the remaining 8 or 10 Federal Reserve banks sufficient to have made the purchases if they had wanted to?

Mr. MILLER. Yes, Senator; but under the set-up which had been in effect for several years, we regarded operations of that character as system operations, to be undertaken by the Reserve banks generally in participation, and on this particular occasion there was one of the Reserve banks that, as I remember, was willing to shoulder far more than its proportion if it were decided to go ahead with the operation on the enlarged scale. There was good cooperation, let me say, at that particular time from the New York Reserve Bank, but there were some of the interior banks, and one of the eastern banks, that took a different view and held off. I do not know whether it would have made any difference, and I know no method of finding out whether it would have made any difference in the outcome if the larger operation had been undertaken at that time.

Senator GLASS. The law did not require unanimous action.

Mr. MILLER. No; it did not.

Senator GLASS. And you say that the resources of the remaining 10 banks were ample to take care of the matter?

Mr. MILLER. Yes.

Senator GLASS. Why did they not go ahead?

Mr. MILLER. I am answering your question as to whether or not the thing had always worked satisfactorily. From my point of view, a satisfactory operation is one in which, when the decision is reached, all the banks accept it and go ahead and participate pro rata.

Senator GLASS. Whether their boards agreed that they were in financial condition to do it or not?

Mr. MILLER. They all were in financial condition to do it.

Senator GLASS. You think so, but perhaps their boards did not think so.

Mr. MILLER. Well, Senator, there are times, I should say—and those, in my judgment, are the only times; I have no hesitation in saying that emphatically, that they are the only times—when the Federal Reserve System, whether it is 1 bank or 12 banks, should engage in open-market operations, from broad considerations of national economic interests.

Senator GLASS. I know; that has been your view all along.

Senator McADOO. Somebody must make the decision.

Mr. MILLER. Somebody must make the decision. Somebody must take the responsibility, and once the thing has been thoroughly discussed and canvassed, and the decision has been reached, I think there ought to be no obstructive action possible by a division of responsibility for action among the several Federal Reserve banks. Open-market policy is peculiarly a national policy, and if it be kept as a national policy and operated only on broad grounds, and when the indications of its need are clear I do not think there is anything to fear in the way of bad action through withholding from any indidividual reserve bank the power of veto so far as itself is concerned.

Senator GLASS. And yet, in the whole 20 years of the existence of the Federal Reserve Banking System, and more, the Federal Reserve Board, so far as I can recall, has never agreed that that should be the case. At least, it has never recommended to Congress that that should be the case.

Mr. MILLER. I have.

Senator GLASS. I know that has been your view all along.

Mr. MILLER. Sometimes, Senator, men do not make recommendations until the situation has become pretty urgent, and experience demonstrates that there has got to be a change in the set-up. I reached the conclusion, after the first great operation in 1924, that the country was going to be in jeopardy economically unless the Board was given a definite responsibility for the outcome of open-market operations.

Senator GLASS. The right to compel banks to use their resources and the resources of their depositors, whether they thought it was prudent to do it or not?

Mr. MILLER. Provided the Board, on full consideration and full canvass of the situation with the operating heads of these banks, as a whole, had reached the conclusion that it was essential in the public interest. Yes; I stand by that.

Senator McADOO. You are really arguing simply for what we do for the President. We give him extraordinary powers to make decisions.

Mr. MILLER. Yes.

Senator McADOO. And everybody respects them. There is a concentration of authority upon important questions which is essential at times.

Mr. MILLER. More important, I think, Senator, is the concentration of responsibility. If there is a blunder then, you know who is responsible for the blunder.

Senator GLASS. You do not think that the people whose property is to be expended should have any voice in the matter?

Mr. MILLER. I would say, Senator, that if the powers are wisely exercised it is going to be one of the best protections of the people whose property is being used for this purpose. That is my feeling; and I should feel, as a private citizen——

Senator GLASS. Of course, anything that is wisely done protects anything to which it is related. But I have never been able to discover that the Federal Reserve Board was any wiser than some other boards.

Senator McAdoo. We took all the gold that belonged to everybody in the country.

Senator Glass. "We took it"?

Senator McAdoo. Yes.

Senator Glass. You may have. I did not.

Senator McAdoo. I am talking about Congress and the President.

Senator Glass. Congress has surrendered every power it ever had under the Constitution, for that matter, but I did not agree to it.

Mr. Miller. Someone here, I understand, made the inquiry the other day of Governor Eccles as to what difference he thought it would have made in 1928 and 1929—if those were the years; they may have been earlier—if the Board had had the powers that are proposed in this bill. I have not read his answer, but I have seen some notice of it in the paper to the effect that it would have made a difference in 1931. From my point of view it would have made a lot of difference in 1928 and 1929.

Senator Glass. You did not even exercise your simple power to kick a man out of a Federal Reserve bank who told you to go to hell, and that he was going to do as he pleased, and the next day he was going into the stock-gambling market and getting $25,000,000 from the Federal Reserve bank and using it for stock-gambling purposes.

Mr. Miller. I think very much is to be said for your feeling, and I am obliged to say that I think your view is right. I felt that way at the time, but, nevertheless, that is a pretty extreme thing to do.

Senator Glass. It is a pretty extreme thing for the president of one of the biggest banks in the United States, and a member of the Federal Reserve System, to tell the Federal Reserve Board to go to hell, and that he is going to do what the law says he should not do.

Mr. Miller. I entirely agree with you, Senator, and yet I believe that if the Board had been in a position where its responsibility for open-market policy had been inescapable in 1927 and 1928—it did not make any difference in 1929—you would not have had the situation that we got into in 1929, and the gentleman to whom you referred would not have had. probably, any occasion——

Senator Glass. But, Doctor, you bought 2½ billion dollars of United States securities. How many more would you have bought just then?

Mr. Miller. We bought them after that, Senator. At that time, in 1928, we were selling, and late in 1927, we were selling Government securities in order to get control. My belief is that if the Board had been charged with responsibility we would have gone very much more prudently in 1927. We would have paid far less attention to the importunings of the New York Federal Reserve Bank and the maneuverings that went on in some of the interior Reserve banks, because the Board would have been distinctly on notice that it would be held publicly accountable for the results.

Senator Glass. The New York Federal Reserve Bank wanted to stop that excessive stock gambling by raising its rediscount rate.

Mr. Miller. Yes; in 1929.

Senator McAdoo. After the fact.

Mr. Miller. After the fact.

Senator Bulkley. The difference you are referring to is in 1927.

Mr. MILLER. I do not want to get unnecessarily diverted. I do not know how much time the committee wants to give me, but I have certain constructive suggestions I want to get before the committee.

Senator McADOO. I would like to hear them.

Senator GLASS. I will stop.

Senator BULKLEY. The big difference, that you characterized as a "hell of a difference"—what was that, specifically?

Mr. MILLER. Specifically this: That in 1927, when a major operation was engaged in by the Federal Reserve System in the purchase of securities in the open market, and one that gave the final boost to a speculation that proved to be wellnigh uncontrollable—actually uncontrollable, I think, in 1929—I think the Board would have hesitated a long, long time to engage in it, if the full responsibility had rested with the Board, and with it alone. I think the Board would have taken a far more serious view of its responsibility. There had always been questions raised in these discussions as to just where the authority of the Board ended, and where the authority of the banks ended.

Senator BULKLEY. But you think you would not have engaged in that operation of buying Government securities in 1927?

Mr. MILLER. I think there might have been hesitation. I think it would have given a talking point to the members of the Board who at that time had the gravest misgivings about it, and to whom it was constantly replied "The act confers these powers upon the banks. If it intended the Board to exercise them, why didn't it give them to the Board?"

Senator McADOO. I do not think myself, Doctor, and have never thought, that the mere raising of the rediscount rate would, of itself, be adequate to meet that situation. I think that when you have such a wild orgy of speculation as went on at that time people are willing to pay any rate, because they see the chance to make a great profit on the exchange, and the speculative fever could not be controlled by that remedy. Moreover, you could not make the rediscount rate effective so long as you did not have control of the financial situation. The Federal Reserve System controls only a part of the resources of the country. The influx of foreign capital attracted into the market when there appear to be great opportunities for profit on the stock exchanges, the enormous surpluses owned by corporations, and the great wealth owned by individuals, are all thrown into the market, and the Federal Reserve Board cannot control it.

Senator GLASS. Oh, yes; it can do it.

Senator McADOO. Partially.

Senator GLASS. That was corrected in the act of 1933.

Mr. MILLER. That is true.

Senator McAOO. I am speaking of the time prior to 1933. This last act did give the power, but prior to that time they did not have it.

Senator GLASS. That is all swept away.

Senator McADOO. We were talking about 1927, 1928, and 1929.

Senator BYRNES. May I ask if we can let the doctor present his constructive suggestions? At 12 o'clock some of us are obliged to leave.

Mr. MILLER. In a few moments I shall read——

Senator BYRNES. I should like to hear the discussion on the bill.

Mr. MILLER. This all has its relevance and pertinence, Senator.

At any rate, before I read a set-up for the open-market authority in the future I want to state again my position, with some slight elaboration. The authority should not be conferred upon the Board unless you are prepared to give to the Board a status of complete independence. From my point of view, when I ask for the authority, I lay that down as a sine qua non. By complete independence I mean one that is completely independent of any improper influence, or any legally suggested influence on the part of the banks of the country, or any influence from the side of the Government.

Senator McADOO. You speak of political influence as well, of course.

Mr. MILLER. Both. I do not like the term "political." It is not political.

Senator McADOO. I know; but that is the common denominator.

Mr. MILLER. You were Secretary of the Treasury, Senator McAdoo, at one time, and so was Senator Glass. Both of you had a great part—the foremost part, next to the President of the United States—at that time in the creation of the Federal Reserve System. You had great and rightful pride in your achievement. I recall particularly in the days before the war Senator McAdoo was a very frequent—almost a regular—attendant at the meetings of the Federal Reserve Board, interested in its proper development. There was no political interference of any character. That was true of Senator Glass. It was not so true of one of his assistants during the short period of a year or so that he was Secretary of the Treasury. But those things have changed.

Senator McADOO. I was only referring to political influence in the sense that so many of the bankers have spoken about it here. I assumed, therefore, that what you meant was the exercise of influence through political power upon the Board, whose independence you feel ought to be established beyond question.

Mr. MILLER. I do; and I say again that in asking for the authority I am not by any means minimizing the mental suspiciousness of the bankers. I think there is a real basis for it, but I think that basis can be cured and should be cured before this authority is conferred upon the Board.

Senator BULKLEY. What do you advise us to write into the bill to cover that?

Mr. MILLER. I would advise as a premise that you write into the law an amendment that no member of the Board shall be removable from office during the term for which he was appointed. First and foremost, that.

Senator GLASS. Except for malfeasance?

Mr. MILLER. I do not have that in the amendment, but I have it in mind.

Senator BULKLEY. If that is not constitutional, what would you substitute for it?

Mr. MILLER. I think it is constitutional. I am no lawyer, but I have read the Constitution of the United States and have reflected on it, and I rather expect that when we get the decision of the Supreme Court in the *Humphrey case* it will be cleared up. I think that it should be written into the terms of the Federal Reserve Act, if you men really mean to set up a sound currency management in this country, that the Federal Reserve Board, when granted these powers, is to be independent in their exercise.

Senator GLASS. Would that necessarily legislate the Secretary of the Treasury and the Comptroller from membership on the Board?

Mr. MILLER. Yes. I would say this in respect to the Comptroller—though I do not want to get diverted; I want to proceed with the main matter—

Senator MCADOO. Perhaps it would be well to have them appointed as Federal judges are appointed—during good behavior. That is the term I believe, used with respect to the appointment of judges. You would not appoint them for life; you would appoint them for definite terms to hold during good behavior?

Mr. MILLER. Congress itself to be the judge.

Senator MCADOO. It has the power of impeachment unless we by statute set up some other method.

Mr. MILLER. I do not care what the method is; but, in my judgment, the Board should not be given these powers unless you are at the same time willing to confer upon it a status that is as impregnable against influence as it can possibly be made in law. And when I say that, I am talking out of the depths of my experience of 20 years in the Federal Reserve System. I would not ask the Congress to entrust us with these powers if it is not willing to give us the necessary independence in the exercise of them. I think it is going to be a very difficult thing at best; and only a body of men who are permanently interested in the thing, who make it their day-to-day and year-to-year responsibility, can do this job without damage to the country and possibly very serious damage, unless they are put in a position where nobody can interfere with the free exercise of their judgment and their sense of responsibility.

Senator GLASS. Or unless they are competent to do it?

Mr. MILLER. Yes.

Senator MCADOO. That is just the question.

Mr. MILLER. I know of no legislative formula by which that can be accomplished; but I will add, gentlemen, that it is amazing how good a performance you can get from men if they are in a position where they have to exercise a very quick and constant sense of responsibility. I think that will be the case in the Federal Reserve System. There would always be men there—and I think that is what the original set-up of the act contemplated—who have experience. You would get continuity. The older men have acquired a certain body of knowledge that gradually the newer men begin to absorb, and the sense of responsibility quickens intelligence and arrives at decisions that probably are as good as we could expect to get under our framework of government.

Next, I would earnestly recommend to your favorable consideration a provision for a retirement allowance for members of the Federal Reserve Board who attain the age of 70 years. It does not mean anything to me, but I am convinced that it would make a considerable difference in getting continuity of service on the Board.

Senator MCADOO. You mean, a retirement allowance analogous to that which is given judges?

Mr. MILLER. Yes, sir.

Senator TOWNSEND. Would you compel retirement at 70 years of age?

Mr. MILLER. No; I would not—but I am not so sure about that; I am not so sure. That is a debatable question. I am inclined to think that age is not a conditioning factor in types of work where judgment, maturity, wisdom, and so forth, count. If it were more definitely an executive routine job——

Senator MCADOO. Or if it were manual labor, for instance?

Mr. MILLER. We would not think of such a limitation in connection with the Supreme Court and the Senate.

Senator MCADOO. I hope not, with respect to the Senate.

Mr. MILLER. Thank God, there are some men there who have grown to intellectual and spiritual maturity through long life and experience. I am not very far behind you, Senator, but I still think that I am of some use on the Federal Reserve Board. Any provision in that respect will satisfy me. I am not arguing for anything personal. I am arguing for what I conceive to be the good of the System.

Third. I would *suggest*, particularly if the title of "governor" is conferred upon the executive heads of the banks, that you change the set-up of the Board and that it be made the Board of Governors of the Federal Reserve System. If you confer this open-market authority or other similar authority upon the Board, it in fact becomes a board of governors of the System, electing its chairman or, if you prefer, having its chairman approved by the Congress. My own view is that we would have gotten a better performance in the past if the members of the Board had all stood on an equal footing with respect to one another.

Senator GLASS. I think the doctor misused the term there and said "Federal Reserve bank", instead of "Federal Reserve Board."

Senator MCADOO. You do not want the chief executive officer of the Federal Reserve banks to be given the title of "governor?"

Mr. MILLER. I have no objection to that.

Senator GLASS. What he means is that instead of having a governor of the Federal Reserve Board, the Board would be denominated as "a board of governors."

Mr. MILLER. Yes.

Senator MCADOO. I understand that; but I wanted to know whether, if that suggestion were adopted, you would exclude the use of the word "governor" for Federal Reserve banks.

Mr. MILLER. No, sir.

Senator MCADOO. I myself would want to do that, because it would avoid confusion.

Mr. MILLER. I had in mind drawing a distinction between the governor of a Federal Reserve bank and the governors of the Federal Reserve System.

Senator MCADOO. But that is confusing in the public mind. It is not so material, however.

Mr. MILLER. They have by usage the title of "governor." I see no objection to letting it go on. They will be called that. That is an immaterial point, from my point of view. I think the main thing is that you will build up the quality of independence in the Board and give it a more assured position for the exercise of its responsibilities if it be restated as a Board of Governors, electing its own chairman.

I do not want to delay too much, but I do want to say just briefly that in the most serious issue in which the Federal Reserve Board was ever involved—the one to which you referred, Mr. Chairman—the Board found itself in the anomalous position that a majority of the Board were thoroughly convinced and of one mind with respect to the policy sought to be pursued, but their effectiveness was largely nullified by the fact that the Governor was not in step with his Board. He tried to do his best to implement the policy of the majority of the Board in which he did not believe. The Secretary of the Treasury was not in step with it, and in large part that policy failed of its full effectiveness and failed of an earlier adoption because of that. I have no question that if the Board had been in position then——

Senator McAdoo. What time are you referring to?

Mr. Miller. 1928 and 1929, notably 1929, right at the very moment when the episode occurred that Senator Glass has referred to. I was a member of the Board and was invited by a group of men to come up to New York and sit with some of the recalcitrants and was even promised that if I would they would come into agreement with the Board. I said, " That is not my business, that is the Governor's business."

Let me call attention in this connection to a fact or two. The Federal Reserve System has been in existence 21 years. In that time it has had seven governors—a startling rate of turn-over for a board charged with the vast responsibilities of the Federal Reserve Board. It is an average service of 3 years, despite the fact that among them was one Governor who served a term of 6 years.

It is not part of my purpose to suggest, nor do I regard it as proper except by way of just asking you to use your imaginations and guess a little why the office of Governor of the Federal Reserve Board is not conducive to longevity. Governors do not last long.

I also call attention to the fact that in that period of time the total number of appointive members of the Board has been 21, with only 4 that were ever reappointed. That is not conducive to independence. In my judgment, the membership has got to be made more attractive to a man who assumes membership in the spirit of accepting a great responsibility and who wants to dedicate his efforts to it and not be interfered with in the discharge of that responsibility.

So much, then, for building up the independence of the Board; and I repeat once more, before I leave it——

Senator McAdoo (interposing). Do you suggest the number who should compose the Board?

Mr. Miller. I do.

Senator McAoo. If you exclude the two ex officio members, that would reduce it to six.

Mr. Miller. I wanted to add this with respect to the Comptroller of the Currency, if I can do it without diverting our attention. I do not doubt—in fact, I expect that it is only a question of time when there will be a consolidation under some organization here in Washington, either the Federal Reserve Board or, if the Federal Reserve Board is put out of business, a successor organization under its general administration. That means particularly the office of the Comptroller of the Currency and, possibly, the F. D. I. C. I think it is doubtful and idle and premature to talk of unification of banking in this country until we have unified the agencies of administration that relate to banking, here in the Federal Government. I have become so thoroughly convinced of that that I know it must come. It is merely a question of time when it does come; and as chairman of the ground or site committee of the Federal Reserve Board I have tried to look ahead as well as I could and get ample space so that when that took place an additional building could be built near the Federal Reserve Board building in which these affiliated departments could be housed.

Senator McAdoo. Assuming such a consolidation of its activities—and I do not think the suggestion is without merit—what number would you have the Board?

Mr. Miller. I would suggest either seven or five. I am inclined to think that seven is none too large a number for a board that is going to deal with the problems that the Federal Reserve Board will have to deal with under this grant of powers. I think seven is none too large. I think that was the number on the original board, with two ex officio members—though I recognize that five also has a great deal to be said for it. If the board is experienced and well qualified for its job, five is a better number than seven. However, that is a thing upon which you men are more competent judges than I am.

I would be perfectly content, until consolidation takes place of these various banking and administrative agencies, to have the Comptroller continued on the Board, particularly as the present Comptroller has been deeply interested in Federal Reserve matters. He does not frequently attend the meetings, but he does attend, and whenever he does he has something helpful to suggest, and he has been cooperative to a remarkable degree. So that, while I think in principle, the Comptroller of the Currency should be eliminated, I do not see that there needs to be any haste, in view of my confident feeling that it is only a question of time when you are going to consolidate these various banking agencies under one supreme supervisory authority.

Now, with that out of the mind, here is what I propose by way of amendment to the open-market provisions of the Federal Reserve Act. I propose leaving the first two paragraphs of section 12 (a) exactly as they read now. I think that is essential. I think it is fair and reasonable that every section of this country in so vital a matter should, through its representative, have a voice in the determination of open-market policy. I object in toto to the narrow concentration of authority proposed in the Senate bill. I assume that the objections are so patent that no time need be spent by me in stating the objections to it. That is the form in which the open-market committee is reduced to a committee of 5, with only 3 Reserve Board members and 2 Reserve bank governors. From my point of view, there is nothing to be said in favor of it and only too much to be said against it. If we have in mind, that we keep the membership of the open-market committee as it is at present—12, one for each Reserve district—I would proceed to redefine the objective and also the procedures with respect to the authority of the Federal Reserve Board.

The objective I would redefine following the language of the existing act as closely as possible, but with certain differences, as follows [reading]:

(c) The time, character, and volume of all open-market operations of the Federal Reserve System under section 14 of this act shall be governed with a view to supporting and reenforcing the credit and discount policies of the Federal Reserve System, when this may be necessary, in order to aid in the establishment and maintenance of sound banking, credit, financial, and economic conditions.

In other words, the open-market policy becomes a supplement to the credit and discount policy to be exercised as a method and a more effective method, something more in the nature of, we will say, surgical intervention, " in order to aid in the establishment and maintenance of sound banking, credit, financial, and economic conditions."

In my judgment, gentlemen, that is as far as you ought to go and as far, I think, as you can safely go in writing a formula into the Federal Reserve Act.

Senator GLASS. From what are you reading now?

Mr. MILLER. The amendment that I propose. Presently I shall come to the objective set up in the House bill; but what I have just read, to my mind, covers every reasonable requirement and carries in it a suggestion of the exercise of discrimination in the discharge of responsibility.

With reference to paragraph (d), this is what I propose as an amendment [reading]:

(d) In accordance with procedure prescribed by regulations of the Federal Reserve Board, the Committee shall from time to time consider, adopt, and transmit to the Federal Reserve Board resolutions recommending the policies which, in the judgment of the committee, should be adopted with respect to the open-market operations of the Federal Reserve System and stating the reasons for such recommendations. Such resolutions shall be subject to review, modification, and determination by the Federal Reserve Board and, if approved by the Federal Reserve Board, shall become binding upon all of the Federal Reserve banks, subject to such modifications as may be ordered by the Federal Reserve Board.

Senator MCADOO. Where do you refer to the power of initiation?

Mr. MILLER. That is coming [reading further]:

The Federal Reserve Board, upon its own initiative and upon the affirmative vote of not less than four of its appointive members, may from time to time, on its own initiative, prescribe open-market policies for the Federal Reserve System.

Senator GLASS. What reservation is there in the existing statute, except that any Federal Reserve bank not desiring to participate in a given open-market transaction may decline to do it?

Mr. MILLER. What reservation as compared with this?

Senator GLASS. I say, what reservation is there in the existing act as to that?

Mr. MILLER. The Board, under the existing act, Senator, simply has power to approve or disapprove the recommendations of the Federal open-market committee.

Senator GLASS. The open-market committee, on the contrary, Doctor, as you will recall upon thought, under existing legislation cannot engage in any open-market operations except under rules and regulations established by the Federal Reserve Board.

Mr. MILLER. Yes.

Senator GLASS. The only reservation at all being that any Federal Reserve bank which does not desire to participate in a given open-market transaction may, upon written objections, be excused.

Mr. MILLER. Yes.

Senator McAdoo. There is no power of initiation on the part of the Federal Reserve Board.

Senator Glass. No; I am talking about the existing act.

Senator McAdoo. That is what I say.

Senator Glass. Under the existing act the only reservation is the one that I have mentioned.

Senator McAdoo. Yes; but I mean there is no power of initiation.

Senator Glass Oh, no.

Mr. Miller. There is no power of initiation, and it is not clear that the Board has the right to say more than "yes" or "no" to proposals submitted to it by the Federal Open-Market Committee.

Senator Glass. The act textually says that the open market committee may engage in open-market transactions only upon rules and regulations adopted by the Federal Reserve Board.

Mr. Miller. Yes; but we have never construed, and I question whether it would be proper to construe it, and we have been advised that it would not be proper to construe it, that the power to make rules and regulations gives us power to annex authority not conferred by the act. We can regulate the manner, but we cannot say to them, "You shall not buy $500,000,000; you shall buy $200,000,000 or $700,000,000."

Senator Glass. No; that would be the initiation that you are advocating now.

Mr. Miller. I question whether we have the right to modify their recommendation. We have done it and they have resisted it at times. At the present time they do not resist so much.

Senator McAdoo. I do not think the Board by regulation, for instance, could alter their decisions, their open market committee decisions.

Senator Glass. They may only make decisions under rules and regulations adopted by the Federal Reserve Board.

Senator McAdoo. You are quite right about that, Senator. They can prescribe the method or manner of procedure by the open-market committee. I do not think the Board has any power to alter the method or decision of the open-market committee when it has acted within the rules of procedure prescribed by the Board.

Senator Glass. Of course not, when it has acted within the rules prescribed by the Federal Reserve Board. The Board cannot alter its decisions.

Senator McAdoo. Precisely.

Senator Glass. The only reservation that the Federal Reserve Bank has under existing law is to decline to participate in a given open-market transaction. In other words, if the Federal Reserve Bank of Atlanta or the Federal Reserve Bank of Minneapolis or the Federal Reserve Bank of Dallas, for example, mentioning some of the weaker Federal Reserve banks——

Mr. Miller. The smaller ones.

Senator Glass (continuing). Should in its wisdom determine that it is not able or that it would be distinctly to its disadvantage to participate in an open-market transaction initiated by the Federal Reserve Banks of New York, Chicago, and Philadelphia, it may decline to do so upon 30 days' written notice if at all.

Senator McAdoo. I am inclined to think as I consider this question—it is rather a new problem in my mind—that the point you make might be safeguarded if the power of initiation were given to the Federal Reserve Board, the powers that Dr. Miller suggested, by giving the Board power to excuse any Federal Reserve bank from participating.

Senator GLASS. You can do that at any time.

Senator McADOO. But I mean, you can expressly provide that the Board can excuse any particular bank or banks from participating if, in the opinion of the Board, it is advisable to do so. I think you could safeguard the position of those banks in that way.

Senator GLASS. Under existing law, by a very simple amendment which could be made—not according to Dr. Miller's idea, but according to my own—it could be adjusted by providing that any Federal Reserve bank may be excused from participating in an open-market operation by a vote of either a majority or two-thirds of the open-market committee.

Senator McADOO. Some safeguard like that might cover it; but what I think is quite important is that the power of initiation shall be lodged somewhere to excuse any bank from participating where upon a showing it seems wise that it should not be required to do so.

Mr. MILLER. It is done, as a matter of fact.

Senator McADOO. It is permissively done now, but you would like to have the authority, would you not?

Mr. MILLER. It is done as a matter of just sensible administration.

Senator GLASS. Yes; but administration is not always sensible. I can recall governors of your Board that were not sensible. They seemed to be ignorant of the banking business.

Senator McADOO. I agree with the chairman about that.

Mr. MILLER. What I want to call attention to in that connection, Senator, is with respect to Federal Reserve banks. Under the present set-up, an individual Reserve bank has the power not to participate, and there is a question as to how far it should participate in a transaction in which it is invited to participate as a result of the deliberations of the open market committee and the procedure of the Federal Reserve Board. But there is a grave legal question as to what power the Board has and what control in the saying of yes or no as to a matter that is submitted to the banks.

Senator GLASS. I do not see why that should be so, except—with apologies to all of you lawyers—that lawyers raise all sorts of questions that are in contravention of the plain language of the statute.

Mr. MILLER. For instance, Senator, I think it is clear that under the Federal Reserve Act as it is the Board has no legal authority to order a sale.

Senator GLASS. No. It was not intended that it should have.

Mr. MILLER. It ought to have the power, however, to modify an order.

Senator GLASS. It would have the power to adopt a rule and regulation, for example, that the Open Market Committee shall not engage in a transaction involving a given maximum amount, without the approval of the Board.

Mr. MILLER. I think the more important decisions that are made by the Open Market Committee, or the more important decisions of inaction, abstention from action, have got to be taken upon pretty broad grounds, a pretty wide survey of what is impending in the country at large. You cannot bottle up the effect of an open-market operation in the district in which it originates. There is no method of doing that——

Senator GLASS. I do not agree with that proposition at all. Nobody has ever been able to convince me that local transactions, for example, in the Dallas Federal Reserve District, have any effect whatsoever upon the financial transactions in the great monetary centers.

Mr. MILLER. Would you say that in the reverse, that a transaction that takes place in the great monetary centers, New York and Chicago, has no effect in Dallas?

Senator GLASS. Very little——

Mr. MILLER. Oh, yes.

Senator GLASS. Let me finish my remark. I say, very little under the general ordinary loans to the mercantile, industrial, and agricultural interests of that district; because I know perfectly well, and I have had it verified over and over again, that banks in a given district have their standard rate of discount which is always the limit of the statutory rate, and that they never depart from it except maybe in the case of a big privileged borrower.

Mr. MILLER. It may not, Senator, have any effect in many cases upon the rate of interest, but it will have an effect upon the ease with which you can get accommodation. Easy money in this country has had a far more sinister effect than cheap money.

Senator GLASS. Oh, yes.

Senator MCADOO. It may have a beneficial effect also?

Mr. MILLER. Yes; it all depends upon conditions, of course.

Senator GLASS. When the New York bank reduced its rate to the ridiculous figure of 1 percent, as it has done, or 1½ percent as it frequently has been, of course that momentarily enabled a big borrower in the Dallas district or the Minneapolis district to get accommodation at a better rate of interest than he otherwise would get.

Mr. MILLER. Yes; and he is very apt to be a speculative borrower, whose operations, Senator, will have distinct repercussions in the field of commerce and business.

Senator GLASS. But I am referring to the current general discount rate and the mercantile, industrial and agricultural interests of the country. They have a standard rate and they never depart from it, and it is always right up to the limit of the statutory rate.

Mr. MILLER. That is true and, I think, substantially true in considerable areas of the country. It is not true with respect to the bulk of borrowings.

Senator GLASS. I am going to stop arguing, because I am going to do my arguing on the floor of the Senate.

Mr. MILLER. I want to convince you of this, Senator. That is particularly what I am up here for. I want you to appreciate that I am speaking out of the depths of experience, and nobody is more profoundly concerned to protect and to defend the Federal Reserve System and the country from bad operations of the Federal Reserve System than I am.

Senator GLASS. Nobody knows that better than I do.

Mr. MILLER. I would not be proposing this if I did not think so; and I would not propose it under any conditions if I did not couple it with safeguards that I think will protect it and result in the country getting a very distinct benefit from it.

Senator McAdoo. It seems to me, Doctor, in discussing this particular question, and while the chairman's view about the local transactions is entirely sound and I agree with him about that, there are broad questions of national policy affecting credit throughout the country for which perhaps more adequate provision, regulatory or otherwise, should be provided in this new law. Open-market operations do affect the credit and financial structure throughout the entire Nation. Of course, they are felt less in one district than in another.

Mr. Miller. Less immediately.

Senator McAdoo. Yes; but they have repercussions.

Mr. Miller. Oh, they do; you are perfectly right about that.

Senator Glass. One of those policies involved the repudiation by the National Government, through congressional action, of its most sacred contract, characterized by the Supreme Court as "repudiation" and a "cheat." That is what it was, too.

Senator McAdoo. We are trying to avoid that the next time.

Senator Glass. Doctor, how much longer do you think you will require?

Mr. Miller. At the rate at which we are going we are not making progress very rapidly.

Senator Glass. Go ahead a while longer, anyhow.

Mr. Miller. All right, Senator. I just want to call attention, in connection with open-market operations, to a episode that may not be without interest. You referred to the episode of March 26 or 27, 1929. Do you know what precipitated that? The withdrawal of $50,000,000 from the market in Chicago by one of the largest banks there that had decided that it would cooperate in supporting the Board's program of getting control through direct pressure on speculative loans. It called $50,000,000 loans in the Chicago market, with the result that the pressure in New York was so immediate, so intense, that it brought on something in the way of a very considerable panic. That was what occasioned the intervention in the market of the gentleman who has been referred to.

Senator Glass. I agree that transactions in the largest metropolitan city have a repercussion in the second largest city.

Mr. Miller. They do, Senator. When money is active, there is an active market for what are called Federal funds.

Senator Glass. But that is no reason why you should strip all of the Federal Reserve banks completely of their jurisdiction and their judgments upon credits.

Mr. Miller. I have had all of that in mind. Let me call your attention again to the open-market formula that I have proposed here. It shall be "governed with a view to supporting and reinforcing the credit and discount policies of the Federal Reserve System."

These policies are made by the banks as well as the Board, "when this may be necessary, in order to aid in the establishment and maintenance of sound banking, credit, financial, and economic conditions."

As a matter of fact, I regard that as a pretty considerable limitation upon any careless or extravagant exercise of these powers when conditions do not clearly indicate them.

Senator GLASS. Just exactly what is the difference between that and what the House has put into the bill?

Mr. MILLER. I want to come to that. There is an awful lot of difference. That is an excursion into Martian economics, lunar economics. This is an excursion into simple, common experience. That implies a world that is to be made over through the operation of the monetary mechanism of the country that, in my judgment, is just not attainable, and I think that should it be attained it would inevitably mean the destruction of the Federal Reserve System. But I shall have something to say about that later.

I propose a further paragraph [reading]:

(*e*) Each Federal Reserve bank shall purchase or sell obligations of the United States, bankers' acceptances, bills of exchange, and other obligations of the kinds and maturities made eligible for purchase under the provisions of section 14 of this act, to such extent and in such manner as may be required by the Federal Reserve Board in order to effectuate the open-market policies approved or prescribed by the Federal Reserve Board under the provisions of this section and each Federal Reserve bank shall cooperate fully, in every way, in making such policies effective.

And [reading further]:

(*f*) All actions taken by the Federal Reserve Board with respect to open-market policies shall be clearly recorded, together with a statement of the reasons therefor; and, if any member of the Board vote against such actions, such vote, together with any reasons therefor, shall also be recorded. In its annual report for each year the Federal Reserve Board shall publish in full all resolutions recommending open-market policies and stating the reasons therefor which were adopted by the Federal Open Market Committee during the year covered by such annual report, together with the full text of the contemporaneous record of all actions taken by the Board with respect to open-market operations and the reasons therefor and all dissenting votes and the reasons therefor.

I regard that as perhaps one of the most valuable and considerable limitations upon any careless exercise of the authority that I am asking that you give to a board that is made independent.

Senator GLASS. And only if it is made independent?

Mr. MILLER. Only. I stand by that to the bitter end. I do not want to see these powers given in any way that will lead to careless, hasty decisions or to any unintelligent or improper use. I think that is a very important safeguard.

You are a Virginian, Senator, and I want to recall to you what you already know but may not have in your mind at this moment—a remark made by a great Virginian of an earlier age, James Madison, in the debates on the establishment of the Treasury Department.

Senator GLASS. He is alleged to have written the Constitution that we once had.

Mr. MILLER. Correct—well, I think we still have it; but it is like the skin on a boy's body; it has got to grow as the boy grows.

A question was raised as to the nature of the safeguards that could be set up to insure that the Secretary of the Treasury would properly discharge his responsibility. I have never forgotten Madison's reply. He went through a number of things, and finally he came to this and said:

Finally, reputation. There is no species of property for which men have a more jealous regard than their good reputations.

I think that is one of the things that you men must rely upon in this act.

I am not going to get through this morning, Mr. Chairman.

Senator TOWNSEND. Are you going to meet this afternoon?

Senator GLASS. I think it is a vital requirement that we hear such testimony as Dr. Miller is giving and as others have given and as others desire to give; but I am being pressed by the chairman of the committee to cut the hearings short and to report the bill.

Senator TOWNSEND. I do not think we can afford to cut Dr. Miller short in the midst of his testimony.

Senator GLASS. No; I do not want to. I want to hear all he has to say, and some other members of the Board also.

Can you come back at 2 o'clock, Dr. Miller?

Mr. MILLER. Any hour you suggest, Mr. Chairman.

Senator GLASS. Two o'clock?

Mr. MILLER. Yes.

Senator GLASS. Shall we meet here or over in the room of the Appropriations Committee?

Senator TOWNSEND. In the Appropriations Committee room, I would think.

Senator BULKLEY. Yes; I would rather meet over there.

Senator GLASS. Come back, then, please, at 2 o'clock in the Appropriations Committee room.

(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 resumed at 2 p. m., in the Capitol, on the expiration of the recess.

Senator GLASS (chairman of the subcommittee). We will resume. You may go ahead with your statement, Dr. Miller.

STATEMENT OF ADOLPH C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD, WASHINGTON, D. C.—Resumed

Mr. MILLER. The first thing I will take up this afternoon are those provisions of the Senate bill and of the House bill that contemplate a change in the status of the chairmanship and the governorship of Federal Reserve banks by consolidating the two. In other words, abolishing the separate position of chairmanship and combining it with the office of governor. And, likewise, certain changes in the tenure of office of various class C directors of Federal Reserve banks.

Senator GLASS. I would be obliged if you would furnish me with a copy of these proposed amendments.

Mr. MILLER. I will do so. What I now hand you is in the shape of an amendment to H. R. 5357 and S. 1715. Strike out everything commencing with line 19, on page 38 (S. 1715), through and including line 22, on page 40, and substitute the following:

Class C directors shall be appointed by the Federal Reserve Board, and one of them shall be designated by the Federal Reserve Board as chairman of the board of directors. The chairman shall be the highest official of the bank, shall preside at all meetings of the board of directors at which he is present, and may, at his discretion, exercise supervision over the bank and its officers.

He shall be a man of outstanding and tested character and experience and shall be eminently qualified to give effective representation to the point of view of the public interest in all matters pertaining to the policies and operations of the Federal Reserve bank and shall consult with and be consulted by the Federal Reserve Board from time to time respecting such matters. He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal Reserve bank to which he is designated. One of the directors of class C shall be appointed by the Federal Reserve Board as deputy chairman and shall preside at meetings of the board of directors in the absence of the chairman. In the absence of both the chairman and the deputy chairman the third class C director shall preside at meetings of the board of directors.

The last few lines read:

At each Federal Reserve bank there shall be a governor, who shall be the active executive officer of the bank.

He is described in the House bill as the "chief" executive officer [reading]:

The governor shall be appointed by the board of directors. He may be appointed by the Federal Reserve Board as one of the class C directors of the bank—

Instead of making it obligatory this would make it optional with the Board. [Continues reading:]

but, in such event, his term of office as class C director shall terminate when he ceases to be governor of the bank. For each Federal Reserve bank there shall be appointed annually, in the same manner as the governor, a vice governor, who shall, in the absence or disability of the governor, or during any vacancy in the office of governor, serve as the active executive officer of the bank. Whenever a vacancy shall occur in the office of either the governor or vice governor of a Federal Reserve bank, it shall be filled in the manner provided for original appointments; and the person so appointed shall hold office until the expiration of the term of his predecessor.

Effective ninety days after the enactment of the Act containing this amendment, the office of Federal Reserve agent shall be abolished and the terms of office of the present incumbents of the position as class C directors and chairmen of the boards of directors shall terminate; but they shall be eligible for reappointment, in the discretion of the Federal Reserve Board, as class C directors and chairmen. Hereafter the duties prescribed by law for the Federal Reserve agent shall be performed by such person or persons as the Federal Reserve Board shall designate.

No class A director shall serve continuously for more than one full term of three years, except that a class A director elected to fill an unexpired term may be reelected and may serve for the next full term. No class B director shall serve continuously for more than two consecutive full terms of three years each, except that a class B director elected to fill an unexpired term may be elected to serve the next two full terms of three years each.

The present bill provides that no director shall serve for more than 6 years.

Senator Glass. And you provide that they shall serve how long?

Mr. Miller. I recommend that the bank directors be permitted to serve only a single term of 3 years. That is in vogue in two Federal Reserve banks now, and it works well.

Senator Glass. Suppose we were to enact a law that no Member of the House of Representatives should serve more than one term; what sort of legislation do you think we would have?

Mr. Miller. Well, of course, this is not a legislative body. This is an operating, or, at the most, an administrative, body, and——

Senator Glass (interposing). That is true; but I have heard it said repeatedly by members of various Federal Reserve bank boards that it takes a year for a member to know what it is all about.

Mr. MILLER. That is true. That is the reason why, in contradistinction to the Senate bill and the bill as passed by the House, I have removed the restriction of 6 years upon class C directors. I look at the thing in this way: We do not want a specific banking influence to overawe the operations and decisions of Federal Reserve banks. That has been one of the troubles in the case of certain Federal Reserve banks. That was undoubtedly true of the Chicago district, where continuously from the inception of the System until, I think, 1931 the leading influence in that bank was the president of the largest bank in the city of Chicago, a class A director.

Senator GLASS. Was that George M. Reynolds?

Mr. MILLER. Yes; and that is not the only instance, but it is the most outstanding one.

Senator GLASS. Well, it is quite exceptional, is it not?

Mr. MILLER. It is not exceptional. There are many cases, but I think that one is exceptional, perhaps, in this way——

Senator GLASS (interposing). Exceptional does not always mean exclusive, but it is not the general practice, is it?

Mr. MILLER. It is not the general thing; no. But I think the position that was taken by the New York member banks at the inception of the Federal Reserve System that there should not be anything in the nature of perpetuity of control, or even a semblance of it, and that therefore there should be a change every 3 years, was and has been a very beneficial thing in the organization of that bank. And my recollection is that from the beginning of the System, or very soon thereafter, the Atlanta bank adopted the same system, and it has worked there well, very well; and I think we feel it in visiting those boards of directors when they are in session. You will see a notable difference in those banks where there has been a long continuance in the position of director by a leading banker of the district, who rather overawes the others. It may not be that he dominates the bank in any conscious way, but the other members show a tendency to defer to him on banking matters, and on matters that are not banking matters but which they think are banking matters, because he has positive views. So that I think that is a good restriction.

Now, when it comes to class B directors, I would not object to a longer term of service. It takes a good 3 years before a good class B director gets fairly oriented and is willing to speak up at meetings and take a position. And certainly he should be given a term of not less than 6 years. The advantage of giving a longer term to my mind would be this: I feel it most important that the class C directors should be the weightest and best men you can possibly get. I would put no restriction upon the length of their term of service. I would leave that to the discretion of the Board.

While it is true that some men have been continued in office in that position beyond what is altogether desirable, I think in view of the great responsibility that the Board is going to have under this act that that need not be feared for the future.

Now, in getting good class B directors, and particularly if you should feel disposed to let their term of service run to at least 9 years, the Board has the opportunity as a vacancy does occur in class C of directorships, or if it wants to make a change, to do so.

And if there is a well-qualified and experienced man among the class B or business directors of a bank, whether he is a merchant, a farmer, or a manufacturer, they can pick that man.

Senator GLASS. And transfer him to a class C directorate, do you mean?

Mr. MILLER. Yes. That is what we did with Owen D. Young. He began as an elected director and then was selected by the Board as a class C director. If I had thought of it I would have brought down here this afternoon and introduced into your record a letter that Mr. Young wrote to the Board at that time, but the purport of it was that as a class C director he said he would feel an even greater sense of responsibility for the welfare of the bank than as an elected class B director, representing more or less the member banks.

I think in that way though the directors appointed by the Federal Reserve Board would be a minority in number, they would be a very strong influence, perhaps a dominating influence, as regards all of the weightier matters concerning the broader field of policy and the general public relations of their respective institutions. I advocate that, therefore, very strongly; and hope that as the legislation emerges there will be no restriction put upon the service of class C directors. We have had some men that under the operation of the law I think would have meant a very, very grievous loss to the Federal Reserve System if that were so. I know there are boards here in Washington, and I know there have been members on the Federal Reserve Board, that have felt it is desirable not to have strong men on Federal Reserve banks. But I feel the other way. I feel it is desirable to have very able men there, men who can put the Board on its mettle. None of our problems are 100 percent clear of solution or simple, and through contact and discussions I believe eventually will come sound determinations, as sound as you can expect to get from fallible human beings.

Now, as to the chairmanship: I think it is most important that the position should be kept alive, only however as chairman. Pursuing the thought a little bit further here is what I would say: That as men moved upward from the position of class B directors, supposing that you fill the class C directors from men who distinguished themselves as class B directors, I feel that there should be designated as chairman of the board of a bank a man of ripe experience, a man of wisdom, a man who is familiar with the problems, who knows his way around, and generally speaking that involves in my judgment a man of very much bigger mental caliber, and certainly of bigger stature as a man, than you can ordinarily expect to command for the position of active executive officer of a Reserve bank. I think his presence merely at directors' meetings, sitting at the head of the table, would do an immense deal to give elevation of thought and purpose and spirit to the meetings of boards of directors of Reserve banks.

I think there are in this country, in every district, men in the business world, men who have built up and developed great organizations and who have done it honorably as well as honestly, who have some sense of social obligation, who have something of the outlook of the man animated by a sense of public responsibility and of honesty, who can be found to be put in the chair of each of the Federal Reserve banks. I should like to see those men in the chair, and I think it would be one of the best guarantees we could possibly get for a better, broader, more publicly inspired administration of the banks.

Let me tell you here just a little instance and you can judge whether you want it on your record or not. There occurred a vacancy in the Buffalo Reserve Bank last winter. I happened to be on the New York committee, and in casting about for a man to fill the vacancy I came upon the name of Chief Judge Pound, who was just retiring from the New York Court of Appeals. I was satisfied that if that man were available, although he was not technically a banker, he would make a most admirable man to introduce into the bank at Buffalo, with a view to bringing him down on the board of the Federal Reserve Bank of New York when and if a vacancy should occur. I felt that a man of his distinction, wide experience, and outlook would be an admirable counterpoint to any petty or narrow banking point of view who would activate the meetings merely by his presence whether he said very much or very little or spoke only at times. I am reminded that the Federal Reserve institution, though not governmental, is vested with a type of serious public interest, and I should like to see that done.

They used to use the expression, in the case of the Bank of England, "passing the chair", when men would gradually come along through experience and had qualified and made good would eventually occupy the chair of Governor of the Bank of England. I think a large part of the success of the Bank of England was due to that. It is a remarkable fact that ought never to be lost sight of, particularly in America at this juncture, though that institution is as private as the law could make an institution private, it has for at least three-quarters of a century been animated by perhaps the most vivid sense of public responsibility of any institution in the world, I do not care whether the institution is governmental or whether it is nongovernmental. It has been an institution of national service, operated and governed by men who are keenly alive to the importance of their powers and responsibilities and who are to be largely credited with the magnificent performance that Great Britain, and particularly the London financial market, has given all through a period of at least three-quarters of a century.

I see no reason why we should not undertake to open a path by which we can gradually emerge toward that goal in this country. My suggestion therefore is that this position of chairman be consecrated to that type of service now. I would have in mind in this thought that such chairman should be in no sense a functionary of the bank. He could be a man in active business life. He should have no routine functions. I have stated here "a compensation", and what I have in mind is rather an honorarium, something or perhaps nothing. I think the men of the kind you want would feel themselves only too happy and greatly honored to be invited to step into a position of that kind of public responsibility even though they held no. appointment technically governmental in its character. I think that at conferences with the Federal Reserve Board, and its conferences with them, they would be most helpful in every way, and that the public relations of the Federal Reserve banks in the several districts, as well as in the country as a whole, would be vastly improved.

Now, Mr. Chairman, are there any questions on that?

Senator GLASS. Dr. Miller, I think you have gotten to be right much of an idealist.

Mr. MILLER. You think I have?

Senator GLASS. I think you will experience a great deal of difficulty in finding men of that sort who would serve without compensation. But you may go ahead with your statement.

Mr. MILLER. Well, they have had that sort of men in some other countries, why not here?

Senator GLASS. Well, never mind. We will talk about it behind the bat.

Mr. MILLER. I will be glad——

Senator COUZENS (interposing). Let us go on with your next suggestion.

Mr. MILLER. The provision for compensation is there, and my thought is that it should not be made an inducement. I think you will find, gentlemen of the committee, that its occupant in time, and in no very long period of time, will come to consider it one of the greatest honors to be sought by American business men of distinction. There are in the circle of men I know or know of, a great many unassuming men but men of ability and broad experience whom I think could be induced to take a position of this kind and who would discharge the responsibilities splendidly, eminently, because they would feel it was an honor and something in the nature of a very much coveted recognition would develop out of it.

Senator GLASS. All right. Let us go on to the next proposition that you have to present.

Mr. MILLER. Now, I come to the proposition of the House bill, which is paragraph (b) of section 204, which reads as follows:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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.

Senator COUZENS (interposing). Well, do you approve of it or do you not approve of it?

Mr. MILLER. I disapprove of it.

Senator GLASS. Well, you need not discuss it.

Mr. MILLER. All right.

Senator COUZENS. Are you going to offer a substitute?

Mr. MILLER. Well, I have already, but I have also prepared a substitute method of handling what I conceive to be the problem here in event that there was any likelihood of that objective being written into the Federal Reserve Act.

Senator GLASS. I do not think there is any. But if you have an amendment and will hand it in we will avail ourselves of it.

Mr. MILLER. I have an amendment here that is pretty completely thought out.

Senator GLASS. If you will let us have it we will take it under consideration.

Mr. MILLER. All right. Here it is.

(Draft of May 27, 1935)

FEDERAL ADVISORY COMMITTEE

For the purpose of aiding in the establishment and maintenance of more stable economic conditions in the United States, there is hereby created a Federal Advisory Committee (hereinafter referred to in this section as "the Committee"), which shall consist of five members appointed by the President of the United States by and with the advice and consent of the Senate. The members of the Committee shall be chosen with particular regard for their qualifications for the discharge of the duties imposed upon them by this Act. Not more than two members of the Federal Reserve Board may serve at the same time as members of the Committee.

For the purpose of assisting the President in the selection of the members of the Committee, two lists of persons eminently qualified for membership thereon shall be prepared and submitted to the Federal Reserve Board on or before October 1, 1935. Each list shall include the names of not less than five nor more than fifteen persons and shall be accompanied by a memorandum stating the qualifications of each such person. One list shall be prepared and submitted by the American Economic Association and one by the twelve Federal Reserve banks, in accordance with procedure to be prescribed by the Federal Reserve Board.

After careful consideration and such investigation as it deems necessary, the Federal Reserve Board shall transmit such lists to the President, shall advise the President which persons among those named in such lists are, in the Board's judgment, best qualified for membership on the Committee, and shall add thereto any nominations of its own selection. In selecting the members of the Committee, the President shall give due consideration to such lists, the additional nominations submitted by the Federal Reserve Board, and the Board's views thereon, but shall not be required to select the members of the Committee from such lists or nominees.

Similar lists shall be prepared and submitted to the President in like manner and with like effect whenever any vacancy occurs or is about to occur in the membership of the Committee.

Of the five original members of the Committee, one shall be appointed for a term of two years, one for a term of four years, one for a term of six years, one for a term of eight years, and one for a term of ten years, and their successors shall be appointed for terms of 10 years each, except that a person appointed to fill a vacancy created otherwise than by the expiration of the term of a member shall serve for the unexpired term of his predecessor.

The members of the Committee (other than those who are at the same time members of the Federal Reserve Board) shall devote their entire time to the business of the Committee and shall receive salaries of $12,000 per annum, payable monthly, together with actual necessary traveling expenses, which salaries and expenses, together with all other expenses of the Committee, shall be paid by the Federal Reserve Board from the proceeds of assessments levied on the Federal Reserve banks in the manner prescribed by the Federal Reserve Act for defraying the salaries and expenses of the Federal Reserve Board: *Provided*, That the Committee shall annually submit a budget to the Federal Reserve Board, which shall be subject to the Board's approval.

With the consent of the Federal Reserve Board, the committee may utilize the services of members of the Board's staff; and, within the limitations of the budget approved by the Board, the committee shall have authority to employ and fix the compensation of such additional experts, assistants, attorneys, clerks, and other employees as may be deemed necessary to conduct the business of the committee. All salaries and fees of its employees shall be fixed in advance by the committee and shall be paid in the same manner as the salaries of the members of the committee.

Retired appointive members of the Federal Reserve Board may, in their discretion and with the consent of the committee, serve as ex-officio members of the committee, in addition to the five appointive members; but such ex-officio members of the committee shall have no vote and the aggregate amount of their retirement pay, plus any compensation received from the committee, shall not exceed $12,000 per annum.

It shall be the duty of the committee to study (1) economic, industrial, financial, and monetary conditions, the workings of the banking system and the Federal Reserve System, the effects of United States Treasury operations, the laws relating to banking, and any other factors which, in its judgment, may affect the stability of general economic conditions, and (2) the methods of aiding in the establishment and securing the maintenance of more stable economic conditions in the United States. The committee shall report its findings from time to time to the Federal Reserve Board.

For the purpose of aiding in the establishment and securing the maintenance of more stable economic conditions, the committee shall also make recommendations to the Federal Reserve Board from time to time with regard to the open-market operations and discount rates of the Federal Reserve banks and the reserves required to be maintained by member banks of the Federal Reserve System. If adopted unanimously by the members of the committee holding office at the time, the Federal Reserve Board shall proceed to put such recommendations into effect, unless they be disapproved unanimously by all members of the Federal Reserve Board holding office at the time.

If the recommendations of the committee be not adopted by unanimous vote, a full statement of the reasons for such recommendations and full statements of the views of the minority members of the committee and the reasons therefor shall be communicated in writing to the Federal Reserve Board. After reviewing such recommendations and the reasons of the majority and minority for and against the same, the Federal Reserve Board shall set a date for a hearing at which the members of the committee shall appear. At such hearing each member of the committee shall be given an opportunity to state fully his reasons for or against the recommendations of the committee and shall answer all questions pertaining thereto propounded by the members of the Federal Reserve Board.

Following such hearing, the Federal Reserve Board shall again review the recommendations of the committee and, within a reasonable time, shall either approve or disapprove the recommendations of the committee, with such modifications as the Board may deem to be in the public interest. If the recommendations of the committee be approved by the Federal Reserve Board, the Federal Reserve Board shall proceed to put them into effect, with such modifications as it deems advisable.

The committee shall not make public any of its recommendations or findings or the results of any of its studies or any other information in its possession; but the Federal Reserve Board shall publish all findings and recommendations of the committee and statements of the Board's actions thereon, in the Board's annual reports to Congress in supplements thereto, or in the Federal Reserve Bulletin.

Upon the completion of the building which the Federal Reserve Board has been authorized to erect for its use, it may assign quarters therein for the use of the committee.

The Federal Reserve Board, the Federal Reserve banks, the Secretary of the Treasury, the Reconstruction Finance Corporation, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Commissioner of Internal Revenue, the United States Tariff Commission, the Collector of Customs, and all other officers, employees, departments, bureaus, boards, commissions, independent establishments, and agencies of the United States are authorized and directed to make available to the committee any information in their possession which the committee may require for the performance of its duties under this act.

Well, Senator Glass, that pretty nearly finishes what I have to say.

Senator Glass. This is the amendment, do you mean?

Mr. Miller. This is an alternative solution for the problem that this paragraph which I was just reading to you from the House bill would impose upon the Federal Reserve Board. I do not want that, and if the Congress of the United States proposes to engage in the problem of economic stabilization I have a different solution to offer from that, that would protect an invasion of the Federal Reserve System from any share of responsibility of that kind beyond what is included in the formula I gave to the subcommittee this morning in connection with a revision of section 12a.

Senator Glass. Well, I do not think the Congress is going to do that. But, Dr. Miller, have you discussed the proposition of the proposed arbitrary right of the Federal Reserve Board to change the reserves whenever and to any extent that it pleases?

Mr. MILLER. No; not specifically, I think; only by a passing reference.

Senator GLASS. All right.

Mr. MILLER. You may recall that in 1916 or 1917 the then Federal Reserve Board prepared and requested that such an amendment to the Federal Reserve Act be passed, to confer upon us that power. I am certain as to the fact and the content, but am a little uncertain as to the date. I am not sure that it was made in 1916, but, at any rate, it had its inception in the Board in 1916.

We had a situation then where gold was coming into this country through vast purchases by the warring governments in Europe, and we felt there was great danger, and subsequent events demonstrated the truth of our fear, that the situation would get out of control. And we knew of no method at that time by which we could probably more effectively counteract it than by being able to raise the reserves.

Now, looking at the situation that will be left when this depression terminates, we will have an enormous amount of redundant money in this country, even supposing that there is no further monetary legislation increasing the already available or potential supply. And I do not think that the two and a half billion dollars of Government bonds that we hold would prove a very available method for counteracting any inflationary influence if and when it develops, and it will develop I do not for one moment doubt in my own mind. It is going to develop, all right. We have outstanding now almost two and a half billion dollars, certainly over $2,300,000,000, of excess reserves that in some way have to be recovered in part when business begins again to get its stride.

Senator GLASS. Well, they are only available for business purposes——

Mr. MILLER (interposing). They are available for——

Senator GLASS (continuing). In response to the demands under the existing law of commerce, industry, and agriculture.

Mr. MILLER. Under the terms of the new Banking Act of 1933 the Board is equipped with powers that it did not realize it had before to restrain the banks from the improper use of Federal Reserve credit used for speculative purposes. It has certain powers as well as responsibilities under the terms of the Securities and Exchange Act as well.

Senator GLASS (interposing). That touches securities on the exchange and not what we speak of as legitimate business.

Mr. MILLER. That is right. Beyond that you do what perhaps ought not to be overlooked, although I had not intended to raise the question in the hearings in which I have participated, of——

Senator GLASS (interposing). I think it is one of the most important, if not of more importance than the open-market question, if the Board here in Washington can do as it pleases with the reserves of the country, differentiating in the case of district from another district, and all that sort of thing. I think that is very important.

Mr. MILLER. Senator Glass, my doubt is whether it will ever be used.

Senator GLASS. Oh! My heavens alive, there has been more of that sort of legislation enacted, such as the N. R. A., the Frazier-Lemke

Act, and innumerable other things, upon the supposition and in some cases upon the direct assurance that they would not be used, but they have been used and are being used, and misused at that, too.

Mr. MILLER. Well, I would suggest there that I doubt whether in any Federal Reserve set-up of which I have been a member, a power of that kind would be used, if at all, except under the pressure of pretty strong compulsion. I would suggest that it might be covered here again by requiring the affirmative votes of a certain number of members of the Board so as to make a test of the necessity to resort to that rather drastic means of control, to make it clear and beyond a reasonable doubt.

Senator BULKLEY. I should like to ask whether in the form as provided in this bill, and in the bill as it passed the House, you think it might have any effect of disturbing the equinimity of bankers, just to know that there is such a power on the part of the Federal Reserve Board.

Mr. MILLER. It might, but I do not think seriously. Our main difficulty in this country is not that we will restrain but that we will not restrain.

Senator GLASS. It is a power to begin with that would enable the Board to destroy the credits in one Federal Reserve district and expand credits in another.

Mr. MILLER. Well, I would not be at all averse to having it apply uniformly over the whole country if it is to apply at all. On the contrary, I think that would be the more logical way to do it.

Senator BULKLEY. And if a banker were to tell you he would be disturbed by it and would not know exactly what reserves to build up, you just would not believe him; is that it?

Mr. MILLER. It would not disturb me if I was a banker and knowing what I know.

Senator GLASS. But every banker has not your equilibrium. [Laughter.]

Mr. MILLER. It is going to require some compunction and some character, and I should say some courage, to raise the reserves of the banks of this country unless indications point clearly to its necessity. My fear would be that it might encourage the mistake of making the Federal Reserve Board feel that because it has a stick of dynamite it can pull out at any time it would not pull it out until it was too late to do anything with it. I mean that it might create a false sense of security.

Senator GLASS. Well, if that is all, Dr. Miller, we are very greatly indebted to you for your testimony. It has been very enlightening to us.

Mr. MILLER. There is one further thing I want to call your attention to that I have not mentioned so far, and that is the new position that the United States Treasury has in recent years come to assume as a factor in the money market, and that is something beyond anything in extent that we have ever had before. I have just looked up to see what the powers of the Treasury are to increase or decrease member-bank reserves and deposits. Mr. Thomas has made certain computations and assembled certain material for me. In the matter of increasing reserves it has the power now to issue $3,000,000,000 of greenbacks. And it has about 1,800,000,000 of stabilization funds with Reserve banks which it can use——

Senator GLASS (interposing). Which it took from its owners.

Mr. MILLER. There would be two vast sources of inflation; and when you realize that things are moving in their ordinary way a dollar of reserve money multiplies itself to $10, and you can see what the Treasury could do there, that the Board would be helpless to counteract unless it is given some authority; and I confess that I view the future in that respect with at least perplexity. And it can issue more silver certificates. That again has the same effect as an open-market operation. It could also further devalue the dollar and spend the profits. That again would be an open-market operation. In other words, they have the power to go into the open market to an extent that makes Federal Reserve banks seem like a toy pistol alongside the modern revolving six-shooter.

The Treasury has the power, on the other hand, to decrease member banks' reserves. It can draw down its own balances at commercial banks and transfer the proceeds to Reserve banks.

Senator GLASS. Well, any private depositor has the power to do that.

Mr. MILLER. Except that he cannot deposit it in the Reserve banks?

Senator GLASS. No.

Mr. MILLER. He cannot get rid of it except by moving it out of the country. He can take it out in the form of currency and lock it up or take it out of the country. The Treasury can do the same thing with its trust-fund balances, to the extent that they are carried with member banks. And it can sell securities to the member banks or the public and place the proceeds on deposit with Federal Reserve banks.

These are very extensive monetary powers and could be operated to produce some startling things. Similarly the Treasury could increase the deposits of member banks without the knowledge or cooperation of the Federal Reserve banks, by spending money raised either by sale of securities to member or Reserve banks, by use of stabilization fund, by issue of United States notes, or by printing silver certificates against silver bullion already in the Treasury.

So that you really have two colossal sources of banking power in the United States, one being the Federal Reserve System, and the other being the Treasury.

Senator MCADOO. How was that?

Mr. MILLER. Senator McAdoo, I am explaining the enormous power the Treasury has to operate in the open market now, quite independently from the Reserve banks, and far more than the power that the Reserve banks themselves possess. It constitutes a problem in the future; and to my mind, if you want any realistic argument against this formula in the Federal Reserve Act, you have it there: that they can just pull the ground out from under us.

Senator GLASS. Do you know the origin of that formula?

Mr. MILLER. No.

Senator GLASS. Well, never mind. We will not go into that.

Senator COUZENS. Mr. Chairman, I think last Thursday or Friday Mr. Miller referred to some interference with the Federal Reserve Board, through political officeholders and bankers, and he stated, in response to a query I made to give us some examples, that he would be glad to give it to us in executive session. Now, if Mr. Miller is through with his statement for the record, I should like for the subcommittee to go into executive session and let us get some of that information.

Senator GLASS (chairman of the subcommittee). All right. The subcommittee will now resolve itself into executive session. Everybody will retire except the members of the subcommittee and Dr. Miller, and at the conclusion of the executive session we will adjourn until 10:30 tomorrow morning to resume our hearings in room 301 Senate Office Building.

(Thereupon, at 2:55 p. m., the committee went into executive session, and after a short time adjourned to meet at 10:30 a. m. Tuesday, May 28, 1935.)

BANKING ACT OF 1935

TUESDAY, MAY 28, 1935

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

The subcommittee met, pursuant to adjournment on Monday, May 27, 1935, in room 301, Senate Office Building, Senator Carter Glass presiding.

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

Present also: Senator Norbeck of South Dakota and Senator Nye of North Dakota.

Senator GLASS. The subcommittee will come to order. We will be glad to hear from Mr. Edward Elliott.

STATEMENT OF EDWARD ELLIOTT, VICE PRESIDENT, SECURITY FIRST NATIONAL BANK OF LOS ANGELES, CALIF., REPRESENTING THE BANKERS ASSOCIATION OF SIX STATES, CALIFORNIA, ARIZONA, NEW MEXICO, OREGON, IDAHO, AND UTAH

Senator GLASS. Be good enough to give your name and occupation to the official reporter.

Mr. ELLIOTT. My name is Edward Elliott. I am vice president of the Security First National Bank of Los Angeles. I am representing the Bankers Associations of six States, California, Arizona, New Mexico, Oregon, Idaho, and Utah.

In appearing in behalf of the bankers associations of these six States, I beg to say that my representation runs to title I only of the bill, and it is only to title I that I wish to address my remarks. What I shall have to say will be confined to a discussion of section 101 of the House bill, subdivision 8, in which provision is made for the assessment upon banks for the Federal Deposit Insurance Corporation.

Senator TOWNSEND. You are referring to the one-eighth of 1 percent?

Mr. ELLIOTT. Yes, sir.

Senator MCADOO. Have you cited the page and line?

Mr. ELLIOTT. I did not. It is subdivision 8 of section 101 of the House bill, page 11.

In the bill before the Senate and in the bill as it was originally presented to the House, the assessment provided for was one-twelfth of 1 percent upon total deposits with the right on the part of the Federal Deposit Insurance Corporation, under certain circumstances, to waive or remit one-half of the assessment. As the bill passed the House the provision was for an assessment of one-eighth of 1 percent of total deposits and the assessment was made mandatory.

The bankers associations of the six States which I represent have, I believe without exception, passed resolutions in opposition to the assessment provided in the House bill. They believe the assessment should not be mandatory and that it should not be an eighth. They believe further that such mandatory assessment of one-eighth is neither necessary from the standpoint of the Corporation nor desirable from the standpoint of sound banking.

Though the system under discussion has been spoken of as an insurance of deposits, and though the Corporation is called the Federal Deposit Insurance Corporation, the contribution to be paid by the banks can hardly be regarded as an insurance premium, as it is not based upon any actuarial figures. At best, any rate suggested may be regarded as an estimate of the amount that the banks can afford to pay. As a matter of fact, the insurance is now and must be for a considerable period of years largely a guarantee on the part of the Government rather than an insurance fund built up by contributions from the banks.

When it was suggested that an assessment of one-eighth of 1 percent of total deposits was not necessary from the standpoint of the Corporation, there was in mind the resources, actual and potential, of the Corporation and the possibility of these resources being sufficient to meet any calls that may reasonably be anticipated will be made upon the Corporation in the next few years.

There has been contributed to the Corporation by the Treasury of the United States and by the Federal Reserve banks approximately $300,000,000 and another $30,000,000 approximately has been contributed by the banks. The bill before you provides that the Corporation shall have the right to issue notes and debentures in an amount three times the sum contributed by the Treasury, the Reserve banks and the banks which are members of the fund, and inasmuch as the Treasury may buy the notes of the Corporation and may guarantee their payment as to principal and interest, the potential resources of the Corporation, should that provision be included in the bill as passed, would approximate $1,250,000,000.

Testimony before the House committee indicates, I believe, that thus far the income of the Corporation has taken care of all demands made upon it by reason of the failures of banks. In view of the large number of banks which were closed and not allowed to reopen in March 1933, and in view of the tremendous contributions made to the capital structure of banks through the Reconstruction Finance Corporation, it seems reasonable to conclude that the next few years should not witness many bank failures and, therefore, the actual funds of the Corporation plus its potential resources should be adequate to take care of all failures. If we are to anticipate that the failures, say, in the next 5 years will be in excess of one and a quarter billion dollars, then indeed the prospect for the country as a whole is a most discouraging one, but I for my part am not disposed to be pessimistic. I am hopeful that the soundness of the banking system will grow progressively better.

In the second place, the bankers' associations of the States I represent believe very strongly that the mandatory assessment of one-eighth of 1 percent of total deposits is most undesirable from the standpoint of the banks themselves. I would not have you believe that the view I am here expressing rests upon mere opposition on the part of the banks to insurance of deposits. As you gentlemen well know, there has been a difference of opinion among the bankers themselves in regard to the matter, but I think there is unanimity of opinion among the bankers of the States I represent that because of the present low earnings of the banks, an assessment of one-eighth of 1 percent of total deposits is entirely too high and will result in one of two things, either the payment of the assessment out of the capital funds of many banks or the withdrawal of many banks from the Deposit Insurance Corporation.

I am sure that all of us hope that the year 1934 was not a normal one from the standpoint of bank earnings, but so far as my information and experience go, earnings thus far in 1935 for the banks as a whole are lower than for the same period in 1934. My plea in behalf of the banks of these six States is based upon the abnormal conditions existing last year and this year, and the belief that a permanent rate of assessment should not be established when earnings are so abnormally low. It is true that in 1934 write-offs of losses were extraordinarily heavy and were largely accomplished through the issuance of debentures or preferred stock. There are, however, few who believe that the banks will not suffer further losses which must be taken care of and that one of the most urgent needs of our banking system at present is a building up of a permanent surplus and reserves. That this is the view of the framers of this bill is evident from the fact that this bill before the Senate and as passed by the House provides that all banks which are insured must set aside each year one-tenth of their net earnings for the preceding 6 months to surplus until the surplus shall equal the capital.

In support of the view I am expressing with regard to the low earnings of the banks in the States which I am representing, I want to present some figures with respect to the earnings and payment of dividends by the State banks. I am unable to supply the figures for the national banks, as I understand they have not yet been compiled for the year 1934, but inasmuch as the State banks constitute about two-thirds of the membership of the insured banks, I think that the figures I give for State banks will be representative of both the State and National banks in these States.

Senator TOWNSEND. You are just speaking of the State banks in the six States to which you have referred?

Mr. ELLIOTT. Yes; I think the percentage applies to the whole country, about 2 to 1.

In California there are 153 State banks, 66 of which paid no dividends on their common or preferred stock during the year 1934, 35 paid a dividend on the preferred stock only, while 52, or about 33⅓ percent, paid dividends on the common stock. In Idaho there are 35 State banks, of which 30 paid no dividends and only 5 paid a dividend on the common stock. In Utah there are 46 State banks, 32 of which paid no dividends on the common stock, 29 paid a dividend on the preferred stock, and only 14 paid a dividend on the common stock.

Senator TOWNSEND. Is the preferred stock owned by the Reconstruction Finance Corporation?

Mr. ELLIOTT. Yes. It carries a dividend rate of, I think, about 3 percent.

In New Mexico, there are 18 State banks, of which only 1 paid a dividend on its common stcok, while 8 paid dividends on preferred stock. I regret that the figures for Oregon are not available. The recent destruction of the State Capitol by fire destroyed the records which have not yet been recompiled, nor have I figures for Arizona in which there are, however, only seven State banks.

A summary of the earnings of the insured State banks of these six States shows for 1934 a net loss of over $16,000,000, while an assessment on total deposits at the rate of one-eighth of 1 percent would amount to $1,400,000. In other words, on top of the deficit in 1935, if like 1934, you would have an assessment of $1,400,000.

Senator MCADOO. Have you any idea what amount in the deficit is represented by write-offs?

Mr. ELLIOTT. I have the figures, Senator McAdoo, supplied as to the net earnings of the banks, the recoveries, the charge-offs, and the net additions to or withdrawal from surplus.

Senator MCADOO. Can you supply them for the record?

(The data referred to are inserted as follows:)

Statistics with reference to all State Federal Reserve member banks and State nonmember banks whose deposits are insured in the Federal Deposit Insurance Corporation, calendar year 1934

State	Number of banks	Net earnings	Recoveries	Charge-offs	Net additions or deductions to or from profits
Arizona	7	$252,000	$397,000	$362,000	$287,000
California	124	8,913,000	10,499,000	34,451,000	[1] 15,039,000
Idaho	35	388,000	323,000	657,000	54,000
New Mexico	17	64,000	120,000	301,000	[1] 127,000
Oregon	49	238,000	302,000	1,276,000	[1] 736,000
Utah	45	828,000	714,000	2,444,000	[1] 902,000

[1] Red figures.

Mr. ELLIOTT. Yes. What I want to urge upon you in the light of these figures is the fact that many banks, and this applies to national banks as well as State banks, and particularly the small banks, are not now earning any money in the six States that I represent; and the prospect for any immediate change in this situation is extraordinarily slight. The question, therefore, arises as to the soundness of a course on the part of Congress which would require a considerable number of banks, if they desire to remain insured, to make a contribution out of capital assets when the Government has been at such great pains through the Reconstruction Finance Corporation to strengthen the capital of the banks of the Nation by purchasing upward of a billion dollars of preferred stock and debentures.

In the light of the figures which have been here presented there is the basis for an argument in support of the view that the wise thing to do would be to suspend the assessment against the banks for at least a year with the purpose of allowing them to strengthen themselves either by adding to their reserves or by further writing off and writing down their losses and doubtful assets. Certainly there is convincing evidence that one-eighth of 1 percent of total deposits is far too high. One-half of that would be adequate for the corporation and far less harmful to the banks. One of the purposes of the insurance of deposits was to create confidence in the public in the banks, and I think it is generally admitted that this purpose has been very largely accomplished. It hardly seems wise now to pursue a course which would result in weakening the banks in which you have sought to create confidence.

Senator McAdoo. What would you suggest should be done—specifically—to have a reduction to one-twelfth of 1 percent or one-sixteenth of 1 percent?

Mr. Elliott. I should like to make this clear, that I am not speaking for my individual bank in this situation, nor am I speaking primarily for the large banks. I am speaking primarily on behalf of the small banks out in the country districts that are having a very difficult time making enough money to take care of normal losses under these conditions. My suggestion here is not any rate, but a suspension of any assessment for 1 year.

Senator McAdoo. Suppose that were not done; what is the maximum that you are prepared to say should be assessed for 1 year?

Mr. Elliott. One-eighth of 1 percent is the amount set by the House. One-twelfth of 1 percent was recommended as adequate by the chairman of the Board of the Federal Deposit Insurance Corporation. I think the banks that I represent certainly feel, and I believe they have so expressed themselves almost unanimously, that even one-twelfth is more than they should be required, under these conditions, to pay; and if you are going down the line, perhaps one-sixteenth.

Senator McAdoo. Suppose it were either suspended or made very low for the first year; then what would you say would be a reasonable percentage to ask after that?

Mr. Elliott. I would say, Senator McAdoo, that under normal earning conditions most banks in the country could perhaps afford to pay one-eighth of 1 percent, though that is a rather high assessment.

Senator McAdoo. You spoke of the mandatory provision to which you object. What is your idea about that?

Mr. Elliott. I do not think you ought to keep piling up year after year without any limit.

Senator McAdoo. You mean, you would leave it to the Federal Deposit Insurance Corporation?

Mr. Elliott. Some discretion in them to determine that.

Senator McAdoo. It has been suggested here that when the fund reaches $500,000,000 the assessments shall automatically cease until there should be an impairment, if any, to the extent of 25 percent, after which the assessments would be automatically resumed until the deficit had been restored.

Mr. Elliott. That would be a total fund of $500,000,000, not a contribution of $500,000,000 from the banks. If you retain in the bill the provision which will allow the Corporation to issue notes and debentures to three times the contribution by the Government and the bank, it seems to me that $500,000,000 which would then produce a fund of $2,000,000,000, under all ordinary circumstances should be adequate to meet even the most unusual conditions.

Senator McAdoo. You mean, under extraordinary circumstances?

Mr. Elliott. Even under extraordinary circumstances.

Senator Glass. That would be upon the assumption, however, that the Corporation is going to issue debentures?

Mr. Elliott. Yes.

Senator Glass. Would it not be well to avoid the issuance of debentures?

Mr. Elliott. I hope we will never have occasion to do so, if that is what you mean, Senator Glass.

Senator Glass. Mr. Elliott, do you happen to know how many banks are now being propped up by the Reconstruction Finance Corporation and to what extent in money they are being propped up?

Mr. Elliott. No. The capital or notes issued amounts to about $1,000,000,000. Some of that has been repaid; the exact amount I have not now in mind.

Senator Glass. Yes; some of it has been repaid; but is it not a fact that a great deal of it has not been repaid and that the Reconstruction Finance Corporation owns the principal assets of those banks?

Mr. Elliott. I think there are relatively few banks in which the Reconstruction Finance Corporation owns a majority of the stock or even 50 percent of it. There are very few cases in which the preferred stock equals the common stock. But they do own, of course, a very substantial interest in the banking structure of this country and have a very important position in it.

Senator Glass. And for the loans made they have taken the cream of the assets of these banks; is not that so?

Mr. Elliott. I am not speaking about any loans. For the preferred stock they do not take any security.

Senator Glass. That is practically a loan.

Mr. Elliott. But they do not take any security for it.

Senator Glass. No; but it is practically a loan excepting in the instances of a few banks.

Mr. Elliott. It would be very helpful to the banks if it could be described or characterized as a loan, because then we could deduct from our income-tax returns as interest instead of dividends, the amount we pay on our preferred stock.

Senator Glass. A very large amount of money was loaned to these banks and the cream of their assets taken as security. Is not that a fact?

Mr. Elliott. Well, I am not in possession of the facts sufficiently to make a statement as to that, Senator Glass.

Senator Glass. I ask you these questions because you were doubtful as to whether we should have another year of bank failures.

Mr. Elliott. I am still of the opinion that in view of the tremendous contributions to the capital of the banks made by the Reconstruction Finance Corporation, plus something that I did not mention, namely, the contributions of stockholders which have been very considerable, running into several hundreds of millions of dollars, if we have anything like a return to normal conditions within a year or two, I do not think we will have heavy bank failures again.

Senator McAdoo. The write-offs of doubtful assets and the charge-offs of loans have put the banks in a very much stronger position than they have been in for many years?

Mr. Elliott. And there is a prospect, of course, of eventually having considerable recoveries of a large part of their assets which have been charged off.

Senator Glass. We are very much obliged to you, Mr. Elliott.

(The witness withdrew from the committee table.)

Senator Glass. Is Mr. Ward in the room?

Mr. Ward. Yes; Senator.

STATEMENT OF LOUIS B. WARD, DETROIT, MICH.

Senator Glass. Will you be good enough to give your name?

Mr. Ward. My name is Louis B. Ward. I am from Michigan. My home is in Pontiac, Mich., and my office is in Detroit.

Senator Glass. We have under immediate consideration Senate bill 1715, but there has been offered in the Senate by Senator Nye a bill that, as I understand it, he will offer as a substitute for the Senate bill if and when reported, Senate bill 2162, in which it was incidentally stated that Father Coughlin was interested and which he helped prepare; and at the suggestion of members of the committee I extended to Father Coughlin more than 10 days ago an invitation to appear here. I have understood from you that he did not find it convenient to come.

Mr. Ward. I wanted to make a statement on that, Senator.

Senator Couzens. Before you start your statement, will you tell us your experience and background to indicate your knowledge of the banking business?

Mr. Ward. I am primarily a student. My occupation, Senator, is that of a business counsellor. For 14 years I have counseled business in Detroit, and that is my occupation today. I come before you, after approximately 25 years of study, an academic study. I never worked in a bank, never stood behind a cage, never counted much change in my life. I have taught constitutional history. My presentation to you gentlemen of the committee——

Senator Bulkley. Have you been an independent business counselor, Mr. Ward?

Mr. Ward. Yes; for a number of years, and I have been with an organization for other years as counsel to the automotive industry.

Senator Couzens. Have you been employed by the General Motors Co.?

Mr. Ward. I have been employed by General Motors, Fisher Body, the interests of Packard, Hupmobile, Graham-Paige, Chrysler, Libbey-Owens-Ford, Champion Spark Plug, and practically all the large accounts of the automotive industry; and I am today representing here the National Union for Social Justice whose program of 16 principles involves not only banking, but general economic problems facing this country, and my work for years has been the study of those problems. I do not appear before you as a banker.

Does that answer your question, Senator?

Senator Couzens. Quite well, I think.

Mr. WARD. The National Union for Social Justice and Father Coughlin are tremendously appreciative of the invitation extended by Senator Glass some 10 days ago. I received a copy of that letter which I requested from Senator Glass office. On getting in touch with Father Coughlin on Sunday I told him that a wire had been sent to him. I was mistaken; it was a letter. That letter has not reached his desk up until this morning. I am very sorry for that and so is Father Coughlin. He would have liked the courtesy of replying to it. It is probably in some mail bag in his building. He on Sunday night extended his appreciation to the Senator's invitation, and as soon as he receives a copy of this letter, Senator, he will, of course, write you immediately.

He arrived in Detroit on Sunday and I talked to him on Sunday night before his broadcast, and he was unable to get here today. In a certain sense it is well that he did not get here. He is tremendously interested in this legislation; but what you gentlemen just witnessed—the photographers stepping into the room and taking pictures—I believe would divert attention from the legislation to the personality.

He has asked me to appear in his place. Our witnesses will be very few. The National Union for Social Justice has requested Senator Gerald P. Nye and Congressman Martin L. Sweeney to introduce the so-called "Nye-Sweeney bill", a central banking bill. Our witnesses will consist of Mr. George LeBlanc, whom I have asked to be here the first thing in the morning. Mr. LeBlanc has been president of two New York banks, has been for 37 years in the Street, and he is a counselor at no. 1 Wall Street today. He was senior vice president of the Equitable Bank, and we rely upon Mr. LeBlanc for the comments of a banker on this bill. We recognize full well that we cannot ask the bankers to appear here in favor of a central banking bill.

The second witness is Mr. Robert M. Harris, of the New York Cotton Exchange, a man who has been a stockholder and, I think, the largest stockholder, in one of the banks in Texas, an owner of agricultural land, and his interest is in the merchandising of the agricultural product primarily, and that is his interest in the exchange.

I have asked Mr. Edward E. Kennedy, the national secretary of the Farmers' Union, to comment on this legislation from the standpoint of the farmer.

Our own organization has now 8,500,000 members, every one of whom has signed his name to 16 specific principles of social justice, and all of whom stand solidly behind six pieces of legislation emanating out of the Seventy-fourth Congress. Those are the Thomas Patman bonus plan, recently defeated; the Frazier-Lemke farm-refinancing bill, the Nye-Sweeney central-bank bill, the Wagner-Connery labor-disputes bill, the Thomas-Massingale cost of production plus a profit bill, and the Wheeler-Rayburn public utilities holding company bill.

Illustrative of the fifteenth principle of our National Union of Social Justice is the Nye bill to prevent profiteering in time of war.

For the information of the committee I ask that these 16 principles be introduced into the record for the reason that they substantiate my position as a witness before this committee, not as a bank specialist, but as a lobbyist in favor of and lobbying for that type of legislation.

Senator GLASS. That may be inserted in the record.

(Preamble and principles of the National Union for Social Justice referred to and submitted by the witness as here printed in full as follows:)

PREAMBLE AND PRINCIPLES OF THE NATIONAL UNION FOR SOCIAL JUSTICE

Establishing my principles upon this preamble, namely, that we are all creatures of a beneficent God, made to love and serve Him in this world and to enjoy Him forever in the next, and that all this world's wealth of field and forest, of mine and river has been bestowed upon us by a kind Father, therefore, I believe that wealth as we know it originates from the natural resources and from the labor which the sons of God expend upon these resources. It is all ours except for the harsh, cruel, and grasping ways of wicked men who first concentrated wealth into the hands of a few, then dominated States, and finally commenced to pit State against State in the frightful catastrophes of commercial warfare.

With this as a preamble, then, these following shall be the principles of social justice toward whose realization we must strive.

1. I believe in the right of liberty of conscience and liberty of education, not permitting the state to dictate either my worship to my God or my chosen avocation in life.

2. I believe that every citizen willing to work and capable of working shall receive a just and living annual wage which will enable him to maintain and educate his family according to the standards of American decency.

3. I believe in nationalizing those public necessities which by their very nature are too important to be held in the control of private individuals. By these I mean banking, credit and currency, power, light, oil and natural gas, and our God-given natural resources.

4. I believe in private ownership of all other property.

5. I believe in upholding the right to private property, yet of controlling it for the public good.

6. I believe in the abolition of the private-owned Federal Reserve Banking System and in the establishing of a Government-owned central bank.

7. I believe in rescuing from the hands of private owners the right to coin and regulate the value of money, which right must be restored to Congress where it belongs.

8. I believe that one of the chief duties of this Government-owned central bank is to maintain the cost of living on an even keel and the repayment of dollar debts with equal value dollars.

9. I believe in the cost of production plus a fair profit for the farmer.

10. I believe not only in the right of the laboring man to organize in unions but also in the duty of the Government which that laboring man supports to facilitate and to protect these organizaions against the vested interests of wealth and of intellect.

11. I believe in the recall of all nonproductive bonds and thereby in the alleviation of taxation.

12. I believe in the abolition of tax-exempt bonds.

13. I believe in the broadening of the base of taxation founded upon the ownership of wealth and the capacity to pay.

14. I believe in the simplification of government, and the further lifting of crushing taxation from the slender revenues of the laboring class.

15. I believe that in the event of war for the defense of our Nation and its liberties, there shall be a conscription of wealth as well as a conscription of men.

16. I believe in preferring the sanctity of human rights to the sancity of property rights. I believe that the chief concern of Government shall be for the poor, because, as it is witnessed, the rich have ample means of their own to care for themselves.

These are my beliefs. These are the fundamentals of the organization which I present to you under the name of the National Union for Social Justice. It is your privilege to reject or accept my beliefs, to follow me, or repudiate me.

CHARLES E. COUGHLIN,
Royal Oak, Mich.

Mr. WARD. The idea of a central bank is precisely 6 years older than the convention which framed the Constitution of the United States.

In the month of May 1781 Pelatiah Webster wrote a pamphlet which he circulated among the people of the States asking that there be called a convention of people to revise the Constitution, which was then, of course, the Articles of Confederation. Madison spoke of this Pelatiah Webster as "an able though not conspicuous citizen"; and that is precisely the point of the National Union for Social Justice—not to emphasize the conspicuous names in America, but to attempt to throw before the people certain economic reforms that have usually emanated from the people.

Webster, in his pamphlet, after discussing the fiscal system of the United States under the Second Continental Congress, suggested as one of the chief remedial provisions that a central bank be established because, and I quote:

the authority of Congress at present is very inadequate to the performance of their duties and then this dictates the necessity of their calling a continental convention for the express purpose of ascertaining, defining, enlarging, and limiting the duties and powers of their constitution.

It was this pamphlet of Pelatiah Webster that so influenced the thought of men that the very idea of the present Government of the United States was predicated upon the theory of a central bank first advocated in 1781, and the convention of 1787 was directly built upon that idea.

In 1787 the Fathers met in a convention, and it was Charles Pinkney who on Tuesday, May 29, of that year submitted article VI of his plan of union, which read [reading]:

The Legislature of the United States shall have the power to borrow money and emit bills of credit; to coin money and regulate the value of all coins and fix the standard of weights and measures.

Significant in this early draft are the words "emit bills of credit." Significant, likewise, is the idea of regulating the value of money and fixing standards of weights and measures. Money was to be regulated, but the standards of weights and measures were to be fixed. Money was something to be created by the Government, while the standard of weights and measures was to be fixed by law.

Money in those days was not confused with wealth, for then as now wealth might only be created by the unremitting toil of man expended on natural resources. But money is not wealth. It is a method of distributing wealth. It was a function of sovereignty; and Charles Pinkney recognized it when he wrote article II of his plan submitted on that same day, Tuesday, May 29, 1787, in these words [reading]:

No State shall emit bills of credit nor make anything but gold, silver, or copper a tender in payment of debts.

I would be tempted to follow the course of this power over money throughout the debates of the Federal Convention, but the distinguished chairman of this Committee said on Friday that he was being pressed for time on these hearings. But I really believe that if each Member of Congress read the Federalist and read Madison's Notes on the Convention, the idea of a central bank would so impress itself that it would not need the tremendous propaganda that I think it needs today.

I want to recall Elbridge Gerry's remarks in that convention on June 13, 1787. It was Gerry who restated the maxim regarding money, that the people should hold the purse strings. I want to call to the committee's mind that Gouverneur Morris was opposed to the issuance of paper money or bills of credit, as was Pierce Butler, on the ground that—

if the credit of the Nation were good no such issuance were necessary, and if the credit were not good the issuance were unjust.

I also want to recall what James Madison said in his desire for the issuance of money to be preserved under the new Government.

Gouverneur Morris had argued that the many interests would oppose the plan of government if paper emissions were not prohibited.

George Mason had a mortal hatred for paper money, but was unwilling to tie the hands of the legislature. Now I quote Madison in respect to Mason:

He observed that the late war could not have been carried on had such a prohibition existed

that is, without the issuance of paper money.

Today the committee finds a wide-spread propaganda against this Government issuing money; and I believe it is well to look back to the debate of the fathers and find them crediting the winning of the Revolution by a Government issue of currency. John Randolph, of Virginia, notwithstanding his antipathy to paper money, would never agree to strike out the words " empower the Government to issue ", because he said that he could not foresee the occasions which might arise.

James Wilson opposed the right of Congress to emit bills of credit, as did Pierce Butler. But the important opinion on the entire subject was that of James Madison himself, who wrote [reading]:

This vote in the affirmative by Virginia (the vote by which the specific permission was not given Congress) was occasioned by the acquiescence of Mr. Madison, who became satisfied that striking out the words would not disable the Government from use of paper notes, as far as they could be safe and proper.

The argument of Mr. Madison is tied up with the nature of sovereignty.

Under article I, section 8, clause 5, of the Constitution, Congress is empowered " to coin money and regulate the value thereof of foreign coins ", and under the eighteenth clause of article I, section 8, Congress is empowered to " pass all laws necessary and proper to carry into execution the foregoing provisions."

The Fathers put squarely in the Constitution of the United States two important powers: The power to tax and the power over the money of this country. The Fathers placed the power over money in the hands of Congress, the power to coin money and regulate its value, and they prohibited this power to the States in this language, by section 10 [reading]:

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a legal tender in the payment of debts.

There is no need to point out to this committee the elementary fact that 74 Congresses have been called into session and every one of them has put solemn thought and endless labor upon the problem of taxation, with commission after commission and great economic study on a tariff, for example, with endless effort on the internal revenue as represented by the excise duties and sumptuary laws, with the initiation of an amendment to the Constitution to permit the income tax, and with the new intricate measures covering new processing taxes.

The tax problem has had 154 years of thought. If we contrast this with the power of Congress over money, we would be surprised. Yet 10 centuries before Christ the city-states of Greece, Athens, and Sparta, recognized that the power over money is the most important single asset of sovereignty. Imperial Rome in later centuries farmed out the taxes, but the coin of Caesar was never permitted to go into private hands.

But the Government of the United States, though denying to any State the power to emit bills of credit—in other words, the power to issue paper money—consistently has permitted the State banks to issue paper money from the earliest days down to 1862.

The Government of the United States, with the power placed in the hands of Congress by the people under the Constitution has abdicated its power over money and permitted the private banking interests of this Nation to usurp the earliest and greatest attribute of sovereignty—the power over money.

From the foundation of our country down to 1862 private banking exercised the prerogative given by the Fathers to Congress, and the States which were refused the right of issue had to witness a State bank incorporated under its authority exercising a power that that sovereign State was denied.

But Congress, by a 10-percent tax on State bank issues, recaptured its prerogative and then there grew up in this Nation the kind of money which has dominated the trade and commerce of the country throughout the recent decades, until now 95 percent of our business is conducted with a new kind of money, undreamed-of in the days when the 55 men drafted the Constitution, and unchallenged by every Congress that has met from the Civil War to the present day.

I refer to the ability and power of a bank to enter upon its ledger a debt and against the debt grant the right of withdrawal. I refer to our demand deposits against which there need be but a 10-percent reserve in currency, so that it becomes the right of the people, the privilege of the people, to pass through the wicket of a bank a promissory note together with people's securities in stocks or bonds or mortgages and against that promissory note with, of course, the security behind it, issue to the extent of the loan, checks which have become the money of the Nation.

What is the present situation in America where we have, unquestionably, the richest-developed Nation in the world; where we had an evaluation in the year 1920 of $488,000,000,000 of national wealth; where we have in 1930, after a decade of so-called "boom" an evaluation of $369,000,000,000, and where in 1935 no economist in the country would evaluate America at over $200,000,000,000 of national wealth?

Our farms have depreciated from $78,000,000,000 in 1920 to 57,000,-000,000 in 1930 to $37,000,000,000 in 1934. That means that a farm, the average farm, was evaluated at $12,000 in 1920, at $9,000 in 1930, and a little less than $6,000 in 1934.

There is little question in the mind of anyone that a man owning a $12,000 farm in 1920 had the right to a $6,000 mortgage on it. The decade of the so-called "prosperity" in the twenties never gave cost of production to the American farm. The farm debt actually increased and the value of the property dropped one-fourth.

By 1934 the entire property had depreciated to $6,000, and 10 years more of such decimation of values will bring the total value of our farms in America down to the present face of the first mortgage upon them, $8,500,000,000.

Dr. Adolph Miller testified here last Friday. His charts and his testimony represent a splendid background for this study. He told this committee how the present Federal Reserve System decreed in 1924 the slump which is indicated in the automotive industry by the chart which I now show you. There [indicating] is the story of the automotive industry from 1913 to 1931. Here [indicating] is the year 1919, where production was held up continuously. Here is your splendid drive straight up [indicating], and here [indicating] correspondence to Dr. Miller's chart with a drop in 1924.

Here is Dr. Miller's second chart [indicating] with a drop in 1927, and here is your market and here is your depression, straight down [indicating].

And that is a reaction that can be pictured in the home.

Senator BULKLEY. What is this—a total of all passenger cars?

Mr. WARD. Yes; and it is backed by the individual companies. The rise and fall of prosperity, independent of management, by the first chart, and of course qualified by the next. One of the distinguished members of the committee knows so well why the automotive industry failed in individual cases. That chart is a picture of the largest single manufacturing industry in this country [exhibiting].

I do not want to take the time of the committee, but I want to show the members of the committee that in the automotive industry 1926 reached the high point in invested capital, and then it tapered off. I want to show the net profit in the automotive industry and the manufacturers' bonuses for the war period. Production was down. Here [indicating] is the war, with the net profit, and there [indicating] is the way the profits rose in the automotive industry.

Senator BYRNES. What year is the peak?

Mr. WARD. 1919 is the peak. We have the net profit in relation to sales of all companies. Here are the sales in the war period [indicating]. Here is the bonus to American industry as reflected by the industry that I have been interested in for 14 years [indicating].

Here is a gross income chart. The capital invested is declining. Eighty-five percent of the people are in the low-price field. It shows that automobiles are a popular thing, for the people that own cars costing $3,000 amounts to 0.28 of 1 percent.

Senator BULKLEY. What do you consider the low-priced field?

Mr. WARD. Below $750—the Ford, Chevrolet, and Plymouth.

I think that these charts, for which I wired Sunday night, are most interesting to some members of this committee. Here is 61.5 percent of all sales going to people with less than $3,000 income.

Senator BYRNES. How do you ascertain that fact?

Mr. WARD. I might say, Senator, that the study cost thousands of dollars in its completed form. They are bought on time. They want to know what Ward does, and what is his income, before they grant the credit. You see, we have 23,000,000 motor vehicles, and 30,000,000 families. We know what kind of people do not own cars. The rest of them do. So it follows the income classes.

Senator GLASS. What kind of people do not own cars?

Mr. WARD. Well, there are a few in America.

Senator GLASS. Those in the almshouses?

Mr. WARD. That is about it. California and the District of Columbia lead, and there are a couple of States in the country that do not own cars.

Senator BYRNES. What did you say about California and the District?

Mr. WARD. One car to every three persons. There is the Federal pay roll in one place, and the retired wealthy in the other. The District of Columbia did not catch California, however, until the last few years. In Kentucky, North Carolina, and South Carolina the ratio is 1 to 10; Mississippi, 1 to 16 people. There is 1 car to every 4 persons in this group of States [indicating], and with this number of millions of cars it becomes an interesting study from the financial standpoint.

The point I wanted to make with the charts was that I enjoined Dr. Miller's testimony tremendously, because, without touching his field, in the field in which I work, there was not a single point in his statistical information where I could not bow my head and say "That is reflected. I know what that is in business."

Dr. Miller told this committee how the present Federal Reserve System decreed in 1924 the slump there indicated in the automotive industry. He testified that the present Federal Reserve System went into its open-market operation in 1927 to start an inflationary process reflected in the automotive industry with the line I have indicated, and the doctor was not questioned in public on what the Federal Reserve did in 1929 in open-market operation, to account for the collapse. He told you that he was against the commodity dollar, for there on his chart was an almost even line and level of commodity prices during which period profits were not distributed but were used in speculation, in the wildest speculation that this country ever knew.

My charts happen to show the withdrawal of capital from the automotive industry before the period of its greatest sales.

Gentlemen, we are suffering in this country, I believe, from a paucity of money——

Senator BULKLEY. Mr. Ward, what happens when capital is withdrawn from the automotive industry? Are automobile factories converted to other use?

Mr. WARD. There have been, Senator, some 565 groups that have gone into the manufacture of automobiles, and there are today approximately 13 companies operating. Five hundred and forty, let us say, of the 565 have disappeared, because of their inability to manufacture cars, because they did not have the brains for that highly competitive business, as the senior Senator from Michigan can also confirm. There are a few of them that succeeded. In 1921 I think there were 171 manufacturers of passenger cars in the country, and today, if you will look at that information, which is 2 years old, you will find that three of them do 90 percent of all the business in the country—Ford, General Motors, and Chrysler. Three out of those 565 have made a substantial success. Two have been down to Jesse Jones this year to bail them out. That accounts for five. The rest are dividing 5 percent of the business.

Senator BULKLEY. When that capital is withdrawn, are the factories devoted to other purposes?

Mr. WARD. Yes, sir. They just become——

Senator BULKLEY. Of no value at all?

Mr. WARD. I think Fisher's had 49 factories for automotive bodies when I first knew the account. They have five operating today. That is accounted for by technological development, plus duco, plus what Dr. Miller pointed out, the eternal march to reduce the cost of production through greater efficiency, and dismissal of labor; and those that cannot follow, fall by the wayside and leave us, in that magnificent industry, three dominating it to the extent of over 92 percent. Many of the rest are unable to get credit. One of the great ones always had it himself. Two others went to the people with stock, and the rest are dependent on bank loans in part. Then, when a situation such as 1921 comes along—I think there is a profit chart that answers that question here. [Referring to chart.] Here is the depression of 1921. General Motors lost $38,680,000; Chrysler, $3,200,000; Packard, $3,400,000; Willys-Overland, $13,000,000; and Peerless and Graham-Paige lost.

Here is your depression, gentlemen [indicating on chart]. In 1929 the net profit of the automotive industry was $424,000,000. They decreed a contraction of call loans and shot the prosperity in this Nation, and in 1930 the profit drops to $200,000,000. The next year, 1931, it drops to $21,000,000—a loss of $460,000,000 in 2 years. You can trace everything there right on Dr. Miller's charts.

Senator COUZENS. What, in your opinion, would have altered that situation?

Mr. WARD. An understanding of the money question, differentiating money from wealth. Let men go on and create the real wealth of the Nation by the labor of men against the national resources and the manufacturing, and let money, which is not wealth, but which is a method of distributing wealth, issue forth from the Government of the United States, and not be in the hands of the private bankers for its control. I do not say that as an arbitrary, quick answer, and I do not say it is a panacea. The fact that we are backing 16 principles and not 1, I think, ought to be suggestive of the fact that we are not interested in panaceas.

Senator COUZENS. Do you make any discernment between money and credit?

Mr. WARD. I include in money the credit money of the demand deposits in the banks, which is pure fiction money, which is the right concept of money, in the sense that it is a purely created thing, and the free issue of that type of money carries on 95 percent of our transactions. That is in the hands of the private banker, who can expand it and contract it at will.

On that question, I have here the best essay on money that I ever read, consisting of four pages. This is an issue of the New York Herald Tribune, called "The Financial Section of a Newspaper", edited by C. Norman Stabler, and sent out to the advertising agencies. I do not think there is a man in the United States who has not a debt of gratitude to the organ of Ogden Mills for contributing the best four-page essay on money that I ever saw. He opens this little book with the wording "preference", showing that (reading):

Sixty-six percent, or 656 of the 994 members of the New York Stock Exchange who responded to the question "What morning New York newspaper do you read regularly?" mentioned the New York Herald Tribune.

He goes on to show the publicity value of this little book. It is addressed to:

Students in schools and colleges, many of whom have had no immediate contact with the financial world and consequently are not thoroughly acquainted with Wall Street parlance, are realizing the necessity of the coming debtor versed in the ways of those institutions in lower Manhattan from whose rooms are directed the flow of credit and commerce to all sections of the globe.

He is going to send the college to school in Wall Street, through the medium that 67 percent of the New York Stock Exchange uses. He shows the art of publicity in this question you gentlemen are dealing with. One of the items is entitled "The Week in Finance", by Edward H. Collins, giving the people the idea that the bankers' convention proved a good show from the news standpoint, but a none too happy occasion for the bankers themselves. "It should have been their great opportunity for a concerted demonstration against the administration's banking heresies—for an appeal to sound public judgment against attempts to sabotage the banking system—but they failed utterly to make anything of the opportunity."

That is the point of view of this against the administration. That is on the news page.

Senator BULKLEY. Mr. Chairman, I ask that that four-page essay on money be printed in our record at this point.

Mr. WARD. I offer it, and thank you for the suggestion.

Senator GLASS. If there is no objection, it will be done.

Mr. WARD. I want to say that it is the best we can find on the secret of money.

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

(NOTE.—This comprises pages 26, 27, 28, and 29 of the attached pamphlet.)

OUR MONETARY SYSTEM

A BRIEF DISCUSSION OF ITS ESSENTIAL ELEMENTS AND MECHANISM

(By Edward H. Collins, associate financial editor New York Herald Tribune)

The modern banking system exists primarily to provide and regulate the supply of money.

There are three general classifications of money in use today. These are: Real money, representative money, and deposit money (or credit). Roughly speaking, they represent successive historical steps in the development of the present monetary system.

The distinguishing characteristic of real money is that it is freely received, not because it bears the seal of the State nor because it is exchangeable for some other form of money, but because of its own value. In most of the civilized world the supply of real money, for more than half a century, has been gold coin and bullion. Before the World War gold coins were widely used as pocket money throughout the more prosperous portion of Europe and in western United States. They could have been employed elsewhere in this country, but a preference had developed for the more convenient paper money. In the West adherence to gold coins was a carry-over from the old days when, during and after the Civil War, paper money had fallen into disrepute.

In the 14 years before the war the European Continent showed some slight tendency toward the increased use of paper money. However, the central banks were, for the most part, forbidden to issue paper currency in small denominations, hence the chief reliance of the public was on gold and silver[1] coinage. In England the lowest denomination of Bank of England notes was £5, about $25. The prohibition of smaller denominations of paper money in Europe seems to have grown out of a desire to protect the man of slender means from loss in case the issuing bank failed to meet its obligation.

It is possible that the whole civilized world would soon have come to the use of the more satisfactory paper money by this time in the natural course of events; as it happened, however, the exigencies of the war made such a course compulsory. Both in the United States and the rest of the world gold was impounded immediately at the outbreak of hostilities. The reason will be seen presently.

Representative money, the second of the three general classifications, is traceable to the goldsmiths, the first private bankers of Europe. People used to leave their money—that is, their gold or silver coins or bullion—with the goldsmiths for safekeeping, and the goldsmiths used to give them in return written acknowledgments, or receipts. These acknowledgments, since they represented claims on specific amounts of gold or silver, soon became widely acceptable in place of money.

Then the goldsmiths made a simple, but epochal discovery. They discovered that only a small percentage of the holders of such receipts ever wanted their gold at one time. They thereupon started the practice of issuing receipts in excess of the amount of bullion which they held, lending these surplus "bank notes" out at interest. They not only added a new and profitable field of banking to their original function, but at the same time laid the foundation of the modern bank-note issue.

Though the principle of issuing money redeemable in gold was sound so long as adequate gold reserves were maintained to accommodate those persons who might, from time to time, wish to convert their paper into gold, it was naturally subject to abuse.

The tendency was to issue as many notes as possible, since these notes were lent out at interest. So bad were these abuses that in most countries the privilege of note issuance early came under close State supervision, and today it is reserved generally to the central banks. Nor are even the central banks permitted to issue notes to their heart's content. So long as the countries of their domicile are on the gold standard they must not issue so many that the convertibility of the notes can be seriously questioned. There are numerous methods of assuring such convertibility. In Great Britain, for example, the Bank of England may issue up to £240,000,000 of notes secured by Government paper, but beyond that every pound note must be backed 100 percent by gold. In this country the law is that the Federal Reserve System must maintain a 40-percent gold reserve; that is, $40 in gold for every $100 Federal Reserve notes outstanding.

Whatever the mechanism employed, the purpose of maintaining an adequate reserve of gold behind the note issue is always the same. It is to guarantee that the currency will be redeemed in gold at the holder's option. This exchangeability of a country's currency at all times for its gold equivalent is what we have in mind when we say that a country is on the gold standard.

(At the time this article is being written—in September 1933—the United States is, temporarily at least, off the gold standard. As a result of the banking difficulties which culminated on inauguration day, March 4, in a Nation-wide banking moratorium, the Government announced that, in order to conserve the country's gold reserves, gold would not be paid out for currency or for export abroad. Similar action had been taken a year and a half earlier, Sept. 20, 1931, by Great Britain as a result of foreign "runs" on the gold reserves of the Bank of England. A number of lesser nations followed the action of Great Britain.)

The reader may ask: If our currency is issued by the Federal Reserve banks in the form of Federal Reserve notes, how is it that one of the bills in my pocket

[1] This was, as will be seen below, a form of representative money.

bears the statement that it represents 1 silver dollar and a legend to the effect that the Seventh National Bank, of Wilkes-Barre, Pa., will pay the bearer $5 on demand The answer to these and similar questions that might be asked is this: Although the Federal Reserve note, issued by the Federal Reserve banks and backed by a gold reserve of not less than 40 percent, is the backbone of the currency today, our system is still cluttered up with the remnants of earlier stages of our monetary development and abortive monetary experiments. Silver certificates, "Treasury notes of 1890", United States notes, Federal Reserve bank notes (not to be confused with Federal Reserve notes) and national-bank notes. It is not possible to discuss the origins and status of all these outmoded forms of currency here. For present purposes it is necessary only to point out that although they have been permitted to remain in circulation, their amounts may no longer, except in the case of national-bank notes and Federal Reserve bank notes, be further increased. The Secretary of the Treasury is compelled by the law of March 14, 1900, to keep all kinds of money at parity with all other kinds, so that these miscellaneous forms are all ultimately redeemable in gold while the country is on the gold standard.

In addition to bank notes there is one other form of representative money. That is what is known as "token money", and comprises the subsidiary coinage which is used for the smaller everyday business transactions—the nickels, dimes, and quarters with which we pay our subway fare and for our movie seats. Token money is coined by the United States Mint on order of the Treasury when and as needed. Token coins, unlike the gold coins that circulated more or less freely before the war, is not real money because the actual value of the metal that it contains is less than the face value of the coins. The latter circulate by custom and as a matter of convenience even though they are not accepted as legal tender in unlimited amounts.

The third type of money that we have is what is known as "deposit money" or "credit." It is represented by the bank check, drawn against a bank deposit, and in the business world of today it far surpasses in volume and importance the representative money employed in hand-to-hand business transactions. In normal times, it is estimated, upward of 90 percent of all domestic business settlements are made by means of checks. This being so, it is important that we should understand clearly the source of this form of "money."

Many persons have a notion that a commercial bank is an institution which is set up with a certain amount of capital, and that its deposits are brought in in the form of cash by its customers, to be drawn against by check as needed. It is true that some deposits do come to the bank in that measure; but if that were the only source of deposits our monetary system would consist today of only about $10,000,000,000—the amount of its gold and currency—instead, as it does, of more nearly $444,000,000,000.

The vast majority of the bank deposits of the country are not brought in to the banks but created by them. For example, a storekeeper wishes to stock up for the Christmas trade. He goes to his bank and makes a loan, giving the bank his note, payable at such a time as, presumably, the goods shall have been disposed of to his customers. Now, the storekeeper does not draw down the proceeds of his loan in cash. What happens is that the bank credits him with a deposit in that amount, and he gradually writes checks against it as he needs it. It is in this manner—through the extension of business loans—that the bulk of our deposit money or credit comes into being.

Just as there is a limitation placed on the amount of representative money (Federal Reserve notes) that the central banks may issue, so is there a limit on the amount of deposit money that may be created by commercial banks. Member banks in the Federal Reserve System must maintain average reserves with their district Federal Reserve bank equal to 10 percent of their deposit liabilities.

Let us see, now, how the modern banking system has taken a given amount of real money—gold—and enabled it, as a monetary reserve, to do a great deal more than it could have done in the way of work had it been continued as a circulating medium.

Since, under our laws, currency can be issued against a 40-percent reserve of gold, it is clear that whereas $1 in gold in circulation is just a dollar, $1 employed as reserves permits the issuance of $2.50 in currency. But the use of deposit money, or credit, makes it possible to stretch our gold much further. For, obviously, if it is only required that member banks carry a 10-percent reserve against deposits $10 in "money" of this sort can be created out of every $1 in gold.

But even this is not the complete picture. The mobilization of our gold in the Federal Reserve banks has added still further to the work that gold can do. To understand how this comes about, however, we must turn a moment to an examination of the mechanism by which the member banks do their banking with the district reserve banks.

Essentially they do it much as one of their own customers does business with them.

For example, if George Jones needs cash, he goes to his bank and draws out some that he has on deposit. But, suppose he wants cash but has none at the bank. In that case, assuming, as we must for purposes of analogy that his credit is good, he borrows at the bank, the latter setting up a deposit against which he may write checks. (See the discussion above of deposit money, or credit.)

A member bank in the Federal Reserve System needing more currency does precisely the same thing. If it has a deposit balance at the Federal Reserve in excess of the 10 percent required as reserve against the deposits of its customers, it simply draws down what it needs in the form of currency, reducing its reserve balance by that amount. Otherwise, under certain restrictions which need not be gone into here, the member bank borrows from its regional bank by rediscounting with it some of the discounted notes that it holds for its customers.

When a member bank does not need currency, but wishes to expand its own loans (deposits) it may likewise borrow at its district Reserve bank. The only difference in this case is that it withdraws no currency; its reserves are simply marked up on the books of the Reserve bank by the amount of the loan.

Let us see what has happened now, so far as increasing the usefulness of the gold dollar is concerned. The Reserve bank, it is clear, can "create" reserves for the member banks just as the latter can "create" deposits for their customers. How does this work out mathematically? Well, the Reserve bank must keep a reserve of 35 percent in gold[2] against its deposits, or $1 in gold against every $2.85 in deposits. But for every dollar of those deposits—since they represent the reserves of the member banks—the member banks may create deposits of $10. Therefore, in theory at least, $1 in gold in the vaults of the Federal Reserve System may, when used as a reserve against the latter's deposits, provide the basis for $28.50 in deposit money, or credit, in the member banks!

From the foregoing it will be seen that under our banking system the Federal Reserve banks provide the ultimate limits of monetary expansion—using money in its broader sense of both currency and credit. It remains to say a word about two mechanisms with which the system exercises some degree of control in addition. One of these mechanisms is the so-called "rediscount rate", loosely referred to at times as the bank rate; the other is the mechanism known as "open market" operations.

It has been observed above that when member banks lend heavily (thus creating deposits in the same amount) they turn to their district Reserve banks and borrow in order to keep their reserves up to the legal limit. By raising or lowering its rediscount rate, i. e., its charge for such loans, the regional bank can, and does, act either to encourage or discourage such borrowing.

The open-market operations consist in buying or selling Government securities in substantial amounts in the open market—in other words, from those dealers who act as a clearing house for this type of security. When such a dealer is paid for the Reserve's purchases he presumably deposits the check with a member bank. Since this check is a check on the Reserve bank it serves to build up the member bank's reserves and thus to add to its lending (deposit creating) power. Hence, a policy of open-market purchases on the part of the Federal Reserve System has the same general purpose as a low rediscount rate; that is, the purpose of stimulating lending. It will be at once clear that a reversal of this policy—heavy sales of Government securities by the Federal Reserve—would have the opposite result, hence would be regarded, along with the establishment of a high rediscount rate as evidence of a "tight money" policy—a desire to curtail, rather than expand, the supply of bank credit.

Senator Glass. Do you think the New York Herald Tribune would like to be responsible for the New York Stock Exchange in 1928 and 1929?

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[2] Or lawful money.

Mr. WARD. No, my good Senator. I think that the New York Herald Tribune, in an honest hour, sent to its advertisers an appeal on the strength of the paper in the Street, and somebody, not guided by the hand of propaganda, proved that he knew something of the money question. He hit it on one page, from the people, and they published it in four pages, which is the finest essay on the monetary system that I have ever read, and I have cracked the books for 25 years.

Doctor Miller told you he was against a commodity dollar, and his chart was an almost even line and level of commodity prices, during which period profits were not distributed but were used in speculation, in the wildest speculation that this country ever knew.

I want to devote a few minutes to Alexander Hamilton, because Alexander Hamilton is my best authority for the Nye-Sweeney bill.

Senator GLASS. Do you think so?

Mr. WARD. I do.

Senator GLASS. I noted that you failed to quote Alexander Hamilton in his statement that the ownership of a central bank should unquestionably be in private hands, and that if it should be in the Government's hands only a miracle could avert disaster. Have you that quotation there?

Mr. WARD. I am not quoting that one, Senator. [Laughter.]

Senator GLASS. Excuse the interruption. Go ahead.

Mr. WARD. That is perfectly acceptable.

I am quoting Alexander Hamilton on the money question. He wrote to Governor Clinton on May 4, 1783, favoring a central authority to gather the creditors of the central Government into a corporation of a central bank which would contribute "an increased circulation without which the people would be disabled from paying the taxes for want of the sufficient medium."

Gentlemen, we are suffering in this country from a paucity of money, and one of the distinguished members of this committee disagrees heartily with me, and says "Ward, we have practically the same amount of money in circulation today that we had during the last decade."

I beg to differ with the Senator, who has more money than I will ever dream of; but the fact is that we had 23 billion dollars in 1929, in demand deposits, in check-book money, in bankers' credit, pure fiction money, and 3 billion dollars of real money in the banks, behind which there was only 10 percent, under the law, in currency and reserve. This 23 billion was issued against a 10-percent reserve, and, of course, the securities that the borrower tossed in through the wicket.

Chrysler stock was selling at $3 under the name of Maxwell at the beginning of the decade and rose to 140. All any man in America did was to shove it through the wicket of a bank, accompanied by a promissory note, and get a dollar and a half in the early twenties or $70 a share toward the end of the decade.

He made a loan and was credited with a deposit. The security was there and against this security he was given the right to withdraw and twenty-three billions of this kind of money was issued by the private banking concerns of this country and existed in the form of demand deposits in the year 1929.

That kind of money does 95 percent of the business of America and when that kind of money is withdrawn from circulation, when the private banks of this country call their loans, then the owner of that security must pay back to the bank not in the counterfeit check-book money, the fiction money of the banker.

The gold and silver and coin and bullion and Federal Reserve notes and Treasury notes and certificates, issued under the authority of Congress will be the only kind of money the bank will take in repayment of such a fiction-money loan.

The bankers of this country demanded the repayment of these promissory notes in cash, and the only way to raise cash is to sell the security.

It doesn't take a Federal Reserve expert, nor a banker, nor a monetary authority to explain to the people of this country what happens when deflation sets in. Chrysler stock was up from 3 to 140; General Motors from 15 to 150, with the stock split time and time again, and then was devaluated until both sold well below $10 per share.

The $22,000,000,000 of demand deposits in this country shrunk to $15,000,000,000. This was a shrinkage of over $7,000,000,000 in the actual money of this country, the credit money, the money which is in the control of the private banker.

When this type of money disappears there is only one thing for a nation to do and that is, replace it by actual money, if you want business to keep going.

Such a thought is considered radical; such a thought is considered inflationary; such a thought brings forth the press of the Nation with its special writers on the continental currency of our Revolution, forgetting that the Revolutionary Fathers won the war, and the only kind of money available was a pure fiat, irredeemable paper currency with nothing but the full faith and credit of the people behind it, and forgetting that the fathers were inspired to write the Constitution by Pelatiah Webster's pamphlet on a Central Bank.

Senator GLASS. Did they not win the war on the coin that France loaned us to pay our troops off, in order to get them to Yorktown?

Mr. WARD. Well, they had $7,000,000 of foreign money, and it was at 10 percent interest. It had a great deal to do with it.

Senator GLASS. But it was the first money that the continental troops had seen for nearly 2 years, was it not?

Mr. WARD. That is true, but they stood at Valley Forge with nothing but the paper, and Howe was in Philadelphia with the gold, and the two were competitive. There was luxury in one, with everything for the Army. There was no shortage of food. Howe ate, and he ate well, on the gold. Washington starved on the paper. I will admit that freely. But the point is that they used the only kind of money there was to use, pure fiat money.

Senator GLASS. I did not ask the question in a controversial sense.

Mr. WARD. I know that.

Senator GLASS. But in a historical sense.

Mr. WARD. And I would give full credit to the foreign loans, and also recall that it was 10-percent interest, and also recall that they were repaid.

The writers in the newspapers and magazines of the country retell the story of the Confederate currency, as though the South had any gold or silver base to which they could attach currency. It issued in its hour of need the same kind of currency Russia issued after the revolution; the same kind Germany issued after the war; and the same kind that France issued after the revolution, and which every nation in the world will continue to issue if driven to economic destruction by the decimation of values through war or economic distress.

Gentlemen, we want to realize, if we are interested in this money question, that when you pick up the paper and get Andy White's book on French assignats, or the Saturday Evening Post, with the cartoons on the German marks and the rubles, and all the bunk on printing-press money, that they make no comparison in these instances with a nation that had billions of gold and silver bullion in a Treasury, free or unfree, 9 billions of it, against which $5\frac{1}{3}$ billions are issued in this country.

Sometimes I sit in the gallery of the Senate and watch the proceedings with tremendous interest. I listen to discussions about rubles, French assignats, Confederate currency, and Continental currency. I do not think any of you gentlemen are guilty of passing bad checks, but I imagine that if death faced you and you thought you might be able to cover if you got a few miles away, you might issue a rubber check. These nations that were destroyed—France, after the revolution—issued the only kind of money there was to issue.

Senator GLASS. The South did not have any Crown lands, and did not seize all the church property as a basis of its issue of currency. That is what France had to start with.

Mr. WARD. That is correct. But is not that money always to be expected in an hour of need? There is no comparison with the country today.

Senator GLASS. It did not do much good.

Mr. WARD. No.

Senator GLASS. I used to play with band boxes full of it after the war.

Mr. WARD. The point I want to make is this: Money is not wealth. It is merely the means of wealth distribution, and it is the function of the Government to issue the money of a country.

Senator GLASS. Mr. Ward, let me clear up one point in my mind, if you will?

Mr. WARD. Gladly.

Senator GLASS. You are opposed to checking accounts?

Mr. WARD. No; I am not. I am coming to that point of 100-percent deposit. I believe money is not wealth, and it should not be confused. Therefore, as an attribute of sovereignty, the Government should issue the money. Private bankers have usurped the power of Congress to coin and issue money and regulate its value. The real money of the country today is the check-book money, doing 95 percent of the work. We had 22 billions of it available in 1929. We lost 7 billions of it in the depression. We have today uncontrolled credit money inflation, and uncontrolled credit money deflation, with the intellectuals of the country cursing printing-press money. We need to recapture, or reassert the congressional power over money. We need to take the function of issue away from the banks and put it in a central bank of the United States, which shall have the power over the money and currency of the Nation. This power over currency and money controls the lifeblood of the Nation. It is the means of the concentration of wealth into the hands of the few.

Senator GLASS. Mr. Ward, would it be convenient for you to come back at 2 o'clock, in the Appropriations Committee room?

Mr. WARD. Gladly.

Senator GLASS. The members of the committee have to respond to the call of the Senate.

Mr. WARD. Gladly, sir. Thank you.

(Whereupon, at 12 noon, the subcommittee recessed until 2 p. m.)

AFTERNOON SESSION

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

STATEMENT OF LOUIS B. WARD, DETROIT, MICH.—Resumed

Senator GLASS. You may as well proceed with your testimony. It is difficult to get all the Senators here on time. We will read it and examine it. Before you proceed, however, I want to hand a telegram to the official reporter from Father Coughlin, to be placed at the beginning of your testimony to supplement what you said about his inability to be present. Do you care to see it?

Mr. WARD. Yes; thank you, Senator.

(The telegram referred to and submitted by Senator Glass is here printed in full, as follows:)

ROYAL OAK, MICH., *May 28, 1935.*

Hon. CARTER GLASS: Deeply appreciate your letter of May 18, which was opened just this minute. Mr. Ward will testify for the National Union and is delegated to speak for me. Serious circumstances at home prevent my being absent for sometime.

Cordially yours,

CHARLES E. COUGHLIN.

Mr. WARD. To resume, the problem of production has been solved in America. Again I refer to the testimony of Dr. Miller, who shows by his chart that year after year the cost of production is and should be lower. Yet we find a condition where 59 percent of the wealth of this Nation is concentrated in the hands of 1 percent of the people; where 26 percent of the wealth of this Nation is in the hands of an additional 3 percent of the people; and where only 15 percent of the wealth of this Nation is distributed over 96 percent of the people.

Picture 100 men lined up in formation. One man carries 59 percent of the wealth, three men follow him carrying 26 percent of the wealth, and the 96 that follow have only 15 percent of the wealth.

Picture it another way—a little group represented by 300,000 families in America having an average wealth of $393,000. Then there are 900,000 families whose average wealth is $57,000. Then a third group represents 28,800,000 families, the teeming masses of labor and agriculture, with a total average wealth of only $1,042 per family.

The Nye bill, S. 2162, attempts through monetary control to provide for the just distribution of the abundance with which the beneficent Creator has blessed us.

Senator BYRNES. What is the source of the information that you are now giving? Where did you get those figures from?

Mr. WARD. It is a combination of a study of income-tax returns on the one hand, together with statistics of the United States Government, in addition to the tremendous data selected with reference to the class that has nothing, out of the relief studies and the unemployment studies of the country. And when we say 59 percent, that is the best obtainable information that we have. Those figures are thrown with the figures of the National Industrial Conference Board of New York City whose figures are used by our Bureau of the Census; and the National Industrial Conference Board, Senator, has the only wealth census that I know of in the country. When I refer to the Census Department they in turn refer me to the National Industrial Conference Board. That is our stnadard source.

This bill attempts to restore to the Federal Government the control over all forms of money, over coin, currency, and credit. The Nye bill would take out of the hands of private individuals the power to inflate and deflate, and the power to value and devalue our national wealth. The answer lies in the proper distribution of our wealth by maintaining the purchasing power of money at a fixed and equitable level.

Our aim is to restore the value of property to just levels, and our bill likewise provides a means of regaining the lost billions of evaluation between the 200 billion we have today and the 488 billion of national wealth we had in 1920. It is the same property. It is revalued at the 200 billion.

Since 1760, the dawn of the industrial revolution, men have addressed their minds to the solution of the problem of production. That problem is solved—solved to the extent that men complain of surpluses. There are organisms high in the councils of this Government that would throw back into the face of the Creator the gifts He has given us. These men set about to destroy our real wealth in cotton, in wheat, in hogs and cattle, just as the private banker destroyed credit in 1929. These men refuse to develop the natural resources. They permit, for example, the St. Lawrence River to rush headlong and unharnessed to the sea, lest an abundance of power be developed, or economical access be available to our land-locked central West.

On the parallel problem of distribution of wealth, no effort is being made except by the Communists or by the Socialists, and by a handful of progressive minds who recognize that God blinds the eyes of reactionaries to the possibility of bloody revolution. In the literature of France no one predicted the French Revolution. In the literature of Russia no one of the old royalty dreamed of revolution.

To the true conservative, he who wishes to conserve the American heritage, the just distribution of wealth is wholly as important as its production. Literally millions of minds have contributed to the solution of the problem of production, and there are only 531 minds in all America directly charged with a true solution of the problem of the distribution of wealth. These are the Members of Congress who were given, under the Constitution, the power to coin money and regulate the value thereof and of foreign coin, and who have permitted this power to go squarely into the hands of the private bankers.

I do not believe in panaceas, but I do believe that the money question is the most important question, the most momentous question of the hour.

I would like to quote Hamilton again. Hamilton was faced with the question of placing the taxing power in the hands of the States in the year 1787. He was faced in that same year with a foreign debt of over 7 millions of dollars, borrowed from Europe at 10-percent interest. Hamilton said, and I quote him:

> We are willing to grant the money but not the power required from us. Money will pay our debts; power will destroy our liberties.

These are good words to remember today.

The power over money when left in other hands, other than Congress, will and has destroyed our economic security. Hamilton knew the function of money. He said, and I quote him directly:

> The paper money of the State of New York in most transactions is equal to gold and silver; that of Rhode Island is depreciated to 5 for 1; that of North Carolina to 2 to 1; that of South Carolina may, perhaps, be worth 15 shillings in the pound.

In his speech upon the impost grant—and I quote from the Federalist—he said:

> The legislature having thought an emission of paper advisable, I consider it my duty as a representative of the people to take care of its credit. The farmers appeared willing to exchange their produce for it. The merchants, on the other hand, had large debts outstanding. They supposed that giving a free circulation to the paper would enable their customers in the country to pay, and as they perceived that they would have it in their power to convert the money into produce, they naturally resolved to give it their support.
>
> These causes combined to introduce the money into general circulation, and having once obtained credit, it will now be able to support itself.
>
> The chief difficulty to have been apprehended in respect to the paper was to overcome the diffidence which the still recent experience of depreciating paper had instilled into men's minds. This, it was to have been feared, would have shaken its credit at its outset; and if it had once begun to sink, it would be no easy matter to prevent its total decline.
>
> The event has, however, turned out otherwise and the money has been fortunate enough to conciliate the general confidence. This point gained, there need be no apprehensions of its future fate, unless the Government should do something to destroy that confidence.
>
> The causes that first gave it credit still operate and will, in all probability, continue to do so. The demand for money has not lessened, and the merchant has still the same inducement to countenance the circulation of the paper.

I picked up today a 10-dollar bill, national currency, secured by United States bonds, deposited with the Treasurer of the United States of America. Underneath those words it says, "or by like deposit of other securities. The Federal Reserve Bank, St. Louis. Ten Dollars."

There was a question asked of Mr. Morgenthau, the honorable Secretary of the Treasury: What other securities? It was asked by a United States Senator, the coauthor of this bill; and the answer of the Secretary of the Treasury was to the effect that it would be very difficult to find out what securities.

"Are Insull securities behind that particular note?" was the specific question; and the honorable Secretary answered that he could not tell except after an exhaustive survey.

No one questions the circulating value of that 10-dollar note. What we question is that when Father Coughlin or the National Union goes before the people of the United States asking that Congress assume authority over the currency of the United States we find the private banking system that secures its currency by bonds of the United States on which the United States pays interest, and we find on one Federal Reserve note that this is redeemable in gold on demand at the United States Treasury, and we know that it is not. The rest of the sentence is " or in gold or lawful money at any Federal Reserve bank "; and there is an open public distinction on where you redeem that type of currency. That is redeemable in gold. There is no fiat money there. That is 100-percent gold redemption. If you walk into the Treasury or if you walk into the Federal Reserve bank, it is redeemable in another one of the same type—gold or lawful money.

Senator GLASS. The lawful money is redeemable at the Treasury in gold.

Mr. WARD. This [indicating] is lawful money.

Senator BULKLEY. It used to be.

Senator GLASS. I mean, it used to be, of course. I have stated all along that we are on a fiat basis now.

Mr. WARD. What we stand for is simply——

Senator BULKLEY. I do not see the point that you are making about that. Of course that is not good now; that redemption clause does not hold good.

Mr. WARD. But when it was good, it was good, Senator, in gold at the United States Treasury, and if you went to the bank it was good in paper money.

Senator McADOO. If they chose to give you paper money.

Mr. WARD. But this is the redemption feature of this money. It is redeemable either in gold or in lawful money.

Senator BULKLEY. What is the point? I do not see what you are driving at.

Mr. WARD. It is redeemable. There is the idea of redemption to distinguish it from fiat money. The idea is that it would be redeemable in metallic money, gold and silver, to distinguish it from paper.

Senator BULKLEY. Of course, it used to be redeemable in gold, before we went off gold.

Mr. WARD. At the Treasury.

Senator GLASS. Or gold or lawful money at the bank. But the lawful money, in turn, was redeemable in gold. The reason for that, or the mechanics of the thing was, that banks did not care to carry so much gold. The Treasury had the gold. So they gave them lawful money, and if they wanted gold they could go and get it. I have no doubt they could have gotten gold at the banks, too.

Mr. WARD. There is no criticism of that whatsoever. The only thing we ask is that that prerogative of issue be recaptured by the Government of the United States.

Senator McADOO. May I ask you a question now?

Mr. WARD. Yes, Senator.

Senator McADOO. You say you want the prerogative recaptured?

Mr. WARD. Yes, Senator.

Senator McAdoo. All money in this country is now issued by the United States, of course. It is a Government obligation to pay on demand the face of the note, either in gold or in lawful money——

Senator Bulkley. Except the national-bank currency which is about to be retired.

Senator McAdoo. But even that the Government of the United States is back of. It is secured with Government bonds back of it. Now, to what extent do you mean that the Government shall recapture the prerogative, since it is exercising its prerogative to issue paper money?

Mr. Ward. This morning, Senator, I tried to emphasize the fact that 95 percent of the money was not currency, but was credit money, deposit money, pure fiction money, that does the work of this country, and I have now gotten into this slight comment upon currency.

Senator McAdoo. You mean, bank checks? Is that what you are driving at?

Mr. Ward. Yes.

Senator McAdoo. Would you have the bank-check currency replaced entirely with Government issue of money?

Mr. Ward. Absolutely, 100 percent behind those deposits, secured precisely in the same way——

Senator McAdoo. I am just trying to figure out in my own mind how that can be done. I am only trying to develop your idea. When you take $100,000 of bank-check currency of the United States and use it in all business operations, how could you supplant that altogether with currency?

Would not that slow down business transactions enormously?

Mr. Ward. I do not think so, Senator.

Senator McAdoo. For instance, as it stands today, I earn my salary I hope. At any rate, the Government sends me a check. I deposit that in a bank. Somebody sends me a bill for a pair of eyeglasses, or some evidence of old age, and I pay it. Suppose it is $9.20. It is a very great convenience to me to be able to write a check for that amount and send it in the mail instead of paying it in currency.

Mr. Ward. I would not interfere with that for anything in the world.

Senator McAdoo. How would you supplant the bank check with currency?

Mr. Ward. In this way, Senator: That type of deposit through the wicket of the bank represents money in commerce and industry. We have no criticism; no attack. It is the normal, natural, economic, business way to proceed. But when the Senator deposits that money which he has earned, the thing that we object to is having that real money used as a 10-percent basis for the issue of credit out of a bank and to permit that bank to take that $10,000 and make it the basis of a $100,000 loan.

Senator Bulkley. Do you think banks ought not to loan money?

Mr. Ward. I certainly think they should lend, but I do not think banks should have the ability to create money.

Senator McAdoo. You mean the bank can borrow $100,000 from somebody?

Mr. Ward. No; I mean that they can create on the basis of your $10,000 cash a $100,000 loan and issue to anyone who hands them a promissory note and the proper security, Senator, against the securities of the borrower $100,000 in credit or check money.

Senator McAdoo. Provided, of course, they get the security for it?

Mr. Ward. I say, against security.

Senator McAdoo. The borrower has to supply securities that are satisfactory to the bank?

Mr. Ward. Yes.

Senator McAdoo. If he did not do that, what other method of getting money from the bank is available, if any?

Mr. Ward. The unsecured only. That is the real way that deposit money is created. It is money; it is real money issued against the securities of the people; and they usually charge around 6 percent for it. Ninety percent is created money. The Government does not participate in that creation; it does not provide for that type of credit. It is in private hands. It is a function of sovereignty.

Senator McAdoo. I may be dense, but I want to see if I can grasp your idea, of course.

Mr. Ward. Maybe I am abstruse.

Senator McAdoo. You say the bank can issue $100,000 of credit against a $10,000 deposit. Let us assume for the sake of the discussion that that is true. They can only issue credit to that extent, provided somebody borrows the money and because the bank accepted security for it, whether it be that man's personally endorsed note or collaterally secured note or what, so long as it is, in the judgment of the bank, a satisfactory security for the amount.

Mr. Ward. That is correct.

Senator McAdoo. The bank then lends you $100,000 and it goes to your credit in the bank and you can draw checks against that?

Mr. Ward. That is correct.

Senator McAdoo. If that process were not followed, how would the borrower otherwise be able to get the $100,000? I mean, how could the Government's intervention enable him to get it in some other way that would be satisfactory?

Mr. Ward. I am leading right into that directly as I go along, Senator. If you want the answer immediately——

Senator McAdoo. I think it would be well if you would just give it here in answer to the question.

Mr. Ward. The Government of the United States has floated already some 30 billions of bonds, and it has sold those 30 billions of bonds, though there never is over 6 or, at most, 7 billion dollars in actual money, currency, existing in the country. That 5 billion and a quarter, or 6 billion a while ago, is not in circulation.

Senator McAdoo. The currency is not?

Mr. Ward. No; we know that. We know that of $5,400,000,000 actual money in this country the banks themselves have about $670,000,000, approximately, at the last statement of the Comptroller or the Federal Deposit Insurance Corporation.

Senator McAdoo. Where is the rest of it?

Mr. Ward. The $670,000,000 is not in circulation and it is not loaned. It is till money. There is in the country approximately $1,000,000,000 in the hands of storekeepers. That money cannot be kept in circulation in the sense of not being needed for change and for day-to-day transactions. In another sense it is money that is in circulation, getting back to the bank and into the hands of the people.

Senator McAdoo. It is bound to circulate.

Mr. Ward. We have in the homes of the people, roughly, another billion of dollars——

Senator McAdoo. On that point I am rather interested in knowing how you arrive at the amount that is in the homes.

Mr. Ward. You have the A. & P. in this country; and when I did a little work on that account they were doing $400,000,000 a year business. They were just coming up, doing a cash business with the home over the counter. There are 23 million motor vehicles running, and it is very difficult for even the distinguished Senator to drive from Washington to California without paying cash.

Senator McAdoo. I know that that is a correct statement.

Mr. Ward. That is one that is admitted. Credit is given some. Garfinckel, perhaps, with his trucks may have credit with a filling station. Maybe we can throw away three million as not doing a cash business. But here is an industry that has come up in the last generation. It did not need any cash expenditure for the horse and buggy. Twenty-three million of them, and the cash expenditure approximates $250 per year per car. Say that car goes 8,500 miles. That cash has a turn-over. It does not all stay in the hands of the gasoline station attendant, naturally. But those are the large items. New York City had a million transients a day in the last decade. The hotels in the country are doing a volume of $900,000,000, which is largely cash where I have been.

Senator McAdoo. How do you deduce from that that $1,000,000,000 is in the homes?

Mr. Ward. Because I approached it that way, and I approached it by labor and wages——

Senator McAdoo. You mean, it is just an arbitrary estimate of your own?

Mr. Ward. If you want to call it that way—an arbitrary estimate. I know there is five billion and a quarter of that currency. I know that you cannot find over $670,000,000 in all the banks of the country. Therefore $4,800,000,000 is outside the banks. Who has the $4,800,000,000? Foreign travel is one check on it Laborers, who do not have bank accounts—what they earn is another check on it. The service fee on bank accounts has reduced the number patronizing the banks.

Senator McAdoo. We know, in any event, that we have got more than four and a half billion dollars of currency in circulation in this country outside of the Treasury. We know that.

Mr. Ward. Five billion four hundred million.

Senator McAdoo. About 5 billion 300 million dollars of currency in circulation outside of the Treasury. That is what we commonly call circulation in the hands of the people, because it circulates among the people. I was just interested in your estimate of $1,000,000,000 as being in the homes. Of course if it is in the homes, unless it is hoarded, it is a part of the circulating medium.

Mr. Ward. I admit that.

Senator McAdoo. I do not yet see how you meet the question I asked upon which the discussion arose as to how you would supplant, through governmental intervention, the bank credits which the individual now procures, when the only way in which he can borrow money is to borrow it from a bank or an individual who has it or from somebody who has it——

Mr. WARD. They would issue currency.

Senator McADOO. If they issue sufficient currency to do that, you would expect that the individual would borrow the money direct from the Government? Is that the idea?

Mr. WARD. No; I would not expect that. I would take the $30,000,000,000 worth of Government bonds now in the country, which I think the distinguished chairman suggested, 60 percent of those in the hands of the banks, or $18,000,000,000 of United States Government securities on which the people are paying interest in the banks, to be used as a basis for the printing of enough currency to back the demand deposits in the banks 100 percent. There is no interference there with the check-book privilege. It is 100 percent reserves; and the function of that is to stop a bank taking your $10,000 in currency, actual money, and building it on the 10 percent reserve theory and principle to $100,000 check-book money, $90,000 of which was created by the banks and by the printing press.

Senator McADOO. It was not created by the bank. It is created by a bank getting adequate security.

Mr. WARD. Absolutely.

Senator McADOO. The extension of credit.

Mr. WARD. That is correct.

Senator McADOO. What I am trying to get through my brain is how you are going to find a successful substitute for that method of doing business with a bank. I repeat, I am only trying to develop your idea so that I can grasp it. I am wondering how the mere issue by the Government of all this currency would affect the question of credit extension through a bank.

Mr. WARD. Well, if I have the securities and go to my bank with a hundred-percent deposit, the banker has all the ability in the world to grant me credit on those securities in the form that they then are. I may have a municipal bond—or no matter what it is, he has an endless supply for a long time to come of governments to turn into cash to back that type of loan.

Senator COUZENS. Assuming that to be true, just what effect would that have upon the Government? If I approach a bank and offer them $100,000 worth of security, your idea is that they should give me $100,000 worth of printed money, currency?

Mr. WARD. Yes; certainly.

Senator COUZENS. So instead of getting a check-book credit that you are talking about, I get $100,000 in Federal Reserve notes or Government notes, or whatnot. Just what difference does that make, so far as the effect upon the commerce of the country is concerned.

Mr. WARD. All right, Senator. We start with the year 1929, as an example, with $22,000,000,000 in deposit money. We have behind that deposit money $2,200,000,000 in currency, and, of course, behind that deposit money is the security of the borrower. That currency circulates in this country just the same as that type of money.

Senator McADOO. You mean check currency?

Mr. WARD. Yes. A minor distinction. But there is 95 percent of the business of the country in this minor money. In 1929 the bankers decided on a contraction. The only thing they had to do was to call loans; but for every loan that is called an equal amount of money disappears out of circulation. For example, in the depression they called $7,000,000,000 worth of this check-book money. They reduced the currency of the country precisely $7,000,000,000.

Senator McAdoo. You mean the check-book currency?

Mr. Ward. Surely; the money of the Nation, check currency, credit money of the Nation. That had the effect that everybody in this room is conscious of and that the automotive industry can chart, as I showed the committee this morning, the collapse of business; that some banker can at a predetermined date decide to extend credit and take in securities, and against those securities grant the right to withdraw; and that right to withdraw is the basis of this check-book money once again.

If the banker in 1929 decided to contract, he has not only his capital and surplus that were put into the business, he has had also the currency that is deposited, and against those three items he has predicated 22 billions of check-book money.

There never was $22,000,000,000 in this country. What we would like to do, of that hundred-percent deposit, is to have that banker who owns $18,000,000,000, perhaps—and that is the Senator's figure the other day—of United States bonds, coupon interest-bearing tax-exempts—take them and turn them in for the issue of currency against them.

Senator McAdoo. You would retire the bonds by issuing currency; is that the idea?

Mr. Ward. Yes. That money does not go into circulation. It goes into the banks.

Senator McAdoo. If you issued $18,000,000,000 of currency and retired an equal amount of interest-bearing bonds, of course, the currency would not bear interest?

Wr. Ward. That is correct.

Senator McAdoo. If you did that, you say the currency would not go into circulation?

Mr. Ward. It would not. It would replace security that is there today. That hundred percent deposit would be just stepped up, the cash reserves, from 10 percent today to 100 percent then.

Senator McAdoo. All right.

Senator Bulkley. That would make the hundred percent reserve all right, would it?

Mr. Ward. Yes.

Senator Bulkley. Loans outstanding are only about $18,000,000,000 today?

Mr. Ward. Yes. The deposits dropped from 22 to 15.

Senator Bulkley. What about the loans?

Mr. Ward. Those are the demand deposits. They dropped from 22,000,000,000 to 15,000,000,000 in the depression. We lost seven and a fraction billion dollars.

Senator Bulkley. Are you talking about all banks or national banks?

Mr. Ward. All the banks in the Federal Reserve System. We built deposits, including time deposits, to $58,000,000,000 in 1929. We have got the same wealth in this country, and we devalued everything and destroyed that money, and we are where we are.

Here we have an individual bank, a member of the Federal Reserve System, permitted under our law to create money, check-book money, and a 10-percent reserve system. An individual member bank in time of depression has orders to go to the Government of the United States and seek relief from the R. F. C. In turn the R. F. C. loaned to the banks in this country nearly $900,000,000 in capital subscription, loaned in the form of subscription to preferred stock and aside from any loans of the assets of these banks.

We have the Central Bank of the United States of America. It is the Reconstruction Finance Corporation. It is limited to the function of loans. It has bailed the railroads out of bankruptcy; it bailed the banks out of bankruptcy and the insurance companies out of bankruptcy. Over in another department we have the Comptroller's Office with its power of regulation and examination of national banks. We have the Federal Deposit Insurance Corporation; and if I heard correctly before I went on the stand this morning I heard a banker ask this committee to reduce or to waive insurance of deposits for a couple of years, so the banks could——

Senator McAdoo. To reduce the payment of premiums for a year.

Mr. Ward. To one-twelfth or one-eighteenth for a year. We have the Home Owners' Loan Corporation, and we have the Federal land banks and endless governmental banking functions. Over in the Treasury we have nine billion in monetary stocks, and we still have the Constitution and we have the power of Congress coining and regulating the value of money. There is no reason in the world why we cannot combine all of that into a central bank.

With those rather extended remarks I want now to discuss the Nye-Sweeney bill.

The bill creates a central bank, known as the Bank of the United States of America ". Section 2 makes this bank the agency of Congress, with the function of issue and the function of controlling the value of money and the value of foreign moneys, as is directly outlined under the Constitution as a power of Congress in section 1, article VIII, clause 5.

The bill places the sole jurisdiction over the monetary stocks and moneys and the public credit of the United States in the hands of this bank. The bill makes this bank the central depository of all reserve funds of all banks under the jurisdiction of the United States.

The bill makes the bank the fiscal agent of the United States Government, and since the drafting of the bill the circulating-note privilege of national banks having been repealed, the sentence may now be omitted—the last sentence in section 2.

Section 3 attempts to set up an independent Board of Governors for the Bank of the United States. The committee has heard the testimony of Dr. Adolph Miller to the effect that pressure from two sources is continuously evident in the management of the Federal Reserve System.

In response to the request for information on the part of the senior Senator from Michigan, Dr. Miller suggested an executive session of the committee so that he might reveal the facts respecting the pressure from New York in times of inflation, and from the Treasury in times of deflation.

The public may well understand pressure that comes from New York, though the details are obscured in the manipulation of the money and credit of this country by the New York bankers and the members of the Federal Reserve Board, but political pressure from the Treasury of the United States on a Federal Reserve bank, generally in times of deflation, is little understood by the people. The fact that it exists along with the pressure from private banking interests makes one thing obvious—there is needed an independent board of directors of the Central Bank of the United States, free alike from the pressure of political influence and free from the domination of the New York bankers.

May I say here that I have no sympathy with the philosophy so current in the press of the Nation nor in the philosophy of the Manufacturers Association or the United States Chamber of Commerce or the American Liberty League or the American Bankers Association, that Government should keep its hand out of business.

The sovereign power to tax puts the Government into every business in the Nation. Business has come to Washington since the year 1818 at least, and from 1832 continuously, in behalf of protective tariffs for business.

The greatest banker in America was interested in government, as he secured our entrance into the World War for the protection of the credit of Great Britain whose fiscal agent he was.

The building industry wanted a housing act; the textile industry desires to shut out Japanese goods; the American match industry wants to compete with both Europe and Japan. Not only business but labor wants the Government to step in, and agriculture wants the Government to step in or out. The point is that this special please against Government activity is always on the part of those who profit most if left unregulated and to their own devices, and this is the case with the private banking interest of America who only exist because there is an R. F. C., the Government Central Bank today, which has bailed them out of difficulty.

The Nye-Sweeney bill attempts to set up an independent board, and for independence this board is modeled after the Senate of the United States, with equal representation from each State. The true wealth of this Nation is distributed over 48 States, but the concentration of money and credit is in the great banking centers of the country.

If the Congress of the United States truly seeks to divorce the power of money and credit from the great financial centers of this country, which have brought us where we are, one key is found in recognizing that banking is a service, and money is a method of wealth distribution, and money under our present private reserve system becomes the basis of credit, and the allocation of this credit follows the money reserves.

It is well to have on the board of directors of this Central Bank of the United States men who know the economic resources, the industrial situation, the labor situation, and the agricultural situation in every one of the 48 States, and we have suggested a board of 48, one from each State, elected for a period of 12 years, and upon election to be divided into classes so that one-sixth retire every 2 years. We have taken our language directly from the Constitution of the United States, as that Constitution originally set up the Senate of the United States. This is a board of directors elected by the people. It is this method of choosing the electors that will undoubtedly come under the attack of the enemies of this bill, or perhaps friends of the bill.

You will hear immediately that it is unconstitutional. You will hear that Congress cannot delegate any power to an elective board. You will hear that the President alone has the appointive power, by and with the advice and consent of the Senate.

You will hear immediately these criticisms, that the Senate is well supplied with great constitutional lawyers. The opinions of two of them were solicited, and they both suggested that they thought the plan was constitutional. It is merely, however, an attempt to secure independence; and perhaps a more certain way is to provide for the appointment by the President, by and with the advice and consent of the Senate, of one member from each State, trusting that only one-third will serve during any one administration. A board of 48 is not a large board. There are over 100 directors of the 12 Federal Reserve banks today. There are 531 Members of Congress theoretically legislating on banking, and over and above these regulations the Federal Reserve Board; and then there are 2,500 members of 48 State legislatures with authority over State-chartered banks; and the commercial State bank is just as much a party to check-book counterfeit currency as the national bank is.

In other words, gentlemen, we have over 3,000 minds with authority over banking in this country, and this bill aims at reducing that number to 48 directors of the central operating bank.

I will not pause at the details of salary, except to say that if the Board is to be independent its personnel must be rewarded; and, as Dr. Miller says, the career of banking must be the aim.

The Nye-Sweeney bill provides for the divorcement of the directors from all industry and financing, and the bill provides a liberal pension after 70 of $1,000 a year for each year of service as a director, up to a maximum of $12,000.

The board of directors under the Nye-Sweeney bill elects an executive committee of 7 to an executive board of the bank, and then the entire board of 48 appoints a president and vice president and other executive officers, examiners, economists, and banking experts as may be needed. The principal office of the bank would naturally be Washington, D. C., with branches in each of the several States.

Section 5 of the bill provides that all the currency of the United States shall be the issue of this central bank.

The senior Senator from Ohio asked Dr. Miller repeatedly for an expression of his opinion why the Government of the United States should not own the Federal Reserve Banking System. This question had been asked before of others by the committee. The question has been repeatedly dodged by such answers as: "Ownership is not important; it is the control, the administration, the men, that are important."

Certainly there is a profit in the Federal Reserve System. Originally Congress provided that 6 percent be paid and that a dividend be cumulative with all excess profit split 50–50 between the Government and the surplus of the Federal Reserve banks. The Government's share was in lieu of franchise tax. The act of 1933 amended this provision and put all profit over and above 6-percent cumulative into a surplus fund for the private bankers.

There is a hidden profit that goes with every right of issue to any bank.

When France called her currency in to revalue it, out of 81,000,000,000 francs, 20,000,000,000 had been lost.

What happens when a *Lusitania* sinks or a *Titanic* goes down at sea?

What happens when Chicago burns or San Francisco has an earthquake?

What happens when the Dillingers hide their loot and then are shot down?

Or the feeble-minded throw hoarded currency into the stove?

The hidden profit from lost money was approximately 20,000,000,000 francs in France or one-fourth of the total currency issue.

With $5,400,000,000 in currency supposedly "in circulation" in this country, the lost item alone would more than pay for the Federal Reserve bank stock, and if the truth were known the banks that own the stock—those of them that are now in receivership—may be found to be owing Jesse Jones far more than its face value today.

Section 8 provides for the purchase of the capital stock of the 12 Reserve banks and branches and agencies at the paid-in value of stock and 6 percent per annum interest from last dividend period. The section further provides the full and complete and absolute and unconditional ownership of the Federal Reserve banks in the hands of the people of the United States.

In answer to the question asked previous witnesses, may I call to the attention of the committee that the witnesses have merely emphasized that the important thing was the Board and not the ownership, and if the ownership is deemed not important, why then there is no reason whatever not to vest it in the hands of the people of the United States.

Section 10 declares that all banks doing a commercial banking business within the United States, all banks which have demand deposits, to be engaged in interstate commerce and subject to Federal jurisdiction; and section 10 bring these banks within the central banking rules and regulations.

There are many very thoughtful men who sincerely believe that the banker of this country cannot absorb many more billions in Government securities. They foresee proximate catastrophe in a 5- or 10-point drop in Government bonds.

They realize that such a 10-point drop in bond prices would bankrupt every bank in the United States should not the R. F. C. come to their rescue with a billion or more in additional loans.

Thoughtful men realize that further Government aid of this kind will destroy private banking in this country.

So the central banking principle and the issuance of currency to retire the Government debt take on a different aspect in the light of the present crisis. Central banking and expansion of the currency in the minds of many thinking men provide the only salvation for private enterprise in our capitalistic nation.

In this light, too, the interstate commerce clause, which by inference in recent Supreme Court decisions has been made to appear as a menace to free individual enterprise, appears as the one avenue to setting up a national control of banking which well may become the sole safeguard of private enterprise in the field of banking.

Clause b of section 10 writes into the bill the 100-percent reserve principle. In other words, it provides that every bank shall keep on deposit in the bank of the U. S. A. notes to the full 100 percent of demand deposits. It is this provision alone which builds the competitive monetary system to that of the United States of America. It is this provision that is just as important at this time as it was in 1862 to tax out of existence the circulating privilege of the State chartered banks.

It is this provision that requires that demand deposits shall be held in trust for the benefit of the depositors and not merged with or become a part of the assets of the bank, thus leaving the depositor a creditor, as the law leaves him today. It is this provision that reverses the whole theory of modern demand-deposit banking and permits a new day, where banking becomes what the people think it is, namely, a place to deposit your money and to withdraw it when one wants to; a place where money may be deposited and the title to it transferred by order, not merely the creation the lawful money reserve required against credit money.

Clause c of section 10 provides that the Central Bank shall purchase part of the debt of the United States and other public debt, and against it issue currency to the amount of the demand deposits of the country. The public debt at the end of this fiscal year will be approximately 34 billion dollars; the State debt is approximately two billion and one-half; the municipal and local Government debt is approximately 20 billion dollars.

Congress has lately authorized the United States debt to go as high as 45 billion. One of the greatest questions facing this Nation is, Who owns the debt?

The individual and the corporation are most solicitious about their creditors.

The committee knows that the banks of the country own 60 percent of the present United States Government debt. We know that insurance companies, endowment funds, schools, and universities own other billions, but a great question facing the country is, Who owns the remaining billions of United States Government bonds that are tax exempt, the ownership of which must be the source of opposition to many of our legislative policies—for example, the bonus. It must be the source of opposition to any expansion of the currency; of opposition to any central-bank idea or other so-called "inflationary measures"; or the opposition to the use of silver; or lower interest rates on farm mortgages; or any monetary or banking reform whatsoever.

This bill provides a use for Government bonds and a market for the Government bond, and permits the central bank to own a large percent of the United States debt and against it issue currency, not for circulation but to be placed in the vaults of the member banks, dollar for dollar behind every dollar of demand deposits.

With regard to the regulation of the value of money, section 11 of the bill permits the Bank of the United States to buy or sell gold, silver, and foreign exchange in the financial markets of the United States, and this power is granted to the central bank, as the agency of the Congress of the United States, in order to carry out the constitutional provision incorporated in article I, section 8, clause 5, "to coin money and regulate the value thereof and of foreign coins."

Section 12 puts supervision under the control of the central bank and puts the Comptroller of the Currency under the authority of the central bank.

Section 13 provides that the central bank shall have the full statistical data essential for a sound monetary system.

How do we find the cost of living today? We go to the Bureau of Labor Statistics. What do they know about it? Why, in 1918 they made a study, and the 1918 study is corrected from year to year by use of index numbers. It is passed on to every governmental department, it is used by the American Federation of Labor.

The basic statistical information was gathered 17 years ago, in the interval we have had 2 panics and 4 administrations. It is rumored they use over 700 commodities in establishing the price level, and the American people are so impoverished that the 96 percent of them who average $1,000 of wealth per family don't participate in 70 commodities, much less 700.

The central bank should have all the facilities for obtaining and compiling authentic data without depending upon politically appointed department heads for such vital information. If there were an independently controlled central bank today, free from political interference on the one hand, free from the private banking influence on the other, and a Senator or a private citizen wanted to know what was contained in the Dr. Beckman report, paid for by the people's money that Senator could have access to that report before it was politically doctored and then even suppressed to deny to Congress the truth.

Section 14 provides a mandate on the central bank to secure stable purchasing power of money on an equitable price level. The Republicans in 1920 placed in their platform the pledge to reduce the cost of living. They did it—they fulfilled their pledge; they withdrew from the circulating medium of the United States $1,900,000,000 in the 18 months that followed the inauguration of Mr. Harding, but they were not content with this. From February 1, 1921 to April 1, 1921, the demand deposits of the banks of the country were reduced $627,934,000.

The committee heard the testimony of Dr. Miller. And by 1923, when conditions had been built up considerably after 1921, the Federal Reserve feared prosperity and its open market depressed things for 1924, and that is reflected in that automotive industry study.

In 1927 it was time to rig the great bull market. The farm had been depressed since 1920; the building industry was shot from 1926 on, but with great production, together with modern efficiency, the price level could be kept low and the huge profits were directed not to the payment of a just and living wage for labor, not to the return of cost of production to the American farmer. They were poured into a speculative market and we boasted of bank deposits of 58 billion by 1929.

The banker was controlling the Federal Reserve Board in that period of inflation and it was left to the Treasury to influence that Federal Reserve policy in the period that followed. Why, the Government itself was induced to borrow itself out of trouble by the issuance of tax-exempt bonds, so that a debt which after the war had been reduced to 16 billion, which during the war was never over

26 billion, is now, at the end of the fiscal year, 34 billion, and permitted to run to 45 billion.

Section 14 provides suitable purchasing power of money by permitting the central bank to purchase the debt of the United States until there are 100-percent reserves behind demand deposits; and lest our fiscal policy be predicated upon debt, the central bank may control the price level, if necessary, by paying extraordinary and then the ordinary expenses of Government by currency issue until the average commodity price level reaches the index of the Bureau of Labor Statistics for 1926. Then the board of directors is charged with determining a true and equitable commodity price level and to regulate the volume of the currency so as to maintain such a level.

In the present Federal Reserve Act there is provision for the issuance of currency 2½ times the gold reserve. The United States Treasury has 9,000,000,000 of monetary metal in its vault. This can support, unchallenged by any modern banker who has supported the privately-owned Federal Reserve System—this 9,000,000,000 can support the currency issue of $23,000,000,000.

This is not fiat money; this is not an irredeemable paper money; this is not any more printing-press money than is any Federal Reserve note ever issued mere printing-press money.

Senator BULKLEY. Would it be redeemable in gold?

Mr. WARD. The same as your Federal Reserve notes.

Senator BULKLEY. Federal Reserve notes are not redeemable now.

Mr. WARD. No.

Senator BULKLEY. Your money would not be redeemable?

Mr. WARD. I am just showing the possibility of that metallic base under the Federal Reserve principle of 2½ to 1.

Senator BULKLEY. But the Federal Reserve principle was to have it redeemable in gold.

Mr. WARD. Yes.

Senator BULKLEY. Of course that has been departed from.

Mr. WARD. Yes.

Senator BULKLEY. You do not adopt the principle of having it redeemable in gold at all?

Mr. WARD. No; nor do I recommend the 23 billion. I simply say that there is the bullion base, and there is the principle of the Federal Reserve, and that with the two, I say that any man who shrieks "printing press money"——

Senator BULKLEY. Let us see if you do not recommend the 23 billion. Did you not say that it would take about $18,000,000,000 to take up these bonds?

Mr. WARD. Yes.

Senator BULKLEY. And there is about 5 billion out already?

Mr. WARD. Yes. That comes to 23 billion.

Senator BULKLEY. And you do not recommend that?

Mr. WARD. Wait a minute. This 18 billion is not in circulation at all.

Senator BULKLEY. I understand that.

Mr. WARD. Fine; if you understand that 18 billion is where it is; absolutely, yes; I will recommend 23 billion.

Senator BULKLEY. And as much more as needed?

Mr. WARD. Certainly, for that commodity price level of 1926.

Senator BULKLEY. Do you have to stop printing currency when the commodity price level changes?

Mr. WARD. Yes; until you finish your new study, Senator. This arbitrary 1926 level is accepted all over the country, on 1918 figures. We want the central bank to study the commodity price level, the relationship to debt, private debt, and the volume of business done. Do not go over to the Department of Labor and pick out a study of 1918, 17 years ago, with a series of index numbers, and look at the year 1926 and say to America, "Thus far you can go, and no further." I do not know where it should be. I only know that the study should be made, and I predicate that solely upon the fact that we had a study.

Senator BULKLEY. Do you favor buying any other Government bonds except those that are in the banks?

Mr. WARD. Yes. I am coming to that right this minute.

Senator GLASS. The $23,000,000,000 to which you refer, and vastly more than that, is available now if business revives and business interests demand it, isn't that true?

Mr. WARD. There is an unlimited amount available to them in check-book money of the private bankers, credit money.

Senator GLASS. Aside from that, counting the gold reserve, and counting that extraordinary provision of the law which returned us to a bond-security currency, a vast number of billions of dollars are available if business should revive and demand it.

Mr. WARD. Of course, the only thing I cannot say yes to is "if business revives." Yes; if business received the credit that it needed there would be use for vast numbers of billions of dollars which are available under the present credit system.

Senator GLASS. I would not have put it that way—if business received the credit that it needed. Well, yes; the credit that it needs. I would accept your phrase. But not the credit that it desires.

Mr. WARD. I would not urge that. With regard to the Beckman report, I pestered six Senators to get that Beckman report.

Senator COUZENS. Tell us what that Beckman report is.

Mr. WARD. Dr. Beckman, of Ohio.

Senator COUZENS. What did he do?

Mr. WARD. He came down and used the people's money in the Bureau of the Census to get a survey of the needs for small industry for credit.

Senator BULKLEY. Did you get the report?

Mr. WARD. Never. I do not think the senior Senator from Michigan would object to my making this statement: They sent two guards over to the office of Senator Couzens with it finally, with the statement, "What do you want it for? We cannot release it."

Dr. Beckman is a fine scholar. He went out and got these facts, and the facts were bad for the "new deal." The people spent their money. The New York Times printed the conclusion, which was released by somebody who made a mistake in the Department, the day the report was out. We can get the conclusion. They will give you those 20 pages. The nearest we ever came, through the efforts of six distinguished Senators, was to get, under guard, a report brought into Senator Couzens' office, but he could not copy it. He could look at it.

Senator BULKLEY. Do you know what it shows?

Mr. WARD. Yes; it shows that small industry had piled up in orders, good orders that they could not fulfill for lack of credit, a demand for $2,000,000,000 worth of credit not available from a private bank in this country, and not available from the Reconstruction Finance Corporation.

Senator BULKLEY. About what date was this?

Mr. WARD. I came down in January, and I would say approximately the first of February. Then they went over the report and doctored the report, Senator, to change some of it. Then they released the statement that it was released prematurely by a clerk. The trouble with the report is that it was the truth.

Senaor GLASS. Who are "they"?

Mr. WARD. Roper's department—Dr. Roper, or whatever should go with it for the record. That report is just unavailable, and there is a bill covering that, to try to bring it out in the House. Representative Kopplemann, of Connecticut, has introduced a bill. We had the same thing in Michigan, with the Reconstruction Finance Corporation. We set up 36 agencies, and I had a request to try to get $10,000 back from the Reconstruction Finance Corporation, privately subscribed in Detroit, Mich., for the industrial-loan department. The Reconstruction Finance Corporation wired the Chamber of Commerce of the city of Detroit, Mich., to gather together a good board to study loans to industry, and to loan the Government money. Certain men threw $10,000 in there. They elected a good business man, I guess—Mr. J. Walter Drake—head of it, and they collected applications for millions of dollars' worth of loans to small industries, and among those industries was the Detroit Steel Products Co., with United States Government orders on its books, and no money to manufacture. They took these applications for loans over to the Government-owned bank in Detroit to see if they were good banking risks. Those that were approved they brought down to Washington. After spending $16,000 of private money in the city of Detroit, it was decided that there was no money out of the Reconstruction Finance Corporation for small industry.

Senator BYRNES. What was the $16,000 spent for?

Mr. WARD. Office expenses and investigation.

Senator COUZENS. Who decided that there was no money?

Mr. WARD. The Reconstruction Finance Corporation, Senator.

Senator COUZENS. Is there a record of that decision anywhere? I never saw it.

Mr. WARD. I have a file on it. I came down twice, Senator, to see if we could get any action.

Senator BULKLEY. The Reconstruction Finance Corporation claimed that they could not get applications for good loans.

Mr. WARD. Dr. Beckman, of Ohio, Senator, is the best man to answer that. He found excellent loans where they needed $2,000,000,000 to start industry on orders that were in.

Senator BULKLEY. Did he find specific cases where the Reconstruction Finance Corporation had refused to go along with them?

Mr. WARD. Yes; and with the Reconstruction Finance Corporation, the private bank.

Senator BULKLEY. What is that?

Mr. WARD. And also the private bank. It was a complete picture. His report is a very fine report.

Senator BULKLEY. I would be interested to see it.

Senator COUZENS. Do you know him?

Senator BULKLEY. No; I do not know him.

Mr. WARD. Senator, I would be more than interested in having you see it. I want to see it. I cannot see it. Senator Couzens came nearer getting it than anyone. He got it inside his office.

Senator BYRNES. What you mean, Mr. Ward, is that this report covered cases where this gentleman said that certain corporations had applied to banks and could not secure loans and then applied to the Reconstruction Finance Corporation?

Mr. WARD. And could not secure loans.

Senator BYRNES. And could not secure loans.

Mr. WARD. And business was halted for the lack of money.

Senator GLASS. Mr. Ward, what do you think banks are in business for?

Senator BYRNES. The question in each case presumably depended upon the judgment of the banker and the Reconstruction Finance Corporation officials as to the collateral offered.

Mr. WARD. That is correct.

Senator BYRNES. You do not know anything about the collateral offered to the bankers or to the Reconstruction Finance Corporation?

Mr. WARD. Oh, no.

Senator BYRNES. That is what you would like to know.

Mr. WARD. Oh, no; I do not know that, and I do not know the details of the report. I have the 20-page summary. The New York Times published that.

Senator BULKLEY. You would presume that detail would show in the report?

Mr. WARD. Oh, yes. That is the report, and they have used Dr. Beckman's study.

Senator GLASS. I just asked the simple question, what do you think a bank is in business for except to lend money on sound collateral security?

Mr. WARD. There are other minor incidental objectives of a banker. The Senator knows far more than I will ever know about it. They do not just go into the business of lending money on good security.

Senator GLASS. I thought they did. I thought that was what they were chartered to do.

Mr. WARD. I know; but that would not account for some of their activities in calling loans on good security, knocking the market down, or raising a bank stock to $1,200 or $1,400 a share, from $200. We had many objectives of Michigan bankers.

Senator GLASS. Of course, if they are in the stock-gambling business or the securities-gambling business they would do things of that sort. I am talking about legitimate banking.

Mr. WARD. I am from Michigan, and it is a very difficult thing to have any exact information on that subject in the last few years.

Senator GLASS. You do not think there is any legitimate banking out there?

Mr. WARD. There is some. We have a few old savings banks.

The United States Treasury has nine billions of monetary metal in its vault. This can support—unchallenged by any modern banker who has supported the privately owned Federal Reserve System—this nine billion can support the currency issue of $23,000,000,000.

This would not be fiat money. It would not be irredeemable paper money, nor printing-press money, to any greater extent than the Federal Reserve notes issued today.

Senator BULKLEY. What would it be redeemable in?

Mr. WARD. Senator, this 2½ to 1 should be used with the full recognition of its historic significance. The goldsmiths of Europe learned that their customers did not come back the same day, and they were smart individuals. They figured out a percentage, and if they had enough to meet those that did come in for their gold, with the gold receipts, that was sufficient.

Senator BULKLEY. That is very familiar to all of us, but what I am trying to get at is what you are proposing in this bill. You just said it would not be irredeemable paper; and I am asking you, if it is not irredeemable, what would it be redeemable in?

Mr. WARD. I did not say it would not be irredeemable, Senator.

Senator BULKLEY. I misunderstood you, then.

Mr. WARD. I said it would not be any more irredeemable than the present Federal Reserve notes.

Senator BULKLEY. It could not be any more irredeemable than the present Federal Reserve notes.

Mr. WARD. I was just comparing them. I will stop there.

Senator GLASS. It could not be any more irredeemable, and the probability is that they would not finally put you in jail if you were caught with any of it. But if you are caught with any gold now, they would fine you and put you in jail.

Mr. WARD. This merely means giving the sovereign power of the United States the same prerogative that the United States gave the private banker in 1913. But lest the purchase of the debt of the United States and the issuance of currency to equal demand deposits provide some physiological reaction in anticipation of higher prices, though such action puts not one penny of money in circulation, and lest further issues of currency raise the price level above that prescribed in section 14, then Congress can retire all excesses of currency through taxation.

Mr. Warburg came before the committee to testify that no government would have the courage to stop a boom. But Mr. Warburg didn't complete the most important thought for the people of the United States, and that thought is this: That no government would have the courage to start a depression.

I am not here for or against the Eccles bill. I do not believe that the committee invited a hearing on this bill at this time, as a means of killing the Eccles bill.

You have here the testimony of the Secretary of the Treasury that he is of that school which believes in a central bank. You have Mr. Eccles himself, presenting a bill to Congress while he needed confirmation as Governor of the present Federal Reserve Board.

In the consideration of the Nye-Sweeney bill, naturally we can't get the bankers of the country to come here and testify in favor of it. It will be universally ridiculed, and, as it gains public respect, the attitude will change and it will be tolerated, and then there will occur that third phase, which Woodrow Wilson said was the fate of every reform measure. It would be embraced with a view of so manipulating it that there would be no reform possible.

I would as soon ask the Egyptians to go easy on the slaves in the matter of making bricks as I would ask the bankers of America to endorse this bill. I would as soon ask Caesar to emancipate the galley slaves as I would ask the modern banker to give up the privilege of counterfeiting money.

I would as soon ask a feudal baron to permit his serfs to transfer land in fee simple as I would ask Wall Street for an objective consideration of this bill. The bill is drafted, and it will follow the course of all legislation which passes, and that is modification.

This Nation has waited upon Congress since 1789 to use the power given it under the Constitution to coin money and regulate the value thereof and of foreign coins.

Through the medium of the radio and through great public mass meetings, the people are being informed, and the people ultimately win every battle they set out to win.

It took 6,000 years before human slavery, man's ownership of his fellow man, disappeared.

It took 9 centuries at least of recorded history before the Constitution of the State of New York finally abolished the feudal tenures which had lasted down from the old Dutch patroon of the rent wars of 1842.

It took from 1765, with the Stamp Act, to 1781 at Yorktown to give us political independence, but they didn't have the radio in those days, and they didn't have the telegraph.

We ask that this subcommittee, which is being pushed to bring out a banking bill, substitute the Nye-Sweeney bill for the Eccles bill, and you will need no deposit insurance; you will need no political control over banking, and you will have no private banker control over money.

I ask the sincere and honest deliberations of this committee, according to its intellectual lights, before the four billion eight hundred million is added to the national debt; before there is a possibility of the Government bond market breaking and the banks forced to run again to Jesse Jones to bail them out.

I want to thank the committee again for the courtesy extended Father Coughlin, and that courtesy will be acknowledged to the millions who listen to him.

I should like to offer for the record an analysis of banking and money by the New York Herald Tribune.

Senator Glass. That may be done.

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

An Analysis of Banking and Money by the New York Herald Tribune

In 1933 the New York Herald Tribune published a little book of 60 pages entitled "The Financial Section of a Newspaper."

The book was edited by Mr. C. Norman Stabler, financial editor, and additional copies are advertised as available for $1 each by addressing the New York Herald Tribune.

The book was obviously prepared for the advertiser, because in a foreword, under the title "Preference", we learn that 66 percent, or 658 out of 994 members, of the New York Stock Exchange who responded to the question, "What morning New York newspaper do you read regularly?" mentioned the New York Herald Tribune. while 65 percent reported that they read the Herald Tribune among Sunday newspapers; all of which is prepared as proof of a substantial preference over other newspapers, both week days and Sundays.

In the introduction to this book, I find the following language:

"Students in schools and colleges, many of whom have had no immediate contact with the financial world and consequently are not thoroughly acquainted with Wall Street parlance, are realizing the necessity of becoming better versed in the ways of those institutions in lower Manhattan from whose rooms are directed the flow of credit and commerce to all sections of the globe. It is for this latter group, principally, that this elementary discussion on how to read the financial pages is published."

On page 25 there is reproduced a portion of an article entitled, "The Week in Finance."

The author, Mr Edward H. Collins, associate financial editor, bemoans the fact that the American Bankers' Association in their 1933 Chicago convention should have held a "concerted demonstration against the administration's banking heresies, and should have put forth an appeal to sound public judgment against the attempt to sabotage the banking system."

But Mr. Collins laments the fact that the bankers made nothing of their opportunity, for the administration stole their thunder by sending Jesse Jones, Eugene R. Black, and James F. T. O'Connor to capture the headlines.

THE BANKING SYSTEM FOUNDED ON TRICKERY

On the next page, page 26, Mr. Collins describes "Our Monetary System."

In the opening sentence, his topic thought is: "The modern banking system exists primarily to provide and regulate the supply of money."

The Constitution of the United States, article I, section 8, clause 5, places this power over money directly under the Congress of the United States.

Mr. Collins, in his article, distinguishes three kinds of money: "real money, representative money (or currency), and deposit money (or credit)."

With respect to currency, in a few brief sentences, he traces the origin back to the goldsmiths of Europe and what he calls the epochal discovery of those goldsmiths to the effect that the holders of their receipts never wanted their gold at the same time. So the dishonest practice of issuing receipts in excess of the amounts of bullion on deposit, and the lending out of these excess bank notes at interest, Mr. Collins terms "The foundation of the modern bank-note issue."

It was the greed for interest on these notes, unsecured by bullion, that lead to abuses so bad that most countries started the supervision of the privilege of note issue.

RULES FOR AN ELASTIC FORM OF CURRENCY

Mr. Collins then explains the Federal Reserve regulation of $40 in gold for every $100 Federal Reserve notes outstanding.

Then Mr. Collins analyzes the third type of money which is deposit money or credit money. In the second paragraph on page 28 he gives the reader the popular conception of bank deposits and follows it in the third paragraph by the true facts regarding the bank's ability to create money.

Later on he states that a dollar in gold is just a dollar, but a dollar employed as a reserve, permits the issuance of $2.50 in currency.

I quote Mr. Collins:

"But the use of deposit money, or credit, makes it possible to stretch our gold much farther. For, obviously, if it is only required that member banks carry a 10-percent reserve against deposits, $10 in money of this sort can be created out of every $1 in gold. But even this is not the complete picture", says Mr. Collins. "The mobilization of our gold in the Federal Reserve banks has added still further to the work that gold can do.

"The Federal Reserve does with member banks precisely what the member bank does with the customer. The Reserve bank must keep a reserve of 35 percent in gold or lawful money against its deposits, or $1 in gold against $2.85 in deposits, but for every $1 of these deposits, since they represent the reserve of member banks. the member banks can create deposits of $10."

Now, finally, this is what Mr. Collins has to say and this I truly believe is the most important single proposition before this country today. I quote:

"Therefore, in theory at least, $1 in gold in the vaults of the Federal Reserve System may, when used as a reserve against the latter's deposits, provide the basis for $28.50 in deposit money, or credit, in the member banks.

"From the foregoing it will be seen that under our banking system the Federal Reserve banks provide the ultimate limits of monetary expansion of using money in its broader sense of both currency and credit."

I ask that Mr. Collins' 4-page article be introduced into this record. It comes from the assistant financial editor of the New York Herald Tribune, that prides itself on influence—67 percent in "The Street." It is the finest short article on our monetary system that it was ever my pleasure to read. It openly admits that there are three kinds of money: The metallic base; the currency of circulating issue, born in iniquity on crookedness; and, thirdly, the actual money in the country which is deposit money, which is fiction money, which is banker-controlled money—the real printing-press money in the country, which doesn't need even the Bureau of Engraving and Printing to process it, which only needs a job printer to run off blank checks and promissory notes to be filled in by anyone in the country to whom the private banker allots credit.

This is money which, according to Mr. Collins, has an ultimate limit of $28.50 for every dollar of gold in the Federal Reserve System.

This is not bankers' money, because the banker has contributed only the capital and surplus. This isn't depositors' money in the sense that it originated by the depositor shoving currency through the wicket of a bank.

This money is available on the security of the borrower who can cash in his real property or his securities at the will of the private banker who alone decrees the allotment of credit in this country—the banker who can and does decree every expansion and every contraction of credit—the banker who throws you into depression at will and whose power over this country represents in his control of money and credit the control over the lifeblood of this Nation.

WE HAVE A CENTRAL BANK

Gentlemen, it is rapidly occurring to everyone in public affairs that we have a central bank.

On February 2, 1932, there came into actual operation a central bank of the United States under the title of the Reconstruction Finance Corporation. From that day until December 31, 1934, the R. F. C. authorized the following:

Loan banks and trust companies, $2,263,000,000.
Building and loan associations, $102,000,000.
Mortgage loan companies, $425,000,000.
Credit units, $622,000.
Federal land banks, $399,000,000.
Federal intermediate credit firms, $9,000,000.
Joint stock land banks, $21,000,000.
Agricultural credit corporation, $6,000,000.
Regional Agricultural Credit Corporation, $178,000,000.
Livestock, $14,000,000.
Railroads, $457,000,000.
Total, under section 5, $4,031,000,000.

In Table 8 of R. F. C., Report to Congress, Document No. 139, a report for the fourth quarter of 1934, 7,327 banks and trust companies had received loans of $2,263,000,000; 5,164 of these loans were granted to banks and communities of less than 5,000,000 people.

I submit the table for the record.

Table 9 in Mr. Jones' report shows that on December 31, 1934, approximately $865,000,000 represents the loans on and purchases of preferred stock and purchases of capital notes and debentures of 5,457 banks and trust companies. This $865,000,000 is 26 percent of the capital stock of all the banks reporting to the Federal Deposit Insurance Corporation.

In the R. F. C., we have a central bank owned by the United States which, in turn, directly owns capital stock to the extent of 26 percent of all the capital of the banks of the country.

We have, under the Constitution, the power of Congress to coin the money and regulate its value, and yet so far we have not been honest enough to combine under the constitutional power the functions of the R. F. C., the Home Owners' Loan Corporation, the various farm credit agencies, the work that should be done in extending credit to small industries, such as is being proposed under the Koppleman bill.

We have the tremendous problem of financing the extraordinary expenses of Government, particularly as covered by the Work Relief Act.

Just as the Federal Reserve was deemed necessary in 1913, so 22 years later there is need as never before since 1781, when it was first proposed, a central bank of the United States of America.

Mr. WARD. I have here a little summary showing how the 108, or 102 who are on the Federal Reserve directorates today—there are a few vacancies—are cast.

(The statement referred to is as follows:)

A BOARD OF 48

The Federal Reserve is headed by a Board with two ex-officio members, the Secretary of the Treasury and the Comptroller of the Currency, and six appointed by the President, by and with the advice and consent of the Senate.

The 12 Federal Reserve banks have, according to the last report, 102 directors, representing 40 States and the District of Columbia. There are, of course, the 12 governors in addition.

Here is management of a System represented ordinarily by 108 directors, 8 members of a central board, and 12 governors; 128 represent the banking interest of the country and 8 represent the administration.

The following list indicates the membership on the boards of the 12 banks, arranged by weight of membership:

Pennsylvania	9	Maine	1
Texas	9	Connecticut	1
New York	8	Rhode Island	1
California	7	Delaware	1
Massachusetts	5	Maryland	1
Ohio	5	South Carolina	1
Illinois	4	New Hampshire	1
Minnesota	4	Florida	1
Missouri	4	Alabama	1
Virginia	3	Louisiana	1
Georgia	3	Iowa	1
Wisconsin	3	Kentucky	1
North Carolina	2	Arkansas	1
District of Columbia	2	Tennessee	1
Mississippi	2	South Dakota	1
Indiana	2	North Dakota	1
Michigan	2	Montana	1
New Jersey	2	Colorado	1
Kansas	2	Oregon	1
Oklahoma	2	West Virginia	1
Nebraska	2		

The following States have no membership on the 12 Federal Reserve bank directorates:

Vermont, Arizona, Utah, New Mexico, Nevada, Washington, Wyoming, and Idaho.

Mr. WARD. I have a summary prepared here, covering my statement, which I will ask permission to insert in the record. The chairman has asked me to be as brief as possible, and with the consent of the committee I will just leave that summary of points.

(The statement referred to is as follows:)

AN INDEPENDENT BOARD

The committee has heard the testimony of Dr. Miller. The banker doesn't want the politician in, and the people don't want the banker or a politician in.

Instead of 128 men directing the destinies of our monetary system, we should establish an independent board, one from each State, appointed for long terms of years.

They don't have to be bankers any more than the Senate of the United States has to be constituted of bankers in order to be able to draft banking legislation.

The experts brought us where we are, and the bankers brought us to our lowest state.

The independent board is the thing, operating under Congress. A board that will make monetary control a career; a board that will be given authority and responsibility.

SUMMARY

Gentlemen, I want to now summarize the presentation of the Nye-Sweeney bill for social justice.

I believe that for the first time in American history a bill is suggested which is intended to correct the most glaring evils of the American monetary system.

The Nye-Sweeney bill attempts to put into effect the true and real intent of money.

It hopes to transform and correct the wrong notions as to the place and work of money, which notions have prevailed since the introduction of the modern banking system.

The following are the theses, which should be challenged by every independent mind of Congress; and if there is anything wrong about any of them, the error should be brought to light.

Point 1.—The monetary banking system came as a usurpation of the sovereign right of the Government to coin and regulate money.

Point 2.—The creation of a counterfeit checkbook money furnishes competition to the money of the United States, is only an extension of the plan of the goldsmiths to circulate gold receipts, and is on its face the usurpation of the sovereign power to government.

Point 3.—The introduction of this counterfeit checkbook money, competition to our national currency, was not an open usurpation, but rather as a usurpation introduction as a " trade secret " discovered by the goldsmiths and handed on " in the trade " to their modern successors, the bankers.

Point 4.—The people do not understand this subtle move or usurpation of the sovereign power over money, since it came in in such a way as not to attract any attention to it or any suspicion of it.

Point 5.—Nevertheless, it is a real, though at first unsuspected, usurpation of the Government's prerogative to coin and regulate the value of money. The bankers now consider this usurpation a vested right. The rank and file of the people, until lately, did not comprehend the real point at issue and have until now paid little or no attention to it.

Point 6.—The present banking system, with its creation of a system of credit money, and operating under the Federal Reserve Act, puts the power over money and credit in the hands of the bankers and gives them the power to create depression or decree prosperity at will. Such power over money and credit is sanctioned by law under the present Federal Reserve Act.

Point 7.—In recapturing the money power by the people and placing that power under Congress, where it belongs, the theory is attacked by such as Banker Warburg, who said in his testimony on the omnibus bank bill, " The Government would not have the courage to stop a boom "; but the converse of Banker Warburg's statement is the important thing for America: " Neither would the Government have the courage to start a depression." The boom is stopped by calling more loans, and the depression is caused by calling loans and stopping credit.

Point 8.—The Nye-Sweeney bill aims at correcting this monstrous injustice. It would take out of the hands of private bankers this power over prosperity and put it into the hands of the Government the control of money and credit, to be administered for the good of all. Since credit performs at least 95 percent of the business of America, the power over it should rest only with the Government.

Point 9.—The argument that the Nye-Sweeney bill will put credit and its allotment into the hands of the politicians—well, this objection applies with equal force to every power which " we, the people " of the United States, have given to Congress in the 18 powers enumerated in the Constitution.

Point 10.—The production problem of the country is solved. The only way to create wealth is the starting of toil and labor on the natural resources of the Nation. This creates the wealth. Money is the means of distributing that wealth, and the creation of money is in private hands today, is the means of concentrating wealth into the hands of the few, and the creation and destruction remain the property of the private banker. If placed under the control of the Government, the power over money and credit would be administered for the good of all.

Point 11.—A depression is caused in only one way; that is, by the banks calling in loans and refusing further credits. Such contracting of credit takes out of circulation a huge amount of the checkbook money of the banker; and though it is legalized counterfeit money, it operates the same and to the same advantage as genuine Government money.

Point 12.—Depressions are inevitable because they occur here in the richest Nation in the world under a provident God and not an improvident God; they are therefore the work of men. The thing to find out is, who are the men that cause them?

Point 13.—The Nye-Sweeney bill will prove it by the means of attacking the problem of interest. The Government is paying a billion a year for interest and approximately 6 hundred million of this goes to the private banker who absorbs practically 60 percent of the national debt. The public and private debt of this Nation is far in excess of 2 hundred billion dollars and actually is greater than the national wealth. Five percent is a low average interest rate. Interest runs from the point of $2.70 average for the financing of the Government to as high as 240 percent a year which the poor pay to the personal loan. The national interest bill is 10 billion dollars a year, or practically 25 percent of the entire national income. This is a millstone around the necks of the people.

Point 14.—All the banks of the Nation will be asked to absorb the 4 billions of Government bonds under the Public Works Act. All the banks have 700 million dollars today in cash in their possession; this 700 million is needed for till money. They can't even loan that to the Government, so what happens. They enter upon their ledgers a credit in exchange for Government bonds, carrying approximately 3-percent interest in exchange for which they give the Government the right to withdraw. Without departing with the slender cash, they now create money and the sovereign power of the United States pays the 75 million dollars a year, so-called "interest" for the use of the usurped right to coin money.

Point 15.—Now if the control of credit was under the Government, why should the Government charge interest for check-book money, the free circulation of which in adequate amounts brings prosperity to the country. Wouldn't it be absurd for the Government to penalize the borrowers whose check-book money brings about prosperity? But the banker under our present system can exact tribute from the borrowers who help to make prosperity. Would it not be to the advantage of the Government, that is, to the advantage of the people, to have at all times enough money in circulation to meet all needs? And by money we mean currency and credit, or check-book money.

Senator BULKLEY. Does the National Union have any message to deliver to us with respect to its determination to defeat any Senator who does not see this thing in the way the Union does?

Mr. WARD. No.

Senator BULKLEY. You would rather have us give sincere and honest consideration to it?

Mr. WARD. I think that was the language, Senator.

Senator BULKLEY. I hope the National Union is going to take that view, because the other view, in my opinion, is just nonsense, and it is very harmful to the cause.

Mr. WARD. I will regard very attentively that judgment, and appreciate your thoughtfulness in giving it.

Senator BULKLEY. I stick to that pretty strongly, for reasons which you probably know, and I hope, at the same time that you thank Father Coughlin for his courtesy to us and for the very interesting and excellent and thoughtful statement you have made, that you will also convey the other message, not in any spirit of antagonism at all, but simply as a statement of principle.

Mr. WARD. You have all been most courteous. Are there any questions?

Senator GLASS. Apparently not. We are glad to have had your statement.

Mr. WARD. Thank you.

Senator GLASS. There are two bankers from South Carolina who had asked to be heard this afternoon. Mr. Beattie.

STATEMENT OF F. F. BEATTIE, PRESIDENT FIRST NATIONAL BANK, GREENVILLE, S. C.

Senator GLASS. I believe you are connected with the First National Bank at Greenville, S. C.

Mr. BEATTIE. Yes, sir.

Senator GLASS. You know the bill we have under consideration.

Mr. BEATTIE. I understand, sir, that I am appearing on the Eccles bill, the banking bill of 1935.

Senator GLASS. Yes, sir.

Mr. BEATTIE. Mr. Chairman and gentlemen of the committee, I desire to say for your information that I am president of the First National Bank of Greenville, S. C. The bank has resources in excess of $6,000,000. I have held my present position for nearly 20 years. The bank has been in existence for more than 60 years. I take pride in saying that it has been able to stand upon its own merits and has neither requested nor accepted any aid or favors from the Government, even during the great depression through which we have been passing.

Greenville, S. C., is a town of about 30,000 people, situated in the Piedmont section of the State. The chief industries of the community are farming and cotton-textile manufacturing. I desire to say also that South Carolina is overwhelmingly Democratic in politics. I have voted the Democratic ticket consistently throughout my life and many years ago served as a Democratic member of the General Assembly of South Carolina. I say this to assure you that I am free from political prejudice in the matter concerning which I appear.

I appear, gentlemen, to protest earnestly against the passage by Congress of title II of the Banking Act of 1935, which act is now before you for consideration. I am of the opinion that title II of this act gives to this administration and to such administrations as may follow enormous and unprecedented control over the resources of the Federal Reserve System. I think that it is a most dangerous power which this bill seeks to create—dangerous not only to those interested in banking, but to the very liberties of the people of America. It is well recognized that a government desiring dictatorial power seeks first to seize control of the credit machinery of a nation. Given the dictatorial control of credit, governmental power over the destinies of a people may easily become supreme. I think also that the open market features of the bill confer powers which may easily lead to currency inflation such as has been experienced since the World War by Germany and other European powers, using the same methods. I cannot believe that this Nation is willing to take the chance of such a disastrous experience.

I desire to say, gentlemen, that I am of that school of thought which believes that the business of banking in this Nation is already unduly controlled and regulated by Government. Such control is now far more vigorous and rigid than exists in other enlightened nations of the world. The banks of this Nation are already so controlled by laws and regulations as to substantially retard their operations and cripple their proper functions, from which communities suffer. A condition has thus been brought about in the banking business where new capital refuses to come into this business and young men are reluctant to choose the business of banking as a career.

It may be proper to ask here, with all respect, who owns the Federal Reserve System? Whose money is invested in the Federal Reserve System? Certainly the Government does not own it and has no money invested in it. The Federal Reserve System is owned entirely and completely by the member banks of the System and through these member banks by many thousands of American citizens who have invested their money in the capital stocks of the member banks. Yet this bill would place the Federal Reserve System with its enormous resources under complete governmental and political control, without the investment of a single Government dollar. Where a strong government is dealing with the property of its citizens, which it may desire, government ownership of the property desired may not be necessary, if the government is willing unfairly to seize without compensation the perpetual use and control of the desired property of the citizens. If there is to be a central bank in this Nation, governmentally and politically operated, of which I do not approve, I think that in all fairness to the owners of the Federal Reserve System, the Government should own and operate it with its own money and not with money invested in good faith by its citizens. If the banks of the Nation are to be operated as the post offices are now operated, they should be governmentally owned and paid for.

I beg to repeat here that I do not advocate Government ownership and political control of banking. I am of the opinion that any system of banking under political control is dangerous in the extreme, whether it be the Federal Reserve System as contemplated by this bill, or whether a new central bank governmentally owned be created by Congress to supplant the Federal Reserve System.

Senator BULKLEY. What alternative do you favor as opposed to governmental control?

Mr. BEATTIE. My opinion, sir, is that the Federal Reserve System, as originally created, under the control of a Federal Reserve Board, with the powers then conferred, and with the Secretary of the Treasury and the Comptroller of the Currency removed from the Board, would meet my ideas.

Senator BULKLEY. You think the present system is all right if we take the Secretary of the Treasury and the Comptroller of the Currency off the Board?

Mr. BEATTIE. With the powers conferred upon the Board by the bill as originally enacted. In other words, I am an advocate of the Federal Reserve System as it was organized, speaking generally, The objection that I have is that the Comptroller of the Currency and the Secretary of the Treasury being on the Board tends to give some political control, which I think it would be wiser not to have. I think the further removed the Federal Reserve Board can be from political domination or control or interference, the better for the banking business of the country.

Senator BULKLEY. Mr. Miller testified last week that world conditions have so changed that we are bound to have a greater measure of management with respect to currency and banking matters than we had some years ago. I was wondering whether you thought the set-up was adequate to cope with that.

Mr. BEATTIE. I do, sir. I assert, in all earnestness, that sound banking and politics will not mix.

Gentlemen, I want to say here that, as I stated a moment ago—and I did so purposely—many years ago I had some little political experience myself before I went into the business of banking, and I thoroughly understand and appreciate the urge that comes upon a man holding political office to seek the influence of someone above him in politics—what an urge there is there to do something which he should not do, to the extent that his judgment is likely to be warped or overridden if he is under political influence or interference.

Senator BULKLEY. Do you think the present Federal Reserve Board is free from that?

Mr. BEATTIE. I think it started off that way, sir. I think in recent years—possibly within the past 2 years—there has been some evidence that there might be political control there.

Senator BULKLEY. Mr. Miller quite firmly testified that there is political influence going back a good deal more than 2 years.

Mr. BEATTIE. Of course, Mr. Miller speaks with authority. My knowledge is limited, and obtained only from general impressions made by reading in the daily press. I thought, however, that up to 2 years ago there was little political interference or control. That was my opinion.

I assert in all earnestness that sound banking and politics will not mix. Political banking is disastrous, whether it be in a local community or on a national scale. The simple reason for this, I think, is that the ability to say " no " firmly and courteously when that word is required is an absolute essential of sound banking; and politicians, thinking about the chief or the boys back home, often have difficulty in pronouncing this simple word. The only way that a bank or banking system can be kept free from political pressure and control is through a board of directors who hold no political office and who have no political aspirations, and manned by executives of the same caliber.

It is interesting to remember, gentlemen, what a great and successful effort was made by Congress at the time of the creation of the Federal Reserve System to keep the System free from political interference and control. I need not recall to your minds that this was during the administration of a great Democrat, Woodrow Wilson; and that another great Democrat—your chairman, now the senior Senator from Virginia, the Honorable Carter Glass—was the leader of the successful fight. Under the Federal Reserve Act as thus created the Federal Reserve System was to be governed by impartial and experienced men far removed from the turmoil and pressure of politics and intent upon giving to the Nation a banking system serving the legitimate and proper banking needs of agriculture, commerce, and industry. Throughout the years the Federal Reserve System has fulfilled its mission well.

Now a determined effort is being made which will destroy that System as created. This bill, if passed, will spell its doom.

The Federal Reserve System, as it exists, has been the envy of the world. It is the child of a Democratic administration. It is now being attacked by those who should be its protectors. Should a Democratic administration now destroy the Federal Reserve System, then the Democratic Party will be classed with those vile creatures of the earth who devour their young.

Senator GLASS. We are very much obliged to you, Mr. Beattie.

STATEMENT OF L. M. WIGGINS, PRESIDENT BANK OF HARTSVILLE, S. C.

Mr. WIGGINS. Mr. Chairman and gentlemen, I testify before you not as a banker nor an economist nor as one "qualified by education or experience or both to participate in the formulation of national economic and monetary policies." I represent the viewpoint of industry, agriculture, and commerce in South Carolina and, to a lesser degree, banking; being president of a small State bank, which is a member of the Federal Reserve System.

With reference to title I of the proposed banking bill, I am in full accord with its provisions, and urge its prompt adoption, with the exception of one provision. I present the serious objections on the part of bankers and business men in our State to the provision in title I that will discontinue on a fixed future date the insurance of deposits in banks not members of the Federal Reserve System. Although it may be a desirable ultimate objective to have every bank of deposit in the United States a member of the Federal Reserve System, it is a practical impossibility for many of the small banks and cash depositories in our State to meet reasonable membership requirements and to survive the loss of revenue which would follow membership in the Reserve System. The only alternative to the discontinuance of banking facilities in many of our small towns and communities would be a restoration of wide-spread branch banking. South Carolina has sustained such serious losses in the operation of branch banks in the State that it will be many years, if ever, before this type of banking will have the confidence of the people. We believe that the farmers and business men of small communities have the right to provide and use banking facilities so long as the institutions set up are soundly administered and profitably operated, even as that right is enjoyed in the larger centers of population.

Senator GLASS. Did you have branch banking or chain banking?

Mr. WIGGINS. We had one main bank in the city of Charleston, with branches all over the State—46 of them, I believe.

Senator GLASS. Were they exactly branches of that bank, or were the smaller banks owned by that bank?

Mr. WIGGINS. They were branches of that bank.

Senator COUZENS. Did they fail?

Mr. WIGGINS. They failed, and the depositors, up to now, have received 10 percent of their deposits.

Senator BYRNES. The Western Carolina Bank, with 12 branches, failed.

Mr. WIGGINS. Yes; it failed. The South Carolina National Bank, with three branches, failed.

Senator COUZENS. Your State law permits branch banking?

Mr. WIGGINS. Yes, sir.

Senator COUZENS. Anywhere in the State?

Mr. WIGGINS. Yes. The profitable operation of many of the smaller banks in our State under the requirements of Federal Reserve membership would be impossible. We, therefore, urge upon you the postponement if not the present abandonment of the proposal to require banks which have their deposits insured to become members of the Federal Reserve System by a specified date.

Senator COUZENS. What do you think of the proposal to require all those with more than half a million dollars worth of assets to come in, and exclude those below that amount?

Mr. WIGGINS. I think that would be all right. In fact, I know of no bank in our State of that size that is not a member.

Senator GLASS. What do you think of the proposal to defer the matter until 1938, according to one suggestion, and 1940, according to another?

Mr. WIGGINS. My idea, sir, is that at the present time it would be pure speculation to determine a future date, considerably in the future, for that to be brought about.

Senator BYRNES. What will be the effect upon your State banks and cash depositories to which you refer if they are not given time?

Mr. WIGGINS. I did not quite get the question.

Senator BYRNES. If the present plan is carried out, what would be the effect upon those cash depositories?

Mr. WIGGINS. Most of them will have to go out of business.

Senator COUZENS. Because their earnings are not enough or because their assets are not good enough?

Mr. WIGGINS. Because their earnings are not enough. Their assets are good.

Senator BYRNES. The earnings come from the amount they charge for cashing checks.

Mr. WIGGINS. That is true. They are principally capitalized at very small amounts. They are prohibited from lending money. They are safeguarded with every provision for soundness, and they must make their earnings out of various charges which the community is willing to pay.

Senator COUZENS. Do I understand you to say that they do not lend any money?

Mr. WIGGINS. No, sir.

Senator BYRNES. They opened just after the bank holiday to serve the communities.

Mr. WIGGINS. That is true; when capital was so limited that it was impossible to organize an ordinary bank we established a system of cash depositories.

Senator COUZENS. Without capital?

Mr. WIGGINS. No, sir. They have a small capital—$10,000 in some cases.

Senator BULKLEY. Do they invest deposited funds?

Mr. WIGGINS. No, sir; not without the permission of the depositor. They can invest their own capital, but not the deposits.

Senator BYRNES. Are there many counties having no bank operating, and relying entirely upon cash deposits?

Mr. WIGGINS. There are not many entire counties, but my recollection is that there are 27 cash depositories in our State, and approximately 130 banks.

Senator COUZENS. Are these 130 banks mostly members of the Federal Reserve?

Mr. WIGGINS. Only the national banks, and four State banks.

My principal comment is on title II. I shall not attempt to discuss in detail the provisions of this title because this already has been done, and ably, by others who have preceded me. I shall attempt only to give you the viewpoint and conclusions of men from my section of the country who represent a fair cross section of agriculture, industry, commerce, and finance.

We regard the major and underlying purpose of title II of the Banking Act of 1935 as a perversion of the Federal Reserve System from the sound principles on which it was founded and a deliberate attempt to appropriate to the Government the banking reserves of this Nation, with the result that they may be used as the means for promoting the financing of governmental needs with a minimum checks and with a maximum of political control, by whatever administration happens to be in power.

Under the recent emergency conditions, the Federal Reserve System, through an urgent necessity which may possibly be justified, turned over to the Government a large part of the reserves of the banks of the Nation and through them the reserves of the depositors in the banks throughout the Nation and accepted in return the obligations of the Government. The great concern today should be the restoration of the liquid reserves of the Federal Reserve System and the divestment of its holdings of Government securities, rather than an attempt to institute a program whereby these reserves could be utilized still further to finance a mounting Government deficit. We urge upon you the desirability of returning the Federal Reserve System to its proper reserve and banking functions as soon as possible.

The Federal Reserve System, which was designed primarily to hold the liquid reserves of the Nation, to provide an elastic currency and furnish a "democracy of credit" that should meet the needs of agriculture, commerce, and industry, becomes, under the emphasis given in title II of this act, in effect a political department of the Government whose chief concern is "in the formulation of national economic and monetary policies" rather than in the operation of a sound reserve banking system to meet the needs of agriculture, commerce, and industry. The individual Reserve banks are practically stripped of any independence by this act and the directors of the Reserve banks representing banking, agriculture, and industry become in practical effect little more than an advisory body. The personnel of the Federal Reserve Board, now selected with some regard for a "fair representation of the financial, agricultural, industrial, and commercial interests" of the people of the United States, will, under the proposed set-up, be limited to persons well qualified to participate in the formulation of national economic and monetary policies.

The concentration of power in the hands of a small group, largely political, constituted with practically no legal limitations or restrictions, as will be given by this title to the Federal Reserve Board, is foreign to our conception of the principles of democratic government. Such a grant of power is unparalleled in our country, except in times of war or grave national emergency, and should be safeguarded by law so as to retain in the hands of Congress the power to regulate the value of money. The broad invitation given to the Federal Reserve Board under the powers granted under this bill, to engage in monetary manipulation and to try out economic theories on a gigantic scale through the use of the reserves of the bank depositors of the Nation offers possibilities of mistakes that may invite financial chaos in this country. It is possible—whether it does it or not, the power is there—for the Federal Reserve System, under the provisions of this bill, to become a bouncing board, against which Government securities, without limitation as to amount or maturities, may be tossed to produce an unending return stream of paper credit to provide for mounting Government expenditures. This can continue only so long as the people have confidence in the ability of the Government ultimately to repay, but when the spark of fear of the ability of the Government to repay is struck, the devastating and uncontrollable chaos of money worth less and less will quickly paralyze the Nation. It will then be too late to discover that the banking reserves of the people of this Nation have been consumed in the great experiment.

I cannot agree with those who believe that title II of this bill can be changed so as to correct the dangers that lie within it. Of course, many of its most dangerous provisions may be changed, but it is my conviction that the whole major premise on which the theories promulgated in title II rest is unsound, violates the sound, commonsense judgment of the American people, and belongs to the realm of dictatorships. Without desiring to raise any unnecessary alarm, I say to you frankly and honestly that it is my deliberate opinion that, carried to its ultimate conclusions, title II of this bill, as now written, will destroy the Federal Reserve System of banking in the United States.

Senator GLASS. We are very much obliged to you, Mr. Wiggins.

We will adjourn until 10:30 tomorrow morning, when Mr. Owen D. Young will appear.

(Thereupon, at 4:15 p. m., the subcommittee adjourned to meet tomorrow, Wednesday, May 29, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

WEDNESDAY, MAY 29, 1935

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

The subcommittee met, pursuant to adjournment on Tuesday, May 28, 1935, 10:30 a. m., in room 301, Senate Office Building, Senator Carter Glass presiding.

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

Senator GLASS. The committee will come to order. Several of the members are detained at other important committee meetings and cannot be here. We are to hear this morning from Mr. Owen D. Young.

STATEMENT OF OWEN D. YOUNG, CHAIRMAN OF THE BOARD, GENERAL ELECTRIC CO., NEW YORK, N. Y.

Senator GLASS. Mr. Young, just give your name, please, and your position to the official reporter.

Mr. YOUNG. I have prepared, Mr. Chairman, a little statement giving my name and qualifications—or disqualifications—and also a statement on title II of the bill, which is the only part of the bill to which I shall speak.

Senator GLASS. Very well, sir. You may proceed.

Mr. YOUNG. That will take me not more than 15 minutes, I think, and if I might be free to present that first and then respond to questions, I would appreciate that procedure.

Senator GLASS. I am sure the members of the committee will observe that request.

Mr. YOUNG. My name is Owen D. Young. My home is at Van Hornesville, N. Y., but I spend the greater part of my time in New York City. With your permission, I shall, as a preliminary, state very briefly my qualifications and disqualifications to express an opinion on the bill before you.

I am chairman of the board of directors of the General Electric Co. In that capacity or as a vice president, I have been associated with that company for more than 20 years. Since 1923, I have been a director of the Federal Reserve Bank of New York. Originally I was chosen as a class B director, which means, as you know, that I was selected by the group of so-called " large banks " as a representative of industry and commerce. I was reelected a class B director in December 1925, and before my term expired, I resigned as a class B director and concurrently, namely, on January 13, 1927, I was appointed by the Federal Reserve Board as a class C director; that is, as a public director, and since that time I have served in that capacity. My present term of office expires at the end of this year, and under the ruling of the Federal Reserve Board, I am not subject to reappointment, so what I say here about this bill has the background of the experience which I have indicated and is said with the full knowledge that I shall not in the future have any responsibility for the operation of the Federal Reserve bank.

I should also say perhaps that in 1924, as a member of the Dawes Committee, I took an active part in the reconstruction of the currency and credit structure of Germany, which, as a result of violent inflation, had completely broken down, and as an incident of such reconstruction, I had to do with the reconstitution and recapitalization of its central bank, known as "the Reichsbank." Later, in 1929, as a member of the Second Committee of Experts, I was concerned with the establishment of the Bank for International Settlements which, through the constitution of its directors, became intimately related to all the principal central banks of Europe. So I have had the opportunity, at least, to observe the personnel and the organization of the central banks of the principal financial and commercial countries of the world.

I should say also that I have had no experience in commercial banking, and I have no greater knowledge of its technical details and special techniques than the average business man. So if in the course of this hearing you seek to explore the technicalities of commercial banking through me, I must warn you in advance of my disqualification and your disappointment.

It is with such a background and in the face of such limitations that I address myself particularly to title II of this bill, titles I and III, I understand, being largely corrective of existing legislation.

At the very outset one must ask whether there is need of banking legislation, and if so, whether the pending bill meets the need. One may well say that a banking system which failed to restrain the boom and collapsed during the depression should be restudied as a whole. This means not only the Federal Reserve but our whole commercial banking system. I predict that such a study would uncover even greater defects in our commercial banking set-up than in that of the Federal Reserve System. This bill is largely directed to far-reaching changes in the Federal Reserve System. One may put the question—I hope free from the charge of destructive criticism—whether it is not wise to look to the soundness of the foundation at the same time that one proposes drastic changes in the superstructure. We have had a great deal of piece-meal banking legislation. Recently we have had considerable emergency legislation. Now, it would seem prudent for us to review it all and present one comprehensive program.

So my conclusion is, Mr. Chairman, that there is need for new banking legislation based on careful study, and I do not think the pending bill meets the need because it deals in the main with only one part of the system.

More than 4 years ago I expressed the view to this committee that all commercial deposit banking in the United States should be carried on under one law; that examination of commercial banks and their controls should be under one authority; and that then, and only then, we could develop for the country as a whole a sound commercial banking system and definitely fix responsibility. I said then that if we were to retain in our system banks of deposit chartered by the States as well as by the Federal Government they should all be required to be members of the Federal Reserve System. That recommendation I repeat now. While this bill as introduced did contemplate that result by requiring all banks whose deposits are insured being brought into the system, I am told that even that provision has been eliminated by the House. So it seems to me that instead of curing one of the most evident weaknesses in our foundation, one of the chief causes of our banking collapse, we avoid it.

I do not criticize the bill because it fails to offer solutions for all our banking problems. That is not the work of a day. If the extension of Federal jurisdiction over all banks of deposit is a prerequisite to any sound system, it is not of itself a panacea. The collapse of 1933 was only the climax to a long and tragic chapter; in the preceding decade nearly 10,000 banks failed in this country. It is true that more than four-fifths of these were nonmember banks, subject in fact to no Federal restraints. It is also true that nearly three-fourths were situated in towns having a population of 2,500 or less, and that these small communities have consequently suffered most. How are we to get banking facilities that are adequate and safe? This question is fundamental and requires exhaustive study. It is only when such a basic question shall have been answered that we can really determine what changes are required in the Federal Reserve System. Yet here we address ourselves instead to the superstructure, which at best can be no stronger than its base.

In proposing sweeping changes, certainly hasty action is to be avoided unless it is imperative. I know of no emergency, either present or prospective, which requires legislation now. Everything which can be done by the Federal Reserve System to relieve the depression either has been or is now being done. The changes proposed in title II will add nothing to the relief of our present condition. The System has provided already, in connection with our gold imports, $2,300,000,000 of excess reserves, credit not in use. Certainly no one would expect or wish it to do more. The Federal Reserve banks are, under emergency powers, making direct loans to commerce and industry under the guidance of the Federal Reserve Board. Certainly nothing in the proposed bill would or should authorize them to do more. The only justification that I know of for new legislation now of the character proposed is to centralize power and responsibility so that we can better control another boom. I venture the opinion that we have ample time for study before that power is needed.

With the consequences of the banking collapse, we are familiar. We have faced them and dealt with them. That was an emergency and it required courage and action. This the Government exhibited and, as a result, our banks are functioning again and are safe. Broadly speaking, the direct consequences of the collapse have been cured except for such corrective legislation as is contemplated in titles I and III of the present bill.

Title II is, I take it, designed to correct some of the causes of the collapse, as distinguished from consequences. Now it is easy to recognize consequences and to cure them. Causes, however, are much more obscure and much more difficult to correct. Where consequences need courage and prompt action, causes require study and reflection. Consequences may require emergency legislation, causes require carefully considered laws. That is especially true in a situation so complex as our banking structure.

Therefore, Mr. Chairman, if there be no need for haste, I see no reason why title II of the pending bill should be dealt with at this session at all. All history shows that one of the characteristics of such a period as we are now going through is a demand, usually somewhat hysterical, for the manufacture of money and drastic revisions of its control. One should not be classed as opposed to corrective and progressive legislation merely because in times like these he suggests study, reflection, discussion, and comprehensive revision.

My chief objection, Mr. Chairman, to the pending bill—and this is a very basic objection—is that it sets up in fact a central bank and destroys the regional system under which we have operated so long. I can see some advantages in a central bank, but I doubt whether such a basic question should be settled until the issue has been fairly made and fully debated both in and out of Congress. It may be that the American people want to destroy the regional system and establish a central bank. I do not know. Members of this committee will not need to be reminded that the last time the issue was presented, the people rejected a central bank in favor of the regional system. Perhaps their views have changed, but I do feel strongly that a result so far-reaching should not be accomplished indirectly. If we are to have a central bank, then our entire law should be redrafted so as to be suitable to one central bank operation. The retention of the regional facade may, I fear, lead the American people to think they are retaining their regional banks when in fact they are creating a central one. Such a basic issue should not be settled by indirection.

The bill puts all the important powers and responsibilities in the hands of one central body in Washington. It diminishes correspondingly those of the 12 regional banks. They are left but little more than administrative branches of this central authority. If such vast powers are to be concentrated in a single body in Washington, then we should take all possible precaution to guarantee the ability and independence of such a group. I am sure that we do not want to have a central bank subservient to any special interests. We must, if possible, keep it free of domination either by politics or finance.

I want to speak about the independence of action in that central body.

We have discovered only two ways in America of guarding against the misuse of great power. One is to take a group of carefully selected citizens, provide for them and their families reasonably for life, and then to some extent insulate them from outside influence of all kinds. The Supreme Court of the United States is a fair example of this method. The other way is to take less care in insulating the group from bias, but to provide diversified representation on the group and to set up appropriate checks and balances within the group itself in the hope and expectation that the power will be exercised wisely even though by compromise.

In the organization of the regional Reserve System, we resorted to this second method. For example, in each of the 12 banks we provided for a board of 9 directors, of whom the chairman and two other directors were to be public representatives named by the Federal Reserve Board in Washington. The remaining six directors were chosen by the member banks, but only one-half of them could be bankers; the other half were the representatives of industry, commerce, and agriculture. The exercise of most of the substantial powers of the regional boards, however, was subject to the approval of the Federal Reserve Board in Washington. It was in this way that we sought to get the views of 3 bankers on the board of each Federal Reserve bank, the views of 3 business men selected by the banks, and the views of 3 independent citizens—and then we superimposed on them the views of the board in Washington, which might be considered to have more intimate knowledge of general conditions, including politics. It was through this balance that we sought results.

It is proposed now to put all the substantial powers in the hands of the board at Washington with no checks or balances from the local boards of the individual Reserve banks on the exercise of these powers. In addition, it is proposed that the Governor of the Federal Reserve Board in Washington shall be recognized as the political appointee of the President, and I assume that means subject to removal by him at any time. The result is that the bill contemplates not only the removal of the regional checks on the central board, but it provides that the most important member of the board shall at least have definite political color. Is it unfair to say, therefore, that the bill contemplates not only a central bank administered from Washington, but that the board of administration shall to some extent be considered political? The proposed bill fails to provide an insulated body, such as has been described as a " Supreme Court of Finance ", and at the same time it removes the checks and balances which have been imposed in the present System. Is it any wonder that such a violent change should create apprehension and dissent?

This apprehension is not alleviated but rather increased by the present state of our budgetary unbalance and the necessity of issuing large amounts of Government obligations. There should be no removal of checks on the bank of issue against taking Government obligations direct and not through the market. It was the exercise of this very kind of power which led to the currency and credit downfall in Germany and the ultimate destruction of the Reichsbank.

I recommend that Government financing direct through the central bank, except for the usual temporary advances, be prohibited in any bill.

I want to speak about the appropriate relationship of Government to a bank of issue.

The central banking organization, whether it be a regional system such as we have or a central bank such as is proposed, must always be subject to the legislative authority of Congress, and to that extent it is politically controlled and properly so. It must always act under the laws and powers granted to it by Congress and within the limitations of these laws. It is a different matter, however, to contemplate either the political domination or the political influence of the executive department of the Government. It is to such political interference rather than to the exercise of the undoubted authority of Congress that exception must be taken.

Whenever a central bank acts, it is an important influence in making credit plentiful and cheaper or in making it more expensive. Someone is always benefited and someone at least temporarily is injured. It has always been so with banks of issue and always will. One consequence is that if the bank does its job properly it is continuously subject to criticism by someone.

It is for this reason that experienced governments generally, while having the undoubted power to take control of the delicate mechanism of the bank of issue, have found it wiser in the interest of Government itself to turn those functions over to an independent body as free as possible from political control or influence. Thus they have sought not only to minimize the abuses which might arise from the temptation to meet the temporary political exigencies of whatever party might happen to be in power, but also to insulate the executive himself from the continuous criticism that must be directed at a central bank whenever it does as it must so often do, the unpopular thing.

Therefore, Mr. Chairman, I look with apprehension not only from the standpoint of a central bank, but from that of the sound functioning of the Government as well, toward any increase of the powers and responsibility of the executive over the operations of the central bank and to any decrease in the independence of the central authority controlling the bank.

I should like to make an affirmative suggestion as to the constitution of this central body, if you get to that point.

Lest I be charged with making merely destructive criticisms, I suggest that if we are to concentrate our banking powers in a group in Washington that we add to the group in addition to the members of the Federal Reserve Board some at least of the governors of the Federal Reserve banks. If we intend to retain fully the regional character of the system, the governors should be a majority of the central body. If we wish to make the banking system, say half regional and half central, there should be an equal number of governors and members of the Federal Reserve Board on the body. If we wish to overweight the centralized character of the institution but retain some of its regional characteristics and benefits, we might have a majority of one, say, from the Federal Reserve Board, with the governors in a minority. If we create a larger majority than one from the Federal Reserve Board, and particularly if we make the election of the governors subject to the approval of the Board, then we have almost as complete centralization as if the governors were not represented at all. In my view, therefore, whatever the number of the central body may be, members of the Federal Reserve Board should not outnumber the governors by more than one at the very most.

The question has been raised whether the Secretary of the Treasury and the Comptroller of the Currency should be members of the Federal Reserve Board. In this respect I shall differ with most of the people, I think, who have appeared before the committee. I suppose the reason for this question is the very thing to which I have previously referred, namely, the increased power of the executive department over the central bank, and in the case of the Secretary of the Treasury the fact that he is specially interested in the money market so far as Government borrowings may be concerned.

My answer to the question is that in principle I think that neither the Secretary of the Treasury nor the Comptroller should be members of the Board. We have, however, an unusual situation in this country today. Due to our change of the gold content of the dollar there is something like two billions of dollars in the hands of the Secretary of the Treasury available for operation in the Government market and over the exchanges. It is a fact, therefore, that the Secretary of the Treasury can, irrespective of any action by the central bank, dominate the money market of the country. So long as that fund exists uncontrolled in the hands of the Secretary of the Treasury and the President, I am in favor of retaining the Secretary of the Treasury as a member of the Federal Reserve Board and thereby imposing upon him that much responsibility at least for cooperation with the central bank in the handling of this vast stabilization fund. Personally, as I have testified before to this committee, I think that stabilization fund should only be administered through the central bank and should not be subject to independent operation in the money market. Therefore, as a matter of expediency only, I would yield the principle and not take the Secretary of the Treasury off the Federal Reserve Board.

As to the Comptroller of the Currency, I have always believed that the powers vested in that office should be administered by the Federal Reserve banks, but until that is provided for I can see many advantages rather than disadvantages from the retention of the Comptroller of the Currency on the Federal Reserve Board. I trust, however, that the reason for his membership, like that of the Secretary of the Treasury, may prove temporary only and that ultimately we shall have no political officers as members of the Board.

I want to speak now about the independence of the governors of the several Federal Reserve banks.

It is proposed in the bill that the governors of the several Federal Reserve banks, and the vice governors too for that matter, shall be appointed annually by the boards of directors subject to the approval of the Federal Reserve Board in Washington. This seems to me to be quite consistent with the evident purposes of the bill, and my interpretation of it. It is intended in fact, as I have said before, to create a central bank administered by the Federal Reserve Board in Washington, and the Governor of the Federal Reserve Board shall in fact become the governor of the central bank of the United States. The governors of the several Reserve banks will be practically only vice governors of this central bank, and it is natural that, as administrative officers of the central authority, they should be subject to a veto by the central authority each year on their right to continue in office. If that is the theory of the bill, as I think it is, then this approval of the governors is entirely consistent with it. That of itself, Mr. Chairman, seems to me to destroy the last vestige of initiative and independence in the regional banks. They are not even permitted to retain the power of selecting their own executives. It illustrates again how false and misleading the facade of the regional system is to be and how truly centralized our bank of issue is to become.

If it is intended to leave even a shred of responsibility in the boards of directors of the several Federal Reserve banks, the most that the central authority should be permitted to do in the selection of governors would be to approve any new man elected to that office as to character and ability, and thereafter leave the power in the boards of directors to reelect. I see no other way to relieve the governors of the several banks from the overhanging threat of coercion by the central authority. This at least will conserve some of the checks and balances of which I have formerly spoken. This is highly important, too, if the governors are to be represented on a central authority in Washington; otherwise disagreement with the members of the Federal Reserve Board by any governor may at least raise the question of the approval of his next election. Obviously, no one or more members of the central authority should have the power to disqualify any other member because of his vote.

Now, I want to say just a brief word on the effect of the enactment of this legislation on recovery.

What we are concerned with today, Mr. Chairman, is to take up our unemployment. Only business can do that. Then our State and local budgets will be relieved from excessive borrowing and taxation. Then our Federal Budget can be brought into balance and all fear both at home and abroad of an uncontrolled inflation may be avoided. That is a necessary step to the stabilization of our exchanges and the restoration of foreign trade. Only when that is done will our great agricultural exports freely move again and so insure again safety and prosperity to the farmers of the Nation.

The key to our whole situation, then, is business activity and particularly in the field of durable goods, where most of our unemployment now lies. As durable goods have to be financed on long time, that market is particularly sensitive to drastic changes or threats of change in our financial structure. Business in durable goods has undoubtedly been reassured by the failure of the Patman bill. It is still apprehensive about the political domination of our central banking system, with the resulting threat to the commercial banking system. Whether business should be apprehensive over the bill pending before you or whether it should not, views will differ, but the fact is that business is apprehensive. The passage of the bill, therefore, either because it is not understood or because it is, will to some extent retard business recovery. If there were any real reason for immediate action on title II, we should be compelled to enact it and accept the delay in recovery; but seeing no reason for action now, I feel that there would be great reassurance to business if a comprehensive study of our whole banking system could be undertaken instead.

We have vast reserves in the banks, more than 2¼ billions, the base for 25 billions of additional credit, awaiting use; an ample amount, certainly, to get all the expansion we need. We have done all the preliminary things that are necessary to do in finance. We have decreased the gold content of the dollar, we have increased our gold supply, we have reestablished confidence in the banks, we have enlarged the volume of our current business and gradually restored the shattered confidence of business men. The upward surge of a basic economic demand is ready now to break through our doubts and fears, and when it does, our credit resources will be put to work by business. It isn't the bankers who are holding back the credit. They are anxious to make it work, for in no other way can they earn their living. It is business which until now has been too apprehensive to use the credit. So I say the way to get recovery today—to get expansion, in fact, today—is to do nothing more and threaten nothing more to shake the confidence of business men. It is careful conservatism, not radical new departures, which will get now the activity which we so sorely need.

I oppose the enactment of title II of this bill, Mr. Chairman, not only because it threatens to retard recovery, but even more because it will postpone the banking reforms we need. It works from the top down rather than from the bottom up. It creates a central bank by indirection. It carries with it the threat and potentialities of political domination of that bank, not by Congress but by the Executive. If it is to be passed, title II at least should be so amended as to preserve the fact and not the shadow of our present regional structure. Concentration of authority should be protected by a regional representation which is adequate and independent. Some of the checks and balances of the present system should be preserved so that the sensitive controls of money and credit may be vested in a body which is free from the fact and from the suspicion of subservience to any selfish interest, whether of profits or of votes.

It is by the revision of our whole banking structure, the commercial as well as the Reserve System, that we may hope to correct the faults which have been disclosed and prevent the recurrence of the disasters we have experienced. Then, and not till then, will Congress have met its full duty and responsibility in giving the American people the kind of banking system they ought to have.

That is all I have to say, Mr. Chairman.

Senator GLASS. Does any member desire to ask Mr. Young any questions?

Senator McADOO. Mr. Young, I was not present when the early part of your statement was made. You touched upon the point, but I do not know whether you gave an answer to the suggestion which has been made, that if the Reserve Board could be created free of political influence, as you described it, whether you would consider it wise to confer upon it the exclusive control and direction of the open-market operations.

Mr. YOUNG. You have two problems before you, Senator, on that. You can destroy the regional system and create a central bank. If you are going to create a central bank, if that be the decision, then it is all important that you establish this body of control as free from all influences as possible in order that you may have something which you might term the "supreme court of finance" and protect the members as well as we protect the members of the Supreme Court. I think that is needed if you are to centralize that large power.

Senator McADOO. You consider that desirable whether we centralize it any more or not, do you not?

Mr. YOUNG. I do not think it is so necessary if you have regional representation, because then the body, within itself, carries, in a way, its own checks and balances.

Senator McADOO. I am chiefly concerned now about this concentration of authority over open-market operations.

Mr. YOUNG. Yes.

Senator McAdoo. Assume it were decided that it is wise to concentrate that authority. Then, of course, I understand your point, that the authority which is to exercise the power should be free of political influence or domination in any way.

Mr. Young. Yes.

Senator McAdoo. Assuming such a body, do you think, in all the circumstances, that if no other changes, for instance, are made in the Federal Reserve System as it exists today, it would be wise to concentrate in that body control of open-market operations?

Mr. Young. No; I think if you are going into the business of concentration, Senator, you have to concentrate three powers, because I think they are all interlaced, and the exercise of one affects the others. You cannot fix responsibility, therefore, without concentrating the three in the same body.

One is the power to fix the rediscount rate, another is the open-market operation, and the third is dealing with reserves.

I can see no advantage over our present system in concentrating any one of those powers and leaving the others still scattered, because the action in one field has such a direct repercussion on the other.

Senator McAdoo. I was going to ask you about the other two. Do you think that if you should concentrate one the others would inevitably have to follow?

Mr. Young. I think they should. Otherwise you accomplish nothing.

Senator McAdoo. As I understand you, you do not think it would be wise to concentrate all those powers in any central authority, no matter how free it might be from political domination or control.

Mr. Young. I do not want to say that, Senator. I would say that if, on a complete revision of our banking system, commercial as well as Federal Reserve, it seemed wise to create a central bank, and we felt we could insulate the central authority adequately, it might be the best solution of the problem. It might be.

Senator McAdoo. Do you think that if those three powers we are discussing now were concentrated in a board such as you have been considering that that would in fact constitute a central bank?

Mr. Young. That is all there is to a central bank. The rest of it is all detail or administrative procedure.

Senator Couzens. There is one other question in connection with that. Do you believe that the reserves should be statutory or flexible, however the board is constituted?

Mr. Young. The power to deal with reserves, of course, is the power of life and death over your commercial banks. I would say that such a vast power as that ought to be protected to the greatest extent possible. My personal inclination would be to have a statutory limit within which the power might be exercised but beyond which it should not be exercised.

Senator Couzens. So that to some extent you believe it ought to be flexible?

Mr. Young. Yes. I certainly think it ought to be flexible within limits.

Senator McAdoo. Do you think there should be a maximum and a minimum or merely a maximum?

Mr. YOUNG. I do not believe I am competent to answer that question.

Senator BULKLEY. In changing the percentage of statutory reserves, do you believe the board ought to be required to declare an emergency?

Mr. YOUNG. No.

Senator BULKLEY. It ought to be entirely free to act as it thinks best?

Mr. YOUNG. Yes. In any banking system, whenever anybody starts talking about emergencies, you have got one at that moment. You create it.

Senator BYRNES. If you did not have it before, you have it immediately?

Mr. YOUNG. You have it immediately.

Senator MCADOO. I think we all see that.

Senator COUZENS. May I point out, Mr. Young, that on page 3 of your memorandum you say this [reading]:

> So I have had the opportunity at least to observe the personnel and the organization of the central banks of the principal financial and commercial countries of the world.

You did not say whether you had any opportunity to study the operations of these central banks. I think there is quite a distinction between the organization of the personnel and the operation of the central banks, and I was wondering whether you had any opportunity to observe the operations of the central banks and could give us any advice in connection therewith.

Mr. YOUNG. Of course, I have watched their operations with considerable interest during these last years in all the countries.

Senator COUZENS. Have they operated well?

Mr. YOUNG. Yes. I think, on the whole, very well, considering the difficult conditions which exist in the world. The currencies of the whole world, unfortunately, are on a managed basis, not particularly because the financial people wanted them there, or the political people wanted them there, but because we have had such dislocations, economic dislocations, and then political dislocations in the effort to correct the economic ones, that the old international functioning of the gold standard did not work any more. I think it is unfortunate.

Senator GLASS. Do you know of any central bank, Mr. Young, that is permitted to manage the property and the deposits of all the other banks in the country?

Mr. YOUNG. No, sir.

Senator COUZENS. From your observation of all the personnel and the organization of these central banks, has any one of them stood out as more effective and efficient than any other?

Mr. YOUNG. It is very difficult to make the comparison, because they function under such different conditions. The Reichsbank, for example, since its restoration, has had exceedingly difficult problems. It is directed by a very able man in Doctor Schacht. The Bank of England has had its own peculiar conditions, and the Bank of France has had them and is having them.

Senator GLASS. There had to be a restoration of the Reichsbank.

Mr. YOUNG. A complete restoration, Senator. The nations of the world had to raise $200,000,000 in gold in order to reestablish the Reichsbank. We established a new reichsmark and provided for the exchange of the old reichsmarks at the rate of 1,000,000,000 of the old for 1 of the new. So you can see the extent to which the currency depreciation had gone in Germany.

Senator GLASS. The Reichsbank was wrecked.

Mr. YOUNG. Completely wrecked.

Senator GLASS. Upon the issuance of its notes upon Government bonded indebtedness.

Mr. YOUNG. Quite true. That is one of the reasons why I am saying that I think any bill here ought not to permit the central bank to take obligations of the Government direct.

Senator McADOO. You mean long-time obligations?

Mr. YOUNG. Yes. Temporary advances, of course, must be made. Such Government obligations as the central bank holds it should take in the open market. What happened in Germany was that the Government put its bonds into the Reichsbank, and the Reichsbank issued its notes against those bonds, and it was only just doing in a roundabout way what the Government might as well have done direct, by the printing press.

Senator McADOO. Was not that done for a specific objective?

Mr. YOUNG. A very specific objective. They were seeking inflation.

Senator McADOO. They were seeking inflation for the purpose of destroying all debts, were they not, in large measure?

Mr. YOUNG. They were seeking inflation partly for the purpose of reducing the burden of debt, but I think more largely, Senator, after the end of the war, for the sake of getting a better base for their exports.

Senator McADOO. Whatever it was, it was not done just for no purpose. There was a definite objective.

Mr. YOUNG. Oh, yes.

Senator McADOO. In other words, that was the method employed, not because it was inflationary, but because it was the means by which they could accomplish the results.

Mr. YOUNG. Quite true.

Senator McADOO. And no other was available.

Mr. YOUNG. I was in Germany several times during the progress of that. The result at the beginning was a stimulation of business. Business itself felt that under those circumstances it would be wise to have some inflation. Everybody was confident that that inflation, after having proceeded just to the right amount, could be stopped. It turned out, as it has always turned out before, that when you get that thing started there is no power to stop it, and so they rode to ruin.

Senator GLASS. They did not happen to cut the heads off those fellows as they did in France in the revolutionary days, did they?

Mr. YOUNG. No. They saved their heads.

Senator McADOO. I do not think it necessarily follows that an expansion of currency under conditions that seem wise at the moment, if it is rationally done and properly safeguarded, results in such an infection that a fatal and malignant disease is going to pursue you to the death. I think it depends entirely upon the conditions and the manner in which this power is exercised.

Senator GLASS. It does not necessarily follow, but it has historically followed.

Mr. YOUNG. It has historically followed.

Senator McAdoo. In other countries, yes; but when we deal with those things and discuss those things, I think we have to discuss them with reference to our own conditions and attempt to apply them here.

Mr. Young. My attitude toward inflation is this, Senator McAdoo—and this is why I am apprehensive about it: I am apprehensive for the same reason that I would be apprehensive if a man who had my most precious possessions began morphine. I would be troubled about that. I would be apprehensive about it. He might argue, and his friends might argue, that he was a good strong chap, and that a shot of morphine now and then did not hurt him, and relieved him a little from his depression of spirits. But, nevertheless, I would not feel comfortable or confident in going on with that chap any longer. That is the reason why I am so scared, as the chairman says, in the light of history.

Senator McAdoo. I do not think the analogy is good.

Mr. Young. Perhaps not.

Senator McAdoo. Nevertheless, while I am not arguing for inflation, what I have been very much interested in is to find out, if possible, where inflation begins. Take the conditions of the country today. Are we on an inflation basis now?

Mr. Young. No; I do not think we are.

Senator McAdoo. Why not?

Mr. Young. That may require definition.

Senator McAdoo. Exactly.

Mr. Young. That is, as to what you mean by an inflation basis. If you mean that we have had so much expansion and we have so much currency and credit in use that we have inflation, I say "no", of course. If you mean to ask whether we have the base on which to get it, I say "yes."

Senator McAdoo. We have created all the evil potentialities, undoubtedly.

Mr. Young. We have what?

Senator McAdoo. We have undoubtedly created all the evil potentialities of which you speak.

Mr. Young. No.

Senator McAdoo. In other words, we have an abundant supply of morphine. It is a question of whether or not it is going to be used.

Mr. Young. We are not in danger because it can only be expanded as business uses it. That is a check, and that is a very real check.

Senator Glass. Adverting to your statement of your observations of central banks in other countries, do you know of any central bank the chief managers of which have not had considerable banking experience and observation of banking policies and technique?

Mr. Young. Every central bank that I know of has officers who have had experience.

Senator Couzens. If you had to reorganize the Federal Reserve System and set up another form of centralized control, have you any plan of your own that you think would be adaptable to it?

Mr. Young. I have not, Senator.

Senator Glass. But if charged with the study of the problem you might have, might you not?

Mr. Young. Indeed.

Senator Glass. You could not do it overnight?

Mr. YOUNG. Quite so, because the problem is so complex; and because I think it has not been adequately studied is the reason why I say that I see no occasion now for the enactment of such a bill as is proposed. That does not mean that I am opposed, necessarily, to many of its provisions, but I think it will delay the comprehensive reforms that we need in the banking structure of the United States.

Senator McADOO. With 49 different banking systems, I have to agree with you that it is a very complex problem.

Mr. YOUNG. Very.

Senator COUZENS. Do you agree with General Dawes, that we are going to have a comeback in July?

Mr. YOUNG. I told the General that it was all right to be a prophet, but he should not fix the date.

Senator McADOO. Sometimes good prophets are wrecked by dates.

Senator COUZENS. You do not contemplate, then, that before any general revision can be made such as you have suggested, there is likely to be a runaway market in the heavy goods industries?

Mr. YOUNG. I am not that optimistic, Senator, certainly.

Senator COUZENS. Have you any optimism with respect to that, that there is going to be a fairly quick comeback in the use of heavy goods?

Mr. YOUNG. It depends entirely on whether or not the reviving confidence is shattered again or whether it can be continued and built up. There is a great underlying demand for durable goods in this country, and if we could get the road cleared to finance them and have confidence on the part of people to buy them, they would revive very quickly and in very large volume, in my judgment.

Senator McADOO. Do you think our $4,000,000,000 is going to help in that regard?

Mr. YOUNG. I do not see how it can, very much. That is one of the fields where I see no way that the Government can reach it. If we could build one or two million $5,000 houses in this country, small houses which are greatly needed, it would do more than all the appropriations that the Government could make toward a restoration of the durable goods industry and the taking up of the slack in unemployment.

Senator McADOO. There is no question about the fact that it is to be employed in useful work and that there will be a distribution in the matter of materials.

Mr. YOUNG. I think you will find, Senator, that it will have only a slight repercussion in the material market. Much of it has got to go for labor, and therefore it will have a repercussion on goods of current consumption, much more than on durable goods, I think. Durable goods require great plans, for example, long planning, a long time for fabrication, and they are not very suited to the quick employment of the $4,000,000,000 which is needed to relieve the distress.

Senator BYRNES. Assuming that $2,000,000,000 of the $4,000,000,000 were spent for material, what effect would an expenditure of that size have?

Mr. YOUNG. I cannot conceive that there would be any such an amount as that spent for material; and if there were it would not have a tremendous effect on the durable-goods market, on the material market, because that field is so large and runs into money so rapidly. You see, a million small houses, which is not a very large amount for this country, at $5,000 each, which means $5,000,-

000,000—that, of course, would have tremendous consequences, a repercussion on the whole durable-goods field.

Senator COUZENS. What would you suggest might be done to restore the confidence of the investors in durable goods that you spoke about a while ago?

Mr. YOUNG. I made the statement here this morning, Senator, that I think now the less we do and the less we threaten to do, the quicker confidence will be restored and the quicker we will get recovery and prosperity in this country. We have done enough now.

Senator COUZENS. You mean, we ought to adjourn and leave everything as it is?

Mr. YOUNG. I think that would be very good.

Senator MCADOO. Will you make a motion to that effect? I might support it.

Senator BYRNES. Have you felt that way ever since 1931 and 1932?

Mr. YOUNG. Oh, no, indeed; not until we had to clear away a great deal of the impediments. We had to enact a great deal of legislation and clear the ground. But we now have, as I said, perfectly sound banks. The people have confidence in them. They have two and a quarter billions of unused credit in those banks, which is a base for $25,000,000,000 of operating credit, and the only question is to get business to use that $25,000,000,000 of operating credit. It will use it the moment it has confidence, because I think the economic needs are here; but it will never use it as long as confidence is impaired. Therefore, I would say that we ought to stop now and take a breathing spell and do nothing and threaten nothing further.

Senator GLASS. Thank you, Mr. Young.

(The witness withdrew from the committee table.)

STATEMENT OF GEORGE L. LE BLANC, NEW YORK, N. Y.

Senator GLASS. Give your name and occupation, please.

Mr. LEBLANC. George L. LeBlanc. I was born in Montreal, Canada. I am an American citizen, and I have been engaged in the banking business all my life.

Senator TOWNSEND. Where?

Mr. LEBLANC. New York City. I have been the senior vice president of the Equitable Trust Co. of New York and, simultaneously, president of the Equitable Eastern Banking Corporation and later president of the Interstate Trust, of 37 Wall Street, New York City. I have had many conferences with the governors of central banks abroad, because most of my experience has been in the foreign banking field, in which I probably have financed more imports and exports than any other banker in the country.

I thank you, Senators, for giving me the privilege of addressing you. It will only take a few minutes.

Our primary objective is to restore and maintain our national economic existence, which must prevail. The most important mechanism to secure this result is now under probe—our banking system.

We now have a privately owned bank, owned by bankers, primarily a reserve bank for bankers, controlled by 108 directors, 13 boards, which are in turn separately governed by 13 governors, and in addition to this we have nearly 3,000 State legislators who can also legislate banking measures.

The already-proven inefficiency of this outworn banking system, accompanied by mistaken leadership, has been powerless in preventing the worst financial calamity in the world's history. Therefore, it is imperative that we should take necessary steps to prevent future occurrences of that kind. You may be surprised to hear that as far back as 1918 the leading bankers of New York were well aware that the Federal Reserve could not cope with a serious banking panic, which has since been demonstrated. This must of necessity be changed.

While the banking amendment of 1935, intended to liquidify the good banking assets and to protect further the Government's credit, is honest in purpose and much needed, however, it is unthinkable to put the Government permanently in full control of the Nation's banking business. You may put me down on the side of the bankers in opposing this legislation.

On the other hand, I believe that the banking control should be put under neutral leadership, and not in the hands of the administration or arbitrary selfish interests.

Overlooking the political reactions, the banking leadership evidently would allow the enormous debts hanging over this country to be partly decapitalized through the bankruptcy courts, while the administration, cognizant of this fact, would use the resources of the Federal Reserve, privately owned, to prevent the ravages of such a policy. No doubt you readily realize that, as long as the Federal Reserve stock is held by banks, its resources cannot be used for political purposes. The stocks of similar banks throughout the world are held in the hands of public citizens. It is undoubtedly a wise step.

On my part, I would much prefer to have a bill such as the Nye-Sweeney bill, because it has the essence necessary to create a sound and practical national banking system, as free as possible from selfish motives, while benefiting and protecting our economic existence, including our banking system. It has also much more potency in regulating bulges, which have in the past been seriously detrimental to our economic life.

The Nye-Sweeney bill is the base of what should be enacted by this Congress. It must follow the course of all legislation with minor correction of detail in this committee and on the floor of the House of Congress. It should not be left to the selfish interest of bankers or politicians to remodel. It should have the aid of impartial, honest critics to refine it.

Probably later on I will read another statement about our situation, but in the meantime I wish to say that a Federal Reserve bank is a reserve for banks. It is an arrested development. We are artificially trying to make it Federal on top of that. It is most important, judging from the experience of the banks of Europe, which have had a great deal of experience, that the leadership must be put in neutral hands, somewhat along the line of the Supreme Court of the United States, which has the confidence of the country. We are going to meet many serious problems, and if the blame is put on the banks according to the present system I do not think it would be wise.

Senator BYRNES. How about the provision in this bill that "the board of directors of the Bank of the U. S. A. shall be composed of one representative from each State, elected by the people thereof"?

Mr. LEBLANC. That is one thing that I shall cover in a paragraph. It has to be reconstructed in the best interests of our country.

Senator BYRNES. I understand that you are going to discuss that later?

Mr. LEBLANC. I am going to discuss——

Senator BYRNES. Are you in favor of that provision?

Mr. LEBLANC. I am in favor of many provisions of that bill.

Senator BYRNES. I mean, of this particular provision, that the directors shall be elected by the 48 States.

Mr. LEBLANC. I will leave that to people who are more versed in it.

Senator BYRNES. What is your view about it?

Mr. LEBLANC. I believe that the men that should be at the head of this supreme court of banking should have no interest in any other activities; that their money should be in governments and municipals. They should be provided for for life, which makes them as neutral as possible.

Senator BYRNES. This provision of the bill reads as follows [reading]:

> The board of directors of the Bank of the United States of America shall be composed of one representative from each State, elected by the people thereof at the same time and by the same method as Representatives in Congress, for a period of 12 years.

Mr. LEBLANC. If that is the best neutral way of selecting these officers, I am in favor of it—unless you show something better.

Senator BYRNES. What is your view of it? Is that the best way that you know of?

Mr. LEBLANC. That I know of.

Senator BYRNES. To be elected by the people for 12 years?

Mr. LEBLANC. It might be better for each legislature of each State to appoint its director.

Senator BULKLEY. Do you mean that that would be the best way to keep it out of politics?

Mr. LEBLANC. The principal thing is that these men cannot have any outside interest.

Senator BYRNES. You call that a "supreme court of banking", and you want them to have this power?

Mr. LEBLANC. To have no interests whatsoever outside of their positions, and not be dependent on any outside interest.

Senator BYRNES. All right.

Mr. LEBLANC. For instance, a good many banks in Europe have that same clause, and I think it is the only proper way to handle it. Unless we have something better, I am for that.

Senator COUZENS. Do you have any other statement to make?

Mr. LEBLANC. I want to make another statement. For years I have faithfully served my masters. Now I have no master but myself, and I come down here to serve my country in the matter of public policy in the most important question of the hour, namely, the money and banking question.

We are facing a serious crisis, and I came to tell you the truth so that you might be guided.

Gentlemen, if we had been told the truth, and had faced the facts, we would not have gone down the way we did. When England went off gold, that automatically made our banks insolvent, and if we had faced the facts then, instead of trying to cover them up, we would not have gone down in a catastrophe as we did. That is one of the important points. With a neutral bank, from a neutral standpoint, we would have stopped that and prevented going down the way we did.

Senator BULKLEY. What would have been the method?

Mr. LEBLANC. To immediately go off gold. In 1927 I was with the Deputy Governor of the Bank of France. I loaned him one of our men to help out their stabilization in 1927, and according to all economic laws 1927 was the year in which we were due to have just what we went through. One of the leading English bankers went to see the President and spoke to him, and at that time I knew what the conversation was, what this country was due to go through, but on account of the boom we had it was delayed. If we had had a central bank run by unselfish interests, we would not have had this tremendous bulge on the way up, and the consequential depression.

Senator COUZENS. The only thing you recommend to have done at that time was to have gone off gold?

Mr. LEBLANC. There was nothing else in the world.

Senator COUZENS. Was that the only thing to have done?

Mr. LEBLANC. There was no other thing to do. On account of the economic life of the world it could not be avoided. England tried to do its best, and on a Friday they had a meeting of the leaders and they said, "We cannot open our banks and stock exchange on Monday." But they did not let them close. They went off gold.

Senator GLASS. England had about $20,000,000, and this country had 43 percent of the gold of the world.

Mr. LEBLANC. But, Senator Glass, England had a foreign investment of probably $15,000,000,000, practically the equivalent of gold. To make the statement that England went off gold because she had no gold is all right for people's consumption, but not for right-thinking bankers.

Senator GLASS. It is a fact, is it not?

Mr. LEBLANC. I never believed it, Senator. Do you know, Senator, that the banks had several hundred millions of gold in their vaults at that time, when they went off gold, and England had a foreign credit balance of perhaps $15,000,000,000, which is the equivalent of gold, and yet a country like that has to go off gold because she has no gold? It is unbelievable.

Senator GLASS. The Bank of England had about $20,000,000 in gold when she went off the gold standard.

Mr. LEBLANC. The Bank of England's statement showed about $650,000,000 gold when they went off, and it did not include in that the gold that was in the English bank vaults.

The surplus gold of the Federal Reserve System should have been kept in the coffers of our American banks instead of letting the public have it. The minute the public had it I said then, "You will lose all your gold." And that is just what happened. It was badly led at that time, and that is what brought on these results.

Let me tell you this economic policy. I do not have to apologize about the technique of it. I have discussed these domestic questions with the foreign governments, with the governors of various Federal Reserve banks in their handling of the situation. We were friends. I knew their inner minds. In 1924 we started our economic policy here which led us to this tremendous boom. England was shipping gold to us. They wanted a higher price level so that they could dump their goods here. The manufacturers and the corporations were called in, and they said, "Gentlemen, don't reduce your wages; don't reduce your earnings, but you must reduce your costs." So they said, "We can only do that by mass production." The question was asked, "How are we going to dispose of goods manufactured by mass production?" They said, "We are going to enter into a policy of foreign loans. That will automatically develop a purchasing power in this country and abroad and you will be able to dispose of your mass production."

That was the beginning of the pyramiding of these foreign loans.

In 1929 we called a halt. "No more loans. Pay us."

Well, first, the foreign countries started to put up their tariffs to protect themselves. They started to form exchange control. They started barter; they started cartels, and finally they developed their armies. In 1929 we used a wrong policy. We should have said, "We have made fools of ourselves in this orgy of lending. Let us nurse it through now." But we said, out of a clear sky, "You have got to pay us." Then the whole world became gradually driven to chaos, and ourselves the same way.

Senator GLASS. Do you discuss the provisions of the bill in your statement? If you do, I think we would better have your discussion of them.

Mr. LEBLANC. All I mention, Mr. Chairman, is the control of the situation. I am not so interested as to the first candlelighter and the second candlelighter and who is going to light the candle. I am only talking of the control, because, after all, the control will be what will determine a great deal of the construction of the bank.

Senator BYRNES. May I ask you one further question? I call your attention to this provision of the Nye bill [reading]:

> Within 1 year after the passage of this act all banking institutions under the jurisdiction of the Bank of the United States of America shall be required to keep on deposit with the Bank of the United States of America, or in its vaults, United States bank notes herein provided for a full 100 percent of its deposits which are subject to check and payable on demand.

What do you think of that?

Mr. LEBLANC. I myself would be in favor of keeping a lower amount of demand deposits, starting with 15 or 20 percent, so when the banks are overloaned and the deposits are withdrawn, they do not have to dump securities over.

Senator BULKLEY. Fifteen or 20 percent of what?

Mr. LEBLANC. Of currency against demand deposits.

Senator BYRNES. Have you studied this bill?

Mr. LEBLANC. Yes; I did, sir.

Senator BYRNES. What do you think of this provision?

Mr. LEBLANC. I am interested in the essence of this bill, but I do not see——

Senator BYRNES. You do not agree with that provision?

Mr. LeBlanc. Well, no. Frankly, gentlemen, my opinion is that it would be probably better to have 15 or 20 percent. Every bank in the world carries more currency than we do.

Senator Byrnes. It says further (reading):

and, in addition thereto, it shall keep within its vaults the further sum equal to 5 percent upon all savings or investment deposits, commonly known as "time" deposits.

Mr. LeBlanc. Yes.

Senator Byrnes. A hundred percent of all deposits subject to check?

Mr. LeBlanc. Yes. I would say 15 or 20 percent, and then it would be left to the head of the bank to determine the reserve of currency.

Senator Byrnes. You would change that to 15 or 20 percent?

Mr. LeBlanc. Yes.

Senator Couzens. Have you any comment to make on the Eccles bill as it passed the House of Representatives? That has been more currently discussed. Have you any point about that?

Mr. LeBlanc. It is an emergency affair. It is only an emergency affair; I am not so opposed to it in one way, because we need it. If our first mortgages in the savings banks and insurance companies are not liquid, we are going back the same old route of insolvency. They must be made liquid.

Senator Couzens. And if we cannot get the Nye-Sweeney bill through at this session, you would not oppose the Eccles bill; is that right?

Mr. LeBlanc. I would not oppose it, provided it is not permanent.

Senator Couzens. Well, nothing is ever permanent, with Congress changing every few years.

Mr. LeBlanc. I am entirely opposed to the Government controlling the banking situation, because they can inflate just whenever they wish to protect themselves, and the banking interests are opposed to that.

Senator Byrnes. You favor the purchase of the stock of the Reserve banks?

Mr. LeBlanc. As long as the stocks are in the hands of the member banks I do not see why anybody would play football with their resources.

There should be an intelligent nursing policy of long international credits against purchasing of goods from this country. This includes stabilization of the currencies of the world.

Long-term domestic credit will not be resumed by private banking until this stabilization is accomplished.

Private banking will remain on strike until stabilization is accomplished. Without it we have only central banking as an alternative.

The only source of long-term credit today is Government credits.

The whole domestic reconstruction program must rest upon breaking the strike of capital. As long as the debt structure is at its height it cannot be paid on present low income. The bankers would like this excess debt wiped out.

What a conservative should stand for is some plan to save the ravages of such a policy which will inevitably lead to another banking moratorium.

Central banking, independent of misguided banking interest and independent of political influence, has promise as never before.

Senator COUZENS. Is that all that you have to say?

Mr. LEBLANC. That is all, unless you have some more questions.

Senator GLASS. We will recess now until 2 o'clock, and will meet in the Appropriations Committee room in the Capitol.

(Whereupon, at 12:05 p. m. a recess was taken until 2 p. m. to meet in the room of the Senate Committee on Appropriations, in the Capitol.)

AFTER RECESS

The subcommittee reconvened at the expiration of the recess, at 2 p. m.

[Uncorrected]

STATEMENT OF HENRY PARKER WILLIS, ECONOMIST, NEW BRIGHTON, NEW YORK CITY

Senator GLASS. Give the reporter your name, address, and occupation.

Mr. WILLIS. My name is Henry Parker Willis; residence 215 Prospect Avenue, New Brighton, New York; profession, economist. The only part of my professional career that I think is germane to the present proceeding is that I was associated with the House Banking and Currency Committee during the time that the Federal Reserve Act was under consideration, and I was then secretary of the Federal Reserve Board during its first 4 years.

Senator GLASS. You were secretary when the position of secretary was of an advisory nature.

Mr. WILLIS. Yes.

Senator BANKHEAD. What period were you secretary?

Mr. WILLIS. From 1914 to 1918. Then I was economist of the Board. I think I had the title of economist of the Reserve System during the following 4 years.

Senator TOWNSEND. From 1918 to 1922.

Mr. WILLIS. From 1918 to 1922. I organized the statistical services of the Board and started and edited the bulletin during my term of office.

How shall I proceed?

Senator GLASS. You had a large part in drafting the original Federal Reserve Act, and therefore you were adviser to the Ways and Means Committee when Senator Underwood was chairman, I believe.

Mr. WILLIS. Yes; for 2 years.

Senator GLASS. You are now professor of banking at Columbia University?

Mr. WILLIS. Yes.

Senator GLASS. You understand what we have under consideration—this bill to reorganize the Federal Reserve Banking System. I would be glad to have you express any views you might entertain on the subject.

Mr. WILLIS. Is it your wish that I present a prepared statement, Mr. Chairman?

Senator GLASS. If you have one prepared.

Mr. WILLIS. I have one that I have prepared, and with your permission I will file it. In order to save the time of the committee I will briefly summarize it, and then add some comments on the bill.

Senator GLASS. Very well.

Senator TOWNSEND. Are you discussing all parts of the bill?

Mr. WILLIS. Of course, there are many things in the bill that I should like to discuss in detail, but I think time will not permit. I shall present merely a general survey of the bill.

Senator TOWNSEND. All three titles?

Mr. WILLIS. Generally speaking; yes.

Gentlemen of the committee, my statement here covers three sections. The first is an argument as to the necessity of the bill at this time. The second is a discussion of the general purport and content of the bill itself; and the third part consists of some suggestions and recommendations with reference to technique in the bill, assuming that it is practically unavoidable to go ahead with the bill at this session of Congress.

In a general way, perhaps the matter I consider most important in what I have to say is to recommend as strongly as I can that the legislation be deferred and not acted upon at this time.

Senator COUZENS. You refer only to title II when you say that?

Mr. WILLIS. I refer to the whole bill.

Senator COUZENS. Titles I, II, and III?

Mr. WILLIS. Yes, sir; unless title I can be considerably altered. I will explain that briefly in a moment.

Senator COUZENS. Is not title I necessary, in view of the Federal deposit insurance?

Mr. WILLIS. I think some portions of it are very desirable. At least, it is very desirable to have those topics covered, because I think the Federal Deposit Insurance Corporation is not now in a position to meet any serious emergency. If that be true, the sooner something is done to put it in a stronger position the better we shall be.

With reference, gentlemen, to the whole question of the immediate necessity of the bill, I want to say that we are officially assured that the banking situation is most satisfactory now; that the recent emergency is over; and that there is no difficulty at all with present banking conditions. If that be true—and I am merely stating what has been officially announced—there would seem to be no good reason for proceeding with any such bill, or, indeed, with any bill, at the present moment.

Senator BULKLEY. What official announcement are you referring to?

Mr. WILLIS. The report of the Comptroller of the Currency. In the first paragraph or two of his report, he states that in so many words, I believe.

Senator BANKHEAD. What is your present relation? What is your present connection?

Mr. WILLIS. Professor of banking at Columbia University.

I will give you the reference to that report of the Comptroller of the Currency a little later, Senator Bulkley.

Senator BULKLEY. It is quite all right. I just wanted to identify the statement.

Mr. WILLIS. Generally speaking, the question whether any such large bill should be enacted at the present time seems to me to be largely a question of whether the material is ready for it, whether we are prepared for it at the present moment and are in a position to enact a final measure that will cover the whole ground. At the present moment it seems to me that that is not the case.

Our monetary policy at the present moment is certainly not settled, and it would seem it cannot be settled for some time to come. There are various portions of this bill that seem to me unfeasible, or, at least, not applicable until one knows what the monetary policy of the country is likely to be in the near future, and if there be any prospect of getting a definite solution of that before a great while, the bill would profit a great deal by being deferred until that time.

In the second place, it seems to me that the bill as it stands now is based upon what I hope will be a temporary emergency in public financing, and one which, if it should pass without serious disaster, would pave the way or permit a very different type of measure from this one.

In the third place, it seems to me that the situation as it stands now necessarily looks forward to a condition of affairs in business and the commercial paper situation that is almost certainly temporary, and until we can see how that is coming out, it seems to me unwise to enact a comprehensive measure of this sort.

Furthermore, many of the powers that are conveyed in the bill here are those that are already enjoyed under emergency legislation, or at least have been exercised by an interpretation of the existing rules and enactments of Congress, so that in fact you are getting, under existing legislation, about all that can be said to be needed under existing conditions without actually having the matter put into permanent form as a constituent act for our banking system.

The great objection to this bill, as it seems to me, is not that it is going to change immediately very drastically what is actually being done at the present time. I am not one of those who look upon the bill as a measure that will immediately bring disaster. I deprecate extreme statements of that kind that are frequently heard at the present moment. The harm in it is that it seems to me to consolidate the bad tendencies in existing legislation, and practically renders them permanent, and treats them as the fruit of valuable experience during the emergency of the past 2 or 3 years, and thus seemingly looks forward to their remaining on the statute books indefinitely.

As against that, it seems to me that what we have done under the stress of emergency, whether right or wrong, should be regarded as definitely emergency legislation, and as such, not to be sanctified or accepted as a permanent basis until we can be perfectly sure the the emergency has passed, and that we know exactly in what direction we are going to go.

Furthermore, there is certainly a very large amount of difference of opinion about this proposed bill. By that I do not mean a controversial, hasty, or superficial opinion, but I mean that the measure as it stands raises some essential differences of view which are supported on either side of the discussion by weighty argument, and which ought not to be hastily dealt with.

I feel in disagreement with some of the statements in your hearings here, to the effect that the bill is based entirely upon the experience of the past 20 years; that no amount of investigation will alter the teaching of that experience; and that consequently Congress is in as good a position to enact it now as it ever will be.

On the contrary, it seems to me that the experience of the past 2 or 3 years, particularly, and in a good many cases of the whole 20 years of the life of the system, is open to very dubious interpretation, and that that deserves a great deal more care and thought in ascertaining what the meaning is than it has ever thus far received.

This, however, is not a plea for indefinite delay. On the contrary, I am fully in agreement with the radio address of Governor Eccles on last Sunday night, I believe—I read it in the newspapers on Monday morning—in which he says that we certainly should do very wrong if we failed to enact legislation designed to correct the evils and bad features in our banking system, especially those that have been developed as the result of experience during the past 3 or 4 years, and that the matter ought to be taken in hand at once. I agree with that fully, but I think the best way in this case to make haste is to proceed slowly and to get competent advice in the matter.

To that end it seems to me the best results would be obtained by appointing a small commission, such as has been recommended by various commercial bodies, with orders to report promptly. Its life might very well be limited to 6 months, or something of that kind, so that it would report before this Congress came again into session.

To that Commission, it seems to me, should be referred the task of finding out exactly what the opinion of experienced men in this country points to as the desirable change in our banking legislation. That such a Commission could wholly overcome all differences of opinion and all prejudices I do not for a moment believe, but I think that it could iron out a great many things, and bring about satisfactory compromise on a good many things, and definitely indicate the lines within which a great statute of revision should be enacted.

In those circumstances I believe that a Congress meeting in January next would be in a far better position to legislate than this one can possibly be, with all due respect to the care and thought that has been given to this matter by the members of the committee.

Furthermore, it seems to me clear that if time will warrant it, another Commission, or a subordinate commission or group in the employ of this first one could codify the National Banking Act. I have been recommending this, by the way, at intervals for the past 10 years, so that it is not a mere emergency proposition. Our banking laws are now full of contradictions, obsolete material, and data that do not exactly fit the situation, and provisions that have been held ineffective or unconstitutional, or otherwise unsatisfactory. A code commission, composed in part of competent lawyers, and some economists, perhaps, would be able to solidify and consolidate our banking statutes, both those relating to commercial banking, investment banking, and agricultural banking, relate them closely to one another, rearrange them, and, without changing anything except the matters I have just spoken of as being obsolete or out of place, establish a workable statute that can be understood by everybody, and will not be constantly giving rise to reinterpretations or revocation of old interpretations.

In addition to this, it seems to me that while I am aware that, of course, nothing of the kind could be put into legislation, it would be desirable if there could be a general understanding or agreement that whatever was done by Congress was going to remain on the statute books for a period of 5 or 10 years without any changes other than those that are necessary to correct obvious errors or meet new conditions. In Canada there is a decennial revision of the banking act, and while minor changes occur from year to year during the 10 years, it is understood that there will be no general recasting, no fundamental alteration, in the intervals between the decennial enactments.

Banking processes are slow. They produce their results only after a lapse of time. It is not well to be changing them from year to year. The fact that that is done unsettles business, prevents bankers from ever really learning the law, and, of course, prevents administrative authorities from applying it very thoroughly or satisfactorily.

If something of that kind could be agreed upon, so as to give the country surcease from banking legislation for a while, it seems to me it would be one of the most helpful things that could possibly be done. We have enacted, in the past 20 or 25 years, 25 or 30 alterations in the Reserve Act. Some of them have been important, and others not very important, but there was no reason why a good many of them could not have been saved, carefully refined by the Reserve Board and its staff, and eventually put into law at the designated periods. That, it seems to me, would enormously have helped the situation.

There is one final reason I have to present in behalf of such postponement as I have spoken of, and that is the exceedingly dangerous and delicate situation of banking in this country at the present moment. The fundamental difficulty there is not, as many have supposed, unwillingness of the banks to lend. On the contrary, they are morbidly anxious to get out loans and to pay their expenses. This subject has been carefully investigated by various bodies, notably by the Industrial Conference Board in New York, as well as by others, and a glance at their monographs, as well as a very limited amount of personal investigation, I think, is convincing on that point.

Then why do not business men borrow more freely at the present moment? One reason, of course, is that they are doubtful about the future, and unwilling to make long-term commitments pending the time when they can find out exactly what their standard of value will be, and exactly what the conditions of repayment may be. But, in addition to that, you have the fact that the Government is steadily taking business away from the banks through its various financial organizations. Governor Eccles has courageously called attention to that in his testimony here before you the other day. He says [reading]:

> Our banks have been losing a large part of their business to the Government which has sold its bonds to the banks and has used the funds to make mortgage and other loans, many of which the banks should be in a position to make themselves. Unless the banks regain some of the business which has been taken over by the Government credit agencies, there will not be sufficient business to support the banking system.

That is profoundly true. Governor Eccles adds [reading]:

> There will also be great pressure for a constantly growing public debt incured in part in taking over business that could be done by the banks.

Senator BANKHEAD. The banks were not willing to lend at the time the Government agencies took over this business. What have you to say about that?

Mr. WILLIS. So far as I have been able to look into it, I have felt that the banks, like other people, were subject to the same psychological hesitations.

Senator BANKHEAD. I am not criticizing them.

Mr. WILLIS. I do not know why you should not. I criticize them a great deal.

Senator BANKHEAD. My inquiry is not for that purpose but to bring out the reason for such a situation. If the Government went into this lending business at a time when the banks would not do it, was it objectionable?

Mr. WILLIS. I think it was, because I do not think the banks were anything like as reluctant as they have been supposed to be, and I think the pressure for very low rates of interest has greatly contributed to the expansion of these lending agencies. I was about to say, if you will allow me to finish this one note, that that situation is very well reviewed in a table regularly printed in the Federal Reserve Bulletin, and appearing in the May number, on page 279, which reviews the operations of the various lending agencies of the Government. One has only to look at that in order to realize the speed with which these agencies are rapidly taking over the entire business of banking throughout the United States.

One of the latest such agencies to be developed in that way is the so-called "savings and loan associations" which, as I understand it, are organized with a contribution of $3 of the Government's money to one of private funds. If my information is correct, they are now being organized in New England with permission to take time deposits at 3½ percent, while the old New England mutual savings banks can pay only 2½, or something of that kind. So that you have a strong impetus to the shifting of savings and long-term business to Government agencies. The men who run the Government agencies are naturally humanly desirous of making a showing and indicating big transactions, and the like, and they do what they can to bring that about.

Then there are the production credit corporations, which are reported here in this table as having aggregate assets, other than interagency, amounting to $121,000,000. After a very short period of months they are paring off the business of the banks at the other end. That is to say, they are taking the liquid business of the banks, moving the crops, and so forth, while the mortgage lending concerns are undercutting the banks foundationally. At that rate you are soon going to have a condition in which banking is much more highly governmentalized than it is today. Suppose that continues for some time hence—I do not know how long. The time may come when we ought to decide whether we are going to definitely socialize the business of banking, as various persons have urged, and have the Government take it over and do it all or to what extent you are going to do that, and where you are going to draw the line between them. It is the same question that the Russian Government has had to settle in its own way, as to just how far it was going to go in carrying on banking as a Government monopoly.

Senator TOWNSEND. How did the Russian Government settle it?

Mr. WILLIS. It settled it, according to my understanding when I was over there, by taking over for itself the entire financing of all industrial business, everything involving capital loans, and leaving the agricultural financing in substantial measure to the local associations of peasants engaged in agricultural lending. But it has been very unsatisfactory, and there has been a great deal of feeling there, I believe, even among good Communists, that it would be better to allow a substantially larger amount of initiative in banking to private enterprise.

For those reasons it seems to me that you will do a very much better and more satisfactory job a few months from now, if you order in the meantime a fairly careful, quick summarization of conditions by a group which, while not more competent than Members of Congress to do the job, is outside the milieu in which Congress exists, and I hope would also be outside the financial milieu. That is to say, you would get the opinion of a small group of men of standing and probity—not necessarily bankers—as to just how far it was desirable to have this country go in socializing the credit. You are on the road to a very complete socialization of it now, but it is a haphazard socialization and one which can only result in disaster because of the dangers that arise from the diversion of capital and funds in directions that duplicate one another, and which thus repeat and intensify the evils of the old banking regime, which were numerous.

That, generally, summarizes the first part of what I have to say.

Senator BANKHEAD. Let me ask you this question. I am interested in what you say. Do you believe that the conclusions reached by a commission of that kind depend very largely upon the philosophy of the members of the Commission, the preconceived philosophy?

Mr. WILLIS. I am quite in disagreement here with Governor Eccles, who states in his testimony that differences of opinion on the proposals contained in title II of this bill are not the kind that can be resolved by study. I am of the opinion that any differences of opinion can be resolved by study on the part of open-minded men, and I see no reason whatever why you should not have the substantial differences of opinion here fairly well ironed out and reduced to, perhaps, something not that all will agree to, but something that all could support. It is very desirable that whatever you do here should have the substantial support of the financial community and of everybody concerned.

Senator COUZENS. Did the Federal Reserve System have that support generally?

Mr. WILLIS. Generally speaking, I believe it did. Bankers, I hasten to say—a good many of them, at any rate—were recalcitrant and threatened to give up their charter—that is, the national banks—while the State banks said they would never join. The fact is that within a year that had entirely disappeared, and you had practical agreement. I believe it is true that before the Federal Reserve System was enacted all except very intransigent bankers were convinced that the essential ideas of the Reserve System would work, and while they were not particularly pleased with them, they had, as reasonable men, to say that they would be substantially satisfactory.

Senator GLASS. Was it not a fact that the antagonism of a large part of the bankers at that time was brought about by a sort of idolatry? In other words, Senator Aldrich, who was at the head of the Aldrich commission, and who bitterly assailed the Federal Reserve proposal, was a master financier, and he practically dominated the American Bankers' Association, and controlled banking opinion largely.

Mr. WILLIS. Very largely. Where you have a few outstanding personalities who are determined to do something you get that result. The trouble with our banking community at the present time is that there are a few or no outstanding personalities in it; and that many of those are afraid of being investigated, as they frankly admit, while a great many others are—well, unwilling to speak for themselves. So that at the present moment we have no leadership in the banking community. If that were merely my own expression of opinion I should hesitate very much to give it publicity here, but I have heard a great many bankers express that opinion themselves.

Senator COUZENS. What is it that they have done that they do not want to be investigated about?

Mr. WILLIS. I think this committee can find out much better than I, and I should like to know myself, so the question is referred back to the Banking and Currency Committee.

Senator GLASS. Doctor, before you get off that phase of the discussion, you, I believe, were secretary to the Indianapolis monetary conference.

Mr. WILLIS. Yes; I was.

Senator GLASS. You know perhaps better than I—certainly as well as I—the futility of the Aldrich Monetary Commission in bringing about legislation.

Mr. WILLIS. Yes.

Senator GLASS. I do not know of any legislation of a valuable nature that has been secured by or through the recommendations of commissions. It is my view that this Senate Banking and Currency Committee, given ample time for securing testimony and discussing both principles and details, could do the work better than a commission.

Mr. WILLIS. I have no doubt that is true, Senator, with the experience of the committee in legislation. But have you that time, and will the Senate allow any such thoughtful consideration to occur?

Senator GLASS. That I do not know. I am waiting to hear.

Mr. WILLIS. As for the various commissions, we have had, of course, within recent years, the well-known commission in Germany, and the McMillan Commission in England, and numerous others which have done rather remarkable work in reestimating the banking position of those countries. The commission I have been inclined to favor would certainly not be one of the Aldrich Commission type, that had practically an indefinite lease of life, with a great deal of money to spend. I suggest that you make the Commission unpaid, a situation that has a tendency to hasten the work of commissions tremendously, in my observation, and, in order to hasten it along still more, that you state to it plainly—perhaps by way of legislation—that it is expected to report and disband by the first of next January. Its work for the next 6 months, then, would be devoted to sizing up the situation and giving the verdict of a nonpartisan group of men.

Senator GLASS. Who would select a commission like that?

Mr. WILLIS. That you would have to decide among yourselves, but I see no reason why this committee could not select such a commission perfectly satisfactorily, and have entire confidence in it. I believe that any group of reasonably outstanding men with reputations to preserve would come to about the same conclusions on this subject, if given a reasonable length of time to talk it over.

Now, I turn to the second phase of what I have to present this afternoon. I have now made it my first recommendation, that the method to be followed shall be the one I have spoken of. I recognize that it is not possible to follow idealistic methods, and that there may be reasons that I am not familiar with which necessitate the passage of some bill on this subject right away. If that is true, I would urgently recommend that title II should be eliminated, and that the final bill should consist merely of the data with reference to the insurance fund and the so-called " technical " amendments to the National Banking Act. You would then at least apply another patch to the existing situation, and one which should enable it to carry on perfectly well for another year or so. If you should do that, however, I strongly recommend that you eliminate from it the provision which requires State banks to enter the Federal Reserve System, whether directly or indirectly, so that they are left free to bring that about. The House bill, I think, has eliminated the 1937 provision on that point, and to that extent I support it.

Senator TOWNSEND. Will you elaborate on that somewhat, Doctor Willis, in giving your reasons?

Mr. WILLIS. I may as well do that at this point, if you approve. I have never favored compulsory membership in the Federal Reserve System. I think that membership in the Federal Reserve System ought to be earned and not forced upon a bank, and I think it would be infinitely better if you had a small Federal Reserve System, consisting of no. 1 banks, so that membership in the Reserve System was a " feather in the cap " of the member, and, instead of working on the scriptural principle of going out and compelling them to come in, it should be left, first of all, to the voluntary decision of the banks whether to come in or not, and then, when they had qualified and wished to come in, it should not be a matter of course that they should enter. This bill works upon the opposite attitude with respect to that. It not only includes the guarantee of deposits provision to which I have taken exception, but it also authorizes, in another section of the measure, the Reserve Board to relax all restraints, both those of the capital stock and every other—to waive those in order to get State banks to come in. The result of that, then, is that you will have two kinds of banks in there, one of which, to use the cant expression of the day, is " underprivileged ", while the other one is subject to the more strict requirements of our national legislation.

Senator GLASS. If you would apply that freedom of action to the State banks, would you not be willing to apply it to national banks as well?

Mr. WILLIS. I should, sir; yes, sir.

Senator GLASS. So that they may withdraw from the System if they desire to do so?

Mr. WILLIS. Quite so. I have seen some of the workings of the Federal Reserve System, and I am convinced that the effect of this compulsory membership has been to allow meticulous Federal Reserve officers to lean back in their comfortable armchairs and to say to themselves, "Well, we should worry." The banks have to be members of the System, and no matter whether they like it or not, they have to pay their assessments and live up more or less to the requirements of the organization.

If the Federal Reserve administrators had been obliged to make the System useful, you would have a totally different attitude toward it now among the banks. The banks who protest against this Eccles bill do so for various reasons, but I do not believe that the love for the Federal Reserve System, in the abstract, is one of them. As a matter of fact, the Federal Reserve banks have not endeared themselves to the member banks, with very few exceptions, and particularly have they not endeared themselves to the small member banks. This very committee, when it was preparing for the Banking Act of 1933, sent out questionnaires to Reserve banks asking them specific questions as to what they had done for their member banks, and as to whether the variations which they made in the discount rate ever resulted in cuts to the public. The answer was no. The Bank of France, with its hundreds of branches, transfers the benefits of a cut in discount rates directly to its customers.

Senator GLASS. That is what I have been contending over this table here ever since we have been having these hearings.

Mr. WILLIS. I know you have, sir. The Bank of England transfers the benefit of the cuts in the discount rate through the money market. I notice that one of your witnesses here said that there is only one kind of central bank in the world, and that was a banker's bank. There are, of course, at least three kinds of central banks in the world: The bankers' bank type, which we have here in the Reserve System; the public-service type, such as the Bank of France; and the money-market type, which you have in the Bank of England, where the benefits of what is done are rapidly transferred to the public through a competitive discount market.

In this country we have not any of those, and the changes in the discount rate do not influence the rates that are made by the banks to their own customers, nor do the Reserve banks concern themselves particularly about serving their customers. It was only after a long time, and against the wishes of the Reserve banks, that we succeeded in getting the idea of par collection over, and we never succeeded in getting it over fully put over, but only to a limited degree under certain conditions. It has been difficult, or impossible, to get the Reserve banks to perform the part of city correspondents for such country banks as wanted to have them do it; and, as you well know, they have never gone into the foreign branch business. If they had we would never have had the trouble with foreign loans, and the like, that we have had.

In those circumstances, I submit that the teaching of experience is that the membership in this system should be voluntary, that it should be left to the banks to maintain a system for their own protection and for their own better organization, subject to constant public supervision.

If it be true that that is not sufficiently helpful, and that there still is a great deal that needs to be done, then let the Government continue its direct intervention in banking. I can quite conceive of a situation in which you may have a set of Bourbon bankers, who never learned anything and never forgot anything, which would result in having the State or the community find it necessary to do that. I hope we will never get to that point, and I do not believe we shall. One way of avoiding it is to make membership in the Reserve System a " blue ribbon " matter, and, as a result of that, to make Reserve bankers active, public spirited, and desirous of doing their utmost for the banks which deposit with them or which own their stock.

In addition to that, in reply to the gentleman who just asked me about the membership, I do not believe that it is a right thing to force State banks to come into this system, either through direct legislation, if you can do it—if that be constitutional—or through holding out competitive inducements to them to come in. I think that the incorporation of banks is a power that belongs to the States of this country, and that their banks ought not to be interfered with, but left to operate as the States in which they are situated think best that they should operate.

Such organization as is arranged over and above that, I think, should be a matter of voluntary acceptation on the part of the State member banks. However, if that doctrine be too old-fashioned you still have the question whether it is a wise thing to compel large banks practically to pay the expenses of insuring the deposits of the small ones by the device that is used in this bill. It seems to me that is what the Supreme Court apparently dislikes—that is to say, the taking of the property of the larger banks without any due process of law, by compelling them substantially to carry the load of bank failures, which as we know, is far greater among the small banks than it is among the large ones—at least, ordinarily so.

Those are my reasons, gentlemen, for feeling that that provision should be eliminated here, and that if you are going to act upon this matter, you should act upon it purely in the way of perfecting the financial responsibility and the smooth operation of the Deposit Insurance Corporation. The Corporation needs it, for I do not think that it can go through a severe panic or crisis and meet the immense obligations that have been imposed upon it.

Some time ago I had the honor of a visit from a representative of the Deposit Insurance Corporation, who asked me to devote some attention to that question and reach some conclusion about it. He supplied me with the figures that were necessary, and I devoted quite a good deal of time to it and that is my conclusion. I do not think the Deposit Insurance Corporation is in a position to do very much insurance if it should be asked to take care of a very high mortality among the members.

If you are going to enact the bill on this narrow basis, then, of course, there is a provision in the latter part, title III, that I regard as of equal rank with this insurance proposition. That is the eligibility of real-estate loans which is provided for here. I strongly urge the committee not to include that.

Senator Bulkley. What is the section number of that?

Senator Glass. That is in title II.

Senator Bulkley. That is in title II.

Mr. WILLIS. But there is a further provision in title III in that connection.

Senator BULKLEY. What section are you referring to?

Mr. WILLIS. I am speaking of titles I and III.

Senator BULKLEY. In connection with the real estate?

Senator TOWNSEND. That is in title II, is it not?

Mr. WILLIS. I had the impression that a large portion of it was in title III. I will not stop to go into that. I will discuss it at this point, if I may.

The inclusion of the real-estate loans is undesirable, not because real estate is bad or because there is anything wrong about financing a real-estate boom under proper conditions, or anything of that kind, but it is undesirable for two reasons.

The first is that it will disturb your existing real estate loan mechanisms. The savings and loan associations of New York are already exceedingly worried about this proposal, that is, to put the banks into the real estate business. The banks have not the mechanism for appraising and studying and finding out about the validity of real estate. The original Reserve Act did a very unwise thing in opening the way for real-estate loans by country banks, but that was very pardonable. The country banks were already in the business. It merely sanctioned an existing situation, and one which, perhaps, was not severely to be criticized. The country banker usually knows all about the real-estate values of the farms in his vicinity. That is not true of the city banks, and the making of city real-estate loans is a complex operation which calls for a high degree of skill and for the organization of an elaborate department in the bank. Our banks have not got that. Some of them probably will develop it—the larger and more careful ones. Others will not. The result is that you inevitably have a lot of doubtful and bad loans, to say nothing of the disturbance and interference to which you will subject the existing loan agencies, particularly the savings and loan associations in the cities. So it seems to me that, at least, should be eliminated, if there be anything about it in title III, as I was under the impression there was, before any enactment takes place.

While there are a great many other provisions that seem to me to be undesirable in titles I and III, I do not think I ought to take the time of the committee to speak about them, but I wish to speak now in some detail of title II, which seems to me to be the real central part of the whole measure.

In the first place, title II, of course, fundamentally changes the general underlying organization of the Reserve System, as well as the theory upon which it is based. There have been a great many statements of late to the effect that the object of title II is merely to carry out the ideas of the Federal Reserve Act which had been seriously marred by some persons unknown, so that they had not quite got full interpretation. So far as I understand the Federal Reserve Act, the ideas of the Eccles bill are diametrically opposed to it; and title II, if it should be enacted, far from carrying out the ideas of the Reserve Act, will carry them out only on a stretcher—in other words, would render them wholly ineffectual. Title II is simply a complete negation of everything in the theory of the Reserve Act.

The fundamental idea of title II is that the supply of money is regulated by banking, and that the total of it that is available there affects business directly. That is, if you have more money you have more and better business; if you have less, then you have what is called deflation.

The idea underlying the Federal Reserve Act is that money is the product of business, and that credit, which is a very different thing from money, is used to supplement the supply of money and to provide that elastic element that is necessary in order to permit a larger volume of business to be transacted without the necessity of importing gold; or, where you have a closed regime, as we have here now, without the necessity of enlarging the legal tender note issue.

Those two ideas are as wide apart as the poles; and, of course, when one starts with one of them to write a banking bill he gets to a very different result from that which he gets if he starts with the other.

I notice in the testimony of Governor Eccles here a statement that there is comparatively little difference of opinion on these essential points. I think there is a very wide difference of opinion about them—so wide that I do not believe that you can reconcile the underlying ideas there, although I do believe, as I said a few minutes ago, that it is possible to bring about some reconciliation of them in practice, so that if you have a careful body of men working on the thing it might be possible to get our fundamental day-to-day mechanism into a shape that would satisfy all sides if they were not determined to go to extremes.

That fundamental idea, or difference of idea, runs through the whole measure. As the outgrowth of it, you have the bill here authorizing the Reserve Board to change the reserve requirements at all times, whenever it gets ready. The bill is not exactly frank or sincere on that subject. I have read through the testimony here, and I find that the provision on that subject is constantly referred to as being a provision for changing the amount or percentage of the reserves. That expression is constantly used in the hearings. But when we turn to the actual language of the law, what we find is that it is the requirements as to reserves that may be altered by the Reserve Board. It is not the percentage of reserves. We have three requirements as to reserves at the present time. One is as to the place where the reserves shall be kept. In the original Reserve act they were kept partly in the Reserve banks and partly in the vaults of the banks. Then, in 1918, under the plea of necessity for inflation, we provided that only credit in the Reserve bank should be reserves.

Senator GLASS. Counted as reserves.

Mr. WILLIS. Counted as reserves. At the present time we still stick to that.

The second requirement as to reserve is the percentage of reserve, which has been varied two or three times since the Reserve Act was adopted. Then third, and, perhaps, most important, is the question of what the reserves shall consist of. We had it at one time lawful money. Then we had it gold, and we had various things. As the reserve paragraph stands, the Reserve Board, as I read it, is given power to alter all of these reserve requirements, which means, of course, that it would be possible for the Reserve Board to direct a bank to hold its present balance in Reserve banks and hold the rest of it in Government bonds; and since it can change the amount of reserve to be held, I see no reason why you should not put into effect a 100-percent reserve at once, such reserve to consist partly of cash—reserve credit, rather—and partly of Government bonds, to be held in the vaults of the Reserve banks.

In fact, I heard a member of the House committee say in public that he hopes that a 100-percent reserve will be put into effect very soon—not soon enough, of course, to disturb business, but as soon as possible.

The provision here, then, as I say, is not a very sincere one, and is one which ought to be reviewed with exceedingly great care. If this is what you mean, then the act should specify that the reserve requirement may be changed.

Senator GLASS. The percentage.

Mr. WILLIS. May be changed as to percentages, as to composition, and as to place, so that you know exactly what you are going to do. If you mean only one of those things, then that should be specified in that same way, so that at least there will not be, after the act is passed, a great deal of debate and uncertainty and controversy about what that means, but so that you will have a perfectly outstanding, clear-cut situation. That is certainly not an unreasonable thing to ask.

Now, in addition to that, the bill as a whole, as I have said, is based upon an entirely new theory of banking. That theory is the one that has gained ground in Russia, to some extent in England, and in other places. But as it is presented here it seems to me quite inconsistent with itself. For example, the proposed act eliminates the present note issue plan in the Reserve System entirely, and substitutes a new one. The old system of note issue, as you know, provided for the collateraling of Reserve notes, so that the notes are not only a prior lien on the assets of the bank but they were a collateral prior lien, the Reserve agent holding the eligible paper or the bonds or the gold in his department. That was based upon the idea that outstanding new currency should come into existence when there was need for it, not because someone wanted to sell bonds or convert bonds into purchasing power, but because somebody really had some business to transact. And so this rather clumsy provision, as it seems to me, was made to secure that.

Senator GLASS. And the notes were to be retired automatically when that business transaction matured.

Mr. WILLIS. Quite so. I have never been a very great friend to that way of issuing notes. It is certainly an anomalous one. It is not found in any other country so far as I know, and I believe it would be a great deal better if you could have a straight bank-note issue so that, as this bill professedly would have it, you get a straight issue of Federal Reserve notes that come out just as the deposits are created and are direct liens on the bank. But unfortunately, as the thing stands now, as I understand it, all of our notes are legal-tender notes, so that apparently what this bill proposes to do is to allow a private corporation, owned by the banks and, of course, carefully supervised by the Government in the extreme way that is provided here, to issue legal-tender Federal Reserve notes. That is as I understand the bill. I do not see anything in it that alters the present status of the Reserve note in that respect.

Senator BULKLEY. A Federal Reserve note is a Government obligation.

Mr. WILLIS. Yes; but it is legal tender.

Senator BULKLEY. It is issued through the banks but by the Government?

Mr. WILLIS. Yes. But here you make it, as I understand, a general claim on the assets of the Reserve bank. If you are prepared to revoke the legal tender quality of the Federal Reserve notes and make them plain bank notes so that, as Governor Eccles expresses it, they do not have the same status as the check-book deposit, I think there is no reason why you should not make this change. Twenty years ago, of course, Congress would not have heard of it.

Senator BULKLEY. Do you think there is any great significance in the character of what is behind the note?

Mr. WILLIS. That depends upon the status of the note. If it is a real bank note, I do not like it at all. The Bank of England, of course, in the old days required a deposit of government bonds or gold for every note that was issued. At the present time that is in abeyance. But generally speaking, the theory of banking calls for the making of the notes and obligations of the bank just the same as the deposit accounts, demand deposits, and of course without debt-paying power unless people are willing to take them.

Senator BULKLEY. Does not this place them in a preferred position?

Mr. WILLIS. I think they are given a prior lien.

Senator BULKLEY. Then what is the difference whether the specific collateral is deposited or not?

Mr. WILLIS. None of importance, as you describe it, but I think it makes a great difference whether a man can refuse to take a Federal Reserve note if he does not like it.

Senator BULKLEY. I am not sure about what point you are speaking of. I thought you were condemning it, because of not having collateral security behind it.

Mr. WILLIS. If you take away the collateral security and leave it to the Federal Reserve banks to issue the notes just the same as they create deposits so that the volume of currency depends entirely upon the will of the Federal Reserve bank, it is not proper that they should be legal tender.

Senator BANKHEAD. Is there any change in this bill that would prevent them from being legal tender?

Mr. WILLIS. No; not that I know of.

Senator BULKLEY. You want to hitch it up to a specific amount of gold and reserve; is that right?

Mr. WILLIS. If we are going to have a Federal Reserve note in approximately a form of money that is identical or nearly identical with a Government legal tender note, it seems to me that the collateral idea is the proper one.

Senator BULKLEY. In order to limit the supply of notes?

Mr. WILLIS. And in order to prevent an individual man from having to take it.

Senator BULKLEY. There are two different things there. If it is legal tender, he does have to take it?

Mr. WILLIS. Yes. But my thought is that if it is a bank note it should not be legal tender. The question is whether it is a bank note or not.

Another fundamental conception in this bill relates to the question of open market, and as to that I want to speak very frankly. When the Federal Reserve Act was adopted I was exceedingly anxious that it should include an open-market provision, and I hoped that the open-market provision would be used for the purposes for which it was used under central banking systems, namely, that of making the discount rate effective, so that if a discount rate of 3 percent were made by a Reserve bank, if a Reserve bank were to fix its discount rate at 3 percent and the other banks would not let that get to the community, that then the Federal Reserve bank should be able to go out into the open market and buy or sell the paper of a business concern, the ordinary business concern, assuming it was prime paper. Now that, of course, is what the Bank of England habitually has done for many long years. Our bankers were not willing to do that. We strained every nerve to have the open-market provision omitted, and they wanted it omitted because they were afraid that the Reserve banks would come into direct competition with them and cut the rate of interest. Of course that was not necessarily the case.

I was talking this matter over with the governor of the Commonwealth Bank of Australia, an institution that was started at just such an agitation as we are having now, and it was headed by a very capable banker and he took pains to use this open-market power merely for the sake of seeing to it that the other banks followed the leadership of the central bank. During the early years of the Board we were never able to get them to use that power; the resistance of banks was so strong and the hostility of some members of the Board was so powerful to the application of it that it never got into effective use at all. It was not until after the war was over that New York bankers began to see what a wonderful opening it gave for siphoning funds out of the Reserve bank, and we began then to have the development of the revolving acceptance and the acceptance based on commodities in stores, and so on, and when the breakdown came we had an enormous volume of acceptances outstanding. I think there were a billion seven hundred million, and we were constantly boasting of how we had beaten England on the acceptance business.

Those acceptances were collateral. They were merely another way of making commodity loans. They had nothing to do with the open market. They were called open market, but they were not.

When the Government began to get into difficulty with its deficits the open market was a very easy way of dumping bonds on the market and of getting them carried along in the way it is being done at the present time. If you are in the hole and Government bonds threaten to go down, you order some open-market operations. You do not say there is anything wrong with the bonds. You say it is for the public welfare, and you desire to order a couple of hundred millions of open-market operations per month. Your central bank buys a lot of Government bonds in the open market and takes them right off the market.

It would be well, since Congress is planning to legislate on this subject, if it would end the open-market hypocrisy completely. I notice in the statements of some of the witnesses that the open-market idea was a brand new idea that was gaining ground all over the world. The open-market idea is a very old one. It has been used by every central bank when and if it was necessary; and it had worn itself out in some countries so that the Bank of France, for example, prohibits it entirely, and one of the finance ministers over there has referred to it recently as an Anglo-Saxon device, which I think is a very good description of it as it had been employed in this country.

If you are going to have open-market operations of the kind that you have now, then they ought to be most carefully safeguarded, free from hypocrisy, and allowed to stand for just what they are worth.

As to who should conduct them—well, that depends entirely on the kind of men that you have got carrying them on. In this bill you practically hand over to the Governor of the Reserve Board, who is a direct appointee of the President, the power of open-market operations. It is too great a power for him to have.

Senator TOWNSEND. Would you care to illustrate your thought there of hypocrisy?

Mr. WILLIS. You mean, what it is?

Senator TOWNSEND. Yes.

Mr. WILLIS. What I have just spoken of, treating open-market operations as a kind of esoteric operation done for the good of the general situation.

Senator BULKLEY. Your contention is that it is only done to support the market for Government bonds?

Mr. WILLIS. At the present time I do not think anybody would deny that.

Senator BULKLEY. That is what you meant?

Mr. WILLIS. Yes, sir.

Senator GLASS. And that is the only kind of operation that they have engaged in?

Mr. WILLIS. Just now; yes. Bankers' acceptances at one time formed a proportion of the operations; but that was only when the acceptances would not go, and for the same reason they had to be taken off the market.

Senator BULKLEY. Part of those bonds were bought not so much for the purpose of supporting the Government-bond market as for the purpose of increasing excess reserves of banks, were they not?

Mr. WILLIS. For the purpose of increasing excess reserves?

Senator BULKLEY. Was there not a theory that we could promote prosperity by forcing the banks to lend——

Mr. WILLIS. There may have been such a theory. There have been many theories; but certainly if that was held by anybody it must be pretty well abandoned now, because we have $2,250,000,000 of excess reserves today and less actual lending than we ever had before.

Senator BULKLEY. I never believed much in that, in the first place, but it certainly was asserted.

Mr. WILLIS. I am afraid it was, and a good many other things have been.

Senator BANKHEAD. Does the volume of excess reserves cause you any concern?

Mr. WILLIS. There are other things that have given me more concern. You can get rid of them in 5 minutes if you want to.

Senator TOWNSEND. How?

Mr. WILLIS. By just having the Reserve banks sell the two and a half billions of Government bonds.

Senator GLASS. What would happen then?

Mr. WILLIS. It would break the Government-bond market.

Senator GLASS. It would not only break the Government-bond market but would break every other security market.

Mr. WILLIS. Then you do not want to get rid of them? Is that it?

Senator GLASS. I did not want them to get them in the first place.

Mr. WILLIS. As it stands now, you would rather keep them?

Senator GLASS. We have got to keep them.

Senator COUZENS. If we have a stabilization fund existing, I do not see why we need to be disturbed about the bond market.

You were speaking about the catastrophe that would happen to the banks if they unloaded Government bonds, but I do not see any catastrophe with the stabilization fund.

Senator GLASS. You mean, the stabilization fund that the Government stole from the Federal Reserve banks?

Senator COUZENS. I am not talking about how we got it. If they unloaded these bonds, the stabilization fund could buy them and there would not be any disturbance.

Senator GLASS. You know the stabilization fund is not going to buy them.

Senator COUZENS. It would if they started to unload bonds on the part of the banks.

Senator TOWNSEND. What is going to happen if we put this additional four billions of currency out?

Mr. WILLIS. If you will allow me to answer—I do not think I said it would cause a catastrophe. I merely indicated what I thought would happen.

Senator COUZENS. I do not think it would happen. We have not got more than two and a half billions out of the whole issue that is out.

Senator GLASS. In the Federal Reserve banks?

Senator COUZENS. Yes. So there is still opportunity for the four billion we have got without anybody getting "het" up about it, as I see it.

Mr. WILLIS. I started on this matter, not with the intention of bringing out any controversial question but with the purpose of discussing the general theory of open-market operations; and the point I came to is this, that the open-market operations that we are now carrying on, if such they may be called, are not open-market operations in the central banking sense at all; that they are not being generally used throughout the world except where they are unavoidable; that they are prohibited in France as the result of experience; and that the Millan committee, which investigated this whole thing very closely, said they might be used in England slightly more than they were, but it would have to be done with a great deal of caution.

Senator GLASS. Is that the committee that set up a bank in Canada?

Mr. WILLIS. No; it was established by Mr. Ramsay McDonald soon after he took office, the committee of which Mr. Kane was a member.

I have covered what I consider the essential differences of opinion about this bill, with one exception. That is the question of eligibility, and I have a few words on that if you will allow me.

The original Federal Reserve Act provided for very narrow restrictions on so-called "eligible paper", with the design of limiting the amount of currency we got out. The theory was that if business increased it would create credit paper to be used as a basis for note issues. That strict interpretation is blamed for most of the ills that exist at the present time; but of course, the trouble with that is that it never was applied. Two weeks after the Reserve System was organized we had a letter from the Federal Reserve bank in Richmond saying that that bank's officers had always been in the habit of taking collateral, and it was a much safer way to do, and they wanted to loan on collateral. The Board allowed them to follow their practice by exacting collateral, provided that the paper which was thus collateraled was technically eligible. Various other Reserve banks have, of course, been able to act under the same general ruling and have done so.

So it has often happened that a Reserve bank would have almost all of the assets of a bank that was just on the point of failure, placed with it as collateral; and you would then have the depositors, and especially the savings depositors, holding the bag. They would simply be an empty shell, while the Reserve bank or branch would have the entire assets of that bank.

Senator COUZENS. When they made those exceptions, did they make any exceptions as to maturities?

Mr. WILLIS. They took the notes, and then they renewed them over and over again in the classical banking way.

Senator COUZENS. So that a maturity of 15 days, 30 days, or 90 days did not mean anything?

Mr. WILLIS. No.

Senator COUZENS. That is another fiction?

Mr. WILLIS. It was a fiction of mere practice, Senator, if you will allow me.

Senator COUZENS. The public have not generally understood that that fiction continued.

Mr. WILLIS. The public knows very little about what has happened in the Reserve System.

Senator COUZENS. I am afraid that is true.

Mr. WILLIS. That is the situation. I am speaking as a realist in the proposition, having seen it developed from inside; so that those who say that this country has been dreadfully handicapped and hobbled by the fact that the Reserve banks would not loan on anything except eligible paper are merely reckoning without their host at all.

In New York, of course, under the 15-day clause, the Bank of New York has merely loaned to the stock market right along for years by permitting the member banks to borrow on their own notes collateraled by Government bonds. The Banking Act of 1933 makes provision for stopping that; and if enforced, I believe it will correct that.

Senator COUZENS. Why do you say "if enforced"?

Mr. WILLIS. The question in my mind is whether you can enforce it. Under this bill I know you cannot, because it practically repeats that and lets in any kind of paper as an asset.

Senator COUZENS. I never saw any law ever passed that we could get the New York Bank people to obey.

Mr. WILLIS. Because they did not want to obey, perhaps.

Senator COUZENS. I am afraid that that is true also.

Mr. WILLIS. Then we are agreed on that.

This is a question that ought to be seriously faced by Congress, this question of what the Reserve System is for; that is, whether it is for the purpose of financing any sound assets or whether it is really a system whose purpose it is to finance business and commerce.

The stock exchange, as you well know, just before the panic in 1929, had its plans all laid. I say that because the then president of the stock exchange admitted it in a public speech. They had their plans all laid for the direct admission of stock-exchange paper as eligible to the Reserve banks. The then chairman of the House committee, Mr. McFadden, told me that the pressure was so strong to get that passed that he doubted whether it should be resisted.

This bill provides on page 52 that—

> 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.

That opens up the whole world of assets, provided only that the Board has declared that they are abstractly sound; that the class of assets is sound—Anaconda Copper, or Allied Chemical. If that is a sound asset and you put out a ruling to that effect, there is no reason why you cannot lend on any kind of paper, mining stocks or anything else, unless some administrative authority should step in to prevent it.

Senator BANKHEAD. Is not the whole question whether or not the assets are sound?

Mr. WILLIS. It depends on what you mean by "sound."

Senator BANKHEAD. Good, liquid.

Mr. WILLIS. I do not think loans ought to be made on assets because they are ultimately collectible. I believe the correct theory of central banking is conversion into immediate means of payment of assets which represent the production of new wealth on its way to consumption. In other words, it should be equivalent to the aggregate of new production of consumers' goods which are on the way to their users.

Senator BANKHEAD. Why that limitation?

Mr. WILLIS. Because the rest of the wealth that we produce is the so-called "frozen" assets, an asset that may be perfectly good 5 or 10 years hence, but not convertible at the present time into a means of payment.

Senator COUZENS. How could you tell whether the assets would be sound 20 years hence?

Mr. WILLIS. I do not think you can, because too many things can occur in that time. You can approximately tell 90 days hence or 6 months, even.

Senator COUZENS. When you use the words "sound assets" I think that is about as broad an expression as "interstate commerce."

Mr. WILLIS. It is a euphemism, I would say.

Senator GLASS. As a matter of fact, as I have called attention to repeatedly, Mr. Whitney and other stock-exchange men testified before the Banking and Currency Committee of the Senate that the soundest asset in the world was a broker's loan, and yet we textually excluded brokers' loans from the Federal Reserve System. We textually excluded them and the bankers actually took them.

Senator COUZENS. Going back to the statement you made previously, about the Government extending its activities into the loaning business and taking business away from the banks, in that statement you made no discernment between investment banking and commercial banking?

Mr. WILLIS. No.

Senator COUZENS. It seems to me that most of the activities of the Government are in investment banking instead of commercial banking.

Mr. WILLIS. To a large extent they are; but you also have the production credit corporations, of which, I believe, there are now some 600.

Senator BANKHEAD. Six hundred what?

Mr. WILLIS. Production credit corporations.

Senator BANKHEAD. They do their financing through 12 regional banks, do they not?

Mr. WILLIS. From groups——

Senator BANKHEAD. They borrow collectively from the production credit bank.

Mr. WILLIS. Do they not recommend loans?

Senator BANKHEAD. They borrow. They do not lend. They get their money directly from the bank.

Mr. WILLIS. It seems to me that if I sign a man's note I am loaning to him.

Senator BANKHEAD. They are borrowing collectively, several signing a note and getting the money.

Mr. WILLIS. They are liable.

Senator BANKHEAD. Yes; but they are not engaged in making loans.

Mr. WILLIS. The effect is to have that amount of business in merchandise?

Senator BANKHEAD. Oh, yes. Banks in agricultural sections cannot do that sort of business because they do not have the money. They were not sufficiently liquid to do it.

Senator COUZENS. Do you think there is justification for a combination of investment and commercial banking?

Mr. WILLIS. I think we have got it now, and we had better make the best of it for a time. Abstractly, I do not like it. The California system, I think, is the best protection against it, perhaps, that we have devised, where we have a savings-bank section, an entirely separate entity within the bank, and no transactions between that and the commercial bank.

Gentlemen, I have finished with the basic differences that divide the Eccles bill from the Federal Reserve System. It seems to me as if they were at opposite poles of credit theory and sound practice from that which was set up in the Reserve System. The fact that the Reserve System has been in the hands of the Philistines a great deal of the time and has not lived up to its early promise is regretted. But it has nothing to do with the validity of the principles under which it was organized.

Senator COUZENS. Do you believe that it is desirable to have some centralized control rather than to have the control diversified or decentralized in Reserve banks?

Mr. WILLIS. I think if the System planned in the Reserve Act is carried out in good faith and effectively it would be a sufficient centralization. If you have good reason for not thinking so—and I can see arguments on that side—then I think we had better frankly have a central bank confessedly operating under that name and title and subject to all of the controls that would surround it.

Senator BULKLEY. How would you make the transition from our present system to that?

Mr. WILLIS. You have already made it pretty well. I should think you could disestablish the Reserve banks and simultaneously start a central bank of the Government.

Senator BULKLEY. Owned by the Government?

Mr. WILLIS. If you want to. I should hate to see that done.

Senator TOWNSEND. Then you do not agree with the Secretary of the Treasury that the Government ought to own the stock of the Federal Reserve banks?

Mr. WILLIS. And pay for it?

Senator TOWNSEND. He did not say that.

Mr. WILLIS. If you interpolate the assumption that he means to pay for it, I think it might be a good thing, because he runs them now. Why not let him pay his bill and take them over?

Senator GLASS. You do not seriously think that, do you?

Mr. WILLIS. I think the way we are going now——

Senator GLASS. I am not talking about the way we are going now, but about the way we ought to go.

Senator COUZENS. This committee has had testimony to the effect that diversity of opinion and interference with the Federal Reserve Board by banks and public officials have tended to diversify authority to such an extent that it has been injurious to the country.

Mr. WILLIS. Yes.

Senator COUZENS. And you would correct that?

Mr. WILLIS. By establishing a Federal Reserve Board which in fact, as well as in theory, is independent and is entirely free from political control.

Senator BULKLEY. How would you do that?

Mr. WILLIS. Simply select a group of the best men you can find, with long terms, and leave them to work out their own salvation.

Senator COUZENS. But if you did not give them the authority, how could they work it out?

Mr. WILLIS. They should have the authority.

Senator COUZENS. That is what I was trying to find out, whether you did not think we should have centralized authority somewhere.

Mr. WILLIS. My view would be that the authority given to the Federal Reserve System in the original act is authority to permit complete centralization for all necessary purposes.

Senator COUZENS. It has not done that, because one of the big outstanding banks of the 12 Reserve banks refused to cooperate, and there was no centralized authority to compel it.

Mr. WILLIS. I would simply say that you did not have men on the Reserve Board who had the courage to oppose that bank.

Senator GLASS. Or to carry out the law and remove that man, as it has authority to do under existing law.

Mr. WILLIS. There is no human mechanism that will ever take the place of upstanding courage, as you very well know, and you have exemplified it in your own career.

Senator COUZENS. I want to go back to that same old question again. The Federal Reserve Board, no matter how strong it has been, has never had the power to compel the New York bank to do anything, has it?

Mr. WILLIS. It has had that power; and the chairman of the committee, when he was Secretary of the Treasury, did just that.

Senator COUZENS. It has been testied here that any one of the banks could refuse to comply with an open-market operation directed by the Federal Reserve Board.

Mr. WILLIS. They will not refuse to comply.

Senator GLASS. The Secretary of the Treasury told me distinctly, and repeated it again, that they had had 100-percent cooperation with the Federal Reserve banks in open-market transactions.

Senator COUZENS. I am going back to testimony that was had in executive session, not during the period of the existing Secretary of the Treasury, in 1927, I think it was, when the banks refused to cooperate. That is one of the difficulties of getting impressions and convictions in executive session that you are charged with being in error about. But I am not in error about that.

Mr. WILLIS. In 1927 the Board had fallen upon very difficult times, with a personnel that was anything but what one would wish it might be. If you have a board of that kind it will never have the courage that is necessary in financial transactions—and more courage is needed there than in almost any other branch of the public service, because you have got direct responsibility coming right home to roost.

Senator COUZENS. That goes back to the very point that unless the Federal Reserve Board has absolute control you will never be able to have assurances that all of the 12 banks will come into line on any one thing.

Senator BYRNES. If the appointments to the Board are made in the manner you suggest, they would be made by the President, would they not?

Mr. WILLIS. Well, they might be, yes. In one of the original drafts of the Reserve Act we did provide for a selection by the Reserve banks themselves of certain members, so we had theoretically a self-governing bank mechanism. Of course there were always Government representatives on the Board.

Senator BYRNES. But assuming that they are appointed by the President and are lacking in courage or experience, as you have indicated, would it be wise then to appoint them for a long term?

Mr. WILLIS. No; I do not think so—not unless you had a much higher sense of the duties involved in making the appointments.

Senator BYRNES. But the manner of appointment would be by the President of the United States, just as it has been in the past?

Mr. WILLIS. We are assuming it would be; yes. When Senator Bulkley asked me about that and how we would get such a board, I answered that it could be done by appointing courageous men with long terms.

Senator BYRNES. I gathered from your statement, however, that they had been lacking in courage and, in critical times, had failed.

If so, and they were appointed by the President, I am wondering what your suggestion would be to overcome that, whether you would overcome it by appointing for a long term men who are lacking in courage, whether we would be any better off.

Mr. WILLIS. If you would exercise, as you used to do in the beginning of the system, the power of refusing confirmation, I think you would attain that result. But it has been quite a long time since you gentlemen here have been willing to do that.

Senator BYRNES. The things to which you have referred have not been recent. The Senate confirmed their appointments just as now?

Mr. WILLIS. But they were confirmed under conditions that were certainly adverse to the getting of good men. I have noticed here in the testimony that some member of the committee, whose name I do not recall, asked for specific cases in which political pressure had been applied to the Federal Reserve Board, and I think the witness said it never had been applied. As to that I would just like to call attention to the well-known statement made by the late President Coolidge in his radio address on the night before he was reelected as President, in which he said—I look it up the other day, but unfortunately I have not got it here with me now—that this administration had always favored low-discount rates and it always would do so. That was, of course, in the nature of a mild suggestion to the then Reserve Board that higher discount rates would not be very satisfactory. Of course, that is merely an illustration.

Until you get a public opinion that is adverse to things of that kind, I do not think you will ever free the Reserve Board completely from the sort of influence that is bad for it. Of course, the President of the United States would never call in, I suppose, a member of the Supreme Court and tell him that he liked N. R. A. very well and he hoped he would get a favorable decision. I do not believe he would do that. But under existing conditions of course, Presidents have done just about that with reference to financial matters. That is the reason you have not had the independence and courage in the Reserve Board that is absolutely essential. That is one reason why I do not like to see a great increase in the power of the Reserve Board over policies, but in actual execution, the actual carrying out of policies that it decides upon. This evil is not a matter of Republican or Democratic politics; it is a fault of all parties.

Senator GLASS. Oh, yes. I have seen some notable exhibitions of courage by members of the Federal Reserve Board who were Republicans, and by members who were Democrats, also. But I agree that they have as a board exhibited a lamentable degree of timidity at times where courage was required.

Mr. WILLIS. I have just one more matter to present that I think I ought to mention and that is the effort to use this banking system as an agency of economic planning. The statement is found on page 50 of the bill, subsection (o) of section 204 [reading]:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses 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.

Of course that last sentence is a very "saving clause"—so far as it is possible. But one might add to that that it is never within the scope of monetary action and credit administration, so that you would use a bank mechanism for doing something for which it was never intended. The function of the bank mechanism is that of keeping banking sound and safe and of keeping it at all times in position to perform its financial functions. It is not its duty to unstabilize or to stabilize production, trade, prices, and employment.

And we have at the present time a very serious difference of opinion among qualified authorities as to just how much it can do in any of those directions. It is ordered here, as if that were an unmistakable, unquestioned monetary power to do something which in my opinion it cannot do. And of course as to bringing the Reserve Board into areas about which it knows nothing and as to which no banking board is in position to act, you almost insure failure.

This question has been discussed a great deal in England. The director of the Bank of England has issued a very interesting book entitled "Planned Money", in which he discusses the question of just how far you can go in what the Board here is ordered to do. He is very reasonable about it. He frankly admits that while he thinks certain things can be done with success, any such program as this is out of the question. At any rate, we have not reached a point where it can be done. It is true, as I said before, that that saving clause was introduced, "so far as possible"; but you surely do not want the Federal Reserve Board experimenting. We had better wait until the condition of theory and scientific thought has reached a very much more advanced point than it has today.

That provision embodies really the essential difference in point of view between the Reserve Act and the proposed act, and in my opinion it puts forward a hazardous program for a Reserve Board to conduct, one that is fated to disappointment, certainly, and perhaps disaster.

Those, gentlemen, are the major reasons why I think that this bill, if you are going to pass it at this session—at least title II of it—needs very, very careful consideration to see which of these theories is acceptable and to harmonize the different parts of the bill so that they dovetail with one another and so that the bill is consistent with those as far as possible.

In addition to that, this measure is a very clumsily written, inexpert piece of work; and if you are going to pass it, you need to have it completely recast.

In my statement I have mentioned a few of the principal points that I think are in that class. I have been talking too long a time and I ought not to keep on much longer, but I will just call attention to a very few of them if I may.

The mechanism for the appointment of the Governor. Supposing that you are wholly in sympathy with it as it stands here and are going to keep it. I think it should be recast in such a way as to make plain exactly what you do mean by it.

At the top of page 45 of H. R. 7617 is a confused sentence which leaves in doubt when he is to be appointed and reappointed and how he is to take office.

Senator Glass. I would suggest, Doctor, that if you discuss that in your prepared statement you could just put it into the record and we will read it.

Mr. WILLIS. My statement covers a few of the points, but I had to make the statement bear upon the House form of the bill. Since arriving here I have added various others, but I will discontinue——

Senator GLASS. I think if you cover those details in your statement it would be more effective to put that into the record than to talk about them here. We cannot carry it all in mind; at least I cannot.

Mr. WILLIS. Very well. I have nothing else to present.

(The prepared statement referred to and submitted by the witness is here printed in full as follows:)

STATEMENT OF H. PARKER WILLIS BEFORE SENATE COMMITTEE ON BANKING AND CURRENCY MAY 29, 1935

THE PENDING BANKING BILL (S. 1715)

Mr. Chairman and members of this committee, in the following statement I have endeavored merely to set down in outline my views about the bill as to which you have asked me to testify. There are many details and many statistical analyses which should be made with reference to its operation in particular aspects, but I assume that you do not care to have me go into such minutiae, and that you merely want a general statement of my position.

I present this under two heads:

1. A survey of the banking situation, designed with a view to showing that no action whatever should be taken upon it at the present time (particularly upon title II of the bill), and

2. A survey of the measure itself designed to offer certain general criticism, founded upon the assumption that the bill is nevertheless to be acted upon presently and is, therefore, a fit subject for specific commentary.

I now turn to the matters of which I have spoken:

I

First is the question whether any such measure should be enacted at the present time. As to this I submit the following statement, the substance of which I have already published in the Commercial and Financial Chronicle of New York:

THE MEANING OF THE "ECCLES BILL"

A student of the Eccles bill must not allow his attention to be diverted by the multitude of suggestions and proposals which it contains. First of all, and before all else, it is essential to try to understand the ultimate purposes that are held in view by the measure. These are presented in three or four very definite and distinct aspects by its authors and sponsors. It is presented:

1. As a completion and logical application of the ideas embodied in the Federal Reserve Act but never fully worked out in practice.

2. As a rectification or corrective of faults and defects in the actual working of the Reserve System, which have been noted as the result of experience and which call for modification or alteration if our present banking system is to be successful in its functioning.

3. As a great advance above anything that has been attempted heretofore in the "supply and control of money", by permitting the Federal Reserve Board to vary the amount of "money" in the country in such a way as to permit "planning", or a "planned economy."

4. As a means of guarding against the arrival of panic conditions or excessive "inflation", such as may easily result, it is asserted, from the present surplus of credit now found on the books of our banks and Federal Reserve banks.

5. As a way of developing needed centralization in the control of banking, in order to prevent conflict of method and purpose and to bring about unification and consistency in the development of banking policies.

Before attempting the analysis of any of these ideas, it is worth observing that the great powers that are conferred by the Eccles bill upon the Federal Reserve Board would also, incidentally, provide for the accomplishment of the following objects:

1. The further and, if necessary, the exclusive use of the resources of the banks for the purchase of Government bonds and obligations in the endeavor to provide funds needed in carrying out the existing program of the administration for money spending;

2. The more or less complete crushing of any independence in banking—the combination of all banks, whether chartered under Federal or State law into one centrally controlled system.

3. The withholding of credit from various types of business or enterprises and the feeding of other businesses and enterprises with a smaller amount of credit which they would otherwise probably not be able to obtain.

4. Particularly, the upbuilding of the mortgage market and the development of real-estate financing by devoting the resources of our commercial banks to that end.

5. The reestablishment of the joint operation of investment and commercial deposit banking which had prevailed before 1929 and which was partially corrected by the Banking Act of 1933.

That there are many other incidental provisions and objects which are made or served in this inclusive measure is, of course, obvious. The foregoing brief survey merely assists in focusing attention upon those that seem most outstanding.

THE ATTITUDE OF THE PUBLIC

It would naturally be expected that so great a measure as this would and should receive the careful attention of the public, with a view to its improvement, or to the reaching of a decision whether it should be adopted or not. Some study of it has undoubtedly been given by the public. This study has resulted in two major suggestions:

1. That of a special committee of the American Bankers' Association which is apparently disposed to accept the bill very largely as it stands in its essentials, but which asks for some important modifications—the chief being a division of power in regard to central banking functions which will leave to the bankers of the country a distinctly larger share than that which is allotted by the provisions of the new bill.

2. That of the special committee of the New York Chamber of Commerce, subsequently ratified by the New York Chamber of Commerce itself for the appointment of a commission to look over the entire situation and see what is needed in connection with banking.

3. That of some outstanding figures in the financial and banking world who have thought best to express themselves with a degree of frankness, either in personal interviews, testimony before committees, or in circulars or other utterances issued by their respective banks.

The reader who surveys these definite pronouncements must necessarily come to the conclusion that only in a very few instances has any positive position been assumed in regard to the proposed bill, whether for or against it. The American Bankers' Association report, for example, tacitly assumes that the general idea of the bill is to be accepted, but merely indicates changes that are thought to be necessary in connection with the administrative working of the measure. The various utterances of outstanding bankers and financial authorities have been concerned with much the same sort of questions as was the committee of the American Bankers Association. For the most part, effort has been made to select provisions that were clumsily written, partisan in nature, inclined to favor this, that, or the other scheme, or to render impossible, this, that, or the other operation, which was thought by the authors of the bill to be desirable. In hardly any of them has there been a careful review of the underlying philosophy of the whole measure. A publicist recently writing on money and banking makes the following statement in behalf of the proposed bill:

"The fundamentalists of the pre-war Federal Reserve System * * * did not believe that the volume of money can or ought to be deliberately controlled. * * * They thought that the supply of money should contract or expand automatically in accordance with the needs of industry and the imports and exports of gold. They are opposed * * * to the whole philosophy of the system in the post-war era. * * * Those who hold this view are in a very small minority."

This cavalier dismissal of the issues involved in the subject referred to would not deserve any notice if it did not represent notions that are being taken for granted by a good many hasty observers. There is, of course, nothing about the real question of "money", its "supply" or its "control", in the Eccles bill, nor is there the slightest warrant for identifying bank deposits with money. To do so is like the statement said to have been found in the introductory paragraphs of an Alice in Wonderland algebra that "in this book we shall regard the signs plus and minus as identical." Bank credit is not money and never can be made such, and what is really under discussion in this whole matter is whether there is any such thing as credit and any such function, desirable or otherwise, of testing the soundness and truthfulness of credit. What the Eccles bill seeks to do is to bring about a complete transformation of the underlying ideas of banking (whether pre-war or other) and to revise the entire banking system accordingly. Unfortunately, this undescriminating attitude is pretty generally accepted by the public itself, including some bankers who have been disposed to regard the controversy about the Eccles bill as little more than a debate as to whether the "money of the country" should be under the "control" of the bankers or of the politicians. This issue, if it can be called such, is, however, an exceedingly small phase of the real questions raised by the Eccles bill. The proposals made in the Eccles bill go far beyond the mere question of controlling money or credit and they raise the issue whether there is any such thing as credit at all and whether it is, or is not, identical with money.

In contrast with this attitude of limited understanding of and partial acquiescence in the Eccles measure, we have the proposals included in (2) above, which merely ask for a study of the entire proposal. The argument in favor of this latter proposal is as follows:

(1) There is no emergency today recognized that would warrant a hasty enactment of any banking measure whatever. The Comptroller of the Currency has emphatically stated that in his opinion, the banking crisis is over and the community well on the way back toward a normal condition. In his last annual report, he said, "There is little evidence remaining of the collapse in March 1933 of the banking struction of the Nation. The entire system has been rebuilt." Practically the same statement has been made by the Secretary of the Treasury, and either directly or by implication in the public utterances of the President. Judged by its own expressions, the administration recognizes that there is no call for any emergency action.

(2) There are enough observers who have expressed the greatest anxiety about the effects of the Eccles bill to make it evident that the measure should not be regarded as a mere routine proposal to be passed as a matter of Executive recommendation and without study.

(3) If for no other purpose then than for that of reconciling conflicting views and obtaining the maximum amount of support for a far-reaching proposal, we undoubtedly ought to have a nonpartisan investigation of the ideas contained in the Eccles bill;

(4) Moreover, as is generally conceded, the Eccles bill, even taking it at its face value, just as it stands, by no means covers the field of desired banking legislation. There is a well-nigh universal recognition among students of American banking that a fairly complete "codification" of American banking law is needed, and with a commission of the kind referred to, if composed of men of standing and probity, they would be able to lay down the lines along which such work ought to proceed and to assure a satisfactory result of the investigation when completed.

This is the case, then, as between hasty enactment of the Eccles measure and the proposal to entrust it to a nonpartisan commission. As to the contention that such commissions in the past have oftentimes been noncommittal, inclined to waste money and disposed to delay action, the answer is perfectly plain. All this depends on the kind of commission that is selected. It might well be a commission serving without pay, and ordered to turn in its report within a very short period of time. In any case, there is no reason whatever to suppose that unconscionable delay and unreasonable expense need necessarily be involved in the effort to get thorough and scientific advice about a matter of utmost importance. The public has not studied the subject, is in no position to do so, and is only conscious of the fact that a great technical problem is before it. What is most urgent is to afford leadership and to grant time for the careful and discriminating presentation of argument under conditions that will permit of arrival of some safe set of conclusions. To drive such a measure through Congress with "whip and spur" at the present time would be unpardonable, since there is no possible basis upon which to defend, much less to justify, it.

"ECCLES BILL" AND THE FEDERAL RESERVE ACT

It is now desirable to devote some attention to the various arguments that have been presented for the immediate enactment of the Eccles bill, despite the general considerations that have just been presented. Among these, one of the most frequently cited is that which has been noted as coming from the advocates of the measure itself—that it completes the ideas of the Federal Reserve Act and carries the views of its framers to a satisfactory, logical conclusion. As to this, an immediate answer may be returned on the basis of general historical knowledge. This is, that there is no respect whatever in which the content of the Eccles bill can be regarded as in any sense completing the Federal Reserve Act or carrying it to its natural and logical conclusion. The obvious attempt of the Eccles bill is to overset most of the notions of the Federal Reserve Act and to make it imposible for that act to function in the way that was intended by its original framers.

The Federal Reserve Act, for example, had as a definite underlying conception, the notion that the desirable outgrowth of a central banking system was an "elastic currency" and that the attainment of such a currency should be a major object in the development of banking. The Eccles bill, on the other hand, holds that the volume of business is a reflection of the volume of media of exchange while it erroneously contends that "deposits" are "money" and should be "controlled" in their amount with reference to what is considered the ideal volume of business. The two measures are thus radically opposed to one another, without the slightest integral connection. The Federal Reserve Act, moreover, in its original drafts, sought to place the management of banking in the hands of bankers, simply giving to the Government the opportunity to be present at all deliberations, know what was going on, and express opinions or have an adequate voice in determining conclusions. "Politics" forced a compromise between friends and opponents of political control at a very early date, with the result that the Federal Reserve Board became a distinctly political body, while the choice of its successive members became a matter to be determined by purely political considerations—a decidedly diametric contravention of the original purpose of the Reserve measure. The Eccles bill places the control of Reserve credit entirely in the hands of the Federal Reserve Board, makes that Board merely a group of marionettes, dominated by a governor who is merely the political puppet of the President who may be in office at a given moment, and takes away all possibility of self-government from banks and bankers.

This review of the essential features of the proposed Eccles bill is sufficient to show abundant reason for thinking that there not only is no furtherance or completion of Federal Reserve ideas in the Eccles bill but that, on the contrary, the adoption of the Eccles bill would be a radical defeat of the major underlying motives or principles upon which Reserve legislation was founded. The effort to make capital out of regard for the Reserve System and its record is thus wholly unwarranted, without the most remote basis in fact.

IS THE ECCLES BILL A NEW PHILOSOPHY OF MONEY?

In contradistinction to those impressions which represent the Eccles bill as merely a further working out of Federal Reserve ideas, we have the opposed suggestions that it is a very original proposal whose adoption would take the Federal Reserve System out of the rut into which it has fallen and give it a new and proper application. Let us see upon what this contention is based. Apparently the idea of the Eccles bill is to centralize the discount and open-market powers in the hands of the Federal Reserve Board, or of institutions or organizations closely connected with it. Thus, the various forms of the bill already available, contemplate the placement of the open-market powers in the hands of a committee consisting of some members of the Board and certain governors of the Reserve banks, with the Governor of the Reserve Board as the chief factor in the organization. This open-market group is to decide upon the policy to be pursued in buying and selling Government bonds or acceptances—the staples of open-market operations. The Eccles bill, furthermore, seems to give to the Reserve Board the power of initiating rates of rediscount, instead of waiting for them to be proposed by the several district banks, later to be approved or disapproved by the Board itself and by this latter means to be harmonized. Finally, the Eccles bill authorizes the Federal Reserve Board to determine the amount and composition of reserves that would be exacted from member banks, by compelling the banks—and, for that matter, the Reserve banks as well—to carry larger or smaller reserves or to change their constituents so as to regulate the supply of credit available. The latter proposal has been endorsed by Mr. Eccles himself as being a weapon which the Board could use to very great advantage in cutting off or reducing the danger of uncontrolled "inflation" or expansion which, it is alleged, exists in very serious form at the present moment.

Here we have a proposal not to introduce anything new but to use familiar methods and factors in a way to bring about an unaccustomed result through the application of a familiar technique. Suppose that the Federal Reserve Board, under the new bill, should determine that it was desirable to raise reserves to 100 percent of outstanding demand deposits. Certainly there is much reason to suppose that such a step might be ordered. Representative Goldsborough, one of the chief proponents of the measure in the House of Representatives has expressly said that, while he would not wish to see such a change ordered, by a step that would cause any disorganization or disturbance to our banking system, he would look forward to an ultimate introduction of the notion under the provisions of the Eccles measure. Advisers of the Reserve Board have strongly advocated the application of the 100-percent reserve requirement, both in public and in private. Governor Eccles himself, it is understood, has disclaimed any present intention of calling it into effect, but much of his testimony and general philosophy points strongly to such a measure as the inevitable outcome of what he says he wants to do under the terms of the measure. If banks were to be ordered thus to increase their reserves against demand deposits to 100 percent of the face of such deposits, they would evidently have to displace other assets such as corporation bonds, in order to draw in claims upon banks from the buyers of such bonds, and these buyers would have to provide themselves as they could; perhaps by further discounting with banks, eventually giving rise to new credits with the Reserve banks, or in some similar fashion. The banks themselves, were they to try to comply with the requirement would, of course, find that they could do so only by rediscounting with Reserve banks, and in order to get the material for such rediscounting would have to buy Government bonds since commercial paper is not available in any such quantity.

An easier way to apply the meaning of the proposed provisions then, would be to require that 100 percent be held in reserve credit plus Government bonds, in which case the banks would have to buy the additional Government bonds as they were issued, giving credit on their own books and then immediately discounting notes collateraled by the new bonds with the Reserve System, or they would have to (as before) get the funds with which to pay for them by disposing of their corporate bond holdings and using the funds to build up their reserves, or would have to obtain the Government bonds by what amounts to an exchange of corporate issues for Governments, so that eventually they would become the holders of the amount of Government bonds needed to equal—with their reserve credits and cash—the amount of their demand deposits. In these ways, unquestionably, several "birds could be killed with one stone"—the Government bonds could be sold in new and huge amounts as a practical necessity on the part of the banks to acquire them; while the theoretic desire to rebuild the reserves of the banks to this "100-percent money" would be attained. On the other hand, such a policy would satisfy the demands of the numerous persons who have asked that Government bonds shall be made convertible directly into paper currency. This policy, said to have been seriously considered in connection with the new bill, might, of course, be subject to more or less modification; the point is, that it has been thought of and is being considered by authoritative persons and represents what must be regarded as unquestionably the gravest of dangers—the development of a situation in which the assets of the banks consist practically wholly of Government bonds, while the banks themselves become merely agencies for the making of loans stated in terms of Government paper. That such a policy would infinitely transcend in danger the issue of more "greenbacks" needs no argument and yet it seems to be a measure which either by actual design or as the result of policies inevitably resulting from what has already been attempted, would necessarily come into use.

We have here the crux of the situation which is raised by the Eccles bill Is that bill, either directly or indirectly, the means of still further devoting the assets of the banks to the purchase of Government bonds, thereby enlarging the potential field for bond issues and thereby enabling the Government to go on with deficit financing for a considerably longer time without perhaps bringing about an immediate crash in our financial structure? The general philosophy underlying such measures would be the same as that which Mr. Eccles outlined in his testimony before the Senate commission investigating economic affairs in the spring of 1933. It cannot be possible that his opinions and views about banking have been very greatly changed in the 2 years that have elapsed since that time. Especially when we know his advocacy of the proposed measure and the easy way in which its terms allow themselves to produce some such outcome. The underlying notion—that the Government and its credit should constitute the foundation of the credit of the Nation and that advances made by the Government for whatever purpose should constitute the basis of the currency rather than to use for that purpose resources or wealth originating through private investment or business enterprise, the latter being necessarily reduced in importance as the scope of Government lending enterprises grow—is the inevitable outcome of what is now urged. Probably there are very few in the community who have seriously contemplated the practical application of any such theories as these, partly because they are so foreign to those which have underlain the education of bankers heretofore, and partly because of the disastrous consequences that must ensue from them to the business of a country that is not completely governmentalized or communized. We must, in short, conclude on this one ground alone that the basic thoughts of the Eccles bill not only are not a completion or further working out of Federal Reserve conceptions, and not only far from being merely a wider application of governmental supervision of banking in order to secure greater honesty and sincerity, but are also something very much broader: The embodiment of the idea of public credit as a substitute for private credit.

It was Lenin who, in discussing the subject of banking, made it clear that in his opinion the first approach to a communized state must be found in complete national control of the monetary and banking system; and in this, he followed other authorities of equal standing among Communists. The Eccles bill, as now termed, does not confessedly purport to aim at any such ideas; and it would be impossible to find a specific recognition of them in any section of the measure. They are present, however, by implication in the ways that have just been indicated; and even though they may not be extensively put into effect upon the adoption of the bill, would always remain as an imminent possibility in connection with its application.

PANICS AND DEPRESSIONS

By an amendment to the Eccles bill which was proposed in the House of Representatives, provision was made for instructing the Federal Reserve Board to use its credit powers as a means of bringing about a balanced or "planned" economy in the Nation at large. The thought underlying this amendment was that since the granting or withholding of credit greatly facilitates, if it is not absolutely necessary to, the investment of capital in the development of an industrial enterprise, the granting of power to withhold such credit must make it possible for the credit-granting authority to deprive undesirable enterprises of funds, while at the same time encouraging those that are thought to be desirable to proceed with their plans. Governor Eccles himself, in commenting upon the interpretation of the House proposal, has expressly stated that the Eccles bill does not give to the Federal Reserve Board any power over credit that it does not already possess and has asserted that the new measure would not in any way whatever enable the Board to deprive a given enterprise of the credit which would otherwise be granted to it.

Probably a case can be made out for the technical accuracy of these assertions. It remains true, however, that the proposal must have had some meaning and that if it had any meaning it was intended to indicate that the centralized-credit power of the community was to be used in checking or advancing the general activity of business so far as any such policy could check or advance that activity. Indeed, much of the testimony of Mr. Eccles himself is based upon the thought that it is possible in this way to further or advance business. In his speech at Columbus, Ohio, shortly after the Eccles bill was first made public, the Governor of the Federal Reserve Board asserted that he did not suppose it would be possible, by the use of reserve credit, completely to smooth out the business cycle, but he thought that considerable progress might be made in that direction.

How would such a result be attained? Obviously by making it harder or more expensive for business to expand under such a policy, when thought necessary, or by rendering it easier for the business to expand when that policy was desired. It may be remarked parenthetically that this is a power which, in the older thinking on banking, was regarded as a fundamental function of banking and which when judiciously exercised tended to prevent the over-expansion of industry leading it to so-called "boom" followed by "panic" conditions. It also has underlain the whole philosophy of "easy money" often advocated by the Federal Reserve Board as may be proven by any number of citations from their reports of recent years. What is proposed, then, is evidently to centralize in the hands of the Board, bank powers in relation to business which have heretofore been resident in the individual banks, or in those banks with the aid and oversight of the Federal Reserve banks. There is probably nothing in the Eccles bill which would authorize the Board to prevent the First National Bank of any given place to continue making loans to, let us say, the automobile industry, or that would compel it to cease making such loans; but there is ample provision in the Eccles bill which would make it possible for the Board to cut off such a bank from rediscount facilities or to render rediscount facilities more available to it.

The germ of such authority, undoubtedly, exists in the present Federal act, but subject to a system of checks and balances which control it, just as the checks and balances of our Constitution prevent the exercise of despotic power by an Executive.

The Eccles bill eliminates many of these checks and balances and thus renders what under proper conditions of use is a beneficial authority, a potential instrument of despotic financial power. It is also a fact that such a power can be wisely used only locally and that it cannot ordinarily be used to good purpose as a general policy to be applied over a large competitive area. It is seldom true that in any given line of business, all concerns are overexpanding or the reverse, and the direction of industry by means of general loan regulations is correspondingly difficult. Desirable as it may be to employ banking as a means to bring about conservatism in business enterprise such means certainly cannot be relied upon less those who use them are more fully informed and far more trustworthy in their use of such powers than those to whom the authority has, in fact, been committed. The Eccles bill, therefore, would largely take away the powers spoken of from those who have heretofore been entrusted to use them and would vest them in political or governmental authorities whose knowledge of their use—as the Reserve Board has heretofore been constituted—must be very seriously questioned. We cannot, therefore, give any credence whatever to the hope expressed by Mr. Eccles and others, that the proposed measure would result in a saner, more conservative, more restrained use of credit for the purpose of preventing the development of "inflationary" or overexpanded industrial conditions, and we must fear that mistakes of judgment in the application of such centralized credit would tend to aggravate danger which might otherwise be self-corrective.

Before leaving this subject it should be carefully noted that by no means all economists are inclined to the opinion that any use of bank credit, however wisely made, can exert any such effect upon the development of business or the arrival of "booms" or in curing of depressions, as is thus alleged A very large school of thought holds that bank credit is the outcome or reflection of business conditions and by no means the motivating cause of changes therein. If the views of this latter school hold good, the use of powers such as those advocated by Mr. Eccles, would be likely to eventuate merely in the "pegging" of enterprises that had become greatly expanded, as in the case of the Reconstruction Finance Corporation. The result in such a case would be nothing more than to divert the resources or credit of the community into the support of unproductive undertakings, or undertakings that are uneconomically operated, with the corresponding loss and disadvantage of the business community.

THE QUESTION OF NEEDED CENTRALIZATION

A very strong point has been made in connection with the Eccles bill of the fact that under existing conditions it is unsafe or unwise to leave a large local latitude in the use of financial assets to banks which might, or might not, employ it wisely. Unwise use of such power has been pointed out as being a major and exciting cause of bank failures, the latter to be viewed as the result of hasty or ill-judged credit manipulation, resulting in stimulating or depressing industry or in "tying up" individual bank offices, by giving to the Federal Reserve Board and its affiliate enterprises of deposit guaranty, and so forth, the authority to simplify control and improve bank examinations, while rendering them less onerous and less expensive. Here is a proposal which naturally appeals to many bankers who have found the present agencies of supervision incompetent, self-contradictory, and costly; but would centralized control bring about the desired result? There is no definite reason to suppose so. Experience in the past has shown that bank examination is essentially a matter which must be carried on locally by men familiar with local paper and with local conditions. The condition of banks cannot be judged by rigid standards. Many a bank is in a sound enough condition for its own locality and for the community which it serves, but would be anything but satisfactory in another place a thousand miles away. Whatever faults there are in the present examination and oversight system, can be easily "ironed out" without any application of broad powers that have nothing to do with the problem of supervision by a Federal body.

There are many bankers in the United States who from the very beginning of the Federal Reserve System have felt that the organization of that system upon a district footing was unwise. Many influential bankers opposed the Federal Reserve Act on that account, and said that it would never be possible under any circumstances successfully to build up efficient discount markets on a local basis. They, therefore, antagonized the underlying thoughts of the original Federal Reserve Act. While perhaps a majority of such former advocates have changed their attitude, and since then have become advocates of the district system; by no means have all done so It seems fairly clear that the proposal made in the Eccles bill to diminish the importance or authority of the several Reserve banks in order to add to that of the Federal Reserve Board has met with some approval. Just here it should be noted that this attitude on the part of some bankers is entirely based upon the thought that the centralization desired was to take place under banking supervision and self-government. Were they convinced that the centralized system now proposed would never be developed or operated upon a basis that was more truly financial than the present, it may well be doubted whether they would advocate the change.

Probably a good many have felt that the proposed system would gradually develop into a plan whereby the great powers vested by it in a political organization would be gradually taken over by some one of the Reserve banks, say by the Reserve bank of New York, just as the latter had during the pre-1929 period succeeded in taking to itself much more than its normal share of influence in the system. The question whether any such development could be counted upon is necessarily more or less conjectural, but there are abundant reasons for believing at the present time that the political organization at Washington will not be likely to part with the authority that it acquires unless compelled to do so by some general collapse. The hope therefore of reaching the development of a genuine bankers' central bank controlled by bankers and centralized through the membership of some institution situated, perhaps in New York, must be regarded as without adequate foundation. There is not enough basis for it to warrant those who believe in that form of transformation of our banking system to trust themselves to the indicated method of attaining it. Even if the proposed measure worked at its best, the kind of financial centralization thus hoped for would probably be rendered more distant, rather than less. If the proposed measure should lead to the disasters which many foreshadow for it, the cost of bringing about the desired consummation would be far too great to be thought of.

DO WE WANT A BANKING COMMISSION?

Enough has been said to indicate, entirely free from any partisanship for or against the Eccles bill, two things:

(1) There is a large field for difference of opinion about the actual effects of the Eccles bill and about the theories which underlie it. It undertakes to do many things that have heretofore been regarded as unsound, dangerous, and contemplated to disturb the entire basis of modern business.

(2) There is a feeling of distrust and doubt about the proposals that exist not only among the banking community, but also among businessmen, without regard to party, and which must necessarily make adoption of the measure unwise, especially in our present economic situation and necessitate its serving as a cause of disturbance in financial and economic relationships.

Inasmuch as it is agreed on all hands that no emergency exists or, at all events, is admitted, which calls for the prompt adoption of such a measure, it would seem to be only the part of common wisdom to obtain the verdict of nonpartisan and capable men, viewed by the country as worthy of confidence, before any irrevocable step is taken. The plain dictate of common sense would be therefore the remedy which has been suggested by the New York Chamber of Commerce and by other agencies of equal weight, in the appointment of a satisfactory commission to look quickly over the entire field of banking legislation and to indicate what is needed. Such a commission need not spend much time in purely technical discussion; it could safely leave that to expert advice, to be rendered to committees of Congress or to be obtained in some other way. But there is the most cogent reason, before taking radical and extreme steps, such as are proposed in the Eccles bill, to ask for a careful weighing of the general considerations that underlie the institution of banking, with a view to focusing upon the proposals the sanest opinion in the community, if for no other purpose than that of obtaining popular assent to or support for whatever may be adopted.

Every modern country has followed this plan before making any far-reaching change in its banking system. It is the method which was employed by Great Britain in the appointment of the Macmillan Committee; in Germany by the institution of the Reichsbank Enquete, and elsewhere by appropriate bodies vested with the necessary powers. We shall act recklessly and unwarrantably if we fail to follow the example of human experience.

II

Second—I now turn to a discussion of the proposed bill as a practical matter, upon the assumption which I have already indicated—that the measure is in fact to be acted upon at this session:

The salient features of the bill are grouped under the head of "title 2, amendments to the Federal Reserve Act", and consist in a series of changes in those parts of existing law which lay down the fundamental bases of our central banking organization. These are: (1) The self-governing character of the System; (2) the maintenance of liquidity and redeemability on the part of Federal Reserve banks and through their agency; (3) the conservation of soundness and liquidity of member banks.

CHANGES IN RESERVE SYSTEM CONTROL

The new bill effects a far-reaching change in Reserve System control through two methods:

(1) Alteration of the composition of the directorates of Reserve banks;

(2) Alteration of the composition of the Federal Reserve Board and of its relation to the banks. At present each Reserve bank has 9 directors, of whom 3 (known as "class C") are nominated by the Government, 1 to be known as "chairman and Federal Reserve agent." The local board of 9 members in each Reserve bank selects its own executive officers who are headed by a governor and 1 or more deputy governors, and these men are and always have been the actual operating officers of the institution. This arrangement was the outgrowth of a compromise at the time the Reserve Act was established. Original drafts of the Reserve Act had called for the selection of local boards consisting of business men and bankers resident in the district, but at the insistence of Mr. W. J. Bryan the Government was given one-third of the directors with the chairmanship, although it never contributed a single cent to the capital of the Reserve banks.

In the same way the original Federal Reserve Board was intended to be a self-governing body, chosen particularly by the Reserve banks themselves, although with a representation of Government officials. It became an all-Government appointive board, with matters so arranged that the Secretary of the Treasury was practically in control of it.

The System has continued even under these conditions to grow more and more political as the years have passed, and there has never been a time when the Treasury Department could not, and at any time when it choose to do so did not, exercise a directive power in the management of the Reserve banks, so far at least as it was necessary to float, manipulate, and market its own securities. Under the new act it is intended to have the governors of Reserve banks replace the chairmen, thus combining the making of policy with the actual execution of it and placing the operation of the banks under the immediate influence of the Reserve Board at Washington.

The Reserve Board itself had always been weak and was intentionally so selected. It has grown weaker as the years have passed, and if the present changes in Reserve structure were to involve the retention of the old type of Board with its former powers, the result might not be of much importance. The proposed act, however, would have the Reserve Board practically originate the appointments of the governors, while the Board itself is to be "packed." Every obvious provision is made in the new act for inducing or compelling the older members of the Reserve Board to retire, while an inconspicuous provision, obscure in language, enables the President to appoint any governor he may please, regardless of the latter's residence or location, he being expressly exempted from the geographical restrictions which apply to other members of the Board. The President, moreover, is authorized not only to designate a governor but to terminate his designation whenever he pleases, and in one form of the bill immediately to drop him from the Board, since when he ceases to be a governor "he shall be deemed to have served the full term for which he was appointed." The structure of the new mechanism then, reduced to its lowest terms, is this:

(1) A President of the United States who appoints a Federal Reserve Board and designates a member of that Board as governor;

(2) The Board itself is given long terms of office and is geographically distributed, but the President may designate any member as Governor, removing him at will and thus change the balance of the Board completely if it should be closely divided.

(3) A Federal Reserve bank board (1 in each of the 12 districts) presided over by a board of directors, 3 of whom are Government appointees with a maximum term of 6 years, and 1 of them designated as governor, who may have an indefinite term, by the Federal Reserve Board (which means by the Governor of the Federal Reserve Board, which means by the President of the United States) and removable without notice.

(4) A reserve banking mechanism which is fully authorized to appoint clerks, pay rent, buy stationery, etc., but which in all other activities shall be controlled by the political authorities at Washington.

CHANGE IN CREDIT STRUCTURE AND POLICY

The original Federal Reserve act provided for a credit structure in which local policies were to be made by the local boards of directors and harmonized through the exercise of a nugatory or veto power of the Federal Reserve Board. It was expressly intended to give to the local Reserve banks full control over the credit conditions in their districts and to make them, so far as possible, democratic and locally responsible for what went on. From time to time, as years have passed, the Federal Reserve Board has assumed a power of domination and has been prone to dictate to the several boards of directors, as on the notable occasion when it forced a bank to reduce its rate; but the theory of the act has continued unchanged up to the act of January 30, 1934, when the Secretary of the Treasury was vested with power to use a stabilization fund of $2,000,000,000 in buying, and selling Government bonds, foreign exchange, and practically any kind of marketable paper that he saw fit. Under the proposed bill, a committee controlling open-market operations on the part of the Reserve banks is established to supersede the present committee, which represents all the Reserve banks and which determines open-market policies, subject to the oversight of the Board. The new committee would consist of the Governor of the Reserve Board, who is chairman of the committee, 2 members of the Reserve Board itself, and 2 governors of Reserve banks. Meetings of this committee are to be held when the Governor of the Reserve Board may call them and it is to have power to direct open-market operations of the several Reserve banks. Put in plain language, this means that an appointee of the President of the United States, selected as he may see fit and accompanied by certain satellites is to have control of the open-market operations of the System and to prescribe such operations on the part of every one of the Reserve banks.

Along with these changes in the credit structure effected through the modification of the open-market committee goes the opening of the rediscount privilege to any "sound assets of * * * a member bank", the Board itself being the sole judge of "soundness" and the ultimate authority as to operations of the Reserve bank. The meaning of this provision evidently is that the Governor of the Reserve Board, appointed by the President of the United States, shall have power to operate Reserve banks on a basis of rediscount which shall admit any assets, bonds, stocks, commercial paper, mortgages on real estate, that may be owned by a member bank, provided that the Board, constituted as heretofore indicated, has designated them as "sound."

In addition to these far-reaching changes of structure, it is specified that the Federal Reserve Board, "in order to prevent injurious credit expansion or contraction", may, when and as it pleases, change the Reserve requirements of the member banks throughout the country. The language of this provision is obscure, but apparently would imply that it may release member banks in a favored Federal Reserve district from all or any part of existing Reserve requirements, at the same time that it maintained and increased them in others.

DEBAUCHING THE CURRENCY

It would have been strange if the new central banking bill had stopped without seeing what it could do toward a further change in our currency system designed to provide "enough money." In order to bring about this desired situation, the new bill specifies that the existing system of placing special collateralled security, consisting of commercial paper or Government bonds, in the hands of the Reserve agent or chairman to be held by him for protection of the Government—the idea of collateralling the notes is to be completely abandoned. Instead of being notes which at first were based upon commercial paper and later upon commercial paper protected by Government bonds—and still later upon Government bonds themselves with a 35-percent gold reserve—our Federal Reserve notes are now to have no special protection whatever, but are to be a general liability of the Federal Reserve bank issuing them, while the reserve of the Reserve bank held against them consists of irredeemable gold certificates, and the assets of the Reserve bank may consist of paper rediscounted by the institution on the basis of "any sound assets" owned by any bank in the country. There is thus no reason why we should not have an issue of legal tender reserve notes limited only by the volume of assets owned by the banks and safeguarded by a reserve which may be controlled in amount at the will of the President of the United States and the Federal Reserve Board; and which, in any case, has behind it only irredeemable gold certificates representing gold stored in the Treasury and paid for at any price the Secretary of the Treasury may choose to name.

FREEZING OUR BANK PORTFOLIOS

The new bill also provides for a more effectual freezing of our bank portfolios than we have yet been able to accomplish. It authorizes national banks to invest their entire capital and surplus if they chose to do so, in real-estate mortgages, which mortgages are not to exceed 60 percent of the actual value of the real estate offered for security, although under easily attainable conditions they may be raised to 75 percent of the value of the real estate. The banks' own premises are not to be included in the limit thus placed upon the real-estate mortgages and, accordingly, it would seem that the provision is definitely made for the possible issue of an aggregate of loans based on real estate and equal to the capitalization of the member banks. This figure, as given in the current Federal Reserve bulletin is approximately $5,000,000,000. Take this provision in conjunction with the power given to the Reserve Board to exempt member banks from reserve requirements and to discount anything they may have in portfolio, and it is clear that something close to a dispensation of Providence would be necessary to prevent complete freezing of the remaining assets of the banks of the country should there be any enterprises that desire to make further loans for working capital.

TECHNIQUE OF NEW BILL

The analysis of the new measure up to this point has touched only upon the high spots in it, and has, for want of space, necessarily limited itself to a view of the more fundamental provisions of the measure in question. We ought not, however, to confine ourselves simply to a technical analysis of specifically dangerous elements in such legislation.

The tone of the proposal and its interpretation in the light of actual experience is far more important than the actual provision. It is an old saying that, even the worst of laws, through good administration, can be made tolerable and workable.

The Federal Reserve Act as originally drafted had many flaws. Some of them were due to inexperience in central banking; others to political compromises which were made necessary in order to secure the adoption of the measure at all. The passage of time has resulted in aggravating these errors and the multitudinous amendments that have been made to the Federal Reserve Act in the score and a half of modifying laws that have been passed by Congress, has defaced the original measure in essential particulars, and has greatly lessened the safeguards against maladministration which were originally set up.

It is fair, however, to add that the 20 years which have passed since the adoption of the Federal Reserve Act have not resulted in a material change in the admitted purport and underlying thought of the legislation. Even those who have found its restrictions irksome and likely to prevent the attainment of their desires and even the ignorant and ill-advised administrators whose lack of knowledge of central banking has made them restive under the restraint, which in other countries would have gone as a matter of course as a result of long-established custom and well-recognized caution, have always made their onslaughts upon the System under the guise of an effort to improve it and to make its provisions more adaptable to the actual needs of the community.

The new bill, however, taken in conjunction with the act of January 30, 1934, must be regarded as a complete repudiation of the entire conception, not only of the Federal Reserve Act, but of central banking as it is practiced today in central banking countries. It substitutes politics for knowledge, guarantees for salability of assets, and irredeemable gold certificates for coin.

III

Apart from this general review of some of the major features of S. 1715, there are a few that need particular attention. In this statement, however, I will confine myself entirely in such further comments to title II which has to do with the proposed changes in the Federal Reserve Act: Title II covers pages 38–51. As to these pages I beg to note the following points:

(*a*) On page 38, line 25, it is provided that the Governor of the Federal Reserve Board shall end his term as a member of the Board when he ceases to be Governor. This would permit an Executive to change the entire composition of the Board by naming successive members Governor and then dropping them one after the other. If the proposed structure of the Federal Reserve Board be retained (as it should now be) some safeguarding language should be introduced to prevent an Executive from thus changing the composition of the Board in such a way as to get rid of persons whom he disliked. The present proposal is, of course, wholly out of harmony with the provisions contained in the bill for pensioning members of the Board at the end of the long term of service. The changes introduced in H. R. 7617 do not satisfactorily cover this point.

(*b*) On page 39, lines 9 ff., the offices of governor and chairman of the board of directors of each Federal Reserve bank are combined. The new officer to be known as "governor" is to be appointed periodically, by the board of directors, subject to the approval of the Federal Reserve Board. This is a highly unsatisfactory arrangement; the annual term of appointment is too brief, while the later provision on page 40, prohibiting directors from serving more than two consecutive terms, tends to make the managements of each bank transitory and ineffectual.

(*c*) On page 41, lines 16 and 17, the Federal Reserve Board is given power to waive the requirements relating to the amount of capital required of banks entering the System. This introduces an element of favoritism and, if many small State banks should enter the System, may weaken greatly the capital structure of the organization. This provision should be stricken out. The provision is itself misleading because there is no provision regulating the use of Government capital in recapitalizing a bank which has an insufficient amount of capital. The entire section needs to be rewritten in the light of the present ownership of large blocs of capital stock by the Reconstruction Finance Corporation.

(*d*) On page 41, line 23, membership in the Federal Reserve Board is to be confined to persons "well qualified by education or experience, or both, to participate in the formulation of national economic or monetary policies."

This is too vague a requirement to be of any value whatever. It practically is notice to disregard the precedent heretofore observed, and at one time incorporated into the act, calling for actual knowledge of banking on the part at least, of some members as a prerequisite to holding a place on the Board.

(*e*) On page 42, line 7 ff. These are merely surplusage, unless the holding of office on the Board is in some way safeguarded against an Executive who might adopt the methods already indicated in (*a*) above for changing the membership of the Board. They should be stricken out unless change is made in the form of the provision.

(*f*) Page 43, line 9 ff. The same comment should be applied to this provision as to the preceding provisions on the same topic.

(*g*) Page 43, line 22 ff. The provision that the Board may assign to designated members certain duties, functions, service, etc., but that such assignment shall not include the determination of any national or System policy, seems to be out of harmony with the provision at the top of page 42, where the only qualification of a member of the Board is that he shall be able to formulate such policies. The meaning of this provision is far from clear, and if the authors of the bill had in mind any definite internal organization which is intended to authorize, the meaning should be made very much clearer.

(*h*) Page 44, lines 11 ff. The provision for an open-market committee included under these lines should be completely reset. The paragraph itself is exceedingly clumsy and self-contradictory, even if it be desired to retain the general structure of the committee which is there suggested. For example, the terms of members of the committee are to expire at the end of each calendar year, but there is no specification of when successors shall be chosen. On page 45 the committee is directed to aid in the execution of such other duties as the Board may prescribe, a provision which apparently would enable the Board practically to substitute a committee for itself in important particulars, while, strangely enough (p. 45, l. 12), details of open-market operations are subject to regulations prescribed by the Board. This section needs complete rewriting in order to get an intelligent picture of the structure of the organization it is intended to create.

(*i*) Page 45, lines 18 ff. Any Federal Reserve bank may discount "any" commercial, agricultural, or industrial paper, subject only to such regulations as to "maturities" and other matters as the Board may prescribe. Apparently here the Reserve bank is given sole power of determining what commercial, agricultural, and industrial paper is. The bank (p. 46, l. 2) may then make advances on promissory notes secured by "any sound assets." There is here no canon or determination of soundness nor any indication as to who shall fix the condition under which the advances are to be made.

(*j*) Page 46, lines 5 ff. Any kind of Government bonds may be bought or sold without regard to maturity. This apparently means that they may be bought or sold by Federal Reserve banks without regard to maturity. Apparently here the Reserve bank is authorized to engage in trading in Government bonds, and without any restriction or control additional to that which may be inferred with regard to any of its other operations. This paragraph should be completely rewritten.

(*k*) On page 46, lines 13 ff., is found a complete change in the base of Federal Reserve notes. The old base of secured note issue is ended and the notes instead of being Government obligations are now made bank obligations. In spite of this fact they are given a legal-tender quality. That is to say, privately owned institutions are allowed to issue legal-tender paper, an anomalous condition.

(*l*) On page 48, lines 22 ff., the Federal Reserve Board is given power to "change the requirements as to reserves." Apparently this means the percentages of reserve, but in fact it includes both the place where reserves are to be kept, their amount, and their composition, as well as their percentage relationship to outstanding deposits. This provision entirely deprives the reserve requirement of any meaning. It would be far better to relieve the banks of any reserve requirement whatever.

(*m*) On page 49, lines 7 ff., national banks are here again authorized to increase the amount of their loans on real estate. This provision carries further a bad phase of the Federal Reserve Act which, unwisely, authorized real-estate loans. The provision ought to be entirely stricken out: but if it is to be retained it should be carefully writen in accordance with the best existing practices with regard to appraisal and the extension of accommodation, such as are employed by savings banks.

STATEMENT OF ROBERT HARRISS, NEW YORK COTTON EXCHANGE, NEW YORK, N. Y.

Senator GLASS. Please state your name, residence, and occupation for the record.

Mr. HARRISS. Mr. Chairman and gentlemen of the committee, my name is Robert Harriss. My address is care of the New York Cotton Exchange, 60 Beaver Street, New York. My principal business is the cotton business. I am interested in the production of cotton and the merchandising, exporting, and financing of it. I am also a partner in Harriss & Vose, who do a general commodity brokerage business.

I am not a banking expert. However, formerly I was one of the principal stockholders in the North Texas National Bank of Dallas, Tex. This bank was one of the larger banks of the Southwest. I have also been a stockholder of some of the larger banks of New York, New England, and in the South.

Senator BYRNES. Do you occupy any position on the New York Cotton Exchange?

Mr. HARRISS. Yes, sir; I am governor of the New York Cotton Exchange, a member of the cotton exchange, and a member of the New York Commodity Exchange. I have prepared a very brief statement here. As I say, I am not a banking expert, but I have had considerable dealings with banks for a quarter of a century.

Senator TOWNSEND. Have you studied this bill?

Mr. HARRISS. I have studied the Nye-Sweeney bill. That is the one I was asked to give my opinion on, Senator Townsend.

Since the depression started in 1929, I have given considerable study to the banking and currency question and have conferred with many of the foremost economists and bankers of this country as well as Europe.

In the early part of 1930 Mr. George LaBlanc pointed out to me why there could be no sound recovery until we had banking and currency reform. Mr. LaBlanc was formerly senior vice president of the Equitable Trust Co., and president of the Equitable Eastern Banking Corporation, and president of the Interstate Trust Co., all New York banks. The Equitable Trust Co., at the time he was senior vice president, did the largest foreign-banking business bank, I believe, in our country, if not in the world.

Senator TOWNSEND. At what time was that?

Mr. HARRISS. I believe he went with the Equitable Trust Co. in about 1915 and retired from the Equitable in the Seaboard merger and accepted the presidency of the Interstate Trust Co. of New York.

Senator TOWNSEND. Do you know what date that was?

Mr. HARRISS. That was along about 1928 or 1929—shortly before the depression.

At that time Mr. LaBlanc pointed out to me that the depression or the deflation was due to the huge inflated war debts; that these debts had to be faced and adjusted before there could be sound recovery.

Since 1930 I have personally been associated with groups that were and are advocating banking and currency reform.

Senator BANKHEAD. Do you belong to any monetary reform organization?

Mr. HARRISS. I am a member of the Committee for the Nation; I am vice president of the Sound Money League; I am a member of the National Monetary Conference; and also a member of the National Union for Social Justice.

In the early part of 1932 Senator Elmer Thomas came to New York. There we had lengthy conferences with the leading bankers and economists, as well as with Governor Harrison and Dr. Burgess, of the New York Federal Reserve Bank. Senator Thomas at that time urged that these people cooperate in a program of currency expansion in order to restore values and economic recovery. He prophetically pointed out that unless this were done we were headed into economic and banking disaster. However, his plea fell on deaf ears.

Also, in the early part of 1932 I appeared before the House Ways and Means Committee. I then urged the payment of the adjusted-compensation certificates in order to expand the currency, get off the ruinous gold basis, and bring about a revaluation of the gold dollar. Later in 1932 I attended the Democratic convention in Chicago and urged that the Democratic platform declare for a program of banking and currency reform.

I believe it is now apparent that the Federal Reserve System has outlived its usefulness; that in the interest of our country we should have—and we are going to have—banking changes or reforms.

I am substantially in agreement with the fundamentals of the Nye-Sweeney central banking bill. The present banking and currency system is too much under the control of those self-interested, or the bankers. In the welfare of our country it is not advisable that the control of banking and currency rest in bankers or private hands. This because the expansion or contraction of the currency and credit may often be influenced either directly or indirectly by prejudice or selfish reasons instead of in the interest of the Nation. At times, as at present, it may be influenced by fear. Today, although our banks are in a more liquid condition than they have been in years and there is much idle money and the interest rates are low, yet, as we know, it is almost impossible to obtain loans or credit with the banks unless the loans are made against Government bonds or against stocks or commodities that are immediately liquidable.

Yet one cannot blame the banks very much for not making loans. They are naturally afraid to loan the farmer because they know agriculture is not on a sound and profitable basis. They also have much reason to fear making loans to industry because, with few exceptions, industry is not on a sound and profitable basis. We cannot expect them to finance and make loans to the railroads when the best of our great trunk lines are not making money or else are running at a loss. We cannot expect them to finance and make loans to the contractors or builders of our country when there are tens of thousands of unoccupied homes and office buildings that will not sell for enough to pay the mortgages. I believe this deplorable situation was caused by an inflation of the debt structure, and that it will continue until we have what some may term radical changes in our banking and currency system.

During the past 5 years we have tried many palliatives and experiments, some constitutional and some not, to try to end this financial and economic depression. The Government formed the Reconstruction Finance Corporation which some believe is a form of central bank. The formation of the Reconstruction Finance Corporation may possibly have been advisable as an emergency. However, I am opposed to the Reconstruction Finance Corporation in principle because in the final analysis it means that the Government itself is competing with private banking. In fact we might say that they are actually in the banking business. It is stated that the Reconstruction Finance Corporation owns 27 percent of the stock of our national banks.

In desperation and in order to try to restore economic and financial recovery we have resorted to the A. A. A.—curtailing agricultural production; the N. R. A.—curtailing industrial production, and making codes, regimentation, doles, and fabulous governmental borrowing and spending. My opinion is that these have not brought about recovery nor can they bring it about. In fact, I believe if continued they may end in disaster. I do not believe we can prosper by a policy of raising and producing less.

The Government debt is now approximately 30 billions of dollars. The average interest rate on same is approximately 3 percent. The interest on this debt compounded for the next 60 years will amount to more than 140 billions of dollars. This, then, with the principal, will exceed more than 170 billions of dollars. I am an owner of some of these bonds. Yet I do not think it is fair or honest for us to pass such a crushing debt of bondage and tax on to our children, nor do I believe it possible for our country to prosper and compete when the people have such a load of Government debt and taxes.

Additional Government borrowing can only mean more taxes; more taxes will only lead to worse business, and worse business will only lead to more unemployed; more unemployed will lead to more relief; more relief will lead to more Government bonds or borrowing, and thus the vicious circle will continue.

As mentioned, I favor the fundamentals of the Nye-Sweeney banking bill. I am opposed to any central bank that can be controlled or dominated by the politicians or by any administration. It is only natural that if a central bank can be dominated or controlled by the politicians or by any administration, Democratic or Republican, it may be run for party or selfish interests instead of for the welfare of our country. This, of course, would be just as serious a mistake as leaving the banking and currency under private control.

I believe the Nye-Sweeney banking bill would overcome both of these grave dangers—either private or political control; that it would leave the control of the central bank in the hands of the people so that it could function for the national welfare and in the interest of the people.

I do not believe that it is fair to brand as radicals. inflationists, or visionary, men those who favor a Government central bank. I believe the real or dangerous inflationists are those who have inflated or acquiesced in the further inflation of the Government debt.

As we know, many countries in Europe have central banks. As a matter of fact, the Bank of England is construed by many as a form of central bank. It might be mentioned that England, with only a small part of the gold and a fraction of the great resources of our country, has managed her banking and currency so well that conditions in the British Empire are prosperous as compared with the conditions existing in our country.

It could also be mentioned that the country bordering on our south—Mexico—has a central bank which has been functioning so well that there is little unemployment and no depression in Mexico—a country that has little compared to our great Nation.

Some will try to frighten us regarding a Government central bank by saying that it will lead to the issuance of "greenbacks." They will not tell you that Abraham Lincoln had no gold or silver against which to issue his greenbacks. They will not tell you that those greenbacks proved to be good money. They enabled Abraham Lincoln to save the Union. These greenbacks have also saved the taxpayers of our country more than 12 billions of dollars, calculated at 5 per cent compound interest. There are still in circulation today 346 millions of these greenbacks that are doing splendid work.

They will not tell you that today, under Treasury control, there is approximately $9,500,000,000 of gold and silver, and that there is outstanding only approximately $5,000,000,000 of actual currency or coin. In other words, there is existing under Treasury control more than $4,000,000,000 of absolutely sterile gold and silver. In fact, the situation is even worse because our people are being actually taxed to carry this sterile gold and silver. This seems unbelievable, but it is a fact.

I should like to bring to your good attention what Benjamin Franklin said in his autobiography in reference to the issuance of money [reading]:

> About this time there was a cry among the people for more paper money, only 15,000 pounds being extant in the Province, and that soon to be sunk. The wealthy inhabitants opposed any addition, being against all paper currency, from an apprehension that it would depreciate as it had done in New England, to the prejudice of all creditors. We had discussed this point in our Junto, where I was on the side of an addition, being persuaded that the first small sum struck in 1723 had done much good by increasing the trade employment and number of inhabitants in the province, since I now see all the old houses inhabited and many new ones building, whereas I remembered well that when I first walked about the streets of Philadelphia, eating my roll, I saw most of the houses in Walnut Street, between Second and Front Streets, with bills on their doors, "To be Let"; and many likewise in Chestnut Street and other streets, which made me then think the inhabitants of the city were deserting it one after another.
>
> Our debates possessed me so fully of the subject that I wrote and printed an anonymous pamphlet on it entitled "The Nature and Necessity of a Paper Currency." It was well received by the common people in general; but the rich men disliked it, for it increased and strengthened the clamor for more money; and they, happening to have no writers among them that were able to answer it, their opposition slackened and the point was carried by a majority in the House.

My friends there who conceived I had been of some service, thought fit to reward me by employing me in printing the money; a very profitable job and a great help to me. This was another advantage gained by my being able to write.

> The utility of this currency became by time and experience so evident as never afterwards to be much disputed; so that it grew soon to 55,000 pounds, and in 1739 to 80,000 pounds, since which it arise during the war to upwards of 350,000 pounds, trade, building, and inhabitants all the while increasing,

though I now think there are limits beyond which the quantity may be hurtful.

It is said that Thomas Edison gave about as much attention to the study of money as to science and invention. With your permission I would like to quote from an interview given by Mr. Edison on his inspection of Muscle Shoals [reading]:

If the currency is issued, $30,000,000, for financing the finishing constructions of Muscle Shoals work, it will be the proper thing to do. Once the currency method is tried in raising money for public improvements the country will never go back to the bond method.

Make it perfectly clear that I'm not advocating any changes in the banks and banking. Banks are a mighty good thing. They are essential to the commerce of the country. It is the money broker, the money profiteer, the private banker, that I oppose. They gain their power through a fictitious and false value given to gold. Gold is a relic of Julius Caesar, and interest is an invention of satan.

Gold is intrinsically of less utility than most metals. The probable reason why it is retained as the basis of money is that it is easy to control. And it is the control of money that constitutes the money question. It is the control of money that is the root of all evil.

Gold and money are separate things, you see. Gold is the trick mechanism by which you can control money.

Gold is not money until the people of the United States, and other nations, put their stamp of approval on it. It is not the gold that makes the dollar. It is the dollar that makes the gold. Take the dollar out of the gold and leave it merely yellow metal, and it sinks in value. Gold is established by law, just as silver was, and gold could be disestablished, demonitized by law, just as silver was. When silver was demonetized the former so-called dollar became worth about 50 cents.

On Monday the United States Supreme Court decided that the Congress had not the right to delegate power to individuals to create codes and regulate business. How can we reconcile the delegation of the constitutional powers of Congress to private individuals of the greatest privilege of all to create and regulate the value of money?

In conclusion, I do not believe our trouble is one of over-production, but it is rather of under-consumption and mal-distribution due to an antiquated banking and currency system. I believe the real road to prosperity is a full agricultural and industrial production—lower tariffs and expansion of world trade. Yet I do not believe that these can be attained without a modern central bank, a bank not dominated by politicians or private or selfish interests, but a bank run in the interest of the country—a banking and currency system that is in accordance with the Constitution, that Congress has the right to coin and regulate the value of money.

For these reasons I favor the prompt passage of a central banking bill having the underlying principles of the Nye-Sweeney banking bill.

Senator BULKLEY. Do you feel that if we should elect directors of the bank in the same way we elect Senators, we could keep it free from politics just the same as we always do in the Senate?

Mr. HARRISS. Senator, I would rather take a chance on that than what we have.

Senator BULKLEY. I just wanted to make sure that that would insure being kept free from politics.

Mr. HARRISS. I believe the Senators and Congressmen on the whole have done a pretty good job.

Senator BULKLEY. Yes; and never have been affected by any political consideration at all?

Mr. HARRISS. I expect at times they have, Senator. But these men would be elected for long terms, for 12 years, and I think they would be more independent of the popular cry than you gentlemen here.

Senator BYRNES. You are in favor, I judge, of the election of members at the time that Representatives are elected?

Mr. HARRISS. Yes, sir; for a period of 12 years.

Senator BULKLEY. And the issue of currency would be committed to that central bank?

Mr. HARRISS. I should think they should have full control of it, both the issuance of currency and the contraction of it.

Senator BULKLEY. Would that be a constitutional delegation of power, inasmuch as the Constitution reposed that right in Congress?

Mr. HARRISS. I am not a lawyer, but it would seem to me far more constitutional than what we have now. It is now in private hands. This would be a Government-owned bank.

Senator BULKLEY. We have got it in private hands now, you say?

Mr. HARRISS. It is dominated by them.

Senator BULKLEY. Not under the control of Congress?

Mr. HARRISS. I do not think so, Senator.

Senator BANKHEAD. At least, you think they are not controlling it?

Mr. HARRISS. I think it has been run and dominated pretty well by the Federal Reserve Bank of New York.

Senator BANKHEAD. On a credit system by private banks?

Mr. HARRISS. Yes; but I think the great question is the control of the expansion and contraction of the currency. That is the fundamental.

Senator GLASS. We are obliged to you.

(Witness withdrew from the committee table.)

Senator BYRNES. Is Mr. Kennedy here?

Mr. KENNEDY. Yes, sir.

STATEMENT OF EDWARD E. KENNEDY, SECRETARY NATIONAL FARMERS UNION, KANKAKEE, ILL.

Senator GLASS. Please give your name, address, and occupation to the official reporter.

Mr. KENNEDY. Mr. Chairman and gentleman of the committee, my name is Edward E. Kennedy; I am secretary of the National Farmers Union; my home is at Kankakee, Ill.

I want to bring to the committee the viewpoint of the farmers as represented by our organization with respect to the Nye-Sweeney banking bill. I do not come before this committee as a banking expert, but one, rather, who represents an industry that has been persecuted by the system that has made possible the deflation of American agriculture beginning in 1920.

At that time I was living on an Iowa farm. I was operating a farm of about 335 acres, feeding about 4 loads of cattle every year, and also about 2 loads of hogs for market. In 1920, when the deflation was put on by the Federal Reserve Board, I owed a local bank about $13,500, and I had hoped and expected, in carrying on my farming operations, to be able to repay that debt in the same kind of dollars that the debt was contracted in. By the end of 1921 I was compelled to pay, insofar as I could, the debt with 3 bushels of corn for every 1 for which I had contracted, and 300 pounds of pork or

300 pounds of beef for every 1; and, of course, it was impossible, under those circumstances, to make the payments. That was the condition not only of one but the condition of thousands and hundreds of thousands—yes—and millions of farmers throughout the United States.

I want to bring to the attention of the committee the fact, if I may, that one of the major changes in the agricultural industry since 1920 has been the almost continuous decline in the value of land and buildings, farm implements, and livestock, from 1920 down to 1934.

Going back to 1910, the value of all farm property increased from $41,354,000,000 in 1910 to $78,436,000,000 in 1920, or an increase of about 90 percent.

During that period when the value of farm property increased about 90 percent, the mortgage indebtedness of the farms of the United States increased from $3,320,000,000 in 1910 to $7,857,700,000 in 1920, and in 1930 the mortgage indebtedness had risen to $9,241,390,000, or very nearly 300 percent.

From 1920 to 1933 the value of farm property decreased to $35,812,000,000, or a decline to $42,626,000,000, or over 54 percent.

At the beginning of 1934 the total value of all farm property was $37,027,000,000, or 3 percent higher than on January 1, 1933; and this 1934 figure is still 10 percent, or $4,327,000,000 lower than the value of farm property in 1910. This notwithstanding the fact that our total mortgage debt as of 1930 was approximately 300 percent higher than 1910.

The agricultural mortgage debt has decreased from 1930 down to 1934 approximately 8½ billion dollars. This, of course, is not because the farmer has been able to pay his debts; he has not been able to pay them. This decline in the mortgage debt is because of foreclosure, bankruptcy, and surrender of farm property.

Taking another angle of the deflation of farm values which come within the figures I have given you, the value of all livestock on owner-operated farms dropped from $8,815,000,000 in 1919 to $3,072,000,000 in 1934. The value of farm machinery on the owner-operated farms dropped from $3,156,000,000 in 1919 to $2,300,000,000 in 1934. This represents a loss on owner-operated farms of $5,743,000,000 in the value of livestock and over $856,000,000 in the value of farm machinery and equipment from 1919 to 1934.

In support of the principle of the Nye-Sweeney bill, that the Government of the United States should own the facilities that provide the currency and credit for the American people, I want to cite to you an instance that happened in 1920. On May 23, 1922, Congressman Phillip Swing, of California, in the House of Representatives, had this to say [reading]:

> Mr. Chairman and gentlemen of the committee, this proposal to add an additional number to the Federal Reserve is here because there is an urgent need that agriculture and its interests be heard by the Board. I cannot understand how men can continue to deny that the deflation adopted by the Federal Reserve Board was deliberately aimed at the farmers of this country. I was present at a meeting of the bankers of southern California, when W. A. Day, then the deputy governor of the Federal Reserve Bank of San Francisco, spoke for the Federal Reserve bank and delivered the message which he said he was sent to deliver. He told the bankers there assembled that they were not to loan to any farmer any money for the purpose of enabling the farmer to hold

any of his crops beyond harvest time. If they did, he said, the Federal Reserve bank would refuse to rediscount a single piece of paper taken on such a transaction. He declared that all the farmers should sell all of their crops at harvest time unless they had money of their own to finance themselves, as the Federal Reserve bank would do nothing toward helping the farmers hold back any of their crop, no matter what the condition of the market.

Mr. Cooper of Wisconsin interrupted Congressman Swing and said, "Did the gentleman from California hear that?" Mr. Swing answered, "I did. I think I was the only person present that was not a banker. This was, in a way, confidential advice given by the Federal Reserve bank for the guidance of the smaller banks, many of whom were members." One of the bankers asked Mr. Day this question: "If you say to us we cannot loan the farmers money to hold crops, to whom may we loan money to hold crops until they can be taken up by the market in an orderly way according to the demand of the consumers?" "Oh", said Mr. Day, "of course, we will have to loan money to middlemen to take up the crop and hold it until the market is ready for it."

It is beyond question that the deflation began on the 18th day of May 1920, at the meeting of the Federal Reserve Board, which not only brought about the deflation that we are still in but it was first applied to the farming sections of America, and the deflation bore down the value of farm products, bore down the value of farm lands, and the banks of the country foreclosed on the farms and the farmers lost their homes and it destroyed buying power, and it has progressively increased unemployment until today we have eleven and a half million people unemployed in the United States.

It is the belief of the Farmers Union that the principles of the Nye-Sweeney bill should be enacted into law to place the ownership of the central banks and the control of the currency and credit of the United States that is used as the economic lifeblood of the Nation out of the hands of those who use it for profit and put it into the hands of the Government, where it can be used for service to maintain equitable and just price levels; price levels that are not fluctuating from year to year and from month to month to increase and multiply the debts of the farmers who are unable to pay their obligations on the basis that they contract them. It is for that reason that the National Farmers Union, not only at its last convention but at previous conventions, has endorsed whole-heartedly and unanimously the principle of a central bank owned by the Government of the United States. We are supporting the Nye-Sweeney bill.

We believe, and I think it is generally accepted, that deflation or contraction of credit, the withdrawal of currency—particularly credit money which is being used as a medium of exchange—has been taken down from around $22,000,000,000 to around $15,000,000,000. That is a loss of $7,000,000,000 in the means by which wealth circulates and the exchange of goods is carried on and commodities are distributed. We believe that that power has been so great in the hands of private bankers or Federal Reserve banks to have destroyed agriculture and employment by destroying money, and everyone also agrees that if we were to expand the currency sufficiently to do the money business of the Nation, we would again bring price levels back so that the American farmer would have an income from the products of his farm enough higher and far above his debt level and the level of his fixed charges so that he could go into the market and buy the products of the now idle labor; the power of the Federal Reserve banks is too great a power to rest in the hands of private individuals or private corporations, because the welfare and the security of 126 million people depend on having a sufficient medium of exchange to distribute the goods and services that the American people produce.

I want to say just one thing more in connection with this matter, and that is that if the situation that has obtained here for the last 5 or 6 years particularly continues, if the situation is that the Federal Reserve banks and our present banking system cannot expand the credit and make it available to agriculture, make it available to small businesses, make it available to the people who must depend upon production, must depend upon their labor for a living—if they cannot under the present system expand the credit, expand the currency, then the system has failed.

On the other hand, if it is because they do not want to do it, because they are afraid that they cannot make loans to the farmer—which they cannot, because the farmer is not receiving a price that covers his cost of production and he is not getting enough above the debt level to make him a good credit risk—if that is the situation, either that they cannot or they will not provide a medium of exchange, and they have a monopoly on the control of the volume of currency and controlling the volume of credit—if they cannot or if they will not do this, then the Government ought to take over the Federal Reserve System and operate it under the provisions and under the principles of the Nye-Sweeney bill.

Senator Glass. The committee is obliged to you.

We will adjourn now until 10:30 tomorrow morning.

(Whereupon, at 4:20 p. m., an adjournment was taken until tomorrow, Thursday, May 30, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

THURSDAY, MAY 30, 1935

United States Senate,
Subcommittee of the Committee on
Banking and Currency,
Washington, D. C.

The subcommittee met, pursuant to adjournment on Wednesday, May 29, 1935, in room 301, Senate Office Building, at 10:30 a. m., Senator Carter Glass presiding.

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

Also present: Senator Fletcher of Florida and Senator Norbeck of South Dakota.

Senator Glass. The subcommittee will come to order. Before we start the hearing, at the request of Senator McAdoo, who cannot be present this morning, I would like to put a telegram into the record from Mr. A. P. Giannini protesting against the proposed one-eighth assessment for insurance of deposits.

(The telegram referred to and submitted by Senator Glass is here printed in full as follows:)

San Francisco, Calif., *May 29, 1935.*

Hon. Wm. G. McAdoo,
Care of Vera Ward, Apartment 516, Albans Towers.

I am heartily in favor of the reduction of the assessment rate for deposit insurance as covered in title 1 of the banking bill from one-eighth to one-sixteenth of 1 percent. The one-eighth percent rate was written into the bill by the House and constitutes a very substantial increase over what the Federal Deposit Insurance Corporation, who should know best about these matters, had recommended. I consider the one-eighth percent an unjustifiable burden to place upon the earnings of banks at this time.

A. P. Giannini.

Senator Glass. I also place in the record, at the request of Senator Fletcher, a letter from former Senator Owen of Oklahoma, suggesting an amendment to the pending bill.

(The letter referred to and submitted by Senator Glass is here printed in full as follows:)

Washington, D. C., *May 29, 1935.*

Hon. Duncan U. Fletcher,
Chairman Committee on Banking and Currency,
United States Senate.

My Dear Senator Fletcher: The Supreme Court decision of Monday, May 27, on the National Recovery Act makes it important that the powers granted to the Federal Reserve Board by the proposed Banking Act of 1935 submitted by you should have a clear mandate instructing the Federal Reserve Board as to what executive use shall be made of the powers granted.

While the purpose of the act is generally understood, as a matter of surmise or conjecture, there is need of a plain declaration of the policy and the purpose for which such great powers are now proposed to be conveyed to the Federal Reserve Board.

I submit for your consideration a declaration of such purposes and proposed mandate as follows:

"It is the purpose of the Federal Reserve Act as herein amended, to regulate the value of money; to furnish the people at all times with a supply of sound credit and currency, adequate for the acievement and maintenance of maximum business activity and employment; to create conditions conducive to the restoration of the value of property, labor and services and to the restoration to normal of governmental revenues, thus enabling the Government, without public distress, to establish and maintain a balanced budget; therefter to establish and maintain a dollar of uniform, permanent debt-paying purchasing power by regulating the supply of money and credit.

"The Federal Reserve Board and the Federal Reserve banks shall use the powers granted to them to make effective the purposes herein set forth."

There is no mandate in the bill introduced in the Senate, and the mandate inserted in the House could easily be interpreted as an instruction of Congress not to expand credit but to establish "business stability" on the present depressed level with 20,000,000 people on relief and a hundred million people in distress.

The officials of the Federal Reserve Board have been advising the President, and did so in my present, "that the banks have more than ample credit" or money with which to furnish the business interests of the country with needed capital. It is true that the banks have excess of over 2 billions and could expand loans 20 billions without violating the laws which limit loans. The banks could restore the working capital destroyed by them when they contracted private loans 20 billions. The banks could furnish the working capital to private business enterprises, but the banks prefer to lend their credits to the United States against Government bonds rather than to private industry at higher rates of interest. The fact that the banks could supply capital but refuse effectually closes this door of relief until the fear of the banks to loan and of business men to borrow is removed. This fear can be removed most speedily by a clear-cut declaration of policy and purpose by the Government of the United States through the mandate which I submit to you. Upon the passage of such a mandate the confidence of the banks and of business men would be greatly stimulated and would increase day by day because it is perfectly obvious that under this mandate working capital destroyed by the banks would be soon replaced either by the Reserve banks or by the member banks themselves.

The Reserve Board could expand the bank deposits by purchasing bonds, Federal, State, and municipal, and other sound bankable assets to the extent necessary to restore the working capital destroyed by this depression. They could restore the demand and time deposits very rapidly by buying such bonds and sound assets.

I respectfully request you to submit this suggestion to the Committee on Banking and Currency of the Senate for its consideration.

Yours faithfully,

ROBERT OWEN.

Senator GLASS. Mr. Willard Hamilton, president of the Florida Bankers Association, will please take the stand.

STATEMENT OF WILLARD HAMILTON, PRESIDENT FLORIDA BANKERS' ASSOCIATION, ORLANDO, FLA.

Mr. HAMILTON. Mr. Chairman and gentlemen of the committee, since coming here from Florida I have developed a little hoarseness, and Mr. Andrews of Pensacola has agreed to read my remarks.

Senator GLASS. Very well. That will be satisfactory, sir.

(Mr. James W. Andrews, cashier, American National Bank, Pensacola, Fla., read the statement of Mr. Hamilton as follows:)

Mr. Chairman and members of the committee, in appearing before your committee in behalf of the Florida Bankers Association on the 1935 banking bill, I wish to state that while our committee is a small one it is truly representative of the bankers of all sections of Florida. Mr. J. W. Andrews is cashier of the American National Bank of Pensacola and represents the banks of northwest Florida. Mr. G. E. Lewis is president of the Lewis State Bank of Tallahassee and represents the banks of north central Florida. Mr. George Avent is president of the Florida National Bank of Jacksonville, and Mr. Rodgers represents the banks of northeast Florida. Mr. H. B. Oliver is vice president of the First National Bank of Miami and represents the east coast. Mr. C. D. Dyal is president of the Florida National Bank of St. Petersburg and represents the west coast, and myself, Willard Hamilton, president of the Florida Bank at Orlando, and president of the Florida Bankers Association.

While I am well aware of the volume of testimony that has been presented to your committee, I would like to comment briefly on title I of the bill.

The proposed bill which you have under consideration is of the utmost importance to country bankers. It is the opinion of Florida bankers that the assessment of one-eighth of 1 percent on total deposits at this time would be ruinous to many banks, particularly in view of the fact that the majority of Florida banks have made less net earnings to date in 1935 than they did in a similar period in 1934, which period was by no means a prosperous one for Florida banks. Due to this lower earning ratio, the payment of one-eighth of 1 percent into the Federal Deposit Insurance Corporation would, in my opinion, be a strain on practically all banks. In addition to the above facts, banks are faced with further declining earnings for the balance of 1935.

To illustrate, I would mention a specific case of one small bank in Florida whose average deposits are $4,000,000, upon which the assessment would amount to $6,000 per year or 6 percent upon the capital of that particular bank.

I strongly urge that you gentlemen consider these facts and if any assessments are written into the bill, that it will not be in excess of one-sixteenth of 1 percent on the total deposits.

Mr. Rodgers, who is president of the Florida Bar Association, as well as a director and member of the executive committee of one of Jacksonville's largest banks, would like, with your kind permission, to comment briefly on title II.

Gentlemen, I thank you.

The statement is signed by Willard Hamilton, president, Florida Bankers Association.

Senator BULKLEY. Has not business generally been better in Florida this year than last year?

Mr. HAMILTON. Generally speaking; yes.

Senator BULKLEY. To what do you attribute the reduced earnings of banks?

Mr. HAMILTON. I would say, principally the lower interest rate on Government securities.

Senator GLASS. The committee is obliged to you, Mr. Hamilton.

(The witness withdrew from the committee table.)

STATEMENT OF W. H. ROGERS, PRESIDENT FLORIDA BAR ASSOCIATION, AND MEMBER OF THE EXECUTIVE COMMITTEE OF THE FLORIDA NATIONAL BANK, JACKSONVILLE, FLA.

Senator GLASS. Please give your name, Mr. Rogers, and your position, to the official reporter.

Mr. ROGERS. My name is William H. Rogers, of Jacksonville, Fla.; director and member of the executive committee of the Florida National Bank, and president of the Florida State Bar Assocaition.

Senator GLASS. You understand, Mr. Rogers, the pending bills, and we will be very glad to hear anything you have to say.

Mr. ROGERS. I appreciate your courtesy in giving us a few minutes for the presentation of our views at this late stage in your hearings. I shall confine my remarks to title II of the pending bill. I do not come before you as a technical banking expert nor as one who is letter perfect in the language of this bill. I have read the bill, however, and heard it widely discussed in my state and have read in the newspapers a substantial number of the statements with regard to the bill which have been made before your committee and elsewhere.

I come before you as one of a delegation which has been officially requested to appear here by the executive committee of the Florida Bankers Association to register grave concern which has been aroused in Florida by the implications of this title as we have read it and understood it.

I realize that many thorough, able, and lengthy expositions have been presented to your committee. I will, therefore, not take your time by attempting to reiterate what you have already heard from so many sources. We do feel, however, that we would be untrue to our responsibilities in Florida if we did not go on record with this committee in protest against the passage of this vitally important legislation, without the most careful consideration.

As we understand this title, it undertakes to alter radically banking practice as it has grown up in this country over a long period of years. It not only changes private banking practice but greatly alters the relationships of the private banks and the Federal Reserve banks to the Federal Reserve System.

As I recall, the Federal Reserve System was established some 20 years ago on the basis of recommendations of a very capable commission which gave years of study to American banking needs. On the basis of the recommendations of this commission, Congress gave careful and deliberate consideration to the proposals advanced and ample opportunity was given for a Nation-wide discussion.

Senator BYRNES. Do you refer to the Aldrich-Vreeland Commission?

Mr. ROGERS. Yes, sir.

As a result, it was decided by the Congress that we did not need in this vast country a central banking system, but rather a regional banking system in touch with local requirements and conditions.

As I read the proposed bill, it does not merely modify the Federal Reserve Act as we have known it for the past 20 years. It substantially repeals the Federal Reserve Act as we know it and, for all practical purposes, establishes a central bank under another name.

I may say that this statement was prepared before Mr. Owen D. Young appeared before your committee yesterday.

Let me enlarge on this very briefly. The bill before the Senate would lessen the authority of the governors of the Federal Reserve Banks by making their selection subject to the approval of the Federal Reserve Board every year. I think it is fair to say that the Federal Reserve governors would not have the courage and independence of action which they now enjoy if they should owe their positions to the favor of the Federal Reserve Board. In the next place, this bill would give to the Federal Reserve Board unlimited power to raise and lower reserves, absolute power to fix rediscount rates, and the tremendous power to compel the Federal Reserve banks to buy Government securities in any amount, whether they individually desired to do so or not. Under the bill as it is written, the Federal Reserve governors would, of course, be consulted, but if their judgment differed from that of the Board, they would have no choice but to carry out the Board's orders. If this does not constitute, in substance, a central banking system rather than a regional system, then my long years of interpreting legislative language have been in vain.

But however all that may be, whether I correctly apprehend the true significance of this bill or not, at least I observe that the bill is most controversial in its nature. I note that there actually exist directly conflicting views as to its significance and effect.

Moreover, there has been little if anything in the presentation before Congress, so far as has come to my attention, that indicates the existence of any emergency calling for the precipitate passage of this legislation. It involves numerous problems vital to the people of the country as a whole. Would it, therefore, not be the part of wisdom to postpone action on title II of the bill for more mature consideration by Congress and by the people?

I am not unfamiliar with the intricacy and gravity of the problems that must confront you in the consideration of this measure. Only a few years ago I was privileged to serve as the chairman of a commission which revised the Florida laws of dower, descent, distribution, wills, and administration. For this comparatively simple matter we took 2 years' time, spending more than 6 solid months solely in deliberation and drafting. For a matter as serious and as vital to the welfare of the whole country as this pending measure undoubtedly is, I respectfully urge that no less deliberate consideration should be given to it than was given to the Federal Reserve Act in its original enactment.

If, however, it is your judgment that a grave condition of affairs precludes deliberate action, then we would certainly recommend that the bill be modified (1) so that a substantial number of the governors of the Federal Reserve banks, the most experienced, practical men in the System, and who are in closer contact than any others with local needs, should be members of the Open-Market Committee, and (2) that Congress should limit the powers of the Federal Reserve Board to raise or lower reserves by establishing some moderate limit beyond which reserve requirements could not be altered.

In making the foregoing recommendations our delegation in no way questions the motives of the proponents of this bill. We are not considering personalities nor any particular administration. We have arrived at these conclusions on the basis of what we regard as established American principles of government, not lightly to be changed. We see nothing in the present emergency which would seem to us to justify establishing in the permanent law of the land an autocratic centralized control in Washington of the money and credit of the people, as opposed to the existing system with its checks and balances. Under our traditional system vitally important policies are formed, with the participation of the heads of the 12 Federal Reserve banks, who are closely in touch with local necessities and of the business men who are the directors of those local banks in every section of the country.

Senator GLASS. Do any members of the committee desire to ask any questions of Mr. Rogers?

Senator TOWNSEND. How many banks have you in Florida?

Mr. ROGERS. I think I will have to ask Mr. Hamilton to answer that.

Mr. HAMILTON. Two hundred and forty.

Senator TOWNSEND. Do you think you represent the sentiment of most of those banks?

Mr. HAMILTON. I think, undoubtedly, in all sections of the State.

Senator GLASS. You prefer a statutory reserve, flexible, as I understand it, to the power conferred by this bill on the Federal Reserve Board to raise or lower reserves as they may please?

Mr. ROGERS. My idea was that there ought to be a limit, so that in some administration we would not have an unwarranted change.

Senator GLASS. Do you concur with the preceding witness as to the proposed assessment on banks for insurance deposit purposes?

Mr. ROGERS. I am not right in the midst of banking insofar as it comes to detailed management, but my knowledge and information of our Florida banks is that the vast majority of them are not able to pay dividends, are not making more than their fixed charge-offs; and it seems to me that if the present fund is sufficient for the present moment, it might be very advisable to go lightly on the banks at the moment. Perhaps in more prosperous times the charge could be raised on a sliding scale.

Senator GLASS. What is the attitude, if you know it, of the Florida Bankers Association as to compelling the insured banks to become members of the Federal Reserve System by July 1, 1937?

Mr. ROGERS. I do not think I can answer that, Senator, for the banks generally.

Senator COUZENS. Do we have any more witnesses here representing Florida banks?

Senator GLASS. No. I will ask you, Mr. Hamilton, if you have had sufficient contact with the bankers of Florida to know what their attitude is on that particular question.

Mr. HAMILTON. I should say that they would desire to have a little longer time; that is, most of the State banks.

Senator GLASS. The committee is obliged to you, Mr. Rogers.

(The witness withdrew from the committee table.)

STATEMENT OF MORTON BODFISH, EXECUTIVE VICE PRESIDENT UNITED STATES BUILDING AND LOAN LEAGUE AND ASSISTANT PROFESSOR OF ECONOMICS AT NORTHWESTERN UNIVERSITY

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

Mr. BODFISH. My name is Morton Bodfish. I am executive vice president of the United States Building and Loan League, which is the national organization of savings, building, and loan associations. I am also an assistant professor of economics at Northwestern University and was a member of the original Home Loan Bank Board.

My statement, Mr. Chairman and gentlemen of the committee, deals entirely with sections 206 and 210 of the bill. These sections have a bearing on the real-estate mortgage credit policies of the banks. We are naturally somewhat interested in those policies, as they not only affect our institutions in a competitive sense, but we feel that the mortgage lending policies that are sponsored by the Federal Reserve System have a real bearing on the year-in and year-out soundness of our banking system.

It is universally agreed that both the banking system and the mortgage credit system in the United States need study and perfection, in light of the recent credit collapse. Much progress has been made through the insurance of deposits and savings accounts, elimination of security affiliates, and the establishment by State and Federal law of restrictive general policies for the operation of both types of institutions.

I refer to banking institutions and mortgage credit institutions.

Outstanding in the recasting of credit systems in the country has been the policy that short-term or commercial credit institutions should not engage in long-term mortgage or capital credit activities. This sound principle has been observed elsewhere and explains in some part the stability enjoyed by the banking structure of other countries, notably Great Britain and Sweden. Section 210 of the proposed Banking Act of 1935, supplemented by section 206, proposes to continue and encourage the mortgage activities by banks which violated the above-mentioned banking principle, and which, in the judgment of many of us, was a factor in the recent over-expansion and collapse of credit. This over-expansion in long-term credits led to numerous failures in the banking field, and to a discouraging freezing in the mortgage credit field. Economic historians will certainly record the banking failures as the major factor causing unprecedented price declines, rapid credit liquidation, business failures, and acute general depression. Everything practicable should be done to prevent a recurrence of these conditions.

Mortgages have always played a dominant role in the banking difficulties in this country. It is generally felt that the failure of State bank guarantee systems was largely the result of real-estate mortgage lending activities on the part of the less experienced bankers, particularly in farm mortgages. The dramatic bank failures of the recent depression in Detroit and Chicago and many other localities were convincing evidence that extensive mortgage lending was not sound banking. The depression experience clearly indicates that a bank failure leads to loss of confidence and difficulty in other types of financial institutions.

The banks are adversely affected when savings or investment institutions encounter difficulty. It would therefore seem proper that public policy should more and more restrict the activities of savings institutions—such as building and loan associations, savings banks and insurance companies—to those which have been proved by experience to be appropriate and safe, while at the same time drawing similar rigorous statutory limits about the field of activity of commercial banking institutions. While examples of the satisfactory results of such a policy in foreign countries could be cited, it is necessary only to point to the New England territory, where the separation of commercial banking from savings banking is considered "theoretically desirable" and is largely carried out. There we have had a comparatively stronger and more stable financial structure than in other parts of the country. The concept of division of labor or specialization is as useful, as sound, and as vital in the field of finance as it is in the field of industry and trade. A great and sound step in public policy was taken in the divorcement of security merchandising from commercial banking. It is the judgment of many that equally compelling logic and experience call for similar action in separating banking from long-term mortgage credits.

The primary function of the national banking structure has been to serve the commercial credit needs of the Nation. Many thoughtful bankers and observers doubted the wisdom of the so-called "McFadden Act", which substantially accelerated the participation of national banks in the mortgage field. The records from 1920 up to the beginning of the recent banking difficulties indicate a sweeping expansion in mortgage loans. A question again arises as to whether the country and its financial structure would not be in a better position if we developed strong but entirely separate managements, directorates, and trustees, each functioning in individual lines of financial activity. Commercial banking and mortgage financing seem to be distinct and different, and specialization rather than department-store activity should be encouraged as a matter of public policy. Commercial banks deal primarily with manufacturers, jobbers, retailers, or men who own business and business institutions. The problem of mortgage credits is quite different, dealing with a more personal risk, an entirely different repayment arrangement, a different field of law and business practice, and an entirely different type of security.

Following this thought further, it would seem that, if banking institutions of the country are to be encouraged to make longer term investments, then the most needed public service which they can render and which they are best, if not exclusively, equipped to render, is that of capital loans to large and small businesses. I have in mind here financing running from 1 to 3 or possibly even to 5 years. This is a field unserved by private capital at the present time and one more appropriate than long-term mortgages for the employment of demand or time deposits of essentially commercial banking institutions. Such loans offer a profitable outlet, and recent investigation has clearly indicated the need of such intermediate credit for business.

Senator GLASS. Right on that point, do you mean loans merely to the capital structure, or capital working loans?

Mr. BODFISH. Mr. Chairman, I am thinking more of working capital loans that do not meet the requirements of 60 days, 90 days or even 6 months liquidation. I was very impressed some time ago by a study that was made in the Department of Commerce in which they interrogated, through the mails, some 16,000 or 18,000 small business men, and the study seemed to develop this one rather striking fact: that prior to the banking crisis and the resulting strict supervision we have had since then, these small businesses were supplied with advances that would run anywhere from 1 to 2 years as a practical matter. Sometimes they are on shorter-term notes, yes, but there was a renewal policy and the like. That study developed that that kind of accommodation where there seemed to be any possibility that it would not be liquidated in 90 days or 6 months was not available. So my thought was that if we are going to stretch any into the capital field it would be better to encourage the banks a little more along that line than real-estate purposes.

Senator GLASS. I asked you the question because Governor Black, when he was before the Banking and Currency Committee on the question of direct loans to industries in certain exigencies, drew a sharp distinction between loans to working capital and loans to set up new enterprises.

Mr. BODFISH. May I continue?

Senator GLASS. Yes.

Mr. BODFISH. Some of us have given considerable study to the problem of building a mortgage credit structure which would better serve the needs of property ownership, and at the same time resist the acute conditions recently experienced. A very cornerstone of this thinking was the common-sense proposition that, if long-term, nonliquid mortgage loans are to be safely made, they must flow from long-term savings or investment capital, rather than from funds of depositors who expected money on demand or, at most, on short notice.

The Banking Act of 1933 moved in the direction of restricting banking institutions to commercial credit activities—sort of a general admonition about going too far in the real-estate field—while at the same time a long-term mortgage credit system was being developed through Federal and State legislation affecting building and loan associations and other types of long-term, trustee, or savings institutions.

There I refer, of course, to the Federal Home Loan Bank Act, and the Home Owners' Loan Act of 1933, in connection with which we have had a great deal of State legislation also in the last 2 or 3 years, and, of course, title IV of the new National Housing Act.

The program was varied and sound, and it is believed that the instrumentalities for furnishing adequate home mortgage credit have been created. They will function adequately at such time as real-estate prices, employment, and other conditions urge citizens to use credit extensively for the building or buying of homes. There is statistical evidence of doubled lending activity today on the part of the trustee institutions. It is my considered judgment that the Congress might better encourage and aid those institutions to greater activity than to desert a sound banking principle in regard to mortgage lending to employ temporarily idle banking capital.

Commercial banking institutions have large sums today at interest costs ranging from nothing to 2 percent. These funds are piled up for three reasons: (1) because the public feels their funds to be safe, as a result of the confidence established through the F. D. I. C.; (2) because of the universal feeling on the part of the public that their funds are available on demand or when they want them; and (3) because of the small present demand for ordinary commercial or business credits. It is emphasized that institutions which cannot directly or impliedly promise immediate availability are not receiving a very substnatial flow of savings regardless of rate. These funds in commercial banks which are obviously demand funds in the minds of the public must be so husbanded and employed that the bank can respond to any demand should less favorable circumstances develop. If such deposits bought at demand prices are invested in real-estate mortgages in large amounts, the result is not only a perilous and deceptive banking structure, but also a situation in which the savings or long-term investment institutions are unfairly placed at a distinct disadvantage in carrying out their normal functions.

It is possible under the proposed Banking Act of 1935 that a substantial portion of the 20 billions of dollars of real-estate mortgages now held by savings, building and loan associations, insurance comcanies, and savings banks might temporarily at least be transferred to the commercial banking structure. It is questionable whether the savings, building and loan association, the savings banks, or the insurance companies can function or expand in face of competition for prime mortgage investments from commercial banking institutions whose cost of capital is today 2 percent or less.

Through the F. D. I. C. the Government of the United States has assumed a moral obligation to the bank depositors of this country. The Congress and the Government must either make certain that safe and sound management policies are followed in the insured banks, or face the alternative of paying off the depositors in cash. It is frightening to speculate on the amount of money and the burden on the public credit which would be caused by a future real-estate deflation of only one-half the intensity of the recent one, if the banking structure should acquire the bulk of the long-term mortages. It is not adequate to merely provide loan facilities on such long-term assets in order to meet withdrawal demands of depositors. In the next credit or real estate deflation period, we would find our banking system substantially weakened by long-term, nonliquid real-estate investments, and we would ultimately have to rebuild a sound and separate mortgage-credit system, either through encouraging private or cooperative enterprise, or through direct Government intervention.

Again, the rates which depositors have accepted for commercial bank savings convincingly suggest that they expect to get their money, either upon demand or upon too short notice to justify its investment in long-term real-estate mortgages. It is no real solution merely to transfer long-term frozen assets from a primary lending institution to another institution, even though it be a reserve institution, especially in times of Nation-wide credit stringency. Real-estate loans by their very nature do not have and will not have an organized market or market liquidity.

At the time of the consideration of the National Housing Act, I ventured to state the opinion neither legislation nor insurance arrangements could make long-term mortgages so attractive or so liquid that they could find a cash market at practically face value in times of money stringency. I still think this observation is sound, and yet to be disproved. I believe we can so reconstruct our financial arrangements that the Government, either directly or through the Federal Reserve System, need not assume this responsibility.

While admitting that the United States is over-banked, both in numbers and in dollars—incidentally I looked up the per capita commercial deposits and find they are practically twice those per capita of commercial banks in Great Britain, substantially in excess of those in Canada, and the ratio runs from two times on up, while we have comparatively much lower per capita assets in long-term savings or investment institutions, while admitting that the United States is over-banked, both in numbers and in dollars, it would seem unwise to embark upon any program which would discourage the sound but effective functioning of the thrift and savings organizations. There is much public and private good in providing savings institutions in which the middle classes, and the persons in the humbler walks of life, may be encouraged and rewarded in the form of 4-percent rates on their systematic or accumulated savings. Such institutions have rendered great public service in the past, and have supplied most of the real-estate credit for homes and residential properties, and their work should be strongly supported and encouraged. The proposed legislation will have an adverse effect on the long-term development of the savings institutions and conflict with the Federal Home Loan Bank Board program sponsored by the Government. From the point of view of Government, the jurisdiction and leadership of the Federal Reserve Board should not be expanded into the field of mortgage credits, which is the important and prime responsibility of the Federal Home Loan Bank Board.

A commercial bank best serves its community by giving it uninterrupted banking service and furnishing credit to those types of business activity for which the bank is intended and equipped.

Commercial banks have never made any consequential volume of construction loans in this country other than short-term advances to construction companies and reliable builders.

The point I am making there is that in the main, construction loans are made by savings institutions and by private mortgage operations direct and do not find their way into the banking system until they become matured and seasoned paper. The reason I make that point is that one of the arguments made, rather effectively, I think, for the extension of those mortgage-lending powers in banks, is that the construction activity is greatly needed now and credit is the only thing that is holding it back. I do not believe an expansion of commercial banking and mortgage lending powers is the answer to construction credit.

Building activity has not been deterred for lack of reasonable safe credit. The price of present properties in relation to costs of construction, vacancies, unemployment, and general unwillingness to incur debts on the part of prudent citizens and conservative businesses explain the lack of volume of construction at the present time. Of course, there are speculative builders and others who would build office building upon office building and hotel upon hotel, and apartment upon apartment if the now regretted 100 percent mortgage credit of 1927–29 were available. Certainly this is not the type of credit that banks or any other type of financial institution should be encouraged to extend even in the interests of more construction.

It is a recognized phenomenon of the business cycle that, following the crisis-depression stage, idle funds accumulate until low interest or complete lack of earnings tempt them into the field of long-term or capital investments. Historically, a large portion of these funds have been needed in the ordinary financing of business when recovery really commences. It would seem to be short-sighted public policy to press bank funds into real estate credits under such conditions.

Furthermore, the savings institutions of the country are able to meet current mortgage demands. Today two-thirds of the building and loan associations are actively making mortgage loans. In addition to the associations, insurance companies have reentered the mortgage market and savings bank participation is increasing in the section of the country which they serve. The problem of these institutions is to obtain sound mortgage risks. The activity and the difficulty of obtaining good loans are attested by active advertising for loans except in a few areas, mortgage recordations and lowering interest rates and loan terms which are a direct evidence of a developing competitive drive for prime mortgage business. In my judgment, another 6 months will see the doubling of this evidence and activity.

So far as building and loan associations are concerned, cash on hand, improved mortgage collections, increased savings and the resources of State and Federal Reserve arrangements put them in a position to lend a billion dollars in the coming 12 months. These institutions loaned over half a billion dollars in 1934. Their resources, together with those of other specialized mortgage lenders, should adequately take care of the mortgage need.

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I refer, of course, to the residential field. I have no opinions or solutions as to the large unit mortgage credit regarding hotels, real-estate bond operations, and the like.

One of the pressing arguments to liberalize the power of commercial banks to make real-estate loans falls when one looks at present restrictions and finds that, if they would, without any change in the act, the commercial banks are authorized to make an additional three billion dollars of such loans. These loans are not limited to 5 years but include any long-term loans insured under title II of the National Housing Act. This indicates, to my mind, at least, that prudent bank managements are not making any volume of real-estate loans, and present authorizations are ample for them to more than double their volume if they consider it sound banking policy.

While necessary and useful at one time, the principal pressure for Government loans—the argument that is made is that the only reason this should be done is because of pressure upon Government lending instrumentalities—in the farm and home field is a result of the unusually favorable terms offered by the Government agencies rather than a clear-cut shortage of mortgage credit for sound risks. Certainly, neither banks nor any other lending institutions should be expected to substitute for the mortgage-relief activities of the H. O. L. C. and the F. C. A., where unusual risks were taken for reasons of broad public policy.

The whole trend in mortgage practice is toward long-term obligations ranging from 12 to 20 years. This is sound, as it provides for repayment of the entire indebtedness in an orderly way and within the income or capacity of the average citizen. These mortgages and all other mortgages, regardless of their legal terms or conditions, are essentially long-term frozen paper which can only be liquidated slowly and over an extended period of time. It does not seem that discount arrangements or other devices can be developed which will safely permit the investment of anything but long-term funds in such securities. The distinction between long- and short-term credits is essentially practical and real. The alteration of the Federal Reserve System to better handle stress or emergency situations should not lead us to broad alterations which would encourage unwise banking.

It should be recalled that when the F. D. I. C. insures deposits it is insuring not only ultimate solvency but it is guaranteeing to a numerous group of creditors that it will pay them on extremely short notice in case of a bank closing because of inability to meet demand deposits or general withdrawals.

It seems to me that past experience indicates that publicly known borrowing under such circumstances does not solve the situation in stress periods. The real solution is a contract or arrangement with those supplying the capital that they cannot withdraw all their funds except through orderly liquidation of the long-term securities in which they are invested. This is the essence of the savings, building and loan associations and cooperative bank plan of operation. If there is a lesson to be learned by English experience which is so often referred to by public leaders in the present day, it is one of no mortgages in the commercial banking structure and broad encouragement of the so-called "building society movement." The active construction and favorable interest rates on mortgages which prevail in England at the present time are attributable to a strong and virile development of savings, building and loan associations. It would seem wise to follow or pattern after that experience rather than encourage or risk a repitition of our own recent experience in the banking and mortgage credit field.

Therefore, Mr. Chairman, we urge the committee to seriously consider the proposal which is made in this bill to further broaden and encourage the participation of the commercial banking structure of this country in real-estate mortgage credit.

That completes my statement.

Senator GLASS. We are very much obliged to you.

The subcommittee will adjourn, now, until tomorrow morning at 10:30 o'clock.

(Whereupon, at 11:30 a. m., the subcommittee adjourned until tomorrow, Friday, May 31, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

FRIDAY, MAY 31, 1935

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

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

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

Senator GLASS. Mr. Vanderlip, please take the chair in front of the official reporter.

STATEMENT OF FRANK A. VANDERLIP, FORMER PRESIDENT NATIONAL CITY BANK, NEW YORK

Senator GLASS. Mr. Vanderlip, you testified before the House Committee, and we have your testimony there available in print, and would not ask you to repeat that, but it has occurred to some of us that since the House acted on the bill you might desire to make some supplemental statement to the committee. We shall be very glad to hear from you.

Mr. VANDERLIP. I dictated after breakfast this morning, without the aid of a lawyer or an economist, just a very brief summary of my views. I thought if you cared to have me do so, I would present that, and then you can question me or I can develop points.

Senator GLASS. Very well, sir.

Mr. VANDERLIP. Congress has been advised by high financial authority to set up a commission to study monetary legislation and go home, in the interests of recovery. I do not agree with that view. Congress has already shown signs enough of abdicating. The Constitution has put specific obligations upon Congress. The Supreme Court has clearly reminded Congress that it cannot delegate its obligations. It is time for Congress to buckle down to business and pass, not a bill that someone else has written for it, but a measure it will devise out of its own understanding. I am afraid it will not get much help from economists, from bankers, or from any other class. This is a job that Congress has got to do for itself.

The trouble with the measure that you now have before you is much deeper than the objections which bankers have belatedly been raising. These banker objections were first raised before you weeks after the measure was presented. They are sound in themselves when they raise questions of political control, when they point to the fact that this measure implements the means of inflation, when they demonstrate that the bill will lead the Reserve System further into illiquidity. The banks are stuffed today with 12 billions of Government bonds, and this bill creates a political power which can compel them to add to that illiquid load.

The fundamental misconception of the measure is that it puts the Government into banking, instead of taking the currency out of banking. The regulation of currency is a Government function, not a banking perquisite.

This bill sets up the theory and the method of a managed currency. With the theory, and with the necessity for currency management, I am in accord. But this bill creates a mechanism political in its character, when it should be as nonpolitical as the Supreme Court. The open-market operations necessary to a regulated currency are improperly made a factor in our credit-banking machinery. Under it, commercial banks are compelled by a political body to manipulate their portfolios in accordance with the view of that body instead of in accordance with the credit needs of the communities they serve.

If you are going to regulate the value of money—and I believe you must—how are you going to do it? First, you must have a measure of value. Recent history is replete with illustrations of the fluctuating value of gold. Gold no longer moves from one country to another in answer to the balances of foreign trade.

Look at the news in today's papers. The Bank of France in 5 days loses 5,000,000,000 francs, $325,000,000 of gold, not in the slightest degree in answer to foreign-trade balances, but wholly as the result of speculative movements and panic pressure. The monetary base of the French currency is seriously attacked, and the results may be of the gravest political and social importance. We see here the stability of government itself threatened by deflation. Deflation may be as dangerous as inflation—and both are supremely dangerous.

It is the first duty of Congress to pass a constitutional measure. My opinion is that the bill before you is unconstitutional in that it passes to a political body both the executive powers of currency management and the policy as well. It sets no limit on the range of value that regulation may create. Congressman Spence on May 4 presented the reasoning as to the unconstitutionality of this measure with great force. I myself urged it to the House Banking and Currency Committee and to Governor Eccles, and I urge you to consider this phase.

I believe title II should be fundamentally rewritten. Congress should mandate the objective in regulating the currency. Congress cannot delegate policy; it can only delegate the executive administration of a policy. Inevitably this means that the only true measure of value, a price index, should be adopted by Congress as the guide, and a dollar having stable value measured by a definite price level should be the objective.

By this means you can create an effective barrier against run-away inflation, and without danger of run-away inflation you can raise prices to a level where it is possible to meet debts that were created at a higher price level. The Supreme Court having declared a general farm-mortgage moratorium as unconstitutional, there is no other way left except through currency action to meet the situation of the beleagured mortgaged farmer.

That covers briefly the main points that I would elaborate if you care to have them elaborated. I believe the measure is unconstitutional. I have been saying that for weeks. I believe it is unconstitutional because the policy management is delegated, and I think that is improper. It is delegated to at least a semipolitical body, and I think that is unwise.

Senator COUZENS. Would it make any difference as to what kind of a body it was?

Mr. VANDERLIP. No. It should be an absolute mandate as to policy.

Senator GLASS. Mr. Vanderlip, would you prefer to have the Congress write in the statute the reserve requirements, whether they be flexible or whether they be stationary, or should that be delegated to what you term this "politically appointed body"?

Mr. VANDERLIP. You have already passed a measure which permits the Board to change those reserve requirements. I believe if you are going to have a stable value to the dollar it is necessary to have the power to change the reserve requirements, because an expansion of bank-credit currency or buying medium could run away with the situation, and the banks are in a position now where, if there were a demand, with $2,300,000,000 of surplus reserves, they could inflate the credit terrifically.

Senator GLASS. Yes.

Mr. VANDERLIP. So Congress might well put limits on it, if it chose, but I should think a nonpolitical body charged with the responsibility of regulating the currency, so as to maintain a price level, might be left free to change those reserves.

Senator GLASS. What would you call a nonpolitical body?

Mr. VANDERLIP. A body organized as nearly as possible along the lines of the Supreme Court—a body appointed for life. Perhaps their terms should terminate at some advanced age, but they should not be removable by the President, and should not be subject to political pressure, and certainly not subject to business pressure.

Senator GLASS. Would have the Secretary of the Treasury and the Comptroller of the Currency on such a board?

Mr. VANDERLIP. Most emphatically not.

Senator GLASS. You would want to see the members of a board such as you describe men of large experience with an understanding both of the philosophy and the technique of banking?

Mr. VANDERLIP. Yes, sir; large experience and great integrity.

Senator GLASS. And courage.

Mr. VANDERLIP. Distinctly courage. The qualifications, in a sense, are the same as the qualifications for the Supreme Court—a knowledge of banking and currency instead of a knowledge of law, but men of irreproachable character, of deep understanding, and of courage and integrity.

Senator COUZENS. Do you have any particular number in mind?

Mr. VANDERLIP. I have thought five would be sufficient. That has nothing to do with the philosophy of the idea.

Senator COUZENS. No. Then you would remove any of the 12 Federal Reserve Banks from any connection or influence with the board.

Mr. VANDERLIP. I would cut the whole currency function out of the banks, and on the other hand I would not have the open-market operations necessary in regulating the currency inflicted on the banks. I would have the Federal Reserve System returned to what it was originally organized for.

Senator GLASS. The open-market provision was never intended to be used as it has been used.

Mr. VANDERLIP. Never.

Senator TOWNSEND. Would you put the open-market transactions in this commission?

Mr. VANDERLIP. Yes, sir; so far as the regulation of the currency is concerned. Of course, the banks, in the ordinary course of their business, will have certain open-market operations, but they should not have the objective of regulating the currency, the responsibility, nor the opportunity.

Senator GLASS. Should they have the objective of financing the deficits of the Government?

Mr. VANDERLIP. They should distinctly be protected from pressure to do that. The deficits of the Government should be financed from the investment funds, not from demand deposits.

Senator GLASS. And by taxation.

Mr. VANDERLIP. Most assuredly by taxation, and mainly. I think this bill will further unsettle confidence in the liquidity of the banks. I do not approve of the long-term real-estate mortgages being injected into bank portfolios. I do not approve of what somebody may call a sound security being rediscountable, and a basis for currency issue. The thing is absurd.

Senator COUZENS. I do not quite understand how you would operate this board to regulate the purchasing power of the dollar.

Mr. VANDERLIP. I would give to this board—I have called it a monetary authority—the exclusive power of currency issue. They would, in the first instance, take over all the gold and all the silver. I am sorry there is silver to take over, but it is there and has got to be provided for. They would issue their circulating notes. Their other powers are all in this bill. First, they should be able to buy and sell in a free open market, gold and silver bullion, just as is being done in England today, and will continue, in my opinion, to be done for a great while to come. The talk of England stabilizing to gold is "moonshine", I believe. Then, having taken the right of currency issue away from the Federal Reserve banks, but wanting them to continue to be able to rediscount for member banks, I would have it obligatory upon the authority to rediscount for Federal Reserve banks, with their signature, the rediscounts they had in their portfolio from member banks. That would enable them to go on in the function for which the bank was organized, ability to rediscount proper paper—not merely sound paper, but short-time paper, self-liquidating paper, I believe. Then, the other powers would be to buy and sell short-term Treasury paper, having not over a year to run, bankers' acceptances, and foreign exchange. The balance sheet would be the simplest thing. There could never be more than one item on the liability side—the notes outstanding. On the other side there would be gold and silver, Federal Reserve rediscounts, short-term Government bonds, bankers' acceptances, and foreign exchange. Those are the levers by which you could manage the currency.

Senator COUZENS. The manipulation of those would be the method that you would use to maintain the purchasing power of the dollar, is that correct?

Mr. VANDERLIP. Yes, sir. Whenever current prices were below the mandated level they would have to manipulate by increasing the currency, or any of these methods; but, so much more important to me, whenever prices got above that mandated level they would have to restrict the currency.

Senator BULKLEY. Mr. Vanderlip, how rapidly do you think you can get an effect on prices by those manipulations?

Mr. VANDERLIP. Very rapidly, because this manipulation includes the making of the price of gold. You make the price of gold in dollars——

Senator BULKLEY. But we did change the price of gold, and did not get a very prompt effect on prices.

Mr. VANDERLIP. We got quite a prompt effect on the basic commodities, and there is a very important point. It must be the basic commodity price index that is used. If you take the general commodity price index of 784 articles, it moves too slowly.

Senator BULKLEY. Excuse me right there. Would you ignore that general list of 784 articles?

Mr. VANDERLIP. Yes, sir. It would follow slowly, and not always accurately, but I would manage it on the basis of about 35 basic commodities having a world market, and there you will eventually get stability of the exchanges. England is doing that today. It is really managing the pound according to the Bank of England basic commodity index, and is keeping the domestic prices level. There is a third of the commercial world in the sterling area now. If we came into the same theory of management of our currency, against a similar price index, there would be the way open for stabilization. You cannot have stabilization between countries that have budget deficits, or that have not the exports to balance their imports, and so forth. You would settle, under this plan, international balances with gold, just as we have always settled them, but you would have to buy the gold in the open market. To me it is so proved that it can be done, by what England has done, that it seems to me almost axiomatic.

Senator COUZENS. Do you think that we can postpone dealing with title II until later, until we go further into this matter, or do you think the circumstances are such that it needs to be treated with now?

Mr. VANDERLIP. You certainly can postpone it rather than pass a bad title II. There can be no question of that—and this is a bad title II.

Senator GLASS. Mr. Vanderlip, Dr. Miller in his testimony before the committee made a suggestion to which I would like to draw your attention and with respect to which I should like to ask for your comment. He suggested that this central board that we speak of in this bill, or that is spoken of in this bill, or the central monetary board that you advocate, should be designated or denominated "a board of governors of the Federal Reserve System"; that instead of having a governor appointed by the President or designated by the President, the Board itself should be a board of governors of the Federal Reserve Banking System, with statuory authority to select its own chairman to preside over its deliberations. What would you say as to that?

Mr. Vanderlip. It seems to me that misses the essential point. You do not want your managing board of a regulated currency to be also the managing board of the Federal Reserve Banking System. That suggestion applied to the Federal Reserve Board, exclusively related to the Federal Reserve banking, would be all right; but it is fundamental, it seems to me, to take currency out of the banks.

Senator Glass. You suggest an entirely separate and distinct board to manage the currency exclusively.

Mr. Vanderlip. Yes, sir. That is its full duty, and I suggest that its powers be mandated. That is the responsibility of Congress; and if it is not done, and such a bill passed, I believe it is unconstitutional.

Senator Bulkley. Do I understand that you are advocating doing, as nearly as we can, exactly the same thing England is doing?

Mr. Vanderlip. Precisely so. England is doing these things without any law. We could not undertake to do it as England is doing it, because we have no such control over the banking system. There there are only really five banks. And we have not the knowledge that the English bankers have, frankly.

Senator Bulkley. Who determines the course in England now?

Mr. Vanderlip. The Chancellor of the Exchequer in conference with the Governor of the Bank of England.

Senator Bulkley. Just those two?

Mr. Vanderlip. I should say that those two were the authoritative voices.

Senator Bulkley. And everyone else follows them voluntarily; is that right?

Mr. Vanderlip. Yes, sir.

Senator Townsend. Mr. Vanderlip, did I understand you to say that you think this bill, as it is now written, is unconstitutional?

Mr. Vanderlip. Yes, sir. The bill as first written had no objective at all. I roared a good deal about that, and whether that did any good or not I do not know, but they then wrote in an objective that was taken from the new Canadian banking act. A few words were changed, to make it even less intelligible, and that is set up as the mandate. Now, the Board could take any action you can conceive of, and nine Supreme Courts could not tell whether it came within that mandate or whether it did not.

Senator Glass. They could not even tell by a 5-to-4 decision? Mr. Vanderlip, I have been very much interested in your testimony this morning. I am sure all the committee has, and we are greatly obliged to you for coming down and giving us the benefit of your advice.

I notice that you still advocate the short maturities.

Mr. Vanderlip. Yes, sir.

Senator Glass. In order to bring about liquidity. As I recall, in 1913 you wanted to have shorter maturities than we finally agreed to.

Mr. Vanderlip. Yes, I did.

Senator Bulkley. Have you indicated your position with respect to the additional facilities for real-estate loans?

Mr. Vanderlip. Yes, sir; in many speeches, before committees, and in letters. Of course, you have some banking legislation ahead of you sooner or later. I believe we must eventually see that we must divide banking, so that we have strictly demand deposits in commercial banks, and investment banks that take care of these long-term things. There is the greatest need for some facilities for long-term real-estate mortgages. Do not think that I am against that at all.

Senator BULKLEY. But you are against mixing it up with commercial banking?

Mr. VANDERLIP. Tremendously against it. I know it will add to the illiquidity of the banks, and I think that they are far from liquid today. Let the banks try to sell these Government bonds.

Senator McADOO. You mean gradually or all at once?

Mr. VANDERLIP. Either way.

Senator McADOO. Mr. Vanderlip, I did not have the pleasure of hearing your testimony, I was unavoidably detained. But on this question of real-estate loans, would you mind stating briefly, for my information, what your attitude is about that? As the law now stands national banks may make 5-year mortgage loans on real estate.

Senator GLASS. Within a certain limit.

Senator McADOO. Within a certain limit, of course. The suggestion has been made here that that period be advanced to 10 years, I believe, or a longer time, for amortization mortgage loans, with monthly amortization payments.

Mr. VANDERLIP. I thought the bill permitted 20-year amortized loans to be taken into the banks.

Senator McADOO. I do not think so.

Senator GLASS. Certainly.

Senator McADOO. Twenty-year amortized loans?

Senator GLASS. Yes.

Mr. VANDERLIP. Twenty years. I am against taking them in at 5 years or 20 years, or any other date, in a portfolio against demand deposits.

Senator McADOO. I am in agreement with you about that, but I am speaking, of course, with respect to time and savings deposits. Do you make the same objection to that? In California, for instance, banks have the right, under State law, to conduct a savings business and a commercial banking business and a trust business, all in one.

They may do that now to a limited extent under the Federal charters, but would you take the position that real-estate loans should not be made against the savings funds of those banks?

Mr. VANDERLIP. Certainly not.

Senator BULKLEY. Those are segregated assets.

Senator McADOO. They are segregated, of course.

Mr. VANDERLIP. I would take the savings banks entirely out of the commercial banking.

Senator McADOO. They are segregated, of course, under the existing law. The savings departments are kept separately.

Senator TOWNSEND. It is not always done.

Senator McADOO. I am speaking of our State law.

How long a time do you think, on amortized loans, real-estate mortgages might run safely in the savings departments of the banks?

Mr. VANDERLIP. European experience is 20 to 30 years. All this great house building going on in London today is, in the main, against 20-year amortized loans, and they are amortized from the first week.

Senator McADOO. You mean they are weekly payments?

Mr. VANDERLIP. Weekly payments.

Senator McAdoo. Of course, that makes them much more liquid than if they were monthly payments.

Mr. Vanderlip. Not very much more.

Senator McAdoo. I mean to say it is a more continuous inflow.

Mr. Vanderlip. Yes.

The Chairman. We are very much obliged to you, Mr. Vanderlip.

Senator Couzens. Have we any other witnesses this morning?

Senator Glass. I have asked Mr. James, of the Federal Reserve Board, to come before the committee.

STATEMENT OF GEORGE R. JAMES, MEMBER FEDERAL RESERVE BOARD, WASHINGTON, D. C.

Senator Glass. Mr. James, the committee has expressed a desire to hear something from other members of the Federal Reserve Board as to the pending bills now being considered, the Senate bill, and the bill as amended by the House. Since you are, in point of service, one of the oldest members of the Board, I thought we would like very much to hear some comment from you on the bill, as to the desirability of immediate legislation of this description, or its deferment to a future session of Congress, or as to the desirability of the proposal as it stands.

Mr. James. Senator, since I have had nothing whatsoever to do with the preparation of the bill, I am somewhat reluctant to offer the committee any suggestions. I would be very glad to answer any questions.

If I had any thought to put in the record it would be an expression of a feeling that I have that the public may be expecting a great deal more from the banking authority, which may or may not be set up by this bill, than it is possible for that authority to accomplish. I think there are distinct limitations as to what can be accomplished through the orthodox central banking operations. The experience of the last 12 years that I have served on the Federal Reserve Board indicates to my mind that there are very distinct limitations as to what can be accomplished, for instance, by raising the discount rates or lowering the discount rates, or by open-market operations.

With the law as it is now, it is perfectly obvious that an open-market operation can be indulged in by the Federal Reserve System so long as it is a case of buying, and making money easy in the market. I am rather at a loss to know where they would find the customers if they wanted to sell any appreciable amount of these securities, in making a reverse movement in the said operation. So, I think it might be well to say that I regard the possibility of control of prices and volume of business and employment through open-market operations and other manipulations of the currency, as a very limited factor in what would be necessary to bring about the stability which I understand is the objective.

I am not in accord with the idea of joining the offices of Governor and Federal Reserve agent, or eliminating the chairman of the Board and agent. I think there is a well thought out and well defined purpose in the original act, which to my way of thinking, is very essential in the proper conduct of the Reserve System. The Federal Reserve banks have two important functions, as I see it. One, of course—and the one in which the public has perhaps the greatest interest—is the authority or privilege of issuing currency. There is a protection under existing arrangements for the currency on behalf of the public that I think is quite desirable and fully justified. I think the present law, which defines eligibility, is quite all right insofar as the kind of paper that is to be used behind the currency is concerned, and it is in that connection that I would like to see this dual set-up in the Reserve banks. The collateral behind the currency is a special responsibility of the chairman and agent looking after that side of it. The governor of the bank is, of course, the chief executive of the bank when the bank is performing its ordinary bank functions, making loans, extending credit to the member banks, and carrying on other activities in the bank. But, as I see it, the governor is the servant or employee of the board of directors, and it is to the board of directors that one should look for the proper conduct of any bank.

I am rather inclined to believe that the proposal to limit the terms of office of directors in a Federal Reserve bank to two terms of 3 years each is a mistake. I never have seen a banker that wanted to change his board of directors every 6 years. If you have a good board of directors, you had better keep them. It takes 6 years, and a lot longer than that, to learn very much about Federal Reserve banking and Federal Reserve matters, as I see it. At least it took me 12 years to learn what little I know, and I have still a lot to learn.

Senator GLASS. You can learn all you want to know now in 6 months, can you not?

Mr. JAMES. No; I would not say that, Senator. I am nearly 70, and I have not begun to learn all I want to know yet.

There is one other thing that I would like to advocate, and that is that the smaller banks, what are known as the little country banks, might be protected by a slight change or amendment to the present Federal Reserve Act which would allow them to continue to collect exchange. It seems to me that the small country bank has really performed and is performing, and will continue to perform, a service that is absolutely essential for those smaller districts, and it seems to me likewise vital to them that they be permitted to collect their exchange charges in order to live. There are quite a few banks that I know of now that are making no loans. They are performing a banking service. They are collecting checks, and are living off this little exchange.

Senator GLASS. Does not that mean, Mr. James, that they are living off the commerce of the country without performing any particular service in return?

Mr. JAMES. Senator, I think perhaps custom has made it—well, I might say justifiable, through long practice. I do not mean to say that all banks should be charging exchange, but I do know that the city banks in many cities charge their customers when they deposit checks on out-of-town banks. They say that is an interest charge, because, in giving them immediate credit for an out-of-town item, they are advancing funds, and therefore they are entitled to an interest charge. The little country bank has not any such chance, and in the Federal Reserve System——

Senator GLASS. He has not any such ingenuity to evade the law, either, has he?

Mr. JAMES. I would not like to answer that question, if you please. But it has been advocated among some of the men in the Federal Reserve System that I have talked to about this matter. It is one that has been heavily on my mind for the last 10 years, at least—that the charge might well be passed on to the customer, to the depositing customer, as a service charge. But, as you know, throughout the South, at any rate, for the last 100 years or more it has been customary for the city merchant to take care of the exchange charges when they came to him, and I assume that he is able to pass that charge on to the consuming public somewhere. He usually does, in the conduct of his business.

Senator GLASS. I recall very distinctly when we passed the Federal Reserve Act that the chairman of the Ways and Means Committee of the House complained that the bank in his town, in which he was interested, got 90 percent of its profits out of charging exchange for collections.

Mr. JAMES. I think, Senator, I could find you any number of banks which, if denied the exchange charge, would fail to show any profit. They would just be sunk. That is the trouble, as I see it, with the little bank today. I am not talking about the large bank. If my suggestion amounts to anything, it would be to the effect that banks having bank deposits, due to bank accounts, be exempt from the prohibition against exchange charges.

Senator GLASS. You know the existing law, Mr. James, authorizes the Board to permit the banks to charge the cost of collecting checks, and in 20 years you have not been able to find an actuary who could even estimate what the cost is. In other words, if a bank in my town, I being a newspaper publisher, for example, had 100 checks which were given me for the subscription price of my paper, and it would cost that bank, perhaps, 10 cents in postage to collect these checks, why should they be permitted to charge 25 cents on each of the 100 checks?

Mr. JAMES. I think Senator, the law itself, as it now reads, puts a limitation on it, so far as the law is concerned. May I read that section of the law?

Senator GLASS. Yes.

Mr. JAMES (reading):

> *Provided further*, That nothing in this or any other section of this act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per 100 dollars or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor, by exchange or otherwise; but no such charges shall be made against the Federal Reserve banks.

Senator GLASS. That is an amendment to the law. That was not the original provision of the law. At the time we undertook to put a stop to this imposition of at least $200,000,000 upon the commerce of the country, we permitted the banks to charge the actual cost, and the actual cost was so inconsequential that we were never able to get an actuary who could estimate what it was.

Mr. JAMES. My suggestion was that the law as now written be amended by adding the following:

> except by banks which have no balances due to other banks.

Senator COUZENS. May I ask you if you have studied title II of the bill?

Mr. JAMES. Yes.

Senator COUZENS. Have you reached any conclusion as to immediate action on it? Do you think the consideration of title II is necessary at this time?

Mr. JAMES. No.

Senator COUZENS. You have not reached any conclusion?

Mr. JAMES. I do not think it is necessary.

Senator GLASS. Mr. James, you stated at the outset that you had nothing to do with the preparation of the bill. Do you know of any member of the Board, except the Governor, who did have anything to do with the preparation of the bill?

Mr. JAMES. No.

Senator GLASS. You did not see the bill until it was printed and sent up.

Mr. JAMES. No.

Senator COUZENS. Have you studied it since it has been printed?

Mr. JAMES. Yes.

Senator COUZENS. Have you reached any conclusions about it that you would care to state to the committee?

Mr. JAMES. I have felt all along that——

Senator MCADOO. You are speaking of title II now?

Senator COUZENS. Yes.

Mr. JAMES. I have felt all along that the provisions which are seemingly the objective of the bill, are already provided. It may be that it might have needed some minor clarification in one or two parts of the act as amended heretofore, but so far as needed authority for carrying out the functions of the Federal Reserve System is concerned, I do not really feel that there is any great need for additional legislation at this time.

Senator GLASS. Have you discovered anything in the proposed legislation to get us out of the depression that may not be done under existing law?

Mr. JAMES. No, sir. I have a feeling, Senator, that the Federal Reserve System has been very much maligned by many writers and many speakers, who seem to attribute our economic evils and ills to a failure on the part of the Federal Reserve System. As I see it, the Federal Reserve System has functioned 100 percent, and if the bankers had not stepped off the reservation, so to speak, and gotten out of the realm of banking into promotion and the creating of deposit liability against prices rather than values, we never would have had quite as much trouble as we have had.

Senator GLASS. The Federal Reserve System has been prepared, and has had a willingness, has it not, to do business with anybody that wanted to do business with the System?

Mr. JAMES. Yes; anybody that was qualified to do it. As I see it, the creation of the Federal Reserve System was for the purpose of providing adequate currency and a reservoir of credit to meet the needs of agriculture, industry, and commerce. There never has been one minute since I have been a member of the Federal Reserve Board, over 12 years, that the Federal Reserve System was not right there to do that very thing, and did do that very thing.

Senator COUZENS. But they did not have any authority to prevent the run-away market in investment securities during the period from 1927 on.

Mr. JAMES. There, Senator, I think that might be a debatable question, as to whether they had the authority or not. They did not exercise it, if they had it.

Senator GLASS. But they have it under the Banking Act of 1933.

Mr. JAMES. They have it under the Banking Act of 1933, as I read it, yes.

Senator McADOO. What is the chief function the Board can perform under the Banking Act of 1933, which you think will enable it to control speculation, for instance, or the unwise investments by those banks?

Mr. JAMES. It would have been possible for the Board to have gone further than it did in the early part of 1929, when it advised the public, if you recall, that banks were not within their prerogatives when they were discounting at the Federal Reserve Bank and lending their money in the call market. The warning was, as far as the Board felt, under the law, it could go.

Senator McADOO. You have not answered my question, but in view of your answer I want to ask if you think that by the use of the discount rate alone you could have materially affected that speculative situation.

Mr. JAMES. No, sir; you could not.

Senator GLASS. But under the Banking Act of 1933 you have complete control of that situation?

Mr. JAMES. Absolutely.

Senator GLASS. Of the member banks as well as the Federal Reserve banks?

Mr. JAMES. That is right. That is as I interpret the law. I am no lawyer.

Senator McADOO. Are you speaking particularly of the power conferred by that act on the Federal Reserve Board to decrease or increase the reserve requirements of the member banks?

Mr. JAMES. Yes; and more direct action, Senator, if you please.

Senator GLASS. That act not only authorizes, but it makes it mandatory upon Federal Reserve banks to keep themselves apprised of the transactions of member banks in speculative investments, and to report any member bank which, in its judgment, exceeds the bounds of prudence, and authorizes the Board to suspend any offending bank from the facilities of the Federal Reserve System.

Mr. JAMES. That is my interpretation of the act, exactly, Senator.

Senator COUZENS. In view of the act of 1933 existing at the present time, you do not think there is any necessity for title II? Is that a correct statement of your view?

Mr. JAMES. In the main, yes. There are some other features.

Senator COUZENS. What are the other features? You put in a qualification that disturbs me. "In the main", you said.

Mr. JAMES. There are certain things that we were talking about in the beginning. There are some minor adjustments necessary.

Senator McADOO. The Senator asks what those are. What are the minor adjustments to which you refer? Can you specify?

Mr. JAMES. The one that we were just talking about a few moments ago.

Senator TOWNSEND. That is not in the act now?

Mr. JAMES. No; that is true.

Senator TOWNSEND. Is there anything in title II that you think ought to be put into law at this time?

Mr. JAMES. Not of necessity or urgency; no.

Senator COUZENS. Do you think that there is or is going to be any general public sentiment for a central bank?

Mr. JAMES. I do not just get your question, Senator.

Senator COUZENS. I say, do you understand that there is any sentiment or do you know of any sentiment anywhere generally throughout the country for the establishment of a central bank?

Mr. JAMES. Why, yes.

Senator GLASS. Among intelligent people?

Mr. JAMES. Well, now, Senator——

Senator GLASS. When I say "intelligent people", I mean people who are acquainted with the philosophy and technique of banking.

Mr. JAMES. I can see no justification for a central bank—if I may be regarded as reasonably intelligent. I think we have got the facilities here, if we merely exercise them within the realm of common sense. There is no trouble about getting along with them.

Senator GLASS. I take it from your testimony, Mr. James—and if I am mistaken, I would like you to point it out—that you advocate a measure of local self-government that now is possessed by the regional Reserve banks?

Mr. JAMES. Yes.

Senator COUZENS. You do not believe that it is desirable to have a central authority in Washington which can control open-market operations?

Mr. JAMES. I think we have that now, Senator.

Senator COUZENS. That has not been the testimony. The testimony has been that a decision of the Open Market Operations Committee, or whatever it may be called, is not mandatory upon the 12 banks. Is that true?

Mr. JAMES. As far as being mandatory is concerned, that may be true; but I am judging from my own experience; and knowing the open-market committee and how it has operated in the past I should say that the Federal Reserve Board has a dominating influence.

Senator COUZENS. Do you know of any instances where the committee's action was not adhered to or was defied?

Mr. JAMES. Oh, yes.

Senator COUZENS. Then it has not been a dominating influence on those occasions, has it?

Mr. JAMES. I do not get you exactly, Senator.

Senator COUZENS. I say, it has not dominated in those cases where there has been resistance on the part of anyone of the 12 banks?

Mr. JAMES. I do not know that there has ever been the kind of resistance that you speak of. The committee has recommended certain things in the past that the Board did not agree with, and because of the failure to agree the recommendations of the committee were not carried out.

Senator MCADOO. Suppose, on the other hand, that the Board's view, if carried out, would have been beneficial to the country; then the Board was powerless to enforce it?

Mr. JAMES. Well, experience has shown, Senator, that the Board has, with the committee, always attempted to reach agreements before action was taken.

Senator McAdoo. But in case of disagreement, and assuming that the Board's position which caused the disagreement, if carried into effect would have been of benefit to the country, no authority now exists in the Board to enforce its view or views. That is correct, is it not?

Mr. James. That is a correct statement.

Senator Bulkley. Has the policy declared by the Board always prevailed?

Mr. James. Yes.

Senator Bulkley. Always?

Mr. James. Yes.

Senator Glass. Does not the law textually provide that open-market operations shall be carried on only under rules and regulations adopted by the Board?

Mr. James. That is right.

Senator Glass. The only reservation at all being that any individual regional bank may, if it pleases, upon written notice to the Board, decline to engage in a specific open-market operation?

Mr. James. In that case, Senator, if the Board chose to do so and it became absolutely essential to carry out the policy, the Board has the authority to request or direct a particular reserve bank to rediscount for some other bank. That provision is there.

Senator McAdoo. Mr. James, there seems to be an idea which prevails in many quarters that if the Federal Reserve Board should have the concentrated authority to deal with certain things it could probably prevent catastrophes like the panic of 1929. For instance, if endowed with absolute power over rediscount rates, regardless of the views of the various Federal Reserve banks. That is one. Second, through open-market operations in which the Board would have absolute power to prescribe and require the performance of its policy by all the Federal Reserve banks. And, third, the question of reserves. Do you think that if the Board had absolute power over those three things it could, for instance, have prevented the great speculative wave with the resulting panic of 1929?

Mr. James. No, sir.

Senator McAdoo. You do not?

Mr. James. No, sir.

Senator McAdoo. To what extent do you think it could have been an influence and perhaps have mitigated the asperity of the catastrophe?

Mr. James. Through the exercise of the powers you have mentioned, none at all. But under the Bank Act of 1933 they certainly have authority to stop the use of a lot of bank credit in the market.

Senator McAdoo. I just wanted to bring out that point.

Senator Glass. You have testified that there has been no serious friction between the Board and the Open Market Committee. Why should it now be assumed that hereafter there is to be very serious friction and disagreement between the Board and the Open Market Committee?

Mr. James. That possibility does not appeal to me at all, Senator.

Senator Couzens. Have you any record of any interference in the deliberations of the Board by any public officials or bankers?

Mr. James. If you mean persuasive influence, rather than interference, I should say yes.

Senator COUZENS. Which is the more undesirable, persuasive influence or interference, as you interpret "interference"?

Mr. JAMES. Whichever happens to be the most effective if you are against it, Senator.

Senator MCADOO. Do you mean persuasive influence with a club or with a "big stick", for instance?

Mr. JAMES. They never used any club on me, Senator; I will say that.

Senator MCADOO. Might the persuasive influence to which you refer have been accompanied by a big stick in the background?

Mr. JAMES. If they had a stick they kept it pretty well hidden. I did not see it when they came in.

Senator MCADOO. Perhaps you possessed the degree of intelligence required to be a member of the Board.

Mr. JAMES. I do not know about that.

Senator COUZENS. Mr. Miller testified that the activities of the Board have been on a number of occasions affected by governmental and banking influence.

Mr. JAMES. I think that might reasonably be said to be correct. I do not mean to say by that that there was any big stick, or anything of that kind, but there was perhaps persuasive influence that modified the views of some of the Board members.

Senator MCADOO. The bigger the man who undertook to exercise that persuasive influence, the more effective it was?

Mr. JAMES. It would not have made any difference to some of us.

Senator GLASS. On one occasion the President of the United States publicly announced that speculative investment on the stock exchange was not unreasonable and need not produce any apprehension.

Mr. JAMES. Was it not just a little while after that that the Board made its pronouncement of warning?

Senator GLASS. I think so.

Mr. JAMES. Yes, sir.

Senator MCADOO. That would be a warning to the President of the United States as well as any others?

Mr. JAMES. The trouble is that they would not listen. You can lead a horse to water but you cannot make him drink.

Senator GLASS. Dr. Miller, when he was before the committee, suggested that the Federal Reserve Board be denominated in the statute the Board of Governors of the Federal Reserve System, with authority to select its own chairman; the implication being that that would put every member of the Board on an equal footing with every other member, instead of having a Governor designated by the President, and a Vice Governor. What would you say as to that suggestion?

Mr. JAMES. Out of my experience I should say that it would be more or less immaterial. I have not found that the Governor appointed by the President and confirmed by the Senate——

Senate MCADOO. He is not confirmed by the Senate as Governor, is he?

Senator COUZENS. Yes.

Senator MCADOO. Then the law has been changed as to that.

Senator GLASS. No; the law has not been changed. He is confirmed by the Senate but he is not appointed by and with the advice and consent of the Senate.

Senator McAdoo. That is what I am getting at. As it stands today, the Governor, as a member of the Reserve Board, is confirmed by the Senate, but he is designated Governor by the President alone and the Senate has nothing to do with that.

Senator Couzens. Oh, yes; it has.

Senator McAdoo. He is confirmed as a member of the Board, by the Senate.

Senator Couzens. He was confirmed as Governor, though. Eugene Meyer was so confirmed.

Mr. James. As a member of the Board, however, not as Governor. What I have in mind is that as to the particular members today, insofar as carrying on the work of the Board is concerned, one has the same standing as another; and the fact that the President should be the man chosen to pick out the gentleman who is to sit at the head of the table and do most of the public relations work is not objectionable to me. It does not make very much difference which one of them is chosen for that particular job, because that is all he does; and I think perhaps he is a little bit handicapped because of the numerous duties and interruptions that come to him from time to time, preventing him from giving the amount of thoughtful consideration to those problems that perhaps some of the other members of the Board are able to give. One suggestion that I understand my colleague recommended is that the Secretary and the Comptroller, the ex-officio members, be eliminated from the Board; and I think that would be a good move if for no other reason than in the 12 years I have been a member of the Board neither of these officers has had the time to give to the consideration of problems of the Federal Reserve Board and to become acquainted with what they were and what the responsibilities were. It is very rarely that they attend meetings. I do not like a divided responsibility, if I can help it. I think the ones that are carrying the responsibility ought to have the authority to do the act.

Senator McAdoo. Their function as ex-officio members apparently is restricted to their appearance at meetings of the Board when you have some important question of policy to decide and where they vote. That is about the way it works out in practice, is it not?

Mr. James. That is practically the way it works, Senator.

Senator McAdoo. I recall that when I was Secretary of the Treasury, as chairman of the Board I was able to attend in the beginning almost every meeting, and was glad to attend. It was in the formative period and it was very important to know everybody's mind upon the problems. But afterwards when the European war broke out and we became more and more involved in big questions that were brought to the country, I found it impossible to attend the meetings of the Board. I think it is a legitimate and very reasonable objection that these ex-officio officers who have very extensive duties to perform outside of the Board have not the time to devote to the business of the Board, and therefore it would not seem to me necessary at all that they should be members.

Mr. James. It is that thought that is in my mind when I state that it would be well to leave them off—not because they have used any influence as far as I am concerned, one way or the other, but because in matters of this kind it seems to me essential that all the members be thoroughly posted and know about the problems.

Senator McAdoo. It is not a question of the personality of the men; it is a question merely as to whether or not they can perform any useful service as members of the Board because of their official character.

Mr. James. That is it. The control of economic forces sufficient to prevent the speculative debacle that we went through would have covered a long period of time. If by monetary control, through some body like the Federal Reserve Board, if any action could have been taken, we would have had to start back in 1908. It is for that reason, largely, the length of time involved, that I have reached the conclusion that a managed currency or economy can never successfully operate, for the reason that the authority which creates the management would never let it function, regardless of what that authority that created the management may have been.

Senator McAdoo. You do not think there are any prescient minds in the country that can do the impossible?

Mr. James. No; I do not.

Senator Bulkley. Do you mean that you cannot conceive of a board being set up that would be quite independent of some other authority?

Mr. James. No; because if they were sufficiently potent in exercising their authority, the authority which created them would step in and interfere before they had functioned through.

Senator McAdoo. You mean that Congress would likely do that?

Mr. James. In the case of the United States, yes. If it were in a monarchy, it would be the monarch. That is what happened with John Law. He did a very good job, as I see the story.

Senator McAdoo. He was beheaded after that.

Mr. James. Along came a high-pressure salesman with a diamond, if you recall, and it was the diamond that upset the apple cart. When the old Regent felt that he ought to have that diamond, and there was no provision in the budget with which to buy it, he gave an order on John Law to go and get the money and Law turned the check back.

Senator Glass. We are very much obliged to you.

The subcommittee will recess until 10:30 o'clock next Monday morning.

(Whereupon, at 11:55 a. m., a recess was taken until Monday, June 3, 1935, at 10:30 a. m.)

BANKING ACT OF 1935

MONDAY, JUNE 3, 1935

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

The subcommittee met, pursuant to adjournment on Friday, May 31, 1935, in room 301, Senate Office Building, at 10:30 a. m., Senator Carter Glass, presiding.

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

Present also: Senator Peter Norbeck of South Dakota.

Senator GLASS. Will Mr. Langford, president of the Georgia Bankers Association, take the witness chair, please?

STATEMENT OF H. GRADY LANGFORD, PRESIDENT GEORGIA BANKERS ASSOCIATION, ATLANTA, GA.

Senator GLASS. Please state your name and whom you represent.

Mr. LANGFORD. My name is H. Grady Langford, president of the Georgia Bankers Association, Atlanta, Ga.

This statement is presented in obedience to the wishes of the recent forty-fourth annual convention of the Georgia Bankers' Association, voting unanimously to request the privilege of filing its views with your body. The association is represented here by two former presidents—W. S. Elliott, vice president Bank of Canton, Ga., Robert F. Maddox, a director of the First National Bank of Atlanta; by its present president, H. Grady Langford, who is now addressing you; by its vice president, Lee S. Trimble, vice president of the Georgia Railroad Bank & Trust Co. of Augusta; by its secretary Haynes McFadden; likewise attending in company with the committee named is R. E. Gormley, superintendent of banks of Georgia, and James S. Peters, president Bank of Manchester, Ga., also a former president of the Georgia Bankers' Association.

From this enumeration you will see that every class of banks is represented with due regard to size and location. I am president of the Bank of Meansville, Ga., which has capital of $25,000 and is located in a town of 300 inhabitants.

There are 224 State banks in Georgia, of which 25 are members of the Federal Reserve System, and there are 58 national banks in the State.

With the permission of your committee I now wish to request Mr. W. S. Elliott, who is chairman of our legislative committee, to present our testimony in the form of a prepared statement.

(The witness withdrew from the committee table.)

STATEMENT OF W. S. ELLIOTT, VICE PRESIDENT AND CASHIER, BANK OF CANTON, AND CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE GEORGIA BANKERS ASSOCIATION, CANTON, GEORGIA

Senator GLASS. Please state your name, address and occupation for the record.

Mr. ELLIOTT. W. S. Elliott; vice president and cashier, Bank of Canton, Ga., and chairman of the legislative committee of the Georgia Bankers Association.

We approve the proposal to continue the Federal Deposit Insurance Corporation beyond July 1, 1935, with a maximum insurance for any one depositor of $5,000, as proposed in the original bill introduced in the Senate. We are opposed, however, to placing the assessment against total deposit liability at one eighth of 1 percent, and making the collection thereof mandatory, as provided in the bill which recently passed the House of Representatives. This assessment is not only unnecessary, in view of the requirements of the F. D. I. C., as shown by the record since it was organized, but the collection of this amount will work a definite and serious hardship on contributing banks. The dearth of safe, profitable loans, the low rate of investment yield and the rising cost of operation under the recovery program—these factors have made it difficult, if not impossible, for the average bank to earn any sort of return upon its capital funds. According to figures compiled by the Federal Deposit Insurance Corporation, undivided profits of approximately 14,000 insured banks showed no increase during the last half of the calendar year 1934, but registered a decline of $651,000. On June 30, 1934, the figures were $470,668,000, while on December 31, 1934, they stood at $470,017,000, while the combined surplus of the same banks declined $47,330,000 during the same period. Reserves against contingencies, and so forth. declined during the last half of 1934 in the sum of $77,039,000, according to the same report. Relatively few banks are paying dividends on their common stock. The charge of one eighth of 1 percent upon total deposit liabilities will be a real burden, at this time. It is respectfully suggested that one sixteenth would be adequate and fair to the banks; if a higher figure should be insisted upon, it is felt that one twelfth, as proposed in the original bill, would be more than sufficient and that discretionary power should be vested in the corporation to collect only a portion of the annual amount. Eventually, a better plan of assessment may be worked out, equitable so far as the banks are concerned and based upon some sort of actuarial figures. Until the necessity for a larger assessment is clearly apparent, it is suggested that the amount be held to the lower figures.

Compulsory membership in the Federal Reserve System—We oppose the requirement in the Senate bill (S. 1715) that Federal Reserve membership be required of all banks who continue in the F. D. I. C. after July 1, 1937. This provision was stricken from the original bill by the House Committee on Banking and Currency, and the bill was passed by the House with that provision omitted. We respectfully urge upon your committee that compulsory membership provision be not included in the bill when reported to the Senate. It is impracticable for many small banks to comply with the requirements of Federal Reserve membership, especially because of capital structure and for other reasons which it is not necessary to mention here. Moreover, joining the Federal Reserve System will entail a substantial loss in exchange on checks which is an important item of income for many small banks and in some cases would result in closure of the banks, should this income be taken away, as it will be if the banks join the system and are forced to remit at par. These small banks perform valuable services in their respective communities many of them, yes, most of them, have been conducted along sound lines for many years. Few of the persons connected with their management entered into the speculative orgy that was such a potent factor in the embarrassment of some of our larger business institutions. The small bank has played an important part in the development of America during the past 75 years and its record compares most favorably with that of other financial organizations. According to the summary gotten out by the F. D. I. C., as of December 31, 1934, there were 1,250 insured banks, not members of the Federal Reserve System, with capital of $100,000 or less; 2,613 with capital over $100,000 but not over $250,000; 1,781 with capital over $250,000 but not over $500,000. This means a total of 5,644 nonmember insured banks with a capital not exceeding $500,000, out of a total of 7,682 insured nonmember banks. These banks have reasons for not entering the Federal Reserve System; they have compelling reasons which have kept such a large number of them out of the system. In our own State of Georgia the toal number of insured banks is 260, of which 58 are national banks, 25 State bank members of the Federal Reserve System, while 177 insured banks are not members of the Federal Reserve System. We feel, Mr. Chairman, that it is not right to force these banks into the Federal Reserve System against their will and better judgment. They are doing very well outside the system. They have carried on for many years, most of them outside the System.

Senator BULKLEY. What are the compelling reasons that keep them out of the system?

Mr. ELLIOTT. One of the reasons, as I just stated, is the fact that they would lose the exchange on their checks if they joined the Federal Reserve System.

Senator BULKLEY. Are there some other reasons also?

Mr. ELLIOTT. There is one other thing; the capital requirements. The capital requirements would be higher in the Federal Reserve System. There are other reasons that a small bank cannot take advantage of some of the benefits of the Federal Reserve System as the larger banks can who have large pay rolls and can ship out to Federal Reserve banks free of charge, and the little bank has few calls of that kind. Consequently it is not able to use the benefits of the system as now constituted, like the larger banks can do. Those are some of the reasons that keep the smaller banks from joining the Federal Reserve System.

Senator BULKLEY. Do many of the banks have a capitalization too small to go into the Federal Reserve System?

Mr. ELLIOTT. A great many of them have capital as low as $15,000. We have quite a number of banks in our own State with only $15,000 capital.

Certainly we should not force them to join when, according to some of those high in official circles, our federalized system of banks is yet so far short of perfection. The Federal Reserve System should not be built up by forcing banks to join; rather should the building-up process start from the inside of the system, and such changes made as will cause membership in the system to be attractive to banks now on the outside. Many national banks and State member banks would welcome liberalizing changes which would make their own membership more tolerable. It is significant that only 980 State banks, out of more than 8,600 insured State banks are members of the Federal Reserve System.

It should be pointed out that forcing 7,600 nonmember insured banks to join the Federal Reserve System as proposed in the original banking bill could easily cause such a large number of closures and a consequent burden upon the F. D. I. C. as would seriously imperil the Federal insurance system itself.

Title II of the banking bill—with the great mass of testimony which has been given to your committee in opposition to the enactment of title II of the pending bill Georgia banks are in substantial accord. We are concerned, as all banks in the Nation must be concerned, over the centralization ideas and the political implications contained in title II. We feel that the Federal Reserve banks should be permitted to preserve their regional characteristics and the directors thereof should be permitted to elect local men as their officers without dictation from the Federal Reserve Board; that Federal Reserve banks should have the right to decide as to their participation in open-market transactions; that they should have a right to their own judgment in the determination of rediscount rates affecting their own territory; and that the Federal Reserve Board should not be given the unlimited power to raise or lower the reserve ratio as proposed in the pending legislation.

Unified banking as the goal—title I of the banking bill is filled with provisions which point toward the supplanting of State control of State-chartered institutions and substituting Federal control and regulation for all banks. Requiring the rendering and publication of reports to the F. D. I. C.; giving the F. D. I. C. power to fix fidelity and burglary and robbery coverage for all insured banks, thus doing what State banking departments have been doing well as a rule; giving F. D. I. C. power to impose penalties upon noncomplying banks, some of which run as high as $100—these provisions duplicate or exceed the powers now exercised by State supervisory authorities and subject the State bank to double trouble and expense in connection with matters of routine regulation. No doubt the regulatory offices of the F. D. I. C. will be increased from time to time, until the State departments of banking will be completely overshadowed, and State banks will be driven, as a matter of self-defense, to acquiesce in the abolishment of their own State banking departments. This will be unfortunate, in our opinion. The time is not ripe for the abolishment of the dual system of banking. Even if we should admit that all banking would better be directed from Washington (which we do not admit) the time is not ripe for closing down all State-chartered institutions. Under authority contained in title I State banks who are members of the Federal Reserve System may be required to make three sets of reports and submit to three examining agencies—namely, State banking department, Federal Reserve Board, and F. D. I. C.

Many bankers see in the liberalizing of loans on real estate a source of danger, and a signboard pointing toward inflation. This will be true if banks take full advantage of the possibilities offered in title II of the bill and expand real-estate lending unduly. It is not believed, however, that commercial banks will be in any hurry to load their portfolios with real-estate paper, notwithstanding the possibility of passing it on to the Federal Reserve System. Today many banks are holding real estate which was once the basis for some of their loans; others have real-estate paper which they have had to charge down materially to the detriment of their surplus and profits. A couple of years ago Federal supervising authorities viewed real-estate loans in a bank as something to be eliminated. It will require a good deal of persuasion, in our opinion, to place many real-estate loans in commercial banks; but, to say the least, the great encouragement given to this type of nonliquid paper is not calculated to emphasize conservatism as a feature of this bill.

On behalf of the bankers of Georgia and of the members of our committee, Mr. Chairman, we desire to express to you our appreciation of the opportunity given us this morning to present our views on this legislation. The superintendent of banks of the State of Georgia, Mr. R. E. Gormley, is present with out committee and has some figures relating to the earnings, and so forth, of State banks in Georgia which may be of some interest to the Banking and Currency Committee. With your permission, Mr. Chairman, I will ask Mr. Gormley to present his statement at this time.

Senator GLASS. Would it be satisfactory for him to present his statement for the record? We have a good many witnesses to be heard, and we want to close the hearings; at least the committee does.

Mr. ELLIOTT. That would be agreeable with me.

Senator GLASS. Just hand Mr. Gormley's statement to the official reporter.

(The statement of R. E. Gormley, of Atlanta, Ga., referred to and sbmitted by Mr. Elliott, is here printed in full as follows:)

STATEMENT OF SUPT. R. E. GORMLEY, ATLANTA, GA.

I speak in behalf of 224 State banks in Georgia. Twenty-five of these banks are members of the Federal Reserve System. I appear before you more specifically in the interest of the other 199 nonmember banks, and to urge the Senate bill be amended to conform to the House bill, as amended by the House Banking and Currency Committee, by striking subsection (y) of paragraph 23, requiring Federal Reserve membership after July 1, 1937, in order to retain membership in the Federal Deposit Insurance Corporation and that a more equitable premium rate for insurance be fixed.

The 199 nonmember banks referred to have capital stocks totaling $8,746,000. Their gross earnings in 1934 were $3,550,000, of which $513,000 was received from exchange. Their net earnings before charge-offs in 1934 was $728,000. Membership in the Federal Reserve System will eliminate practically all of the revenue now received from exchange. Based on figures of 1934 the net income of 199 nonmember banks would be reduced in case of enforced membership in the Federal Reserve System to less than $250,000, or a net return, before charge-ofts, on invested capital of $8,746,000 of about 3 percent.

These nonmember banks have loans to Georgia agriculture and industry totaling $40,000,000. These banks are performing a necessary exchange service in the rural districts, and are and will in the future afford the fairest and most intelligent distribution of credit possible to the rural communities. The total deposit of the nonmember banks is $67,000,000. Based on a one-eighth of 1 percent rate, the per annum cost of insurance to these banks will approximate

$84,000. With enforced Federal Reserve membership and deducting the cost of insurance at the rate of one-eighth of 1 percent, the net income of nonmember banks in Georgia would in 1934 have been reduced to approximately $150,000 on invested capital of over $8,000,000. The earnings of these banks in 1934 were better than in the three preceding years.

Senator GLASS. Is Mr. Stern here?

Mr. STERN. Yes, sir.

STATEMENT OF J. DAVID STERN, EDITOR, PHILADELPHIA RECORD, PHILADELPHIA, PA.

Senator GLASS. The subcommittee has been advised that you desire to be heard on the pending bank bills, and we will be very glad to hear what you have to say.

Mr. STERN. Thank you very much, Senator.

Credit is the coin of today.

Therefore, control of credit is as inherent a function of sovereignty as control of coinage. That is the reason I am for the Eccles bill, which gives the Federal Reserve Board, appointed by the President of the United States, control of the credit volume of the Nation.

It would be as absurd for the Government to grant private citizens the right to coin money as to allow the bankers to continue to dictate the credit policy of the Federal Reserve System. This political paradox has come upon us as gradually as the substitution of credit for cash currency since the Civil War.

Quoting from Woodward and Rose—

In 1860 cash in circulation was $9.76 per capita, demand bank deposits $9.85 or almost even. In 1880 cash per capita, $13.96; deposits, $44.30. In 1900 cash, $17.10; deposits, $111.57. In 1930 cash, $29.76; deposits, $485.57, or 16 to 1.

But these figures do not tell the whole story. Before the Civil War checking accounts were used only by large concerns for major transactions and had comparatively slow velocity, while cash currency bore most of the burden of the usual business and household transactions.

Today bank deposits or credit dollars represent 85 percent of our medium of exchange. Cash currency is merely a supplementary medium of exchange. The control of the purchasing power of the dollar depends upon the volume and velocity of bank credit in relation to the volume of trade.

Since credit volume and velocity control the value of the dollar, it follows that credit volume and velocity also control the value of the cash dollar, no matter what may be its monetary base. This has been proven again and again as the futility of the Warren and Fisher schemes of varying the gold content of the dollar has become so apparent.

The Constitution reserves to the Federal Government the right to coin money and "to regulate the value thereof." The Government cannot fulfill this function of regulating the value of the cash dollar unless it controls the volume and velocity of the credit dollar, which is the intent and purpose of the banking bill of 1935.

The 12 regional banks of the Federal Reserve System afford a credit reservoir for the Nation. By varying their discount rate, as well as by open-market operations in Government securities, they can vary the credit level in the nonmember as well as in the member banks of the Nation. Here we have a system with 12 intake and 12 outlet valves to the reservoir. If 6 of the regional banks open their intake valves and the other 6 regional banks open their outlet valves, they neutralize each others' efforts and defeat the very purpose for which the Federal Reserve System was created.

Therefore, central control of the open-market transactions and rediscount policies is essential to credit control and stabilization of the purchasing power of the dollar at any agreed credit level.

This great economic crisis is the test of efficiency of democracy. If we continue with an irrational system because we haven't awakened to the obvious fact that credit dollars have displaced cash dollars, democracy is doomed.

History bears witness to the persistence of old errors and the bitterness with which the victims of those old errors denounced anyone who tried to correct them.

Copernicus and Galileo are conspicuous examples. Pasteur was laughed off the platform when he attacked spontaneous generation. Today we have with us the advocates of the gold standard. What makes their disillusionment more difficult is that their error is not so old. The gold standard did work and gold did control the value of monetary units when cash currency was the main medium of exchange. It was only when a great credit structure gradually grew atop the gold base that the gold base became relatively unimportant in the price equation.

Persistency of error is based on a natural psychological tendency. The believer refuses to see anything which contradicts his preferred belief.

Thus man had seen the masts of ships appear above the horizon before the hull, and he had seen the curved shadow of the earth on the moon for thousands of years before he accepted these evidences of curvature of the earth.

So monetary conservatives with gold payments suspended in every country except France, Switzerland, and Holland, and with France in the throes of an economic catastrophe, refuse to see any evidence that the gold standard won't work, that credit control has taken its place, that the value of a monetary unit can be measured only in terms of commodity indices and that governments, if they are to survive, must throw off tradition and "can't"—

I sincerely believe that this bill is a great forward step toward modernization and rationalization of our monetary system.

As far as I can discover the main argument against this bill is that it places national credit under political control.

Well, what of it? Political control is certainly safer than private banker control, judging by past experience.

Why shouldn't the administration control national credit as it controls the Army, the Navy, and the Department of Justice? Who wants the Army placed under control of the munition makers to expand or contract as it suits their selfish ends?

They have private armies in Europe, but it hasn't worked out so well for democracy. There's no more room for private control of national credit in a democracy than there is for a private army.

The hand that holds the purse strings rules the roost. Bankers, who can tell the Government how many bonds it can sell, exercise a supersovereignty as surely as the Fascist leader threatens a subservient government with his armed forces.

Uncle Sam, hat in hand, making terms with the bankers, presents a humiliating spectacle—which should be resented by every true American. This bill will cure that.

The Federal Government should have as much right to say what percentage of the national credit it will take for its own use as it has to say what percentage of our individual incomes it will take in the form of income taxes.

"Supposing the Government misuses this great power over credit, what then?" ask the pessimistic conservatives.

The answer is twofold. If the Government expands or contracts credit unwisely, it will defeat its own ends by impairing credit and business—on the same principle that the Government can dry up sources of taxes by overtaxation.

Just as the power to tax is the power to destroy, so the power to expand or contract credit is the power to avoid or create economic chaos.

But if costly mistakes in credit control are to be made, it is much better that they should be made by the Government than by the bankers. At least we could vote the bungling Government out of office.

We can't do that with the bankers. The same bankers who are responsible for the terrible blunder of uncontrolled inflation which came to its disastrous climax during the fall of 1929, still control our Federal Reserve System and its credit policy.

What is more exasperating, they have the nerve to come down here and argue against this bill, the nerve to tell you gentlemen that credit control is safer in their hands than in the Government's.

Such self-assurance is sadder than it is funny. It bespeaks an utter lack of comprehension of this great power and the responsibility it involves.

National credit control is the keystone of economic stability. It belongs to the Government of the people, by the people, for the people.

(The witness withdrew from the committee table.)

STATEMENT OF CHARLES S. HAMLIN, MEMBER FEDERAL RESERVE BOARD, WASHINGTON, D. C.

Senator Glass. I assume that you are familiar with the pending proposals for revision of the Federal Reserve Act, and the committee will be glad to hear from you.

Mr. Hamlin. Gentlemen, I want to say that I am very glad to come here today at the request of the committee and to express my views on the pending legislation. I shall not try to go into the intimate wording of various amendments. I think I can make myself clear as to the general subject matter.

After an experience of 21 years in administering the Federal Reserve Act I can only say that my respect and admiration for it has increased year by year. The great principles underlying that act, the discount of commercial paper, the massing of reserves, the issue of Federal Reserve notes and, last but not least, open-market power, I think have demonstrated to the country the necessaty for its creation and altogether the success with which it has been administered.

To my mind, without the open-market power the Federal Reserve System would be purely an emergency system; but I shall speak on that a little later.

I find, however, in reading the various speeches and letters that have been written for and against the proposed bill or bills that there is a great deal of hysteria. I find the air filled with adjectives of fear—perhaps you might say hatred, despair—and some, of course, of comfort. It reminds me of Milton:

> Thick as autumnal leaves that strow the brooks
> In Vallombrosa.

I think it is the duty of any student looking into this matter to rake away these superincumbent leaves and get down to the bottom and find just what these proposed changes in the act are and whether they are consonant with the principles of the act as originally framed and as broadened by Congress.

The original Federal Reserve Act, as you all know, was somewhat enlarged by the provisions for advances to member banks. The scope of it was enlarged by permitting the issue of Federal Reserve notes to banks on the pledge of gold or other collateral, or both. Therefore, I think, in considering whether any proposed amendment is consonant with the principles of the act, we must take the act as originally enacted and as Congress subsequently has broadened it.

The principal cry that I hear throughout the country is that this will make the Federal Reserve Board a central bank. That seems to be the most terrible epithet that can be applied to this proposed legislation. I can remember, back in 1912, I think it was, when the Aldrich Monetary Commission prepared an act for a central bank and when the term was almost a benediction. Now the words "central bank" seem to be used to terrify people. It would almost make a mother take her children and go down into the cellar as if to avoid a zeppelin raid.

Senator GLASS. Was it not so used, Mr. Hamlin, in both the Democratic National Convention and the Progressive National Convention, and in the platform written by Theodore Roosevelt, as well as the platform on which Mr. Wilson was elected?

Mr. HAMLIN. I am not very fresh on that, Senator.

Senator GLASS. Was there any declaration even in the Republican platform in favor of a central bank?

Mr. HAMLIN. My recollection is that the Democratic National Convention declared against a central bank. As I understood it, however, it was a direct blow at the Aldrich monetary plan.

Senator GLASS. It declared in terms against the Aldrich bill or a central bank.

Mr. HAMLIN. I understood that to mean the Aldrich bill or any bill like it which established an operating central bank in Washington.

Senator GLASS. Or a central bank. And the platform upon which Mr. Theodore Roosevelt was nominated as a Progressive candidate declared in equal terms against the centralization of credit in Washington and against the proposed Aldrich bill.

Mr. HAMLIN. Well, my point simply is that the words "central bank" require an explanation of their meaning when you say them as an epithet or an argument against anything.

Senator GLASS. We have been discussing it ever since the days of Mr. Jefferson and Mr. Hamilton.

Mr. HAMLIN. Yes; that is true.

The Federal Reserve Act established 12 regional banks with the Federal Reserve Board as the supervisory, controlling authority. As a matter of fact, each one of those Federal Reserve banks essentially is a central bank with autonomy of its own. It has practically all the powers that any central bank in Europe has. In fact, in 1932 Congress extended the power so that the Federal Reserve bank, under certain circumstances, could make a direct loan to individuals. It seems to me that these banks are essentially central banks in their power; but the Federal Reserve Board of course has supervisory control over those 12 autonomous banks, but it has certain centralized powers, if you wish to call it that.

You cannot have control over 12 autonomous banks unless you have some kind of centralized power. That does not make it a central bank; and I can see nothing in this proposed bill that would turn the Federal Reserve bank into a central bank.

Senator GLASS. You make no distinction between 12 regional banks representing business interests of 12 defined territories of the United States, and a central bank here in Washington? Is that so?

Mr. HAMLIN. No; I should say there was all the difference in the world. The centralized power in the Federal Reserve Board to my mind does not create a central bank in any sense of the term.

Senator GLASS. It does not now, no; because it has a supervisory power within the meaning of the law. There is such a thing, however, as our amending the act so as to make it a central bank.

Mr. HAMLIN. Well, the Federal Reserve Board now has power not very much different from the central banking power. It has power to regulate the issue of Federal Reserve notes. It has the power given by the act of 1933 to close the discount window for abuse of the privilege. It has power, which I will speak of in a few minutes, of ordering one Federal Reserve bank to discount the paper of another Federal Reserve bank.

Senator GLASS. It has had that from the beginning, but that requires a certain number of votes of the Board to do that.

Mr. HAMLIN. Yes.

Senator GLASS. In other words, it is a power that must be very cautiously exercised.

Mr. HAMLIN. Absolutely.

Senator GLASS. Under the statutory restrictions?

Mr. HAMLIN. Yes. It has, of course, as I have said, the open-market powers of which I shall speak in a moment.

To my mind, the opposition against these proposed bills is really based on a fear that the Federal Reserve Board is not sufficiently independent to be trusted with those powers—not only the powers which it has, but the powers which it is suggested be added to it; and in my discussion of these amendments I shall base my opinion on the understanding that the Federal Reserve Board, if in the judgment of Congress it is not sufficiently independent, will be made independent; and I believe, if the people of this country felt that the Federal Reserve Board, which I shall show, I hope, is independent in fact, is also independent in law, I believe that two-thirds of the opposition to these amendments would disappear.

The point is raised that this is not an opportune time for making changes in the law, and that theory has been advanced by a great any bankers.

I understand fully how bankers are fearful of regulations, fearful of power being applied to them, and you can naturally, perhaps, sympathize with the view. But the question arises, why should we now postpone legislation if legislation is necessary? I believe we ought to decide these questions today, because I think the Federal Reserve Act needs some of the amendments suggested in this bill. I think that without the broadening of the open-market power it will destroy the opportunity of major policies designed by the Board. I believe that it is absolutely necessary that some control over reserves be given to the Federal Reserve Board, and that control was asked for, I think, 15 years ago. We asked and almost beseeched Congress to give us that power. I realize that that power, under the Thomas amendment, can now be given with the consent of the President of the United States; but it seems to me that that is a burden which should not be placed upon the President of the United States; that a board of men sworn to do their full duty, men supposed to be of good judgment, could safely be entrusted with that power. Any limitation on that power, limiting the increase in reserves by any percentage Congress wishes, would be perfectly satisfactory, at least to myself.

Senator GLASS. But that is not the limitation provided in this bill, is it?

Mr. HAMLIN. I think not, Senator. But I am going to say that that is one of the things that I should be very glad to see provided, so that there should be some reasonable limitation.

Various questions have come up. The first amendment that I want to speak of is the power given to the President, of the appointment of the Governor of the Board.

I cannot see that this bill in anyway is a radical step in what it does as to the power of the President to appoint a Governor. The President now, of course, can designate any member of the Board as Governor, and from time to time can change that designation. In the proposed bill, or in the bill of Governor Eccles that was passed by the House, the President is given the power to appoint from any Federal Reserve district a Governor, whether or not there is a member already serving from that district. That is the only change that I can see in that regard.

Then it is further provided that if the Governor should cease to be designated, he may resign free from the 2-year limitation on accepting any employment in a member bank.

Senator GLASS. Is there a pressing emergency for that alteration in the law?

Mr. HAMLIN. I do not think that there is any pressing emergency because, as I say, I consider that it is a very slight advance, if it is at all, over the present law. I think the provision as to qualifications of members of the Board should be looked over very carefully, and I assume that the Senate committee will take care of that. I think they are a little exclusive. But so far as the Governor goes, that matter could go along perfectly well. I do not regard that as one of the essentials at all of the problems now before us.

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Next, as to the appointment of a governor by the local board of directors. To my mind that is a grant of very great autonomy to the Federal Reserve banks. At the present time, as you know, the Federal Reserve Board has its chairman appointed by it at each Federal Reserve bank. He has an office there, and an office for the Federal Reserve Board. The chairman presides at all meetings, and we have two other directors to help him and to help the Board.

Under this proposed bill the chairman is absolutely withdrawn. One of the class C directors is withdrawn, and the governor may be appointed by the directors, and he is given supreme executive authority over the bank. I think that is a tremendous grant of autonomy to each Federal Reserve bank.

Some say that the fact that the Board under the law would reserve the right to confirm the appointment of governor would make that governor, as one man said to me, the office boy of the Board. I cannot see that at all. I do not care whether you confirm once for all or once every 2 or 3 years. I cannot see that that cuts down the power of the Federal Reserve bank in any sense. The fact that the President has to have many of his appointees confirmed by the Senate to my mind does not cut down or destroy his appointing power. Neither would it make the officer confirmed the office boy of the Senate. The Board has in a sense power nor over that matter, because it has the absolute power to fix salaries of every officer. In one case the Board refused to fix any salary of a governor—that was a good many years ago—because they felt that on the whole he did not measure up to the required standard.

But I cannot see anything radical there except a radicallly increased grant of power or autonomy to ever Federal Reserve bank.

Then there is the matter of the consolidation of the Rederal Reserve agent and the governor. That I think is vital in the sense of economy and simplicity. I think that if the Federal Reserve agent is abolished and the collateral for Federal Reserve notes done away with, it would save the System about $500,000 a year. But that of course is not a grave emergency, although I think on the whole it would be a very advisable step.

Senator TOWNSEND. In what way would that saving be brought about?

Mr. HAMLIN. If the policy of collateral for Federal Reserve notes were abolished, you would abolish a tremendous amount of work, and of course save the salaries now paid to Federal Reserve agents; and I think it is estimated that the whole thing would be a saving of somewhere near half a million dollars. If you desire that exactly I can give it to you in extenso.

Senator TOWNSEND. You might furnish it for the record.

Mr. HAMLIN. The question comes up with regard to the open market powers. As I said at the beginning, without open market power the Federal Reserve System is practically an emergency system. It has to sit still until banks come to it. Through the exercise of the open market powers it can go to the banks and can make its discount rates effective. What do you mean by making the discount rates effective? If you feel the discount rate is too low and you put it up, it does not follow that the banks will impose any higher rates upon their individual customers or in this case will raise the rates to the individual customers. You go into the open market and sell bonds. You take out the money from the reserves of the member banks, and it tends to make them cautious and it tends to make them raise the rates to their individual customers. On the other hand, if you wish to lower rates, you do it because you wish to see the benefit of that reduction percolate through the country so that the borrower of the bank can get his money at a lower rate.

Senator GLASS. Did you ever know it to so percolate?

Mr. HAMLIN. I think, Senator, it does; yes.

Senator GLASS. I have never known it.

Mr. HAMLIN. We have no uniform discount rate, but I think it does percolate through the country.

Senator GLASS. I have been observing it for 21 years and I have never known it to percolate.

Mr. HAMLIN. Well, that is the theory.

It is an interesting fact that under the original Federal Reserve Act our counsel advised us that the Board had power to order the banks to buy or sell securities. As a matter of fact, we never exercised or tried to exercise that power, but went along and got together between the banks and the Federal Reserve Board and we got along very successfully as a whole. Then came the Banking Act of 1933 which specifically gave the right to each Federal Reserve bank, through its directors, to decline to participate. As a sovereign board it has to enter into treaties with 12 other sovereign bodies, and although most of the time we were able to get together harmoniously, yet from time to time there did occur clashes where the policies of the System were sadly interfered with.

Senator GLASS. Do you think a central board here would know better than a regional bank what its local conditions are and whether or not it should be compelled to participate in an open market transaction?

Mr. HAMLIN. I think that if there is not some power, that is, a right to determine that question, it would be very difficult to agree on the carrying out of any major policy.

Senator GLASS. You have said that your counsel advised you that you have had that power all along.

Mr. HAMLIN. Yes; but of course that depended on a somewhat involved construction of the act, and as a matter of fact we did not exercise it.

Senator GLASS. I should think it would be a very much involved construction of the act.

Senator BULKLEY. What are the instances where the Federal Reserve banks refused to cooperate in the policy of the Board?

Mr. HAMLIN. There are two instances that I wanted to point out to the committee. The first was in August 1931 when conditions, as you all remember, were very bad. Prices were dropping; liquidating was going on, and the Board made up its mind, and in a conference the Federal Reserve Bank of New York concurred that a major policy was absolutely necessary, and the open market committee were called together. Governor Meyer, who was then Governor, went before the committee for 2 hours explaining that under existing conditions nothing but a major stroke would help this situation, and perhaps that would not; but that it was vitally important that the System should make a bold stroke and buy, say, 300 millions or 400 millions of Government securities, hoping that that might turn the tide. For 2 hours he discussed the matter with the governors We then came together in a conference and we found, after their meeting by themselves, that a motion to amend that power which had been asked for by the Governor of the Federal Reserve Bank of New York, cut down the power from $300,000,000 to $120,000,000. The 20 millions was an unexpended balance. Practically the vote was 300 millions cut down to 100 millions, which naturally would destroy the effect because it would cease to be a major operation.

Senator GLASS. Did not the subsequent purchase of two and one-half billions of Federal Reserve securities demonstrate the utter futility of the policy which you proposed to adopt?

Mr. HAMLIN. I am not sure of that, Senator. A bold stroke of that kind, involving three or four hundred millions of dollars, one day, might have had a great deal of cumulative benefit. No one can tell. But the policy of the Board was to build up the reserves of the member banks by these bold strokes. No one can say now whether that policy, if it had been increased intensely, would have accomplished anything or not.

Senator GLASS. It was increased in intensity to the extent of two and a half billion dollars.

Mr. HAMLIN. But I am perfectly satisfied that the purchases that were made of Government securities helped to stop the precipitate deflation that was going on, but, of course, it cannot be measured.

Senator GLASS. The idea was that it would enable the member banks to pay their indebtedness to the Federal Reserve banks, and that thereupon the member banks would proceed to liberalize their own loaning policies. Did they do it, or did they keep on intensely providing liquidity?

Mr. HAMLIN. We kept on intensely helping them to do it, and that help is there now.

Senator GLASS. Your purpose was, as I understood it at the time, as I have said, to enable the member banks to pay their indebtedness to the Federal Reserve banks, the supposition being that thereupon the member banks would proceed to loan, and to loan, and to loan, in a very much more liberal measure than had theretofore prevailed. But, as a matter of fact they did not do anything of the kind, and they did not do it because public confidence had been badly impaired, and every member bank was intent upon being in as liquid a condition as it could be. Isn't that a fact?

Mr. HAMLIN. I think that is true in large measure, Senator. I know of no way that you can force a customer to go to a bank to borrow, but there are ways in which you can make it easy for a bank to make a loan.

Senator GLASS. You can make it easy for a customer to borrow when you reduce your discount rate to 1½ percent.

Mr. HAMLIN. Yes.

Senator GLASS. Which is perfectly ridiculous.

Mr. HAMLIN. That was the purpose of our purchase of Government securities, to help the general credit situation, that is to say, to give the borrowers of the country an opportunity to get money at lower, more favorable rates. The fact that that policy has not succeeded in that is something, of course, beyond the power of the Federal Reserve Board.

Senator GLASS. I know; but that takes us back to the immortal declaration that we should take our steps in the light of experience. Was it Mr. Jefferson, or somebody of that type, now out of date, who said that?

Mr. HAMLIN. We certainly have had the experience, and we are still having it.

There is one point I want to make, that I trust the Senate committee will not advocate cutting down the members of the Federal Reserve Board to five. I think that is one of the propositions which has been laid before it. I believe that the appointive members should rather be increased to 7, because with the new autonomy given to the Federal Reserve banks, the members of the Board have got to increase their visits to those banks and keep in closer touch with them, and that will take up so much time that I should prefer to see it increased to 7 rather than reduced to 5. My point is that somebody should be given absolute authority to determine this matter of open-market policy. Governor Eccles has submitted a way of doing that with five governors bound to render an opinion to the Board before the Board makes any major change. I think that would work out very satisfactorily.

Senator BULKLEY. Before we get too far away, I want to get a better understanding of that difference of opinion that you just related between the Board and the banks. What was the result? Was the operation restricted at that time to $100,000,000?

Mr. HAMLIN. Yes.

Senator BULKLEY. When were further purchases resumed after that?

Mr. HAMLIN. Very shortly after that; but this was a major operation. It was voted down 11 to 1 by the Board of Governors, and at that time, while we had been told we had power, we had rather gone along in a spirit of cooperation, and usually that was perfectly successful. There was another instance. I think it was in——

Senator BULKLEY. Right there, you accepted the view that you did not have the right to compel them to make those purchases?

Mr. HAMLIN. We acted under that view, that it was a very doubtful question.

Senator BULKLEY. How was the matter next revived after that?

Mr. HAMLIN. Then, of course, the banking bill of 1933——

Senator BULKLEY. Before that, there were some considerable purchases, were there not?

Mr. HAMLIN. Oh, yes.

Senator BULKLEY. How did that come about?

Mr. HAMLIN. It came about by voluntary cooperation.

Senator BULKLEY. At the suggestion of the Board?

Mr. HAMLIN. We have our regular open-market meetings, and we make suggestions, and the Governors make suggestions. They come together, and they let us know what they think the policy should be, and the Board, of course, has the power to disapprove it, but in most cases we have got together very satisfactorily.

Senator BULKLEY. The Board simply acquiesced in that $100,000,000 limitation at that time, and then revived the subject a little later.

Mr. HAMLIN. Yes. It was the best we could do at that time.

Senator BULKLEY. What did you do next?
Mr. HAMLIN. The next clash, I should say, was in 1933, after——
Senator BULKLEY. But how did you revive the question of getting more bonds purchased by the System?
Mr. HAMLIN. We got together, and we bought from time to time.
Senator BULKLEY. You say "we bought." You mean the Federal Reserve banks?
Mr. HAMLIN. The Federal Reserve System bought from time to time, as the result of a cooperative movement between the Governors and the Board.
Senator BULKLEY. When did you get past that $100,000,000 operation, and go into a larger scale of buying?
Mr. HAMLIN. I should say very shortly. I think it was in February. We began and went right ahead. I merely cite that as one case where there was a conflict of authority, to show the necessity of having somebody with final authority.

In 1933 the matter came up again. I think it was in the fall of 1933. I attended a meeting at the Federal Reserve Bank of New York of the executive committee. Governor Harrison reported that the Federal Reserve Banks of Boston and Chicago had passed resolutions absolutely declining to participate in any further open-market purchases unless in cases of grave emergencies, and the Governor at that time was very much worked up. He felt that we should go ahead strongly and vigorously, and pointed out that if New York did it alone—and New York, I think, was somewhat inclined to do it—it would pull its reserve ratio down to 47 percent, leaving the reserve ratio of Chicago and Boston at 70 percent. The Governor delivered an oration worthy of Demosthenes. He nearly drew tears to my eyes, when he told us it was the duty of the Board to force Boston and Chicago into line. I agreed with him entirely. I said, "I don't know how we can do it, but I will go back and see what can be done."

Then he made a very interesting suggestion, that the Board might be able to do that if New York were to take practically this whole issue—the Board could require Boston and Chicago to rediscount for New York, and thus equalize on the reserve ratio. But I merely cite that as an instance of the desirability of having somebody who can absolutely finally determine this question.

Senator GLASS. Does not the existing law authorize the Board to make rules and regulations for open-market transactions?
Mr. HAMLIN. Yes.
Senator GLASS. And is not the sole reservation that reservation that authorizes a Federal Reserve bank, upon written notice, to decline to participate in an open-market operation?
Mr. HAMLIN. Yes; and the question arises whether, under the power to regulate, we could issue an order to the banks to make open-market purchases.
Senator GLASS. I do not think you can. That is not regulation. Let me ask you this, Mr. Hamlin, before you leave that topic of increasing the appointive members of the Board. Would you drop the ex-officio members from the Board?
Mr. HAMLIN. In my opinion, I should like at least to see the Secretary of the Treasury retained as a member of the Board. Of course, Mr. Owen Young has given sufficient reasons for that, I think, for the

next 2 or 3 years, but beyond that the Secretary of the Treasury, under the Federal Reserve Act, has absolute, supreme power over the Federal Reserve banks as fiscal agents, and he is a large depositor, and it seems to be very desirable to have some link between a board, we will assume, to be made absolutely independent, and the fiscal branch of the administration.

Senator GLASS. That is a pretty broad assumption, is it not?

Mr. HAMLIN. That is a pretty broad assumption, but I have always had that feeling. I think the Secretary of the Treasury should come to our Board and tell us exactly what his policies are, and we should exchange views with him and know precisely what he is doing, and I think the best way to bring that about is to have him remain a member of the Board.

Senator TOWNSEND. Does the Secretary of the Treasury do that now?

Mr. HAMLIN. Oh, yes. He consults with the Board.

Senator TOWNSEND. And outlines his policies?

Mr. HAMLIN. And tells us, in a general way, his policies.

Senator GLASS. How many meetings has the present secretary attended?

Mr. HAMLIN. I should say three or four, but he has been ready at any time the Board has asked him, to answer any questions that he could. He has always been ready and eager to come before the Board, and I have found him very frank and square in all his relations with the Board.

Senator GLASS. What have you to say of the suggestion by Doctor Miller that the Federal Reserve Board should be made a board of governors of the Federal Reserve System, with authority to select their own chairman and chief executive officers?

Mr. HAMLIN. I think that is a solution that will make the Board certainly independent in law. I shall try to show in a moment that they have been independent in fact. I think that would undoubtedly satisfy the people that the Board is independent in law as well as in fact. There is no personal feeling about this. I could say, if that were the law, that I should take pleasure, as the first Governor appointed by the President, in nominating Governor Eccles as the first chairman of the Board. But I think that probably would satisfy the people that we have an independent Board in law as well as in fact.

Senator GLASS. What people would it satisfy?

Mr. HAMLIN. I think the people of the United States.

Senator GLASS. I do not agree with you.

Mr. HAMLIN. There is another reason why I think that the present is the time for bringing about some amendments in this law, and that is broadening the eligibility features of the law. We have had complaints and protests and earnest requests from all over the country that some types of what you call finance paper should be made eligible. I have always felt that under the original Federal Reserve Act it would be possible to construe the act so as to admit certain types of finance paper, but the Board never has been able to agree on that proposition. It came up first with cotton factors' paper, and for years that matter was before us. The cotton factor borrows from the bank, and gives his note. The bank pays him the money, and he devotes every dollar of that money to the business of raising and producing cotton, and yet his note cannot be presented to a Federal Reserve bank for rediscount.

Senator GLASS. You mean under the decision of the Board it cannot be?

Mr. HAMLIN. Yes. In 1923 we appealed to Congress, and Congress changed the law, and made cotton factors' paper eligible. It seems to me that same principle could be well extended to other forms of paper. Take installment paper, which has turned out to be, I think very good, sound paper. The individual purchasers could give their notes to a bank. That would be eligible, but the practice is, to save trouble, to go to a finance company, and the finance company gives them the money and gives its note to the bank with these other notes as collateral, and the bank cannot rediscount that with the Federal Reserve Bank. It seems to me, on the principle of cotton factors' paper, which we must take now, as a broadening of the scope of the Federal Reserve Act, much of that paper could be made eligible.

Senator GLASS. What is excluded from your definition of eligible paper? You are given complete power to define the eligibility of paper within the law. What is excluded from your definition of eligible paper, except investment securities and notes executed for purchasing and carrying speculative stocks?

Mr. HAMLIN. Well, we have had to define that as broadly as we could, but we have had to rule, in a great many cases, against the eligibility of paper.

Senator GLASS. You mean you have ruled?

Mr. HAMLIN. We have ruled, and I think now it is perfectly safe to give the Board the power to broaden slightly the eligibility features of the law, founding that opinion on the cotton factors' decision, which Congress finally settled.

Senator GLASS. And to make it without limitation, as this bill does, and not to apply to the commerce and industry and the agricultural interests of the country?

Mr. HAMLIN. Any limitation, of course, which Congress saw fit to place upon that power would be reasonable. I am not arguing as to that, but the power, perhaps subject to reasonable limitations, should be given to this Board, which I assume, now, is an independent Board.

Senator BULKLEY. Do you favor any limitation other than sound assets?

Mr. HAMLIN. No. The Federal Reserve Board years ago asked Congress—I can almost say begged Congress—to give it the power to buy the sound assets of any bank in trouble. This bill would simply permit a loan on the sound assets. Fifteen years ago we were willing to take the risk of buying the sound assets to help the bank. I believe that that is a proper provision in this proposed bill. You could put in any limitation on it that you deemed advisable, but the subject-matter, I think, is sound and reasonable.

Senator COUZENS. Under what construction of the law did you decline to take this so-called "finance paper"—the installment paper you refer to?

Mr. HAMLIN. On the ground that the proceeds of the note were not directly used for agricultural or commercial purposes. That is, the note was discounted at the bank, and the bank gave the money, in this case to the cotton factor, and he loaned it to the producer. The producers could have given their notes direct to the bank. That would have been proper agricultural paper, but because it was first given to a cotton factor to be loaned by him, we were obliged to rule that that was ineligible.

Senator GLASS. In other words, the cotton factor was to make a profit out of the transaction instead of the bank.

Mr. HAMLIN. In a certain way. He acted as the agent for all these people who needed help, and the fact that he took the money and loaned it to them made that piece of paper ineligible. But, as I have said, Congress has changed that, and that is now eligible paper, and on that principle I think the Board should be permitted to go further.

Senator COUZENS. When you decline to accept and rediscount the paper for the financing of radios, automobiles, and refrigerators, under what law do you refuse those rediscounts? Are they not to help agriculture, industry, and commerce?

Mr. HAMLIN. These are all, I suppose, related to finance companies, who do the financing for the installment purchasers.

Senator COUZENS. Yes.

Mr. HAMLIN. We do it on the theory that when a bank discounts the note of a finance company, they give the money directly to the finance company. It is the finance company that then distributes it for agricultural purposes, and we found, under the law, that we could not hold that that was eligible paper.

Senator COUZENS. What part of the law? That is what I am trying to get at. What part of the law prohibited you from rediscounting this paper, which was in aid of commerce?

Mr. HAMLIN. I would have to ask our counsel to explain that, Senator.

Senator COUZENS. Certainly I cannot understand it. I am not urging it, but I just do not understand how you reached the decision.

Mr. HAMLIN. The original law provided for notes the proceeds of which have been or are to be used for agricultural purposes, as in this case. I have always thought that was broad enough to cover this finance paper, but it is a question of very grave doubt, and that is the reason we went to Congress as to cotton factors' paper, and I think that is the reason this bill would give that power to the Board, which I thought it always had, but I believe it is a very doubtful question.

Senator GLASS. Was not the opinion of your counsel based upon the fact that the finance company was doing a banking business within itself, and was not a member of the Federal Reserve System or subject to the restrictions or the privileges of the Federal Reserve System?

Mr. HAMLIN. The finance company was just like any farmer or anyone else borrowing from a bank. The Board held that he was borrowing in order to relend.

Senator GLASS. Did he not constitute a bank without the system?

Mr. HAMLIN. That is possible, but Congress said, in the case of the cotton factor, no; and his paper was made eligible.

Senator GLASS. Congress said that very definitely, and if you want it to be definite in the statute, that is one thing. But if you want it to be unqualified, without limit, that is another thing.

Mr. HAMLIN. Any limitation that Congress saw fit to place upon it would be perfectly reasonable.

With respect to this power to order purchases or sales in the open market, as I have said, I think the authority ought to be put somewhere. The suggestion in the House bill, that a board of five governors be required to give an opinion before the board exercises that power, I think probably could work out very satisfactorily. But the power must be vested somewhere, and, as I have said, I earnestly hope that it will be vested in the Federal Reserve Board, with the duty of calling for a formal opinion from all the governors, or from five of the governors. It Congress sees fit to impose some limitation on that, that before the Board departs from the official opinion of the governors it must have, we will say, an affirmative vote of five, that would be reasonable. I think that is the law now, where we force one bank to rediscount for another.

Next, as to the proviso as to the initiation of rates. A great many opponents of this bill seem to think that for the first time this bill gives the Board power to initiate rates. The fact is that this bill somewhat restricts the power. It says that before the Board can use that power of initiation it must get the opinion from five of the governors. The power to initiate rates is not an original power for the first time given to the Board in this bill. The power to initiate rates, as the Attorney General has advised us, is in the original Federal Reserve Act.

Senator GLASS. What Attorney General?

Mr. HAMLIN. The Acting Attorney General, but he was acting as Attorney General. It was the Attorney General's Department.

Senator GLASS. I am glad he found something in the bill that I never discovered, and the Board never discovered it either. It attempted it once.

Mr. HAMLIN. It did it twice, Senator. In 1920 the Federal Reserve Board initiated a rate of 6 percent at the Federal Reserve Bank in New York, raising the rate, I think, from 4½ to 6 percent on commercial paper, and the New York directors declined to put in that 6-percent rate. The Board all agreed that there should be an advance in rates, but many of the Board felt that a jump from 4½ to 6 was rather sudden and extreme. The matter finally came up before the Board, and was lost on a tie vote, whereupon the chairman was asked to vote, and the chairman voted aye, and that initiated the rate of 6 percent in the Federal Reserve Bank of New York. The directors pointed out that if we wished that rate we could only get it by initiating it, and initiate it we did.

Senator BULKLEY. What was the date of that?

Mr. HAMLIN. That was 1920. I think it was March. I can get that exact date for you.

Senator BULKLEY. That is sufficient.

Mr. HAMLIN. Then in 1927, a lower rate was initiated in the Federal Reserve Bank of Chicago. To my mind the power to initiate rates is absolutely vital to the Federal Reserve System, never to be exercised except in some extraordinary condition, and I think I can speak without any prejudice, because in both the cases where rates were initiated I voted against initiating, not on the ground of lack of power, but on the ground that there was no good reason shown for lowering the rate in Chicago, and I believed that it was rather extreme to raise the rate in New York. But I think that is a vital power which should be given to the Board, or which should be retained in the Board, assuming that the opinion of the Attorney General's Department is correct.

Senator GLASS. You look at your wonderful diary and see if you did not vote against it because you did not think you had the power.

Mr. HAMLIN. No; I have gone through that diary very carefully, and I took the opinion of the Attorney General of the United States, or his office, as binding on the Board, and I voted for the reason that I thought it was too excessive an increase.

Senator GLASS. An opinion of the Attorney General is not binding on the Board.

Mr. HAMLIN. It is binding on the Secretary of the Treasury.

Senator GLASS. It is not binding on any department of the Government. It is merely advisory.

Mr. HAMLIN. I may be wrong. I accept your criticism, but I have always supposed that the opinion of the Attorney General was binding on every executive department, and when the Secretary of the Treasury asks an opinion of the Attorney General, I assume that he is bound by that opinion. I may be wrong. It is merely the assumption that I carry in my mind. I feel that it might be well to have the same limitation—an affirmative vote of five—before you initiate a rate, for example. There would be no objection that I could see to that at all.

There is one other question, the question of Federal Reserve notes, which the proposed bill would authorize without collateral. I regard that as not very vital at the present time, because today the Federal Reserve notes can be issued, and just as many notes can be issued with the collateral of Government bonds as could be issued under the Eccles bill without any collateral at all.

Senator BYRNES. Who was Secretary of the Treasury at the time that opinion was asked of the Attorney General? Was it Secretary McAdoo?

Mr. HAMLIN. Who was Secretary of the Treasury at the time of the Attorney General's opinion?

Senator BYRNES. Yes.

Mr. HAMLIN. I think the Honorable Carter Glass was Secretary of the Treasury.

Senator GLASS. When what?

Mr. HAMLIN. When the Attorney General's Department rendered that opinion.

Senator GLASS. What opinion?

Mr. HAMLIN. As to the power to initiate discount rates. That is what I thought the question was.

Senator GLASS. I always opposed the proposition, whether the Attorney General rendered an opinion or not. I do not recall ever having asked the Attorney General for any such opinion. I do recall that I was very definitely told that the Board was so ashamed of its attempt to usurp that power with the Chicago bank that it eliminated the fact from its record.

Mr. HAMLIN. I heard that the other day, and I had the most careful examination of the records made, and I can say that not one paragraph has been eliminated of that whole discussion.

Senator GLASS. I will not enter into that further than to say that a member of the Board, and one of the original members of the Board, certainly told me that. I did not dream it.

Mr. HAMLIN. I heard it the other day, and asked to have it checked up, and the report was that there was nothing eliminated.

On the subject of Federal Reserve notes, of course, this proposed bill would make those notes practically an asset currency. I can remember very well the old Baltimore plan for an asset currency, and that was considered as sound currency, with the proper reserve, and, of course, a first lien on the assets. But the point I wish to make is that this bill, so far as that is concerned, is no radical departure, because for 2 years, at least, we can issue as many Federal Reserve notes with Government bonds as collateral, as could be issued without any collateral at all, because there is the upper limit of two and a half times the free gold. So that no one could fairly claim that the purpose of that is to increase the issue of Federal Reserve notes. They are always bound by the reserve requirement, two and a half times the free gold, which could be used as a reserve against the notes.

Senator BULKLEY. And the reserve requirement may be freely changed at any time.

Mr. HAMLIN. The reserve requirement under the original Federal Reserve Act——

Senator BULKLEY. I mean under this proposed bill.

Mr. HAMLIN. No; I do not understand that there is any change in the existing law. You can reduce the reserve requirement under existing law for Federal Reserve notes, but that was the law under the original Federal Reserve Act. There is no more danger of that now than there would be under the original law. But for 2 years——

Senator GLASS. You can only reduce the reserve requirement under penalty.

Mr. HAMLIN. Certainly, under penalty. But for 2 years, with the privilege of having Government bonds as collateral, just as many notes can be issued as under the House bill, without any collateral whatsoever. I think it is hardly likely that at the end of 2 years, even, we will do away with the privilege——

Senator BULKLEY. I am interested in that, because it does not seem to me that there was any limit at all to the amount of notes that could be issued under the bill as it passed the House.

Mr. HAMLIN. The limit is 40 percent. There must be 40 percent gold reserve.

Senator BULKLEY. Unless the Board sees fit to change it.

Mr. HAMLIN. The Board, under existing law, could lower those reserve requirements for periods of 15 days, imposing a heavy tax on the Federal Reserve notes.

Senator BULKLEY. Under the bill as it passed the House, what can they do?

Mr. HAMLIN. Just the same, I do not understand that that reserve clause is changed in any way.

Senator BULKLEY. They have changed it so that the Board can do anything it pleases at any time, without any penalty.

Mr. HAMLIN. If that is so, that ought to be covered. The Board can now make a change in the reserve requirements.

Senator BULKLEY. For a limited time, and under penalty.

Mr. HAMLIN. Yes.

Senator GLASS. That has been the law from the first.

Mr. HAMLIN. That has been the law from the first.

Senator BULKLEY. You do not think it would be material to remove those limits?

Mr. HAMLIN. No; I think that limit should be kept just as it is—a fixed reserve. Of course, as I have said, that would make the Federal Reserve note an asset currency. I believe that is ultimately a wise step, but, of course, that is not any grave emergency. I remember perfectly well, under the Aldrich monetary bill, for forming a central bank, the notes could be issued on the collateral of Government bonds, which, of course, now, for 2 years, is the law. Ultimately I should hope to see that removed, and to see those notes a pure asset currency, with the proper gold reserve, and make them a first lien on all the assets of the bank.

Senator BULKLEY. So that the only change you would suggest in the House bill is that you do not believe in removing all restrictions on the maintenance of a reserve against the notes.

Mr. HAMLIN. Oh, yes. I do not remember the exact wording of the House bill, but I should say the present law ought to remain, as to lowering the reserve requirement. There is no change in the proposed law on the reserve requirements, I am informed. I did not know of any change until you spoke.

Senator BULKLEY. I would like to put in the record what it says, if I can find it.

Senator GLASS. Is there any other provision you want to discuss, Mr. Hamlin?

Mr. HAMLIN. There was just one point I wanted to refer to briefly. The Board has been very severely criticised because, as I have said, it has shown a lack of independence, and the principal fact cited to prove that lack of independence was its attitude in objecting to the increased rate in 1929, which the Federal Reserve Bank of New York advocated, and which the Board 10 times refused to approve. The Board is criticised for lack of independence. As a matter of fact, I think that is an instance of independence rarely equalled in the history of any board in the United States. A majority of the Federal Reserve Board put through that policy against the votes of the Secretary of the Treasury, the Governor of the Board, and the vice-governor of the Board, and, whether the policy was correct or incorrect, I think it was certainly a sign of virile independence. The real gist of the criticism apparently is that the Board refused to be dominated by the administration, and had the courage to stand up for what it believed to be correct. That question was a very simple one. The public thought the controversy was between the Board and New York; that New York wanted to increase the rate from 5 to 6 percent, and the Board 10 times refused. That is partially the truth, but not the whole truth. What the Federal Reserve banks of New York desired was to have the Board accept a policy of affimative increase of rates, beginning at 6 percent, and going up to 7, 8, 9, or 10, until the situation was corrected. I remember 3 years ago you asked me what that meant, and I said I supposed it meant until the speculation on the New York Stock Exchange was at an end. The Board took this position: "It is not our duty to go in and regulate the New York Stock Exchange. Our duty is complied with when we take Federal Reserve credit that has seeped into the exchange out, and that duty we propose to perform." We said the existing rate of 5 percent on agricultural and comercial paper was certainly not too low a rate. Many thought it should be lower, that it should be 4½ percent, but we were asked, because of speculation in New York, to enter on a campaign of higher rates for agriculture and business, men whose lives depended on short-term credit, beginning at 6 percent and going up to 7, 8, 9, or 10. To my mind it was like asking a father to cut the ears off his child because a drunken man was carousing in the street.

Senator GLASS. Is not that exactly what we are asked to do now, order to prevent a repetition of that?

Mr. HAMLIN. No; I do not so understand at all. We are asked to put up the reserve requirements, but we are given power now to take an individual bank under the Banking Act of 1933. We can fix the percentage, but I feel that it would be a great help to us——

Senator GLASS. But the proposition is to repeal all that.

Mr. HAMLIN. Not to repeal the Banking Act of 1933. I hope not.

Senator GLASS. Those two sections.

Mr. HAMLIN. I hope not. I think they are most valuable features. In that connection, a great many men have said that it is not now expedient to make these changes. That reminds me of the gentleman whose roof was leaking, and he did not want to repair it while it was raining, but when the rain was over there was no necessity of repairing the roof.

I have read Mr. Owen Young's testimony. I have the very highest esteem for him in every way. I have known him many years before this act was formed, but I think he is a little nervous and scared about what may happen from bringing about these changes. Three years ago, Senator, you will remember that Mr. Young and Governor Harrison signed a memorandum to you, giving—to them—conclusive reasons why there should be no legislation at all in the year 1933. Those same reasons would almost apply today. I think bankers necessarily are easily moved and scared. They do not want any change.

Senator GLASS. On the contrary, Mr. Harrison came down here, and over and over and over again, urged our subcommittee to legislate.

Mr. HAMLIN. You mean this subcommittee?

Senator GLASS. Yes. This subcommittee has existed, except for the three members who were recently added, under the administration of Senator Norbeck as chairman, as well as under Senator Fletcher. We were urged to take legislation, and did take legislation, and have practically turned the country back to a bond-security country.

Mr. HAMLIN. Was this with relation to the act of 1933?

Senator COUZENS. Yes.

Mr. HAMLIN. There is a memorandum filed with this committee, signed by Governor Harrison and Mr. Young. I think it was before the act of 1933, and in relation to that act.

Senator GLASS. Perhaps that related to certain powers that the Federal Reserve banks generally did not want vested in the Federal Reserve Board.

Mr. HAMLIN. It covered the whole bill. It said that there were some good things in it.

Senator GLASS. What whole bill?

Mr. HAMLIN. The bill which subsequently became the Banking Act of 1933. It covered that whole bill, in the shape in which it then was.

Senator GLASS. For that matter, the Governor of the Federal Reserve Board appeared before our committee and opposed the whole bill.

Mr. HAMLIN. Opposed the whole bill?

Senator GLASS. Yes.

Mr. HAMLIN. My recollection is that the Governor of the Federal Reserve Board appeared before this committee and spoke for a unanimous opinion of that Board in favor of the bill as it then was.

Senator GLASS. I do not recall that at all.

Mr. HAMLIN. I think that is a fact, Senator. The Board had a long discussion——

Senator GLASS. You have a diary, and unfortunately I have not. You may be correct, but my recollection is that Mr. Meyer appeared before the subcommittee and opposed many provisions of the bill, and filed with us, as I recall, a very elaborate opinion of your counsel, Mr. Wyatt, who is here now, pointing out just exactly how we might have a unified banking system in this country, putting under the Federal Reserve Board control of all banks of deposit.

Mr. HAMLIN. I think that was another occasion. My memory is absolutely clear that the Governor of the Federal Reserve Board and the members went to a session of this committee, and the Governor read a unanimous report. We made some minor criticism of the bill. Of course, that is a matter of record, and I will endeavor to make that perfectly clear. Then, you will remember, Senator, that all the governors of the Federal Reserve banks were on record as opposing the bill in 1933, even taking the amendments the Board had suggested, many of which were accepted by the committee. I am not criticizing them. I am simply saying that it is the natural state of mind to hesitate to have any new change.

As I have said, I am confident that this Board is a virile, independent board, in fact. I assume, from what Secretary Morgenthau and Dr. Miller said, that the question will be before you of making it an absolutely independent board in law. On that assumption, after a thorough examination of this bill, with many minor reservations, of course, that are not very material. I am prepared to say that I support this bill, and I believe it would be for the greatest good of the people of the United States to have these questions settled now, and, incidentally, that it will be of great help to the bankers themselves.

That is all that I think of.

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

Senator BULKLEY. Senator Glass, permit me to say that after having reread the House bill I want to confess my error concerning proposed changes in reserve requirements. The authority given the Federal Reserve Board to change reserve requirements relates only to reserves of member banks, and the requirement of 40 percent reserve over gold certificates behind circulating notes is absolutely fixed.

Senator GLASS. Very well, Senator Bulkley.

The committee will recess until 2 o'clock, when it will convene in the Appropriations Committee room of the Senate. At that time other members of the Federal Reserve Board will be heard.

(Whereupon, at 12:15 p. m., a recess was taken until 2 p. m.)

AFTERNOON SESSION

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

Senator GLASS. I understand that there is a banker here from Texas who wants to be heard for a few moments.

Mr. WOODS. Yes, Mr. Chairman.

STATEMENT OF J. E. WOODS, PRESIDENT THE TEAGUE NATIONAL BANK, TEAGUE, TEX.

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

Mr. WOODS. My name is J. E. Woods; I am president of the Teague National Bank, Teague, Tex.

I am a small-town banker operating a national bank with $100,000 capital and surplus and average deposits of $600,000. While I have been delegated by the officers of the Texas Bankers Association to speak with authority for the member banks of the association, it shall be my endeavor to convey to you particularly the thoughts of the so-called "country bankers" and "small-town bankers" of our State concerning certain phases of the pending banking bill.

My remarks concerning the bill will be confined to subdivision 8 of section 101 of the House bill providing for a mandatory annual assessment of one-eighth of 1 percent of the deposit liabilities of member banks as a premium on the limited insurance of deposits by the Federal Deposit Insurance Corporation and to some observations concerning Postal Savings competition.

Regardless of the wide difference in opinion as to the feasibility and the wisdom of the undertaking prior to the enactment of the act providing for insurance of deposits, it is now a part of the law of the land and it is the earnest desire of all of us to lend our best efforts and give our full cooperation toward making the plan the success that it proponents cherished. Imbued with that spirit, our views are offered not in a spirit of criticism but to try to acquaint you with the views of the average banker who is in close contact with the people and who is fighting the economic battle in the front-line trenches. The matter is of vital importance to his welfare and, indirectly, to the welfare of the community served by his institution. It is sincerely hoped that with the expression of these views you may be assisted in a small way in your deliberations on this important proposition.

The wisdom of the plan providing for the payment of an annual premium for the purpose of creating and maintaining a fund to take care of current losses and to provide a reserve for future losses (such rate of premium to be arrived at on a proper actuarial basis) cannot be questioned; and the conservative thought that prompted the committee to fix the premium at an adequate rate is commendable, although we feel that in view of the present condition of the banking structure the rate of one-eighth of 1 percent fixed by the House bill is too high. The difficulty in arriving at a just and adequate rate on an actuarial basis is fully appreciated. That a rate based on losses on the insured deposits during the 16 months that the temporary insurance plan has been in operation, when the losses amounted to only a small part of the annual income from investments of the capital funds of the corporation, would be inadequate, is elementary. On the other hand, a rate based on losses during the 4 years ending June 30, 1934, during which 4 years' period two-thirds of the losses occurred during the 70 years' period ending on that date, would not be fair.

Indeed, we are in an experimental stage with insurance on bank deposits; no statistics are available that are accurate enough to be relied upon as a criteria for future performances. The amount of premium necessary to collect must of necessity result from study and experience. With the banks as a whole, thanks to the wise policies of the administration, beginning with the bank holiday in 1933, probably in the soundest condition that they have been in during our banking history, can we not safely assume that during the next biennium, at least, fatalities will not increase appreciably? According to figures released by the Federal Deposit Insurance Corporation, only 17 insured banks had failed as of May 15, 1935, resulting in an estimated loss to the Federal Deposit Insurance Corporatin of 2½ million dollars. For the next few years, at least it seems that losses could conservativly be expected to be less. It is admitted that by reason of the emergency, unsound banks were admitted to membership in the Insurance Corporation. In an address delivered recently, an officer of the Federal Deposit Insurance Corporation said [reading]:

> The urgent necessity of reopening the banks made it imperative that all banks which had a reasonable chance of continuing their business should be licensed. The examinations preliminary to such licensing were necessarily made with tremendous speed and under unusual conditions. It was natural that some banks were licensed which did not have adequate support really to warrant their continuance as banking institutions.

With the fine job that the Reconstruction Finance Corporation, the Federal Deposit Insurance Corporation, the Comptroller's Department, and the various State banking departments cooperating are doing and with the wise provisions of the pending bill that will force member banks to get their houses in order where necessary and exclude from membership unsound banks, does it not seem that fatalities in the next few years should not increase materially over the past year and one-half? Income to May 15, 1935, from investment of capital funds exceeded losses and expenses by approximately 2½ million dollars.

The Federal Deposit Insurance budget for the year 1935 provides for current expenses of 2½ million dollars against a present income of 8½ million dollars from investment of capital funds, leaving $6,000,000 net income that may be used for the payment of losses on insured deposits. For the past 2 years, and there is nothing at this time to indicate a favorable change in the near future, banks, particularly the country banks where the volume is small, are having difficulty in meeting operating expenses and taking care of losses that inevitably occur. In Texas, where it appears that the banks have withstood the depression better than the average, only a small percentage of the total number were able to pay dividends during the past year. Out of 469 State banks only 121 paid a dividend in 1934. We have not been able to get similar information as to national banks. It was very generally the case where the smaller or average-size banks were able to earn enough to permit paying a dividend such profits resulted from profits from the sale of securities the market value of which had appreciated and such earnings were nonrecurring.

At first glance, the proposed assessment, at even one-eighth of 1 percent, does not appear great as to the country banks, but with very limited income the additional load placed on the expense side of their operations in most cases will be more keenly felt by the small banks than by the large banks with greater incomes. In considering the shrinkage in income which the banks have suffered, I call attention to the loss of profit on circulation, which is in the process of retirement. The discontinuance of approximately $800,000,000 circulation will result in a loss of profit to the national banks of not less than $12,000,000 annually. To the little bank of which I am president, the loss will amount to $900 annually, or 1½ percent of the capital stock. This loss in income will be reflected by bank operations for the period beginning July 1, 1935.

In order to exist and perform their important functions in the community life, banks must earn enough to pay the stockholder a reasonable return on his investment. While protection of depositors' funds is always of prime importance in the operation of a bank, the interest of the stockholder who provides the capital structure of the bank must have next consideration. For the past several years ownership of bank stock has been a liability, and the stockholder has, indeed, played the role of the forgotten man in the banking industry. He deserves and, eventually, must receive consideration.

An assessment of one-eighth of 1 percent premium, as provided by the House bill, would yield annually on the basis of present deposits of insured banks approximately 47½ million dollars, while, as pointed out, losses from January 1, 1934, to May 15, 1935, in insured banks that have failed have amounted to only 2½ million dollars, and the net income from investment of capital funds on the present basis is estimated to yield $6,000,000 per year. I respectfully submit that the addition of this vast sum to the already heavy operating expenses of the banks would be a distinct shock to a great majority of the institutions, especially the so-called "country banks." It would be revolutionary in its nature. If as we go along it is found that such a charge will ultimately be required, it seems that it would be a more desirable plan to gradually increase the rate to the required figure than to apply the maximum assessment at a time when the banks are not in position to withstand the shock. It is earnestly urged that there would be no departure from conservatism in fixing a rate of one-sixteenth of 1 percent for the present.

Concerning the operation of the Postal Savings System, I wish that I might impress upon the members of your committee the serious inroad that postal savings competition is making upon the operation of the smaller city banks. The effect of this competition has been most damaging to banks in towns ranging in population from 2,000 to 5,000. It is not because these banks have compacently accepted this condition that relief from this menace has not been persistently urged upon the Congress, but it is because of the fact that during the past 2 years each session of Congress had had under consideration major banking bills, which the legislative committees of our associations have felt were of such vital importance to the banking industry or profession as a whole that they should concentrate their efforts on these major bills; and as the small-town banks are the ones that are bearing the brunt of this competition the matter of urging relief has been deferred pending settlement of the major measures.

It is my opinion, arrived at after careful study of the postal savings question, that the operation of the Postal Savings System has served to dry up credit in our erstwhile prosperous communities more than any other cause that possibly could be reached by legislation. The ideal functions of a bank are to provide facilities for impounding the earnings, savings, and the liquid wealth of the community and use it as the basis for legitimate credit which is used in the channels of trade and the building up of worthy enterprises in the community. Any enterprise or operation that drains this liquid wealth from the community that produced it will retard the development of and, if continued long enough, will wreck the community economically.

Senator BYRNES. It is your information that the postal savings deposits have increased during the last few years?

Mr. WOODS. Is it; yes, since the deposit insurance it has increased.

Senator BYRNES. The figures I saw within the last few weeks show no increase, or a very slight increase.

Mr. WOODS. Possibly the current figures; but over 1934 I understand they increased $10,000,000. I believe that is shown in the Postmaster General's report.

Senator COUZENS. What interest do they pay?

Mr. WOODS. Two percent.

Senator COUZENS. What are you paying?

Mr. WOODS. We pay 2 percent on savings accounts. The average country banker, before the postal savings competition became so great, had very few interest-bearing accounts.

Senator TOWNSEND. The competition of the postal savings bank forced the country bank to pay that interest?

Mr. WOODS. Yes. The country banks cannot benefit by this deposit insurance like the city banks can because we have to compete with the postal savings. The city banks can take our money that we used to get as interest on daily balances, and they do not have to pay it. They kind of break even and, in a way, offset their expenses.

This is just what is happening in the operation of the Postal Savings system. In many towns having good banks, deposits in postal savings almost equal the deposits in the banks and where this condition exists contraction of local credits and the resulting stagnation in business are apparent.

It was confidently hoped that when the insurance of deposits became a reality that the Congress would, at least, eliminate from the Postal Savings System all competitive features, if not repeal the act in its entirety. This hope was strengthened by statements made by our efficient Comptroller of the Currency, Hon. J. E. T. O'Connor, in an address delivered at the annual convention of the American Banker Association in Chicago in 1933 and on several occasions. In his Chicago address, Mr. O'Connor, in commenting upon the growth of the postal savings, said:

> When the insurance fund becomes operative most of this money will be returned to the banks and Congress will be justified in repealing the Postal Savings Act.

Contrary to Mr. O'Connor's prediction, postal savings deposits have increased rather than decreased; the total deposits at the close of 1934 being $1,207,200,000. While all but a negligible percentage of this total is in postal savings offices in towns where one or more insured banks are located, it might be argued that the existence of the System is necessary to provide a safe depository for funds where no insured banks are located. Granting that in a few cases that is true, can it be argued that it is necessary to penalize the whole banking industry of the Nation to accommodate the convenience of just a few? To the argument that might be advanced by some that we have not gone far enough with our experiment with insurance of deposits to insure its permanency and warrant the repeal of the Postal Savings Act, we of the smaller banking cities who are suffering from what we honestly feel is an unjust and unwarranted Government competition, suggest that for the present instead of repealing the Postal Savings Act the law be so amended that the payment of interest on deposits be discontinued. In the alternative, if it is deemed the best policy to check and gradually eliminate the operation of the System, reduce the interest paid on postal savings deposits one-half and that to be paid on strictly time deposits. It is suggested that provision be made for reduction of interest from 2 percent to not over 1 percent on time deposits and prohibit the payment of certificates of deposit before maturity as the law now applies to time deposits in banks. The present rate of 2 percent was fixed when the act was passed in 1910 at a time when banks paid 4 percent and more on open deposits and although changed conditions have reduced interest rates until member banks of the Federal Reserve System are now prohibited by law from paying any interest on demand deposits, the interest on postal savings deposits has not been changed.

As an excuse for continuing the Postal Savings System, the argument has been advanced that the System is used largely by our citizens of foreign extraction who could not be trained to use our banking system. A close observation and study of the operation of the System in Texas reveals that the postal savings is patronized less in centers thickly populated by citizens of foreign extraction than in places where the foreign population is negligible. The argument also is sometimes advanced that the total is made up of very small savings accounts, too small for the banks to handle and which remain on deposit from year to year. While the average deposit in postal savings per depositor is about $500, an investigation will reveal that a big percentage of the total amount is composed of deposits of from $1,000 to $2,500 per person; and as evidence of the activity of the accounts, it is noted that deposits during the fiscal year ending June 30, 1934, amounted to $966,000,000 and withdrawals amounted to $955,000,000. It has also been suggested by some who seem to favor the continuance of postal savings that postal savings depositors are only small depositors that commercial banks do not want and on which accounts the banks make a service charge. That argument is not correct as banks generally accept savings accounts no matter how small and charge only on the small active accounts that are expensive to handle.

In appealing to you gentlemen, who have given the matter of banking and its relation to the welfare of our people so much of your time and consideration, to give us relief from this unwarranted competition, I am sure that I express the sentiment of every banker in the country who has felt the damaging effects of its operation.

In conclusion, I desire to present and file with you a copy of a resolution unanimously passed by the Texas Bankers Association at its annual State convention in Galveston on May 23, 1935, memorializing Congress to fix the premuim to be paid by banks at one-sixteenth of 1 percent and setting out the reasons therefor.

(The resolution referred to and submitted by the witness is here printed in full as follows:)

RESOLUTION

Whereas there is now pending in Congress House bill no. 7617, better known as the "Banking Act of 1935", which under title 1, Federal Deposit Insurance, provides for the fixing of a permanent assessment rate of one-eighth of 1 percent per annum, to be levied annually upon the average total amount of deposit liabilities of banks for the purpose of creating a reserve with the Federal Deposit Insurance Corporation in the insurance of deposits as provided for in the bill; and

Whereas we are not unmindful of the necessity of putting the Federal Deposit Insurance Corporation on a functioning basis by fixing a rate that would yield a sufficient amount to give ample protection under the insured liability, we can see no reason for taxing the banks for the purpose of creating unnecessary excess funds in the Treasury of the Federal Deposit Insurance Corporation, especially since the corporation at the present time has assets of approximately $350,000,000, and has the power to issue debentures in a substantial amount in time of emergency; and

Whereas the House Banking and Currency Committee in fixing the rate seems to be unaware of the fact that the banks of the country as a whole during the past few years have had practically no earnings, and that over a long period of years the average earnings of banks as a whole have been less than 1 percent on total deposit liabilities; and

Whereas in considering this matter, it is evident that after the serious crisis through which the banks have passed involving heavy losses which have not yet been completely written off, with increasing taxes and with the present tendency toward declining earning power, there is a great need for net earnings in the banks with which to write off losses currently and build up depleted capital structures; and

Whereas it is obvious that every dollar that is transferred to the Federal Deposit Insurance Corporation to lie idle in its reserve is a dollar taken out of the lifeblood of the banking system, where it could be put to work for the strengthening of the individual banks and the banking structure as a whole; and

Whereas the administration recommended to Congress an assessment of a twelfth of 1 percent per annum on total deposits, and the House of Representatives saw fit to raise this assessment to an eighth of 1 percent per annum without permitting the corporation to assess a lesser amount; and

Whereas the bill affects large and small banks alike, and the raising of the assessment to one-eighth of 1 percent per annum and making same mandatory works a particular hardship on the small banks of the country by imposing this additional burden upon them at a time when they are least able to meet it: Now, therefore, be it

Resolved, That this association in convention assembled go on record as opposing in strongest terms the action of the House of Representatives in making mandatory the assessment of one-eighth of 1 percent per annum od total deposit liabilities of banks; and be it further

Resolved, That the Secretary of this association be instructed to wire our Senators and Congressmen of its action, and that the representatives of the individual member banks of the association be urged and requested to wire or write their Senators and Congressmen, setting forth the injustice of this assessment; also urging their influence, support, and vote in fixing the rate at one-sixteenth of 1 percent per annum which, in our judgment, would yield sufficient revenue to meet the requirements of the corporation.

(The witness withdrew from the committee table.)

STATEMENT OF J. J. THOMAS, VICE GOVERNOR FEDERAL RESERVE BOARD, WASHINGTON, D. C.

Senator GLASS. You are familiar with the pending banking legislation, and if you care to express any view on the problem, the committee would be very glad to hear from you.

Mr. THOMAS. I am somewhat familiar with it. I do not think I should take up the time of the committee to go into detail, and I do not know of anything that I can offer that would add to what has been said. It would seem to be presumptuous to try to add to anything that Dr. Miller and Governor Hamlin have said. I would say that I am in harmony with the objectives of the bill.

Senator COUZENS. Do you think title II ought to be enacted now?

Mr. THOMAS. I am inclined to feel as Mr. Hamlin does, that we should patch the roof before it rains. I think there are things in that title that will be needed if the time comes. No one can tell when that will be.

Senator GLASS. What is there in the bill that cannot be as well done under the existing act?

Mr. THOMAS. I think, open-market operations, principally, that we do not have power over now. I think that authority should be centralized in the Board. I think it is not a regional bank operation. I think it is a system operation that affects the entire country as a whole, and is not a regional matter. Therefore I think authority ought to be in some central body representing the public's point of view rather than the bankers'.

Senator GLASS. You differ, then, with the unanimous verdict of the Board in March 1932?

Mr. THOMAS. I was not a member of the Board at that time.

Senator GLASS. I say, you differ with the unanimous action of the Board in 1932?

Mr. THOMAS. If that does not agree with what I have said now, then I differ: yes.

Senator GLASS. I wanted the record to indicate that.

Mr. THOMAS. I am in harmony with what Mr. Hamlin said.

If that is all the committee cares to ask, there is another matter that has not been brought out. It is in title III. I should like to call it to your attention. It has reference to interlocking directors between banks and also between institutions that are engaged in the sale, purchase, and handling of securities. We are sending a recommendation which differs from what is contained in the printed bill.

The original Clayton Act prohibited interlocking directors between banks having resources aggregating more than $5,000,000; also in cities of more than 200,000 inhabitants. The act excepted certain banks, but as to others, was absolute in its prohibition.

Later Congress enacted the so-called "Kent amendment" which vested the Federal Reserve Board with discretionary powers to permit interlocking directors in certain cases provided such banks were not "in substantial competition."

In 1928 the act was again amended so as to authorize the Board to grant permits for interlocking directors if, in the Board's judgment, it would not be "incompatible with public interest."

We found a great deal of difficulty in understanding what that means or in agreeing upon a policy or arriving at some standard by which we could measure what was "incompatible with public interest" in a given case.

Under the interpretation of our Legal Division we gradually took in everything, and there are some twenty or thirty different factors which have been considered under various circumstances in trying to ascertain what was "incompatible with public interest." Furthermore, it has been very difficult and unsatisfactory to administer from Washington.

We have recommended that the law be amended so as to prevent interlocking directors between two or more banks in all cases whether or not they are located in the same town, and regardless of the size of the bank or the town.

If the Senate does not feel it should go that far, then we would like to have the law amended so that we can decentralize its administration and have the applications acted upon in the first instance by the Federal Reserve banks.

I am in favor of more autonomy, so far as administration of the Banking Act is concerned. If we are going to pass on applications individually I think they should be originally passed on by the Federal Reserve banks under rules and regulations adopted by the Board, to insure uniformity, and permitting appeal or review.

Senator GLASS. So you are in favor of giving regional banks some authority?

Mr. THOMAS. Yes. I want to give them some work.

Senator GLASS. Do you think it is incompatible with the public interest for a regional bank to determine how to use the reserves of member banks, which involves also the deposits of the member banks?

Mr. THOMAS. I think this, Senator. The money of the banks belongs to the public, and it is recognized. Otherwise we would not regulate the banks.

Senator GLASS. What public?

Mr. THOMAS. The depositing public.

Senator GLASS. It belongs to the depositors, does it not?

Mr. THOMAS. The depositing public; and the directors are handling other people's money, just as we are, and I think the same principle applies to the Interstate Commerce Commission. The Commission does not own the railroads, and the Government does not. They are privately owned, but they are charged with the public interest; and I think the money and credit system is just as much charged with public interest as are the railroad systems.

Senator GLASS. The Interstate Commerce Commission cannot change a rate without due notice and public hearing, can it?

Mr. THOMAS. Perhaps not.

Senator GLASS. Is not that a fact?

Mr. THOMAS. It is a fact. But they can change it. They regulate even more than that; they regulate the character of service, and things of that kind; they tell a road whether it can discontinue a branch, and so on.

Senator GLASS. Railroads are not regional, are they?

Mr. THOMAS. No. I do not think a national banking system ought to be regional, either, excepting so far as the ordinary banking functions are concerned. I think the proper function of banking should be regional, and for that reason I recommend that in passing upon interlocking directors' applications they could handle it better than we can from Washington; but I think when it comes to policies that are national in scope, they should be under the ultimate control of some body which represents the public. You may call it a political body if you want to, but that is the way I feel about it.

Senator GLASS. Let me ask you one other question. You say you are in sympathy with the objectives of the bill. Did you have any part in its preparation?

Mr. THOMAS. None.

Senator GLASS. Did you see it until it was sent up here and printed?

Mr. THOMAS. No; I think not. We were meeting the same day on which it was printed and introduced, and we were to have a meeting to consider it, but I think that inadvertently it was introduced without that. But we have discussed it considerably since then.

Senator GLASS. Since then?

Mr. THOMAS. Yes.

(The witness withdrew from the committee table.)

STATEMENT OF M. S. SZYMCZAK, MEMBER OF THE FEDERAL RESERVE BOARD, WASHINGTON, D. C.

Mr. SZYMCZAK. Mr. Chairman and gentlemen of the committee, it seems essential to preserve our regional Federal Reserve System, which consists of 12 Federal Reserve banks with 9 directors in each bank, together with a Federal Reserve Board in Washington. In this particular respect, our System is different from that of most countries because of our extensive area, and because of our political and economic structure of States and districts, based upon industrial, agricultural, commercial, and financial conditions and needs which are widely different in the various parts of the United States. The System is composed of essential parts. These parts, however, must be cohesives for the best functioning of the System.

To make for an efficient administration of the act by the System and to arrive at the purposes for which the act was passed by Congress, it appears necessary for the Federal Reserve Board to have a more direct contact with the various sections of our extensive area.

To be effective, the whole Federal Reserve System must be one. This end is not difficult to attain; personal contact of the members of the Board with the directors of the 12 Federal Reserve banks seems one of the best direct avenues.

Bank powers of the boards of directors of the 12 Federal Reserve banks should be retained, and in some respects increased and extended, at least by regulation of the Federal Reserve Board.

While of course it is sound to have the Federal Reserve Board and its principal offices in Washington, and while it is sound for the board to hold its meetings in the capital because of the national scope of its considerations, yet it would be desirable from a practical standpoint for the Federal Reserve Board to meet at least four times a year in at least four parts of the country—the East, West, North, and South—to meet with and understand better the directors of the Federal Reserve banks and their officers; as well as the conditions and needs of commerce, industry, agriculture, and finance in the respective districts. It would also seem wise to provide by law that each member of the board should be assigned by the Federal Reserve Board to the task of keeping himself especially familiar with conditions in at least two of the Federal Reserve districts each year, in order that he might act as a liaison officer between the Federal Reserve banks, their directors and officers, the representatives of commerce, industry, agriculture, and finance on the one hand, and the Federal Reserve Board in Washington on the other hand. Provision could be made to have members of the board rotate in their district assignments, so that eventually each member of the board would have covered by direct contact all of the sections of the country and would know their needs thoroughly. Without this it is next to impossible for the board members to appreciate fully the needs and requirements of the Federal Reserve banks and of the country as a whole; without this the Federal Reserve Board inclines too much to theory and bureaucracy; without this there is bound to be misunderstanding between the Federal Reserve banks and the Federal Reserve Board leading to differences of opinion on authority; and without this a cry is heard on the one hand that the private interests wish to control the system and direct its operations for their own selfish purposes; and that on the other hand political interests wish to control the system and direct its operation in accordance with their own political ambitions.

Members of the Board, when assigned by the Board to several districts, would keep personally in touch with the boards of directors and the officers of the Federal Reserve banks in those districts. They would thus become familiar with the management of such Federal Reserve banks, with their viewpoints, and with the problems of their districts. They would also know men in the industrial, commercial, agricultural and financial fields of the districts. They would not be compelled to depend entirely on the Board's staff for information having to do with the internal management of the banks, as well as with the general agricultural, commercial, industrial, and financial banking conditions of the districts; thus there would be a better opportunity for sound and practical rulings of the Board on all questions when they are presented by the banks to the Federal Reserve Board under the law. It is specifically stated in the act that the Federal Reserve Board has general supervisory responsibilities, but in order to supervise, one must be in direct contact with those supervised. Otherwise, one is compelled to act upon information obtained from other sources.

Of course in all cases the Board, as a whole, would act officially on all these matters, but the Board would have the benefit of the information obtained by the individual member assigned to the specific district.

It would also seem desirable to have the boards of directors of the Federal Reserve banks meet once every year with the Federal Reserve Board in Washington, or, if this could not be accomplished, with the directors who are farther removed from Washington, the Federal Reserve Board could arrange to meet them at a point more accessible at least once every 2 years to discuss frankly and completely matters pertaining to the operation of their banks and the conditions in their districts, as well as problems of a national character.

The execution of many of the powers vested in the Federal Reserve Board could, under the provisions of the Banking Act of 1935, be decentralized under regulations of the Federal Reserve Board so that they could be carried into effect by the Federal Reserve banks without the reference of many individual matters to Washington, and thus obtain desirable and effective administration. This will be facilitated by the provision in the bill authorizing the Board to delegate its powers to individual members or other representatives.

To make for a constancy and a permanency of the work of the Board by its individual Board members, I recommend that there be a specific requirement in the law that the Board assign its work to individual Board members, each Board member to have a specific task assigned on which he is to specialize and through which he is to keep in touch with the Federal Reserve banks and the country, and on which he is to report to the Federal Reserve Board with recommendations. This seems to me to be very important, from the standpoint of good administration.

It has been my experience that the Federal Reserve Board does not wish to, nor should it, assume any more powers than it can properly use for the effective administration of the System, and whenever powers are granted to the Federal Reserve Board having to do with matters that could be handled better by the directors and officers of the Federal Reserve banks, the Federal Reserve Board should be able to give the 12 Federal Reserve banks the power of determination of many important matters.

It is good organization for the Federal Reserve Board to recognize this fact and to avail itself of the commercial, agricultural, industrial, and financial experience of the directors of the 12 Federal Reserve banks, as well as the technical and banking experience of their officers, who are the vehicles through which the policies of the System are executed.

There are many powers now in the Federal Reserve Board, however, which in my opinion should be placed in the regional Federal Reserve banks. This would expand the authority and responsibility of the directors of each Federal Reserve bank and make for more prompt and efficient administration of the Federal Reserve System. The general supervision should be retained, but the direct and ultimate action in these matters should be taken by the directors and officers of the Federal Reserve banks.

The detailed matters which might be delegated to the Federal Reserve banks (or the Federal Reserve agents, if their offices are not abolished) include the following:

1. Admission of State banks to membership in the Federal Reserve System.
2. Expulsion of such banks from membership for violations of the law or the Board's regulations.
3. Waiver of 6 months' notice of voluntary withdrawal of State banks from membership.
4. The granting of voting permits to holding-company affiliates of member banks.
5. The revocation of voting permits for violations of the law or the regulations.
6. The issuance and revocation of permits authorizing officers, directors, and employees of member banks to serve not more than two other banks (if the provision for individual permits is not repealed as proposed in the bill).
7. The issuance and revocation of permits for officers, directors, and managers of security companies to serve as officers and directors

of member banks (if the provision for individual permits is not repealed as proposed in the bill).

8. The granting of trust powers to national banks.

9. The cancelation of such powers at the request of national banks.

10. Approval of reduction of capital stock by national banks (if the requirement of the Board's approval is not repealed as proposed in the bill).

11. The granting of permission for member banks to invest amounts exceeding their capital stock in bank premises or in the stock of corporations holding their bank premises.

12. The approval of the establishment of branches by State member banks (if this power is transferred from the Comptroller of the Currency as proposed in the bill).

13. Authorizing national banks to establish foreign branches.

14. Authorizing national banks to invest in the stock of banks or corporations principally engaged in international or foreign banking.

15. Permitting interlocking directorates between member banks and foreign banking corporations in which they own stock.

16. Approval of compensation of officers and employees of Federal Reserve banks.

In addition to the above, where action by the Board is required under the law, numerous matters are presented to the Board for consideration in connection with banking supervision and requiring action on individual cases; for example, reductions of capital stock of State member banks, consolidations of State member banks with other banks, and whether or not individual banks should increase the amount of their capital and surplus in relation to their deposit liabilities. In some cases of this character the Board has already authorized the Federal Reserve agents to act on its behalf in the individual cases within certain prescribed limitations.

Some, or perhaps all, of the powers enumerated above, and perhaps others too, it seems to me, should be vested directly and ultimately in the Federal Reserve banks. This would make for efficiency and good relation between the Federal Reserve Board and the Federal Reserve banks. It is quite natural that the Federal Reserve banks know more about that subject matter because they are directly and constantly in contact w'th it. It is also natural, however, that the Federa Reserve Board should supervise and coordinate and bring to the attention of the Federal Reserve banks any incorrect or improper administration of these powers. This would make for unity.

Therefore, in view of what I have already stated, it seems that the chairman and Federal Reserve agent of the Federal Reserve banks should be retained, because this is consistent with the purposes of the framers of the Federal Reserve Act, namely, that the Board should have an official representative at each Federal Reserve bank to directly supervise the operations of the bank. It seems that in the minds of the framers of the act the chairman was apparently to be the supervisor of the bank as a representative of the Federal Reserve Board. Actually the governor appointed by the board of directors of the bank has been the chief executive. By consolidating the offices of chairman and governor, the governor would be mentioned for the first time in the act, and would be designated as the chief executive of the bank, and since he will also be chairman of the Board, he will report to himself. At the same time, however, the representative of the Federal Reserve Board at the Federal Reserve banks is eliminated.

Some say that under the pending act the combination of the two positions takes away powers from the directors of the Federal Reserve banks because the Federal Reserve Board would have a veto power over the appointment of the governor and chairman. The fact of the matter is that the chairman and Federal Reserve agent, appointed under the Federal Reserve Act by the Federal Reserve Board, would be eliminated and the directors of the Federal Reserve bank would appoint the governor, and when the governor is approved by the Federal Reserve Board, he would become a class C director. The vice governor, who would also be appointed by the directors of the bank subject to the approval of the Board, might also be appointed a class C director by the Board. This would leave the Federal Reserve Board only one additional class C director for appointment as compared with six class A and B directors elected by the member banks, and two class C directors selected by the board of directors and approved by the Federal Reserve Board.

Here it seems to me we are getting away from what was originally intended by the framers of the Federal Reserve Act, namely, that the chairman of the board, the head of the board of directors of the Federal Reserve bank, be likewise a representative of the Federal Reserve Board, and that the Federal Reserve Board, of itself, and not upon recommendation of the class A and B directors, appoint three directors of the nine at each Federal Reserve bank.

Also by having the Governor feel that his appointment rests with both the directors of the bank and the Federal Reserve Board, we divide responsibility, and, therefore, we divide authority over the chief executive officer. This places the Governor in a dual position. This is another reason why I should prefer to have the chairman and Federal Reserve agent retained.

An effective relationship between the directors of the regional banks and the Federal Reserve Board in Washington can be accomplished if individual members of the Board are each assigned several Federal Reserve districts with which they must keep constantly in touch, especially on matters affecting the relation between the Board and the banks.

Proper assignments of districts among the Board members should be directed by law. This might be done by some modification of the proposed amendment authorizing the Board to assign specific duties and functions to designated members of the Board or its representatives.

I agree with the recommendations made by Dr. Miller, with some modifications, with reference to making the Board further independent, except that I feel that the chairman and vice chairman of the Board should be designated by the President.

At the present time the President designates the Governor of the Board without the advice and consent of the Senate.

His term as a board member should not expire with the expiration of his term as chairman. The Secretary of the Treasury should continue as ex officio member, but not as chairman of the Board. The Comptroller of the Currency should be continued on the Board as an ex officio member. Both the Secretary of the Treasury and the

Comptroller of the Currency should have no vote on the Open Market Committee.

Under the bill, authority for open market policy is taken away from the Federal Reserve Board and the directors of the Federal Reserve banks, and the governors, and is placed in a committee of five, a majority of whom are members of the Federal Reserve Board.

It would seem that a better method would be to have the governors make recommendations on open market policies. However, actual determination of what these open market policies should be seems to be a national and not a local question. Therefore authority should be vested in the Federal Reserve Board. The Board should receive information from the Federal Reserve banks and should not act until after it has received proper advice and guidance from the Federal Reserve Bank directors through their governors. Power should be granted to these directors, if they object to open market policies, to make objections to the Federal Reserve Board in writing, and opportunity should be provided for hearings before the Federal Reserve Board, but final determination of policies in any case should be with the Federal Reserve Board.

I understand that Governor Eccles has made a recommendation to this effect. I should, however, like to suggest that all 12 of the governors constitute the committee to advise the Board on open market policies. They should be allowed to choose any method of procedure they think best.

It is generally assumed that the Federal Reserve Board is responsible for open-market policies. Few people, even today, are aware of the fact that the present open-market committee consists of 12 men who represent the 12 Federal Reserve banks, and that the Federal Reserve Board merely approves or disapproves, but does not initiate open-market policies. Few people also realize that each Federal Reserve Board has the right to refuse to participate in an open-market operation after it has been adopted by the 12 Governors and approved by the Federal Reserve Board. It may be contended that the Federal Reserve Board should not have this power because it is in Washington, the Government's capital, and because its members are appointed by the President with the advice and consent of the Senate. It may be said that political pressure might be used against the Board and that the Board might be influenced by such pressure in its monetary control. On the other hand, it is argued that the Governors are appointed by the directors of the Federal Reserve banks, six of whom are elected by member banks—private interests—and that such Governors may be guided in determining open-market policies by the private interests of the member banks, and not by national needs and requirements of the country. Both views are most extreme.

Authority must be vested where responsibility rests. That is logical. With 3 of the members of the open-market committee consisting of Federal Reserve Board members and 2 of Federal Reserve bank governors, the open-market committee would be construed to be the Federal Reserve Board without the Board actually having any authority over open-market operations. But since open-market policy is a national question, authority as well as responsibility for this policy should be located in one place, and in the Federal Reserve Board, which is a national body.

Senator GLASS. Whence are the funds used in open-market operations derived?

Mr. SZYMCZAK. From the member banks. I come to that point later, Senator.

Senator GLASS. Proceed.

Mr. SZYMCZAK. This seems to be in the essence of the purposes of a Federal Reserve Board. This seems to be the surest way of establishing the fact whether the System or the Board is, or is not, functioning in accordance with the purposes for which it was created. It removes the opportunity for excuses.

Of course, the Board would feel that its own research organization should be extended and strengthened and given more active functions to perform and the membership of the Board would feel the need of keeping more closely in touch with current developments which might affect open-market policy and the interpretation thereof, but the Board would be in far better position to determine when and in what circumstances to initiate an open-market policy on the basis of a coordinated view of all the factors entering into the monetary situation—reserve requirements, discount rates, lendings of member banks, the Government's fiscal policies, etc.,—and could take action promptly on its own responsibility in whatever direction seemed best to meet the needs of the situation at the time. However, to make the parts of the System more cohesive a provision might be made for a sufficient representation of the regional banks on this committee for the sake of unity in the System so long as the tendency is in the direction of making the System one and not two.

In the interest of unity, the Open Market Committee might consist of the 6 appointive members of the Board and 5 Governors—the 5 Governors to be designated by the 12 Governors of the 12 Federal Reserve banks and to be chosen from five sections of the country, namely, the North, South, East, Middle West, and the Far West. While the Secretary of the Treasury and the Comptroller of the Currency might continue as members of the Board they should have no vote on Open Market Committee policies. Their membership on the Federal Reserve Board is valuable in many respects, but the Act might provide that they have no power of a vote on open market operations, but might be called by the Open Market Committee for information that the committee might wish to have in the consideration of adopting open market policies.

I also recommend the striking out of the following words from the suggested amendment on the objective of the System:

As to promote conditions conducive to business stability.

I agree with Dr. Miller also with slight amendment, that the offered amendment on eligibility of discounts be amended to read as follows:

"Notwithstanding any other provision of law, when it deems it in the public interest, a Federal Reserve bank may recommend, and by an affirmative vote of not less than five of its appointive members, the Federal Reserve Board may authorize any Federal Reserve bank, for limited periods to be recommended by the Federal Reserve bank and prescribed by the Board, but which may be extended by the Board from time to time upon application of the Federal Reserve bank, 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 upon recommendation of the Federal Reserve bank."

My recommendation places in the Federal Reserve banks the power of making the request.

Of course, I can understand that this Banking Act offers much opportunity for extreme interpretation. However, with the amendments offered, it seems to me to meet existing conditions and to serve a definite purpose without being extreme in either direction. It deserves at least having each section considered on its merits. It seems to serve the definite purpose of a better administration of the Federal Reserve Act.

Senator GLASS. Did you have any part in the preparation of this bill?

Mr. SZYMCZAK. No, sir.

Senator GLASS. Did you see it until it was printed?

Mr. SZYMCZAK. No. I saw certain parts of it from time to time, but I did not see it as a whole until it was printed.

Senator GLASS. I note that in March 1932 Governor Eugene Meyer suggested, with respect to membership on the Board of the Secretary of the Treasury and the Comptroller of the Currency, that it might be well to permit them to be continued as ex-officio members without vote.

Mr. SZYMCZAK. I did not know that he made that recommendation.

Senator GLASS. I note that you have, in a modified form, made the same recommendation.

Mr. SZYMCZAK. Yes, sir.

Senator GLASS. What is your reaction to the suggestion of Dr. Miller that the Federal Reserve Board be constituted a board of governors of the Federal Reserve System?

Mr. SZYMCZAK. I think that is very sound. I think the suggestion is a very good one.

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

(The witness withdrew from the committee table.)

Senator GLASS. Is there any other banker here from Texas who desires to be heard? (No response.)

Senator COUZENS. I move that the hearings be closed.

Senator GLASS (after conferring with members of the subcommittee). The committee has determined to close the hearings, there being nobody representing groups of people who seem to desire to be heard. So that we will close the hearings for the present, and I think finally.

Mr. CZERWONKY. Senator Glass, would you like to hear from an engineer? I have some information here that is vital on this bill, and I want to have an opportunity to put it into the record or present it before the committee.

Senator GLASS. You may present it for the record, and if the committee deems it of the same importance you think it is, it will agree to put it in the record.

Mr. CZERWONKY. I would surely appreciate it. It would take about half an hour. I think it would change the opinion of some of the members of the committee. This is an engineering and scientific approach to the problem.

Senator GLASS. It would have to be very scientific and very superior engineering to change the minds of any of the members.

Senator COUZENS. I move, Mr. Chairman, that his brief be placed in the record.

Senator GLASS. Without objection, if, after examining the brief, we determine it ought to go in the record, we will place it there.

The committee will go into executive session at this time.

(Whereupon, at 3:05 p. m., the hearings were concluded and the subcommittee went into executive session.)

STATEMENT SUBMITTED BY HUGO E. CZERWONKY,[1] 705 EIGHTEENTH STREET NW., WASHINGTON, D. C.

Answer to the questions: (3) Does the banking bill of 1935, with amendments that have been proposed, remedy the defects in our present money rules, and (4) How can this banking bill be strengthened and made more effective.

The object in the first stage of this treatise was to explain why changes in our money rules were necessary. The last part, answer to questions 3 and 4, was to center the attack on the best methods (technique) which might be utilized.

There was no thought in the presentation of the preceding or subsequent material to publicly express opinions, but to give those who are interested in economics and economic liberty a factual analysis of why our economic system breaks down, and why it will continue to break down until certain changes are made in our money rules. There was no intention to attack the "new deal." The President has all along indicated his receptiveness to constructive criticism.

My special purpose in appearing before your committee is to offer an amendment to the banking bill which I believe will materially strengthen it, add something constructive to it. Before stating the amendment, copies of which I will later give each of you, I would like to refresh your minds on the mechanics of the bill as it appears at present.

There is provision therein which permits the Board to alter the reserve requirements or reserve ratio. The authority to increase the reserve requirements is intended to prevent an expansion of bank credit which would be injurious to those members of society who receive fixed return on investments (owners of bonds, mortgages, etc.) or fixed incomes. As Governor Eccles has mentioned before this committee, the member banks, with the reserves that they now have, could expand credit by approximately 20 billions of dollars if there existed a demand by industry or individuals for loans, and provided the bankers were willing to make the loans. The discretionary power, therefore, to increase reserve requirements is well taken under present conditions.

There exists power in the Banking Act should it later become necessary, for the Board to likewise decrease the reserve requirements below what they are today should this be justified. There always exists then within the power of the Board to permit an expansion of bank credit, providing a combination of necessity of loans (necessity of expansion) within the Nation and a demand by entrepreneurs or individuals for loans exists. These conditions provide for a solution of one-half of the problem.

Should, however, there exist a need for expansion of the flow of dollars within the Nation, a need to ease the market as economists might say, but no demand for increased loans, then the Reserve Board is empowered to resort to open-market operations, buying United States bonds from member banks and exchanging therewith dollars in currency or credits subject to check. The member bank would then have its reserves increased, enabling it to make new loans to others. The resorting of the Reserve Board to the purchase of United States Government bonds does not, however, provide any positive assurance that the new dollars or bank credits will be put to work (loaned to others), that they will be spent for goods or services on wants which otherwise would go unsatisfied. If banks cannot

[1] The writer is a member of the engineering profession with more than 10 years of practical experience in engineering, sales, and advertising, 6½ years acting as technical advisor (sales engineer) on the processing of products through labor-saving equipment. For 2 years he was on the faculty of the University of Wisconsin, college of engineering, extension division, as instructor in statics and dynamics. For approximately the past 2 years he has been engaged full time in scientific research in the field of economics. Part of this research was at Government expense, and part at his own expense. The approach to the economic problem was dynamic and not static, viewed from the physical concept of flows and changes of flows.

find a place where they personally believe they can profitably and safely invest them, even at lower interest rates, cannot find entrepreneurs who desire to use them or individuals to borrow for current consumption of goods, then business instability will set in. The net result of open-market operations is to influence an increase in demand for goods, not assure increased demand.

As you gentlemen well realize, there is a distinct difference between trying to influence the attainment of an increased flow of dollars for goods, and taking conscious measures to see that increased flow takes place; the latter can be accomplished without price inflation.

With the new powers, controls available in this legislative act, it is impossible to maintain business stability. This bill within itself lacks the definite, drastic double-edged means of action to control the situation. The method of performance is weak. The apologetic statement "so far as such purposes may be accomplished by monetary and credit policy" is well taken. The controls authorized herein must be supplemented by another instrument, outside this measure, governmental works projects financed by bank credit expansion. Budget deficits balanced by governmental borrowings; the Government undergoing an interest-bearing obligation to the commercial banking system of the Nation. The latter is the direct means for reinforcing the flow of dollars.

A direct method of expansion, or direct method of inducement to create expansion of credit, should be incorporated in this banking bill; a method which is not made inoperative by failure of Congress to approve governmental Budget deficits; a method which would for one thing result in a positive impetus by entrepreneurs for credit when the expansion is necessary to maintain business stability; a direct method which would work hardship on no groups or individuals in society, which would result in cooperation by all parties concerned—generated through the motive of gain. With this added feature in the banking bill there need not ever be another general business depression.

The maintenance of the flow of dollars and adjusting it when necessary is the vitalizing factor which keeps the wheels of industry turning—the water which motivates the turbine wheels—and the method of accomplishing this must be positive. Failure to adjust and maintain the flow accounts for our economic system getting the way it has, out of order.

Section 2 of the banking bill as now drawn has some constructive proposals, such as powers to raise or lower the reserve ratio; power to raise or lower the discount rates; and wider eligibility of paper for discount, bu t the main device, open-market operations, is not an effective instrument of monetary and credit control. Those who are advocating open-market operations as the instrument for maintaining industrial stability have overlooked the importance of the indirect method of "capital" formation which in the main characterizes our economy.

A recovery which shall be accompanied by continued business stability cannot come through makeshift tactics or devices. The tools must comply with sound scientific principles.

The statement of Mr. Aldrich before this committee, challenging the theory that under conditions which have existed in this country the volume of bank credit can be stimulated by open-market operations, substantiates my scientific contentions of the inadequacy of these working tools. He (Mr. Aldrich) recalled that between March 1932 and November 1933 the Reserve banks bought $1,600,000,000 of Government obligations in open-market operations, and that the effect in the beginning was to relieve strain on the member banks, but there was no proportionate stimulation of the growth of bank credit, one of the purposes of the operations.

Let me cite you another instance as recorded in Credit Policies of the Federal Reserve System, page 221, by Dr. Hardy. "The purchase of securities by the Reserve banks has somewhat more effect on the volume of credit than have changes in the rediscount rate, but its primary incidence is on the rates charged in the open market. It does not produce corresponding changes in the amount of credit taken by businessmen. Reference has been made to situation in 1924. In the 12 months from October 31, 1923, to October 31, 1924, the Reserve banks increased their open-market holdings from $296,000,000 to $784,000,000, yet during that time the total of Reserve bank credit outstanding decreased by $130,000,000."

Governor Eccles in his appearance before this committee flatly said he did not believe the stock of the 12 Federal Reserve banks should be held by the Government. He pointed out that the powers of management are "the important matter rather than who owns the bank." I concur with the Governor in his statement, providing the powers (instruments) granted to management under either set-up are identical. A management without power (the proper tools) is impotent, no matter how good their intentions or capabilities. This bill as it is written, with amendments suggested or requested by Governor Eccles has not the instruments within it that are as effective as if ownership resided in the Government, but by properly drawn amendments it can be made as equally effective as the latter, and without doing injury to private bankers or stockholders. My personal belief is it could even be made superior in performance to a bill as it is now drawn, pending in the committee, with Government ownership of the 12 Reserve banks as its objective. This amendment I now offer in the interests of the public and of the banks to assure effective and workable banking legislation.

AMENDMENT TO TITLE 2 OF THE BANKING BILL OF 1935 (THE FLETCHER-STEAGALL BILL)

An account known as the "business stability account" shall be caused to be set up in the Federal Reserve System [2] by the Federal Reserve Board, and be subject to control by this Board. (It is the purpose of the business-stability account to supplant open-market operations as the instrument for maintaining business stability within the Nation.)

To the business-stability account of the Federal Reserve System shall be caused to be debited:

(1) Such total number of dollars as are credited by member banks to entrepreneurs as a result of negative interest rates on loans when these rates are authorized by the Board;

(2) Such total number of dollars as are credited to member banks for services rendered on loans involving negative interest rates when these rates are authorized by the Board; and

(3) Such total number of dollars as are authorized by the Reserve Board as grants to be credited to the account of the Federal Government.

The total number of dollars credited to the Federal Government as grants shall be expended with minimum delay by the Treasury, in accordance with previously drawn recommendations by Congress. In general these dollars are to be used for promoting education, scientific research, the arts, and for such other public projects as Congress may hereafter specify.

It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses in such manner as to maintain business stability and promote full employment.

EXPLANATION OF OPEN-MARKET OPERATIONS FROM CREDIT POLICIES OF THE FEDERAL RESERVE SYSTEM, BY DR. HARDY, PAGE 229

"When it is desired to ease (increase the flow of dollars) [3] the market, securities are bought and the discount rate is lowered. The lowering of rediscount rates by itself would give some incentive to banks to make added use of their rediscount facilities. But the fresh money which comes into the reserves of member banks on account of the open-market purchases makes it their immediate problem to find uses for new money rather than to increase their balances by rediscounting. Under such circumstances the practical alternatives are either to buy securities, to increase open-market loans, or to pay off rediscounts * * *. In the converse case, when sales of United States securities are made in large volume the banks lose reserves. They cannot sell securities except to one another, nor can they quickly collect any substantial amount of their outstanding loans. Consequently they borrow, at least temporarily, to replenish their reserves, and the higher rates which are exacted at such times have no apparent restrictive effect."

[2] This means the 12 Federal Reserve banks.

Illustration of the principle of negative interest rates as suggested by Hugo E. Czerwonky; purpose, an instrument to promote business stability

Amount of loan	$1,000
Length of term ... years	12
Rate of interest ... percent	—3
Annual payments tendered	$70

Annual periods	Tendered annual payments	Interest, —3 percent	Total paid on principal	Amount of principal still unpaid
1	$70.00	—$30 00	$100 00	$900 00
2	70.00	—27.00	97 00	803.00
3	70 00	—24 10	94 10	708 90
4	70 00	—21 25	91.25	617.65
5	70 00	—18 50	88.50	529.15
6	70 00	—15.80	85.80	443.35
7	70.00	—13 30	83 30	360.05
8	70.00	—10 80	80.80	279.25
9	70 00	—8.40	78.40	200.85
10	70 00	—6 05	76.05	124 80
11	70 00	—3.75	73.75	51.05
12	49 52	—1.53	51.05	
Total	819 52	—180.48	1,000.00	

NOTE —All calculations were made by slide rule.

BOOKKEEPING ENTRIES (JOURNAL ENTRIES) FOR LOANS INVOLVING NEGATIVE INTEREST RATES,[4] AND SERVICE CHARGES ON SUCH LOANS

EXAMPLE: An illustration of a $1,000 loan involving an annual tendered payment by entrepreneur of $70; a negative interest rate of 3 percent; a service charge of member bank established by the Board of $100:[5]

Books of member bank

Debit:		
Notes receivable (note given by entrepreneur)	$819. 52	
Notes receivably (note given by Federal Reserve System)	280. 48	
Credit:		
Entrepreneur		$1, 000. 00
Service account of member bank		100. 00

Books of Federal Reserve System

Debit: Business-stability account	$280. 48	
Credit: Member bank		$280. 48

BOOKKEEPING ENTRIES (JOURNAL ENTRIES) FOR GRANTS, AUTHORIZED BY THE BOARD, TO BE CREDITED TO THE ACCOUNT OF THE FEDERAL GOVERNMENT

Example: A $10,000 grant to be spent in accordance with previously drawn recommendations by Congress:

Books of Federal Reserve System

Debit: Business-stability account	$10, 000	
Credit: Member bank		$10, 000

Books of Member bank

Debit: Notes receivable (note given by Federal Reserve System)	$10, 000	
Credit: Federal Government		$10, 000

[4] Rate to be established by the Federal Reserve Board

[5] Service-charge rate to be determined by the Federal Reserve Board, sliding scale of rates. The $100 charge was decided on arbitrarily in order to illustrate the principle.

DEFINITION OF "SOUND" MONEY

A "sound" money is one that obeys or conforms to scientific money rules. Scientific money rules depend on the nature of the economy. We have in the United States a profits economy with "capital" formation in the main indirect. Scientific money rules for such an economy are not identical to scientific money rules in a profits economy wherein everyone is a producer, owner of "capital", and marketer of goods.

The above definition declares by implication that a money which by combination of statute and rule of thumb is caused or permitted to expand or contract only with respect to the total of any specie or combination of specie is unsound money for a profits economy wherein "capital" formation in the main is indirect.

DEFINITION OF INFLATION AND DEFLATION

Deflation and inflation arise out of a failure of a nation to adhere to scientific money rules. Deflation (in a profits economy wherein the formation of "capital" in the main is indirect) is the phenomenon resulting from the failure to maintain, or adjust to, the proper minimum flow of dollars.

Inflation (in a profits economy wherein the formation of "capital" in the main is indirect) is the phenomenon resulting because of making adjustments or maintaining a flow of dollars that are excessive.

NOTE.—To understand these definitions a person has to have a physical concept of flows when thinking of an economy.

The prime idea of negative interest rates on loans made to industry is to induce both a current expansion of flow of dollars, and an absorption of idle man-power where employment will be sustained in the community, not have to be supported through taxation. If dollars are spent on public-works projects the workers directly engaged therein lose employment when the projects are completed. This is not true when workers are absorbed by industry.

The Board should be given authority to establish the interest rates, varying them so as to induce action by entrepreneurs, be able to cope with economic conditions.

Compensation to the member bank for their services could be established at a definite interest rate (detailed schedules could be worked out, or a definite percentage of the face of the loan could be allowed for service, these charges or the lump sum being likewise debited to the business-stablility account, and credited to the account of the member bank originating the loan to industry. The entire matter could be handled in a very businesslike manner. Observe that the community as a whole, not the entrepreneur, would bear the service charge as well as the dollars accruing to entrepreneurs because of negative interest rates. This would not, however, represent a sacrifice on the part of the members of the community, maximum goods flow otherwise not generated.

The loans at negative interest rates would not be granted for refunding present indebtedness by industry, but to bring into existence an increased flow of goods, or the maintenance or expansion of industrial facilities. These loans would not be permitted excepting for purposes of "capital" formation as previously defined, and for fixed investment in goods in process. This eliminates such loans to individuals for purchasing either durable consumers' goods—homes, automobiles, radios, apartment buildings, etc.—or such loans for more perishable consumers' goods as food, clothing, etc. The board, under these conditions, should be permitted to establish such rules as would assure the loans being properly employed.

It is very likely that if the Board were addressing the problem with complete current data on the flow of finished consumers' goods and of dollars from week to week, or month to month, that the total of grants to industry during a period of a year would be a ridiculously small amount after our economic system was again functioning near capacity. Regurdless of the amount, society would be the gainer because we would be running at capacity instead of having idle workers and idle plants.

Under present conditions this method would be a very much more effective tool to get the unemployed back in their normal pursuits in industry than public works projects. If this method were introduced now, the negative interest rate could be set very high, possibly −6 percent, and then gradually reduced as business got into full swing.

Here, gentlemen, is a positive practical stimulant to employers (entrepreneurs) to provide steady work, and not an appeal to patriotism. Here is a measure providing real social security, scientifically sound.

The granting of negative interest rates in loans to industry in order to induce entrepreneurs to increase the flow of goods, compensating for the difference between the total dollars loaned and those eventually to be repaid by debiting the business-stability account, or making grants to the Government to spend as Congress shall decree, likewise debiting the aforementioned account, are not utopian panaceas. They are practical measures to positively deal with a situation in a pecuniary system wherein profits are the motivating factor, and where "capital" formation in the main is indirect. Failure to make adjustments as suggested herein will otherwise necessitate periodic writing-off of losses by industry, with consequent confiscation of property of savers (investors, endowments of our educational and charitable institutions; untold suffering to individuals through unemployment, etc.) in order to balance the bookkeeping system of the Nation.

The question will undoubtedly be asked, "For what purposes are the member bank service charges?" It should be made clear that the establishing by the Reserve Board of negative interest rates on loans in no way changes the procedure which would be followed by entrepreneurs in making loans. The individual banker in the community would continue to pass judgment on whether a loan should or should not be made. They would be held responsible to see to it that the entrepreneur repays his obligations to the banking system. For this responsibility, and the bookkeeping and check handling expenses which would be incurred, the service charge is intended.

It is not the intention that the Federal Reserve banks shall make loans directly to industry to engage in banking functions. The functions of Reserve banks and the Board are only that of monetary policy, maintaining business stability and using their offices to gain full employment of the people within the Nation.

The physical purposes for which the loans would be utilized, outside of the fact that they must be for "capital" purposes and goods in process, are of no concern to the Board. From this it is apparent that industry would have nothing to fear, that entrepreneurs would be dealing with their local banker, and not with any one person or group who had visions of a planned economy. Elimination of political domination would also be maintained.

Observe the difference to the member banks in using the business-stability account to ease the market instead of open-market operations. First, the member banks would not be forced to part with some of the their income-earning property (assets), their revenue would be sustained. Better still, they would be assured increased earnings. There is no class economics in this proposal or amendment. It is consistent with the American method of doing things, the ideal of fairness. A society as a whole working through science and the scientific professions is enabled to enjoy an increased consumption of goods (increased flow of consumers' goods has been generated and is ready for consumption) then the private bankers and their stockholders also benefit and share in the prosperity. They are not singled out as a group through open-market operations and punished by having their income or goods consuming ability curtailed. Second, the new loans would be made under more favorable conditions for the bank, the risk would be less because the entrepreneur would be obligated to repay less to the banker than he had borrowed. Third, if entrepreneurs could not be induced under any conditions to make additional loans, or provided the Board believed the funds could be more sensibly utilized by the community in making grants to the Government for encouraging science, the arts (general unemployment had been overcome), then the adjustments could still be made and business stability positively assured. This would protect the investment portfolio of the banks. Fourth, we could positively fulfill our responsibility as a creditor Nation, and some of the assets which are now owned by banks, which are practically worthless, foreign government bonds and private foreign issues, would regain their income-earning capacity, rewarding the community and the officers and stockholders of banks.

An additional advantage in the establishment and the utilization of the business-stability account rather than open-market operations in order to maintain business stability is that this would disarm all those critics of the control of the flow of money whose objections are that this bill (1) opens the way to the political seizure of the assets of the Nation, what is meant is the seizure of the income-earning assets of the member banks (Uuited States bonds), and (2) those from whom emanate the fear talks of governmental insolvency made possible by "turning debt into money through the means of a political bank.[4]

[4] Rate to be established by the Federal Reserve Board.

It would seem to me to be in the best interests of society both from a practical point of view, and public honesty to protect the private member banks in the event that a positive interest rate less than what was adequate [4] to meet expenses and allow a "fair" profit to the owners and managers of private banks were necessary in order to induce entrepreneurs to make loans at a given period of time.

Example: Let us assume that it was necessary that the member banks realize at least 2½ percent interest on new loans which were extended in order to meet running expenses, and be protected against the risk they were taking, but that a 2 percent positive interest rate was necessary to induce entrepreneurs to make loans at the given time, and decreed by the Reserve Board.

It is herein suggested then that in fairness to the member banks that the difference of one-half percent in interest be made up by the Reserve banks upon authorization of the Reserve Board, debiting the business-stability account, and crediting the member bank. (The member bank would thereupon receive a note from the Reserve bank. The face of the note would be the amount of the interest charge in dollars, and this would be gradually liquidated by the Reserve bank by extending credit for the amount of interest as it became due from year to year. These credits, what ever the amount in dollars, would extend over the period of the loan made to the entrepreneur.)

It must be remembered that timing of the additions in the flow of dollars is of foremost importance, and nothing must be permitted to stand in the way of performance, nothing which might preclude the adjustment in the flow of dollars from either the viewpoint of the private banker or the entrepreneur. The interest rate is of secondary importance to the economy as a whole. The major thing is the adjustment in the flow of dollars at the time and in the amount needed to maintain business stability.

With a profits economy functioning under scientific money rules the risk of the private banker would be minimized, but a certain margin for protection against bad judgment is necessary as well as for covering bookkeeping, check handling, and return on investment. If these charges are not met in one manner they must be met in another, or else result in an ill-managed business enterprise. The latter cannot be tolerated in so vital an institution in our economic life.

I cannot concur with the statement made by Owen D. Young in his testimony before this committee when he said, "everything which can be done by the Federal Reserve System to relieve the depression either has been done or is now being done." If he had said that everything within the limited imagination and understanding of the leaders of industry and finance, and within the powers of the officers of the Reserve System then I would agree with him.

The powers now sought by Governor Eccles should not, and I believe are not only intended to prevent another credit runaway, but for purposes of rapidly regaining prosperity. Unfortunately the instruments for effecting recovery in the banking bill are weak and inadequate; especially so now.

The Reserve Board if equipped with the proper tools (suggested in the amendment) can make it so attractive to business men (entrepreneurs) by the use of the business-stability account (negative interest rates) that they will borrow. Tactics can be employed which will remove any hesitancy, or apprehension on the part of entrepreneurs to go into debt to put the unemployed back to work, and take up some of the vast reserves which the banks are anxious to lend. The motive would be gain.

A great emergency exists today and title 2 with revisions as I have suggested should be passed without fail in this session of Congress. It will not retard, but to the contrary, speed recovery. It is a constructive plan for progress and stimulation of borrowing from our commercial banking institutions, by a group of borrowers with whom the member banks are accustomed to do business (no entrance into real estate or mortgage loans wherein officers of banks lack business experience).

If the suggestions proposed in my amendment to the banking bill are understood then open-market operations would be completely abandoned as an instrument of monetary control. The authority over reserve requirements would be used only to permit a scientific adjustment and a curb in the flow of dollars; it is very likely that member banks would maintain their minimum legal reserve. The broadening of the eligibility of paper for rediscount would be intended only to protect against runs on the banking institutions, purely for emergency purposes to protect against the accumulation of dollars by individuals through fright, etc., at any rate not as the instrument to encourgae member bank borrowing. The rediscount rate would be high to discourage rediscounting excepting

[4] Rate to be established by the Federal Reserve Board.

for emergencies. The lowering of reserve requirements would permit the adjustment in dollars as mentioned previously. The business-stability account coordinated with interest rate charged by member banks on loans would be the real tool for securing adjustment of the flow of dollars to maintain business stability; compensate for the action of indirect "capital" formation by saving within the community; for accumulations of dollars by individuals through habit or fright; for the increased flow of goods or services necessary to perform our function as a creditor Nation, a double-edged instrument. As long as general unemployment was with us the attack would be through inducement of loans to industry (negative interest rates) and not through grants to the Government.

Failure to adopt scientific money rules will undermine the political and economic structure of the Nation. We do not have to call upon social justice and morality to solve our economic problem but simply obey physical laws and combining this with common sense. These are days of grave doubts and confusion because those who are controlling our economic policies do not understand fundamentals, fundamentals in economics as applied to our present pecuniary arrangements within the Nation. Instead of business men "fighting" as Gen. Hugh Johnson recently implored them to, they should first think cleanly in terms of fundamentals and then act. Then a sound prosperity, in keeping with our democratic principles, will be attained.

Now the question will be asked, maybe it has not yet risen in your mind, How will the credit on the books of the member banks, which is the counterpart and which has been originated by debiting the business-stability account of the Federal Reserve System, be repaid (retired or cleared from the books of the member banks)?

Here again it is necessary to remember the physical concept of flows. The new dollars were originated in order to adjust for the increased flow of finished consumers' good brought about through indirect "capital" formation. As long as this flow is maintained there is no physical need for retiring the credit (the dollars) nor can the specific credit be retired excepting if it is immediately recreated in a loan to someone else within the community. To violate this principle would result in injury to entrepreneurs in general.

Now there are sound reasons why expansion of dollars justified within a nation, and effected by crediting dollars to the account of individuals, corporations, cities, or States should be repaid to the economic system as a whole, or remain as a debt to the banking system, but inasmuch as the whole community, bankers, bondholders, stockholders, wage earners, salary workers originally benefited through the expansion (or new credit emission) there is no social justification for taxing the entire community for the dollars debited to the business-stability account so that they may be reloaned to a private individual for use.

The answer to the question then is, That as long as the flow of goods is maintained the credit will rmain open (this will not interfere with the individual member banks balancing their books), as will the debit in the business-stability account of the Federal Reserve System.

The matter of maintaining an unbalanced budget, when it is necessary to maintain business stability, and meeting the deficit by borrowings from the commercial banking system which it is as mechanically correct as grants made from a business-stability account to entrepreneurs through negative interest rates or to the Government, is psychologically wrong. It is negative to the entrepreneur. He hesitates to use savings offered him for use, because he envisions Government borrowing as requiring future taxation, which in turn might seriously jeopardize his employing the savings profitably.

It should be clearly understood that in making the adjustments in the flow of dollars the Federal Reserve Board is not engaged in fixing the prices of commodities. The selection of, and the price of goods would still be a matter of individual bargaining between the entrepreneur and the individual. The Board would just be making adjustments which were necessary because of the changes in our economic structure, such adjustments which were necessary to maintain the proper relationship between the parts (between the flow of goods and the flow of dollars) to assure security of property and individual opportunity. In this everyone would be the gainer. The development of financial institutions as investment banks, life-insurance companies, investment trusts, etc., have modified our economic system over that of our earlier or more primitive period.

It will be observed that in the adoption of the amendment we have within the hands of the Board a positive double-edged instrument for maintaining business stability. If entrepreneurs do not desire loans our system can still be kept in balance.

There are some who would possibly oppose the method of making grants to the Federal Government, claiming that it would be so easy to pay debts. We would not be using the central bank credit to finance the Public Treasury. I would remind the Senators that this action is only intended to compensate the action of thrift. The latter being a process of individual self-denial, the additions would be limited.

In making the grants from the business-stability account for education, science, arts, etc., we are not fostering the theory that the people should look to the Government for support. The grants have to be made for a purpose which benefits the whole Nation, not a class, and where they will do the most good, give vitality, and stimulate progress in a democratic nation. I believe that governmental support and encouragement of scientific labors, free from political control, would repay the Nation many times over.

In conclusion, in regard to the grants to the Federal Government, let me say that it would be false to state that in the neutralizing introductions of money which are made to maintain business stability that because they are devoted to socially desirable ends we are gliding into acceptance of the theory that when the Government wants money it is not necessary to go out and borrow it, or raise it by taxation, but that it is only necessary to telephone the Bureau of Printing and Engraving to send up another truck load of money.

What we are embracing is the recognition of the fact that most of the economics we have been taught and which has been guiding our industrial leaders and legislators has been static in concept; that the theorizing did not embrace the pecuniary profit-seeking economy existing today, wherein in the main indirect "capital" formation predominates; that the classical economics while it provided entertainment; mental exercise, was but a diversion into a land of make-believe, not realistic; further that it is urgent that we protect ourselves and not subject ourselves to pummeling just to prove we can take it; further that if we continue artificial production control we are frustrating science and the possibility of attaining the higher standard of living which science can provide, yet if we eliminate production control with our present unscientific monetary rules we will again be fighting between ourselves in the dark, which will lead inevitably to despair; finally, that our trouble does not arise fundamentally through error or misjudgment on the part of managers of the banking system, but a failure to know the money rules, have the instruments to carry them out, and use them, all of which cannot be righted by firing the present managers.

The business-stability account is a recognition of the fact that we are in an economic system wherein "capital" formation in the main is indirect, a recognition that investors will only be rewarded provided the entrepreneurs can dispose of the goods in general offered for sale and recover money costs; a recognition of the fact "capital" formation is induced by the entrepreneur only if he believes he can use the dollars profitably which are offered to him.

Gentlemen, in effecting the change in the banking system which is recommended in this amendment we are not destroying or modifying democracy. Rather, we are just adjusting the functioning of our money system to the complex industrial organization (indirect "capital" formation), which did not exist in the simple life of an earlier day. There is no need to alter the fundamental form of our society. There is a great difference between putting in 8 hours at work and doing 8 hours of work as anyone versed in industrial activity can attest to from personal observation and experience. It seems a personal incentive of gain is needed to bring out initiative and ambition in individuals. It is then "gain" which is the mainspring. And even then, only comparatively few are capable of planning their own work to good effect. This requires an expert knowledge in production methods, organization ability, and marketing for which entrepreneurs are paid. It is this mainspring (gain), which this amendment protects.

By effecting the adjustment recommended herein the paralyzed state of the market for new bond and stock issues will be remedied because those receiving income in excess of what they need for their own gratification will be induced to invest their dollars (the profit motive will be the inducement), and entrepreneurs will be induced to use these dollars for "capital" formation. By these methods the heavy industries will receive the needed impetus for revival.

As long as we have an unsound money system (one which does not obey scientific money rules) all the benefits arising out of regulation of securities will be for nought (at least lessened) because under those conditions the most honestly financed industries cannot be assured to give a reasonable return to the investing public. Further, even should we succeed in restoring prosperity it cannot be maintained, made permanent.

The proposed amendment represents the simplest and easiest method of meeting the new conditions and of eliminating the check (leash) on production. If industry were to have but this one objective in its platform, striving for it unrelentlessly with all the energy it is dissipating on trying to counteract consequences arising from this abuse it would quickly enjoy the prosperity, freedom of action, which have been realized but in rare intervals. If these leaders of industry will but think this problem through, instead of engaging in but wishful thinking or the establishing of production rules which science and human inventiveness will quickly wreck, they will put an end to our economic paralysis.

This is not an "easy" money doctrine, but a positive instrument to guarantee against a repetition of the disaster which took place in 1929. I believe that the amendment is conservative in the sense that it is practical, and that it is liberal in the sense that we are no longer living in an era (economy) wherein everyone owns his own "capital", produces, and markets his product, and we are meeting todays problems on theorizing and methods adjusted to the practical facts of today.

Our economic and social security is dependent on sustaining (freeing) our productive machine and these measures provide the simple instruments for accomplishing that end. This amendment prevents the exploitation of legitimate business, the savers, and the workers in industry. This it is the right and duty of Government to adopt. These measures remove the artificial brakes upon individual initiative and enterprise through which alone private employment can be expanded. It would then be possible to discontinue those temporary measures as the National Recovery Administration and Agriculture Adjustment Administration, and grant the fullest practicable freedom for the individual to conduct his business without interference by the Federal Government.

I maintain that by reason of failure of Congress to exercise its constitutional right, which is mainly due to the ignorance of its members in dynamic economics—the physical implications of indirect "capital" formation in a profits economy—the constitutional right of citizens as guaranteed by the amendment to the Constitution, article 7th, is being and has been constantly violated. This article literally interpreted means that no person shall be deprived of life, liberty, or property without due process of law. When a Congress fails to see to it that its money system obeys scientific money rules then it is collaborating, not willfully, but none the less, in confiscating the property of individuals without due process of law, depriving individuals of incomes from investments which property through the inactions of Congress is made worthless, and is depriving individuals of the opportunity to earn a livelihood or their economic liberty.

We have had a depression not because of the selfishness of man, the cussedness of industrial leaders, or the dishonesty of bankers. The way to recovery is not through moral regeneration. We must not look at this problem from a sentimental viewpoint because that will hamper our vision. Nor have labor-saving devices, or the World War, or tariffs been the fundamental cause of this depression as some people would like to have us believe. We are undergoing this depression not because we are bankrupt as far as resources are concerned—manpower, plant, technical training, and raw materials—but because we have money rules which are scientifically unsound. They will pull us down again unless they are made scientifically sound. There is no need for privations. Our master, whether we be business men, workers in industry, widows who clip coupons, or farmers in the field, is ignorance. Rout this and we tread forward steadily with the advance of science.

Gentlemen, I repeat that it is my contention that provided the Reserve Board is granted full power and responsibility to initiate, adopt, and enforce open-market operations it is still impotent to cope with the problem in the most efficient or effective manner, and with the least possible disturbance to our economic system. The instrument is as crude in the performance of its function as attempting to hit a baseball with a broom handle.

I am in accord and in sympathy with centralizing the responsibility for the exercise of the powers which control the establishment of business trends, but deplore the ineffectiveness of the controls, and favor the substitution of more effective methods. To fix or "nail down" the responsibility is excellent, but the body (the Board) should be equipped with the proper tools to perform the task.

I offer my amendment to provide these double-edged tools. I believe that it is in keeping with the principle and spirit of the Constitution as stated in the preamble, as an effective means to assure justice, domestic tranquility, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity.

GENERAL REMARKS

There are some bankers who are protesting a greater measure of control. To those who would suggest amendments to the banking bill which would retain most of the existing autonomy of the Reserve banks with proportionate lessening of powers for the Federal Reserve Board the expression "some men learn and live, others only live" can be fittingly addressed.

If you would write a prescription directing that a research moratorium be declared; of stopping progress, then you need only sit by and permit things to take their course. That is resignation to defeatism at its worst, and not statesmanship. Those of us in the engineering profession who understand the problem do not intend to follow such a procedure, but will subject intimate beliefs and practices which are employed to scientific scrutiny, helping in whatever manner we can to effect practical remedies.

It is short-sighted for the officers of banks, or their stockholders to consider their business as a purely individualistic enterprise. The functioning of money is a matter which concerns every individual, and every corporation and every business, large and small. These new measures safeguard the banker against the evils which have repeatedly been his undoing, and will continue to do so, overcoming his best judgment. What bankers should do is to concentrate on the design of instruments of control which will be most effective to maintain business stability. Unless they cooperate and agree to reasonable measures the Government will have no other alternative but to purchase the stock of the Reserve Banks.

It is true that the Government owns not one dollar of stock in the Federal Reserve banks, but it has a vital interest in their proper functioning. With these measures the member banks are not being forced to lend their money to an entrepreneur or to the Government, nor are they being dispossessed of their property.

If giving the power and the instruments to a body within a nation which will enable our industrial machine to operate and enable it to continue to operate at full speed, free from governmental meddling, free from regimentation and snooping; and which will grant ample work opportunity to our people and enable them to regain their self-respect (economic liberty); which will permit the full expression of human initiative and curiosity; which will enable free selection of goods by individuals; which will assure steady profits to entrepreneurs and protect the investments of individuals against confiscation; which will provide a firm basis for security in old age; if giving powers to a body which will assure this is a grant of despotic power it surely is a benevolent form of despotism. Control we now have, though unintelligent. We are just substituting more scientific methods.

The establishing of negative interest rates by the Reserve Board would be in the public interest in order to—

(1) Restore and maintain the economic liberty of the individual citizen within the Nation, open up work opportunity sufficient to enable him to gain a wide selection of work, and under remunerative conditions;

(2) Maintain domestic peace and tranquillity, minimize industrial disputes and their accompanying disorders;

(a) Cutthroat competition eliminated;

(3) Prevent the taking of the property of investors (savers) without due process of law;

(4) Remove the obstructions to the free flow of interstate and foreign commerce, permit foreign citizens and nations to repay their obligations to our citizens, and gain the widest selection of goods; and

(5) Permit science and the scientific professions to fulfill their function as a benefactor of society.

It is a step which is necessary because of the nature of our economy, a profits system wherein, in the main, "capital" formation is indirect. It maintains the Reserve system as an agency intended to accommodate industry, commerce, and agriculture not in a passive, but in an active roll. There is nothing "planned" about it excepting that the system is made to conform to scientifically sound principles.

If the method of negative interest rate on loans were undertaken now and acted as a tax, increased the price of consumers' goods over what they would otherwise be, it would be constitutional in that it did not discriminate against anyone, but was borne by the public in general. The recuperative efforts would be in a manner consistent with the authority granted by the Constitution, acting as a stimulus in starting the forces making for expanding commercial activity.

It would be an inexpensive method of relieving the burden of relief, much more inexpensive and effective than public works projects.

Our present money rules in this Nation became obsolete from the inception of the industrial revolution in the late eighteenth century, but the evil effects were not so pronounced then as they have recently become because we were primarily an agricultural Nation. We were a Nation wherein individuals in the main performed the triple role of (*a*) producer of goods, (*b*) capital owner, and (*c*) marketer of goods.

Mechanization and indirect "capital" formation developed slowly. It was only beginning about the middle of the nineteenth century that decided progress began to be made in the practical application of scientific discoveries. But upon the beginning of the engineering professions in the last quarter of the nineteenth century and the accompanying research which followed, the importance of scientific money rules were destined to play an increasing role, and failure to adhere to them to cause depressions of increasing severity.

Scientific money rules grew in importance with the industrial development of this Nation because industrial efficiency demanded specialization and large expenditures for equipment and goods in process; this required the pooling of large quantities of dollars from savers scattered all over the Nation.

The rapid development of investment banks, life-insurance companies, investment trusts, and the further developments in science and the scientific professions and the increased specialization in industry since the establishment of the Federal Reserve System have intensified the need for obeying scientific money rules. The repercussions which follow their violation now intimately effect everybodys welfare. We no longer can run away and hide ourselves in an environment where we can barter goods and services; nor is there a need for following such an unintelligent procedure.

We cannot hold on to the present money rules without suffering periodic business convulsions, confiscation of property of individuals and widespread unemployment. The banking bill of 1935 is intended to cope with this problem, prevent the undermining of our economic system. Unfortunately, the instruments of control are weak.

Please understand, gentlemen, that I am not expounding or endorsing the theories of Major Douglas—the A+B theory. I maintain that under our present monetary system (the present money rules) the flow of dollars may be sufficient; may be in excess; or may be deficient to enable the disposal of the flow of finished consumers' goods in general offered for sale at prices covering the total of money costs (plus a fair profit) incurred in their production.

It must always be borne in mind that the primary object of making the expansion of dollars is not to create employment, but to adjust the stream of dollars so that the flow of goods is not impeded, so that finished consumers' goods in general offered for sale by industry can be disposed of remuneratively. The purposes for which the expansion of dollars are utilized (used) is of secondary importance.

The adjustment of the flow of dollars is vital to prosperity, outside the control of industry, but not of the community or Nation. Good and bad trade in general are but conditions resulting from ignorance of the community in knowing how to control or adjust the flow of dollars. We can, of course, permit supply and demand to work themselves out, but not without periodic convulsions within the Nation. By exercising a positive control over the flow of dollars the simplest and most effective instrument is being utilized over economic environment.

It cannot be overemphasized that in order to understand the functioning of our economic system we must have the proper physical concept, not only in terms of flows (flows of goods and flows of dollars) but also in terms of changes of flows. Then we must bear in mind how these changes in flows of goods are effected. We are in an economic order which is based on the private ownership and operation of industry, conducted for profit. The formation of "capital" is, in the main, indirect (the savings of individuals are utilized for "capital" formation only providing an entrepreneur is assured that he can make a profit through the use of the savings—can make a profit off of new plants, machinery, etc.). Then we must bear in mind that in the production of all goods that minister directly to the satisfaction of human wants (consumers' goods) the attainment and maintenance of an increased flow involves a fixed investment in "capital" as well as a fixed investment in consumers' goods in the various stages of fabrication. Finally, if we would understand our present predicament we must understand the institutional arrangement and present money rules which govern expansion and contraction of dollars (must understand the functioning of our commercial banking system).

It should not be so difficult to see what physical actions are necessary to counteract the instability caused by the indirect method of "capital" formation. The latter results in an adjustment in the flow of goods (an increased flow of consumers' goods) in which—the increase in flow—definite money costs are borne by entrepreneurs, and which costs must be recovered in goods in general offered for sale. No one questions that stones are sure to fly if he kicks them, or that he is certain to be injured if he fails to leap out of the way of an auto which is bearing down on him. Then why stand by idly and be punished for violating the physical factor of indirect "capital" formation instead of positively correcting (adjusting) the flow of dollars so that the increased goods flow can be disposed of remuneratively.

(The following statement is from Robert B. Warren, economist of Case, Pomeroy & Co., New York City, who was invited to appear before the committee to speak for a large number of political economists in protest against title 11 of the pending banking bill. Hearings having ended before Mr. Warren was called, the chairman of the subcommittee is presenting his statement for the record:)

STATEMENT OF ROBERT B. WARREN, NEW YORK CITY, N. Y.

In one sense, the Banking Act of 1935 is a routine measure. In its two central themes, namely those relating to the activities of the Reserve system in what are called "open-market" operations and those defining the nature of the currency, it does no more than clarify and perpetuate de facto actualities. These de facto actualities represent gradual and evolutionary developments over the 20 years since the establishment of the Reserve System. Even those which have the appearance of innovation (specifically, for example, those defining the relation of the currency to gold) prove, upon even superficial examination, to trace their origins considerably earlier. They have developed gradually and cumulatively; and it is only by retrospection that we can recognize that the entire nature of the Federal Reserve System has been revolutionized. By a succession of small turns, each dictated by the exigencies of an immediate situation, we have reoriented our course so completely that we are now proceeding in a direction exactly opposite to that which the Congress, under the leadership of President Wilson, laid out 20 years ago.

The original Federal Reserve Act was devised to give the United States an effective gold standard. The proposed Banking Act of 1935 is devised to give the United States a managed currency, almost completely divorced from gold. But in the twenty-odd years between December 28, 1913, when President Wilson signed the Reserve Act, and the present time, the original act had been so amended, its basic principles so obliterated, the actual relation of the currency to gold so obscured, that when the people of the United States and the Congress of the United States are presented with a bill definitely and finally renouncing (I might almost say, denouncing) the basis of the original act, it is presented by the drafters and accepted by the Congress, the financial community, and the people, as a routine administrative measure. Such objections or suggestions, or even questions, as have been offered at these hearings have mostly related to matters of detail—whether a given board should consist of X members or Y members, whether a given type of credit should be X percent or Y percent of a given sum.

It may be that I exaggerate the importance of monetary problems in the function of government and functioning of economic society. But I cannot regard a fundamental change in our monetary policy as a routine matter. Nor has Congress previously so considered it.

The passage of the original Federal Reserve Act was far from a routine matter; although it involved no fundamental change from the familiar and long-established monetary system. The Congress of that period considered the matter of sufficient importance to provide first for an elaborate study of prevailing systems, practices and theories, and second, a deliberate debate upon every major item of the bill. The record of the study was published in the encyclopedic report of the National Monetary Commission, which I venture to say a century hence will still be studied and quoted as a compendium of the monetary wisdom of the race.

Cynics often quote the philosopher Hegel: "What experience and history teach is this: That peoples and governments have never learned anything from history, nor acted on principles derived from it." But for once at least Hegel was wrong; for the Congresses of that period, when they undertook that major legislation, drew upon history, and were guided by it. As I said before, the original

Federal Reserve Act involved no basic change in our money system, yet Congress deliberated over it for a good part of a decade.

The definitive abandonment of metallic money and the adoption of what is called a managed currency is a major decision, in comparison with which the passage of the original Reserve Act was simple. That involved no more than the perfection of a familiar and well-tried standard. The formal adoption of managed currency carries the United States into the unfamiliar and the experimental.

Mere abandonment of the gold standard does not create a managed currency. It might create instead monetary anarchy. The concept of managed currency, from Aristotle to the present, has run through a long history. There is a long and controversial literature on the subject. The fact that irredeemable paper has tried many times in many countries, and invariably with consequences ranging from the unfortunate to the disastrous, has never deterred adventurous minds from speculating on the possibilities of an ideal money, free from the vagaries of the prospector's pick.

Since 1929, several of the theories of the managed currency school have been put into effect, notably, artificially low discount rates and large open-market operations, both prior and subsequent to our abandonment of gold. In no case, was the economic consequence comparable to the indicated hopes of the proponents. This would suggest that something was lacking either in the theory or the technique. But neither the debates in the Capitol nor the hearings on the bill have adverted to that obvious, if disagreeable, fact, nor raised the question as to why it should be expected that certain monetary devices which had produced such mediocre results in the past should be expected to produce superior results in the immediate future.

Furthermore, certain economic results which in the past have been claimed for managed currencies, such as the control of the price level, were expressly disclaimed in the testimony before the House committee. Since the claim to the control of the price level is perhaps the commonest and most persuasive argument of advocates of managed currency, this disclaimer must disappoint the hopes of many persons who had believed in this act, Congress was creating a money of such constant value as would permanently establish equilibrium between the status of debtor and creditor. Since the argument that a managed currency can control the price level has usually been rated as the chief reason for adopting it in preference to the gold standard, it seems appropriate to question whether this hope is to now be regarded as vain, or whether the disclaimer is to be understood as remarking a defect in the bill under consideration. If the former be the case, the presumed advantage of adopting managed currency is brought into doubt; if the latter be the case, the bill should be perfected. I do not advance these comments so much in criticism of the proposed measure, as to emphasize my contention that the whole question of establishing a managed currency is one of considerable intricacy; that exponents of managed currency are by no means in agreement either as to its possibilities or its mechanics; and that the bill under consideration far from being a routine measure, subject to debate only in its details, is a piece of major legislation which deserves the investigation and deliberation accorded previously to major acts of legislation.

If my first point is simple—namely, that Congress should thoroughly explore basic question of whether or not a managed currency should be adopted in preference to some other standard, my second is even simpler. The adoption of a managed currency involves the delegation to the managing authority one of the fundamental attributes of sovereignty. It would seem needless to emphasize the fact that it endows this authority, whether termed a board or a committee, with the power to create and to annihilate money. It endows this board or committee with the full power to issue "money and regulate the value thereof." Our Constitution, as recently interpreted by the Supreme Court, expressly gives this power to Congress. It is not to be supposed that this should be interpreted to require of Congress attention to the details of administrative routine; nor to prohibit Congress from delegating details of administrative routine to its qualified administrative servants. For example, Congress has never directly conducted the operations of the mint; it has delegated the actual minting of coins to appropriate administrative officials, acting strictly under authority delegated to them by Congress.

But the power granted under this act far exceeds any power previously delegated by Congress. Under the provisions relating to open-market operations, it absolutely delegates to this group of administrative officials, full power to issue money and to regulate the value thereof, not according to terms and principles strictly defined by Congress, but at their personal discretion. It is true that the original Reserve Act authorized open-market operations; but it authorized them only under strict limitations imposed and defined by Congress—namely, that all currency, whether notes or deposits, issued under such discretionary power, must at all times be kept interchangeable with the standard of value prescribed by the Congress itself. It has been decided that Congress has authority under the Constitution to alter the standard of value. It is for constitutional lawyers to question the authority of Congress to delegate to a group of administrative officials the powers to issue money and regulate the value thereof at their discretion. I will question the economic expediency of endowing any committee of administrative or quasi-administrative officials with such a delegation of sovereignty, except in the limited capacity and with the limited authority of agents of Congress.

To me, the much-disputed composition of the open-market committee, whether it should be composed of X members from this group and Y members from that group, or of Y members from this group and X members from that group, is a mere quibble over a routine detail. The essential fact is that if this committee is the agent of Congress, its qualification requires no more than that it should scrupulously, diligently, and with technical efficiency execute the will of Congress. If, on the other hand, this committee is not the agent of Congress, then we must concede that Congress has abdicated its prescribed function and has delegated to this committee the soverign power to issue money and regulate the value thereof; and in that event, the composition of the committee still seems to me a secondary matter. I should be equally dubious of the economic merit of intrusting 5 individuals or 7 individuals or 10 individuals with the sovereign power to issue money and regulate the value thereof, at their discretion, whether the individuals appointed were bankers, college professors, farmers, or any mathematical combination thereof. Nothing in my reading of monetary history, or in my experience in financial affairs, has led me to the conclusion that any committee of economically omniscient supervisors exists, to whom could be delegated discretionary power to issue money and regulate the value thereof in such a way as to insure a system equal to, or superior to, the gold standard.

Yet if Congress delegates this sovereign power to a committee as its agent, it seems to me imperative that Congress define the terms and powers of the agency—that it should prescribe guides and standards of action for its agents—in order that their administrative discretion may not conflict with the intent of Congress in issuing money and regulating the value thereof.

Thus I return to my first point. It required long study and arduous debate on the part of Congress to devise the original Federal Reserve Act, which delegated to the administrative officials of the Reserve System relatively simple and limited powers available within the canons of the gold standard. It is an infinitely more difficult thing to frame an act governing the operations of a managed currency. Whether one considers it a merit or a defect, the gold standard, as defined under the original Reserve Act, imposed strict boundaries and limits to discretionary action. Under the system contemplated by the proposed act, all the old boundaries and landmarks are swept away and the area of discretionary action infinitely widened. Assuming the intent to abandon the gold standard to be final, the task before Congress is to set up new norms, standards, and criteria for the guidance of a committee of administrative agents, to guide them in their delegated functions, to the end that their administrative action may conform to the will of Congress in the matter of issuing money and regulating the value thereof.

But I find in the bill under consideration no such concept. In the bill, as presented, Congress is called upon to delegate to a committee its full sovereign power to issue money at their discretion and to regulate the value thereof at their will, except for such reservations of power as are left, not in the hands of Congress but in the hands of the Executive.

My objection to the bill, therefore, does not lie against its details but against its essentials. It is, perhaps, superfluous for me to affirm my personal belief in intrinsic money as contrasted with currency which represents a mere monetization of debt; and to reaffirm my opinion that the original Federal Reserve act, the fruit of years of congressional study and debate, was infinitely superior to the novel forms that in the past 20 years have been superimposed upon it, including the present bill. In this, I do not believe I am stating an individual idiosyncrasy; I believe I am supported by a considerable body of opinion, both academic and practical, impressed, as I am, by the records of monetary history. But I take it that these views are the views of a minority, and that by the majority they are regarded as out of keeping with the age. Evidently it is the intent of Congress and of the people of the United States to complete the break with the monetary past and to establish a new system in the hope that the new system will be better than the old. If this be the case, I can only offer my opinion that the success of the new, difficult, and untried system will be proportionate to the study, deliberation, and debate expended by Congress in determining its principles and establishing norms, standards, and criteria for the guidance of those administrative officers to whom, under Congress, will be delegated the power of issuing money and regulating the value thereof.

(The following statement is from Prof. Walter A. Spahr, economist of New York State University, who was invited to appear before the committee to speak for a large number of political economists in protest against title II of the pending banking bill. Hearings having ended before Dr. Spahr was called, the chairman of the subcommittee is presenting his statement for the record:)

STATEMENT OF WALTER E. SPAHR

1. There are no circumstances calling for legislation dealing with the fundamentals of the Federal Reserve System at this time. It appears to be assumed by the advocates of title II of the bill that the proposed changes will enable the Federal Reserve banks in some better manner to aid business recovery. In reply to this apparent assumption, it may be pointed out that there are no powers which a central banking system can employ in aiding a sound business recovery that are not now possessed by the Federal Reserve banks. The arguments for the passage of this title II must, therefore, rest upon other grounds.

The proposals in title II deal with far-reaching fundamentals and should not be undertaken until after a commission of competent experts has made a thorough study of the money and banking problems of this country and, on the basis of adequate evidence and after careful deliberations, has drafted a plan which offers real promise of providing this country with appropriate and workable money and banking systems. Both systems have suffered sad mutiliation in recent years; and what is needed now is careful and deliberate overhauling and reconstruction, rather than further mutilation and distortion such as will result if title II of this bill is passed, particularly since efforts are being made to force its passage in an atmosphere characterized more by a tense emotionalism than by careful and searching examination of the fundamental principles underlying our money and banking problems.

The monetary legislation of 1933 and 1934 was enacted without giving opportunity for careful or comprehensive consideration by the appropriate committees. Some parts of the legislation received no committee consideration. The Emergency Banking Act, for example, was rushed through all legislative stages in a single day. Few members of Congress had an opportunity to read it. Some of the other measures received, at best, only perfunctory consideration. Sometimes parts of bills were scattered among 3 committees in the House—those on Banking and Currency; Coinage, Weights, and Measures; and Ways and Means—and 2 committees in the Senate—Banking and Currency, and Agriculture. These methods of rushing through legislation, which the Administration at the time insisted was pressing in nature, have made it impossible for Congress to give careful consideration to fundamentals and to various implications of much of this legislation. We thus have on our statute books money and banking laws of such a hodge podge nature that it is imperative that a careful study be made in order to give this country a rational money and banking system. To add the provision of title II to the existing chaotic collection of money and banking statutes, many of which either have an emergency character or are fundamentally unsound, would be quite unwise, especially since there are no pressing circumstances which call for such a radical change in the fundamental nature of our Federal Reserve System.

The 3-year limitations in the Gold Reserve Act expire on January 30, 1937. The act provides that authority shall continue for 2 years with power to the President to extend it for a third year. Undoubtedly the Administration will come forward with legislation to be effective at the expiration of the 3-year period. January 1937, is a logical time in which to consider legislation of a permanent character, which will preserve good features of the new laws but eliminate unsound provisions. If a commission were appointed by the end of the present session of Congress, it would have a year and a half in which to make its investigations. There would not be sufficient time before the session of Congress of

1936. It would be unsatisfactory also to attempt to enact new legislation in the year of the Presidential campaign. Conditions for a proper consideration of the subject would be more favorable in January 1937, after the Presidential election has taken place.

There should be no legislation at this time beyond that necessary to correct technical difficulties, or to remove crude inconsistencies, in existing laws. And even this type of legislation should be undertaken only upon the recommendation of the Federal Reserve Board and in strict accord with specific proposals drafted by the Board.

2. There are other reasons why legislation dealing with the fundamental nature and functions of the Federal Reserve System should not be passed at this time. These are found in the nature of the principal notions which obviously surround the proposals embodied in title II and which provide the excuses for attempting to enact them into law at the present time.

Running throughout the arguments of practically all advocates of title II is the fundamental notion that our money and banking systems were primarily responsible for the depression and also that recovery can be aided, if not actively generated, if only our money and banking systems are changed.

Both notions are fallacious. The depression was caused by the World War and the attendant maladjustments which it created. Abnormalities of almost every kind crept into our economic system after the war as a result of the efforts made to avoid the painful readjustments which the economics of the situation demanded. One of these abnormalities assumed the form of credit inflation. It resulted from the prevailing notion that through installment buying and cheap credit the prevailing apparent prosperity could be maintained indefinitely. Those were the days of the "new era" economics. The stability of the price level, maintained in the face of what we now know were unsound underlying conditions, mislead most people. Only because the commercial banks and Federal Reserve System went long with the notions of the day were they partially responsible for the depression. But the prevailing notions of the day were Nation-wide; they were part of the "new era" economics; they were all part of, or in harmony with, the devices employed to maintain production at an artificially high level on the assumption that a painful readjustment could be avoided. The Government, as well as business men, banks, retailers, and consumers, was responsible for the prevalence of those notions. The whole Nation was involved. Therefore, to single out the money and banking systems, and especially the banks and the bankers, as being responsible, is hardly rational.

In addition to the fact that the World War and the attendant maladjustments were fundamentally responsible for the ultimate collapse, two other lessons should stand out as warnings to the advocates of title II. One is that the price level was maintained at a very steady level from 1923 to 1929, and the other is that underlying it and bolstering it up was a huge credit inflation which finally collapsed. Despite these facts, the chief advocates of title II propose to restore these same conditions, and they wish to employ the same general methods. They wish to inflate the currency to obtain the price level which they think desirable—and this usually means that of 1926—and then they expect to keep average prices at that level by currency manipulation. To do this they hold that the Federal Reserve Board and banks should be brought under the control of the party in power so that these notions as to inflation, price-level stabilization, and currency control can be made effective.

Stated briefly, the lessons as to the causes of the depression do not appear to be clearly understood by the advocates of title II (and of similar proposals) and their notions as to how to generate a sound business recovery involve the reemployment of some of the very devices which contributed to inflation and the collapse and which would lead to a repetition of the same things.

These advocates, who hold our money and banking systems primarily responsible for the crash and who believe prosperity can be aided or generated by changing these systems, also seem to forget that the depression, like the war, was almost world wide. They forget that regardless of the type of money and banking systems in vogue, the depression came and currency systems collapsed. They also appear to ingnore the fact that the losses and sufferings were most severe in those countries in which the central banks were brought under the control of the Government and paper money issued. These lessons seem to have no meaning to the advocates of title II who would bring our Federal Reserve System under the control of the party in power and provide the means by which inflation can take place through the conversion of illiquid assets into deposit currency or legal-tender Federal Reserve notes.

These advocates also fail to understand how a sound business recovery starts itself, and just what part a Government and central banking system may play in aiding a sound recovery. They do not understand that a rise in the price level which accompanies a sound recovery is radically different from the rise in prices which is caused by currency inflation. They do not seem to appreciate the fact that the former is a sound rise in prices and the latter is an unsound one. In short, it is quite clear that they do not understand that there are two types of rising prices, that the causal factors in each case are different, that the reactions of people to each type of rising prices are different, and that the economic consequences flowing from each type of rising prices are very different. To them all rising prices are alike. That idea has been underlying all the monetary legislation of this Administration. Professor Warren expressed the common notion when he said "The effect of rising prices is the same regardless of cause." (See his Prices, 3d reprint, revised, p. 371.) This same confusion of thought, but in a different form was revealed by Governor Eccles, to use but one illustration, in his testimony before the House Committee on Banking and Currency (Mar. 13, 1933). Asked regarding the nature of inflation, Governor Eccles replied: "The difficulty is that so many people, when you say inflation, think it is something unsound; they think of worthless money. What I mean is that a rise in the general price level, in employment, and improvement in the business situation, from whatever it is, would be inflation, no matter how small the extent."

It should be emphasized that the causal factor in a sound rise in prices, which accompanies a sound recovery, is the increased activities of producers, particularly those in the heavy goods industries, whose inventories and costs are reduced sufficiently to enable them to resume operations at a profit. This condition comes about as a consequence of the persistent though declining purchasing which takes place during the business recession and depression. On the average 3½ years will tend to bring about such a condition; and, as a matter of fact, the middle of 1932 seemed to show that recovery was ready to start and might have maintained itself had not other strong and overwhelming factors intervened. It also should be emphasized that as the activities of these producers increase, their loans at banks increase, and deposit and other currency are drawn into circulation. It is for these reasons that the amount and velocity of currency in circulation increase under conditions of a sound recovery and are a result rather than a cause of increased business activity.

The unsound rise in prices, on the other hand, is caused by currency inflation. Indeed, inflating the currency is the only certain way known by which a currency can be made a positive causal factor in raising prices. Since devaluation of a currency is not inflation, but is the adoption of a new standard unit of less weight, there is no known predictable relationship between a given amount of devaluation and the effect on the price level. The effects of devaluation are on foreign exchange parities. Inflation takes place on the basis of the prevailing currency unit and does not affect foreign exchange parities, but it does have an effect upon the price level.

Under conditions of a sound rise in prices a feeling of widespread confidence is generated because it is based upon increased productive activity, increased employment, increased wages, and increased prices. Prices are pulled up as a result of the increased demand and because the demand runs ahead of the supply of goods in stock.

Under conditions of an unsound rise in prices, caused by inflation or the threat of inflation, a feeling of widespread fear is generated. People rush to purchase not because there has been increased production, or increased employment, or wages, or increased income, but to save what they can of their savings from the devasting effects of a depreciating currency. They draw out their savings and borrow and buy if they have property on which to borrow. It is startling to notice that the Governor of the Federal Reserve Board, in his testimony before the House Committee on Banking and Currency (Mar. 14) said it was a fear of the currency which is desired. To be more exact he said: "Inflation can only be brought about by the willingness of the people and corporations to borrow money and that is one thing we are trying to do. We are trying to induce the borrowing and lending of money upon which recovery is based. We are talking about the fear of inflation or reflation when as a matter of fact that is what we want."

This illustrates once more the fact that the Governor is confused in his thinking on these fundamental points. He does not recognize the difference between a sound and an unsound rise in prices and he fails to distinguish the causal factors in each case. It is for this most fundamental reason that the Governor's advocacy of the proposals incorporated in title II are fraught with such great dangers for this country.

Under conditions of a sound rise in prices the ultimate economic consequences tend to be a state of economic equilibrium and a condition of widespread prosperity. It is the best condition of economic affairs known to human beings. It is the condition for which we should strive. A sound rise in prices is the only kind known which need not, of necessity, culminate in an aftermath of liquidation.

Under conditions of an unsound rise in prices, caused by currency inflation, a state of economic equilibrium can never be attained; only heavy losses in some form can be the ultimate result. This disaster can take any one of three forms: (1) There will be a business collpase if inflation is halted; (2) repudiation may follow upon the extreme inflation of the currency; (3) devaluation may be the ultimate device used to peg an inflated currency in order to avoid the collapse or repudiation and to obtain a new starting point for working toward a new equilibrium. In every case severe losses are suffered; and it is for this reason that there is no sound argument which can be offered in behalf of currency inflation.

Yet the advocates of title II, in the main, overlook these fundamental facts and propose to aid recovery, which they confuse with an unsound rise in prices, by providing the means for pumping additional supplies of currency into circulation.

Another aspect of the unsound inflationist theories lying behind title II is seen in the notion presented to the House Committee on Banking and Currency by the Governor of the Federal Reserve Board to the effect that there is presumed to be a causal connection between national income and the amount of currency in circulation. The obvious flaw in this most unsound theory is that the national income of the German people must have been phenomenal as the amount and velocity of their currency reached their peak. Nevertheless, this riduculous notion, to the effect that the national income is determined in this manner, is being used by some of the chief advocates of title II as a basis for urging that it is necessary to put more currency in circulation and to increase its velocity in order to enlarge the national income.

It should be understood that in a normal expansion and recession in business both national income and currency supply and its velocity are the resultant factors; that an increased monetary income, resulting from currency inflation, as in Germany, is something radically different from an increase in real national income; and that the velocity of a currency which accompanies a currency inflation is a type of velocity differing from that associated with a sound rise in prices. An inflation velocity may be a fear velocity and is likely to be much sharper in its ups and downs than is the velocity associated with a noninflated currency. This attempt to relate the supply and velocity of currency to national income has been advanced by Governor Eccles and by Mr. Robert Hemphill, an inflationist, who recently wrote some articles for the Magazine of Wall Street (Oct. 27 and Nov. 10, 1934, issues) and for the New York American. Dr. Currie, Assistant Director of Research at the Federal Reserve Board, in his book, The Supply and Control of Money in the United States (p. 6), relates the currency supply to the country's aggregate money income and employs the concept of income velocity. This concept obviously is not the same as that of the velocity of currency, but it has confused some of those who have attempted to relate the currency supply and its velocity to national income. Real national income is not the same as national income in terms of money; and the concept of income velocity has no value in reality. Indeed, the notion has had the unfortunate effect of misleading the inflationists.

These points are mentioned so that the nature of some of the philosophy lying behind this title II may be more clearly understood. This section of the banking bill is supported in whole or in part by the ardent economic planners, by the inflationists, by the managed currency advocates, and by those who believe a government can spend a nation into a state of recovery and that the Federal Reserve System should be so adapted as to make it easy for the Government to use the Federal Reserve System to finance the former in its borrowing and spending program. The fundamental purpose, in title II, in its final analysis, is to convert the system into a politically controlled agency of the party in power so that these purposes can be accomplished.

In title II are also found misconceptions as to (*a*) the proper functions of central banking systems, especially with respect to the appropriate relation between a nation's central banking system and Government financing; (*b*) the appropriate functions and powers of the central banks with respect to the control of the money and credit supply; and (*c*) the appropriate relationship between the Government, acting in its supervisory capacity, and a properly constituted central banking system.

These false notions and misconceptions show themselves clearly in those sections of title II which will enable the party in power to control completely the personnel of the Federal Reserve Board. They are revealed in those sections which will enable this politically controlled Board to attempt to put into effect the theories of money and credit control held by many of those in power. They are seen in those sections of the bill which will enable the Government to force the central and commercial banking structures to aid the Government in carrying out its fiscal policies regardless of their wisdom, to give Government credit an artifically high rating, and to use the banking system and people's savings without their approval and regardless of the effect upon commerce, agriculture, and industry. In short, nearly all the fundamental conceptions regarding the appropriate functions and methods of operation of a well-conceived central banking system, and regarding the proper relation of the Government to such a banking system, are contrary to the most outstanding lessons learned from central banking experiences, are dangerous, and are almost certain to lead to great trouble in the future.

The analysis of the various parts of title II, given below, provides ample support for these observations regarding the nature and fallacies of the fundamental notions lying behind this title II. There is, also, some support for the bill from those who are anxious to see all our major economic institutions socialized.

3. Considering the nature of the money, banking, and fiscal theories underlying title II of this bill, and considering the further fact that there are no circumstances, insofar as a sound recovery is concerned, which demand any fundamental changes at present in our Federal Reserve System, the Senate Committee on Banking and Currency could perform no better service at this time, with respect to the proposed legislation, as embodied in title II of this bill, than to refuse to vote it out of committee. Instead, the committee should substitute a bill of technical corrections, such as those in titles I and III, embodying the recommendations of the Federal Reserve Board on specific difficulties.

It is also urged that a joint resolution be prepared providing for the creation of a National Commission on Money and Banking to gather evidence on our money and banking problems and to draft bills to provide this country with the proper type of money and banking systems. It would seem rational to have such a commission composed of the leading money and banking authorities of this country. Its membership might well be composed of (1) those members of the Senate and House Committees on Banking and Currency who have devoted years to the study of problems of money and banking; (2) the most outstanding and experienced professors of money and banking in our leading universities—men whose reputations, intellectual integrity, and capacity are beyond question; (3) outstanding bankers who are men of experience, maturity, and social vision; and (4) other students of money and banking, drawn from other fields of activity, if they are recognized as thorough students of money and banking problems.

The delay in legislation which would result from the adoption of such a program is eminently desirable. Money and banking mechanisms are probably the most delicate and, at the same time, most vital of all instrumentalities in our economic system; and it is for this reason that hasty and ill-conceived legislation in such a field is very unwise and is to be deplored. In its stead there should be substituted legislation growing out of careful deliberation by our most competent experts.

4. The following analysis of the various sections of title II of the banking bill of 1935 support the accuracy of the preceding observations.

Section 201 (a) provides the means by which the board of directors of each Federal Reserve bank will be brought under the control of the Federal Reserve Board, which, in turn, can be and doubtless will be politically controlled. This means of control is found in the fact that the governor and vice governor of each Federal Reserve bank can be appointed only with the approval of the Federal Reserve Board.

The governor and vice governor can come from any district. In this manner the Federal Reserve Board can, for practical purposes, inflict any outsider on a Federal Reserve bank as governor or vice governor. The Federal Reserve Board could state to any board of directors of a Federal Reserve bank that unless a certain individual is appointed by the directors none other will be approved by the Federal Reserve Board.

Since the governor and vice governor are approved by the Federal Reserve Board, and since two other class C directors, other than the Governor, are representatives of the Federal Reserve Board, the Government can have four representatives as against the present three, since the vice governor need not be appointed a class C director. Why the office of deputy chairman is not combined with that of the vice governor is not clear unless the purpose be to enlarge the number of Government representatives on the board of directors of each Federal Reserve bank.

It is to be noticed also that "all other officers and employees of the bank shall be directly responsible" to the governor of the board of directors. This gives him the powers of a czar, and through him the politically controlled Federal Reserve Board can reach directly and arbitrarily down to every employee in every Federal Reserve bank. This means, of course, that the political authorities can reach any employee they please. In this manner every employee of every Federal Reserve bank can and may lose his independence and become, like the Federal Reserve Board, an unwilling vassal of the political party in power. The powers of classes A and B directors can be crippled if not nullified under such a system, since the Governor of each Federal Reserve bank is given this authority and is a Government agent.

Today the elected governors of the Federal Reserve banks are chairmen of the executive committees and, in this manner, they have increased their powers as against the chairmen-Federal Reserve agents. This bill makes a Government agent chairman of the executive committee and thus the Government worms its way into the direct operation of each Federal Reserve bank.

The slightest reflection upon such a proposed arrangement should convince one that all activities of each Federal Reserve bank can be brought under the absolute control and domination of the political party in power. These Governors and Vice Governors may be as arbitrary as they please, so long as they satisfy the politically controlled Federal Reserve Board. In this manner the political party in power can lay its rough hands on the Federal Reserve banks and turn them into a politically controlled agent of the party in power.

Such an arrangement provides the means by which the party in power can extend its political tentacles over the banking system. And there seems to be ample evidence to support the belief that such is their intent. But should they protest that this is not their purpose, then the reply still must be that a prudent people will not put such powers within the reach of any political party. No one may assert with any assurance that the next Executive may not be of such a character that he will not take advantage of the authority which this title II places in the hands of the present Executive. When a political administration lays hold of our central commercial banking system, it has control of one of the most delicate and most vital agencies of our economic system—an agency that must be free from such domination if our economic system and our people in it are to maintain any appreciable amount of their traditional freedom. When a nation's banking system passes into control of the political power in power, the freedom of a people can speedily disappear. And certainly there is no reason to expect that better banking can or will result from any such proposal as this one in section 201 (a) of this bill. Were the Federal Reserve Board a properly constituted independent body, there might be less argument against such a proposal; but considering that the Board can be made into a subservient agent of the Government, such a plan opens the way for making a political agency out of the Federal Reserve System. Nor does Governor Eccles' recently suggested modification, to the effect that the Reserve Board should approve the Governors' appointment every 3 years, instead of annually, seem to change the picture fundamentally.

It is also to be observed that one of the class C directors shall be appointed deputy chairman of the board of directors, and that the Vice Governor may be appointed a class C director. It is because of this word "may" that the Federal Reserve Board may have four representatives on the board of directors of each Federal Reserve bank.

The duties now performed by the Federal Reserve agent "shall be performed by such person as the Federal Reserve Board shall designate." This provides the means by which the Federal Reserve Board can have another representative at each Federal Reserve bank. In this manner it can have five agents there.

It may easily be an open question whether membership on the boards of directors of the Federal Reserve banks should be restricted to 6 years. Maturity in membership may be a most desirable thing. This is a provision to which careful study should be given. Lack of continuity and tradition in Reserve policies is widely supposed to be a weakness of the Reserve System.

The last paragraph of section 201 (a), page 40, lines 17–22, permitting present incumbents of the boards of directors to serve out their terms, would seem to require a modification of these parts of the bill which provide that this section shall be effective 90 days after enactment.

Section 202 is one of those coaxing, half-hearted measures by which attempts are made to persuade nonmember banks to become members of the Federal Reserve System. Our statute books are cluttered up with these conciliatory provisions in law. This particular provision merely lowers still further the capital requirements of banks which may enter the System. At present the capital requirements are too low. And if it is believed that nonmember banks should be members of the System, then the Federal Reserve Act should be amended so as to provide that all banks should, after a certain date, be members of the System. If the capital requirements of some of the banks are too small, such banks should be made branches of larger member banks. But all legislation of this type probably should be left until a competent money and banking commission makes its report.

Section 203 provides the means by which the Federal Reserve Board can be made into a politically controlled and dominated agent of the President. Lines 1–3, page 42, of section 203 (1) deserve special attention. They may have little significance, or they may be very subtle. In any event they open the way to possible developments which should be examined. They provide that the President "shall choose persons well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies" It will be noticed that these members of the Board are to be qualified to participate in the formulation of national economic policies as well as monetary policies. Does this mean that they are to participate in the formulation of national economic policies? If this sentence means what it appears to mean, then this Board can be made a part of the planning bureaucracy of the Government, and the Federal Reserve System can become, and can be made to become, the financial agent of the Government in carrying out its planning policies. It can be made an engine of oppression rather than a neutral agent to finance commerce, agriculture, and industry.

If this section of the bill is not intended to be subtle, it at least opens the way to dangerous developments. And we should remind ourselves that these developments would be in absolute harmony with the theories of some of the chief advocates of title II of the bill. It also reveals how far removed its drafters are, in their notions of how to constitute a central bank board, from those who would profit from experience.

On this point it might be profitable for us to see what Kisch and Elkin, two of the world's best-known writers on central banking, have to say (in 1932) as to the proper relation between the state and the management of a central banking system: They say: "Just because the decisions of the bank react on every aspect of the economic activities of the country, it is essential that its direction should be as unbiased as is humanly practicable and as continuous as possible. But clearly, if the bank is under state control, continuity of policy cannot be guaranteed with changing governments, nor can freedom from political bias in its administration be assured. * * * But if the government has a controlling influence over the bank, there are obvious ways by which the most powerful interests in the country can try to enforce their wishes. The road is open for political intrigue, and there can be no safeguard that the policy of the bank will be carried on without bias as national interests require. It seems a paradox that when the object is to secure the execution of a national policy, this should not most readily be achieved by the creation of a state bank under official control; but even in the countries where the capital of the bank is held by the state, steps have been taken in certain instances to remove its administration from political influence and to give it a measure of independence from the government" (Kisch and Elkin, Central Banks, Macmillan & Co., Ltd., London, 1932, pp. 20, 23). These authors say further: "In most economically developed countries the probabilities are that the national government will be the largest individual customer of the local money market. In such circumstances it is evident that if it also controls the administration of money-market policy, it may easily find itself in an equivocal position where it may be called upon to decide between two courses, one of which may be immediately convenient to itself and the other conducive to the ultimate interest of the country as a whole. The creation of such dilemmas should be avoided" (p. 21).

There is a definite and overwhelming consensus of opinion among competent authorities that the control of credit and money supply and of the price level is not improved, but definitely weakened and endangered when governments assume or dominate the functions of central banks. The fact that nearly all leading nations in the world avoid such a device should provide strong evidence in support of the accuracy of this statement. Only Sweden, Finland, Latvia, and Russia have State-owned central banks.

The experience of Germany with the Reichsbank placed under Government control was so disastrous that the German Bank Act of 1924 opened with the sentence that "The Reichsbank is a bank independent of Government control." Regarding the unhappy experiences of the Bank of France under the domination of the treasury, Kisch and Elkin, writing in 1932, had this to say (p. 22): "There can be no question that the power of the Government to force increased loans from the Bank of France intensified the depreciation of the franc and contributed to the financial crisis that culminated in 1926."

During the war period our Federal Reserve System was under the domination of the Treasury, its policies were controlled by the fiscal interests of the Government, rather than by those of sound commercial banking, and the result was a gorging of the banks with Government bonds, an inflation until the price level reached the highest point in our history, an exhaustion of bank reserves, and finally, the collapse of 1920–21.

Reflecting upon the world's experiences with Government-dominated central banks, Kisch and Elkin remark (p. 22): "* * * if the control of the operations of the central bank lies directly or indirectly with the government, it becomes fatally easy for the government to finance itself for a time by means of book entries and short loans from the bank, a course which is the first step toward currency depreciation and inconvertibility."

Since the World War the tide has set strongly against granting the state power to interfere with the functioning of a central bank. The Brussels Conference Resolution (III) of 1920 crystalized this general feeling. It said: "Banks, and especially a bank of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance." The same statement was issued by the Genoa Conference in 1922. The independence of the central bank was a cardinal feature of the League of Nations reconstruction schemes for Austria and Hungary. As Kisch and Elkin point out, central banks have come more and more to be looked upon as analogous to large public trusts and less and less as departments of state. From the most independent central banks, such as the Bank of England and the Reichsbank (prior to the Hitler regime), there is a gradually ascending scale of government influence or control, until it culminates in the state owned and controlled system in Russia.

It is necessary and proper for a government to intervene in the affairs of the central banking system (*a*) in times of war, when the government's will must be enforced in all departments of government, business, and private affairs; and (*b*) when a national crisis occurs which makes it impossible for the bank to meet its obligations.

At other times the security and independence of the bank should be assured and unassailable, although knowledge of the affairs of the bank and of the treasury should be exchanged, since the activities of the bank and treasury affect each other. But each should be left to make its own decisions. This type of relationship has been expressed most admirably by the Deputy Governor of the Bank of England, who was recently quoted with the approval by Chancellor of the Exchequer Chamberlain in explaining the relationship between the treasury and the Bank of England (*The Times*, London, Dec. 22, 1935, p. 5): "We on our part", said the Deputy Governor of the bank, "never venture to interfere in any question which is considered a political question unless we are asked to express an opinion as to what the financial effect of any political operation may be. The treasury, on the other hand, are good enough to reciprocate. That is to say, that while we keep them fully informed as to the general trend of affairs in the city, and as to any occurrence affecting the position of finance and credit, they do not seek to dictate any alternative lines of financial policy if we, in our judgment, consider a particular line of policy essential for the protection of the country's main reserves." He also said: "The Bank of England is in daily touch with the treasury, sometimes many times a day. Probably twice in the week the Governor himself will pay a visit to the treasury * * *. We have no secrets from them."

This type of relationship seems to be the ideal one and appears to be supported by the leading authorities on the subject. Kisch and Elkin have this to say on the question (op. cit., p. 28): "The complete independence of the bank is perhaps an ideal to which countries can only approximate in different degrees according to their state of economic development and the sense of responsibility inherent in their public and particularly their commercial life." These well-known authors on central banking are representative of the best thought on the subject when they hold that, with the exception of the event of war and that of a national crisis in which the bank is faced with collapse or default, the ideal is found in removing the central bank or system as far as possible from government domination.

Although most countries give the government authority to appoint at least some of the officials to the central bank's board, such appointments or nominations are not generally intended to give, and should not give, the government any power of interference with the administration of the bank but should be looked upon as a device for insuring that the direction of the bank is in the hands of competent and disinterested men. And in no sense does this type of appointment provide legitimate ground for assuming that such men are representative of a political party or are to serve the political interests of any particular politicial group.

Since government financing is in nature an intrusion into, and often a disturbing factor in the bank's attempts to carry out the major and appropriate functions of aiding in the financing of business transactions, it is generally deemed wise to reduce as far as possible government borrowing from the bank and to limit the freedom of the government to put upon the central bank or banks its fiscal burdens. Kisch and Elkin go so far as to say (p. 37) that "* * * it is of cardinal importance that it should be made as difficult as possible for the government to resort to the expedient of borrowing from the bank a practice which, if continued, can only lead to a repetition of past disasters."

This is typical of the best thought on the question. Despite this fact, it is the purpose of the advocates of title II of this proposed banking bill of 1935 to lead this country in a direction contrary to the best conclusions of the world's leading authorities on the subject.

Section 203 (2) provides a means by which Mr. Hamlin may retire at once and Messrs. Miller and James in 1936, thus removing from the Board in a very short time, should they choose to retire and even if more arbitrary methods are not used, its three most experienced members. If this provision is to be enacted into law, it would seem that it should be so amended that all ex-members of the Board would become ex officio members of some advisory body, such as the Federal Advisory Council, in order that the benefits of the knowledge and experience of such men are not lost to the younger members of the Board. Such an arrangement could be an effective factor in developing fine traditions in central banking.

Lines 17–25, page 42, are awkard and confusing. Lines 17–22 say literally that "each member of the Board so retired from active service who shall have served for at least 5 years shall receive, during the remainder of his life, retirement pay in an amount equal to the annual salary paid" now. Thus he would receive a total pension of $12,000 for the rest of his life. How much will he be paid the first year of retirement? Or is he to be paid $12,000 in a lump sum? This sentence doubtless was intended to give the retired members who have reached 70 years of age and who have served 5 or more years an annual pension based upon the years served, the yearly amount to be determined by the number of years served multiplied by $1,000, but the bill certainly does not make this point clear. According to the first proviso, a person who has served, say, 8 years will receive $8,000 per year, and if he lives 3 years thereafter he will receive $24,000 in a pension; whereas lines 17–22 preceding the proviso would give him only $12,000, regardless of how long he lived. This proviso also omits the 5-year minimum; in line 24 the words "per annum" should be inserted after the word "pay", and in line 25 the word "served", apparently, should be inserted after the third word, "year." The entire section is badly muddled, and it should be rewritten and made to say what the authors intended that it should say.

Nor is the second proviso, page 43, clear or sufficiently specific in its meaning.

Furthermore, it is to be noted that, according to section 203 (3), every Governor appointed and removed will come in for this pension if he is 65 years of age, since he shall be deemed to have served the full term for which he was appointed even though he may have served only 1 month or even 1 day. What a great opportunity this proviso provides a President to place his friends on a fine pension for life. In 30 days he could give 30 of his friends who had reached 65 years of age a $12,000 annual pension for life. In 4 years he could develop a large pension list, all to be paid by the Federal Reserve banks. The Vice Governor apparently can have his term of service terminated by the President without the benefit of its being deemed that he had served his full term. It would appear that no member of the Board could afford to accept the office of Vice Governor.

This section 203 (3) reveals clearly the method by which a President can change the Board's personnel within the space of a week, to suit his particular wishes. This section provides specifically and openly that the members of this Board are to serve "until the further order of the President", whereas the present act includes no such provision. In fact, there is not a single word in the present act authorizing the President to remove a member of the Board, and it was expected that under the present law the members of the Board would be freed from any such interference. It has also been generally supposed that no President would presume to remove a member of the Board except for cause.

Experience and the recognized principles of central banking teach that the members of the Federal Reserve Board must be freed from risks of removal by the President, and all that is necessary to accomplish this is to write into the act the specific provision that a member of the Board may not be removed by the President except under certain specified conditions. The recent Humphrey decision (May 27) provides ample legal grounds for the incorporation of such a provision in the law. Furthermore, it would appear that the Governor and Vice Governor should be selected by the Board rather than appointed by the President.

The issue is not that of political control of the Board versus its domination by the banks, as the advocates of political control commonly assert. Those are not the only alternatives, and neither is the proper one. The correct solution lies in creating a board which would be independent of domination by the banks, by the political party in power, and by any other group that might attempt to put pressure upon it in an effort to obtain some action in its behalf. Only in this manner can our banking system be made to function in the interests of commerce, agriculture, industry, and the general public.

It would be difficult to conceive of a more dangerous provision written into any central banking law than that found in section 203 (3). The only reasonable interpretation to be placed upon this provision is that its authors and advocates propose to convert the Federal Reserve System into a political instrumentality of the party in power. Such a provision opens the way for the destruction of what remains of the independence of our Federal Reserve System, which we have tried to evolve into a useful and independent system over a period of 20 years. If every other section of this bill and of the Federal Reserve Act, as amended by this bill, were perfect, the System still could be converted into an agency of the party in power, and the bill still would be dangerous. Considering the dangers in sections 201 and 203 of this bill, the possibilities of dangers in the other sections of title II are accentuated. For this reason there are many today who oppose other sections of title II, principally because they would be administerd by a politically controlled Federal Reserve Board.

The answer to this proposed amendment to the Federal Reserve Act is that it should never be permitted to pass.

The independence of the Federal Reserve Board should be strengthened, not weakened, and our Federal Reserve System will not be what it should be until this is accomplished. Our experiences with our Federal Reserve System teach us that our Federal Reserve Board has not been sufficiently independent of the Government. The major weaknesses in the Board today center largely in the fact that it has been subject to too much interference by the political authorities.

There are various ways in which the independence of the Board can be insured. While few authorities doubtless would care to insist that their suggestions are necessarily the best ones, it would seem that considerable weight should be attached to those of Dr. Adolph Miller, of the Board, considering his great experience and distinguished service on the Board.

Everything that any central banking system can be expected to accomplish can be written in general terms into the organic banking act, and thereafter the administration of the System should be left to independent nonpolitical administrative bodies. As the Board is reconstituted and strengthened, after a careful study of the problems by our best experts, it may be found wise to remove the Secretary of the Treasury from the Board, though it may be desirable to make him a nonvoting auditor or participant in the Board's discussions; and it probably would be found desirable to have the office and functions of the Comptroller of the Currency absorbed by the Board. It would seem also that the Federal deposit insurance mechanism should be brought under the complete jurisdiction of the Board. But these are questions which can be answered with greater accuracy after adequate study has been made of the problems by a well-constituted monetary commission.

As a further observation on the question of the relation between the treasury and a country's central banking system, it may be instructive to note what the Financial News of London had to say on the subject in its issue of February 20, 1935, with respect to the independence of the Banks of England and France:

"The resistance of the Bank of France to the reflationary efforts of the Government throws curious light upon the relations between treasury and central bank. Great Britain is, apparently, not the only country where the central bank is in a position to pursue a policy of its own, which is at times at variance with the Government's policy. Although technically the Bank of France is controlled by the treasury—the governor and senior exectuive officials are appointed and can be removed by the Government—it is not always easy to impose the official policy upon the central bank. The example of M. Moret, who, in spite of the fact that he was a former treasury official and was nominated by the treasury to the governor's post, was a firm defender of the independence of the Bank of France against the treasury, shows the influence of an institution with strong traditions upon those who enter it.

"It is probable that if the executive officials of the Bank of England were to be appointed by the treasury, the result would be similar to that witnessed in the Bank of France. In a few years the treasury officials in charge of the bank would be as much under the bank's traditions as if they had grown up within its walls. Under their guidance the bank would probably retain a high degree of independence. It may well be asked, therefore, What would be the use of nationalizing the bank?"

The modifications recently suggested by Governor Eccles do not add appreciably to the assurance that the Federal Reserve Board could maintain its independence. As a matter of fact, the one thing that stands out, in all the concessions made to criticism of this provision of title II, is that care is taken to keep the way open so that the Federal Reserve Board can be converted into a political agent of the party in power. If the advocates of this section of title II really desire to see an independent Federal Reserve Board, let them demonstrate their good faith by devising the mechanism which will close the door absolutely to any possible interference on the part of the political authorities. This is probably the most fundamental issue involved in title II, and it should not be forgotten.

Section 204 appears to be free from criticism.

Section 205, creating a new type of Federal Open Market Committee, might have some virtues if the Federal Reserve Board were a properly constituted, independent board. But considering the fact that the Board can be politically controlled, this section of the bill merely provides additional means by which the Government can extend its powers over the activities of the Federal Reserve banks. It should be noticed that this amended section of the Reserve Act omits the requirements of the present law with respect to open-market operations to the effect 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. Thus the way is opened for engaging in open-market operations for purposes which may suit the political group in power and which need have no beneficial bearing whatever upon general business conditions as contemplated in the present law. Through this open-market mechanism the managed currency advocates can attempt to put into effect their ideas of controlling the volume of money and credit; the currency can be inflated for the purpose of raising prices to assist, as they think, recovery; and support can be given to the Government's credit. By means of this amendment the Federal administration can compel open-market operations to conform to their particular purposes, regardless of the principles of sound central banking and the needs of commerce and business. This is unsound in principle.

Government financing, in the final analysis, should be looked upon as an intrusion into, and a disturbing factor in, the fields of private finance. And if a well-ordered central banking system performs its functions properly, there will be many times in which it must and should go into the open money markets to combat the effects of Government financing. It is not the function of a central banking system to give Government credit a higher rating than it would otherwise have in the open money markets to which non-Government borrowers and lenders must go. It is the function of all commercial banks to give borrowers the exact credit rating to which they are entitled; and it is the function of these banks and of the central banking authorities to give Government borrowers exactly the same type of credit rating. To assume that Government credit should be given an artificially high value by a central banking system is to assume that it is the function of a central banking system to inflate the currency. This section 205 is out of harmony with what are known to be sound principles of central banking.

Although it would be preferable to have the question answered by a national monetary commission, the query may be raised as to why the Council of Governors if they are not made Government appointees, or even the Federal Advisory Council might not also assume the functions now assigned to the Open Market Committee. The Federal Reserve Board, the Federal Advisory Council, and the Council of Governors might well draft a plan for the open-market mechanism, if

Congress is determined to pass title II of this bill. To write into this bill a plan for a new type of open-market committee without consulting with the governors of the Federal Reserve banks and with the Federal Advisory Council is certainly not a commendable procedure.

It is provided by this amendment, at the time these comments were prepared (Apr. 20), that all five members of the Federal Open Market Committee will be government agents. The fact that two of the members are to be selected from the governors of the reserve banks by the governors does not change this fact since all these governors will be Government agents. The suggestion made by the Governor before the House committee to the effect 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 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 is difficult to appraise since all these men would still be agents of the Government. If the Board were an independent body then the suggestion might have merit. But considering that the Board could be a politically controlled body the suggestion would not seem to change the general picture appreciably.

With respect to the power given the open-market committee to make recommendations to the Federal Reserve Board from time to time regarding the discount rates of the Federal Reserve banks, it may be presumed that this has no particular significance unless it be assumed that the Reserve Board exercises the power of prescribing discount rates for the reserve banks. It would seem preferable that the present method of having rates initiated by the respective reserve banks, subject to approval of the Board, is preferable. But if the Reserve Board were properly constituted and independent of political influences one could appropriately advocate that the Board be given the power not only to review discount rates but to institute them when a Federal Reserve bank is clearly running counter to sound national banking policies.

Section 206, which opens the way for discounting any commercial, agricultural, or industrial paper and for advances secured by any "sound assets" of such member bank, seems to be tacked on to the preceding parts of section 13 of the Federal Reserve Act without any regard to how it affects the preceding paragraphs of that section. It would appear that most of the preceding paragraphs are nullified. Just what the law would be if this amendment were passed as drafted, would be difficult to determine. It reveals a hasty and careless type of bill drafting.

It is doubtful whether, under the best type of central banking system, such a provision can be defended. It would seem that, under such a system, this wide-open provision should at the most be reserved for emergencies.

Under a politically dominated system of central banking, as provided by this bill, section 206 provides the means by which the Reserve Board can admit to the portfolios of the Federal Reserve banks any kind of paper, regardless of its illiquidity, and fix the maturity of the paper at any distant date it chooses to adopt.

Since it is not the functions of a central banking system to accept illiquid paper, the proper restrictions against such acceptance should be set up. It is possible that exceptions to meet emergencies could be provided, with the proper penalties and handicaps attached, so that emergency transactions would not become the normal ones. But it would seem preferable to retain the true and proper commercial characteristics of the central banking system and determine whether a separate institution might not be devised to absorb illiquid paper of commercial banks in times of stress. Perhaps the Reconstruction Finance Corporation could become a permanent institution for this purpose. This is a question deserving the best attention of a national monetary commission. One thing seems clear, however, and that is that section 206, as it stands, is unsound and unwise.

Section 207 provides the means by which the Federal Reserve banks can be compelled to absorb the direct obligations of the Government or those fully guaranteed as the principal and interest by the United States, regardless of maturities. In this manner the Reserve banks can become gorged with such securities having long maturities and consequently can become very illiquid. Under a properly organized Federal Reserve Board, and with other appropriate administrative machinery, such a provision might be safe enough, because any properly constituted central banking authority would keep the amount of such securities held down to a small amount, but under the system provided in this bill, this section merely adds another unsound provision to the Federal Reserve Act.

Section 208 (1) provides the means by which Federal Reserve notes are to be issued against the general assets of the Reserve banks in addition to requiring the 40-percent reserve of gold certificates. If these assets were liquid, this provision would not be objectionable, but since the way is opened by this bill for admitting all kinds of illiquid paper to the portfolios of the Reserve banks, this section provides the way for converting illiquid assets into legal tender paper money. This, of course, means inflation and is unsound in principle.

The argument is advanced that since deposits are created against these illiquid assets there is no reason why the Federal Reserve notes also should not be issued against the same assets. The answer to that argument is that neither Federal Reserve deposits nor Federal Reserve notes should be created or issued against illiquid assets. It is not the function of the Federal Reserve banks to receive illiquid assets; and to issue Federal Reserve notes or to create deposits against such assets is an inflationary procedure and destroys the desirable elastic element in both the note and deposit currency.

Considering the fundamental importance of the questions involved in this amendment, perhaps it would be appropriate to make some comments upon the principles which should guide in creating a proper type of note and deposit currency.

The most economical currency ever devised by man is credit; and the most useful forms of such a currency are deposit and note currency. Of these, the deposit currency normally effects about 90 percent of our exchanges. Both the notes and the deposit currency function properly and meet all requirements if they are issued against reserves and self-liquidating paper, which, in turn, is based upon transactions that will, by their nature, pay off the loans which give rise to the deposit or note currency. In this manner, both redeemability and elasticity are provided, and inflation is avoided. And inflation is always to be avoided, because it is an extension of purchasing power, either in the form of paper money or credit, which is not secured by reserves or commodities that will liquidate it at the proper time; and this, of course, means losses for some one.

Therefore, when Federal Reserve notes are issued against bonds, the desired and appropriate feature of elasticity is destroyed, and the inflationary procedure is being followed. Elasticity is destroyed because there is nothing in the nature of the bond security which automatically liquidates the notes after the exchange transaction is completed. When such notes are issued against commercial paper, they are an advance to business men who will, in 30, 60, or 90 days, for example, sell goods, retire the paper lying behind the notes, and, consequently, retire the notes. Thus the notes effect the exchange, which could not be completed for 30, 60, or 90 days, then they disappear. When, on the other hand, such notes are issued against bonds, the exchange is completed; the notes remain outstanding; there is nothing in the nature of the transaction that remains to be completed beyond the payment of the bonds when they mature, and there is nothing to take place which will retire the notes until the bonds do mature. Thus, there is a net addition to the currency; the price level tends to be disturbed; the currency goes into circulation without any new wealth being produced to liquidate the notes; and the procedure, therefore, is inflationary. Bonds should represent a transfer of savings from the bond buyer to the bond seller, and the currency supply should remain undisturbed. But the issuance of currency against the bonds has the effect of creating an additional supply of currency with no new creation of wealth. Hence it is inflationary; and an inflationary procedure can never be defended on any grounds, because it always involves losses to someone; and these losses are due to the character of the medium of exchange.

Properly constituted bank note and deposit currencies should also be elastic in nature. And if the currency is to be elastic it must expand and contract, either automatically or as a result of control or both, in a manner that will contribute to the stability of the price level under conditions of economic equilibrium. If the price level is rising soundly—that is, in harmony with, and as a result of, a sound recovery or expansion in business—an elastic currency, either note or deposit, will permit that rise in the price level to take place. But when production and consumption tend to come into balance, the currency having the quality of elasticity contributes to this price level stability, as it should. A stable price level under conditions of general economic equilibrium, as already pointed out, is probably the most desirable condition known to man, and a currency which contributes to such stability is probably the best currrency which people can devise.

According to the terms of section 208 of this bill the Reserve banks apparently are to receive Federal Reserve notes without posting anything with anyone. It seems that the Reserve banks are to be supplied with all the notes they may need, the only requirement being that the Reserve banks maintain a reserve of 40 percent in gold certificates, which are, at present, inconvertible paper money. In addition, the notes are made, as at present, a first and paramount lien on all the assets of the Reserve banks.

As the Federal Reserve banks purchase bonds, by creating a deposit to the credit of the Government, a deposit currency is created which is inelastic and inflationary in nature. The banks receive the bonds and the Government receives the deposit. But the currency supply does not remain unchanged; it is increased by the amount of the deposit less any reserve which might be needed. If there is a surplus of reserves then there is a full net increase in currency equal to the value of the bonds. If the withdrawal of deposits gives rise to the withdrawal of Federal Reserve notes, the effect is in general the same. There is a net increase in the Reserve notes without any additional reserves or commodities being created to liquidate them. This is an inflationary procedure and one that can continue as bonds are purchased until the reserves of the Federal Reserve banks are reduced to the legal limit. Thus the price level tends to rise as against the available wealth. The assets held by the banks against these notes will not retire the notes automatically, and it is doubtful if any management group would force such a retirement. People must pay higher prices for things, not because there has been an increased production and a resulting increase in income, but because of a defect in the currency itself. It is a depreciating currency, and the general public loses in the form of an increased cost of living resulting from a defect in the currency.

If an effort is later made to retire such a currency, it will be necessary for the Government to raise taxes to pay off the bonds. Taxes are a burden to all people and all business and have a depressing effect on productive activity. Thus additional burdens must be incurred as a means of retiring the currency which, in itself, caused the public losses.

If the notes, on the other hand, are issued against self-liquidating paper they do not disturb the price level, they do not cause losses to people, and they retire themselves automatically and without involving any such depressing agents as taxation, provided the usual restrictions used to force a note contraction are attached. Title II of this bill removes some of these restrictions on Federal Reserve notes and, consequently, there will be less tendency for them to contract as they should. The bill apparently repeals the provision prohibiting one Federal Reserve bank paying out the notes of another, and it removes the tax penalty for such payment. Thus, from this point of view, as well as from the point of view of the assets underlying these notes, the elastic feature is impaired.

The same line of reasoning is applicable to the creation of a currecny against mortgage paper as an asset. Some paper should represent a transfer of savings from one group to another, so that the currency supply will remain unchanged. And when the mortgage is paid off it should be paid off out of savings. Hence it is proper, within limits, to use savings deposits for investment in such paper. But if a commercial bank creates deposit currency against such investment paper, it is inflating the currency because the currency is not self-liquidating, and it is inelastic for the same reason. When notes, for example Federal Reserve notes, are drawn into circulation as a consequence of the creation of deposits against such illiquid assets as mortgage paper the note currency becomes inflated and inelastic.

These, in short, are the fundamental principles which should guide in the issue of bank notes and in the creation of deposit currency. Sections 206, 207, and 208 of title II are for these reasons unsound in principle.

Then the question may be raised as to why the Federal Reserve notes are made legal tender for all purposes. When a money is legal tender for all purposes, it can be used to pay all debts, public and private. This means, literally, that these notes could be used for lawful reserves and could be used to redeem any other currency. Is it intended that these notes shall be "lawful money" for reserve purposes, thus converting a liability into an asset? This, of course, is not a rational procedure, and yet this is what lines 22 and 23, page 46, really provide.

In contradiction to this, lines 24 and 25 exclude these notes from the lawful money for reserve purposes in the Federal Reserve banks. This means that the Federal Reserve notes are not permitted to fulfill their functions as full legal tender money. The two provisions are in direct conflict and should make clear the fact that it is irrational to attempt to make Federal Reserve notes full legal tender. The words "receivable for certain purposes", originally employed with respect to these notes, should be restored and the words "legal tender" abandoned.

It might be pointed out incidentally here that the Federal Reserve Act has never used the term "lawful money" properly. It speaks of gold or lawful money when it should say gold or other lawful money, since gold and gold certificates obviously are also lawful money.

Part of section 208, in lines 8–10, page 47, provides that the Treasurer of the United States shall cancel and retire unfit Federal Reserve notes coming from a source other than a Federal Reserve bank, but it does not specify or provide any fund for such retirement. The last sentence of this section, lines 10–12, page 48, provides that notes unfit for circulation should be returned by the Reserve banks to the Comptroller of the Currency for cancelation and destruction. Just why both the Comptroller of the Currency and the Treasurer of the United States should be involved in canceling unfit notes is not clear.

This bill abolishes the 5-percent redemption fund with the Treasurer of the United States. It also permits one Reserve bank to pay out the Reserve notes of other Reserve banks without any penalties, and, in this manner, one of the factors forcing a retirement of these notes is removed. There appears to be no good reason for repealing either of these prevailing requirements. The omission of the latter requirements merely serves as another means of inviting a looser type of banking. The omission of the redemption fund may be due to careless bill drafting.

Section 208 (2) reveals careless bill drafting in the fact that care was not taken to strike out all words which should be deleted. For example, in the second line of the Federal Reserve Act following the last deletion the words "or subtreasuries" appear again and are permitted to stand by this repealing section.

Section 209, which permits the Federal Reserve Board to change the reserve requirements of the reserve banks as they see fit, is a dangerous weapon to put into the hands of a politically dominated Board. The preceding sections of title II of this bill, combined with this section, make it possible for the Board to pack Government securities and other illiquid paper into the portfolios of the Federal Reserve banks until the surplus reserves are exhausted, and then the reserve requirements of member banks can be reduced, thus permitting the Board and banks to proceed with their inflation without let or hindrance. The provision that the reserve requirements of these banks may be changed "in order to prevent injurious credit expansion or contraction" would probably prove to be little more than the statement of a pious hope. It probably would mean nothing in the hands of a politically controlled Reserve Board determined to inflate the currency. And, if it were used, it would seem that the effects might be unfortunate for the reason that it would tend to have a sharp deflationary effect on those banks with no surplus reserves and with little inclination to rediscount. If such a plan were to be used, it would seem that it should be applied to individual banks rather than indiscriminately to all banks of a given class. But even this would have its dangers under a politically controlled system. It would appear that a much better plan would be that recommended by the Federal Reserve Board, namely, that reserve requirements of member banks be based not solely upon the volume of deposits but also upon the rapidity of their turnover.

Section 210, stipulating the conditions under which member banks may lend on real estate, flies in the face of all practical experience with such loans by commercial banks. Provisions for such loans should be restricted, not enlarged To raise the percentage of the value of the property for lending purposes from 50 to 60 is unwise, as is the 75-percent provision for loans amortized within 20 years. To raise the limits of such investments from 50 to 60 percent of time and savings deposits and from 25 to 100 percent of the bank's capital and surplus is a denial of the value of our past experiences with such loans.

In lines 13 to 18, page 50, in which real-estate loans are insured by the provisions of title II of the National Housing Act, all restrictions appear to be removed. The answer to this is that in sound commercial banking the question of the proper type of loans is not one of insurance and ultimate liquidation, but one of maturity and immediate liquidity. This section, like sections 206, 207, and 208, contribute to inelasticity and inflation of the currency.

5. Thus we see in title II of this bill a multitude of illustrations of the dangerous banking philosophy held by the advocates and authors of the bill. It should not be passed. It is unsound in principle and opens the way to extremely dangerous central banking practices. The conceptions underlying it run counter to the best opinion on central banking. There are no sound defenses than can be offered for the bill, and there are no reasons why it should be passed at the present time. Title II does not provide for better central banking, but it does open the way directly to political banking. Even though considerable weight

might be attached to the denials of such intent, this bill unquestionably provides the means desired by those who may decide they wish to use the system for their political purposes once the powers are placed in their hands. It would merely be the exercise of the most elementary prudence to hold all such legislation in abeyance until a carefully chosen commission had made its study and drafted its plan.

LETTER OF J. F. T. O'CONNOR, COMPTROLLER OF THE CURRENCY, TO OWEN D. YOUNG, CHAIRMAN GENERAL ELECTRIC CO.

TREASURY DEPARTMENT,
Washington, June 6, 1935.

HON. OWEN D. YOUNG,
Chairman General Electric Co., New York, N. Y.

MY DEAR MR. YOUNG: I notice in the New York Times of May 30, 1935, in your testimony before the Subcommittee of the Banking and Currency of the Senate, with respect to the banking bill of 1935, you stated:

"As to the Comptroller of the Currency, I have always believed that the powers vested in that office should be administered by the Federal Reserve banks, but, until that is provided for, I can see many advantages rather than disadvantages from the retention of the Comptroller of the Currency on the Federal Reserve Board."

I, of course, am not familiar with your reasons for making the suggestion that the powers vested in the Comptroller should be administered by the Federal Reserve banks. However, I wish to call your attention to what I believe are some of the important objections to such a change.

The national banking system is governed by one set of Federal laws and the rulings and interpretations and regulations issued thereunder. Consequently, whatever position the Comptroller takes with respect to the many questions under the law which arise in the administration of these banks affects all of the banks alike and are applied uniformly. It would be, in my opinion, not only highly impossible but impracticable to have any uniformity or correlation if the administration were divided into 12 separate units.

Federal Reserve banks are owned by member banks. Six of the directors of such banks are elected by member banks (private interests) and should the present title 2 of the Banking Act of 1935 be enacted, the entire supervision would be in the hands of the governor of the Federal Reserve bank who would be elected by the directors. You would then have the situation of the very men in some cases, whose banks are to be examined, sitting on a board of directors of an institution charged with the responsibility of an examination of the particular institutions these men represent. It would certainly seem to be against the public policy for a man to appoint an examiner to examine his own bank.

When member banks of the Federal Reserve System either borrow or rediscount with Federal Reserve banks a creditor and debtor relationship exists and even where they are not borrowing, their reserves are carried by such banks and then a creditor and debtor relationship exists. The responsibility of supervision over banks involves the principle of trusteeship in that the supervision must be impartial and not affected by any interest of the supervisor. It is dufficult to see how Federal Reserve banks can take the responsibility of supervision when, as is frequently the case, they are the member banks' largest creditor; and how can a Federal Reserve bank deal impartially with depositors in insolvent banks in the hands of receivers if it is responsible for the appointment of the receiver and must also collect its own debt against the bank. Concrete illustration of this conflict may be found in the number of lawsuits between receivers of insolvent national banks and the Federal Reserve banks which suits are instituted at the direction of the Comptroller of the Currency to protect the interests of the depositors and to prevent the Federal Reserve banks from establishing their claims as preferred creditors. Illustration of this may be found in the case of *Vann* v. *Federal Reserve Bank, Richmond* (47 Fed. 2d, 786), and the case of *Hirning* v. *Federal Reserve Bank, Minneapolis* (52 Fed. 2d, 382).

A brief outline of the facts in these two cases is attached for your information.

These are some of the matters I have in mind and I should be glad to have your reaction to them.

Sincerely yours,

J. F. T. O'CONNOR, *Comptroller.*

In the first case, the First National Bank of St. George, S. C., was in failing condition. Representative of the Federal Reserve bank went to the national bank and presented certain checks for payment—about 10:30 a. m. on March 31. He was informed by the president of the bank that the bank was not able to pay the checks and also that the bank was making an effort to obtain money at Charleston, S. C., and that the continued operation of the bank would depend upon the success of that effort. The bank was unable to secure this money and notified the Federal Reserve representative at 4 a. m. on the morning of April 2 and asked his advice. He advised that the national bank examiner should be called and this the cashier did, informing the bank examiner that the board of directors would meet at 8:30 that morning and that they were about ready to deliver the bank to him. The bank examiner being some distance away, did not arrive until about midday. In the meantime, the representative of the Federal Reserve bank found the bank open and the officers waiting for the bank examiner to arrive. The checks were again presented and the cashier at the request of the Federal Reserve representatives thereupon paid him $8,027.02. At 10:30 o'clock the bank closed its doors by order of the board of directors and when the examiner arrived he took charge. The receiver at the direction of the Comptroller brought suit to recover this illegal preference and was successful in obtaining the money for the general depositors and creditors of the bank.

In the second case, without going into all of the details, the president of the bank after talking with the governor of the Federal Reserve Bank of Minneapolis returned to his bank and took steps to close the bank; that after the meeting of the board of directors was called and a resolution had been passed to close the bank, $13,000 in currency was packed and shipped to the Federal Reserve Bank of Minneapolis in payment of certain checks thus creating a preference in favor of the Federal Reserve Bank of Minneapolis. The receiver, at the Comptroller's direction, demanded that this amount be returned. The demand was refused and as a result suit was filed against the Federal Reserve Bank of Minneapolis and the money recovered for the benefit of the depositors and general creditors after the case had gone to the United States Circuit Court of Appeals.

THE PEOPLE'S LOBBY, INC.,
Washington, D. C., June 11, 1935.

Hon. DUNCAN U. FLETCHER,
Chairman Senate Committee on Banking and Currency,
Washington, D. C.

MY DEAR SENATOR FLETCHER: I enclose a statement which I would like to have inserted in the record of the hearings on your bill, S. 1715, as I was unable to get the committee to arrange a time when I could appear before it.

Also, may I request that your enclosed statement on this bill, read into the Congressional Record by Senator Costigan, be incorporated as part of the hearing, as I feel it is a very important and complete analysis of the purpose of the bill?

Yours sincerely,

BENJAMIN C. MARSH,
Executive Secretary.

STATEMENT OF BENJAMIN C. MARSH, EXECUTIVE SECRETARY THE PEOPLE'S LOBBY, INC.

The assumption of the proposed Banking Act of 1935 (S. 1715) introduced by Mr. Fletcher, is the continuance of the present overhead on production, to wit, capitalization of corporations, land values, and debts.

The issue raised by this bill, particularly by title II, is not whether the manipulation of credit by private banking agencies is to be ended, alone, but whether cheap credit is to be used to foster speculation in stocks and speculation in land.

There is a vital distinction between nationalizing the banking and credit system of the country, and socializing the banking and credit system of the country.

As far as the general public is concerned, it may be fleeced quite as much under the proposed Banking Act of 1935, as under the present Federal Reserve System with the private banking. To the laymen the proposed act seems to be chiefly a conflict between bank exploiters and stock gamblers and speculators in land, with the public paying the bill under the proposed bill as under the present system. Unless a direct mandate is given to Government officials for whatever it may be worth, that the credit system of the Nation is to be used to bring about an orderly and gradual but continuous deflation or reduction of land values and of overcapitalization of corporations, and some reduction in interest rates as well as principal of many mortgages, the bill will fail of the purpose of achieving a more equitable banking and credit system. Such a mandate must of course be made effective through specific and inescapable provisions of the law.

The bill, S. 1715, by Mr. Fletcher, amending the Federal Reserve System, provides in part II, page 49, section 24, that a national banking association may make loans secured by first liens upon improved real estate (line 15), but that the amount of such loans shall not exceed "60 percent of the actual value of real estate offered for security" for under 3 years, but provides (line 18): "That loans may be made in amounts not exceeding 75 percent of the actual value of the real estate offered for security", if they are to be completely amortized within not over 20 years by stipulated payments on principal with interest.

Granting power to Federal employees to make such appraisals and guess at the actual value of real estate is a unique extension of Government power. The Federal land banks, as you know, limit loans to 50 percent of the value of land and 20 percent of the value of buildings. This is quite generous.

This is important particularly as if we are to avoid a complete collapse it will be necessary for the government, local and State chiefly, to cover into the Public Treasury within the next few months, or years at the most, a very large part of the ground rent which is now retained by private land owners through taxation. The inevitable result of such taxation of land values will be to reduce the selling price of land, and therefore, under our present economic set-up, to reduce the security of loans. Just the reverse is evidently the intention of certain municipal governments in connection with the Public Works program.

Last week the mayor and tenement-house commissioner of New York City requested a loan of $150,000,000 for public housing in New York without any interest, although the city of New York has paid Vincent Astor, boon companion of the President, about $3.50 a square foot for land to house unskilled workers in New York. The irony of such a proposal of course is so obvious as to preclude its acceptance, but city and State governments will increasingly ask for Federal credit at very low rates of interest for the benefit of speculators in land, whom they are afraid to tax.

There seems danger that under the proposed Banking Act of 1935 the power of the Government to extend credit will be used to stimulate a bull stock market in connection with credit inflation. It would appear that the Government has done sufficient to save financial cats and dogs through the Reconstruction Finance Corporation and through the codes dealing with natural resources, particularly the Oil Code and the Coal Code. For this reason the bill should be definitely amended as suggested above.

Easy credit will make socialization which comports with the actual worth of natural resources, industries, and transportation, much more difficult, and will involve a much higher cost to the Government. High interest charges, on the other hand, would facilitate Government acquisition of such natural resources and natural monopolies.

With respect to insurance of deposits, it is difficult to understand by what stretch of political clairvoyance government should guarantee deposits even up to $5,000 before it guarantees employment at a reasonable wage for the employable and maintenance for the unemployable, and a fair return to farmers for the production which is essential to the national welfare.

This cannot be achieved if any attempt is made to maintain present values of real estate, present debt totals, and present capitalization of corporations.

The bill should be amended to prevent the use of government credit for any form of speculation or enhancing of property values, and to restrict it to fostering consumption and production upon which the profit is limited to a minimum. The announced purpose of the bill "To provide for the sound, effective, and uninterrupted operation of the banking system (and for other purposes)", indicates the necessity for the changes we have suggested. This should not be the major purpose of revising our banking system. The major purpose should be to increase the general welfare, not to protect property valuations.

Statement of Hon. Duncan U. Fletcher, of Florida, Chairman of the Senate Committee on Banking and Currency, April 21, 1935

(Printed in the Congressional Record of Apr. 22, 1935)

The Proposed Banking Act of 1935

Since the introduction of the proposed banking act of 1935 (S. 1715 and H. R. 5357), a flood of letters and telegrams have been sent to Senators and Congressmen in protest against one particular section of the bill, namely, title II. I myself have received several hundred letters which show evidences of having originated from one central office. On the face of the facts, I would say that they have been signed and mailed by persons who have neither read the provisions of the bill nor are conversant with the principles incorporated in it. For the enlightenment of probably thousands of ill-advised correspondents, I am herewith reproducing one of the "form letters":

April 8, 1935.

Hon. ———,
Senate Committee on Banking and Currency,
Senate Office Building, Washington, D. C.

Dear Senator ———: I hope that you will find it possible to use your influence against the banking bill (H. R. 5357, S. 1715). I believe that it endangers the development of sound banking in this country, not only because its banking principles are unsound but because it permits political control of the Federal Reserve Board and the Federal Reserve banks.

Respectfully yours,

(Signed) John Doe.

On the other hand, a number of bankers, editors, pseudo economists, and so-called "financial experts" have bandied the subject back and forth in the press and through the medium of "form letter" correspondence for something like 2 months. Such tactics have resulted in a wealth of misinformation. Much of this misinformation has been deliberate and willful.

At this stage of the matter, I wish to warn the general public, and particularly the correspondents to whom I have just referred, that they must be on their guard lest they be abused as were thousands of business men by the use of similar methods against the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. To this date there are literally thousands of well intentioned but misinformed business men who do not know the facts pertaining to the prospective issuance of their own securities under these acts. This misunderstanding is not due to defects in either of the acts or to the administration of them. It all goes back to the campaign of vicious propaganda and misinformation.

Similar results are now evidenced with respect to the proposed Banking Act of 1935. Do not be misled. This legislation will serve a public purpose and its enactment is essential to the establishment of the financial and economic security of this Nation's domestic enterprises.

As a result of having devoted much thought and study to the numerous articles which have appeared in the press and hundreds of letters which have come to my desk, I think it best that this attempt be made to explain more clearly to the public the issues which are in controversy and discuss the principles involved in order that a much clearer understanding may be had of the necessity for the passage of this piece of legislation.

In my opinion, the proposed Banking Act of 1935 is, in all probability, the most important piece of banking and monetary policy legislation with which this or any other Congress has dealt. This statement is based upon the importance of title II alone; and, curiously enough, title II of the bill is bearing the brunt of almost all the opposition made to the entire piece of legislation. Please be advised, however, that all of those who are offering concerted opposition to the bill on the basis of the incorporation of title II are almost spontaneous in their clamor for the enactment of titles I and III.

Hence, I shall deal only briefly with the first and third titles of the bill. The first title provides for the merging of temporary deposit insurance funds into permanent funds, that $5,000 be designated as the maximum insurable deposit for assessments, withdrawal from the fund, buying assets of insured closed banks, and a number of other important matters. The third title provides for "accidental" holding-company affiliates, security affiliates in liquidation, security dealers accepting deposits, employees' deposits, liquidation of assets of banks in voluntary liquidation, termination of double liability, examinations, and a number of other important matters.

Title II, on the other hand, deals almost wholly with the creation of machinery for the effective regulation of a definite monetary policy in accordance with the campaign promises of President Roosevelt based on the Democratic platform of 1932 which advocated "a sound currency to be preserved at all hazards" and proposed to put an end to "the indefensible expansion and contraction of credit for private profit at the expense of the public."

Moreover, it is a definite attempt to accomplish the ends which the President had in mind when on July 3, 1933, he stated to the American delegation to the London Economic Conference and again reaffirmed on October 22 in his address to the American people in which he stated that "when we have restored the price level, we shall seek to establish and maintain a dollar which will not change its purchasing and debt-paying power during the succeeding generation. I said that in my message to the American delegation last July and I say it now once more."

This bill among other things provides that:

(1) "The offices of governor and chairman of the board of directors of each Federal Reserve bank shall be combined." In their places a governor and vice governor "shall be appointed annually by the board of directors, subject to the approval of the Federal Reserve Board. The governor shall be the chief executive officer of the bank."

Whereas in the original Federal Reserve Act the executive head of the bank was to have been known as chairman of the board of directors and at the same time act in the capacity of Federal Reserve agent, the active head in control of purely banking operations was to function in the capacity of a bank manager. The Federal Reserve banks gave to the bank manager the high-sounding name of "governor."

Since that time it has developed that the governor of each Federal Reserve bank has not only superseded the chairman and agent as the executive officer of the bank but has also become the virtual dictator of the Federal Reserve bank to the extent of practically controlling the election of directors who are presumed to be independent in the exercise of their power in the election of said governor. The results are obvious.

The above provision of the bill merely merges the two offices and at the same time provides for the retention of all governors and chairmen—if they are qualified and if, subject to the approval of the Federal Reserve Board, the various boards of directors elect them governor and vice governor. At the same time the language of the bill makes it clear for once that banks cannot evade or override the law through the creation of a high-sounding office and wrest control from the Board by creating a dictatorship within the Federal Reserve System.

The bill further provides that:

(2) Prior to July 1, 1937, the Federal Reserve Board may waive the capital requirements for the admission of nonmember State banks as members of the Federal Reserve System.

It is intended, through such a provision, to recognize the fact that small banks—that small State banks—are not mere "pawnshops." It is in recognition of the fact that smallness and bigness in a bank's capitalization, deposits, investments, or loans is not an indelible evidence of either soundness or weakness. The success or failure of a bank depends primarily on its management and not on its size.

It is a recognition of the fact that there are thousands of small State banks in this country which are worthy of membership in the Federal Reserve System. On the other hand, it absolutely does not provide a license for, or inducement to, the inclusion of unsound banks, or of undercapitalized banks, within the Federal Reserve System. Assuming an unbiased and unprejudiced administration of the act in accordance with the intentions of Congress, there should result no unfair treatment of, or impositions on, either State banks or national banks under the provisions of this section.

The next provision to which I wish to call your attention is: (3) "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."

Moreover, each director is to receive a salary equal to that of a member of the President's Cabinet, and shall be retired at the age of 70 upon a retirement wage to be paid out of funds derived from levies on Federal Reserve banks.

Such a provision is conceived in the public interest. It provides for no favoritism between bankers, lawyers, economists, manufacturers, or men from any other profession. The administrative duties of a Board member are such as to require a far broader experience and basis for the exercise of sound judgment than that derived from the narrow confines of any one profession. Please note that the section reads: "The President must choose persons well qualified by education and experience, or both, to participate in the formulation of national economic and monetary policies."

That is a mandate.

The next three points to which I wish to direct your attention are of the greatest vital importance. They have to do with the Federal Open Market Committee flexibility of reserve requirements, and discounts.

They are, in order of sequence, numbered (4), (5), and (6).

(4) The creation of a Federal open-market committee consisting of 5 members, 3 of whom shall be members of the Federal Reserve Board, the other two to be governors of the Federal Reserve banks selected by all the governors of said banks. Their terms of office shall expire at the end of each calendar year. Said committee shall have supervisory control over the open-market operations of the Federal Reserve banks.

(5) The Federal Reserve Board is empowered to change the reserve requirements of member banks as to any or all Federal Reserve districts and/or any or all classes of cities and as to time and/or demand deposits.

(6) "Subject to such requirements 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."

SIGNIFICANCE OF PROVISIONS (4), (5), AND (6)

The first question which arises in connection with these three provisions is as to whether they involve a radical change in the present powers and functions of the Federal Reserve Board and the Federal Reserve System as it is now constituted. The second question is as to whether there will be established a political dictatorship of banking.

The unequivocal answer to the first—aside from a technical splitting of hairs—is "no". To the second an unequivocal answer of "no" must be given.

It is a fact that all of the powers which are by this bill centralized in the Federal Reserve Board have since the enactment of the original Federal Reserve Act existed within the Federal Reserve System. That is, all open-market powers dealt with in title II of this act exist in the present law, and were so read into the original act by the "governors" of the Federal Reserve banks, as I shall subsequently point out. But it also must be mentioned that when any or all the reserve banks, the Reserve Board, or the Treasury, through its stabilization fund, engage in open-market operations, they depart from and transcend the field of banking and become engaged in operations foreign to banking per se.

That is, when banks or the Board engage in open-market operations, they are buying and selling money; they are expanding and contracting the total volume of money; they are laying the foundation for inflation, deflation, and economic chaos if intelligence and prudence are not exercised in accordance with the sound principles of monetary science.

Such principles are not one and the same with even those of sound banking, where private profit is predominant. On the other hand, the principles of monetary science to which I refer are the principles of national monetary policy operations which absolutely must be made to conform with a public interest which oftentimes is directly opposed to the private-interest motives of bankers if they are to be administered in the interest of the general public.

DEVELOPMENT OF COORDINATIVE SYSTEM

Policy in open-market operations of Federal Reserve banks.—For your information, I want to give you a brief historical sketch of the development of open-market operations by Federal Reserve banks under the original Federal Reserve Act and the centralization of their power without any specific authorization of law.

My wish is first to narrate in terms of what might be called "bankers' technical language"; then I wish to translate it into good everyday English.

Prior to 1922, the Reserve banks, having the power to invest money, made considerable investments in the open market, buying bills and buying Government securities. The holdings of United States Government securities by Federal Reserve banks gradually increased in the early years of the System to about $300,000,000 in 1920 and were slightly smaller in 1921. Their purchase and sale of bankers' acceptances were made largely in accordance with seasonal changes in the supply of acceptances and in the demand for funds.

In 1922 Federal Reserve banks, facing a decline in earning assets because of repayments of discounts by member banks, began to buy Government securities for the purpose of increasing their earnings. It was observed that the operations of Federal Reserve banks, acting independently, were affecting the market for Government securities, and that these operations conflicted with each other and with those of the banks as fiscal agents of the Treasury.

In May 1922, at a meeting of the governors of the Federal Reserve banks, a committee was appointed to coordinate the buying and selling of Government securities so as to have a more orderly program under central control.

In October 1922 this committee undertook to make recommendations to the Federal Reserve banks regarding the purchase and sale of Government securities. It was observed in this year that purchases of Government securities did not cause an increase in the earning assets of the Federal Reserve banks, nor did sales cause a decrease, but rather that they affected the volume of borrowings at member banks. As a consequence, the conference of governors of the Federal Reserve banks voted that "investment policy should give minor consideration to the question of earnings and constant consideration to the effects which open-market operations have upon the condition and the course of the money market and the volume of credit."

On April 7, 1923, the Board advised the governors of the Federal Reserve banks formally of a resolution adopted by the Federal Reserve Board on March 22, 1923, with respect to open-market operations by Federal Reserve banks, pointing out the necessity for the coordination of open-market operations of the Federal Reserve banks with their discount operations and their general credit policy. It also announced the organization of the open-market investment committee for the Federal Reserve System. This committee consisted of five representatives of the Reserve banks and was to be under the general supervision of the Federal Reserve Board. From this time on open-market operations could not be engaged in by Federal Reserve banks, except with the approval of the Federal Reserve Board.

In March 1930 the open-market policy conference, consisting of representatives of all the Reserve banks, replaced the open-market investment committee. Under the Banking Act of 1933 the Federal open-market committee, consisting of 12 Reserve bank governors, was established.

What I have said in the immediately preceding six paragraphs is, in technical bankers' language, a correct statement of what Federal Reserve bankers did and are now doing. But in the language of the layman, this simply means that the Federal Reserve System is already engaged in all of the operations and performing all of the functions which will be required under the proposed bill; however, there is added one factor of the greatest significance to the public. We shall, through this act, definitely fix the responsibility for and the power to engage in open-market operations in the Federal Reserve Board. In the future, when money becomes "easy" or money becomes "tight" or when we are led into a period of inflation or a period of contraction and economic demoralization, we shall be able to put our finger upon the Federal open-market committee and say, "You are responsible."

May I reemphasize the fact that when the Federal Reserve banks back in 1921 and 1922 began their open-market operations "for the purpose of increasing their earnings" and later when they appointed a committee "to coordinate the buying and selling of securities in the open market", they were literally buying and selling dollars for profit. They were buying and selling dollars in just the same manner and for precisely the same purpose that hundreds of carloads of wheat were bought and sold, a hundred times over, in the Chicago wheat pit or in the street, despite the fact that the wheat was in freight cars and stood on the railroad sidings for days, weeks, even months without once having been moved. That is, the open-market committee was dealing in previously created credit obligations for profit and eventually awakening to the fact they were shooting the price structure to pieces, upsetting the financial plans of the Government, disrupting business, and confusing the bankers. Through this act we propose to introduce responsibility for such activities—in fact, to command that the necessary operations must be engaged in at the direction of the Federal open-market committee with a mandate laid down for the orderly conduct of such operations in the public interest.

To what extent is this the introduction of a new principle into the law? The answer is: "It is not new."

Section 8 of the Banking Act of 1933 provided for the insertion of a new section in the Federal Reserve Act, to wit:

"There is hereby created a Federal open-market committee * * *" immediately followed by subsections (b), (c), and (d), which made all open-market operations subject to "regulations adopted by the Federal Reserve Board." Based upon the latter fact, I insist that the proposed title II does not in any way increase the political control over the operations of the Federal Reserve Board, the Federal Reserve banks, or of member banks. On the contrary, the law remains as it has been for over 20 years. Under the above provisions of subsection (d) any Federal Reserve bank might be excused from participation provided it "filed with the chairman of the committee, within 30 days, a notice of its decision, * * * not to participate." In this respect our proposal is to strike out the exception and leave the power to initiate action with the Board.

Now, what of the flexibility of reserves provided for in the bill?

May I remind you that the same Congress which enacted the Banking Act of 1933 wrote a similar clause into Public, No. 10 (in that part known as the Thomas amendment), a provision for the "increase or decrease from time to time, in its discretion, the reserve balances required to be maintained against either demand or time deposits."

On this point, the proposed Banking Act of 1935 gives recognition to the fact that there is no safety to be found in arbitrary judgment or arbitrary figures with respect to the reserves or either Federal Reserve banks or of member banks. Several hundred years ago the goldsmiths retained 100 percent reserves. Later they arbitrarily reduced their reserves. England has no such arbitrary reserve requirements established by law. This country has progressively found it advisable to reduce the legal reserve requirements for even commercial banks from an arbitrary figure of 50 to 40 to 25, until now they stand at 13, 10, and 7 percent on demand deposits of commercial banks, depending upon the size of cities in which they are located.

No banking dictatorship created

The powers referred to in no. 6 as I am designating them cannot and should not be construed as the creation of a Federal Reserve Board dictatorship over purely banking operations of the Federal Reserve banks and their member banks. In this respect the Board's directions to banks are either permissive or prohibitive as to all purely banking operations. Within these two extremes all actions with respect to purely banking matters are left to the discretion of Federal Reserve banks and their member banks. That is, bankers will decide as to whether they shall or shall not make loans or investments which lie purely within the field of banking operations, such as whether loans shall or shall not be made to an individual or corporation, or a mortgage purchased, or the calling of a loan. And it is likewise left to the Federal Reserve bank as to whether it shall or shall not rediscount any of the paper of a member bank, or make a loan to said member bank upon any of its sound assets.

The next provision to which I wish to refer is:

(7) "Federal Reserve notes are to be issued by the Federal Reserve bank and retired under such rules and requirements as the Federal Reserve Board may prescribe."

From the orthodox banking point of view such a provision is sound. Banks are not opposing this feature of the bill.

The next and last provision to which I wish to make a specific reference is:

(8) National banks will be permitted to "make loans, securedby first liens upon approved real estate, including improved farm lands and improved business and residential properties."

This is a long-established principle. Do you want it stricken out, or do you have some arbitrary limit you think should be fixed? This is definitely up to the Congress. We must choose reasonable limits. What is your suggestion?

It is because of the above provisions incorporated in title II that the American Bankers Association, a number of the State bankers' associations, and numerous bankers and economists throughout the country are making a concerted effort to divide the bill and enact titles I and III, alleging that said title II effects radical changes in the banking laws of the Nation.

May I point out that, with one or two exceptions, all of the above requirements have to do with the control over the monetary policy of the country. Monetary-policy operations cannot and should not be merged with purely banking operations.

The administration of a monetary policy has to do with the contraction and expansion of the credit and currency of the country and directly affects the purchasing power of money. This function transcends those of banking, farming, manufacturing, or that of any other business activity. It literally controls the economic and social welfare of the whole Nation. Traditionally, to be sure, this function has been turned over to banks and bankers who have operated it without direct responsibility to anyone. We propose, as I have previously pointed out, to centralize the powers and responsibilities in the Federal Reserve Board.

There are literally thousands of bankers in this country whose heads are bowed in humiliation and shame. They are blamed for the vicious results, many of which they are not able to rationalize. They have had their lines of credit shut off or have experienced the withdrawal of huge sums of money upon demand. In turn they have been forced to try to call in loans which they oftentimes have made with the greatest of caution and deserved confidence, to be peremptorily thrown into the maelstrom of a financial panic, contraction, or depression.

Among them, however, there have been a few bankers "in the know" and also in a dominant position for laying down the rules for making money "tight" or "easy"—of literally determining the trend—yet the latter have not personally been singled out nor can they, under our present system, be called to account for the disastrous results of their acts. It is my earnest desire that the fifteen or twenty thousand bewildered bankers, who have never known and never will know what it is all about, demand that this great destabilizing and disturbing factor of monetary policy shall be separated from banking per se and placed in the hands of men who must and who shall be held responsible and accountable for their acts. Undoubtedly in this great Nation we can find at least 5 or 8 men, depending upon the final provisions of the act, who know what it is all about and can be trusted to administer our monetary policy intelligently and with the greatest amount of integrity and respect for the people, and act for the public welfare.

Bankers as a whole are not qualified to determine nor competent to administer our monetary policy. They have not been able to discern the difference between purely banking functions and monetary policy operations. As a whole they have known only that money was "easy" or money was "tight" without knowing the "whys" and "wherefores" and have been wholly ineffectual if not irresponsible in the administration of our monetary policy.

We have been sifting and winnowing the basic facts for the past 6 long years. We know the facts. We have weighed the evidence. We have made up our minds as a result of the collapses of 1920 and 1929. None of the opposition will dispute the facts. They cannot deny them. If they have not made up their minds after 6 years, we have little promise that they will have anything to offer after another 2 years.

It is common knowledge, however, that there now lies within the hands of bankers the potential makings for one of the most stupendous inflations this or any other Nation has ever experienced. And experience teaches us that banker control of monetary policy will probably give us an equally devastating financial whirlwind when that bubble is pricked.

This bill is conceived as our most essential safeguard.

[From the New York Times, Apr. 21, 1935]

FLETCHER ATTACKS BANKERS, DECLARES OMNIBUS BILL NEED—"AS A WHOLE, THEY ARE NOT QUALIFIED TO DETERMINE OUR MONETARY POLICY", HE SAYS—HOUSE REPORT IS FILED—ASKS PASSAGE IN ECCLES' FORM—MINORITY CALLS RESERVE CHANGES DANGEROUS

WASHINGTON, April 20.—Opening a campaign to put the omnibus banking bill through the Senate, Chairman Fletcher, of the Senate Banking and Currency Committee, struck out today against a "flood of letters and telegrams" attacking the measure, which, he said, has been sent to Congress Members.

In support of the bill's proposal to lodge control of open-market operations, discount rates, and member bank reserve requirements in the Federal Reserve Board, he declared in his statement that "bankers, as a whole, are not qualified to determine, nor competent to administer, our monetary policy."

"They have not been able to discern the difference between purely banking functions and monetary-policy operations", he said. "As a whole, they have known only that money was 'easy' or money was 'tight', without knowing the whys and wherefores, and have been wholly ineffectual, if not irresponsible, in the administration of our monetary policy."

BILL REPORTED IN HOUSE

As this defense was voiced from the Senate side, the House Banking and Currency Committee filed its report recommending passage of the bill in substantially the form it was drafted by Marriner S. Eccles, Governor, and other officials of the Federal Reserve Board. A minority report filed by the seven Republican members of the committee recommended that the bill be not passed if it contained the title II reorganizing the Federal Reserve System and broadening powers of the Federal Board.

The fight in both branches will center around this portion of the bill as title I and III have aroused little opposition. Senator Glass, chairman of the subcommittee which is now holding hearings on the bill, has predicted that his group would take title II out of the bill and reserve it for further consideration.

Senator Fletcher has predicted with equal emphasis that the full committee would put title II back in the bill, and that the Senate would pass it in the form he said President Roosevelt told him he wanted it.

FLETCHER SEES PUBLIC BENEFIT

"This legislation will serve a public purpose and its enactment is essential to the establishment of the financial and economic security of this Nation's domestic enterprises", Mr. Fletcher's statement said.

"Title II deals almost wholly with the creation of machinery for the effective regulation of a definite monetary policy in accordance with the campaign promises of President Roosevelt based on the Democratic platform of 1932, which advocated 'a sound currency, to be preserved at all hazards', and proposed to put an end to 'the indefensible expansion and contraction of credit for private profit at the expense of the public.'"

Asserting that the control of monetary policy must be placed in the hands of men who can be held accountable and responsible for their acts, Senator Fletcher declared that "when banks or the board engage in open-market operations they are buying and selling money; they are expanding and contracting the total volume of money; they are laying the foundation for inflation, deflation, and economic chaos if intelligence and prudence are not exercised in accordance with the sound principles of monetary science."

REPUBLICANS ISSUE WARNING

The Republicans said in the House minority report that "no emergency has been shown requiring the passage of the title II."

"No immediate need for it has been evidenced," they continued. "The inherent dangers in it are obvious. Its presence in the bill jeopardizes the early passage by Congress of titles I and III."

The minority report was signed by Representatives Hollister, of Ohio; Wolcott, of Michigan; Cavicchia, of New Jersey; Fish, of New York; Gifford, of Massachusetts; Dirksen, of Illinois; and Fenerty, of Pennsylvania.

The two titles of which they approved, dealing with a permanent Federal deposit insurance system, to be eligible for which State nonmember banks do not have to join the Federal Reserve System, and clarification of technical details of the existing Federal Reserve Act, are generally conceded to be noncontroversial.

"One of the things most dreaded today by thinking people is the possibility of weakening, or perhaps the collapse of Government credit because of continued deficits," the minority said in commenting on the open-market powers the bill proposes to confer on the Federal Reserve Board.

"Government financing should be on the same basis as private financing—that is, a free and open market, where the savings of the people are voluntarily used in the purchase of Government obligations. Wherever the Government is in a position to compel the use of the savings of the people to acquire such obligations, such financing becomes a forced loan and is one of the most vicious inroads on liberty."

OPPOSE "FORCING" BANKS

"Weakening of the market for Government obligations is a danger signal in the spending program of any government, and this bill would make it easy to ignore such a danger signal. What most people do not realize is that whenever banks may be forced to acquire Government bonds against their will or at rates which they would not recognize if the transaction were voluntary, as far as the actual credit of the Government is concerned deficits might just as well be financed by fiat money."

Mr. Hollister and his colleagues made much of this argument during the long hearings on the bill. Mr. Eccles at that time replied that the intent of the proposed open-market powers was not to force banks to buy Government obligations and pointed to the ease with which the Treasury has aready carried through important refinancing operations.

The Republican report remarked that "open-market operations are always conducted for all the banks by the New York Federal Reserve Bank, for New York is the money and bond market of the country."

URGES FURTHER STUDY

"If this new provision becomes law, it means that the resources of the Federal Reserve banks from the 12 districts may be drained to New York for the purpose of acquiring bonds, no matter how unwise it might appear to bankers generally," the minority went on. "Thus the board of a particular Federal Reserve bank might consider that it was already overloaded with Government bonds and yet be forced to buy more."

They recommended further study of the contents of title II, calling it a "clear example of hasty and ill-advised legislation on a matter of vital importance to the country." They also condemned the proposed power to control Reserve requirements.

"The right to raise is the right to curtail or even stop entirely the normal banking function of lending," the report said. "The right to lower brings the possibility of endangering deposits by requiring insufficient reserves. Neither power should be lightly exercied."

House leaders predicted that the bill would pass practically as reported, with the chief fight on the floor centering on defeating radical amendments, including those for the "commodity dollar", fixed-price levels, and other such proposals of the sort.

[From the Baltimore Sun, Apr. 21, 1935]

BANKING BILL CALLED VITAL BY FLETCHER

(By C. P. Trussell)

WASHINGTON, April 20.—Banking today took the center of the Washington legislative stage.

Routed in every attempt it made during the last 8 legislative days to strip the principal features from the social security bill, which it finally helped to pass yesterday, the House Republicans turned their guns against the omnibus banking measure, just emerging from the committee.

3,500-WORD STATEMENT BY FLETCHER

Almost immediately there came from the other side of the Capitol a 3,500-word statement from Senator Fletcher (Democrat of Florida), Chairman of the Senate Committee on Banking and Currency, in which he warned:

"There now lies within the hands of bankers the potential makings for one of the most stupendous inflations this or any other Nation has ever experienced. And experience teaches us that banker control of monetary policy will probably give us an equally devastating financial whirlwind when that bubble is pricked."

CALLED ESSENTIAL SAFEGUARD

"The omnibus banking bill is conceived as our most essential safeguard."

His defense of the measure centered almost wholly upon the so-called "central bank section." That part of the bill is being attacked not only by the Republicans but also is the subject of a Nation-wide protest which the Florida Senator denounced as an organized movement.

"Bankers", Senator Fletcher said, "are not qualified to determine nor competent to administer our monetary policy.

"They have not been able to discern the difference between purely banking functions and monetary-policy operations. As a whole they have known only that money was 'easy' or money was 'tight', without knowing the 'whys' and 'wherefores' and have been wholly ineffectual if not irresponsible in the administration of our monetary policy."

FACTS CANNOT BE DENIED

"We have been sifting and winnowing the basic facts for the past 6 long years. We know the facts. We have weighed the evidence. We have made up our minds as a result of the collapses of 1920 and 1929. None of the opposition will dispute the facts. They cannot deny them."

The pending bill, identified as the Banking Act of 1935, is the next piece of legislation on the administration's "must" program to be tackled by the House. Whether it is actually an administration instrument has been a subject of heated debate between Senator Glass (Democrat of Virginia), of the Senate Banking Committee, and Representative Steagall (Democrat of Alabama), chairman of the same committee of the House.

ALSO HELD REPLY TO GLASS

Senator Fletcher's statement was received in some quarters not only as a reply to Republican and banking opposition to the pending bill but to the Virginian, who has maintained the measure is only sponsored by Marriner S. Eccles, Governor of the Federal Reserve Board, rather than by the President.

"Title II," said Senator Fletcher of the controversial section of the banking bill, "deals almost wholly with the creation of machinery for the effective regulation of a definite monetary policy in accordance with the campaign promises of President Roosevelt based on the Democratic platform of 1932, which advocated 'a sound currency to be preserved at all hazards' and promised to put an end to 'the indefensible expansion and contraction of credit for private profit at the expense of the public.'"

CITES ROOSEVELT'S PROMISE

Mr. Fletcher also declared the measure was a "definite attempt" to accomplish the ends "which the President had in mind" when, on July 3, 1933, he stated to the American delegation to the London Economic Conference, and again reaffirmed on October 22 in his address to the American people in which he stated that:

"When we have restored the price level we shall seek to establish and maintain a dollar which will not change its purchasing and debt-paying power during the succeeding generation."

Senator Fletcher's statement made categorical reply, although he did not refer to it, to an arraignment of title II in the first legislative report to be made in connection with the banking measure.

VIEW SIMILAR TO THAT OF GLASS

Without waiting for the release of the majority report of the House Banking Committee, which was sent to the printers this afternoon, the Republican members of that body made public their minority report. It asked for complete elimination of the central-bank section.

Taking a view similar to that of Senator Glass, this report asserted:

"The present title II is not even the original title II as presented in the bill, but is almost without change an amended title II submitted by Governor Eccles after he had entirely completed his testimony before the committee.

"While the committee was assured that the first draft was the joint work of all the various financial departments of the Government, and had their joint approval, we have no assurance that title II in its amended form has received any approval except that of Governor Eccles, or has even been submitted to anyone else."

TWO SECTIONS HELD SATISFACTORY

Title I, providing for the merging of temporary F. D. I. C. funds into permanent ones and keeping the deposit insurance maximum at $5,000, and title III, making various changes in the present banking statute, including termination of double liability, were found by the minority committeemen to be "in the main" satisfactory.

"But title II," their report added, "while containing some provisions of merit, is in its entirety such a radical departure from the sound principles of central banking that the evils it contains more than counteract the advantages of title I and title III."

BASIS OF MINORITY OBJECTIONS

The minority objections centered upon:

Changes in control of the Governor and Vice Governor of the Federal Reserve Board and the governors of the Reserve banks.

Increasing the power of the Federal Reserve Board.

"Too great liberalization" of the discounting and borrowing provisions of the Federal Reserve member banks.

CITES BANK OF ENGLAND AS EXAMPLE

The present separation of the Reserve banks from Federal control, the minority maintained, "is in accordance with the central banking practice in most of the more highly civilized countries under a democratic form of government", and cited the Bank of England as an example.

"Conversely," the report continued, "countries under close dictatorship, like Italy and Russia, have central banks entirely under government domination. One of the first and essential steps in any dictatorship is to extend power over the credit resources of the country."

To realize the full effect of the proposed changes in control of governors of the Board and the Reserve banks, the committeemen asserted, "it must be remembered that the governor has always been the dominant figure on the Board, and the Board is thus made more subject to control by the Executive (the President).

FLETCHER EXPLAINS PROVISIONS

"The bill provides", said Senator Fletcher, "that the offices of governor and chairman of the board of directors of each Federal Reserve bank shall be combined. In their places a governor and vice governor shall be appointed annually by the board of directors, subject to the approval of the Federal Reserve Board. The governor shall be the chief executive officer of the bank."

CALLS GOVERNORS VIRTUAL DICTATORS

"Whereas in the original Federal Reserve Act the executive head of the bank was to have been known as 'chairman of the board of directors' and at the same time act in the capacity of Federal Reserve agent, the active head in control of purely banking operations was to function in the capacity of a bank manager, the Federal Reserve banks gave to the bank manager the high-sounding name of 'governor.'

"Since that time it has developed that the governor of each Federal Reserve bank not only has superseded the chairman and agent as the executive officer of the bank, but has also become the virtual dictator of the Federal Reserve bank to the extent of practically controlling the election of directors who are presumed to be independent in the exercise of their power in the election of said 'governor.'

"The results are obvious.

"The bill merely merges the two offices and at the same time provides for the retention of all governors and chairmen—if they are qualified—and the various board of directors elect them governor and vice governor.

REPLIES TO G. O. P. CRITICISM

Replying to the Republican charge that under the bill the Federal Reserve Board would become the open-market committee with its decisions as to the buying and selling of Government bonds "mandatory on all" of the Reserve banks, Senator Fletcher said:

"We shall, through this act, definitely fix the responsibility for and the power to engage in open-market operations in the Federal Reserve Board. In the future when money becomes 'easy' or money becomes 'tight' or when we are led into a period of inflation or a period of contraction and economic demoralization, we shall be able to put our finger upon the Federal open-market committee and say, 'you are responsible.' "

FORESEE DANGER TO DEPOSIT

The Federal Reserve Board, acting "perhaps by a bare majority of a bare quorum", the Republicans held, could raise or lower reserve requirements at will, and they added:

"The right to raise is the right to curtail or even stop entirely the normal banking functions of lending. The right to lower brings the possibility of endangering deposits by requiring insufficient reserves."

Replying to this, Senator Fletcher said:

"The proposed banking act gives recognition to the fact that there is no safety to be found in arbitrary judgment or arbitrary figures with respect to the reserves of either Federal Reserve banks or of member banks. * * * England has no such arbitrary reserve requirements established by law. This country had progressively found it advisable to reduce the legal reserve requirements for even commercial banks from an arbitrary figure of 50 to 40 to 25, until they now stand at 13, 10, and 7 percent on demand deposits of commercial banks, depending upon the size of the cities in which they are located."

Radio Colloquy Between Hon. Duncan U. Fletcher and Sherman Mittell in the Broadcast, "An American Fireside", April 28, 1935

[Printed in the Congressional Record Apr. 30, 1935]

OPENING ANNOUNCEMENT

An American fireside. Our guest at an American fireside tonight is the Honorable Duncan U. Fletcher, United States Senator from Florida and Chairman of the Senate Committee on Banking and Currency, who will talk with Sherman Mittell, of the National Home Library Foundation. Mr. Hapgood is unable to be with us tonight but will be back again next Sunday.

Mr. Mittell has just greeted Senator Fletcher and they are seated around the fireside.

Mr. Mittell is speaking.

Mr. Mittell. A number of these half hours are given over to discussing the problems of democracy. Senator Fletcher, more and more we begin to see that our national problems are tied up with correcting the errors of the past. While our frontier was open we could develop without worrying about consequences or the future. With a closed frontier and with a nation well-knit, we begin to see more and more that our commercial and industrial activities affect the very foundations of our social well-being. The history of banking hasn't been any too fortunate for the American people and for some reason or other Americans have always felt, until recently, that it was a field beyond their common everyday knowledge and concern. Our last tragic experience, I believe, has opened the eyes of the people to the realization that without a sound banking system it cannot have a safe, economic, or secure social life

Justice Brandeis has told us in that memorable book—Other People's Money and How the Bankers Use It—which was written 20 years ago and which today is a classic in democracy, how the control of the private bankers, particularly a handful of men, constituted a strangle hold on our industrial life. This book, as you know, was written immediately after the Pujo investigation in 1913 It is the opinion of many that had his advice been taken and his warnings heeded, we should not have been thrown into the tragic situation we experienced 20 years later, affecting disastrously millions of people.

For 2 years your committee, with you as its chairman, carried on an investigation of our banking practices that has already led to banking reform. Last year Senator Cutting introduced an excellent bill that went a step further, but, Senator Fletcher, what is the most important piece of legislation on your committee's calendar at this time, and can you tell us something of that?

Senator Fletcher. In my opinion, the proposed Banking Act of 1935 is, in all probability, the most important piece of banking and monetary policy legislation with which this or any other Congress has dealt. Hearings are now being held, and within a short time the committee will attempt to perfect this piece of legislation.

In connection with this bill, I think it's of interest to note that numbers of people misunderstand its purpose. Few of them have read the bill, due, probably, to the pressure of personal business.

Mr. Mittell. Senator Fletcher, I understand that the bill is, like all Gaul, divided into three parts; title I dealing with amendments to the deposit-insurance law, the main provision of which is that of establishing the maximum insurable deposit at $5,000.

Senator Fletcher That is correct.

Mr. Mittell. And that title III carries a number of amendments to various banking provisions. I also understand that bankers, a number of bankers' associations, some economists, editors, and financial writers support these two titles. On the other hand, numbers of these people whom I have just mentioned are opposed to title II. If my statement is correct, Senator, I should think you would like to explain to us just why you think "the proposed Banking Act of 1935 is in all probability the most important piece of banking and monetary policy legislation with which this or any other Congress has dealt."

Senator Fletcher. I base that statement upon the importance of title II alone; and it is title II of the bill which is bearing the brunt of almost all the opposition made to the entire piece of legislation.

The general public must not be misled. This legislation will serve a public purpose, and its enactment is essential to the establishment of the financial and economic security of this Nation's domestic enterprises.

Mr. Mittell. Suppose you outline it more fully, Senator Fletcher.

Senator Fletcher. Title II deals almost wholly with the creation of machinery for the effective regulation of a definite monetary policy in accordance with the campaign promises of President Roosevelt. Those promises were based on the Democratic platform of 1932, which advocated "a sound currency to be preserved at all hazards" and proposed to put an end to "the indefensible expansion and contraction of credit for private profit at the expense of the public."

Moreover, it is a definite attempt to accomplish the ends which the President had in mind, when, on July 3, 1933, he stated to the American delegation to the London Economic Conference and again reaffirmed on October 22 in his address to the American people, in which he stated that:

"When we have restored the price level, we shall seek to establish and maintain a dollar which will not change its purchasing and debt-paying power during the succeeding generation. I said that in my message to the American delegation in July and I say it now once more."

May I point out that, with one or two exceptions, title II of the bill deals with the control over the monetary policy of this Nation. Such monetary-policy operations cannot and should not be merged with purely banking operations.

Mr. Mittell. Pardon me, Senator, may I ask that you explain a little more fully your last statement to the effect that "monetary-policy operations cannot and should not be merged with purely banking operations"?

Senator Fletcher. Certainly. The distinction must be kept clearly in mind.

The administration of a monetary policy has to do with the contraction and expansion of the credit and currency of the country and directly affects the purchasing power of money. This function transcends those of banking, farming, manufacturing, or that of any other business activity. It literally controls the economic and social welfare of the whole Nation. Traditionally, to be sure, this function has been turned over to banks and bankers who have operated it without direct responsibility to anyone. We propose to centralize the powers and responsibilities for the total expansion and contraction of currency and credit in the Federal Reserve Board.

Mr. Mittell. Senator, what are those matters that have to do with purely banking operations?

Senator Fletcher. Purely banking operations have to do with the direct lending of the bank's cash or credit to borrowers in which the major interests of the banker or bankers must always be concerned with the character of the borrower, security for the loan, and the uses to which the borrower is going to put the cash or credit he obtains from the bank.

A loan made by a bank is definitely an investment of the bank's cash or credit just as is the purchase of Government bonds, a mortgage, or any other type of paper representing either ownership in or obligations on a piece of property, are investments of a bank.

Such transactions as I have enumerated go to make up purely banking operations and to the extent that a banker engages in these transactions, he should be held strictly accountable for their soundness And in order that we may be assured that bankers are conforming with the law and the rules and regulations made by the various examining agencies created by the Federal Government and the 48 State governments, bank examiners periodically examine the banks as to the soundness of their assets and the legality of their operations.

Mr. MITTELL. Senator Fletcher, haven't we heretofore had bank examiners do the thing you are now asking should be done?

Senator FLETCHER. We have had bank examiners and expect to retain them. But bank examiners pass upon the soundness of an individual loan or investment of a bank, and finally upon the soundness of the bank as a whole. But the generative forces to which I refer are of such a nature as to affect the total volume of all loans, investments, and deposits of all banks at one and the same time, irrespective as to whether those loans, investments, and deposits are or are not sound. These forces are such as to increase that volume, or decrease that volume, irrespective of the soundness of the work done by bankers or by bank examiners.

May I stress the fact that even though bankers and bank examiners use the greatest amount of discretion in making and supervising the loans and the investment of the bank's funds, it is possible to undermine and even destroy all of their painstaking efforts by bringinig about, through open-market operations, rediscount rates, and control over reserves, a contraction of the total volume of credit and currency outstanding.

Mr. MITTELL. Then you do not blame bankers as individuals for our difficulties?

Senator FLETCHER. No; of course not. There are literally thousands of bankers in this country whose heads are bowed in humiliation and shame. They are blamed for the vicious results, many of which they are not able to rationalize. They have had their lines of credit shut off, their reserves reduced, or have experienced the withdrawal of huge sums of money upon demand. In turn they have been forced to try to call in loans which they oftentimes have made with the greatest of caution and deserved confidence, to be peremptorily thrown without warning into the maelstrom of a financial panic, contraction, or depression.

Mr. MITTELL. Do you hold all bankers more or less blameless?

Senator FLETCHER. No. Among them there have been a few bankers "in the know" and also in a dominant position for laying down the rules for making money "tight" or "easy"—of literally determining the trend—yet the latter have not personally been singled out, nor can they, under our present system, be called to account for the disastrous results of their acts. It is my earnest desire that the fifteen or twenty thousand bewildered bankers, who have never known and cannot be expected to know why money is "tight" or "easy", demand that this great destabilizing and disturbing factor of monetary policy be separated from banking per se and placed in the hands of men who must and who shall be held responsible and accountable for their acts. Undoubtedy in this great Nation we can find at least 5 or 8 men, depending upon the final provisions of the act, who know what it is all about and can be trusted to administer our monetary policy intelligently and with the greatest amount of integrity and respect for the people and to act for the public welfare.

Mr. MITTELL. Senator Fletcher, I think I see your point, but I wonder if you can't explain to us somewhat more clearly the relative position of a banker or bankers to the expansion or contraction of the total volume of credit and currency?

Senator FLETCHER. Very well; I think that relationship should be explained very clearly.

In the first place, it should be explained that about 90 or 95 percent of our total money supply is in the form of bank credit.

The remaining 5 or 10 percent is made up of legal-tender currency. For all normal business needs bank credit serves all of the functions of money. Hence, whenever bankers increase or decrease the total supply of bank credit, they are for all intents and purposes increasing or decreasing the supply of our money.

The total supply of bank credit outstanding at any particular time is expressed in terms of the total deposits of all banks. When bankers make loans they increase the total amount of bank credit outstanding by increasing the amount of their customers' deposits. Likewise, when loans are paid off or bankers call loans for payment, the total amount of bank credit is reduced.

Mr. MITTELL. Senator Fletcher, are there any "rules of thumb", so to speak, which control the total expansion or contraction of bank credit during periods of normal business conditions?

Senator FLETCHER. In periods of normal business conditions bankers are permitted to have deposits outstanding in any amounts not to exceed the maximum permitted under either a banker's "rule of thumb" or a comparable statutory "rule of thumb." Either of these "rules of thumb", which I shall subsequently explain, afford us no ultimate protection against the overexpansion, even "inflation", of bank credit, as I shall point out. The first "rule of thumb" I wish to explain is that which the Comptroller of the Currency and bankers through long experience have been applying to the capital structure of a bank in comparison with its total outstanding deposits. It has received quite a bit of attention during the last 2 or 3 years on the part of the Comptroller in his attempt to bring the capital structure of a bank in line with its total deposits and has resulted in the sale of either the preferred stock or debentures of a bank to the Reconstruction Finance Corporation, where private subscription could not be had. Under this rule, bankers are permitted to have deposits outstanding not to exceed 10 times their capital, surplus, and undivided profits.

Mr. MITTELL. Can you express that rule in terms of figures for us, Senator Fletcher?

Senator FLETCHER. That means that if the total capital, surplus, and undivided profits of all banks in the country is $5,000,000,000, then the banks of the country cannot have deposits outstanding in excess of $50,000,000,000.

To make it more concrete, may I remind you that on June 30, 1934, the total amount of capital, surplus and undivided profits was approximately 7½ billion dollars. That would mean that the banks would be permitted under normal business conditions to expand their deposits in an amount not to exceed $75,000,000,000. On that date, however, the total of deposits stood at 46½ billions. If we considered only the 10-to-1 "rule of thumb", bankers would in the course of time be permitted to increase their deposits some $30,000,000,000. However, before they reach that maximum of $75,000,000,000 they will, of course, have to give immediate consideration to the building up of what is known as their reserves.

Mr. MITTELL. What is the evident weakness of such a 10-to-1 "rule of thumb"?

Senator FLETCHER. The weakness of the above 10-to-1 "rule of thumb" is that the limitation on the expansion of the total amount of bank credit outstanding is a fleeting fantasy, for the reason that bankers may and will increase their capital, surplus, and undivided profits solely in the interest of private profits. That power absolutely must be exercised and controlled in the public interest and not for private profit.

Under such a rule, the total of bank credit outstanding may range between two extremes where the upper limit is 10 times the variable factor of capital, surplus, and undivided profits; and the lower limit of contraction, destruction, and deflation of bank credit is an absolute zero.

Mr. MITTELL. It does not seem the 10-to-1 "rule of thumb" of the bankers and the Comptroller affords us much security.

Senator FLETCHER. That leads us to the consideration of a statutory "rule of thumb" incorporated in the Federal Reserve Act and subject to a comparable limitation from the point of view of safety, security, or protection of the public interest if the instruments, the power, and the responsibility for the administration of our monetary policy are not placed in a competent and responsible administrative body.

Mr. MITTELL. You mentioned reserves, Senator Fletcher, and I recall there was some statutory provision in that connection. What has been the result of our experience under the statutory rule?

Senator FLETCHER. As a result of bitter experience, a fixed statutory rule has proven to be unsatisfactory. Under it in times of normal business conditions the total supply of bank credit outstanding at any particular time is determined by the volume of bank reserves and the required reserve ratio which is, roughly for all deposits, another 10-to-1 ratio; and is almost as unsatisfactory from the point of view of the public's security when left to the control of banks and bankers as has been demonstrated with the first "rule of thumb." The public's safety, security, and welfare are not adequately protected in this "rule of thumb" which is expressed in terms of an arbitrary ratio, yet variable item of "required reserves."

Mr. MITTELL. Why do you say bank reserves are a variable item, Senator Fletcher?

Senator FLETCHER. Bank reserves are variable for the reason that they can be increased through gold imports, inflow of currency from circulation, or receipt of Federal Reserve funds. Hence the banking system as a whole will be able to increase the total volume of bank credit outstanding by approximately 10 times the amount of increased reserves. Inversely a loss of reserves has a tendency to result in a tenfold contraction of bank credit.

To make this observation more concrete, may I recall certain years of depression, when banks were suffering severe losses of deposits and reserves. The banks, in order to meet reserve deficiencies, were forced to curtail loans and investments, with the result that fully one-third of our supply of bank money was destroyed. Thus, at the very time when the rate of spending was declining, the volume of money available for spending was also being destroyed with disastrous effects on business activity, employment, and national income.

Mr. Mittell. Senator Fletcher, may I interrupt your discussion for the moment and ask as to how banks are situated with respect to required reserves?

Senator Fletcher. At the present time the member banks alone hold approximately two billions of excess reserves, which would permit them to expand their deposits by approximately $20,000,000. Nonmember banks possess additional powers for the expansion of bank credit. Even thirty billions of expansion is not the maximum, for the reason that reserves are in turn built up through the sale or rediscounting of banker-created credit obligations to the banker-owned and banker-controlled Federal Reserve banks. It is evident that this situation has the possibilities of an unsound expansion of bank credit for private profit.

Mr. Mittell. If I understand you correctly, it is possible to have a thirty-billion-dollar inflation of bank credit?

Senator Fletcher. Yes. At some time in the future they will at least have built up their deposits to a maximum of, we might say, sixty-five, seventy, or even seventy-five billions of dollars. This they can do only by literally creating credit money. Such a process of building up deposits is commonly termed "expansion of credit", and consists of the extension of loans by commercial banks to their customers by giving them credit on the books of the banks.

During a period of contraction the reverse takes place. What we have is an actual wiping out of—or the destruction of—these credits through the calling of loans and the refusal of banks to extend further credit where obligations have matured.

Mr. Mittell. Just at that point, Senator Fletcher, permit me to ask to what extent has the contraction or destruction of bank credit taken place since the collapse of 1929?

Senator Fletcher. The destruction of bank credit alone amounted to over $20,000,000,000 between October 1929 and December 1933. This paralyzed all business. The cumulative results upon our national income have been likewise disastrous. At the darkest hour of this depression we were losing in excess of $4,000,000,000 monthly in national income. The total loss of national income during the 6 years of this depression will amount to probably $150,000,000,000. Such an amount is in addition to the physical suffering and mental anguish of millions of our unemployed and other millions dependent upon them.

The aim is to end this sort of thing.

Mr. Mittell. Thank you, Senator. That answers my question. Please proceed with your general discussion of the expansion and contraction of bank credit.

Senator Fletcher. The general policy of expansion of bank credit by all banks arises during a period of what is known as "easy money", and takes place after a definite easy-money trend is established. A reversal of the trend is referred to as money being "tight" and is accompanied by a contraction of loans and a reduction in the total of bank credit outstanding. The process of establishing these trends is the very heart of what has become known as "monetary policy operations." Such operations vitally affect the economic life of the Nation. The results of these operations have had ascribed to them the colorful names of periods of prosperity, booms, crises, panics, and depressions. Much more inclusive terms have been used, however, such as "periods of expansion" and "periods of contraction."

Mr. Mittell. What part does the individual banker play in these periods of expansion and contraction, or of creating them?

Senator Fletcher. Individually they have almost nothing to do with the creation of the up or down trend. After the up trend is established, however, bankers may or may not follow the trend by increasing their loans and coincidentally increasing their deposits at the same time that all other banks are expanding. On the other hand, when a period of contraction sets in, every banker, must in self-defense, not only refuse to extend further loans, but more often is forced of necessity to call loans and refuse to permit the extension of the life of loans which are at the time outstanding.

Mr. Mittell. Then, Senator, you are not condemning bankers individually, but, on the other hand, are offering a defense of them, are you not?

Senator Fletcher. That is correct, except to the extent they have failed to recognize the facts which I am now pointing out. It would seem that the American Bankers' Association and their connections might have—as a result of a thorough analysis of the facts—ameliorated, if not prevented, the paralyzing contraction of bank credit so disastrous to this Nation.

Mr. Mittell. Who then, is responsible; and at what forces is this bill directed?

Senator Fletcher. Title II of the bill does not deal with banks or bankers individually. It deals with banking operations as a whole only to the extent of centralizing the responsibility for the exercise of the powers which control the establishment of these trends. The individual operations—such as lending, investing, and so forth—of commercial banks are not contained in the subject matter of title II. However, the power to create or destroy the reserves of commercial banks, to raise or lower the rediscount rate, and other operations incidental to the effective regulation and control over the monetary policy of this Nation, constitute the sole subject matter of this portion of the bill.

The power to determine the trend is at the present time committed without definite responsibility to the Federal open market committee, the 12 Federal Reserve banks, and the Federal Reserve Board. They are unwilling, however, to assume the responsibilities for the disastrous results which have prostrated the Nation. Moreover, no adequate penalties can be ascribed. It is futile to attempt to continue under the present set-up. In conformity with that provision of the Constitution which declares the "Congress shall have the power to coin money, regulate the value thereof, and of foreign coin", we propose to perform our legislative duty through the enactment of this bill.

Mr. MITTELL. Well said, Senator. I am beginning to understand why you attach such vast importance to the bill.

Senator FLETCHER. The power to initiate open-market operations is now in the hands of the committee which consists of governors of the Federal Reserve banks. The Reserve banks individually, however, may or may not choose to cooperate. The choice depends upon the purely private interests and private profit motives of these banks. Public interest must not be compromised for private profits.

Mr. MITTELL. Well, what do you intend to do to protect the public's interest?

Senator FLETCHER. We propose to revert approximately to the original purpose of the Federal Reserve Act in which the executive head of the Reserve banks was designated as an agent of the Federal Reserve Board. Moreover, we shall both in spirit and in fact conform with the original provision of section 11 of that act, which states "The Federal Reserve Board shall be authorized and empowered * * * (subsection j) to exercise general supervision over said Federal Reserve banks."

Mr. MITTELL. What effect will that have upon the regional operations of a Federal Reserve bank?

Senator FLETCHER. We are not destroying the purely regional banking operations of the 12 Federal Reserve banks. We are only restoring to the Federal Reserve Board powers which have been wrested from the Board by the governors of the Federal Reserve banks. Bankers, per se, will not be deprived of a single purely banking function. At the same time we expect to give to them that security which is absolutely essential to the protection of the economic and social life of this Nation.

Political control over the system is not our object, nor is it the issue. Again I say, "Do not be misled." The people of this Nation, through the Congress, are determined to "nail down" and fix the responsibility for the expansion and contraction of our credit and currency and concentrate those powers in the hands of men who must "do the job."

Mr. MITTELL. Thank you, Senator Fletcher. I think your remarks tonight were of great educational importance to our people. It is my feeling that the public will support your efforts at banking reform if they receive adequate information.

Our problem today is to bring enlightenment on those social and economic questions that press for a solution and about which there are no adequate texts accessible to the millions. To meet this need we recently brought out inexpensive reprints of that great classic in democracy, Other People's Money, by Justice Brandeis, and have recently issued a new book, Money and Its Power, by Winslow and Brougham, which explains simply and comprehensively the questions and problems related to money, its uses, and power.

Senator FLETCHER. I have read both books. The first, of course, is a classic, and should be in every home. But Money and Its Power I found particularly appropriate at this time. It is an excellent condensed discussion of the uses, characteristics, standards, inflation, foreign exchange, and related subjects. It contains much valuable information, well arranged, and expressed. I have recommended it to friends who are studying banking, currency, and monetary policy.

It is a very helpful and useful book.

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